IPART New South Wales

Independent Pricing and Regulatory Tribunal

The tradeoff between regulatory flexibility and certainty

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Summary

- Certainty is a basic prerequisite of good regulation
- But flexibility may be needed:
  - For unforeseen events
  - Where certainty is impractical or unrealistic
- Upfront pricing determinations are better suited to a "certainty strategy"
- Negotiate/arbitrate approaches adapt to circumstances over time
  - Can promote a regulation as last resort approach
  - But still should be reasonably predictable

Summary

- Coverage decisions better suited to flexibility.
- Note that flexibility requires consultation, due process, and carries risks of appeal.
- Poorly designed or imbalanced regulation undermines certainty.

Definitions

Certainty

- An informed party can predict a regulator’s decision;
- Different parties will make near-identical predictions.

Flexibility

- Regulatory discretion;
- Change predicted decision for unexpected events;
- Regulator still bound to observe overall objectives.

Both Certainty and Flexibility are strategies

When is each strategy most appropriate?

Nature of tension between certainty and flexibility

Certainty implies little discretion:

- Regulation by formula or black-letter rules
- Appropriate for stable business environment

Fundamental change in assumptions requires flexibility:

- Avoid certainty of making a mistake
- Adaptation requires flexibility

Certainty permits rapid decision-making, but

Need for due process makes flexibility slow

- Exercise of discretion requires consultation
- Possibility of later review increases lead time.

Upfront Price/Revenue setting

Price determination well suited to a certainty strategy

- Circumstances may require rapid price response
- Due process around flexibility implies untimely decisions

Formulae work best if the only changes are to cost, demand, macro settings

Choice of reset period is strategic:

- Should be decided ex ante based on clear principles
- Should not be varied unless technology changes
- Match period to economic life of prime asset?
  - But investment decisions are usually non-binary and ongoing

Negotiate/Arbitrate Model

- Key feature of National Competition Policy
- Least intrusive form of regulation (after monitoring)
- Fixed principles fit with negotiate/arbitrate
- Opportunity to react to unforeseeable changes
- However, predicted decision should prevail if changes were foreseen

Reach of regulation

Coverage decisions require flexibility

- Declaration creates structural break.
- Many decisions were unanticipated.
- Suggests a flexibility strategy.
- Part IIIA embodies flexibility based on principle
- Facilitates testing of non-intervention

Applied Examples

Most infrastructure regulation in Australia trending to increase certainty

- Settling in
- Repeat determinations
- Locking in particular parameters

Certainty in changing telecommunications environment challenging

But still trends toward certainty

- Mobiles regulation
- Building block approach to Telstra copper
- The NBN undertaking

Certainty for access seeker investments important as well

Regulatory execution

Poor execution can undermine confidence

- Inconsistency between rules and economic principles
- Lack of balance in regulatory policy

Two examples:

- Authorities (High Court, PC) conflict on interpretation of declaration criterion (b)
- 2006 changes to the NEM rules put investor interests ahead of consumer interests

Certainty is at risk when legitimacy of regulation is in doubt

Conclusions

- Dilemma of certainty vs flexibility—which strategy best suits the circumstances?
- For pricing, timeliness of certainty is preferable.
  - Requires artful regulatory design.
  - Fixed principles would help.
- For declaration, flexibility is preferable.
  - Slower process is needed
  - Structural break with the past
  - Testing of non-intervention
- Poor regulatory policy undermines certainty