

Economic Regulators: Achieving Compliance to Promote Efficient Regulatory Outcomes

William E. Kovacic
George Washington University Law School
ACCC-AER Regulatory Conference
Brisbane, 7 August 2014

Steve Edwell, AER Chair, July 2005

- AER's priority is "to promote investment and the long term interests of users. . . . [T]here is still a question of balancing the interests of service providers and consumers. We want to provide an environment that supports efficient investment, but this doesn't mean going soft on the industry. We need to ensure that consumer[s] share in efficiency gains achieved by the industry."

AER, Overview of the Better Regulation Reform Package (April 2014)

- Three Foundations:
 - “incentive-based” economic regulation
 - “necessary and efficient investment”
 - “strong consumer engagement framework”

This Afternoon's Session

- How Can a Compliance Strategy Help the Regulator Achieve Its Aims?
- Which Measures Promote Desired Levels of Compliance?

Agenda

- Notable Initial Conditions
- Characteristics of Effective Regulatory Regimes
- The Responsive Regulation Pyramid
- Elements of a Compliance Strategy
- Caveat: Personal Views Only

Electricity and Natural Gas Regulation: Notable Initial Conditions

- Repeated Supplier-Regulator Interaction
- Reputation Matters to Suppliers
 - General absence of a rogue mentality (“If you ain’t cheatin’, you ain’t tryin’.”)
- Shifting Boundaries of “Natural Monopoly”
- Temptations to Renege on Regulatory Contract
- Internally Inconsistent Social Expectations

Social Preferences for Energy

- Energy Supplies Should Be:
 - Inexpensive
 - Abundant
 - Reliable
 - Safe
 - Green
 - Sourced out of sight

Effective Regulation Characteristics

- Fulfills Policy Mandate
- Clearly Disclosed, Coherent Requirements
- Accurate Diagnosis of Observed Behavior
- Rigorous Testing of Evidence/Data
- Cost Minimization for Suppliers/Regulators
- Regular Assessment of Outcomes

The Responsive Regulation Pyramid: Key Elements

- Urges Strong Supplier-Regulator Cooperation
- Preference for Non-Confrontational Methods
- Nuanced, Proportional Responses
- Escalate to Forceful Sanctions As Last Resort
- Regularly Evaluate Policy Outcomes
- *See Braithwaite, The Essence of Responsive Regulation, 44 UBC L. Rev 475 (2011)*

Pyramid Strengths

- Promotes Effective Compliance at Lower Cost to Suppliers and Regulators
- Encourages Supplier Innovation in Carrying Out Regulatory Commands

Pyramid Problems

- Political Process: Compatible with Pyramid?
 - Often highly impatient
 - Prefers powerful remedies (e.g., for price shocks)
- Cooperation Can Seem to Be (or Be) Capture
- How to Cooperate While Signaling Sanctions?
 - Ask: Are sanctions essential to cooperation?
- Long-Term Policy Needs vs Short-Term Leaders
- Innovation Requires Taste for Risk (Errors)

Pyramid Implications

- Meaningful Disclosure
 - Goals and means
- Participation
 - Consumer Challenge Panel and Consumer Consultative Group
- Evaluation

Thinking About Compliance

- Classify Lapses by Harm and Frequency
- Identify When/Where Lapses Have Occurred
- Analyze What Caused the Lapses
- Which Precautions Are Appropriate?
 - Measures internal to the supplier
 - External scrutiny: regulator, customers, consumers
- Evaluate Outcomes of Policy Tools
 - E.g., which interventions establish credibility?

Classification of Deviations

- Which Lapses Pose Greatest Consumer Harm?
 - Cost mis-estimation or mis-allocation?
 - Dispatch order violations?
- How Often Do Specific Deviations Occur?

When/Where Do Deviations Occur?

- Operations Research Approach
- Comprehensive Profile of Violations
 - By type and by supplier

Causes

- Ambiguity or Complexity of Legal Commands?
- Disagreement About Meaning of Commands?
 - Interpretation of key operational terms/concepts
- Inadvertence?
- Deliberate Choice Known to Be Wrong?
- Note: Value of Regular Consultation Between Regulator and Supplier

Precaution-Taking by Suppliers

- Quality of Compliance Training
 - In person, on-line
 - Top management support
 - Case studies
- Internal Monitoring
- Internal Self-Assessment
 - Example: Commercial aviation
- Consider: Incentives for Self-Reporting

Precaution-Taking and Intervention by Regulators

- External Audits
- Routine Monitoring
- Consider: Reward Schemes
 - Self-reporting and whistleblowing
- External Consultation: Suppliers, industrial customers, residential consumers
- Sanctions for Clear/Deliberate Infringements

Evaluation

- Regular Assessment of Policy Outcomes
- Market Studies Policy Tool

Effective Compliance: Summary of Key Elements

- Meaningful Disclosure by Regulators
- Operations Analysis of Deviations
- Internal Quality Control for Suppliers
- External Observation Mechanisms
- Evaluation

Benefits of Comparative Study

- Agencies with Roughly Similar Portfolios
 - E.g., UK CMA, NZ Commerce Commission, Netherlands ACM, Spain Nat'l Authority on Markets and Competition
- Pooling Experience
- Routine Consultation