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National
Association of
Regulatory
Utility
Commissioners

Key characteristics of regulatory commissions

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Center for
Energy and Natural Resources

Plan of the presentation

- what is independent energy regulation
- main requirements to the regulators
- emergence and development of energy regulators in the EU countries
- requirements to regulators under the EU Electricity and Gas Directives
- further development of regulatory agencies in the EU

Independent energy regulation

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Independent regulator

- Energy regulation – why?
- Energy regulation – how?
- Independent regulator – why?

What is regulation?

- Government has 3 functions: tax, spend and regulate
- regulation is Government intervention
 - direct: primary and secondary legislation
 - indirect: telephone calls, friendly advice, personal favors, etc.
- economic regulation is a (bad) substitute of competition

Objectives of regulation (why?)

- protection of customers
- ensuring the financial viability of the companies
- promotion of competition
- collection and dissemination of information

How to regulate?

- No regulation
- Self-regulation
- Command and control
- Independent regulation

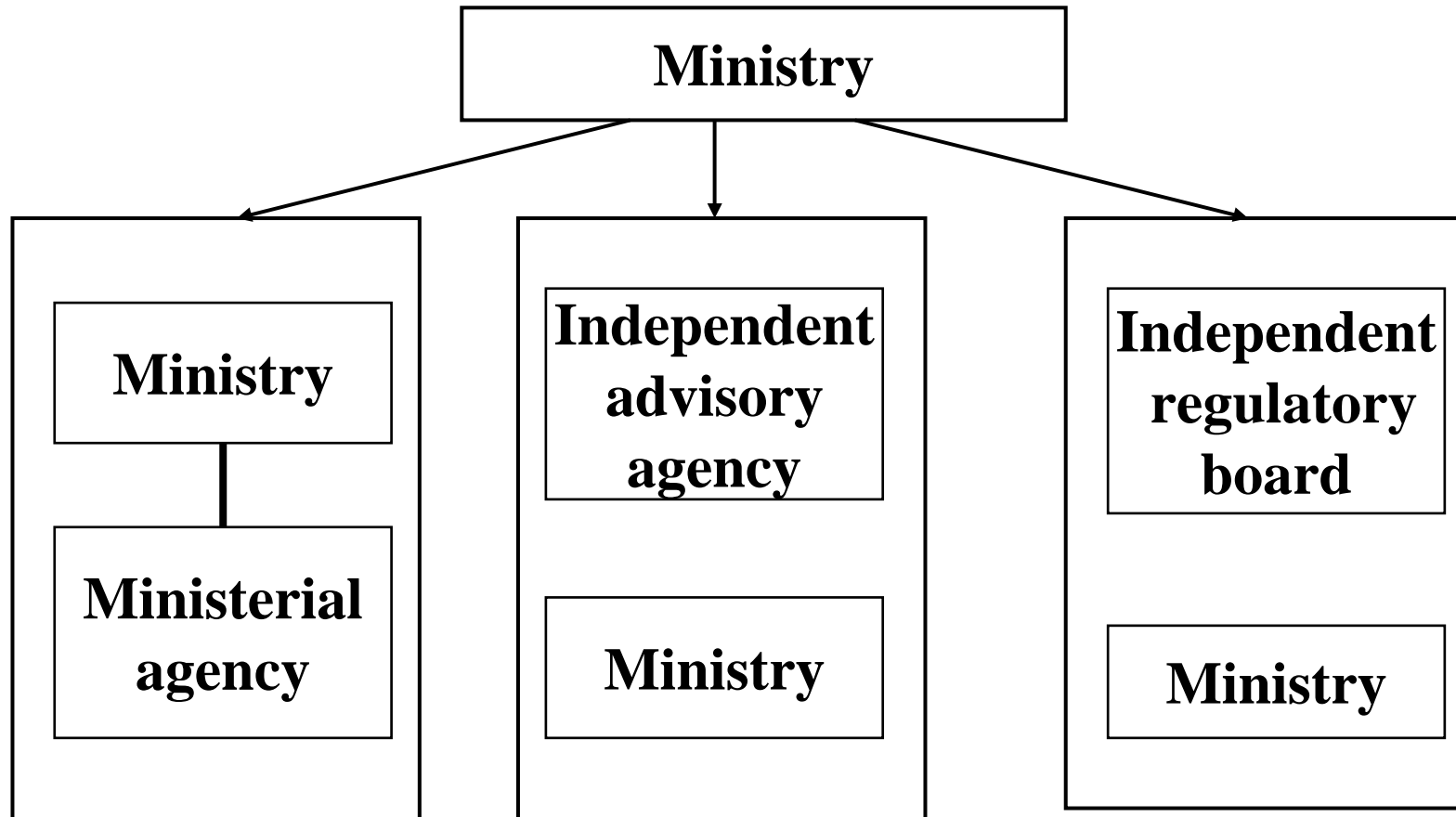
Old style regulation (command and control)

- energy companies - state owned monopolies
- Government approves minor operating decisions
- sectorial ministry is an owner and a regulator
- state owned enterprise is protected from competition but may be not allowed to cover all its costs
- subsidies and cross-subsidies are allowed and politically supported

Need for a new type regulation

- emerges with an introduction of a private capital
- investors want to secure themselves from the Government intervention
- increases with the liberalization of the sector (unbundling, introduction of competition)
- regulation of the liberalized, privatized sector require new tools and approaches

The regulator vs. the Ministry (1)



The regulator vs. the Ministry (2)

	Ministry	Indep. regulator	Compet. authority	Judicial system
Specialised knowledge	high	high	low	very low
Risks of capture	depends	depends	low	very low
Speed in decision making	high	high	low	very low
Trustworthiness	depends	high	low	high

- old type regulation was performed, in general, through
 - setting prices and technical standards,
 - using ownership as a control mechanism
- it was unclear, non-transparent, unpredictable
- the goal of a new type regulation is
 - to encourage competition (where it is possible)
 - to regulate monopolies by using clear, transparent rules and mechanisms

- to protect investors from unacceptable risks
- to protect consumers from the monopoly power abuse
- to give to all the market players clear, transparent stable rules of the game

Why to protect investors?

- utilities are heavily capital intensive and have very long-life assets
- investments are large and immobile, with long pay-back periods
- investors require clear rules of the game
- distrust of the investors reduces credibility of the country and increases the cost of capital

Main requirements to the regulators

Main requirements to a new regulator

- independence
- transparency
- accountability
 - *or a bit differently, 3 A:*
- autonomy
- authority
- accountability

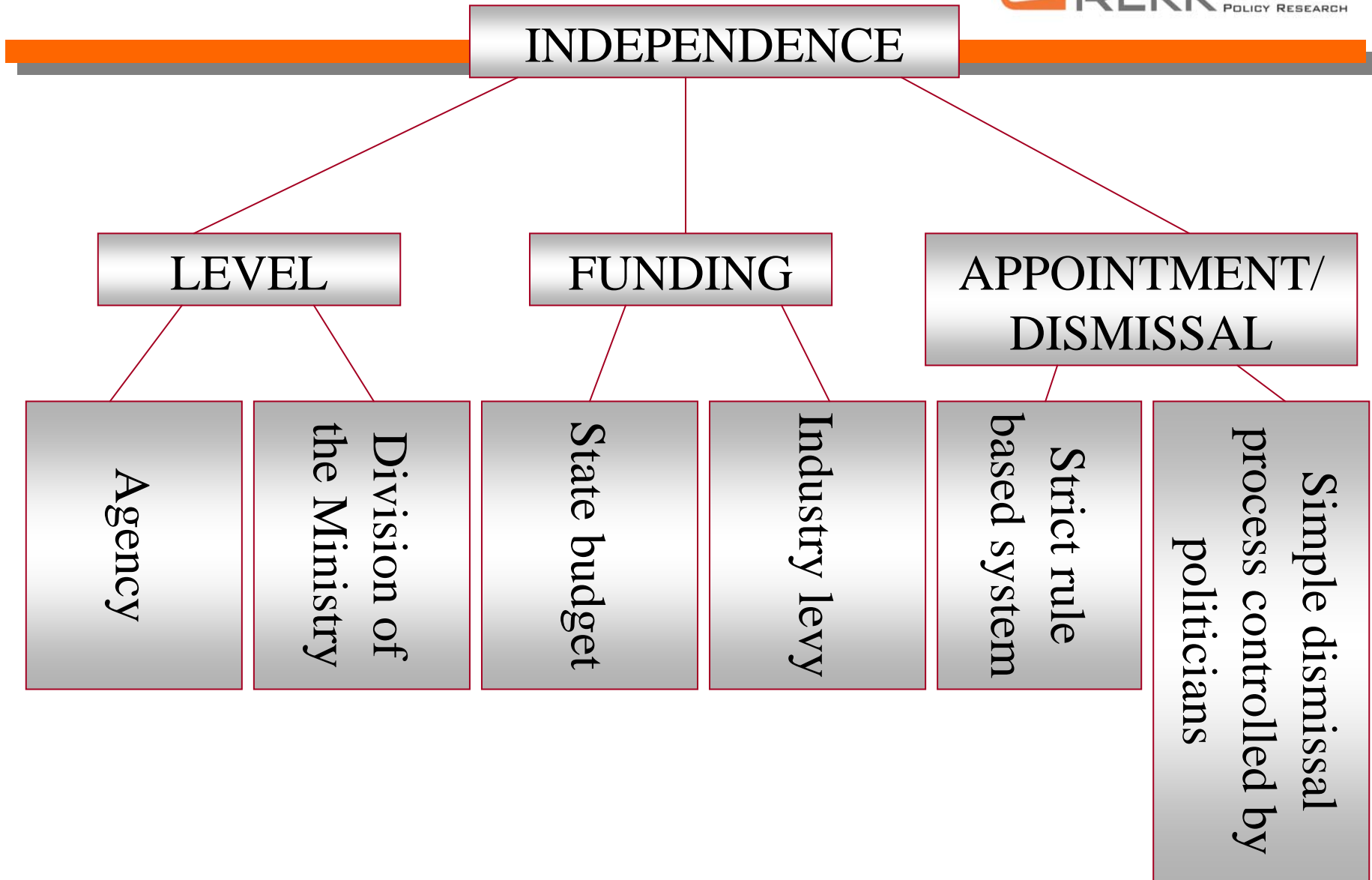
What is independence?

- outside ministerial structure
- does not require approval for
 - changing tariffs
 - granting licenses
 - settling disputes
- clear separation of roles

- to ensure that Government can give credible commitment to consumers and investors
- politicians find it difficult to resist temptation to keep tariffs low
- independent regulators may give a commitment that investors can trust, as they are better protected from political pressures

Independent regulator is good for the politicians

- blame shifting for unpopular decisions
- get rid of technically complicated and boring tasks without much appeal to the public
- implement the EU policies
- gives an opportunity to demonstrate credible commitment



- appointment of Commissioners
 - staggered terms
 - quality criteria
 - who makes appointment
- exemption from civil service? Government salary rates
- financing the agency/Commission
 - license fees
 - budget approval
- removal from office – for cause only

- no government agency is truly independent:
 - general policy directions
 - appeal
 - budget
- capture by politicians, industry or other interest groups

It is very difficult to sustain independent regulation when

- legal framework is underdeveloped
- competition policy is absent
- political pressures typically dominate over economic and commercial factors
- there is little or no separation of political powers

Major threats for regulatory independence

- In case of monopoly regulation: the direct conflict is more with profit oriented companies
 - capture
- In case of depressed prices: the direct conflict is more with politics
 - politically influenced / modified prices
- Insufficient resources - low quality decisions
 - lack of enforcement
 - lack of information

Accountability or who regulates the regulator

- decisions are taken after open discussions
- all relevant parties are involved
- decisions and methodologies justified by the regulator
- generally, clear “rules of of the game”

Characteristics of accountability

- public participation and transparency
- annual Report and audit
- appeal of decisions to courts only
- budget review
- Code of ethics
- removal from office – for cause only

- regulators often under suspicion-especially in transitional economies
- regulators first act, often, is to increase prices to cover costs
- regulators should convince the public that increases come with elimination of subsidies and cross-subsidies
- all process should be very transparent:
 - methodologies widely and openly discussed
 - decisions taken after consulting all interested parties involved
 - meetings are open to general public, etc.

Common roles of the regulators

- issue, suspend, amend and revoke licenses
- monitor compliance with the license requirements
- approve pricing methodologies and set prices
- settle disputes between market players
- impose penalties for non-compliance etc.

What is left for the Ministry?

- sector planning and policy, including its restructuring
- privatization
- development of a legal framework
- approval of investments important for the security of the state
- support of R&D

Emergence and development of energy regulators in the EU countries

Development of energy regulatory institutions in the EU countries

- first energy regulatory agencies were established in the U.K. in late 80's
- related with the privatization and liberalization of the gas and electricity sectors
- British approach was an agency instead of a commission (U.S. experience)
- agencies or commissions were established in all EU member states in the late 90's early 00's (Germany was an exception)
- EU Electricity and Gas Directives (2003) require establishment of an independent from the sector energy regulatory agency

Regulatory authorities under the Directive 2003/54/EC shall as a minimum

- approve or fix at least the methodologies used to calculate or establish the terms and conditions for connection and access to national networks
- regulate, in the same way, provision of balancing services
- require the TSO or DSO to modify the terms and conditions, tariffs, rules, mechanisms methodologies for connection and access to the network or for balancing services
- arbitrate, with binding effect, on complaints against TSO or DSO in relation to the above

Directive sets out the particular activities, regulatory authorities should monitor

- rules on management and allocation of inter-connector capacity
- mechanisms to deal with congestion on national networks
- time taken by network operators to carry out connections and repairs
- publication of network information
- effective unbundling of accounts to ensure there is no cross-subsidies
- etc.

EU energy regulators – independence

- most are legally independent agencies headed by a commission or a director
- some of the regulators are subordinate to a ministry (Estonia, Finland, Germany, Greece, Hungary) or competition agency (Netherlands)
- only in small number of countries (France, Greece, Spain, Slovenia) ministry may approve or reject the decision of the regulator
- majority of the regulators are financed not from the state budget (except Germany, France, Finland, Denmark and most of the new Member States)

EU energy regulators – appointment/removal

- regulators are appointed by the Parliament, Government, President, Prime Minister, sometimes by the minister (Estonia, Finland, Great Britain, Ireland, the Netherlands)
- usually there is a criteria set
- terms are 5-6 years (in Italy – 7 years), with possible re-appointment (except Italy and France)
- removal usually for cause only (requirements set by the legislation)
- but in some countries even corresponding ministers may remove the regulators (Finland, Estonia, Great Britain, the Netherlands)

EU energy regulators – their powers

- almost all regulators are authorised to set network tariffs (except of France, Greece, Hungary, Spain and Slovenia)
- less than half of the regulators have a power to issue secondary legislation in the area of tariffs
- almost all the regulators have an authority for balancing and ancillary services and setting connection fees
- only about a half of the regulators issue licences, modify their conditions and impose fines

Hard to sustain independence

- politicians are not always happy that the Regulator takes independent resolutions and want to reduce its powers
- regulators' independence was restricted recently by changing legislation in Slovakia, Poland, Slovenia
- there are numerous examples when politicians were pressing on the regulator to take a different decision or to change the one already taken
- many examples when the regulators were replaced before the end of their tenure (Hungary, Romania, Slovakia, Slovenia)

Further development of regulatory agencies in the EU

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EC on 10 01 2007 has identified the following deficiencies

- regulated prices preventing entry from new market players
- insufficient unbundling of transmission and distribution system operators which cannot guarantee their independence
- discriminatory third party access to the network, in particular as regards preferential access being granted to incumbents for historical long term contracts
- insufficient competences of the regulators

EC intends to take action to address the remaining issues in the following areas

- ensuring non-discriminatory access to well developed networks,
- improving regulation of network access at national and EU level,
- reducing the scope for unfair competition,
- providing a clear framework for investment,
- resolving issues relating to households and smaller commercial customers

Enhancing the cooperation of national regulators

- Establishment of the European agency for cooperation of energy regulators (ACER)
- main tasks of the Agency
 - Providing framework for national regulators to cooperate
 - Regulatory oversight of the cooperation among the transmission system operators
 - Individual decision powers on exemption requests concerning infrastructure assets of European interest
 - General advisory role vis-à-vis the Commission as regards market regulation issues

Commission proposes to strengthen the market regulation powers of the national regulators in



- monitoring compliance of transmission and distribution system operators with third party access rules, unbundling obligations, balancing mechanisms, congestion and interconnection management;
- reviewing the investment plans of the transmission system operators, and providing in its annual report an assessment of how far the transmission system operators' investment plans are consistent with the European-wide 10-year network development plan; monitoring network security and reliability, and reviewing network security and reliability rules;

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Commission proposes to strengthen... (cont.)

- monitoring transparency obligations;
- monitoring the level of market opening and competition, and promoting effective competition, in cooperation with competition authorities; and
- ensuring that consumer protection measures are effective.

The Commission considers that regulators should be independent

- Existing legislation calls for regulatory authorities to be wholly independent of the interests of the gas and electricity industry, however it does not guarantee independence from short-term political interests
- It is proposed that the regulatory authority be legally distinct and functionally independent of any other public or private entity, and that its staff and any member of its decision-making body act independently of any market interest and neither seek nor take instruction from any government or other public or private entity
- It is proposed that regulatory authorities have legal personality, budgetary autonomy, appropriate human and financial resources and independent management

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Examples

Example 1: the Regulatory Authority for Electricity and Gas of Italy

- **Established under law no. 481 of November 14, 1995**
- **Fully operational since April 23, 1997**
- **Independent entity with three Commissioners**
- **Sets its own organisation and procedures for decision-making**
- **Self-financed by contributions from regulated companies and entities**
- **Member to the Council of European Energy Regulators (CEER) since March 7, 2000**

Example 1: RAEG responsibilities

- **Tariff setting (level and price-cap) and price monitoring**
- **Quality of service (minimum requirements and sanctions)**
- **Directives on activity unbundling**
- **Advice on market structure and promotion of competition**
- **Overviewing electricity and gas service supply and contracts**
- **Settlement of disputes and complaints**

Example 2: Greek regulatory body

- has very limited powers
- Minister of Development sets network tariffs
- Minister sets salaries to the regulators and their staff
- RAE has no role in resolving cross-border dispute issues
- shortly, lacks the power of a fully autonomous body
- Greece is lagging behind in implementing EC Directives
- the trend is bad: a Law was passed in 2004 terminating the terms of regulators (professor P.Capros and his colleagues were removed from the office)
 - Source: Regulatory benchmarking report for the Athens MoU signatory parties, 2004

Different historic background

- a number of countries (Ireland, UK, France, Italy, Greece, new MS) have a long history of state-owned monopolies
- to make liberalization credible in these countries calls for a regulator with a broad mandate
- Nordic countries, Germany, the Netherlands have a different background with a much more decentralized industry structure, less state ownership and tradition of self-regulation
- approach to market regulation in these countries is less ambitious, building on existing institutions that gradually are modified to cope with the changing situation

Comparison of two regulators

- Estonian regulator until 2008 was an Agency at the Ministry
- It has no separate budget
- But it had a final say on tariffs, licenses, dispute settlement
- Ministry never challenged the Regulator's decisions
- Georgian Energy Regulatory Commission is an independent and legally strong regulator
- It's independence and functions set in the Law
- It has an independent budget
- But in practice it acts as a ministerial agency

What is necessary for a new regulator

- Well-defined legal background (general law and secondary legislation)
- Clair separation of the responsibilities with the Ministry
- Public acceptance (it is not easy as one of the first tasks is to raise tariffs, remove subsidies)
- Dedicated management (Commissioners)

THANK YOU FOR YOUR ATTENTION!

REKK was established at the Corvinus University of Budapest in December, 2003. The mission of REKK is to contribute to the creation of working energy markets and the establishment of efficient regulation by carrying out applied research, training and quality consultancy activities for all those interested persons and organizations that are active in the field.

We think that the experiences that Hungary and some other Central and Eastern European countries have gained through the restructuring and re-regulation of their energy markets are valuable and relevant for all transition economies. This is why the Centre intends to put a special emphasis on the research and dissemination of the regional experience and intends to become a regional research and training centre.

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