

ROLE OF A REGULATOR

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OUTLINE

- **Basics of regulation**
- **Main requirements to regulatory bodies**
- **Functions of regulatory agencies**
- **Different principles of regulation**
- **Requirements to regulatory bodies according to Directive EU 2003/54/EC**
- **Regulation in ERRA countries**

OBJECTIVES OF REGULATION

- **Protection of consumers**
- **Ensuring financial viability of companies**
- **Promotion of competition development**
- **Collection and dissemination of information**

OLD TYPE REGULATION

- **Energy companies are natural monopolies**
- **The Government approves all decisions related to governance of these companies**
- **The sector ministry is both the owner and the regulator**
- **The state owned company is protected from competition, but it is not allowed to cover all costs**
- **Subsidies and cross-subsidies are allowed and politically approved**

THE NEED FOR THE NEW TYPE REGULATION

- **Appears when private capital appears**
- **Investors want to be insured against Government interference**
- **Becomes necessary after liberalization of the industry (unbundling of accounts, appearance of competition)**
- **Regulation of liberalized, privatized sector requires new approaches and instruments**

COMPARISON OF THE NEW TYPE REGULATION WITH THE OLD ONE

- As a rule, old type regulation was carried out by means of
 - Setting pricing and technical standards
 - Using property as a governing mechanism
- It was not clear, transparent, and predictable
- The goal of the new type regulation is
 - Promotion of competition (wherever possible)
 - Regulation of monopolies using clear rules and mechanisms

THE REGULATOR SHOULD BE INDEPENDENT IN ORDER TO

- **Protect investors against unacceptable risks**
- **Protect consumers against abuses of monopoly power**
- **Guarantee to all market participants clear, transparent, stable rules of the game**
-

WHY TO PROTECT INVESTORS?

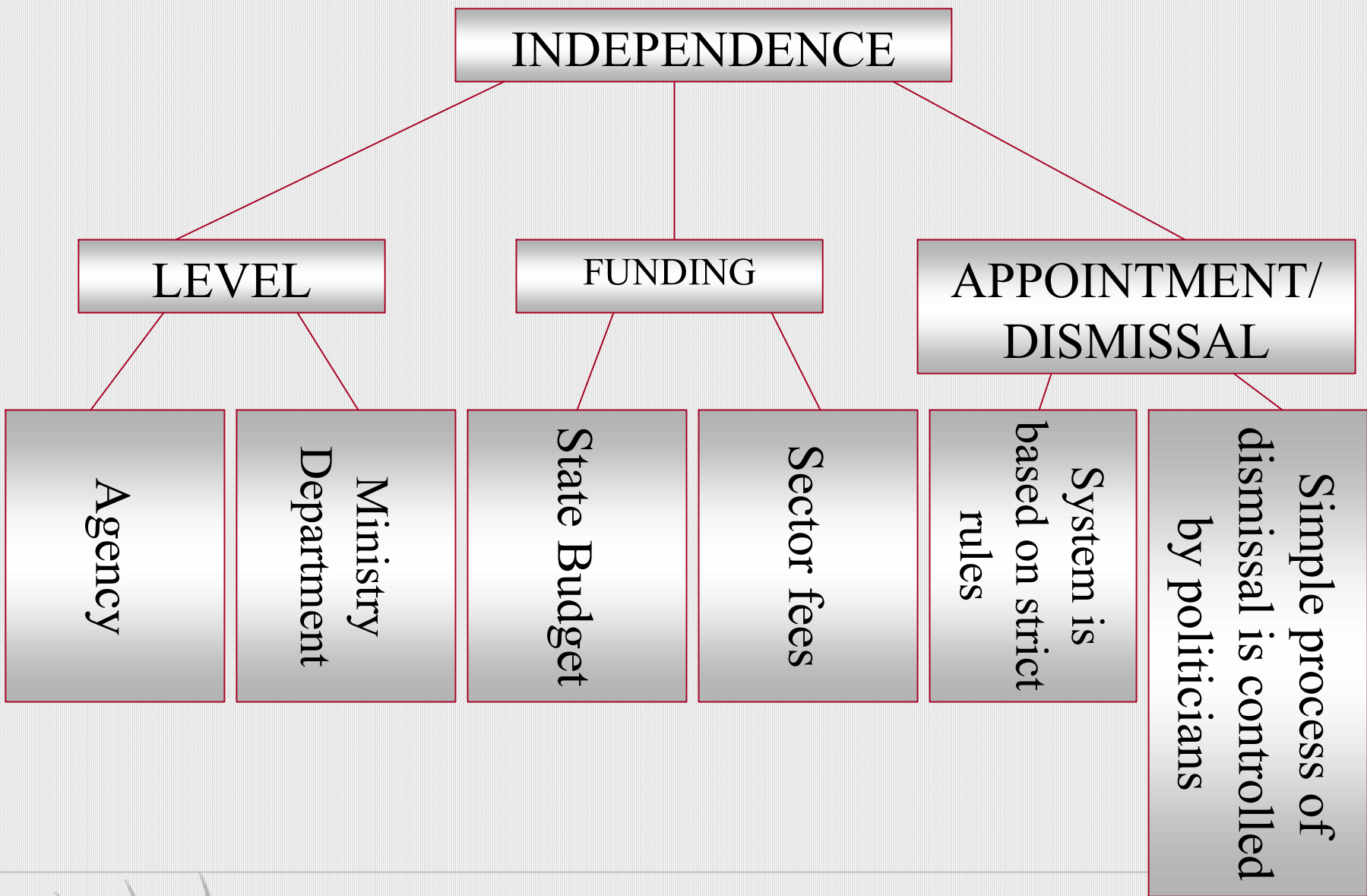
- **Energy companies are very capital intensive and their property is of long duration**
- **Investments are huge, immobile, with long pay-off period**
- **Investors need clear rules of the game**
- **Distrust of investors decreases trust to the country in general and increases the cost of capital**

MAIN REQUIREMENTS TO A NEW REGULATOR

- **independence**
- **transparency**
- **reporting, or to put it a little bit differently, FOR:**
 - **autonomy**
 - **authorities**
 - **accountability**

WHY IS INDEPENDENCE NECESSARY

- **It ensures that the Government fulfils promises given to consumers and investors**
- **It is difficult for politicians to resist the temptation to maintain tariffs on a low level**
- **An independent regulatory body can give to investors promises which they would believe, as such a regulatory body is less dependent on the political influence**



PROBLEM OF INDEPENDENCE

- **Not a single state institution is completely independent:**
 - **General strategic principles,**
 - **Appeal,**
 - **Budget**
- **Falling under the influence of politicians, regulated industry and other interested groups**

IT IS VERY DIFFICULT TO ENSURE INDEPENDENCE WHEN

- **The legal framework is not sufficiently developed**
- **There is no competition policy**
- **Political pressure dominates economic and commercial factors**
- **Political authorities are not separated or are poorly separated**

ACCOUNTABILITY

- **Decisions are made after open discussions**
- **All stakeholders are involved**
- **Regulator's decisions and methodologies are justified**
- **In general – clear rules of the game**

TRANSPARENCY

- **Regulators often arouse suspicions, especially in countries with transition economies**
- **Quite often their first decision is to increase prices in order to cover costs**
- **Regulators have to persuade the population that price increase is related not to excess profits, but to elimination of subsidies and cross-subsidies**
- **All work should be transparent:**
 - Methodologies are broadly and openly discussed,
 - Decisions are made after consultations with all stakeholders,
 - Meetings are open for the general public, etc.

SCOPE OF REGULATION

- One industry
 - separate agencies for electricity, gas, etc.
(Romania, France, U.S.)
- One sector
 - separate agencies for energy, transport, etc.
(in most ERRA countries)
- Multi-sectorial
 - One agency for all or almost all utilities (U.S. State Commissions , Latvia)

ADVANTAGES OF A MULTI-SECTORIAL AGENCY

- **Saves resources, reduces costs**
- **Reduces risks of excessive industry influence**
- **Reduces risks of political influence**
- **Promotes exchange of experience between industries**
- **Helps to address inter-sectorial problems (thermofication)**
- **Fosters development of consistent approaches to common problems**

LOCAL OR NATIONAL AGENCY

Advantages of a local regulator

- **Better knowledge of local conditions**
- **More direct reporting**
- **More efficient monitoring of regulated companies**
- **Better coordination with local governing bodies**

Disadvantages of a local regulator

- **Technical literacy of regulators leading to economy of scale in regulation**
- **Deficit of local specialists**
- **External factors requiring uniform approaches and a single agency**
- **Higher probability of excessive influence of the sector**

DEGREE OF REGULATORY AUTHORITIES

- **Monitoring**
- **Consultations/recommendations**
- **Coordination**
- **Approval**
- **Setting/approval of directions**
- **Ensuring compliance**
- **Imposition of sanctions**

COMMON TASKS OF REGULATORS

- Issuance, suspension, amendment and revocation of licenses
- Supervision over meeting license requirements
- Approval of pricing principles and setting prices
- Settlement of disputes between market participants
- Application of sanctions for non-execution of license terms, etc.

WHAT REMAINS FOR THE MINISTRY?

- **Sector planning strategy, including restructuring**
- **Privatization**
- **Development of a legal basis**
- **Coordination of investments important for the security of the country**
- **Support of scientific research**

VARIOUS TYPES OF REGULATION

- **Old type regulation**
- **Regulatory approach in the U.S.**
- **Regulatory approach in the UK**
- **German model**

REGULATORY APPROACH IN THE U.S.

- **Independent commissions**
- **Is responsible for all economic regulation, including pricing, development of methodologies and rules, enforcement, financial and managerial audit, settlement of disputes, etc.**
- **Public hearings**
- **Decisions are final, can be appealed in courts**
- **Requires significant resources (human, financial), procedures are quite lengthy**

REGULATORY COMMISSIONS IN THE U.S.

- **Federal sector commissions (FCC, FERC, etc.)**
- **Multi-sectorial commissions in states (3-7 members)**
- **Appointed by the Governor (much more seldom, elected) for a certain period of time**
- **Staggered terms of offices**
- **Are dismissed only for certain reasons**
- **Is responsible for the whole economic regulation**
- **Is funded from fees**

PRINCIPLES OF REGULATION IN THE UK

- **One general director of the institution (usually for one sector)**
- **Decisions are final, but can be appealed in the Competition Commission**
- **Requires less resources than U.S. Commissions, is less formalized**
- **Certain functions (issuance of licenses) remain with the ministry**
- **Decisions are made quicker, but are less predictable**

EXAMPLES OF OFWAT

(English water regulatory agency)

- **One general director of the Water Services Institution**
- **Is responsible for setting prices, monitoring financial and managerial functions, settlement of disputes, setting service standards, compliance control, promotion of competition**
- **Is not responsible for issuance of licenses, water quality**
- **The general director is appointed for a certain period or time by the Secretary of State (Minister), is dismissed from the position only due to certain reasons**
- **Decisions are final, can be appealed in the Supreme Court**

GERMAN MODEL

- **There is no separate regulatory agency**
- **Federal cartel institution (antimonopoly agency) acts in accordance with the Law on competition**
- **Requires even less resources, but a strong competition agency is necessary**
- **EC requires to set independent agencies that regulate electricity and gas**
- **There is a separate agency for regulation of telecommunications**

REGULATORY AUTHORITIES IN ACCORDANCE WITH DIRECTIVE 2003/54/EC

- **Should ensure equal access to networks**
- **Should ensure non-discriminatory, effective competition and efficient functioning of the market**

REGULATORY AUTHORITIES IN ACCORDANCE WITH DIRECTIVE 2003/54/EC SHOULD, AT LEAST

- **Approve or, at least, set methodologies for calculation or setting terms and conditions for connection and getting access to national networks**
- **In a similar way, regulate provision of balancing services**
- **Require TSO or DSO to modify terms and conditions, tariffs, rules, mechanisms, methodologies for connection and getting access to networks or balancing services**
- **Act as referees with binding decisions in case of complaints against TSO or DSO in connection with listed above**

DIRECTIVES SET SPECIFIC TYPES OF ACTIVITIES THAT ARE MONITORED BY REGULATORY AGENCIES

- Rules for management and allocation of interconnection capacities
- Mechanisms for congestion management in national networks
- Time required to network operators for connection and repairs
- Publication of network information
- Effective unbundling of accounts to ensure elimination of cross-subsidies
- etc.

REGULATORY AGENCIES IN ERRA COUNTRIES

1. Commissions

Country	# Members	Appointed by	Term, years
Armenia	5	PM	5
Bulgaria	7	PM	5
Croatia	5	Parl.	5
Georgia	3	Pres.	6,4,2
Latvia	5	Parl.	5
Lithuania	5	Pres.	5
Russia	7	Pres., Gov.	4
Slovakia	6	Pres.	6
Ukraine	5	Pres.	6

REGULATORY AGENCIES IN ERRA COUNTRIES

2. Agencies, Bureaus, Authorities

<i>Country</i>	<i>Director appointed by</i>	<i>Term, years</i>
Czech Republic	CM	5
Estonia	Min.	Not set
Hungary	PM	6
Moldova	CM	6
Poland	PM	5
Romania	Parl.	Not set

3. Some other agencies

Kazakhstan – Agency for regulation of natural monopolies

SECTORS REGULATED BY ERRA REGULATORS

- Only electricity or gas sector
 - Albania – electricity, ANRGN Romania - gas
- Electricity and gas industry
 - Ukraine, Czech Republic, Hungary, Georgia
- Electricity and district heating
 - ANRE Romania
- Electricity, gas and district heating
 - Most organizations
- Energy and water
 - Lithuania
- Multi-sectorial
 - Latvia, Armenia

OTHER REQUIREMENTS RELATED TO INDEPENDENCE AND CONTINUITY INTRODUCED IN ERRA COUNTRIES

- Funding from fees from licensed companies or from tariffs
 - Croatia, Georgia, Hungary, Latvia, Moldova,
- Staggered terms of offices
 - Armenia, Georgia, Lithuania, Moldova, Ukraine
- Clear rules for dismissal
 - In most countries

COMPETENCE OF REGULATORS

	Network tariffs (el./gas)	Settlement of disputes	Involvement of the Ministry
Estonia	R/R	R/R	supervision
Latvia	R/R	R/R	no
Lithuania	R/R	R/R	no
Poland	R/M	R/R	supervision
Czech Republic	R/R	R/R	no
Slovakia	R/R	R/R	no
Hungary	M/M	R/R	Approval of tariffs

COMPETENCE OF REGULATORS

(continued)

	Network tariffs (el./gas)	Settlement of disputes	Involvement of the Ministry
Slovenia	R/M	R/R	no
Romania	R/R	R/R	no
Bulgaria	R/R	R/R	no
Turkey	R/R	R/R	no
Croatia	M & R	R	Approval of tariffs
Albania	R	R	instructions