

Self-Regulation in a Frame of Utility Reform Governance

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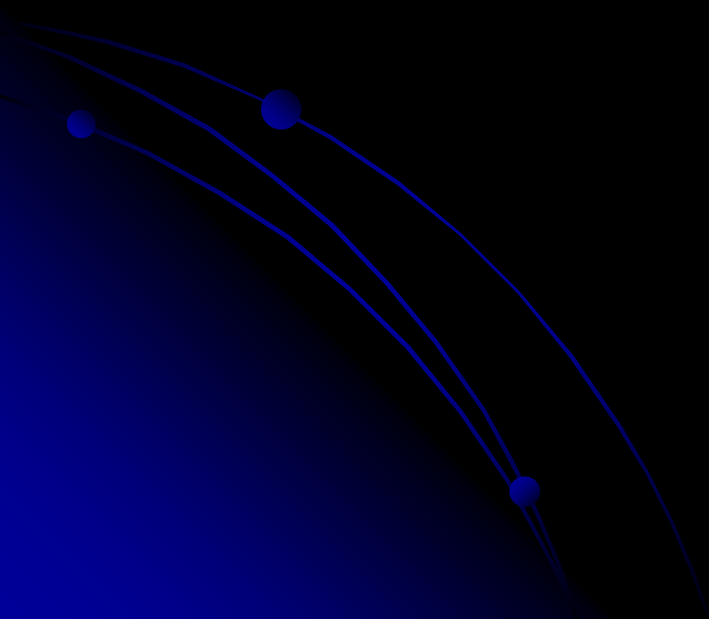
Governance structures in utility reform

- Reform of network industries often linked with creation of regulatory bodies
 - Long term objects, put in place by incomplete laws
 - Authority of regulator
 - Residual lawmaking functions
 - Law enforcements functions
 - Resolution of conflicts
- The independent regulator is of central importance for the **credibility** of reforms (Levy & Spiller [1994])
- So what is the role of self-regulation?

Organisation of the presentation

1. What role for self-regulation in utility governance ?
 2. The role of self-regulation in German electricity reform
 3. Self-regulation and adaptability of reforms
- 

1. What role for self-regulation
in utility governance ?



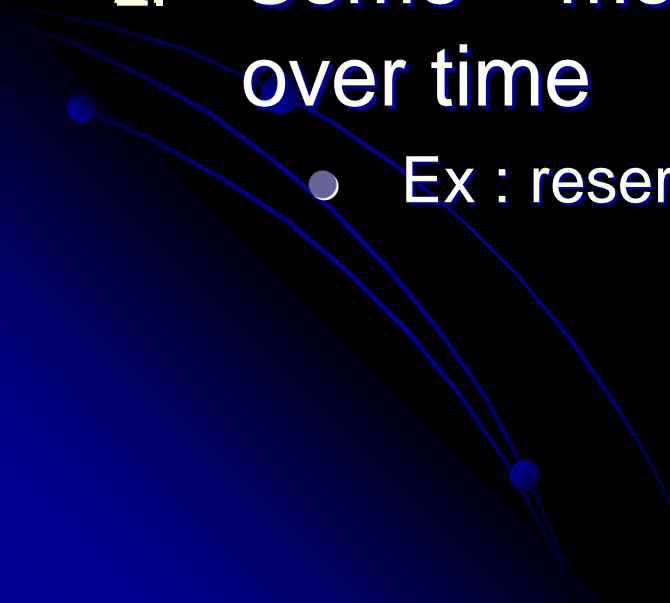
Why self-regulation ? (1)

- Characteristics of reforms
 - Long term
 - Sectors with strong asset specificity
 - Modular and sequential
- Example of electricity:
 - reforms can be started by modifying only some « modules »
 - Over time, extension of reform to additional « modules »
 - cf. Rious [2006]

Why self-regulation ? (2)

- In general, credibility is a central condition
- In modular / sequential reforms, credibility is not the only goal of design of reforms
 1. Credibility, when there is no « optimal » reform and no « optimal » governance structure ?
 - 2. **Adaptability over time**
- Self-regulation can play a role in making reforms credible and adaptable

Examples of adaptation of electricity reforms

1. Extension of competitive reforms to additional « modules »
 - Ex : retail markets, interconnection mechanisms
 2. Some « modules » have to be adapted over time
 - Ex : reserve markets
- 

Modularity of electricity reforms

Access to networks

Property rights on the network

Access regime

Long term management of the network

Coordination with other TSOs

**Wholesale
Market**

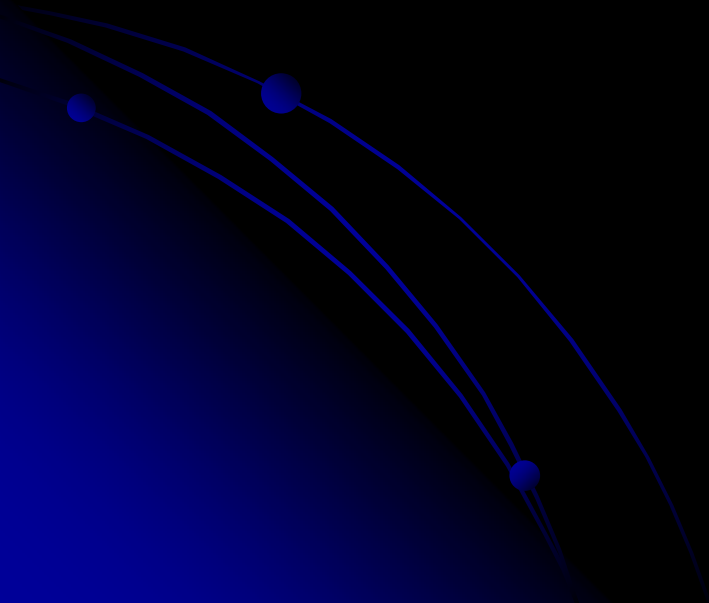
Management of externalities and public goods on the network

Ancillary services

Balancing mechanisms

Allocation of transmission rights

2. The role of self-regulation in German electricity reform



Self-regulation as a governance structure of reforms: the German electricity reform of 1998

- A reform without a regulator
- Definition of rules for access to networks by stakeholders
 - Network operators and big customers
 - Three Association Agreements signed between 1998 and 2001

Germany: a typical case of stakeholder regulation

Energy Law of 1998

- **Federalism**
- **A detailed law was not feasible**
- **Incomplete law:**
 - No regulator
 - Negotiated network access
 - Implementation : role of competition law

The private Association Agreements

- **Participants :**
electricity companies' and big consumers' associations
- **The rules**
 - Rules for calculating network tariffs
 - Conflict resolution mechanisms

Regulation by Competition Authorities

- **Competition authorities intervene ex-post and in a non discretionary way**
- **but they can also intervene ex-ante**
 - Authorisation of Association Agreements
 - Signals

Sources of adaptability of the German electricity reform

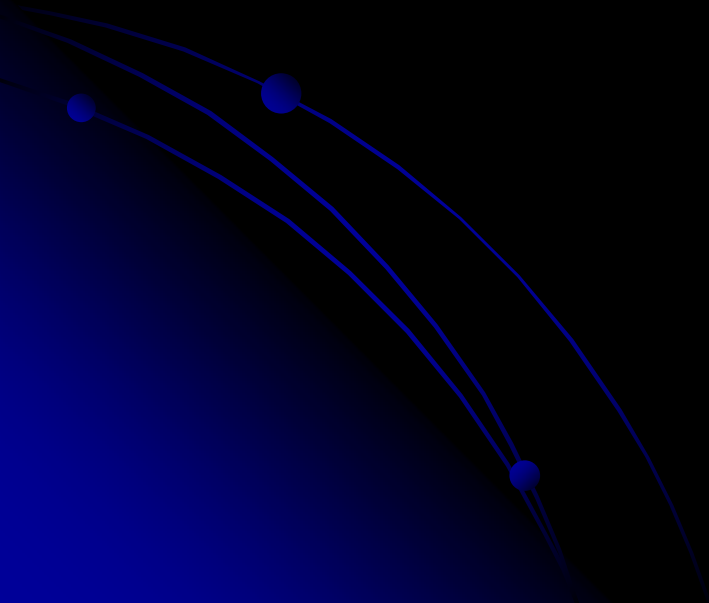
- Limited duration of Association Agreements (two years max.)
- Structure of negotiations
 - Participation of (strong) customers
 - Diversity of interests of electricity companies
 - Big utilities vs. municipal utilities
- Threat of sanctions by competition authority

Is Germany an exception ?

There is some self-regulation in other reforms

1. Governance of power pools and TSOs (Barker et al. [1997], Glachant [1998])
 - Stakeholders control parts of the rulemaking process in electricity reforms (UK, US)
2. “Stakeholder regulation” (Prosser [2005])
3. Rulemaking at the EU level: Florence Forum (Eberlein [2005])

3. Self-regulation and adaptability of reforms



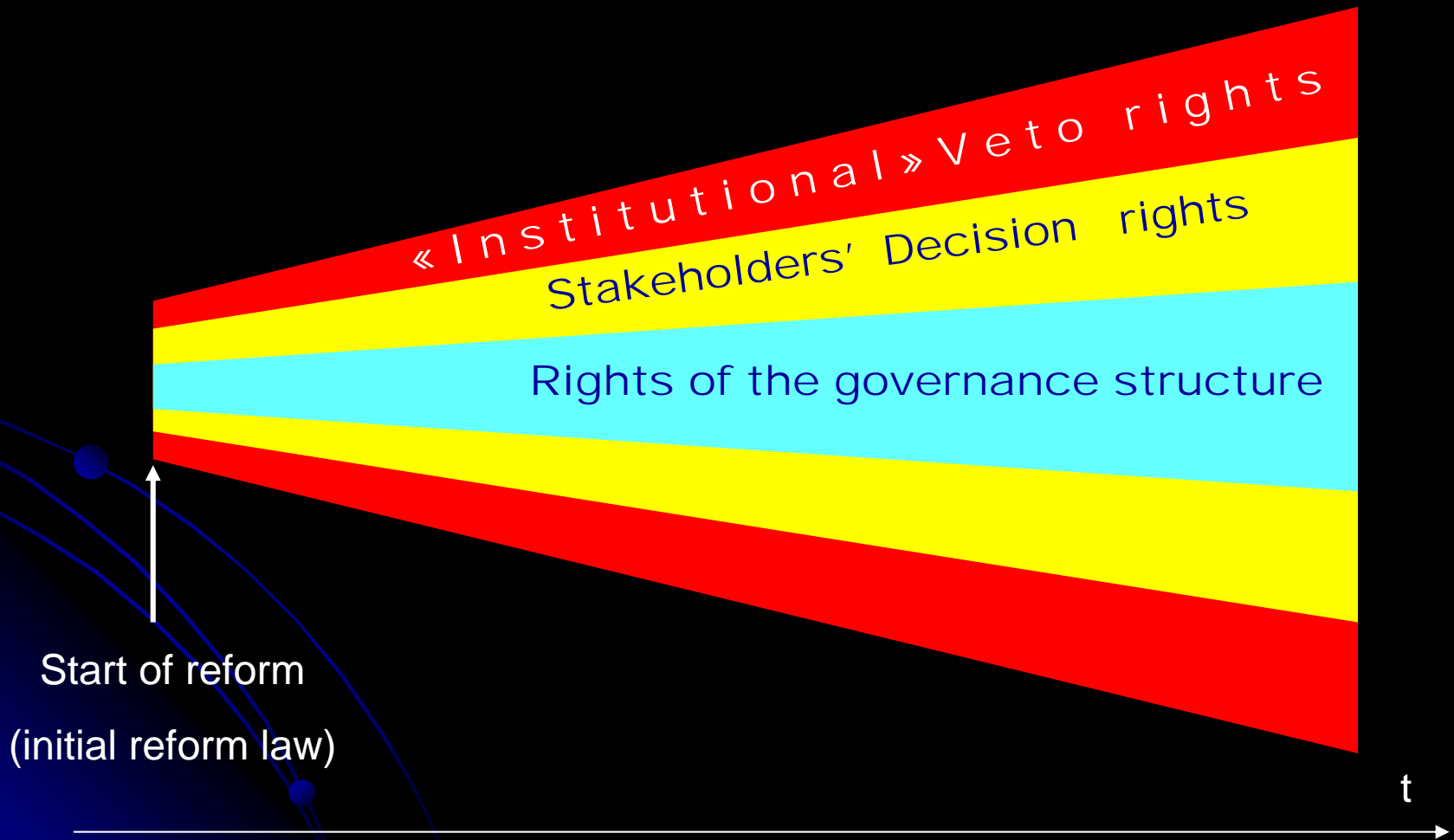
Explaining stakeholder regulation

- In a context of modular / sequential reforms, stakeholders de facto have rights on adaptation decisions
 - Incomplete reforms: decision rights of the regulator are limited (he cannot adapt all modules)
 - Stakeholders' rights: property rights, decision rights on some modules
 - Technical expertise
 - Private information of SH
 - Advantages / monitoring and enforcement (Ogus [1995, 1999])
- Consequence : some adaptations are made by bargaining with stakeholders

The institutional dimension of adaptation

- Adaptation of reforms similar with adaptation of contracts ? (Williamson [1991]) :
 - Inconsequential disturbances: automatic adaptation clauses
 - Small disturbances: adaptation within the initial contract
 - Ex : one party or an arbitrator is given authority to decide changes of the contract
 - Big disturbances: renegotiation of the whole contract
- **The “functioning” of the contract *ex-post* is important - Role of « governance structures » !**

Adaptation of reforms : « constrained » reform paths

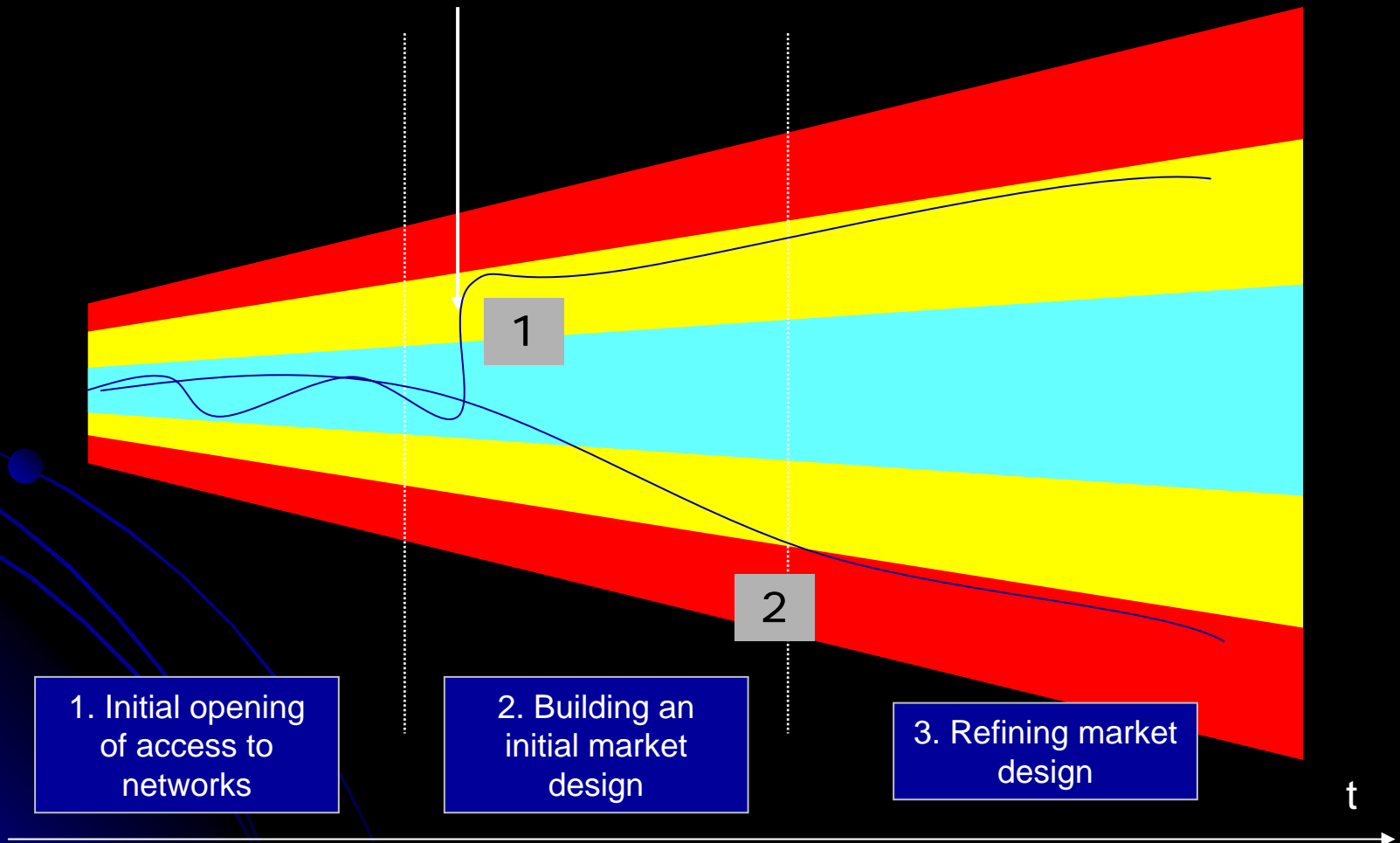


Three types of adaptations depending on the allocation of rights

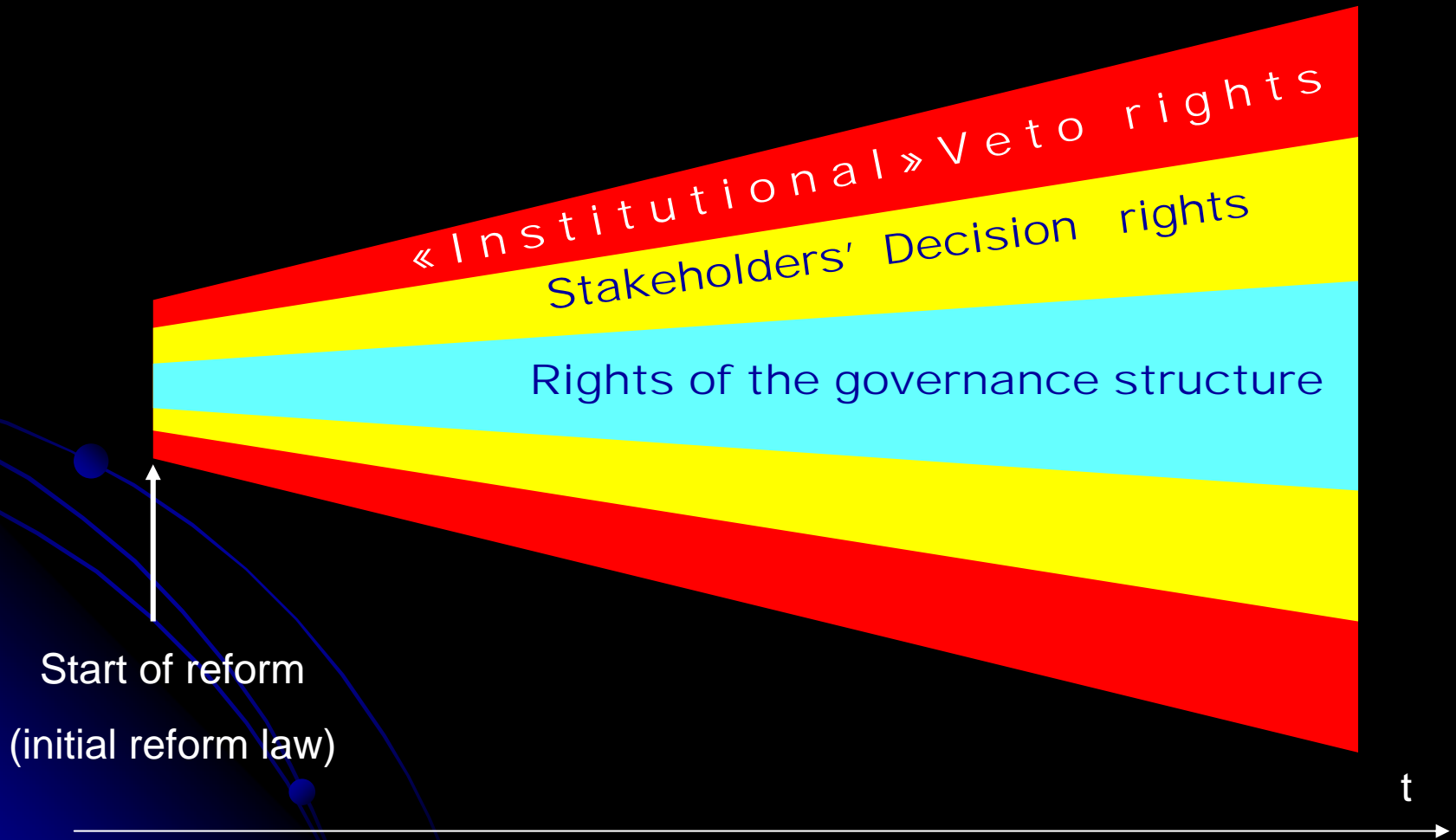
- Type 1 - blue area : adaptation by the regulator alone
- Type 2 – yellow area : adaptation by negotiation with stakeholders
 - Ex : UK renegotiation of licenses
 - Ex : Germany – Association Agreements
- Type 3 – red area : adaptation by « institutional » actors
 - Ex : government, legislature
 - « reform of reform » Hogan [2002]

Adaptation of reforms

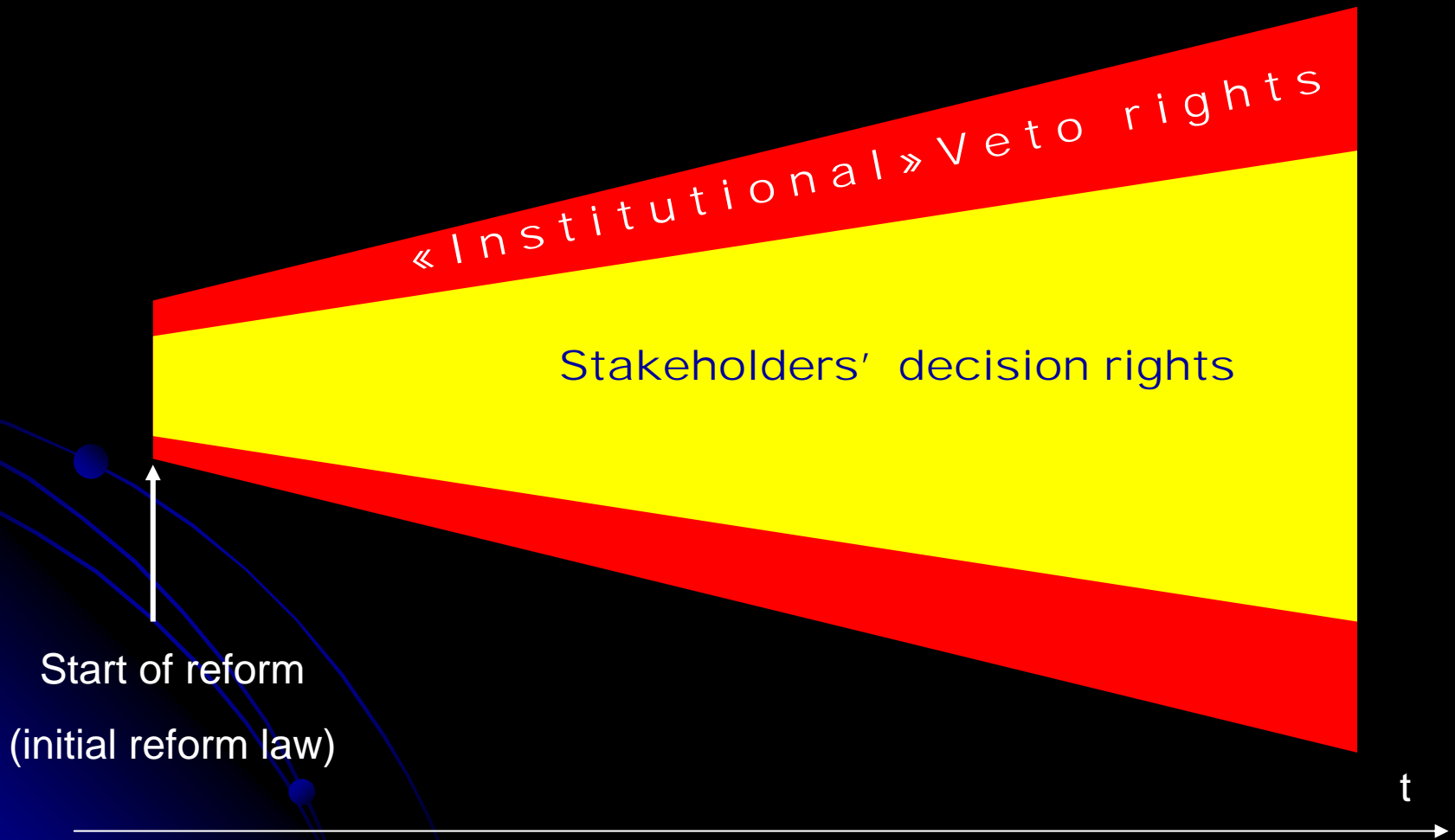
Unforeseen event /
disturbance



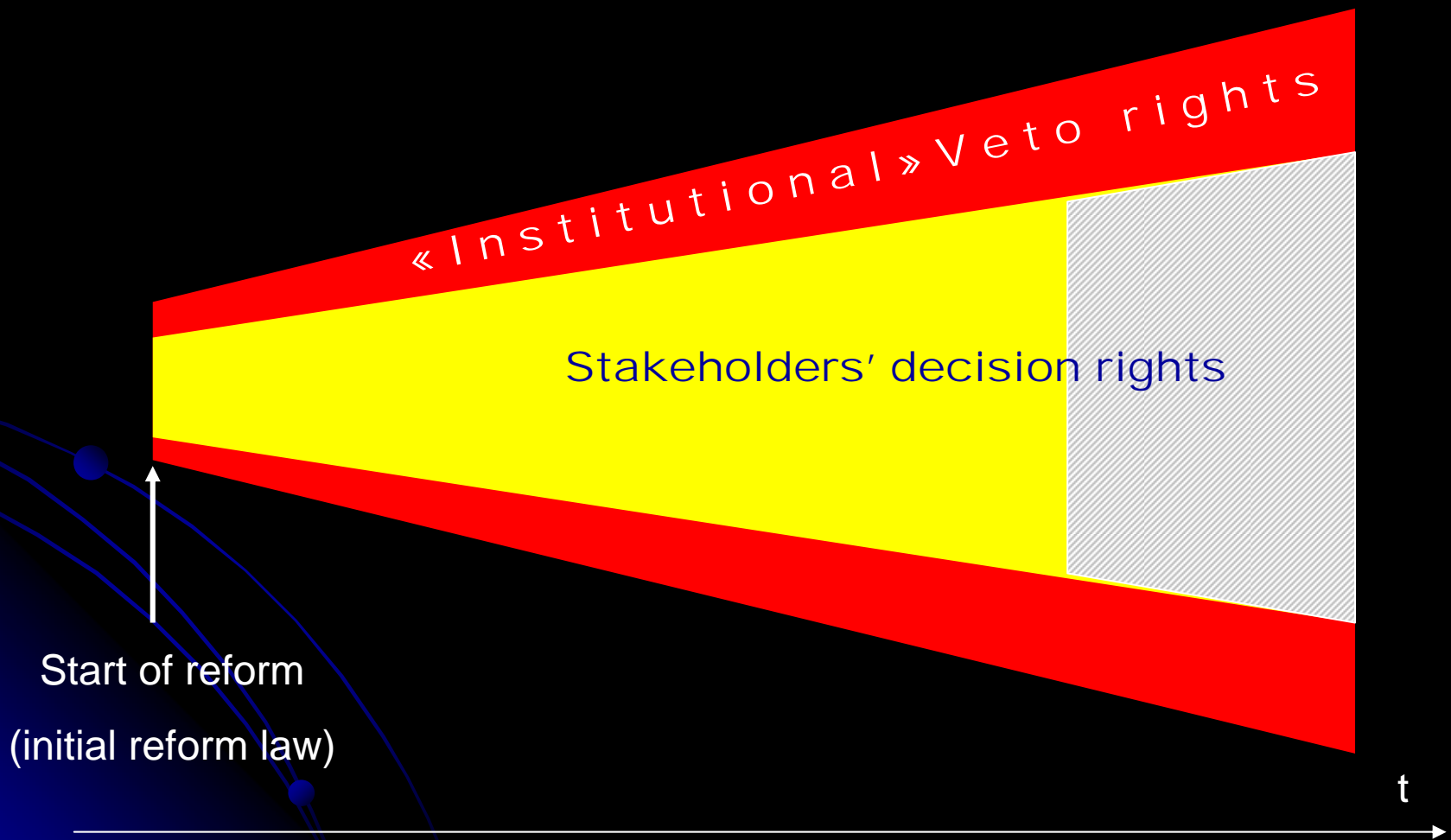
The general case



Pure self-regulation



Self-regulation can increase credibility (in the sense of protection of stakeholders against expropriation) but what about adaptability ?



Conclusions

- Self-regulation is not an exception but generally present in reforms
 - important in the context of
 - long term
 - modular reforms
- Self-regulation is linked with a certain type of adaptations (bargaining)
- Potential problem of self-regulation is the extent of adaptability (stakeholders willing to develop pro-competitive rules ?)

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