Paul Hunt: Response to "Review of CER Public Consultation Process – a Consultation Paper", CER/07/140, 7 September 2007

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1.1 Introduction

In its Consultation Paper the CER effectively concedes that the current process of public consultation is not working. It declares that it is "fundamentally important that full participation is achieved in all public consultations, as the public consultation process is the key method by which regulatory decisions can be influenced." (Section 2.2, p6) But it acknowledges, with regret, that many consultations receive few comments.

The CER is inviting interested parties to respond to a structured questionnaire about the consultation process. Not surprisingly, this questionnaire is designed to avoid a detailed exploration of the underlying reasons for non-participation, so a separate submission has been prepared.

The opportunity to make a submission is welcome, even if the case made in the submission demonstrates that it is both irrational and futile to do so. This submission outlines possible reasons for the lack of participation in the consultation exercises conducted by the CER, shows that the flaws in the current process are symptomatic of deeper flaws in the policy and regulatory process and argues for thorough-going reform of the regulatory process.

1.2 Possible Reasons for Non-Participation

There is no evidence that the CER has contemplated the possibility that the paucity of responses to its consultation papers may

- reflect perfectly rational behaviour on the part of most stakeholders and interested parties;
- signal a recognition of the futility of attempting to participate in consultations which are, in essence and in most cases, negotiations between the public energy enterprises and the CER; and
- indicate that a consultation process, however constituted, may not be the most effective means of achieving a valid and sustainable regulatory determination in certain cases.

1.2.1 Rationality of Non-Participation

There is no incentive to expend time and effort and to incur expense preparing submissions when:

- there is little, if any, evidence that submissions, irrespective of their quality or the evidence they contain, have any impact on the final regulatory determinations,
- the time period for consultation is often short and frequently ends close to the date for enforcing the specific determination;
- the CER unilaterally determines the scope of, and issues for, consultation and has the power to exclude relevant matters that it might find inconvenient to address,
- the CER, in many cases, sets out its preferred approach and dismisses any modifications proposed in submissions,
- there is no obligation on the CER to present all of the evidence on which it bases its determinations (even when issues of commercial confidentiality do not arise);
- the CER has the time, staff resources and considerable consulting support to attempt to undermine selectively, if it so chooses, any evidence that might cast doubt on its preferred approach,
- there is no ability to contest inadequate or selective consideration of a submission or the ignoring of evidence submitted as the CER's response to submissions and its final determination are usually issued around the same time and
- the appeals process is available only to regulated businesses.

1.2.2 Futility of Participation

This futility is best illustrated by the CER's treatment of submissions on network revenues and tariffs.

Network Investment

Electricity networks, in particular, have experienced, and will continue to experience, a high investment requirement. The three principal sources of investment finance are funds generated from operations, borrowings and shareholder equity injections. Successive governments have affirmed their determination to maintain energy networks in public ownership, but have evaded their shareholder responsibility to ensure that these networks are adequately and efficiently financed by refusing to advance Exchequer funds to part-fund network investment.

Overpayments by Network Users (and Consumers)

In the absence of Exchequer finance, network users (and, ultimately, all electricity consumers) are paying twice for the share of investment that should be funded by the State. They pay to finance this share of investment directly and continue to pay the full return on, and of, the investment. This is analogous to a house buyer being required to service a 100% mortgage, but is allowed to borrow only 70% of the purchase price and is required to provide own funds for the remaining 30%. Rather than confronting the failure of successive governments to provide funding, the CER sets network revenues that enforce this double-payment. Indeed, the legislation establishing the CER facilitates this outcome, since the CER is empowered to set tariffs and not maximum tariffs as in other jurisdictions. Since it cannot refute the evidence of this double-payment, the CER simply rejects it.

The CER, not surprisingly, contends that the financial structure of network businesses is not its responsibility and attempts to maintain the fiction that its network revenue

determinations are derived without regard to the financing cash flow requirements of the network businesses. To some extent, this may be true for the Bord Gáis Networks (BGN), since BGN has captured, and continues to capture, windfall gains, but it defies belief that this fiction is advanced in the case of the ESB Networks.

Policy and Regulatory Failures

The decisions not to advance Exchequer funding reflect policy failures of successive governments, but it is the responsibility of the CER, given that it is required to have regard to the ability of regulated businesses to finance their activities and given its duty to protect the interests of consumers, to highlight these policy failures. The CER has shirked its responsibilities, penalised consumers and allowed successive governments to evade their shareholder responsibilities. Yet it continues steadfastly to reject the evidence of these serious regulatory and policy failures.

The splitting of policy and regulatory responsibilities between the Department and the CER has diminished accountability. The parcel labelled "policy and regulatory failures" is passed cheerfully from one to the other, but neither ends up holding it. Since the application of regulation to gas and electricity networks, it is estimated that consumers have over-paid in excess of €1.25 billion.

Lightening the Overpayment Burden

The network overpayment burden on consumers has lightened, and been lightened, over time, but the impact is limited and inadequate. Continuing increases in network throughputs have contributed to a decline in unit costs. The extension of the ESB's borrowing limit allowed by the Electricity (Supply) (Amendment) Act 2004 reduced the requirement to extract a share of network investment financing directly from network users. This was reflected in the CER's 2006 – 2010 review of the electricity networks' revenues. The CER was able to tweak the asset base and the depreciation periods so as to align the funds generated from operations with projections of a reduced requirement for investment financing from these funds.

For the future, the Energy Policy White Paper includes a government commitment to give positive consideration to an Exchequer contribution to the cost of strategic energy infrastructure to address security of supply over the period of the National Development Plan (NDP) 2007 - 2013. The possibility of some Exchequer funding is clearly welcome as it should prevent, providing the funding is sufficient, an increase in the existing overpayment burden on network users and consumers. But no decision has been made.

The White Paper also includes a government decision to operate the electricity distribution network business under a risk-related rate of return that will reduce ESB profits and redistribute the benefits to consumers. This decision is also welcome as it will reduce the overpayment burden. However, the implementation of this decision is likely to test the ingenuity of the Department and the CER. Successive Ministers and the Department have frequently pointed out that

- the position in law is that sole responsibility for the regulation of electricity and gas tariffs lies with the CER as an independent statutory body;
- Ministers or the Department have no function in the setting of these tariffs; and that
- the CER is, by law, completely independent in its decision-making processes.

The objective is to reduce the effective cost of electricity supply without usurping the CER's much-vaunted independence in setting revenues and tariffs. It is almost certain that an approach to implementation was agreed between the CER and the Department prior to the inclusion of the decision in the White Paper. It is both ironic and inefficient that so much effort will be expended to effect a limited reduction of the overpayment burden, when a small fraction of this effort would remove it.

For example, the passage of a simple one clause Bill defining the tariffs set by the CER as maximum tariffs would initiate the process. An allocation of Exchequer funds would allow electricity network tariffs to be reduced almost immediately. BGN would be deprived of its windfall gains and gas network tariffs would fall. The Government, as the dominant shareholder, could direct the companies to make the necessary adjustments.

Reluctance to Acknowledge and Resolve the Problem

Despite all this, the nature and extent of the underlying overpayment/financing problem on electricity networks remain unacknowledged, as do the continuing windfall gains on the gas networks, and both continue to have a detrimental impact on energy consumers and on the economy. An opportunity to raise this problem will not arise again in the consultation process until 2010 for the electricity networks and 2011 for the gas networks.

It would be difficult to find a better example of the futility of participating in consultations on regulatory matters. All the parties – the Government, the CER, the ESB and Bord Gáis – realise there is a problem. This is evidenced by the belated and inadequate attempts to lighten the overpayment burden (and by a call from the ESB for the CER to set maximum tariffs). But they have tied themselves into a legislative strait-jacket and cannot release themselves without admitting serious policy and regulatory failures.

1.2.3 Inappropriateness of Consultation

Consultations may have their place in the regulatory process, but they may not be appropriate or effective in all circumstances. In the light of the features of the current consultation process outlined in Section 1.2.1 above it is not appropriate for consideration of network tariffs and revenues. The objective evaluation and testing of evidence and analysis is crucial in this exercise and the current consultation process is entirely unsuited to facilitate this.

1.3 Reforming the Consultation Process?

The current legislation restricts the CER to a "one club" approach, i.e., the use of public consultations. Therefore the CER's focus is on making this process work better. The current consultation may provide some guidance, but it is unlikely to provide information of which the CER is not already aware. It would make sense for the CER to accompany this exercise with a full review of the consultations it has conducted to date. The discussion in the previous sections highlights many of the flaws in the current process.

If such a review were conducted, ideally by an independent body and in association with the current consultation, it would go a long way to explain the lack of participation in the current process and why thorough-going reform is required.

1.4 Reforming the Process of Regulation

Although the CER is compelled to operate in accordance with the statutory powers granted and duties imposed by the Houses of the Oireachtas, this does not prevent it from advancing proposals to amend legislation so as to improve the regulatory process. However, since there is little, if any, incentive for the CER to propose alteration of the current arrangements, it would make sense for any legislative proposals to emerge from the comprehensive regulatory review to which the government is committed (Energy Policy White Paper, Section 3.18.6, p51).

There is an urgent requirement for this review in the light of the serious inadequacies in the current regulatory process and in the context of the Regional Energy Market Initiative being advanced by the European Regulators' Group for Electricity and Gas and of the Third Legislative Package proposed by the European Commission. The legislative proposals bearing on regulation, inter alia, should include:

- an obligation on the State to ensure that public energy enterprises subject to regulation by the CER are adequately and efficiently financed so that the CER is not required to deal with any failure by the State to discharge its shareholder responsibilities;
- the establishment of a separate statutory body charged to protect the interests of energy consumers – an energy consumers' protection agency;
- a revised and expanded appeals process achieved by
  - the repeal of the Appeals Panel provisions in the existing legislation,
  - the empowerment of the Competition Authority (or the establishment of a separate quasi-judicial body) to hear, and to decide on, appeals of regulatory determinations and
  - the extension of the right of appeal to the energy consumers' protection agency and to other parties impacted by regulatory determinations; and
- establishing a clear distinction between the powers and duties of the CER when it deals with market structure and process (where the primary objective is to promote competition) and when it regulates the revenues and tariffs of the network businesses. In the former case the current consultation process (if it is reformed, strengthened and supported by the amended appeals process) should be sufficient. In the latter case the current consultation process should be replaced by a process similar to that employed in the USA and Canada, where
  - the CER establishes a comprehensive set of Regulatory Accounting Guidelines and the time-frame for the process leading to a determination in a specific case;
  - towards the end of the relevant control period, each regulated network business submits its case for multi-year revenues and tariffs in compliance with these guidelines and with the time-frame for the process;
  - network users (and other interested parties) review the case presented and make their submissions;
  - provision is made for all parties to defend, contest and rebut the evidence presented; and
  - the CER reviews all of the evidence presented and deliberations conducted and makes its determination.

These are the minimum requirements to restore public confidence, if not participation, in the regulatory process.