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Directing regulation!
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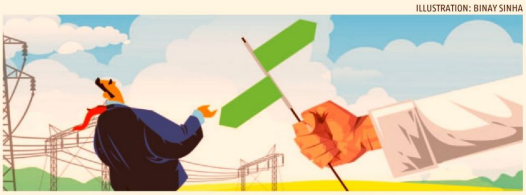

# Directing regulation!

**The recent issue of a direction by the Ministry of Power to the Central Electricity Regulatory Commission does not augur well for either regulatory autonomy or for the longer-term development of the sector**

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In a letter dated May 8, the Ministry of Power gave an unusual statutory direction to the Central Electricity Regulatory Commission (CERC). The letter says that "the CERC is required to consult all stakeholders before framing regulation and the Government are the most important stakeholder. In view of the above, (the) CERC must consult the Ministry of Power in detail at the stage of formulating regulations. This will ensure that the Regulations are consistent with the Rules framed by Government and the Government's Reforms Agenda; and will also obviate the necessity of any subsequent policy direction (by) the Government under Section 107."

This points to a conflict. The conflict is rooted in the deeper real-world complexities of the Ministry of Power and the CERC. The experiential wisdom in the field of Indian regulation is that regulators in India have displayed many kinds of bad behaviour, and governments also show improper conduct towards them. Everyone, including those connected to the state, needs a better appreciation of what a regulator is, and to recognise that this is not a subordinate office of any ministry. There are foundational mistakes in how regulators are established under present laws, which makes bad behaviour by regulators and ministries inevitable, and sets the stage for these conflicts.

Section 76 of the Electricity Act, 2003, creates the CERC. The mandatory functions of the body are laid out in Section 79, which also confers on the CERC some responsibilities to advise the government and mandates that it should function with transparency and should be guided by the plans and policies mentioned therein. Sections 94 and 95 confer on the CERC the powers of a court functioning under the Code of Civil Procedure as well as treating these functions as judicial proceedings. It has the powers to enter the premises of an organisation and seize records.

Under Section 178, it has powers to write law ("regulations") and Sub-section 3 of this Section mandates it to follow the process of previous publication. The Act similarly confers regulation-making powers on the Central Electricity Authority (CEA) for another set of subjects and confers on the Ministry of Power rule-making powers. These are, as in other similar pieces of legislation, the powers to make rules on the governance of the various entities created by the Act and mostly cover processes and procedural aspects. The substantive powers of regulating the domain are vested by the Act in the CERC and CEA. Of these, clearly the CERC is the "statutory regulatory authority" (SRA).

SRAs write regulations that shape the working of an industry, investigate violations, and, uniquely in India, mete out punishment (in violation of the separation of powers doctrine). They exist for two reasons: First, to encourage private investors that the rules of the game will not be stacked in favour of the public sector. A private investor into electricity generation would like regulations to be made by an SRA that treat all electricity-generation companies equally, and not rules to be made by the Ministry of Power, which owns NTPC, a public-sector entity. And secondly, because licensing, investigation, punishments, and rule making can favour some and harm others, it is better that these things are not controlled by a ministry, headed by an elected political person, but are placed inside a neutral technical organisation. When this is done right, it increases the confidence of private investors who would then focus on productivity and investment.

In India, the Securities and Exchange Board of India (Sebi) was the first such modern regulator. In 1992, it replaced the Controller of Capital Issues, who used to be an officer of the rank of joint secretary in the Ministry of Finance. The Sebi Act, 1992, required that the regulator get regulations made by it approved by the government before notifying them. As part of the process of building sound SRAs, the Act was amended in 1995 to delete this clause. Sebi regulations are now made by the Sebi board and do not require government approval. The regulatory autonomy of Sebi created the conditions for revolutionary gains in the Indian equity market.

These larger noble ideas have, however, run into many difficulties. The checks and balances that make an SRA work well — combining independence, fairness, rule of law, and accountability — require laws be drafted in a highly sophisticated manner. The present laws governing SRAs in India are inadequate in this regard. With poorly drafted laws, the working of SRAs has fluctuated, depending on the individuals at both ends. SRAs have behaved heinously and so have ministries. The experiment of building regulators in India worked well only when exceptional people were on both sides. At best, the ministry is supposed to have a say on questions of policy and never get involved in transactions. But all too often, in India, SRAs give favours on transactions and play truant on policy.

Viewed in the small, the text of the letter from the Ministry of Power to the CERC appears unfortunate because it is creating an unlevel playing field as well as giving the government a role that is not envisaged in the law. The law requires the CERC make regulations on its own and not with government approval. When the legislature wanted it otherwise, it said so. For example, this is not the case at the Tariff Authority for Major Ports (TAMP) or the Food Safety and Standards Authority of India (FSSAI), where regulations made by them require government approval. But the problems run deeper. The law that created the CERC is ultimately at fault because it does not set in motion the possibility of a high-quality agency characterised by rule of law, accountability mechanisms, checks and balances, and independence.

Policymakers made mistakes in building regulators, in 1991-2015, because they did not have this intricate knowledge. Knowledge on how to build such sound regulators was created over time, culminating in the report of the Financial Sector Legislative Reforms Commission. The answers are in the draft Indian Financial Code, which has 140 sector-agnostic Sections on the recipe for making a sound regulator.

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