# Royal Commission into Victorian Bushfires

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As requested, this note "review[s] the witness statement of Kenneth Gardner and the transcript of his evidence and critique[s] the role of Energy Safe Victoria (ESV) as a regulator and the possible options available to ESV to assist it in fulfilling its role". It begins by establishing a context for regulation and comments on regulatory systems, capacity and style. All of these influence regulatory effectiveness, which is at the heart of the Commission's interest.

**Regulation**

The phenomenon of regulation has over the past twenty years, been rethought[1]. It is now defined in terms of being '*…the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes…'*.[2] This is a broader definition than the typical legal understanding of regulation as those rules developed under Acts of Parliament[3]. Regulation is now seen as a broad concept crossing all three sectors - government, business and civil society. And as well, it is also now viewed as an expanding role of government[4], and indeed has been described as a policy preference[5].

The modern-day task of regulation is now understood as being undertaken in both formal and informal terms. Formal regulators consist of either explicitly titled regulators acting under legislative mandates or organisations not formally titled as such but nevertheless which attempt quietly to alter behaviour according to standards to produce outcomes - such as government departments, businesses or not-for-profit organisations. Informal regulatory measures include quieter pressures from governments or other organisations to behave in particular ways. In developed countries, formal regulation matters

[1] See Julia Black (2002), London School of Economics, who has reconceptualised regulation as far broader than traditionally held, and the work of Braithwaite et al (2007a), Braithwaite (2008), Minogue (2004) and Sunstein (1990) all of whom have slightly different labels for the modern era of 'regulatory capitalism'.

[2] Freiberg (2006 p.2) based on Black (2002).

[3] See Morgan and Yeung (2007) for example.

[4] Braithwaite et al (2007b) suggest that the work of governments includes three functions; providing, distributing and regulating. They suggest that whilst the work of distributing (or redistributing wealth) will continue unabated through time, the role of directly providing services is currently decreasing (through outsourcing and privatisation for example), and the role of regulating is increasing. A cogent example of regulating here is the current move to design regimes which aim to reduce gas emissions leading to climate change. Another example includes bushfire mitigation measures.

[5] This modern view of regulation also implies, as Minogue and Carino (2006, 4) say, that regulation has moved from being rules-based, focused on institutions, and principally about compliance and accountability towards a view that regulation is equally about broader analyses of political institutions and administrative practices as well as being a distinctive mode of public policy making.

most and has grown massively over the past two decades[6]. It is also understood by scholars as being a phenomenon which has witnessed equal growth in the spheres of both social regulation (in arenas such as food safety, pharmaceuticals and social behaviours) as well as the typically better understood arena of economic regulation (such as competition law through Australia's ACCC, for example).

**Regulatory Systems and Tools**

Regulatory systems vary enormously, and whilst the formal independent regulators are now highly visible, today's 'regulatory state' does not necessarily consist principally of independent regulators. A constant stream of regulatory reforms across centuries has seen today's regulatory practices now including; 'regulation inside government, outside government, across national government boundaries, in hybrid institutions that cross the private-public divide, and mechanisms of self-regulation' as Minogue (2006, 69) puts it. All five of these mechanisms matter, and whilst we might be relatively familiar with regulation by government, with its long pedigree, less acknowledged today is the longevity of self regulation which, with guilds going back to the 9th century, also has a long and proud historical lineage.

Within the particular mandate given to a regulator, the tools at their disposal also vary widely today. Freiberg (2006) for example suggests that regulatory tools available for government include governmental activities as an *economic actor* (such as taxing or through quotas), a *party* (where governments influence behaviour through contractual conditions for minimum wages for example), as a *facilitator* (through markets or say, licensing), as an *information provider* (through product labelling or disclosing interest rates for example), or through the more traditional and familiar *legislator* role (where laws, rules and regulation are made). Another version of regulatory activities which are undertaken by regulators in pursuing their mandate is given by Ayres and Braithwaite (1992). They suggest that the practice of regulation comprises a pyramid of mechanisms ranging at the top from hard law regulatory strategies to soft law self regulatory strategies at the bottom. At the top, non discretionary punishment occurs whilst further down discretionary punishment and enforced self regulation exists. This pyramid[7] has multiple variants nowadays. Notably, the middle regions of the pyramid include many non-law mechanisms such as guidelines, codes of conduct and best practices. Importantly, this enforcement pyramid has formed the basis of much regulatory thinking and development over the past decade or so and has now been widely accepted as a fundamental challenge to the traditional assumption of 'command and control' regulation through rule as the dominant form.

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[6] Hodge notes Majone (1989), for instance, who articulated that there had been a fundamental re-ordering of the state over the past three or four decades, and that as a result, a spectacular questioning had occurred of both the role of government itself and the role of markets in 'producing wealth'. These, in turn, had led to the need for a more sophisticated understanding of regulation and its structures. He also noted Gilardi, Jordana and Levi-Faur (2006: 127) who stated that "the era of privatisation is also the era of regulation". One key characteristic of this rise, was the increased emphasis on establishing independent regulatory bodies. Indeed, Gilardi et al (2006) observed that there has been a spectacular explosion in regulatory agencies around the globe. They note that for 36 countries (including 17 European countries) the number of regulatory agencies grew steadily from a dozen or so to around 50 in the three decades after 1960, but that in the single decade of the 1990s, numbers more than tripled up to 174 by 2002 (Hodge 2006, 184).

[7] Under this broad notion of an 'enforcement' pyramid, a wide range of regulatory pyramids now exist. These all follow the general idea that regulatory efforts cover a vast set of behavioural possibilities rather than one set of traditional 'command and control' assumptions and activities. A more positive 'strengths based' pyramid is also proposed in Braithwaite et al (2007a).

This change, too, reminds us that regulation occurs in all sectors of society - in the business sector, in civil society as well as by government.

**Regulatory Capacity and Style**

An important lesson above has been that regulatory activity should be viewed as existing in the context of public policy. By its nature, it has been socially constructed, and is thus political activity. The legal mandate developed for any one regulator will be unique, and the style adopted by regulators may also be quite different. Not only will a style depend on the regulator's professional capacity in terms of competence and staffing numbers, but it will also depend on the manner in which it chooses to interpret its mandate. There exists considerable 'regulatory discretion' here. At one extreme, a pro-active regulator may tend to try new professional strategies to head off poor behaviours before they occur, adopt new regulatory tools to trial them, evaluate the effectiveness of their activities, and even perhaps act informally as well as formally, including through the courts. At the other extreme, a reactive stance might see a regulator adopting more traditional administrative measures and a quieter, more passive approach. At the extreme, this latter approach might even see a regulator adopting 'compliance systems' which amount to little more than 'compliance ritualism'[8].

Both the regulatory mandate and those activities undertaken by regulators depend, too, on the political and cultural context existing when the regulator was established. Looking back at the energy sector over past few decades, for example, the value of operational daily efficiency has probably triumphed over other values such as infrequent events like fire related safety concerns[9]. Also present over the past few decades, too, has been the constant call for public sector organisational reform through techniques such as outsourcing and through performance measurement regimes. Many reforms, though, have been adopted as much on the basis of management fashion or habit as from a desire for more effective organisational performance, and debates continue as to the degree to which such reforms have genuinely enhanced organisational capacity and effectiveness[10].

All regulatory regimes have strengths and weaknesses. As Baldwin and Cave (1999) suggest, for example, formal legislative regulation is the strongest, is seen as highly protective of the public and is appealing to citizens, but is also expensive, inflexible and slow compared to co-regulatory systems or self regulation. Self-regulation and co-regulation schemes are now viewed as typically less resource intensive, as well as more dynamic, more flexible and timelier than traditional state-based regulation. But self-regulation, in particular, has also been accused of serving the interests of industry above that

[8] Ritualism is defined by Braithwaite et al (2007a, vii) as 'the acceptance of institutionalised means for securing regulatory goals while losing all focus on achieving the goals or outcomes themselves'. To some, the issue of compliance ritualism is 'the most daunting challenge of regulatory capitalism' (Levi-Faur 2005). Conformity and innovation is required in compliance systems rather than retreatism or rebellion.

[9] The creation of regulators such as the Victorian Competition and Efficiency Commission is evidence of the continuing dominance of economic efficiency as a value.

[10] Hodge (2000) for instance noted that organisations should not, in their zeal to contract-out services, ever get to the stage of effectively 'outsourcing their own brains'.

of society, and as having variable standards of enforcement and of lacking the accountability and legitimacy of government regulation[11].

**Regulatory Effectiveness**

Clearly, the effectiveness of a regulatory regime ought to be judged in terms of the degree to which the regime achieves the public policy objectives initially articulated by government. These policy outcomes may be in terms of the risks avoided or in terms of other objectives sought (such as amenity or equity). Within this primary question of 'effectiveness', 'good regulation' might also be viewed through many lenses. One such framework has five dimensions incorporating; legislative mandate; accountability; due process; expertise and efficiency[12]. Within such a taxonomy, multiple questions of organisational capability, culture, decision discretion, as well as the actual activities undertaken might all be relevant considerations.

**Comments**

Having established the broader regulatory context noted above, and after reviewing the witness statement of Kenneth Gardner and transcripts of his evidence, it is now possible to critique the role of Energy Safe Victoria (ESV) as a regulator. It is also possible to discuss options available to ESV to assist it in fulfilling its role.

There are several issues at stake here and a full analysis is a large task. Focus will be put on the priority issues alone, and will be broadly tackled under three headings: regulatory mandate; pro-activity; and capability.

The first point to be made here is that most observers would argue to the degree that some of the state's bushfires were a consequence of Victoria's electricity infrastructure, citizens suffered a significant regulatory failure. And whilst the bulk of the resources of Energy Safe Victoria may have been devoted to issues directly concerning electrical safety in domestic and commercial arenas along with the licensing of practitioners, it has been the indirect safety concerns around electricity transmission and distribution systems that appear to have failed. I offer the following observations and opinions.

**Regulatory Mandate**

In retrospect, the mandate of ESV appears weak, and confused. It is not a fully independent safety regulator, but a statutory authority reporting directly to the Minister for Energy and Resources and Community Development and charged with ensuring regulations are met.

The Authority CEO is independent in the sense that he is appointed by Governor in Council and cannot be removed other than by the G-I-C. But Dr Gardner explicitly agreed with the statement that 'ESV is not responsible for setting policy in relation to electrical safety and bushfire safety' and that this policy was set by the Minister and the Department of Primary Industries. And key amongst his

[11] See Braithwaite (1993), Webb and Morrison (1996). Gunningham and Rees (1997:370) also note that in relation to self-regulation 'the effectiveness (or ineffectiveness) of self-regulation [can] var[y] enormously among industries...'

[12] See Baldwin and Cave (1999).

accountabilities is the need to 'liaise closely with the Minister through the Department of Primary Industries (DPI) and provide information and policy advice to the Minister … work closely with DPI in relation to policy development…and the provision of advice in response to emergencies' as well as providing expert knowledge and advice on energy safety regulation. So, whilst the ESV has a regulatory role, it is not independent of government and acts under policy directions set by others. From the perspective of organisational culture, too, working closely through the DPI, one might also expect that the ESV would be influenced strongly by a prevailing culture of economic efficiency and the desire to minimize business costs for electricity suppliers. Independence from political influence here is at issue.

Dr Gardner's answer to a question concerning whether he felt the ESV had 'sufficient capacity to exercise muscle in a regulatory sense', illustrates this confused mandate (p.6887). He replied that 'we tend to work in a consultative way' and that they aimed to systemically look at the businesses 'in terms of their asset management plans in order to build into the safety framework and the tariff frameworks the issue of bringing forward the replacement of some assets…'. To my mind, this answer seemed to confuse the need to consider both business cost issues with energy safety issues. Similarly, the history of the ESV as emanating out of the former SECV (as noted on p6843) also appears to have led to a situation where Dr Gardner was ambivalent about the statement that the 'ESV is placed to make a more objective judgment about the level of risk that should be accepted' than the electricity companies (p6843).

Additionally, there seemed to me to be a continuing ambiguity around the mandate of the ESV (and its predecessors) in decisions such as that required when a proposal was put forward in 1997 by industry to lengthen the inspection cycle from three and a half years to five years. When this change initiative was put forward by industry, the assumption seems to have been that the industry's proposed change should proceed unless the ESV could prove otherwise - a reverse onus of proof for the ESV. Again, amidst concerns in the ESV about the appropriateness of a five year inspection cycle, the assumption was made that the industry's current (now five year) inspection cycle should continue unless the ESV could prove otherwise. Gardner replied in this instance that 'on the basis of the data that was available and the analysis that was being carried out, there wasn't sufficient there for us to mount an argument to say that it should change' (p12278). Viewing these interactions from a distance, industry actors appeared to have the upper hand in this relationship. Thus, concerns about the degree to which the ESV was truly independent of its regulated businesses is at issue here. Our expectation of a safety regulator nowadays is that it has the upper hand, not vice versa.

In terms of the scope of the ESV mandate, there is also a lack of clarity. The *Electricity Safety Act* 1998 (VIC) confers on the ESV an objective of ensuring the electrical safety of electrical systems, installations and equipment, and subsequently regulatory responsibilities for bushfire mitigation plans were also placed on the ESV. But the ESV's institutional responsibility for minimizing fire hazards resulting from electrical equipment appears to have been implied through expectation, rather than set down formally.

Overall, concerns around the mandate of the ESV might be summarised in the passage from the transcript which commented on the co-regulatory approach taken in the energy sector. The question

put was ‘Would you agree that what that really means is that ESV’s approach to its regulatory role of electricity distribution businesses is to focus on the processes adopted by those businesses rather than to mandate particular outcomes?’ The reply was simply ‘that’s correct’ (p12248).

**Regulatory Discretion (Pro-activity versus Passivity)**

Adding to the lack of clarity around the mandate of the ESV, it also seems to have displayed a style which might be characterised as more passive and administrative than pro-active. On the surface, this was confirmed through Dr Gardner’s reply to a range of questions regarding his reactive stand point. When Dr. Gardner was asked if he tended to be more reactive as a regulator, his response was ‘That's correct. We would like to see the evidence that says, "Okay, these things are happening so this alternative would be the best option”.’ (p6876).

But there is a deeper matter here. The assumption under modern strong regulators is that their work incorporates significant professional expertise (often with a scientific element), is independent of both day to day political influence and systemic business influence and has a fierce analytical basis on which regulatory activities proceed. This assumption does not appear to have been justified here. The ESV’s role appears to have been that of a passive administrator rather than a strong safety regulator. Examples of this tendency included;

- The lack of expressed concern about facts such as no penalty for a bushfire plan not being approved, no penalty for breaching the submitted plan (and his reply that ‘I think it is one of the policy changes which is under consideration at present, but it hasn’t been raised previously’ - p6842).
- The fact that the regulation prescribes topics within the Bushfire Mitigation Plans that have to be covered but ‘it doesn’t prescribe standards or contents’ (p6843).
- The implicit acceptance of the five year inspection cycle which seemed to amount to an erosion of the value of safety as against economic efficiency
- Gardner’s belated acknowledgment that some of the recent risk assessments made of serviceable conductors/ties were questions that the ESV ‘should have been asking quite some time ago’ (p12270) in the form of an ‘in-depth audit’.

The result of this style of regulation was that the ESV oversighted an administrative system of box ticking, and was not as effective a safety regulator as might have been expected.

One case of pro-activity was presented by Dr Gardner (p6891) from the gas side, whereby the cast-iron pipes around Melbourne were leaking considerably after 90 years or so of service, and a program was put together to replace them over 20 years. In this instance, ESV took this proposal to the economic regulator and it was funded. The electricity side of the business, however, was viewed by ESV as being ‘very reliable at the moment, [and] it seems to be effectively maintained, but we just want to keep monitoring it and make sure we have all those tools in place to make sure that we don't have to deal with issues like that.’ It appeared to me strangely passive to quote the operational performance of the network in glowing terms (ie ‘the network overall is very reliable and is more reliable than it was, say, 10 years ago in terms of interruptions to supply and so forth’, p6891) and yet

evidence for the safety of the network in terms of fire risks did not seem to be presented to the Commission by the ESV.

Overall, an administratively elaborate system of regulation was presented to the Commission in that five 'compliance management' levels existed to mitigate fire risks (pp6892-6894). These comprised the Acts (the most important of which was the Electricity Safety Act); various sets of regulations (such as the bushfire mitigation regulations, electrical safety management regulations, the network asset regulations, and line clearance regulations); the code for line clearance (and a set of guidelines); distribution business plans (called within SP Ausnet's 'vegetation mitigation plans'); and a suite of internal company policies or procedures to give effect to the plans submitted to the ESV.

Philosophically, Dr Gardner explained that the role of the regulator was based on the principle that 'the organisation that creates the risk should be responsible for managing the risk'. He further explained that this 'sort of philosophy is picked up in gas safety regulation, in major hazards regulation that's administered by WorkSafe, in the rail safety system and is the one that is being applied in relation to electricity' (p6836). Furthermore, he stated in reply to a question concerning whether as a safety authority the ESV should 'err on the side of conservative rather than push risk management to the limits', that he was as a person conservative, noting on p6891, that '[a]s the regulator, I'm always conservative'.

But observations of personality mean little unless the organisation has a strong and clear mandate, is fiercely independent, and has both strong capabilities and is well resourced. It is to these latter issues that I now turn.

**Capability**

In terms of capacity to undertake the ESV's work in the domain of bushfire risk and electric line clearance plans, the staff resources applied consisted of 'the equivalent of two full time staff plus external resources that we hire to conduct audits on our behalf' out of the total ESV staff number of 90 (p6830). Whether this capacity was in fact sufficient, is a question of judgement[13]. But the broader issue here concerns staff competencies as much as numbers. The role of energy safety regulator expected of the ESV by the community would have required professional and analytical skills across several domains (in much the same way as such skills are expected for staff of the electricity system pricing regulator). To begin with, the collection of high veracity safety data, an ongoing monitoring and diagnosis role and an overall assessment of organisational effectiveness might all be reasonably expected of a safety regulator. As well, rigorous ad-hoc analyses of the effectiveness of proposed changes to the regulatory regime might also be relevant. In other words, an expectation of a modern regulator is that they carefully monitor the subject of their regulation, and as well, track their own performance.

[13] One aspect relevant here is the tendency for Victorian public organisation's to contract-out services almost as a policy. Of course, contracting-out services or functions for expertise or efficiency is sensible. But it is also important for regulatory organisations to maintain sufficient expertise and task knowledge to ensure that those functions contracted out and the information gathered from such services both have high levels of veracity.

Various figures relevant to how well relevant bushfire risks were being mitigated by the ESV were bandied around the Commission. These included for example;

- 'A rate of 1.1 per cent of fire starts caused by the company assets' (p12249)
- Figures such as '185 fires caused by the assets of [Powercor and SP Ausnet]' (p12257)… or 'possibly 200 fires a year starting from electrical assets…' (p12258)
- The statement that 'the businesses have been able to demonstrate …that they have put in place changes and improvements over a period of time that has reduced the number of fire starts that are caused by their assets' (p12250)
- The current bushfire mitigation and vegetation clearance regime is 'reaching a point of diminishing returns in relation to the improvements that it can deliver' (p12255)
- The appearance of 'a general upward trend' (p12256) over the past ten years of electrical fires.

The fact that it was not the ESV but others who seemed to have had these figures at their fingertips is a potentially worrying feature to my mind. All of these issues are central to safety regulation. It appears that whilst there are existing arrangements between companies such as Powercor and the CFA to gather fire start data from electrical infrastructure[14], its veracity is uncertain and the degree to which it is put to systematic use is unknown. The practice of relying on the integrity of business information systems for defining, reporting and monitoring fire outcomes in retrospect could be seen as stretching one's regulatory faith. Indeed, it may also indicate a lack of capability from ESV to do the task of regulating safety for electrical assets itself. Further, this lack of capability may have contributed to a passive acceptance of the reduced regularity of inspections (p12265). Within the context of a less visible overarching political and management cultural priority being given to the value of safety compared to the value of economic efficiency throughout electricity industry reforms, the regulatory stage may then have been set for failure.

Further examples exist of this capability deficit. In the ESV's response to the Commission's questions around the practice of 'undergrounding' (eg. pp12261-12262), for example, debates around the degree to which this practice delivers safety benefits in the public interest (as well to private interests in terms of improved amenity in urban areas), ought be a core issue for a safety regulator. Indeed, there are presumably many practices which might claim to deliver varying degrees of safety payoff. One would expect significant resources, scientific study and professional analytical skills to be applied to such effectiveness questions. Such rigorous analyses are at the heart of a safety regulator doing an effective job. The degree to which practices such as undergrounding are actually effective is not at issue in this brief, but the apparent absence of scientific and rigorous analytical approaches to questions which are the lifeblood of the regulator's job remains the concern.

Knowledge of the relative community exposure to risk from electrical asset related fires is a key concern of the safety regulator. How these risks compare to other risks existing in the community in an absolute sense, how such risks change over time, and how Victoria compares to other jurisdictions internationally are all part of this core regulatory business.

[14] See Bushfire Mitigation Powercor Australia: Final Audit Report 2008, IJM Consulting Pty Ltd, p4.

**Summary**

It is clear from this assessment that whilst the ESV is the state's electrical safety regulator, it has only a weak formal role in regulating electrical related fires. It is not the bushfire safety regulator which some might hope. The difference between what we probably now expect of the ESV as the state's "regulator of fire risks related to electricity assets" and its powers, is huge. There exists a regulatory gap here, and as a result, several actions might be contemplated.

**Options Available to Assist**

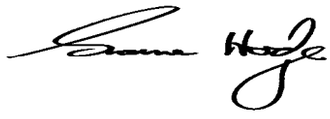
A stronger regulatory regime is clearly now required.

The initial policy proposition is that the state should have an enhanced role in mitigating fire risks from private electricity assets. Whilst a degree of tinkering is possible (for example, by increasing penalties and with minimal explicit word changes to the existing regime) more substantive regulatory changes are needed in my view. A new operating regime is perhaps more appropriate. Under such a new regime our expectations as to the formal role of the fire safety regulator would need to be clarified explicitly, the scope of its functions articulated and its responsibilities for managing fire related risks from electrical assets made explicit.

Institutionally there is a question as to the independence of such a regulator from Government and from private businesses. Again, whilst minor adjustments to the existing arrangements are possible, the broader question is the need for more substantial independence. If greater independence is required, as I suspect it is, this safety function could be transferred, for example, to the Essential Services Commission (ESC) or the Australian Energy Regulator (AER). Such a transfer would work most effectively if mechanisms could be found to assure trade-offs being made between safety and economic efficiency are explicit and transparent. This arrangement would ensure the public interest is independently met.

To undertake these regulatory responsibilities, a significant increase in competency in terms of staff numbers, financial resources, and professional analytical skills would clearly be needed.

A further action which would be sensible is to undertake a review of arrangements for fire related safety regulation in other jurisdictions employing privatised electricity systems. Such a review could as part of its terms of reference, assess what works most effectively and how Victoria's safety regulation system could best learn from international practices.



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