



# Regulatory institutions and practices



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June 2014

## The New Zealand Productivity Commission

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# Foreword

Regulation is a pervasive feature of modern life. Its coverage stretches from the workplace to the sports field, the home to the shopping mall, and from the city to the great outdoors. When it works well, it underpins our everyday transactions and interactions, allowing us to do such things as travel within and outside of New Zealand safely, buy and sell goods and services and invest with confidence, and start businesses with ease.

Despite its extensive reach and impact, in many ways regulation is the poor cousin of government. In comparison with taxation, spending or monetary policy, little attention is paid to regulation. There is no annual review of regulation, as there is with government spending (the Budget). We do not know how much of our income is taken up by complying with regulations, as we do with our tax bills. And unlike spending, tax or monetary policy, there is no one minister or agency in charge of regulation. This lack of attention has real consequences. Although the 'price' of regulation in general may often be invisible, the costs of poor regulation are all too clear, as the events of the Global Financial Crisis, Pike River and leaky buildings have demonstrated. Rapid changes in technology and markets make the need for good regulation ever more pressing. Better regulation may be the best opportunity to reduce the pressure for more regulation.

This inquiry has looked at the various institutions, practices and elements that affect how regulation is designed and implemented in New Zealand. This report provides guidance, and is intended to serve as a resource, for officials and elected representatives designing new regulatory regimes in future and others with an interest in regulatory matters. It also makes recommendations for both ministers and government departments on how to make existing institutions and practices work better.

The picture which emerged from the inquiry was that, while New Zealand's "regulatory system" is often compared favourably with those in other countries, there are a number of areas of weakness and the current system is falling behind. A number of important quality checks are under strain, regulators often have to manage with outdated legislation, more attention should be paid to finding the right people to govern regulatory organisations, and greater effort needs to be put into developing a professional regulatory workforce. Too much of our system relies on the goodwill and commitment of dedicated individuals. We can do much better. Without improvements on these and other fronts, New Zealanders may not receive the protections they expect and deserve from regulation.

The Commission has consulted widely, receiving 104 submissions and holding 113 meetings with participants. We also surveyed businesses and chief executives of regulatory agencies, interviewed members of regulator boards, and sought the advice of international experts. This has contributed enormously to our understanding of the issues and to our recommendations. I would like to thank all those who provided this valuable information.

Professor Sally Davenport, Dr Graham Scott and I oversaw the preparation of this report. We acknowledge the work and commitment of the inquiry team: Steven Bailey (inquiry director), Judy Kavanagh, James Soligo, Kevin Moar, Nicholas Green, Dennis MacManus, Rosara Joseph and Richard Clarke, and the other Commission staff and external providers who made important contributions.



MURRAY SHERWIN

Chair

June 2014

# Terms of reference

## IMPROVING THE DESIGN AND OPERATION OF REGULATORY REGIMES

### Purpose

1. The purpose of this inquiry is to develop recommendations on how to improve the design of new regulatory regimes and make system-wide improvements to the operation of existing regulatory regimes in New Zealand. The inquiry is not a review of individual regulators, specific regulations or the objectives of regimes.
2. The aim is to improve the design and operation of regulatory regimes over time and ultimately improve regulatory outcomes.

### Context

3. This Government is focused on delivering better regulation. We have improved the processes around introducing new regulation, increased our understanding of the stock of existing regulation, and conducted a number of significant regulatory reviews. There is more that can be done to improve the design and operation of regulatory regimes in light of the recent need to develop new or amended regulatory regimes and regulators to manage instances where regulation has not achieved its intended outcomes.
4. The demands on regulatory regimes are often more complex than in the past. The range of regulatory regimes, the nature of the risks involved, the expectations of the community, and the regulatory tools available to achieve regulatory objectives, are wide and varied. It is crucial that government has a good understanding across regulatory regimes of their issues, challenges, similarities and differences and how to improve their design and operation.

### Scope

5. Having regard to the above purpose and context, the Commission is requested to undertake an inquiry that addresses the parameters set out below.

### An overview of regulatory regimes and their regulators

6. Develop a high-level map of regulatory regimes and regulators across central government, including their organisational form.
7. Develop a set of thematic groupings which can be used to broadly categorise regulatory regimes by their objectives, roles or functions. For example core objectives might include health and safety, environmental protection, or economic efficiency.

### Understanding influences and incentives on regulatory regimes

8. Outline and explain key factors which act as incentives or barriers to regulatory regimes and regulators producing the outcomes stated in legislation. For example these factors may include:
  - institutional form of the regulator
  - quality of the regulatory design and clarity of mandate, functions and duties
  - resourcing and funding
  - capability
  - approach to consultation and engagement with stakeholders
  - accountability mechanisms, including the ability to challenge regulatory decisions
  - performance measurement and reporting
  - external monitoring
  - approach to risk management and innovation

9. Undertake a series of case studies to compare and contrast the approaches taken to these factors across different regulatory regimes. A key part of this analysis would be to identify strengths and weaknesses of different approaches taken to these factors to support broader insights into the design and operation of regulatory regimes.
10. This analysis should be undertaken in the context of existing guidance about good practice for the performance of different regulatory functions.

### **Recommendations**

11. Develop guidance that can be used to inform the design and establishment of new regulatory regimes and regulatory institutions, and the allocation of new regulatory functions to existing institutions. The guidance should take into account other existing work in this area to avoid duplication, such as the State Services Commission's *Reviewing the Machinery of Government*.
12. Develop system-wide recommendations on how to improve the operation of regulatory regimes over time. The recommendations may include how to both build on strengths and address weaknesses in current practices and may lead to general comments about key differences between regimes within thematic groupings. The recommendations will not be specific to particular regulations or regulators.
13. The Commission should also specifically consider how improvements can be made to the monitoring of regulator performance across central government.
14. In developing the recommendations, the Commission should take account of any key features or characteristics of New Zealand's regulatory environment that differ from other jurisdictions. For example, these may include differences in scale, resourcing, or the need to coordinate with overseas regulatory regimes.

### **Other matters**

15. The Commission should prioritise its effort by using judgement as to the degree of depth and sophistication of analysis it applies to satisfy each part of the Terms of Reference.

### **Consultation requirements**

16. In undertaking this inquiry the Commission should consult with key interest groups and affected parties, including on the selection of case studies in paragraph 9 above. Consultation should include both regulators and those subject to regulation.

### **Timeframe**

17. The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 30 June 2014.

### **Referring Ministers**

Hon Bill English, Minister of Finance

Hon John Banks, Minister for Regulatory Reform

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## KEY


**F**

Findings


**R**

Recommendations



# Overview

The Government has asked the Commission to examine how the design and operation of regulatory regimes and their regulators can be improved – ultimately to improve regulatory outcomes. Specifically, the Commission has been asked to develop guidance that can be used to inform the design and establishment of new regulatory regimes and regulators. It has also been asked to develop system-wide recommendations on how to improve the operation of regulatory regimes in New Zealand over time.

## Why this inquiry is important

Regulation touches the lives of New Zealanders in many ways. It is indispensable to the proper functioning of economies and societies. Regulation, when implemented well, underpins markets, protects the rights and safety of citizens, and their property, and assists the efficient and equitable delivery of goods and services (Organisation for Economic Co-operation and Development [OECD], 2011). In this way, regulation is an important tool for preserving and advancing the public interest.

New Zealand has a large and complex regulatory sector, made up of 200 or so regulatory regimes. More than 10,000 people work in regulatory roles. The regulatory system is a major piece of government infrastructure, and is as significant as the tax and spending systems in terms of its impact on the lives of New Zealanders. Yet surprisingly little information exists about regulation and its effects or about the wider regulatory system and its performance.

There is also a question of whether New Zealand's regulatory regimes are unnecessarily complex and whether they could be simplified, recognising that capability and expertise, for regulators and regulated alike, is likely to be an ongoing issue.

There is a growing interest in regulation in New Zealand. This stems from a number of important developments:

- individual freedoms and human rights taking on greater importance in New Zealand society, for example the passing of a Bill of Rights Act in 1990 and a Human Rights Act in 1993;
- a growing awareness of the role that good-quality regulation and institutions can play in promoting economic growth, and that bad regulation can impede productivity and growth;
- reforms over the last quarter of the 20<sup>th</sup> century that have changed the way government organises itself, provides services and implements policy (often at arms-length from government); and
- society has become more diverse, with a broader range of attitudes to risk and expectations about what government can and should do.

These changes have made regulation a more visible and important government activity. They have also underlined the importance of making sure that the design of regulatory institutions and their operation achieves government's public policy goals.

If regulation has misplaced objectives, is used when it is not needed, or is poorly designed and executed, then it can fail to achieve policy objectives and have unintended consequences that harm the wellbeing of New Zealanders. The two main ways regulation can fail are failures of design and failures of operation.

Poorly conceived and implemented regulatory arrangements can also impose significant costs. Such costs affect business productivity and profitability, and the wealth of individuals and families. Ultimately this will harm the country's economic performance and wellbeing.

Good design of regulatory institutions and good regulatory practice can reduce the likelihood of regulatory failure. The institutional arrangements that make up the architecture of regulatory regimes shape how regulators and those regulated behave, the quality of decision making, and ultimately the success of regulatory regimes in achieving the desired outcomes.

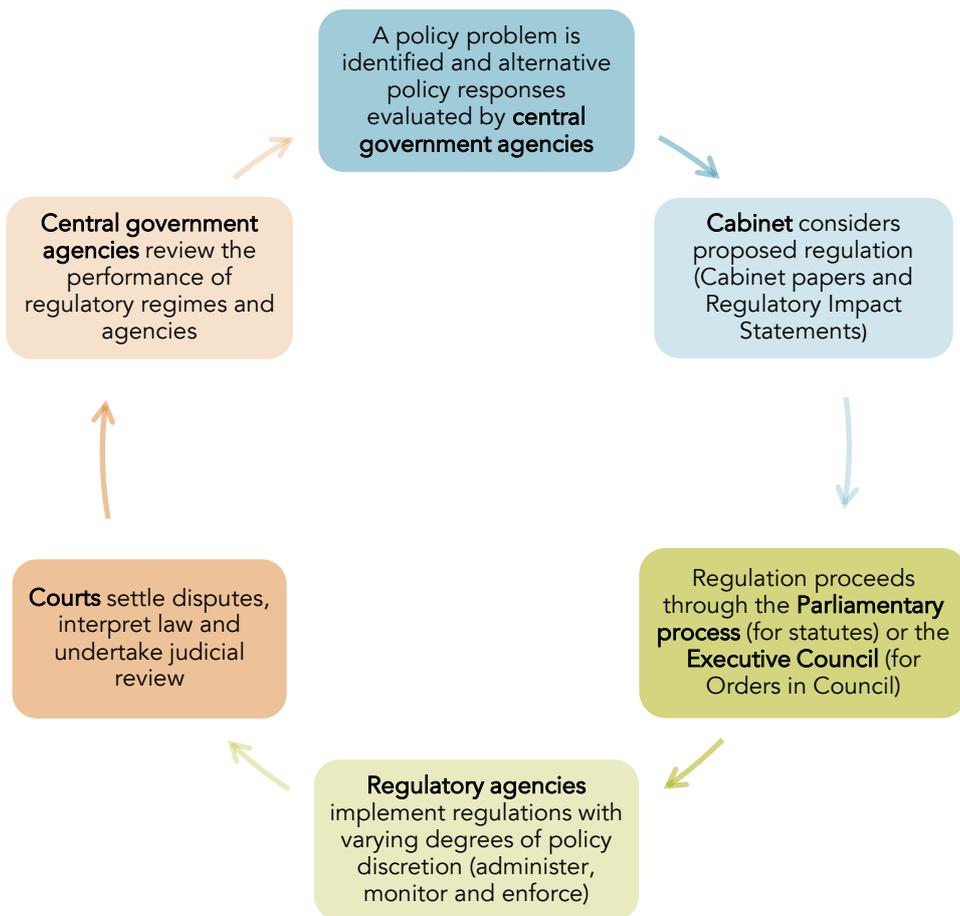
This inquiry seeks to better understand what regulatory institutions and practices look like in New Zealand and how they can be improved. Getting these right not only means the objectives of regulation will more likely be achieved; it builds legitimacy and trust in New Zealand’s regulators and regulatory regimes and, with that, a higher level of trust by society.

## New Zealand’s regulatory system

New Zealand’s regulatory system includes the institutions, principles and processes through which regulations are made, implemented, enforced and reviewed. It involves all three arms of government – the Executive, Parliament and the Judiciary (Figure 0.1).

The performance of the regulatory system is determined by internal and external factors, including pressures from the public and industry for or against new regulation, internal quality control processes (such as Regulatory Impact Analysis and select committee review of bills), judicial oversight of regulator behaviour, and processes for reviewing the currency of regulatory regimes. What emerges from an analysis of the dynamics of the New Zealand regulatory system is that, while a number of checks, constraints and rules are in place to test that a proposed new regulation is in the public interest and of a high standard, few of these controls are binding. Most controls are self-imposed by the Executive and depend upon collective self-enforcement or can be overridden. With the exception of the courts, the constraints that are less easily overcome – especially limited resources and Parliamentary time – tend to undermine the production and implementation of effective regulation.

Figure 0.1 The regulatory system



The performance of New Zealand’s regulatory system is in need of improvement – in particular around developing and maintaining the capability needed to effectively implement regulation and the need to oversee and manage the overall system.

## Successful regulation

The Commission examined 18 official reports of disasters from New Zealand and around the world. The reports covered such diverse topics as leaky buildings, mining tragedies and the mis-selling of financial products. Notably, regulatory failure was a central theme identified in all official reports. Insights gleaned from these reports, together with the other evidence assembled for this inquiry (p. 18), have provided the Commission with a rich picture of what aspects of the regulatory architecture, institutional design and practice need to be present, and working well, to be effective and achieve important regulatory objectives.

To be successful, regulators need to have:

- an approach to regulatory practice that is based on a sophisticated understanding of the nature of the risk, the nature of regulated parties and changes in the regulated environment (Chapter 3);
- leaders who foster a culture that values operational flexibility and adaptation to changes in the regulatory environment, continuous learning and a culture of challenge and “speaking up” (Chapter 4);
- capability across all levels of the organisation and a purposeful, structured and integrated approach to achieving a professional workforce (Chapter 5);
- communication and engagement processes that promote the legitimacy of the regulatory regime (Chapter 6); and
- the ability to fulfil their regulatory objectives within constitutional and statutory requirements – such as ensuring the principles of Treaty of Waitangi are appropriately taken into account in regulatory practice (Chapter 7).

Regulatory institutions need to be designed to provide:

- clarity of role, as clear regulatory roles and objectives are critical to regulator accountability and focus; for compliance by regulated parties and the legitimacy of the regulatory regime (Chapter 8);
- an appropriate institutional form and degree of independence to enable them to function as intended (Chapter 9);
- good governance and decision-making arrangements, and appropriate allocation of decision rights, including where and how discretion is exercised (Chapter 10);
- appropriate mechanisms for reviewing regulatory decisions (Chapter 11);
- adequate funding, according to good principles for the recovery of the costs of regulatory activities – and where the funding mechanism does not create perverse incentives for either the regulator or regulated parties (Chapter 12); and
- strong monitoring and oversight arrangements to ensure that regulatory agencies are effective, efficient and accountable and that regimes are working as intended (Chapter 13).

Management of the overall regulatory system needs to have:

- systematic and cost-effective approaches to keeping the stock of regulation up to date, so ensuring that outcomes are still achieved and unnecessary or inefficient rules are removed (Chapter 14);
- information and tools to enable the centre to understand and better manage the whole-of-system (Chapter 15); and
- strong institutions and leadership, particularly from the centre of government but also in the legislature and judiciary (Chapter 16).

## Improving regulatory institutions and practices

Together, these institutional, practice and system features determine the incentives that regulators face and, ultimately, their capability to achieve mandated public interest goals. Importantly, these design features are inextricably linked and can be thought of as a mutually reinforcing system. For example, developments in regulatory practice will have implications for the skills and competencies required of the regulatory workforce. Likewise, the level of regulatory independence will determine the most appropriate accountability, performance and monitoring framework. Also, if the regulatory system fails to update and refresh regulation to ensure that it continues to achieve its goals, given the continual change in the regulatory environment, then this will hamper the ability of the regulator to achieve both compliance and the intent of the regulatory regime.

### Regulatory practice

Many factors support effective regulation; none more so than the practices of the agency charged with implementing the regulatory regime. The regulator is at the “sharp end” when it comes to delivering the objectives that Parliament intended.

Both traditional “responsive” and newer “risk-based” approaches are evident in the strategies of New Zealand regulators, although agencies differ on how far they prioritise reducing harm or maximising compliance and to what extent the two objectives are integrated or treated separately. Implementation of either approach presents considerable challenges: regulators can face barriers to using high-powered tools, such as prosecutions, and there can be a lot of uncertainty about the nature of the risk and at what point the regulator should intervene.

It is important to note that there is no single superior regulatory strategy. Different strategies and approaches have different strengths and weaknesses, with different levels of effectiveness, in different contexts. The key lies in understanding and adapting regulatory strategies to take account of the influences and dynamics of the many different contexts in which they are deployed.

Irrespective of whether regulators practice responsive regulation (including variants such as “smart” regulation) or risk-based (including “regulatory craft”) approaches, or a mix of approaches, regulators still face considerable challenges. The regulator may be operating in an environment where they only have a partial view of the activities of regulated parties and that view is continually changing. The regulator may have limited scope to influence the behaviour of regulated parties or be hampered by the institutional environment in which it operates.

Modern regulatory practice requires a deep and nuanced institutional analysis of the motivations, interactions and institutional environments of the regulatory actors in regulatory regimes. Being *really responsive* (Baldwin & Black, 2008) means recognising that a range of organisational and institutional factors influence the effectiveness of regulation. Attentiveness to these factors is also important when designing new regulatory regimes and new regulatory institutions.

### Regulatory culture and leadership

The Commission has found near universal agreement from inquiry participants of the importance of organisational culture to the performance of regulators.

Regulator culture refers to the shared norms, values and beliefs that influence the behaviour of the organisation’s staff. These norms, values and beliefs are heavily influenced by:

- the beliefs, values, assumptions and behaviours of the *founding leaders* of the organisation;
- the *learning experiences* of staff in the performance of their duties; and
- new beliefs, values, and assumptions brought in by *new staff, particularly new leaders*.

It is important to distinguish the impact of culture from the numerous other factors that motivate regulator behaviour. It is often too easy to attribute organisational dysfunction to “culture” issues rather than wider regulatory practices, structures and institutional issues.

While generic conclusions are difficult, the Commission’s analysis of New Zealand regulators suggests some themes.

- The culture of regulators places significant weight on managing *risks to the organisation*, at the expense of the efficient management of social harm. Such cultures can resist innovation in regulatory practices.
- Poor internal communication exists within some regulators. Workers feel unable to challenge poor practices, contributing to the perception that regulatory bodies are unable to learn from their mistakes and successes.
- Previous restructuring of regulatory organisations has required significant cultural shifts. These shifts have not always been well understood or managed.
- Stakeholders often perceive the quality of engagement as a “window” to the culture of a regulator. In making this connection, it is important to assess whether the regulator’s approach to engagement is driven by its values and beliefs, or whether it is driven by some other factor – such as the legislative framework or available resources.
- A common understanding of the purpose and mission of a regulatory body is the first step in developing culture. Yet, generally, regulatory workers in central government do not perceive that senior managers communicate a clear organisational mission. Those workers that do perceive clear communication of the mission are more likely to feel emotionally attached to the organisation, be more loyal to the organisation, and be more committed to the organisation.

While legislation can codify certain actions (such as consultation), it does not guarantee that a regulatory body will develop deeply held values around the importance of the behaviours. The culture of the organisation will evolve as its members discover what works and what does not. The culture of a new regulator can be shaped in two main ways.

- Government can seed a “desirable” culture by appointing founding leaders who have values, beliefs and experiences compatible with those it believes are most conducive to achieving the desired regulatory outcomes. However, selecting the “right people” does not guarantee that the “right culture” will emerge. Rather, it is the *actions* of founding leaders that are critical to embedding culture.
- Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.

The Commission identifies the attributes of regulatory culture, suggests practical strategies and actions that promote favourable regulator culture and provides principles for effectively managing cultural change.

## Workforce capability

Workforce capability matters for the successful achievement of regulatory outcomes. Between 10,000 and 14,000 people work in regulatory roles in New Zealand. Gaps in capability can undermine the credibility of regulation and the achievement of regulatory outcomes. While only 5 of the 23 chief executives of regulatory agencies that the Commission surveyed agreed there are significant skill gaps among regulatory staff, the Public Service Association survey and the Commission’s business survey both indicated considerable concern around the level of skill, knowledge and training of central government regulatory workers.

The environment that regulators operate in is constantly changing, requiring that they are flexible and able to adapt. New technologies, new risks and new risk creators may require new skills and the upskilling of regulatory staff. Changing regulatory practices can also require different sets of skills or mixes of skills. The growing sophistication of regulatory regimes requires an increasingly professionalised regulatory workforce.

Professionalisation involves creating a workforce where staff:

- possess a core set of theoretical, practical and contextual knowledge;
- are recognised and respected by others in the profession and by the broader community for the knowledge they hold;
- have opportunities to meet, network with and learn from others undertaking similar tasks;
- are continually challenged to stay up to date with the latest developments in their field;
- share a world view about the role and purpose of their profession and are guided by a common code of professional conduct; and
- share a “professional language” and culture that instils a sense of “belonging to the regulatory profession”.

Individual regulatory agencies are responsible for identifying the required mix of skills and developing strategies and programmes to boost capability. But a more active role by central agencies appears warranted, such as strengthening the responsibility on regulators to focus on workforce capability and increasing the emphasis on workforce capability through performance reviews. Other system-wide responses are also needed to professionalise and boost the capability of the regulatory workforce, such as developing and promoting system-wide guidance material, supporting knowledge sharing across the system, and providing intellectual leadership.

To meet the capability challenges facing regulatory agencies requires a purposeful, structured and integrated approach to professionalising New Zealand’s regulatory workforce.

## Effective consultation and engagement

Effective engagement can help to reassure stakeholders and the wider community that good regulatory processes are being followed, and that the decisions of regulators are robust, well-informed and well-reasoned. This promotes confidence that the decisions of regulators are in the public interest and are evidence-based and impartial. This in turn builds trust in the regulatory system and in the regulator. It also helps strengthen the legitimacy of the regime and improve the durability of regulator decisions.

The choice of engagement mechanism is influenced by the goal of the interaction, and by the relative efficiency of alternative mechanisms. Goals can range from merely *informing* stakeholders of their regulatory obligations, to *involving* them in regulatory decisions, to *empowering* them to make decisions. The greater the level of public participation, the more critical it becomes to ensure a common understanding of the goals of the engagement process. Failure to do so can result in unrealistic expectations around how much participants can affect the decisions of regulators.

When designing a regulatory regime, a key consideration is whether engagement strategies should be left to the discretion of the regulator, or whether statutory provisions are required to promote the regulatory objectives of Parliament or protect fundamental principles of natural justice. (Of the more than 50 statutes that the Commission examined, more than half contain some form of statutory consultation requirement).

This decision should be made in the context of other features of the regulatory regime – particularly the extent of discretionary powers assigned to the regulator, the level of regulator independence, and the strength of accountability mechanisms.

Inquiry participants raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement processes with predetermined views, and concerns that some regulators lack the capacity to engage affectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably the New Zealand Transport Agency and the Environmental Protection Authority (EPA).

Inquiry participants also advocated more extensive use of advisory groups and greater involvement of consumers in decision making (that is, through mechanisms such as “constructive engagement” and

“negotiated settlements”). Such approaches change the very nature of the regulatory decision-making process and the role of the regulator, and are not without drawbacks. These include that stakeholders can lack the expertise, resources or time to effectively engage in technical decisions, it can be hard to ensure that the views of the broader community are represented, and it can generate unrealistic expectations around the extent to which stakeholders can affect the decisions of regulators.

Five factors that are central to the success of any collaborative process are examined:

- a shared understanding of the boundaries of influence of the group;
- commitment to implementing the outcomes of the collaborative process;
- understanding the information needs of all parties and reducing information imbalance;
- selecting participants that represent the wider interests of the community; and
- establishing clear and transparent processes.

## Regulation and the Treaty of Waitangi

Regulators work within a constitutional, statutory and legal context that can change and evolve over time. An important issue in establishing regulatory regimes in New Zealand is ensuring that the principles of the Treaty of Waitangi are appropriately taken into account in both regulatory design and practice.

The Commission provides guidance for officials considering whether to recommend the inclusion of Treaty clauses in statutes that establish regulatory regimes or regulatory agencies.

Excellence in regulatory practice, however, cannot be legislated for. Good practice in upholding Treaty principles of partnership, mutual respect and good faith depends on senior leadership, good internal policies and processes, and guidance for staff and stakeholders.

The Commission has reviewed examples from government agencies of guidance for applying Treaty principles. The overall quality of guidance material can be improved. The assessment framework used in reviewing the guidance material could be used as a tool to help regulatory agencies develop guidance about the application of Treaty principles.

Sharing good regulatory practice is one way to raise the standard of practice among regulators. Lessons from the experience of the EPA have been identified. An important lesson for other regulators is that investing in good relationships to develop trust can pay off in reduced costs and better regulatory decision making.

## Role clarity

Clear regulatory roles are critical to regulator accountability and focus, compliance by regulated firms, predictable decisions and enforcement, and regime legitimacy. Poor role clarity can lead to a regulator’s scope expanding beyond its original mandate; duplicative or contradictory regimes; gaps in regulation, monitoring or enforcement; and inconsistent enforcement.

Achieving “clarity” is not a simple or straightforward task due to the complex issues regulation often deals with, the multiple stakeholders in any regulatory regime, and the large amount of existing regulation.

Regulatory regimes may lack clarity because:

- the standards used do not fit the industry or activity being controlled;
- policymakers give insufficient guidance about the desired objectives;
- regulators have functions that create conflicts of interest; or
- the regime does not recognise the role of other regulators or the interaction of different regimes on regulated firms.

There are a number of ways to improve the clarity of regulator roles. If a range of capability levels exists within a regulated industry, “deemed-to-comply” models can be useful. Deemed-to-comply models allow more capable firms to develop their own compliance strategies, while also providing detailed guidance for other firms on how to comply. Legislative frameworks that minimise the number of objectives and conflicts and provide a clear hierarchy of objectives help to support consistent and predictable decision making by regulators.

To promote better engagement with industry about the definition and interpretation of regulatory objectives, the Commission recommends that the Cabinet Manual be amended to encourage more use of exposure drafts, before significant regulatory legislation is introduced. New regulators, or agencies implementing new regimes, should publish statements outlining how they will give effect to their new mandates, and consult on these statements.

Before allocating new regulatory functions to an existing agency, policymakers should assess whether its mission is compatible with the objective of the new regime, and whether it is likely to give sufficient resources and attention to the new functions.

Exemptions and memoranda of understanding between agencies can help manage issues with overlapping regimes.

## **Regulatory independence and institutional form**

The institutional form of the regulator, and the degree of independence with which it is expected to undertake its regulatory functions, are important considerations in the design of a regulatory regime.

There is widespread agreement of the importance of regulation being undertaken by independent regulators. It will usually be appropriate for regulatory powers to be exercised independently of political control so they are not used for partisan purposes where the risks are long term, where powerful private interests are at stake, and where a substantial degree of technical expertise is required.

Designers of regulatory regimes need to carefully appraise the arguments for and against regulator independence. Arguments for political control must be weighed carefully against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.

Independence is multi-faceted and is more than a matter of legally designating an agency as “independent” or at “arm’s length”. In practice, choices about institutional form are more important for what they signal about expected independence, rather than the legal constraints and freedoms associated with particular agency forms. As such, careful attention must be paid to establishing clear expectations, norms and cultures in new independent regulators.

The Commission has found that regulators often have to work with legislation that is outdated or not fit for purpose. Regulator independence could be enhanced by the greater use of secondary legislation and ensuring greater care (and consistency) in the allocation of legislative material between primary legislation and types of secondary legislation.

Submitters had mixed views on who should be delegated authority to make secondary legislation. Regulations made by the Governor-General in Council have more checks, but this still relies on policy departments and Cabinet giving higher priority to the routine maintenance of often highly technical matters. The Legislation Advisory Committee (LAC) could expand its guidance on this issue.

Political imperatives will inevitably diverge sometimes from the objectives of independent regulators. While political interference in independent regulatory regimes is undesirable, providing transparent mechanisms for political intervention is preferable to undertaking more fundamental and ad hoc regulatory reform to solve political problems. Providing such mechanisms can actually enhance the independence of regulators. This also allows for ministers to be properly held to account for their actions.

Government has signalled an intention to consider reallocating some functions currently undertaken by Crown entities (which are operationally independent) into a new type of institutional form known as

departmental agencies. The Commission has a number of concerns with this proposed new institutional arrangement for regulators.

## **Governance, decision rights and discretion**

The internal governance of a regulator (the systems of direction and control), where decision rights sit within the organisational structure (who makes decisions and how they are made), and the discretion available to the regulator in making decisions, all affect the quality of regulator decision making. The variety of internal governance arrangements and allocation of decision-making rights in New Zealand regulators appears to be ad hoc rather than based on sound governance principles.

Governors of regulatory Crown entities are accountable to ministers for the performance of the regulator, and need to be empowered to govern. Their strategic leadership is important to the success of the regulator. Having a capable board with the right mix of skills is critical to good governance. But appointment and reappointment processes are of variable quality. More central support to departments would improve the quality of appointment processes and, in turn, the quality of governance.

Sector or industry experience can be an important voice in governance. There is some confusion about the role that Crown entity board members nominated by industry are expected to play as governors. Board members owe a duty to the public interest and their minister as outlined in the Crown Entities Act 2004, regardless of any background in the regulated industry.

Multi-member decision-making bodies offer the potential to produce better quality decisions than individuals. Whether they do depends on the quality of members and decision-making processes, highlighting the importance of robust appointment processes.

In any system of authority there is tension between certainty and flexibility: between having definite rules and applying them consistently and in an even-handed way, enabling decisions to be made according to the specific circumstances of the case and within a broader framework of goals and values.

The exercise of discretion is constrained by legal and non-legal methods of control, including judicial review and the common law principles of administrative law, guidance and policy that the decision maker adopts to guide the exercise of discretion, cultural and institutional constraints and transparency. In particular, there are strong protections where those decisions intrude on the civil and political rights enshrined in the New Zealand Bill of Rights Act 1990. Despite the statutory and common law arrangements that require regulator transparency, several submissions raised concerns about inadequate access to information about regulatory approaches and reasons for decisions.

Many regulatory agencies also develop policies and guidelines for decision makers who exercise discretion, and publish information about their decision-making processes. These policies and guidance help to ensure that decisions with similar circumstances are made consistently and fairly.

## **Decision review**

New Zealand is fortunate to have a judiciary that its citizens have confidence in – the second highest regarded in the Organisation for Economic Co-operation and Development (OECD, 2013a). In New Zealand, the courts have a constitutionally important role to ensure that the Executive acts reasonably, fairly, and within the bounds of the laws established by Parliament. Unlike in other countries, New Zealand courts have no role in supervising Parliament. Courts cannot strike down or invalidate legislation passed by Parliament.

Judicial scrutiny of the exercise of Executive power is particularly important in the area of regulation, given the coercive nature of those powers. Where Parliament provides for appeals, courts also provide a forum for parties to test that regulators have made “correct” decisions.

“Appeals” of regulatory decisions involve the courts scrutinising the merits and correctness of those decisions. In contrast, “judicial review” involves the courts scrutinising the process and legality of decision making. These are distinct processes. “Merits review” is an appeal that looks at the correctness of decisions.

Appeal rights of administrative decisions exist only where Parliament expressly provides for them. There is a perception that New Zealand statutes provide limited access to appeal of regulatory decisions, but this is not supported by research undertaken by the Commission. Most regulatory regimes provide for appeals, and only a small minority of regimes provide limited or no access to appeals.

Judicial review is an inherent power of the High Court, and so does not need to be provided for in statute. The Commission found no evidence that judicial review is ineffective in ensuring the lawfulness and reasonableness of the Executive's actions. It is an important constitutional check on the exercise of state power, and protects the right of New Zealanders to be treated fairly and in accordance with the law. Attempts in legislation to exclude judicial review of the Executive are wholly undesirable.

In New Zealand the scope of judicial review is comparatively broad and can sometimes include scrutinising the substantive merits of the Executive's decisions. The overlap between judicial review and appeal in New Zealand means that judicial review already adequately provides many of the advantages that submitters ascribed to merits review or appeals in many areas of regulation. This includes sharpening the incentives on decision makers to come to the correct decisions.

In scrutinising the decisions of expert regulators, the courts will examine the legality and process of decisions via judicial review. But they will typically defer to expert regulators about the substantive merits of the decision, requiring a higher threshold to establish unreasonableness. This means the availability of merits review may provide some stronger performance incentives for regulators in highly complex or technical fields.

Appeal rights should be provided where the designers of regimes are confident the appeals will improve regulatory outcomes and support the objectives of the regulatory regime. This requires taking into account the costs and uncertainty that appeal rights create. In deciding whether to provide for appeal rights of complex or highly technical regulatory regimes, designers need to critically assess the institutional capability and expertise of the court or tribunal reviewing the decision, relative to the decision maker at first instance.

A range of mechanisms are available to support the institutional capability of the appellate body to deal with appeals of complex and highly technical decisions – for example, using technical experts as lay judges and providing for more inquisitorial processes.

The LAC guidelines on review and appeal provide a good list of considerations to take into account when designing review and appeal provisions in regulatory regimes. The LAC notes that appeals:

- scrutinise and correct individual decisions, with the aim of providing redress, and
- maintain a high standard of public administration and public confidence in the legal system.

Even so, the LAC notes that the value of appeals needs to be balanced against the considerations of cost, delay, significance of the subject matter, competence and expertise of the decision maker at first instance, and the need for finality.

## **Approaches to funding regulators**

Regulators can be funded from various sources, including Crown contributions, levies on the regulated industry, or through fees imposed either on the beneficiaries of regulation or on those who cause the "problem" that needs to be regulated. The way that regulators are funded can affect the efficiency of resource use, equity and the achievement of policy outcomes.

The Commission's survey of businesses and submissions to the inquiry reveal concern in the business community about the quality of the consultation before regulatory fees or levies are introduced, the weak constraints on the level of charges, and the structure of charges.

While there can be benefits in regulators recovering some costs through fees or levies, a case-by-case assessment of proposals for funding regulators is required. Frameworks for choosing between sources of funding in New Zealand and elsewhere, generally:

- set out efficiency and sometimes equity as the main objectives of cost recovery;
- require consent, usually of a minister or Parliament, before a fee or levy is introduced; and
- are based on a distinction between cost recovery and taxation.

But in other jurisdictions it is also typical to find:

- more rigorous consultation and impact assessment before fees are introduced;
- more detailed advice about how to implement cost recovery;
- stricter requirements for performance standards and reporting against those standards; and
- penalties for failing to achieve the standards.

Improvements in New Zealand's approach to cost recovery can be made through strengthening the governance and accountability framework. Specifically:

- publishing the Government's cost recovery policy;
- requiring agencies proposing a new or amended fee or levy to publish a statement explaining, for example, why they are doing so and the expected effects;
- strengthening performance reporting;
- introducing regular reviews of regulators' cost recovery practices; and
- improving the implementation of cost recovery by refreshing and rationalising the guidance material, and ensuring adequate departmental advice is available to regulatory agencies about how to approach cost recovery.

## Monitoring and oversight

Monitoring of regulators helps ensure that they are effective, efficient and accountable and that regimes are working as intended. Although ministers are accountable for the performance of regulatory regimes, decisions about the implementation of regimes are generally delegated to departments or Crown entities. Monitoring helps ministers assess whether the objectives of the regimes are being achieved, and whether changes should be made to legislation or the regulator's behaviour.

The effectiveness of current monitoring practice varies. Interviews conducted for the Commission with regulator board members and their departmental monitors highlighted issues around:

- insufficient support from departments for regulator Crown entities, especially around progressing legislative amendments;
- role confusion, where some departments attempted to influence how a Crown entity was run or "second guess" the regulator's actions;
- inadequate capability and high turnover in departmental monitoring staff; and
- too much reporting sought from regulators, and insufficient focus in reporting on the regulator's performance and strategy.

Monitoring practices can be improved by providing greater stability in monitoring staff, making stronger links between monitoring staff and policy staff who provide advice on the relevant regime, adopting a more risk-based monitoring approach, and re-focusing departmental and ministerial engagement on the boards of regulatory Crown entities.

Current monitoring practices do not pay enough attention to the detail and effectiveness of a regulator's strategies and practices. The best judges of regulatory practices are other practitioners. The Commission

therefore recommends establishing a peer review process, through which panels of senior regulatory leaders would review the practices and performance of individual agencies.

The logical home for this new peer review function is the existing Performance Improvement Framework (PIF) process run by the State Services Commission (SSC). The SSC should identify current and former regulatory leaders to join PIF review teams, and to assist in developing regulator-specific questions for the reviews.

The priority for the PIF peer reviews should be the larger regulatory Crown entities, those entities that implement regimes managing significant potential harms, and departments that implement regulatory regimes. Small regulatory Crown entities should be able to volunteer for a peer review, but not obliged to undertake one.

## Better regulatory management

The regulatory system is vast and distributed across departments, agencies and ministerial portfolios. By and large, this developed model makes sense. The knowledge needed to run individual regimes lies in the individual departments and agencies. But for the model to work well there needs to be oversight, supervision, coordination, prioritisation and continual improvement of the overall regulatory system. This is regulatory management.

The Commission has identified improvements to regulatory management: through better system-wide regulatory review, better information, and stronger institutions.

### System-wide regulatory review

New Zealand's stock of legislation is large, growing rapidly and complex. Parliament has enacted between 100 and 150 Acts and about 350 Legislative Instruments each year since the mid-1990s, although the net increase after revocations is less than this. Keeping it up to date – ensuring that outcomes are still being achieved and unnecessary and inefficient rules removed – is an important task for the Government.

As the OECD notes, “one of the most important tasks facing governments today is updating of the accumulated regulations and formalities that have gone unexamined over years or decades. National regulatory systems require periodic maintenance. Periodic and systematic review of existing regulations is needed to ensure that outcomes are assessed, unneeded or inefficient rules are weeded out, and needed rules are adapted to new economic and social conditions” (OECD, 1997, p. 224).

In New Zealand, in-depth reviews of regulatory regimes have often followed a crisis, rather than a systematic and strategic approach to review. Notably, New Zealand does not use many of the approaches to system-wide evaluation of regulatory regimes used in other countries. Currently, the Government is implementing a suite of initiatives to improve how the stock of regulation is managed. Cabinet has articulated a set of expectations of what departments need to do to keep the regulatory systems they are responsible for up to date.

To improve the effectiveness of these proposed measures for system-wide evaluation of regulatory regimes, the Government should:

- publish the regulatory system reports prepared by departments;
- require departments to articulate in their Statements of Intent their strategies for keeping their regulatory regimes up to date;
- within three years, commission a review of each department's progress and seek advice from that review about whether it is necessary to create a legislative framework or other obligations for managing the stock of regulation;
- articulate a set of principles to encourage departments to focus effort on reviews of regulatory regimes that have the largest anticipated benefits (these could be supported by capping annual expenditure, or

setting a target number of reviews, to force identification of the reviews with the largest potential benefits); and

- direct the Treasury to articulate in more detail its overall strategy for improving how the stock of regulation is managed, indicating how the initiatives it is implementing fit within the strategy and how success will be measured.

## Information to understand and manage the system

The volume and complexity of the regulatory stock in New Zealand poses challenges to people wanting to understand their regulatory obligations, and for the centre of government (ministers and central agencies) to manage the system. Tools are needed to help people navigate the stock and for the centre to effectively govern the system.

The absence of a central electronic repository of Other Instruments (also known as “tertiary” or “deemed” regulation) constrains the ability of firms and individuals to understand their regulatory rights and obligations. The Parliamentary Counsel Office should expand its New Zealand Legislation website to provide a single, comprehensive source of these regulations.

The centre does not need to develop or maintain a deep understanding of the institutional arrangements and regulatory environment for 200 different regimes to govern the system. Instead it should look to identify areas where central organisations have a comparative advantage (eg, provision of public goods, coordination and facilitation between agencies) and ensure that the key actors in the regulatory system – especially policy departments and the boards of Crown entities – properly carry out their duties and obligations.

The Commission considered creating maps or typologies of regulators and regimes, standardised reporting obligations and a framework for assessing the health of the system overall. Of these options, the last has the greatest potential, in that it would allow the centre to assess how well the regulatory system is delivering proportionate and necessary regulation, prioritised regulatory effort, adequate resourcing of implementation, fair and effective implementation and self-aware and adaptive regulatory organisations. The Treasury has already begun to collect information from departments on the performance of the system. This work would be strengthened by making greater use of information from external and independent sources, and by focusing more on the outputs and outcomes of departmental processes.

## Strengthening institutions

The Commission found weaknesses in the institutions responsible for oversight and management of the regulatory system. There is no overarching government strategy for regulation, no clear programme for its improvement, and no clear “owner” of the system. There are also long-standing concerns about the quality of some policy and legislative processes, and about the ability of Parliament to ensure legislative regimes are of a high quality and remain current. While some improvements have been made in recent years, other quality checks have eroded. The Government should commission a review of these quality checks and processes, to promote higher-quality legislation in future and ensure legislation remains current over time.

Moving regulatory management to the next level of performance requires:

- energetic and focused leadership from within the Cabinet, as the “owners” of the system;
- paying more attention to organisational design, implementation, monitoring and review;
- stronger encouragement and support for regulators to fulfil their stewardship obligations; and
- better understanding by departmental monitors of regulators about the monitoring role, and increased importance attached to the monitoring role.

Ministerial leadership of the regulatory system should be strengthened. The responsibilities of the Minister responsible for regulatory management should be clarified and expanded to include:

- defining the overall objective of the system and bringing focus and attention to it;

- strategic prioritisation of effort across the system;
- specifying and allocating tasks for improving the system; and
- promoting continuous improvement in regulatory design and practice.

Effective institutional support for the Minister is needed, through an expanded team within the Treasury that has a published charter setting out its objectives and functions, its own website, and the authority to identify itself as a separate unit within the Treasury. The proposed position for providing intellectual leadership on regulatory practice should be located in this team.

## Conclusion

The regulatory system is a large and important part of New Zealand's policy infrastructure. This report has reviewed the components of the system and has found deficiencies in each of them alongside a surprising complacency about how the system as a whole is performing. Insufficient, and in some cases declining, resources are being committed to matters of regulatory design and review. The designers and implementers of regulation face escalating expectations, complexity and challenge.

This report shows many areas where the capability and performance of the regulatory system in designing and regularly upgrading regulatory regimes falls well short of what it should and can be. There has been some progress through recent initiatives, including the creation of a ministerial portfolio for regulations, the 'Better Regulation, Less Regulation' package, the Regulatory Standards Bill, and the regulatory stewardship requirements. But while efforts to improve the regulatory system can be identified, these are fragmented and follow-through has been inadequate in some initiatives. Focus, continuity and a system-wide view of performance weaknesses and potential improvements are required. There is considerable scope to get much better performance out of the system, with a real imperative to do so in support of the greater wellbeing of New Zealanders, and reduced risk of regulatory failure.

This inquiry has concentrated on the role and contribution of the regulatory system to the wellbeing of New Zealanders. The Commission recommends a more strategic approach to the regulatory system, and suggests initiatives aimed at:

- sharpening the accountabilities of those who have important roles to perform in improving the system;
- redirecting effort to improve the system to where it can yield the highest dividends;
- increasing the attention devoted to improving organisational and workforce capability; and
- building in mechanisms to encourage continuous improvement of the system, to keep it current.

New Zealand is not so well off that it can afford to settle for second best in its foundational systems. Indeed, given the disadvantages of small scale and isolation, New Zealand needs to excel in such matters if it is to meet its aspiration to deliver first-class living standards to all New Zealanders. Achieving this will require focus, enthusiasm, professional capability and active political support.

# 1 About this inquiry

## Key points

- Regulation is indispensable to the proper functioning of economies and societies. It underpins markets, protects the rights and safety of citizens, and their property, and ensures the efficient and equitable delivery of public goods and services. In this way, regulation is an important tool for preserving and advancing the public interest.
  - However, if regulation has misplaced objectives, is used when it is not needed, or is poorly designed and executed, then it can fail to achieve policy objectives and have unintended consequences that harm the wellbeing of New Zealanders.
  - Regulatory failure occurs where regulations fail to improve outcomes, or even make outcomes worse, than had there been no regulation. The two main ways regulation can fail are failures of design and failures of operation. Analysis of 18 major disasters by the Commission reveals the centrality of regulatory failure as a major contributing factor to such disasters.
- The Government has asked the Commission to examine how the design and operation of regulatory regimes and their regulators can be improved – ultimately to improve regulatory outcomes. Specifically, the Commission was asked to develop:
  - guidance that can be used to inform the design and establishment of new regulatory regimes and regulators; and
  - system-wide recommendations on how to improve the operation of regulatory regimes in New Zealand over time.
- This inquiry is focused on better understanding what good regulatory institutions, practice and system management look like in the New Zealand context and on ways to improve them. This focus goes to critical issues such as:
  - what organisational form is best, the appropriate level of independence, how the regulator is governed, is held to account, makes decisions, engages with industry and the public, carries out its regulatory practices, its leadership and culture and, finally, how the regulator is resourced with the right workforce capability to deliver on its mandate; and
  - effective ways to review the large stock of regulation, accessing information about the performance of the system (and tools to manage regulatory system), and building institutions that promote continuous improvement of regulation and the regulatory management system.
- Getting these issues right not only makes it more likely that the objectives of regulation will be achieved but, importantly, it builds legitimacy and trust in regulatory agencies and regulatory regimes and, with that, a higher level of trust by society.
- Regulation has become an increasingly prominent tool for protecting the public and improving the performance of markets. The growing use of regulation as a way of achieving social and economic objectives poses a number of challenges in terms of complexity, accountability, effectiveness, accessibility and fairness. Good design of regulatory institutions, practices and the proper management of the overall regulatory system can help overcome these challenges.

## 1.1 What the Commission has been asked to do

The Government has asked the Commission to examine how the design and operation of regulatory regimes and their regulators can be improved – ultimately to improve regulatory outcomes.

### The terms of reference

The Commission has been asked to provide:

- a “high-level map” of regulatory regimes and regulators across central government, and a typology of how regimes and regulators might be classified or distinguished;
- guidance to inform the design and establishment of new regulatory regimes and regulators; and
- system-wide recommendations on how to improve the operation of regulatory regimes over time.

#### Box 1.1 Defining regulatory regimes

Any regulatory regime has three working components: standard setting (identifying the regulatory goal or target), monitoring compliance with the regulatory standard, and enforcement when there is non-compliance. Together, these three elements form the basis for controlling the behaviour of individuals and businesses.

*Source:* Hood, Rothstein & Baldwin, 2001.

In addition, the Commission has been asked to give particular attention to:

- any key features or characteristics of New Zealand’s regulatory environment that differ from other jurisdictions (eg, differences in scale, resourcing, or the need to coordinate with overseas regulatory regimes);
- ways to improve the monitoring of regulator performance across central government; and
- other existing work in this area to avoid duplication, such as the State Services Commission’s *Reviewing the Machinery of Government*.

See page iv for the full terms of reference.

### What this inquiry will not include

The inquiry is not:

- a review of individual regulators, specific regulations or the objectives of regimes (this was explicitly excluded from the inquiry’s scope by the Terms of Reference); and
- about improving the policy-making process for developing new regulation or regulators, already a topic of some focus by ministers and officials, with less attention given to other factors that contribute to regulatory success, such as regulatory institutions and practices.

The Commission has already commented on the policy-making process for formulating new regulation in its report *Towards better local regulation* (NZPC, 2013a).

### What regulation is in scope

Various definitions of regulation exist, each displaying varying degrees of specificity and breadth. Black (2002) offers three definitions from the literature, each involving the exercise of some authority to affect behaviour. Regulation is:

- the promulgation of rules by government accompanied by mechanisms for monitoring and enforcement, usually assumed to be performed through a specialist public agency;

- any form of direct state intervention in the economy, whatever form that intervention might take; or
- all mechanisms of social control or influence affecting all aspects of behaviour from whatever source, whether those mechanisms are intentional or not.

The first definition best aligns with the scope of this inquiry. The Commission has focused on regulation that is implemented where the operation of markets fails to produce behaviour or outcomes that are aligned with the public interest. Traditional market failure rationales for regulating arise where there are:

- monopoly or anti-competitive behaviours;
- information problems (asymmetries);
- externalities (where the full costs and benefits of a private action are not fully accounted for, and spill-over to third parties and society); or
- public goods (goods and services that are not produced by the market, or are under-produced).

A focus on regulation that addresses traditional market failures has, from a pragmatic perspective, made the scope of this inquiry manageable. However, the guidance provided in this report equally applies to a broader range of regulatory interventions.

Regulation can be carried out by government or quasi-government organisations. It can also be “de-centred” and carried out by a diverse array of non-state organisations (Black, 2001). The latter include self-regulatory bodies such as professional bodies, industry groups, certification bodies, trade associations, corporations, community and voluntary bodies. For the purposes of this inquiry, the Commission will confine itself to public agencies as regulators that carry out two or more of the regulatory functions listed in Table 1.1, so enabling a focus on the major regulators. This construction means that 34 regulatory agencies are within scope for this inquiry (20 are Crown entities).

**Table 1.1** Types of regulatory functions

Function	Description/examples
Make rules or standards (under legislative or delegated authority)	Set standards, guidelines or rules to which regulated entities, individuals or activities must comply, reflecting the regulatory objectives set out in statute.
Inform and educate	Provide general or targeted information to firms and individuals that are subject to regulation about compliance.
Approve/ban activities	Provide approval to carry out regulated activities (eg, issue consents, approve mergers), refuse to provide approval, or ban activities that are contrary to the objectives of the regulatory regime.
Promote and monitor compliance	Actively seek information from regulated entities and/or collect market intelligence to assess compliance levels and identify potential risks.
Handle complaints from the public	Receive and process complaints from the public about the performance of regulated entities and their compliance with regulatory requirements. Where appropriate, require the regulated party to make amends.
Enforce compliance where breaches suspected	Investigate cases where entities or individuals are suspected of having breached regulatory requirements, assess whether any breach has occurred, and assess the impacts of any breaches. Where appropriate, issue penalties or enforcement action.

*Notes:*

1. Adapted from a framework from the Victorian State Services Authority, 2009.

The regulatory instruments used cover the full range of legal and informal mechanisms through which government seeks to influence or control the behaviour of individuals and businesses to achieve desired economic, social and environmental outcomes. Regulation therefore includes primary legislation,

government regulation (such as Orders in Council), deemed regulations, licences, codes and consents, rules, informal instruments and agreements for achieving compliance (see Table 1.2 for the different types of legislation).

**Table 1.2** Types of legislation

Type of legislation	Definition	General Features
Statutes	"Primary legislation"	Drafted by the Parliamentary Counsel Office (PCO)  Passed by the House, assented by the Queen, the Governor-General or the Administrator of the Government
Legislative Instruments	Legislative Instruments are the category of legislation once loosely known as "Regulations", "Statutory Regulations" or "secondary legislation". Legislative Instruments can include Orders in Council, regulations, rules, notices, determinations, proclamations, and warrants. The term is defined in section 4 of the Legislation Act 2012. Legislative Instruments are laws made by the Governor-General, Ministers of the Crown, and certain other bodies under powers conferred by an Act of Parliament.	Drafted by the PCO  Generally approved by Cabinet and made by the Governor-General in Executive Council  Disallowable by Parliament
Other Instruments	"Other Instruments" are now the category of legislation that has been known as "Deemed Regulations" and informally as "tertiary legislation". They are disallowable Instruments under section 38(1)(b) of the Legislation Act 2012. Examples include most land transport rules, civil aviation rules, and a wide variety of other rules, codes, and other Instruments.	Usually drafted by the organisation responsible for the Instrument  Generally made by the authority of a minister or official  Not usually considered by Cabinet or Executive Council  Disallowable by Parliament

## Gathering evidence

This inquiry's findings and recommendations have been informed by a range of evidence.

- **Submissions:** A total of 104 submissions were received for this inquiry. An issues paper was released in August 2013 (NZPC, 2013b) calling for submissions and feedback from interested parties (54 submissions were received). A draft report (NZPC, 2014a) was released in March 2014 (50 submissions were received).
- **Engagement:** 113 meetings were undertaken with representatives from businesses, regulatory agencies, central government agencies and academia.
- **Roundtable discussions:** Roundtable discussions were held with officials who had been involved in designing new regulatory regimes, and with businesses subject to economic regulation and regulatory compliance professions.
- **Surveys:** The Commission drew on three surveys to gain information about regime and regulator performance in New Zealand and the experience and impact of regulation on business:
  - Colmar Brunton conducted an online survey for the Commission of 1,526 senior decision makers in New Zealand businesses (from a cross-section of industries), examining business experiences with government regulations (Colmar Brunton, 2013).
  - Victoria University of Wellington's Industrial Relations Centre (VUW IRC) and the Public Service Association (PSA) surveyed 15,762 PSA members on their experiences working in government

agencies. The Commission used the survey results to compare the experiences of regulatory workers within central government agencies (around 300 in regulatory roles) with 160 in local government or district health board regulatory roles) and non-regulatory workers (VUW IRC & PSA, 2014).

- A short survey was undertaken of 23 chief executives of New Zealand regulatory agencies. The survey focused on their perceptions of regulatory regimes (NZPC, 2014b).
- **Interviews:** Structured interviews with Chairs or board members of eight regulatory Crown entities and officials in five monitoring departments.
- **Information request:** An information request went to 33 regulatory agencies seeking detailed information about their institutional features and regulatory practices. Twenty-six agencies responded.
- **Case studies:** Four case studies were undertaken to develop a deeper understanding of a particular sector, regulatory domain or regulator. Case studies examined the regulatory framework for financial markets; and the aged care sector (NZPC, 2014c). The Ministry for Primary Industries (MPI); and the Environmental Protection Agency (EPA) (Pickens, 2014) were also the subjects of case studies. MPI was of particular interest as this agency has undergone restructuring over the years, with changing regulatory functions and responsibilities. The EPA is an exemplar in its approach to, and results achieved, in incorporating the principles of the Treaty of Waitangi into its decision making.
- **Expert review and feedback:** The Commission had the benefit of meeting with two leading international experts in the field of regulation (Professors Martin Lodge and Julia Black from the London School of Economics and Political Science) who provided a critique of the draft report. Professor Edgar Schein (from the Massachusetts Institute of Technology) reviewed and provided feedback on *Chapter 4: Regulator culture and leadership* of the draft report. Professor Philip Joseph (University of Canterbury) reviewed and provided feedback on *Chapter 11: Decision review* of the draft report.

Together, the evidence gathered has provided a rich picture of New Zealand's regulatory landscape, institutions, regulatory practices and regulatory impacts on business and productivity.

## 1.2 Regulatory developments and challenges

Regulation – that is, the promulgation of rules by government accompanied by mechanisms for monitoring and enforcement (Black, 2002) – has become a topic of increasing interest and concern for governments, industries and academics over the past 30 years. In New Zealand, this has led to:

- the progressive introduction of greater obligations on public service departments and ministers to test whether new regulation is necessary, proportionate and efficient (eg, the obligation to complete Regulatory Impact Analyses);
- requirements for departments to regularly review the stock of existing regulation, to ensure it is still fit for purpose (eg, the *Regulatory System Report 2013: Guidance for Departments*);
- the establishment of a dedicated agency for regulatory management and quality (the Regulatory Quality Team located within the Treasury);
- establishment of a dedicated parliamentary Select Committee, the Regulations Review Committee, to review, hear complaints on, and (if necessary) recommend the amendment or revocation of secondary legislation; and
- the detailed consideration, by ministers, Parliament and an expert taskforce, of legislative tools for improving the quality of regulation.

The interest in regulation in New Zealand stems from a number of important developments.

- Individual freedoms and human rights have taken on greater importance in New Zealand society, as signalled by the passing of the Bill of Rights Act in 1990 and the Human Rights Act in 1993.

- There has been a growing awareness of the role that good-quality regulation and institutions can play in promoting economic growth (Nicoletti & Scarpetta, 2003; Crafts, 2006; Conway et al., 2006).
- Reforms over the last quarter of the 20<sup>th</sup> century have changed how governments organise themselves, provide services and deliver policy. These changes made regulation a more visible and important government activity (Yeung, 2010; Majone, 1994; Christensen, Lie & Laegreid, 2008).
- Society is much more diverse with a broader range of attitudes to risk and expectations about what government can and should do.

In New Zealand, late 20<sup>th</sup> century reforms saw some traditionally publicly-provided services transferred to the private sector or commercially-focused state entities (eg, electricity and telecommunications) or devolved down to local or community bodies (eg, school education and some health services). A range of decisions once taken centrally by a minister or within a public service department are now taken by state providers, private firms and individuals. But governments have retained (and in some cases set rules or standards through regulation) their ability to affect the quantity, quality, safety and distribution of services.

These public sector reforms are part of an observed global international trend. Public management scholars have described this trend as governments “steering” rather than “rowing” (Osborne & Gaebler, 1992). Governments in the developed world now focus more on setting the rules of the game than deciding how the players will move. This has had a number of implications, and created a series of challenges.

- Rules and standards in regulation are generally set in advance of operational decisions by firms and individuals, and are available to the public. This has meant that, in many cases the actions of governments are more predictable. However, public and ex ante rules are more easily contested than decisions taken within departments that are not transparent.
- The control of activities or risks through regulation imposes costs on firms, individuals and the wider community. These costs include compliance or administrative burdens (such as the time and money devoted to filling out forms, participating in audits, changing internal systems to comply with regulation) and opportunity costs (such as innovation or production foregone, because they were not permitted by the regulatory framework or because firms were uncertain whether they would be permitted). The design of regulatory systems can affect the extent of these costs.
- Effective regulation often relies upon specialised expertise (such as a detailed understanding of a particular industry, economic or legal training). This may limit the ability of the public and Parliament to assess the effectiveness or efficiency of the regulatory regime if the expertise is absent.
- In many cases monitoring and enforcement of regulation has been delegated to legally independent organisations. This is usually done to prevent political interference in regulatory decisions. However, this delegation and legal independence can raise questions about how to ensure accountability to Parliament and the public.
- As the delivery of services has been transferred to commercial or local bodies, consumers and consumer interests have taken on a prominent role in regulation. Many regulatory regimes have specialised consumer complaints and redress mechanisms (such as the Health and Disability Commissioner and the Banking and Insurance Ombudsman), with a number aimed at promoting the “long-term benefit of consumers”. However, effective consumer participation in regulatory regimes can be challenging, especially where the regulatory area requires specialised expertise and producers are well organised and resourced.
- Independent regulatory authorities may wield coercive powers, such as the ability to block entry to a market or profession or to prevent profitable transactions, and the scope to impose fines and penalties. As part of the wider legal system, affected individuals or firms may expect to have a right of appeal or review of regulatory decisions.
- In some cases, regulatory authorities are required to balance competing interests or objectives (eg, consumers and producers, development and environmental protection). On one hand, regulators often

need to exercise discretion, so that they can judge a case on its merits. On the other hand, citizens and firms may wish regulators to spell out the principles, rules or processes they will apply to a case, so that more decisions are predictable. Discretion and certainty are a constant tension in regulatory regimes.

In summary, regulation has become an increasingly prominent tool for protecting the public and improving how markets perform. The growing use of regulation as a means to achieve social and economic objectives poses a number of challenges in terms of efficiency, accountability, accessibility and fairness.

There is a question as to whether New Zealand's regulatory regimes are unnecessarily complex and whether they could be simplified. It is commonly thought that increasing complexity is inevitable in modern societies. But complexity can instead call for simple decision rules. Indeed, the Nobel prize winner Herbert Simon, the father of decision-making behaviour under uncertainty, argued that it was precisely because humans operate in a complex environment that they seek simple behavioural rules. Despite this logic, the tendency of governments and regulators is to think "more is more". Andrew Haldane and Vasileios Madouros of the Bank of England wrote:

The response to the financial crisis by banks and regulators has been swift and sizable. Gaps in risk management have been filled, deficiencies in regulation plugged, errors by regulators corrected. This is a self-healing and familiar response. Past crises have also been met by a combination of more risk management, more regulation and more regulators. More has been more. (Haldane & Madouros, 2012, p. 7)

It needs to be recognised that the capacity of individuals and firms to comply is a function of the complexity of regulatory regimes. Capability and expertise, for both regulators and regulated alike, is likely to be an ongoing issue in New Zealand. Complicated rules require complicated processes and information, which increases the demands on those who are regulated.

This observation has two implications. First, that assessments of capacity are relative to the demands made by the regulatory regime. Second, that one way to increase regulatee capacity is to simplify the regime. (Black & Baldwin, 2012, p. 137)

This inquiry provides an opportunity to look at New Zealand's regulatory regimes to see where the regulatory management system can be improved. A trajectory of "more is more" is not inevitable. Improvements can be found, for example, in clarifying the roles and expectations of regulators, removing inconsistencies in regimes, improving workforce capability, introducing systematic processes for reviewing the existing stock of regulation, improving transparency – in short – by making the system simpler for those who design and implement it and for those who must comply with it.

### 1.3 Why getting regulation right is important

The Commission's principal purpose is to provide advice to the government on improving productivity in a way that is directed at supporting the overall wellbeing of New Zealanders, having regard to a wide range of communities of interest and population groups in New Zealand society (New Zealand Productivity Commission Act 2010, s 7).

Regulation is indispensable to the proper functioning of economies and societies. It underpins markets, protects the rights and safety of citizens, and their property, and ensures the efficient and equitable delivery of public goods and services (Organisation for Economic Co-operation and Development [OECD], 2011). In this way, regulation is an important tool for preserving and advancing the public interests. It is pervasive in everyday life, more than is often appreciated (Box 1.2). However, if regulation has misplaced objectives, is used when not needed, or is poorly designed and executed, then it can fail to achieve worthy policy objectives and have unintended consequences that harm the wellbeing of New Zealanders.

Regulatory failure occurs where regulations fail to improve outcomes, or even make outcomes worse, than had there been no regulation. The two main ways that regulation can fail are failures of design or failures of operation. Poorly conceived and implemented regulatory arrangements not only fail to achieve stated objectives, but also impose significant costs that can undermine the very purpose of regulatory intervention. Such costs affect business productivity and profitability, and the economic circumstances of individuals and families. Ultimately this will harm economic performance and the wellbeing of New Zealand.

The institutional arrangements and regulatory practices that constitute the architecture of regulatory regimes shape the behaviours of regulators, the quality of decision making, behaviours of those regulated, and ultimately the success of regulatory regimes in achieving the desired outcomes. This inquiry is focused on better understanding what good regulatory institutions and regulatory practice look like in the New Zealand context and on ways to improve both.

Getting these things right not only means the objectives of regulation will more likely be achieved but, importantly, it builds legitimacy and trust in the regulator and regulatory regime and, with that, a higher level of trust by society.

### Box 1.2 A day in the life of a New Zealand family

It's 6 am and the kids barge through the door wearing their safety standard-compliant pyjamas. You reach over and turn on the clock-radio. The local station is playing its regular morning show, the content of which is subject to a code of practice for radio broadcasting.

Scratching your head you rise from your recently purchased mattress (which is covered by the Consumer Guarantees Act), make your way to the bathroom and turn on the light. The light complies with the energy performance standards administered by the Energy Efficiency and Conservation Authority. The price and reliability of the electricity used to power the light comes through a transmission network overseen by the Electricity Authority.

You turn on your shower. The quality of water flowing from the tap is regulated by the National Environmental Standard for drinking water, while the Commerce Commission regulates the amount you pay for the gas that heats the water.

You wash your hair with anti-dandruff shampoo approved for sale by the Minister of Health. The soap runs down a drain built in compliance with the New Zealand Building Code.

Once out of the shower, you dry yourself and reach for the shaving cream, or perhaps some makeup. The packaging proudly proclaims that the product was not tested on animals – a claim subject to scrutiny under the Fair Trading Act. You fill a glass of water and take your daily vitamin tablets – which are regulated under the Dietary Supplements Regulations administered by Medsafe.

Once dressed you make your way into the kitchen to get breakfast for the family – cereal topped with banana. The cereal has its nutritional value printed on the side of the carton. The information complies with the Nutritional Information Requirements of the Australian New Zealand Food Standards Code. The banana is from the Philippines, but it poses little threat to biosecurity due to New Zealand's quarantine regulations.

You tip milk on the cereal. The quality of the milk is regulated under the food safety standards, while the price you paid for it is monitored by the Commerce Commission.

After breakfast you take the kids to school. On the way out of the house you lock the door. Maybe you have recently purchased the house, having paid attention to some of the provisions in the Property Law Act. Or maybe you are renting the property under the conditions set out in the Residential Tenancies Act. Either way, you probably used the services of a real estate agent who was legally bound to act in accordance with the Real Estate Agents Act.

You buckle your children into a car seat that meets the joint New Zealand/Australian standard and then start your vehicle (which of course has a current registration and warrant of fitness). You then drive (under the authorisation of your New Zealand driver's licence) to your children's school – being sure to obey local traffic regulations as you only have 10 demerit points left on your licence!

You drop your children off at school, where their teacher is registered by the New Zealand Teachers' Council as being capable to deliver the New Zealand Curriculum and the newly-elected school board is charged with giving effect to the Government's National Education Guidelines. As you drive away,

you wonder how the project to earthquake strengthen the old school hall to the Ministry of Education's building design standards is going.

At work, regulations administered by the Ministry of Business, Innovation and Employment promote a safe working environment, while the Human Rights Act seeks to protect you against discrimination from your co-workers. Your pay and conditions are covered by the Employment Relations Act which (among other provisions) protects the holiday entitlements you negotiated with your employer.

And all this before smoko – which of course is outside...

## 1.4 How regulation fails

Julia Black, in her Sir Frank Holmes Memorial lecture at Victoria University in April 2014, presented the uncomfortable thesis that “disasters” – from leaky buildings to mining tragedies to the mis-selling of financial products – although unique in many respects, are failures of regulation in complex systems. And when regulation does fail, it fails in quite consistent ways (Black, forthcoming). Black's analysis was based on an analysis of eight official reports of disasters in a range of fields including workplace safety, and the failure to protect patients, people's homes and their savings.

The Commission has extended this work to include 18 official reports of major disasters (Appendix B and Figure 1.1). These reports capture over 5,000 pages (2 million words) of commentary, roughly four times the word count of the Lord of Rings trilogy, all devoted to articulating what and why things went wrong. The Commission wanted to test Black's hypothesis that failures of regulation are often a contributing cause of major incidents and, further, it wanted to identify what aspects of regulation – its design or its institutions or practices – were implicated.

As a first step the Commission used the linguistic software program Leximancer ([www.leximancer.com](http://www.leximancer.com)) to “read” the reports. Leximancer identifies, counts and rates commonly occurring concepts from multiple documents or text. Key words are identified based on the frequency of occurrence and the software “maps” relationships between key words, depending on how closely they appear together in the text. This step revealed the centrality of regulation in the official reports and the relationship of the terms “regulation, regulatory and regulator” to key terms such as “standards”, “monitoring”, “compliance”, “risk”, “training”, “effectiveness” and “concerns”. Then, guided by these findings, the Commission analysed the factors surrounding the failure around regulation more closely. The Commission found that a number of factors were implicated:

- the lack of clarity of the regulator's role;
- the complexity of regulatory regimes;
- weak governance and management of both regulator and regulated parties;
- weak regulator accountability, monitoring and oversight;
- the capability and resourcing of the regulator;
- failures of compliance and enforcement;
- failure to understand and assess risk;
- poor engagement and communication about regulatory requirements;
- the culture and leadership of both regulators and regulated parties; and
- out-of-date regulation or lack of review of regulation.

Figure 1.1 Common themes in inquiries into disasters and regulatory failure

**Role clarity**

"The Inquiry has brought to light a lack of clarity, which I did not expect, as to the respective provinces of the Health and Safety Executive and local authorities in relation to safety standards in industrial and commercial premises in which there is an LPG supply" – ICL Inquiry (House of Commons, 2005, p. 126).

"In the case of Mid Staffordshire, the regulatory regime that allowed for overlap of functions led to a tendency for regulators to assume that the identification and resolution of non-compliance was the responsibility of someone else" – Mid Staffordshire (House of Commons, 2013, pp. 67-68).

**Regulatory complexity**

"One of the difficulties with this regulatory framework was that it lacked a clear structure, and the various Acts, amended numerous times over the years, could be confusing" – Inquiry into finance company failures (Commerce Committee, 2011, p. 11).

"The legislative framework surrounding the management and use of flammable refrigerants is complex, and it is not clear to what extent the Icepak facility complied with all requirements" – Explosion and fire at Icepak Coolstores (Beever et al., 2008, p. ix).

**Compliance and enforcement**

"The current practice for appraisals is inadequate and in many cases they do not provide a means for a territorial authority or building certifier to be "satisfied on reasonable grounds" that the product complies with the Code without additional verification" – The weathertightness of buildings (Hunn et al., 2002, p. 28).

"Over a prolonged period, the Meat Hygiene Service failed to perform effectively its overall enforcement function in relation to the Abattoir. Despite knowledge of longstanding, repetitive, failures, the Abattoir was allowed to continue functioning in breach of legislative requirements" – Outbreak of E.coli O157 (Pennington, 2011, p. 14).

**Governance and management**

"[The National Cervical Screening Programme had] a poorly designed management structure which split the responsibilities for parts of the Programme between various health agencies which resulted in confusion and consequent failure to discharge responsibilities" – Under-reporting of cervical smear abnormalities (Duffy et al., 2001, p. 9).

"While we welcome the Chancellor's admission that he was ultimately in charge of the decision making process relating to Northern Rock, we are concerned that, to outside observers, the Tripartite authorities did not seem to have a clear leadership structure" – The run on the Rock (House of Commons Treasury Committee, 2008, p. 110).

**Accountability and oversight**

"The single thread that runs through the multi-faceted building sector we have portrayed, is the seeming lack of accountability. The practical effect of the current system when it comes to the crunch of litigation (and as we have said that is where the battle over weathertightness tends to be fought) is to dump most of the responsibility on the building inspector ... While we have found that this part of the process requires significant improvement, the number of parties required to arrive at the end product should be mirrored in the system of "responsibility, accountability and public liability"" – The weathertightness of buildings (Hunn et al., 2002, p. 41).

**Culture and leadership**

"The inspectors were at the bottom of the organisation and their managers were unfamiliar with their speciality and had difficulty in understanding their work" – Pike River Coal Mine tragedy (Royal Commission, 2012, p. 30).

"[W]e call for leadership to ensure the Board recommendations result in sector-wide improvements so as to maximise the learnings and positive impact from Buncefield" – Buncefield Major Incident Investigation Board, 2008, p. 36).

**Capability and resourcing**

"The department has been underfunded from the outset, with consequent difficulty in carrying out its statutory functions and duties. ... The lack of resources has given rise to a culture of doing more with less" – Cave Creek (Commission of Inquiry, 1995, p. 51).

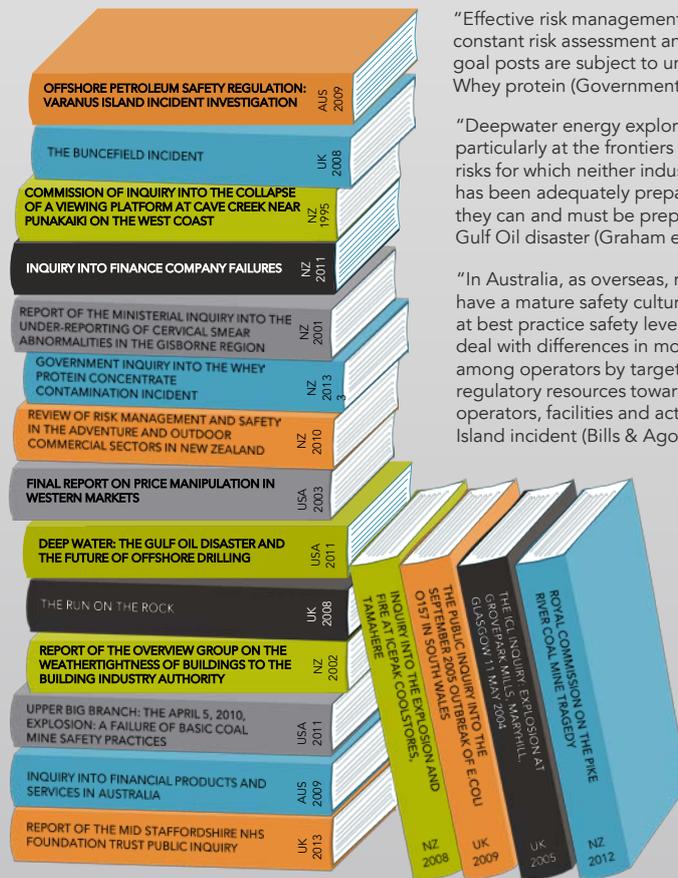
"It is by no means a crisis, but the shortage of experienced people with dairy processing expertise at every level of the regulatory sector demands attention" – Whey protein (Government Inquiry, 2013, p. 24).

**Risk assessment**

"Effective risk management strategy requires constant risk assessment and reassessment. The goal posts are subject to unpredictable change" – Whey protein (Government Inquiry, 2013, p. 23).

"Deepwater energy exploration and production, particularly at the frontiers of experience, involve risks for which neither industry nor government has been adequately prepared, but for which they can and must be prepared in the future" – Gulf Oil disaster (Graham et al., 2011, p. vii).

"In Australia, as overseas, not all operators have a mature safety culture or seek to operate at best practice safety levels. Regulators must deal with differences in motivation and culture among operators by targeting scarce regulatory resources towards higher risk operators, facilities and activities" – Varanus Island incident (Bills & Agostini 2009, p. xv).

**Engagement and communication**

"The final area of weakness that I have identified is in the lack of effective communication to users of the risks inherent in LPG installations, and particularly in buried pipework, and in LPG escapes; a lack of effective sharing of knowledge of risks between users and suppliers; and a lack of prompt and effective notification of LPG incidents, and of the lessons to be learned from them, to users and suppliers" – ICL inquiry (House of Commons, 2005, p. 127).

**Regime review and out-of-date regulation**

"... New Zealand's regulatory framework for underground coal mining is years behind those of other advanced countries, including Australia. It does not provide the support that employers and workers need" – Pike River Coal Mine tragedy (Royal Commission, 2012, p. 32).

"21st century coal mine safety practices have failed to keep pace with 21st century coal mine production practices. Improved technology is required to ensure that the lives of miners are safeguarded" – Upper Big Branch (McAteer et al., 2011, p. 109).

"The legislation governing the sector is often ill-fit for adventure activities, as its main intent is to regulate things like transport activities or the health and safety of employees in a workplace" – Adventure and outdoor commercial sectors (Department of Labour, 2010, p. 24).

Not all factors were identified as a main cause of the regulatory failure in all reports, but each of the above factors was identified in a number of the reports. A factor that was mentioned in at least five reports was regarded as significant, with the some factors mentioned in as many as ten reports.

## 1.5 Successful regulation

The main sources of regulatory failure gleaned from analysis of official reports of major disasters, together with the other evidence assembled for this inquiry (p. 18), has provided the Commission with a rich picture of what aspects of the regulatory architecture, institutional design and practice need to be present, and working well, in order to be effective and achieve important regulatory objectives.

To be successful, regulators need to have:

- an approach to regulatory practice that is based on a sophisticated understanding of the nature of the risk, the nature of regulated parties and dynamic changes in the regulated environment (Chapter 3);
- organisational leaders that foster a culture that values operational flexibility and adaptation to changes in the regulatory environment, continuous learning and a culture of challenge and “speaking up” (Chapter 4);
- capability across all levels of the organisation and a purposeful, structured and integrated approach to achieving a professional workforce (Chapter 5);
- communication and engagement processes that promote the legitimacy of the regulatory regime (Chapter 6); and
- the ability to fulfil its regulatory objectives within constitutional and statutory requirements – such as ensuring the principles of Treaty of Waitangi are appropriately taken into account in regulatory practice (Chapter 7).

Regulatory institutions need to be designed to provide:

- clarity of role, as having clear regulatory roles and objectives are critical to regulator accountability and focus, for compliance by regulated parties, and the legitimacy of the regulatory regime (Chapter 8);
- an appropriate institutional form and degree of independence to enable it to function as intended (Chapter 9);
- good governance and decision-making arrangements, appropriate allocation of decision rights, including where and how discretion is exercised (Chapter 10);
- appropriate mechanisms for the review of regulatory decisions (Chapter 11);
- adequate funding, according to good principles for the recovery of the costs of its regulatory activities – and where the funding mechanism does not create perverse incentives for either the regulator or regulated parties (Chapter 12); and
- strong monitoring and oversight arrangements to ensure that regulatory agencies are effective, efficient and accountable and that regimes are working as intended (Chapter 13).

Management of the overall regulatory system needs to have:

- systematic and cost-effective approaches to keeping the stock of regulation up to date, so ensuring that outcomes are still achieved and unnecessary or inefficient rules are removed (Chapter 14);
- information and tools to enable the centre to understand and better manage the whole-of-system (Chapter 15); and
- strong institutions and leadership, particularly from the centre of government but also including the legislature and the judiciary (Chapter 16).

## 1.6 The Commission's approach

Together, these institutional, practice and system features determine the incentives on regulators and, ultimately, their capability to achieve mandated public interest goals. These features are the focus of this inquiry. Importantly, each of these design features is inextricably linked and can be thought of as a mutually reinforcing system. For example, developments in regulatory practice will have implications for the skills and competencies required of the regulatory workforce. Likewise, the level of regulatory independence provided for will determine the most appropriate accountability, performance and monitoring framework. Also, if the regulatory system fails to update and refresh regulation to ensure that it is achieving its goals, given continual change in the regulatory environment, then this will hamper the ability of the regulator to achieve both compliance and the intent of the regulatory regime.

## Guide to this report

This report is set out in two parts. Part 1 investigates regulatory practice and institutions and provides guidance for designing regulatory regimes and regulators. Part 2 suggests how the management of the regulatory system can be improved. Throughout the report, system-wide recommendations to improve the operation of regulatory regimes over time are made.

**Table 1.3 Report structure and content**

<b>Introduction</b>
<b>Chapter 2: New Zealand’s regulatory system.</b> Describes the nature of the regulatory system in New Zealand, outlines the various factors affecting its performance, and provides an overall assessment of the system’s health.
<b>Part 1: Better regulatory practice and institutional design</b>
<b>Chapter 3: Regulatory practice.</b> Examines the strategies that regulators use to achieve the objectives of their regulatory regimes and discusses how recent developments in the theoretical literature can assist in meeting the challenges that modern regulators face.
<b>Chapter 4: Regulator culture and leadership.</b> Provides a framework through which the concept of organisational culture can be understood, and highlights the mechanisms through which leaders embed culture in regulatory bodies.
<b>Chapter 5: Workforce capability.</b> This chapter examines the current state of the regulatory workforce and sets out a purposeful, structured and integrated approach to professionalising the New Zealand workforce to lift capability
<b>Chapter 6: Consultation and engagement.</b> Examines engagement practices that regulators use and explores issues for officials to consider when designing new regulatory regimes.
<b>Chapter 7: The Treaty of Waitangi in regulatory design and practice.</b> Provides guidance for officials in applying the principles of the Treaty of Waitangi into the design and operation of regulatory regimes.
<b>Chapter 8: Role clarity.</b> Examines the impacts and causes of unclear regulator roles, and proposes actions to improve role clarity.
<b>Chapter 9: Regulatory independence and institutional form.</b> Discusses the importance of independent regulators and how this relates to their institutional form.
<b>Chapter 10: Governance, decision rights and discretion.</b> Examines appropriate governance and decision-making arrangements, including the role of administrative discretion.
<b>Chapter 11: Decision review.</b> Discusses the types of decision review and appeal that should be available to challenge the decisions of regulators.
<b>Chapter 12: Approaches to funding regulators.</b> Assesses the approach to funding regulators in New Zealand and suggests improvements.
<b>Chapter 13: Monitoring and oversight.</b> Reviews the role that monitors of regulatory agencies play, assesses their performance, and identifies options to improve the effectiveness of monitoring.
<b>Part 2: Better regulatory management</b>
<b>Chapter 14: System-wide regulatory reviews.</b> Reviews the approach to managing the large stock of legislation and regulation in New Zealand, and recommends improvements.
<b>Chapter 15: Information to understand and manage the system.</b> Considers mechanisms to improve the ability of regulated parties to access information about their obligations, and tools to help central institutions govern the regulatory system.
<b>Chapter 16: Strengthening institutions.</b> Provides suggestions about how the report’s recommendations could be embedded in New Zealand’s regulatory management system by strengthening existing institutions and creating an environment in which the recommendations will have most effect.

## 2 New Zealand's regulatory system

### Key points

- New Zealand's regulatory system includes the institutions, principles and processes through which regulations are made, implemented, enforced and reviewed. It involves all three arms of government – the Executive, Parliament and the Judiciary.
- The performance of the regulatory system is determined by a number of internal and external factors, including pressures from the public and industry for or against new regulation, internal quality control processes (such as Regulatory Impact Analysis and select committee review of bills), judicial oversight of regulator behaviour, and processes for reviewing the currency of regulatory regimes. However, while there are a number of checks, constraints and rules in place to test that a proposed new regulation is in the public interest, few of these controls are binding.
- New Zealand's very centralised constitutional system, and the absence of a "budget constraint" on the production of regulation, creates a bias in favour of more regulation.
- One key constraint in the system is the limited availability of Parliamentary time. New Zealand makes more use of statutes in implementing regulation compared to other countries, and statutes often address matters in considerable detail. One effect of scarce Parliamentary time is that it can be difficult to carry out "repairs and maintenance" on existing legislation. As a result, regulatory agencies often have to work with legislation that is out of date or not fit for purpose.
- The ability of the courts to review the behaviour of regulators and, in many cases, the merits of regulator decisions, is the other significant constraint on the exercise of regulatory power in the system.
- New Zealand does not have strong processes for reviewing regulatory regimes, leading frequently to a "set and forget" mindset.
- The regulatory system's current performance indicates that there is clear room for improvement, in particular around the prioritisation of regulatory efforts, the development and maintenance of the capability needed for effective regulatory implementation, and the ability to identify and resolve areas of risk and to learn from experience.

### 2.1 Introduction

This inquiry has two main objectives: to provide guidance on how to better design new regulatory regimes, and to recommend "system-wide improvements" to the operation of existing regimes. This chapter describes the operation of the overall regulatory system, which is an important contributor to the performance of individual regimes. The "regulatory system" includes "the institutions, principles and processes through which regulations are made, implemented and enforced and reviewed" (NZPC, 2013a, p. 64). In particular, this chapter:

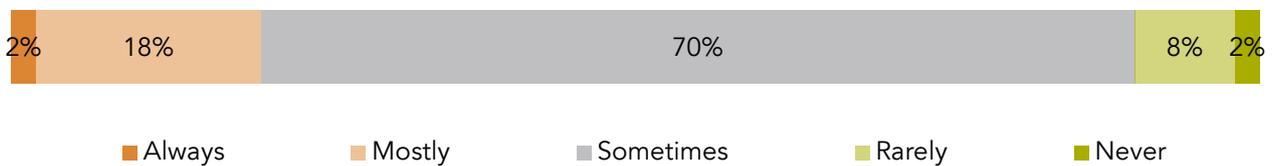
- explains why the Commission has taken a systems approach to analysing government management of regulation;
- describes the core components of the New Zealand regulatory system;
- outlines the pressures, checks, constraints and rules that affect its operation; and then
- provides an overall assessment of the system's performance.

## 2.2 Why focus on the system?

Discussion and analysis of regulatory matters often focuses on specific regimes (eg, competition policy, energy regulation, environmental regulation). However, there are two main reasons why it is useful to think about the production and implementation of regulation at a system level.

First, firms and individuals that have to deal with regulation typically deal with multiple regimes (eg, employment law, workplace safety, industry-specific regimes such as food safety, building and resource consents). The interplay of different regimes can create cumulative costs on businesses and people, especially where there are conflicts between regimes. Only 10% of businesses surveyed by the Commission believed that regulatory requirements in New Zealand were “rarely” or “never” contradictory or incompatible with each other (Figure 2.1). Looking at the overall system, rather than individual regimes, will better allow the conflicts and contradictions to be identified and dealt with.

**Figure 2.1** Businesses that agree with the statement “Regulatory requirements in New Zealand can be contradictory or incompatible with each other”



Source: Productivity Commission; Colmar Brunton.

Second, the production and implementation of regulation in New Zealand relies on a number of common rules, processes and institutions. Weaknesses in these underpinning rules, processes or institutions may affect the performance and effectiveness of a wide range of individual regimes. And, as will be seen later in this report, individual regulators and regimes face a number of common issues, such as capability constraints, how best to apply Treaty of Waitangi principles, and how best to consult with stakeholders affected by regulation. A system-level focus provides opportunities to highlight commonalities, learn from the experience of others, and create efficiencies through shared solutions.

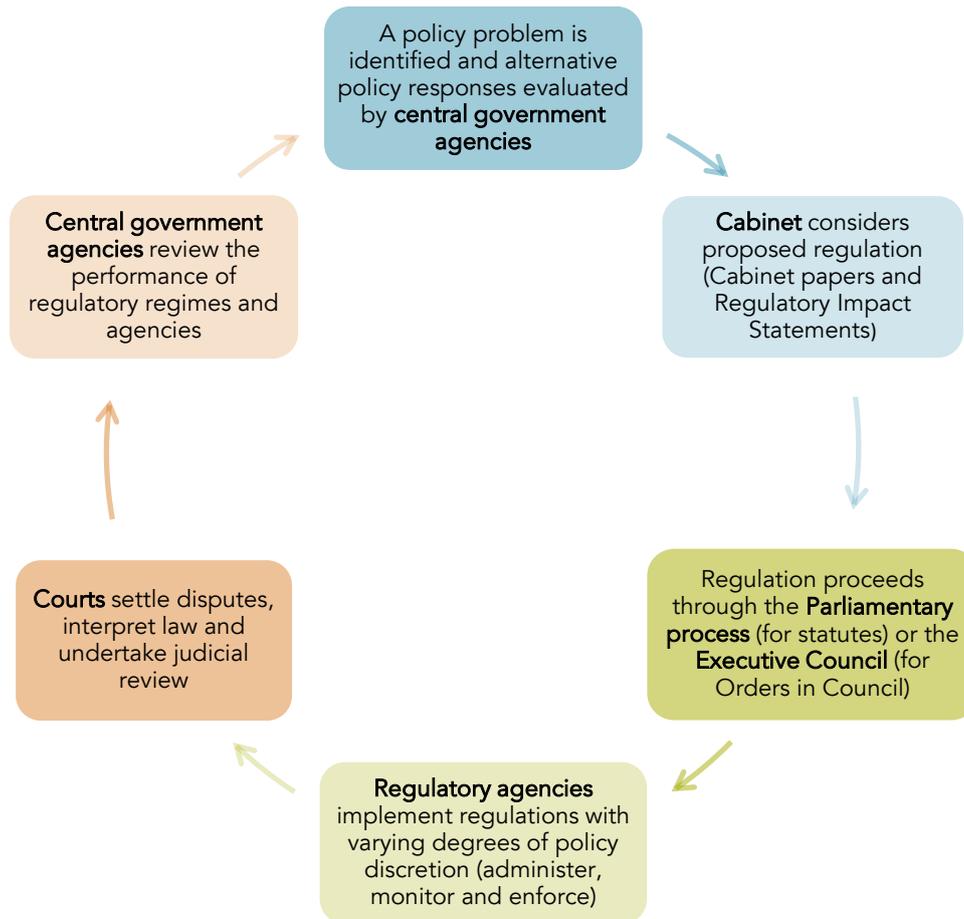
A stylised version of the regulatory system is outlined in Figure 2.2.

In some regimes, the functions in the regulatory system are carried out by different sets of people or organisations than those identified in Figure 2.2. For example, the Electricity Authority, an independent Crown entity, is empowered to make certain amendments to the Electricity Industry Participation Code (the rules that govern the New Zealand electricity market) and to administer and enforce the amended Code. In other regimes, a central government department provides policy advice and administers and enforces regulation (eg, the Ministry for Primary Industries).

Organisations outside of central government can also implement regulation. In the gas industry, a private company (the Gas Industry Company) has a role in identifying policy problems, recommending new regulations, administering regulations and monitoring compliance. Local authorities play significant administrative, monitoring and enforcement roles in a number of regimes (NZPC, 2013a). Self-regulatory arrangements can see industry, professions and the community delegated regulatory responsibilities.

Underneath the national regulatory system sit a number of individual regime-specific systems (eg, the occupational health and safety system). Within each of these individual systems, firms interact with a number of actors and are subject to a range of pressures from external parties. These interactions and pressures can affect how well regulatory obligations are complied with. For example, the need to generate cashflow and make repayments on a loan might lead a firm to cut corners on regulatory requirements. Examples of the types of actors that can have influence in a regime-specific system are outlined in Figure 2.3).

Figure 2.2 The regulatory system



Chapter 3 discusses the challenges of being a regulator in these individual systems. This chapter and Part 2 of this report focus on the national regulatory system. As will be seen in the course of this chapter and the rest of the report, not every function in the system is carried out as consistently or as well as Figure 2.2 implies.

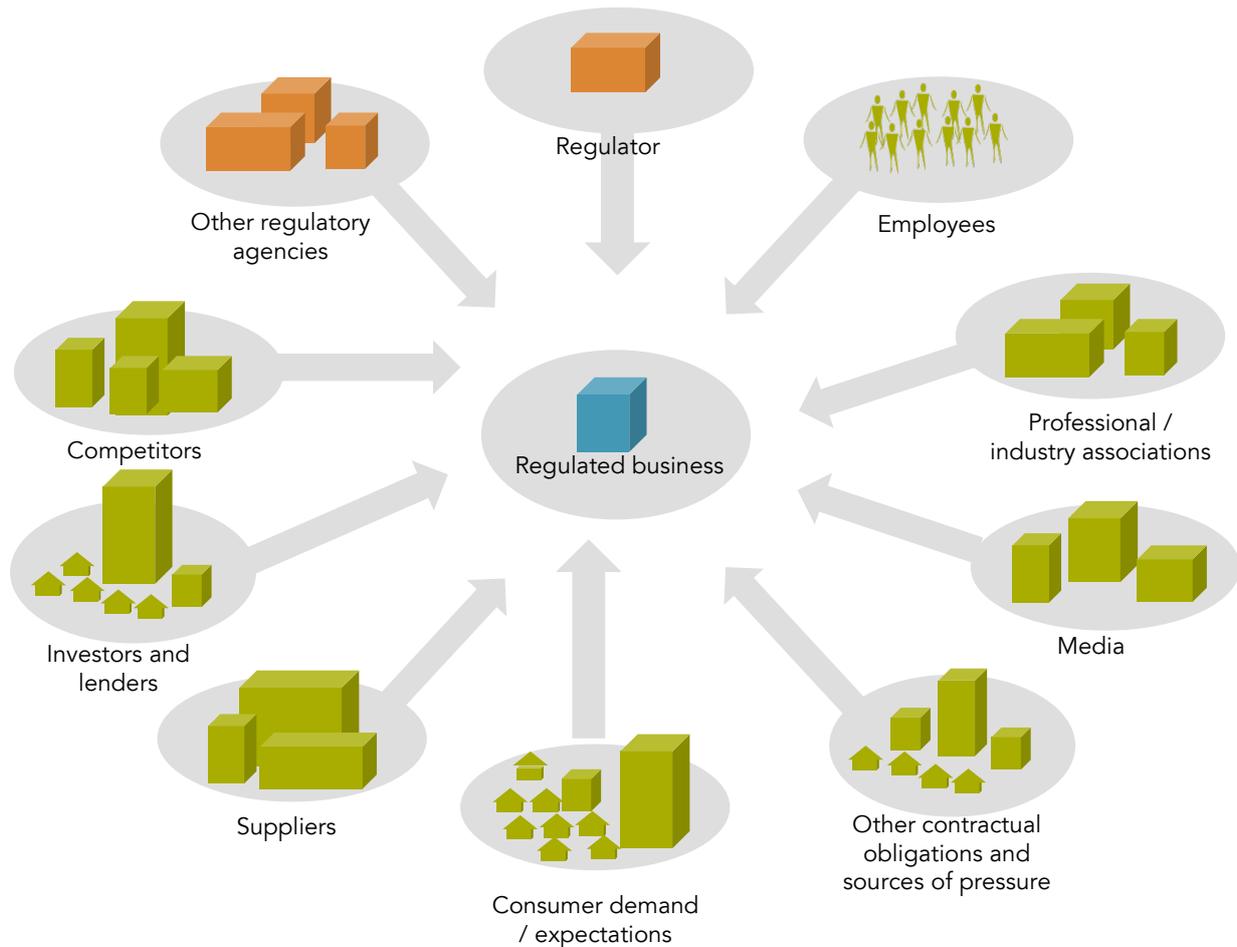
### 2.3 System dynamics are important

The performance of a system is determined by a number of internal and external factors. There may be competing pressures for action, and deliberate or unintended constraints on action. The challenge is to strike the right balance between competing forces and to organise rules and constraints to promote good outcomes.

An example of how these dynamics play out can be seen in the fiscal system. Governments may face pressures from voters to spend more on public services. Governments that wish to respond to this pressure are limited by the revenues they can raise, largely by taxing or borrowing. Both taxation and borrowing are subject to constraints – in the former, by the electorate’s tolerance of the tax levels; in the latter, by the extent to which investors are satisfied with the returns they will receive and the level of risk they face.

Governments that exceed either of these constraints can face significant penalties. If taxation is too high, voters can punish the Government at the next election. If borrowing is too high, investors may demand higher returns and the Government may face a credit rating downgrade, increasing the cost of capital to both the public and private sectors.

Figure 2.3 Actors in a regime-specific regulatory system



In New Zealand's case, the system governing fiscal policy until the early 1990s failed to adequately balance these pressures and constraints. Spending exceeded revenue, public debt increased, and New Zealand's credit rating was repeatedly lowered. After 1994, the rules were changed to encourage governments to:

- commit upfront to clear and measurable fiscal goals;
- impose constraints on themselves as a means of achieving those goals – governments set “budget allowances” for new spending, which they agree to live within; and
- prioritise proposals for new spending against the budget allowance.

By encouraging governments to set clear, objective objectives and publicly commit themselves to achieving the goals, the new fiscal rules helped introduce a more sustainable balance between the pressures to spend and the constraints on revenue.

## 2.4 Measures of the regulatory system's performance

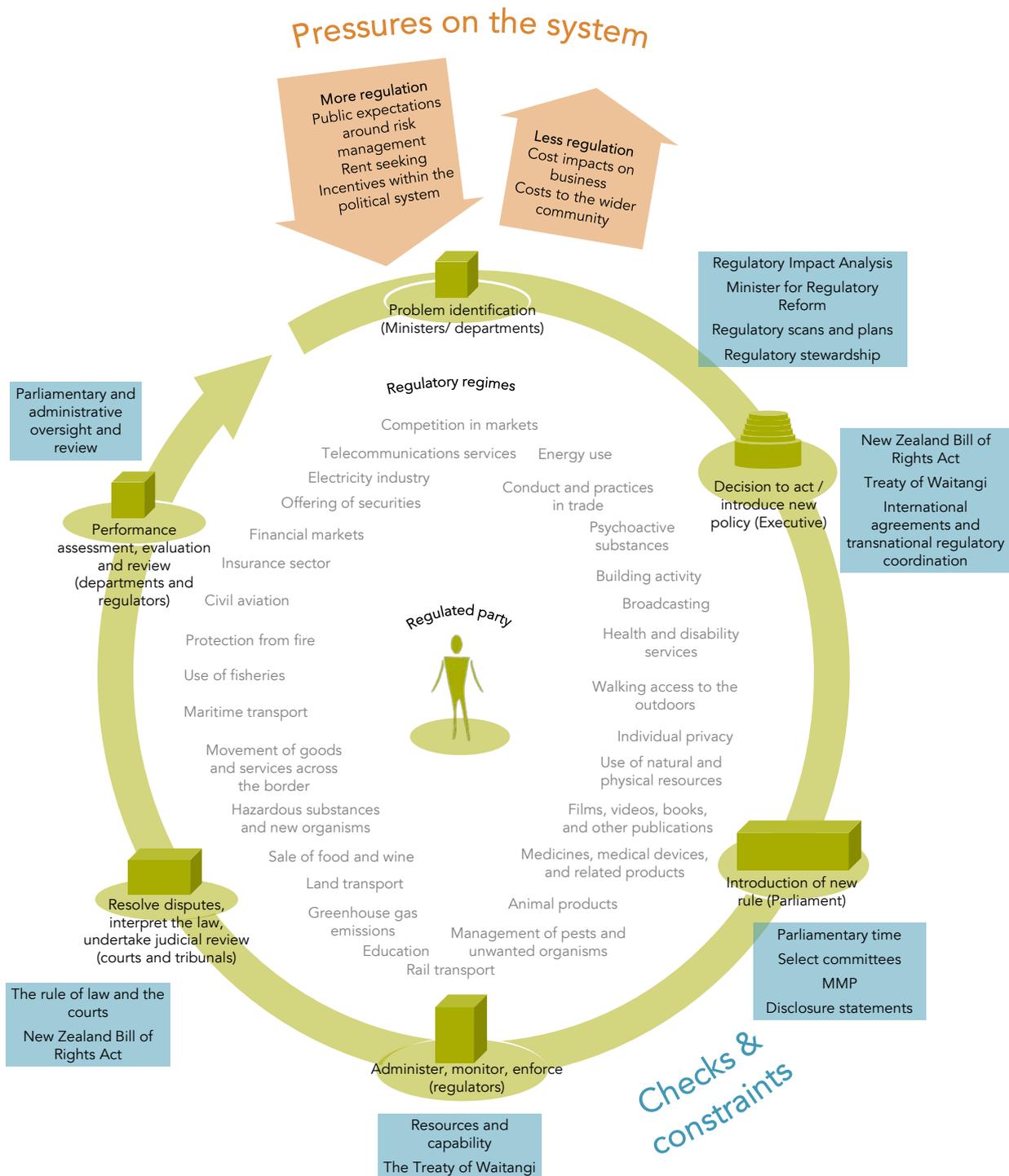
In the context of regulation, the balance and distribution of pressures, checks and constraints, and the effectiveness of institutions, administrative rules and processes, will affect how well the system:

- produces only rules that are needed and proportionate to the issue or risk being managed;
- prioritises effort towards the most significant issues or risks;
- resources the implementation of new rules adequately;
- ensures that new rules are implemented fairly, effectively and in line with the rule of law; and
- understands how it is performing and learns from experience.

In the New Zealand regulatory system, a number of pressures, constraints, checks and rules can be identified. In this chapter, “pressures” are external or internal forces that affect the incentives to produce regulation, and “checks” or “constraints” are factors that limit, shape or direct the production and implementation of regulation. The following sections describe the main pressures and constraints, and assess their impact on regulatory design and implementation (Figure 2.4). In particular, they discuss:

- the sources of pressure on the Government for more regulation;
- countervailing pressures for less regulation;
- the factors that can check or constrain the production and implementation of regulation; and
- the rules and processes within the system that have been introduced to promote good regulatory decision making.

Figure 2.4 Pressures, checks and constraints in New Zealand's regulatory system



## 2.5 Pressures on the government for more regulation

Elected representatives in democracies can face considerable pressures to regulate. These pressures reflect rising public expectations around the management of risks and externalities, rent-seeking by firms or interest groups, and incentives within the political system.

### Public expectations around risk and externalities

A key source of pressure to regulate is growing public expectations that the Government will intervene to reduce risk and manage externalities. These rising expectations partly reflect a more prosperous society; as incomes rise and technologies to identify and prevent injury, death or loss become more accessible, tolerance of potential harms drops. Pressures particularly rise in the aftermath of a crisis or regulatory failure, where risk is more immediate in the public mind.

Similarly, as knowledge grows of the extent and effects of negative externalities (eg, smoking, pollution of waterways), the community looks for mechanisms to manage them. A number of participants in the Commission's inquiry into local government regulation identified rising pressures on councils to deal with social issues such as alcohol abuse and associated crime as leading to greater use of regulation (NZPC, 2013a).

The increasing complexity and uncertainty of modern life is another contributor to the demand for regulation. Giddens (1999) attributes the growth of the "risk society" to the increasing influence of science and technology and the corresponding demise of nature and tradition.

A world which lives after nature and after the end of tradition is one marked by a transition from external to what I call *manufactured risk*. Manufactured risk is risk created by the very progression of science and technology. Manufactured risk refers to new risk environments for which history provides us with very little previous experience. We often don't really know what the risks are, let alone how to calculate them accurately in terms of probability tables...In a world where one can no longer simply rely on tradition to establish what to do in a given range of contexts, people have to take a more active and risk-infused orientation to their relationships and involvements. (p. 4)

Some submitters to the inquiry argued that public tolerance levels for risk presented problems for regulation in New Zealand. The Civil Aviation Authority listed increasing "public expectations of 'no-risk' results in high-risk aviation sports/activities" and "[m]edia [that] seeks to 'blame' regulators (and Investigators) for failure to 'keep people safe' in high-risk aviation sports/activities" as challenges for their compliance and enforcement efforts (sub. 6, p. 41). Federated Farmers said that:

...what is clear to farmers is that New Zealand has a problem with both the volume of legislation and regulation passed and its quality. This is worsened by public, media, and political "angst" over real and imagined risks, accidents, and misdeeds. This angst has encouraged in both central and local government a culture of excessive risk aversion and a "government knows best" mentality. (Federated Farmers, sub. 11, p. 10)

The Ministry for Primary Industries observed that in several of the sectors it regulated, "there is a gap between the science-based risk assessments made by the regulator and public perceptions about risk" (sub. DR 102, p. 13). Such gaps may create pressure for disproportionate enforcement approaches.

### Rent seeking

In some cases, regulation may be sought to protect an industry or group against competition. Stigler (1971) argued that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit" (p. 3). In particular, industries with sufficient political power seek regulation to restrict new entrants to their markets, encourage complements and restrict substitutes, and introduce price control to "achieve more than competitive rates of return" (Stigler, 1971, pp. 5-6). Political representatives may be inclined to respond, because political systems are "calculated to implement all strongly felt preferences of majorities and many strongly felt preferences of minorities but to disregard the lesser preferences of majorities and minorities" (p. 12). Although regulation imposes costs on the public, these costs are generally not large enough at the level of the individual to warrant attention or generate widespread resistance.

Rents extracted from regulation may not be stable or permanent. Becker (1983) argued that regulation was the result of competition between pressure groups. The introduction of new regulation may encourage competing interests to contest, and undermine, any resulting rents or inefficiencies. Peltzman (1989) posited that some regulation may undermine the wealth of protected firms (eg, prices are fixed, but costs rise), leading to regulatory controls being replaced or abandoned. Peltzman cites the deregulation of rail, airlines, stockbrokers and banking in the United States as examples of this theory in practice.

## Incentives within the political system

Representative democracy and political parties provide “a vital link between the people, Parliament and the government” (Cabinet Office, 2008, p. 4). It is appropriate and unsurprising, therefore, that the political system will often respond to pressure for regulation. At the same time, however, its role is also to act in the public interest, which involves testing the need for new regulation, assessing the quality of its design, and holding regulators to account for carrying out their mandate effectively, efficiently and reasonably. Incentives within the political system mean that these public interest activities may not always be carried out consistently. These incentives include:

- constant media scrutiny, which encourages rapid responses to risks, failures or incidents and discourages politicians from looking for and reporting evidence that their regulatory initiative is ineffective;
- a short Parliamentary term, which puts pressure on politicians to deliver results quickly and minimise the use of House time; and
- Party disciplines, which prevent MPs from challenging or critically scrutinising regulatory proposals that emanate from their side of the House (New Zealand Treasury, 2011a, pp. 9-10).

## 2.6 Pressures for less regulation

Pressures to refrain from regulation or to remove existing regulation can emanate from within government, or from segments of the community. The ability of these pressures to crystallise into policy can depend upon the ability of parties affected by current or potential regulation to organise, the strength of analysis opposing or supporting regulation, and the tenor or mood of public debate (Derthick & Quirk, 1985).

Analysis has pointed to the importance of leadership roles and institutions and of public sentiment in New Zealand and Australia’s experiences of deregulation. Paul Kelly’s history of economic reform in Australia cites the influence of the Industries Assistance Commission and non-government think tanks in laying the groundwork for change (Kelly, 1992, pp. 44-48); in New Zealand, that role was most prominently played by the Treasury (Easton, 1997, pp. 85-98). In both countries, public discontent with poor economic performance created an environment that enabled reform (Kelly, 1992, p. 35; James, 1989, p. 5).

### Cost impacts on business

Business may oppose new or changed regulation because of its cost impacts. Banks (2005) argues that the experience of deregulation during the 1980s and 1990s created a constituency for regulatory reform in Australia, by exposing business to greater competition “with the desirable effect of making them more conscious of the need to reduce their costs and raise their productivity” (p. 2). 77% of New Zealand businesses surveyed by the Commission who had experienced changes to regulation reported that these had led to increased costs (Figure 2.5).

A number of submissions argued that regulatory compliance costs were a significant issue for New Zealand firms. Federated Farmers noted that “farmers consistently tell us that one of their biggest concerns (often bigger even than the exchange rate or the weather) is the burden of regulation and associated compliance costs” (sub. DR 65, p. 2). BusinessNZ observed that compliance costs were “[o]ften top of mind for many businesses” and that new regulations had a “shockwave” effect, with compliance costs rising dramatically after the introduction of new rules (sub. DR 66, p. 3).

**Figure 2.5 Impacts of changes to regulation on business**

Source: Productivity Commission; Colmar Brunton.

Additional or changed regulation can increase the costs to business of raising finance and discourage investment. This can be the case particularly in sectors where assets are expensive, have long lives and are specific to the industry (ie, they are of little use to other firms and cannot be easily sold to recover capital). Without some confidence over the security of their revenue (which can be affected by regulatory decisions over prices), firms may see investing in replacement or new assets as too risky.

Repeated changes to the underlying regulatory frameworks have contributed to relatively poor risk ratings for some New Zealand industries, particularly electricity and telecommunications. This point was made to the Commission in its engagements with credit rating agencies; although many of New Zealand's economic regulatory regimes are generally sound, they are also relatively new. One key criterion that rating agencies use to assess risk is "consistency in the regulatory framework over time", particularly with regards to decisions over the pricing of regulated firms. In other countries, regulated utilities have been through several cycles of re-setting prices, allowing investors and rating agencies to gain confidence about the consistent application of regulation over time. By comparison, New Zealand is still in the process of bedding in its first set of regulated prices and information disclosure requirements for lines companies, gas pipeline firms and airports. As a result, New Zealand regulated utilities were recently assessed by Standard and Poor's as having a higher risk profile than equivalent sectors overseas (information provided to the Commission during an engagement meeting).

### F2.1

Frequent changes to the underlying regulatory frameworks have contributed to New Zealand utilities being assessed as having a higher risk profile than equivalent sectors overseas.

## Costs to the wider community

Regulation may be resisted because it is too inflexible or imposes undue costs on the community. This can particularly be the case in dynamic industries, where regulation cannot keep up with change, or where its bluntness prevents or inhibits potentially positive developments from emerging. For example, Thierer (2014) argues that the application of the "precautionary principle" – the principle that "new innovations should be curtailed or disallowed until their developers can prove they will not cause any harms" (p. vii) – in regulating technology reduces choice and welfare.

Social learning and economic opportunities become far less likely under a policy regime guided by precautionary principle regulatory schemes. In practical terms, it means fewer services, lower quality goods, higher prices, diminished economic growth, and a decline in the overall standard of living. Put

simply, living in constant fear of worst-case scenarios – and premising public policy upon them – means that best-case scenarios will never come about. (p. viii)

Finally, while many societies have experienced a falling tolerance for risk, the public's tolerance for regulation is not limitless. Regulatory requirements that are judged to create excessive ("nanny state") burdens – especially relative to the risk being managed – may lead to public opposition.

## The balance of pressures favours regulation...

While there is insufficient evidence to objectively measure the relative strengths of the pressures to regulate or not, it is clear that the regulatory system has no equivalent to the external pressure placed by taxpayers, bondholders and credit rating agencies on the government through the fiscal system. As Gary Banks has observed, regulation is often an "off-budget solution" (Banks, 2005, p. 5). Policymakers generally do not directly bear the costs of regulation themselves, or experience the failure of regulations they introduced. Regulatory costs are dispersed throughout the community and regulatory failure may occur or be revealed some time after the rule was introduced. This suggests that the disciplines placed on policymakers around regulation are weaker than those which affect government spending.

### ...as does the constitutional system

The propensity to regulate is facilitated in New Zealand by a highly centralised constitutional system that lacks many of the checks and balances available in other countries. Matthew Palmer (2007) notes that New Zealand:

...inherited the doctrine of parliamentary sovereignty from Westminster. Yet, as a unitary state with no supreme law, no federalism, no written constitution and no membership of a supra-national body that binds domestic laws as does the EU, New Zealand now manifests this doctrine in an even purer form than the United Kingdom. (p. 582)

Other factors contributing to a powerful central government include Parliamentary procedures (such as urgency) which can permit the passing of legislation with limited scrutiny, and the lack of strong industry bodies (Gill, 2013). Comparatively few functions are delegated to local or regional government; central government plays a far more dominant role in public administration in New Zealand than is the case in most other OECD countries (OECD & Korea Institute of Public Finance, 2012).

These features have a number of implications for the design and implementation of New Zealand regulatory regimes. First, Cabinet plays a very strong role in developing regulatory policy, including technical matters and lower-level rules in some cases (Gill, 2011). Palmer (2006) commented that it is "notable in New Zealand that Cabinet decisions get down to a level of detail and specificity that is not found even in Australia" and observed that Cabinet has a much more central role in government in New Zealand than is the case in the United Kingdom (p. 21).

Second, individual ministers are central and often active "customers" in many New Zealand regulatory systems. Conway (2011) noted "a very 'hands on' approach from some government ministers, who are often involved in regulatory decisions and enforcement at a very detailed level" (p. 22).

#### F2.2

The balance of pressures from industry and the community, and New Zealand's very centralised constitutional system, create a bias in favour of more regulation.

Third, New Zealand appears to make more use of primary legislation in its regulatory regimes than other jurisdictions and statutes often address matters in considerable detail (see, for example, Frankel & Yeabsley, 2013; Parliamentary Counsel Office, sub. DR 88, p. 8). New Zealand's heavy use of statute, compared to other countries, is discussed in more detail in Chapter 9. The Commission heard from members of the Regulations Review Committee (RRC) that the reluctance in New Zealand to delegate rule-making powers reflects a desire by parliamentarians to ensure stability and accessibility of regulation for the public, and to contain scope creep by regulators.

**F2.3**

New Zealand appears to make more use of primary legislation in its regulatory regimes than other jurisdictions, and statutes often address matters in considerable detail.

## 2.7 Checks and constraints

A number of checks and constraints shape the operation of the regulatory system in New Zealand, including limited time on the Parliamentary agenda, the Mixed-Member Proportional (MMP) electoral system, the Treaty of Waitangi, international agreements, the rule of law and the role of the courts, the New Zealand Bill of Rights Act 1990 (BORA), limited fiscal and human resources, and oversight of regulators by Parliament and government departments. These constraints are spread throughout the regulatory system and vary in terms of strength. Some constraints have been deliberately designed to constrain and check the powers of the government, while other constraints on the ability to regulate are unplanned. The strongest constraints – in terms of their ability to frustrate a government's intentions – occur at the point where new rules are introduced (Parliamentary time) and implemented (resources, especially capability) and where the new rule has to be interpreted (the courts).

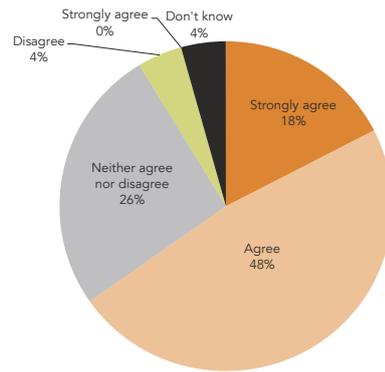
### Parliamentary time

Given the strong reliance on statutes, the availability of time on the Parliamentary agenda is one of the major constraints in the New Zealand regulatory system. New Zealand has a relatively short electoral term and Parliament's rules of procedure require the House of Representatives to sit "in total on about 90 days in the calendar year" (House of Representatives, 2011, Standing Order 79(3)). One effect is that it can be difficult to find time in the Parliamentary calendar for the "repairs and maintenance" of existing legislation. This puts pressure on regulators working with outdated statutes. Maritime New Zealand commented:

There is so much legislation on the NZ statute book that even if changes were identified due to perception of risk, the ability to make fundamental shifts is often hampered by more urgent matters on the political and social landscape. This tends to lead to crisis driven law-making (i.e. policy initiatives that are only made in response to a significant event or crisis) at the expense of clearly programmed initiatives that ensure maintenance of regulatory stock. As a result regulators are often left to perform their functions within old, outdated regimes with seemingly increasing public and political expectations they will "adjust" to the changes within those outdated regimes. For entities that are creatures of statute, this presents particular challenges because they are limited to perform the functions given to them by law. (sub. 15, p. 3)

The Department of Internal Affairs said that a lack of progress in updating gambling legislation "cost the Department thousands of dollars in legal costs and left the Department and the Gambling Commission without power to suspend a license for past breaches of the Act for a year" (sub. DR 63, pp. 2-3). The Ministry of Transport noted that the inflexibility of their current framework impeded the introduction of new technologies and created an "increase in regulatory compliance and administration costs as increased use of 'work-arounds' are required" (sub. 39, p. 3).

Almost two-thirds of public sector chief executives who participated in a Commission survey on regulatory regimes either strongly agreed or agreed with the proposition that agencies with regulatory functions "often have to work with legislation that is outdated or not fit for purpose" (Figure 2.6). A further 26% of chief executives neither agreed nor disagreed.

**Figure 2.6** “Agencies often have to work with legislation that is outdated or not fit for purpose”

Source: NZPC, 2014b.

#### F2.4

It can be difficult to find time on the Parliamentary calendar for “repairs and maintenance” of existing legislation. As a result, regulatory agencies often have to work with legislation that is out of date or not fit for purpose. This creates unnecessary costs for regulators and regulated parties, and means that regimes may not keep up with public or political expectations.

## Select committees

All legislation (except bills under urgency) must be referred to a select committee for consideration under Parliament’s rules of procedure (Standing Orders). Select committees generally seek submissions from the public on the bills before them. As a result, the public can have a significant ability to influence the design of regulatory systems in New Zealand. David McGee, the former Clerk of the House of Representatives, noted that, through select committees, “the public is enlisted into the legislative process in a way that does not occur with overseas legislatures. Select committee consideration of a bill and the public’s ability to participate in it are regarded as akin to democratic rights” (McGee, 2007, p. 424). George Tanner, former Chief Parliamentary Counsel, said of the select committee process: “At its best, it works well and is probably a more effective scrutiny process than many upper Houses around the world” (Frankel & Yeabsley, 2013, p. 13).

Malone’s analysis of law-making in New Zealand before and after the introduction of the Mixed-Member Proportional (MMP) electoral system concluded that the importance of select committees has grown under MMP (Malone, 2008). It is increasingly common for committees to be chaired by non-government Members of Parliament (MPs) and for non-government MPs to make up the majority of committee membership. As a result, “ministers under MMP must work harder and be more flexible as to the content of their bills in order to secure something approaching the level of control ministers enjoyed in relation to select committees under FPP” (Malone, 2008, p. 168).

However, the Executive has a number of options for working around difficult committees, including referring bills to other committees where government MPs make up the majority of members, or convincing support parties to vote down a select committee’s recommended changes to a bill. The effectiveness of select committees as a constraint on regulators also appears to depend on their membership. Scott comments that the:

...effectiveness of select committee in reviewing departmental performance against specifications has been disappointing, with some exceptions. Most notably two former finance ministers on the finance and expenditure committee (the Rt Hon David Caygill and later the Hon Ruth Richardson), were skilled and vigorous in exploring the implications of performance information for government policy and administration and in exposing performance weaknesses. Typically, however, select committees do not attempt to examine performance systematically, but rather pursue particular issues of interest to individual members, sometimes including matters beyond the formal terms of reference of the hearings. (Scott, 2001, p. 180)

## MMP

The move to the MMP electoral system in 1996 has acted as a brake on the Executive's ability to pass legislation, especially in comparison with the previous First-Past-the-Post system. Palmer and Palmer (2004) concluded that MMP had "slowed down the system of government, made it less friendly to executive power, increased the distinction between the Executive and Parliament and revitalised Parliament" (p. 13). Malone (2009) agreed, noting that under MMP, the number of government bills passed each year has fallen since 1996 and government bills take longer to pass through all their stages than was the case under FPP. According to Malone (2008), this slower pace and lower output reflects the fact that the Executive under MMP has to devote greater time and energy to building and maintaining parliamentary support for legislation and cannot resort to urgency as easily.

However, while MMP has slowed the pace of government and forced policy changes in some areas, the Executive continues to have significant scope to implement policy:

...it is relatively uncommon for governments to find themselves in a position where they are unable to legislate on account of a lack of a parliamentary majority. It is true that changes may need to be made to proposals to take into account a policy position of a non-government party, but the main thrust of a policy will invariably survive intact and be passed into law. Scores of major government bills have been passed by MMP parliaments. (Malone, 2008, p. 234)

The extent to which MMP acts as a constraint on the production of regulation depends on the issue at hand, and whether it has captured the attention of the public. One recent example where MMP has contributed to halting regulatory change is the refusal of Parliamentary parties to support the government's proposal to override by legislation the Commerce Commission's decisions on the regulated prices for broadband delivered through Chorus' network (Keall, 2013).

Because MMP can act as a constraint on government legislation, it may have strengthened incentives on the Executive to use other forms of regulation (eg, legislative instruments) to advance government policy.

The power to make regulations assumes greater importance under MMP. Where there are governments with minority support in Parliament or a coalition with some uncertainties within it, a Cabinet may not always want to run the gauntlet of Parliament to get its policies adopted. It may instead use its power to the full to make regulations from statutes already passed. (Palmer & Palmer, 2004, pp. 207-208)

## The Treaty of Waitangi

The Treaty of Waitangi places "solemn obligations on the Crown and Parliament" to consider the rights and interests of Māori when developing and creating regulation, and to do so reasonably and in good faith (Joseph, 2014, p. 562). In addition, "the courts will not lightly ascribe to Parliament an intention to permit conduct that is inconsistent with Treaty principles" (ibid). In general this discourages governments from regulating over Treaty rights and interests, not least since to do so requires a very clear legislative intent.

The obligations on the Crown and Parliament are reflected in official guidelines and rules. The Legislation Advisory Committee (LAC) states that there is a general presumption that Parliament will legislate in line with the principles of the Treaty and will appropriately apply the principles on issues of relevance to Māori (LAC, 2012a). The Cabinet Manual requires that all proposals to introduce a new bill to Parliament clearly specify whether the proposed bill complies with the principles of the Treaty, and identify any variances (Cabinet Office, 2008). Similar requirements apply to proposed new Orders in Council (Cabinet Office, n.d.). Disclosure statements for government legislation must outline the steps that have been taken to determine whether the policy to be given effect by the bill is consistent with Treaty principles (New Zealand Treasury, 2013a).

A number of individual regimes oblige regulators to act in line with Treaty principles, acknowledge Māori interests in regulation, or directly involve Māori in the implementation of regulation. Prominent areas of Māori involvement include customary fisheries, joint management agreements, and iwi management plans. There has also been a rising interest by some Māori in other taonga – such as language, education and health – as well as environmental and natural resources. The initial proposal for a joint trans-Tasman therapeutic products regulator failed in part because of concerns from Māori that the new regime would limit the use of traditional medicines or claims to intellectual property rights in traditional medicines (von Tigerstrom, 2007).

However, although the requirements and practices outlined above provide protection for Māori interests, this protection is not absolute. Joseph (2014) describes the unusual position of the Treaty in the New Zealand constitution.

The reach of the Treaty must not be overstated. It does not impose on governments a duty to consult Maori before taking legislative or executive action affecting Maori. Nor is the Treaty a bill of rights or fundamental constitutional document controlling Parliament's powers of legislation. But nor should the reach of the Treaty be understated. The Treaty's institutional presence permeates the processes of executive government. (p. 38)

## International agreements and transnational regulatory coordination

International agreements (such as treaties) and other forms of transnational regulatory coordination may limit the ability of governments to introduce regulation, or require governments to regulate in a way they might not otherwise have done. Transnational coordination tools play a significant part in New Zealand regulation. Former Supreme Court justice Sir Kenneth Keith stated in 2004 that "New Zealand surveys of the Statute Book have concluded that about 200 of the approximately 600 public statutes appear to raise issues concerning New Zealand's international rights and obligations" (Keith, 2004).

The degree and nature of this constraint depends on the coordination mechanism used. For example, World Trade Organization (WTO) agreements require that New Zealand governments give citizens of other member countries the same treatment as New Zealanders ("national treatment") and do not discriminate between trading partners ("Most Favoured Nation"). As a signatory to the 1944 Convention on International Aviation, New Zealand is obliged to comply with the International Civil Aviation Organization's (ICAO) standards and recommended practices on global aviation, unless it is impracticable to do so. Where New Zealand's domestic rules vary from ICAO's standards and practices, New Zealand must report this to ICAO. Other forms of coordination – such as unilateral recognition of another country's standards – can provide more freedom for governments to move, allowing domestic rules and processes to be changed.

Although transnational coordination can impose restrictions or duties on New Zealand authorities, it also confers benefits on New Zealand citizens and firms. For example, the WTO agreements have reduced barriers to New Zealand selling its products overseas, and provide protection against arbitrary or discriminatory barriers being re-imposed in the future. The WTO agreements also provide mechanisms of redress for countries who have been subjected to discriminatory treatment. Such protections are critically important for small trading countries like New Zealand.

## Resources and capability

As a distant country with a small population and per-capita incomes below the Organisation for Economic Co-operation and Development (OECD) average, New Zealand faces a number of tensions and trade-offs that affect how its regulatory regimes are designed and run.

Limited resources mean that New Zealand has to be selective in the regulatory issues it tackles or approaches it adopts. As the Reserve Bank of New Zealand commented:

Our smaller market size means that it is not always practical or in our best interest to mirror every single regulatory initiative or institution that significantly bigger economies have. Those bigger economies are usually in a position to dedicate more resources to regulatory affairs and to set up specialised regulatory institutions. (sub. 9, p. 1)

Vector argued that limited fiscal resources have led to an excessive focus in New Zealand on reducing costs in the design of regulatory regimes:

...there has been a general reluctance on the part of officials and Ministers to establish regulatory bodies across all of New Zealand's regulatory regimes and/or set up formal arrangements for oversight and review... A reluctance to consider proper separation of regulatory roles in order to manage costs, which has been a barrier to regulatory reform in New Zealand in the past, is arguably misplaced. (sub. 29, pp. 25 and 27)

Arguably the most significant resource constraint New Zealand faces is expertise. A number of regulatory regimes rely on specialised technical expertise, yet New Zealand's size provides fewer opportunities to specialise than are available in larger-scale economies. Searancke noted:

New Zealand has relatively limited competition in many markets and lack of depth or capability amongst expert professions and advisors. This increases the risks for us that regulatory systems which rely for their effectiveness on vigorous competitive disciplines, well-developed markets for information and readily available expertise, may not be effective, or as effective, in New Zealand. (Searancke, 2013, pp. 1-2)

Even in areas where New Zealand has a comparative advantage, it can be difficult to attract and retain capability. A recent review of the dairy food safety regulatory regime concluded:

The shortage of experienced people exists at all levels of the system, whether it be putting together risk management programmes; carrying out accreditation and verification; providing leadership or technical know-how inside the regulator; or working within the ranks of the industry itself. Interviewees spoke of the difficulty of attracting such dairy experts, and also of that expertise drifting away from regulatory agencies and concentrating in dairy companies. As one interviewee said, there is a 'very small gene pool' available in New Zealand. (Government Inquiry into the Whey Protein Concentrate Contamination Incident, 2013, p. 24)

Expertise constraints also affect how well regulatory regimes are designed. In the Commission's engagements with senior government and industry officials, it was noted that designing a regulatory regime in New Zealand could be a "once in a career" experience for some officials, and that lessons learned were often not well retained or shared with others.

## The rule of law and the courts

Like other agents of the state, regulators must act in accordance with the law and can have their decisions or behaviour challenged in the courts. The rule of law and the role of the courts as independent arbiters of legality constitute another major constraint in the regulatory system.

A central principle of the rule of law is that state power, to the extent that it affects individuals, must be exercised according to binding general rules made and known in advance, and must be of sufficient specificity to allow individuals to know with tolerable certainty their rights, obligations, and liabilities (Box 2.1).<sup>1</sup>

### Box 2.1 The rule of law

The rule of law has been defined in many ways, but in Commonwealth countries, it often encompasses such ideas as "the absence of arbitrary power on the part of the government", equality before the law and the right to due process, and the central role of the common law which encapsulates such concepts as "the right to personal liberty or the right to public meeting" (Dicey, 1889, pp. 173-83).

Lord Bingham, former Lord Chief Justice of England and Wales, identified eight principles of the rule of law.

- The law should be accessible and so far as possible, intelligible, clear and predictable.
- Questions of legal right and liability should ordinarily be resolved by applying the law and not the exercise of discretion.
- The laws of the land should apply equally to all, save to the extent that objective differences justify differentiation.
- Ministers and public officers at all levels must exercise the powers conferred on them in good faith, fairly, for the purpose for which the powers were conferred, without exceeding the limits of such

<sup>1</sup> For classic accounts of the rule of law, see Fuller (1964) and Raz (1979).

powers and not unreasonably.

- The law must afford adequate protection of fundamental human rights.
- Means must be provided for resolving, without prohibitive cost or inordinate delay, *bona fide* civil disputes that the parties alone are unable to resolve.
- Adjudicative procedures provided by the state should be fair.
- The rule of law requires the state to comply with its obligations in international law as in national law.

Source: Bingham, 2010; Dicey, 1889.

The courts have three main ways to constrain the implementation of regulation.

- The courts have the power to declare a disallowance instrument invalid if it goes beyond the scope of authority granted by Parliament in statute.
- The courts can review a regulator's decision or actions for their legality, and in many cases can review the merits of regulator decisions.
- The courts may interpret legislation narrowly, or in the context of other law which limits a regulator's powers or freedom of action.

One key source which may be called upon when interpreting legislation or reviewing regulator actions is the common law. The common law consists of "judge-made rules built up over the years by judges in New Zealand, as influenced by such rules developed in other common law jurisdictions such as Australia, Britain, Canada and the United States" (Palmer & Palmer, 2004, p. 181). It has developed over centuries, and is "organised around a respect for individual dignity and individual possession of property, and the supremacy of Parliament as a source of law" (LAC, 2012a). Examples of common law principles are noted in Box 2.2.

### Box 2.2 Fundamental common law principles

The LAC has outlined the following "illustrative, not comprehensive" list of common law principles.

- The dignity of the individual is a paramount concern of the law.
- The principle of legality which essentially means that legislation will be interpreted in a manner consistent with legal principles.
- The citizen is entitled to have access to the courts, despite legislation which might be construed to remove it.
- Construction<sup>2</sup> of legislation is a matter for the courts and not the Executive.
- No-one will be required to perform something that is impossible, from which follows the presumption against construing legislation as having retrospective effect.
- No-one is guilty of a crime who has not committed a criminal act with knowledge of the facts that make it criminal.
- The citizen is not required to answer questions by anyone, including officials.

<sup>2</sup> ie, interpretation of the law's meaning.

- The principle in favour of liberty of the subject.
- No-one may be penalised except by a general measure rather than by act of attainder.<sup>3</sup>
- No tax will be imposed except by Parliament.
- Property will not be expropriated without full compensation.
- Everyone exercising public authority must act legally, responsibly, and honestly. These requirements include, among many others:
  - giving a person who may be adversely affected by a decision the opportunity to respond; and
  - satisfying minimum standards of competence.
- The principle of the rule of law that no-one, including the Crown in the exercise of executive authority, is above the law.
- All are treated equally under the law.
- New Zealand's constitutional conventions are not infringed.
- New Zealand law conforms with both international law and our treaty obligations (in particular, that it conforms with the Treaty of Waitangi).
- Delegated authority must be exercised within the power actually conferred, despite use of subjective language.
- Foreign tax legislation is unenforceable in New Zealand courts.

*Source:* LAC, 2012a.

The protections provided by the courts and common law have limitations. Under New Zealand's constitutional system, statute law is superior to the common law and Parliament has "full power to make laws" on any matter (section 15, Constitution Act 1986). This power includes the ability to override common law principles and vested rights, and a number of existing statutes violate some of the principles outlined in Box 2.2.

Unlike judiciaries in a number of other countries, New Zealand courts do not have the power to strike down legislation. However, there is debate among legal scholars and practitioners about the limits of Parliamentary sovereignty. Former President of the Court of Appeal Lord Cooke expressed the view in judgments and speeches that there may be some "truly fundamental rights and duties" that Parliament may not be able to override (Cooke, 1988). Although this view has not been universally accepted, the LAC guidelines cite Justice Baragwanath's comment on the balance between the Executive and Judiciary that the "process is like that of a spring: as the Crown attempts to depress the court's power of control of constitutional balance the courts' resistance increases progressively" (LAC, 2012a, p. 4). The Committee goes on to state that it is "the responsibility of the Executive and of Parliament to avoid imposing such pressures on the courts as to risk constitutional brinkmanship" (ibid).

## F2.5

The ability of the courts to review the behaviour of regulators and, in many cases, the merits of their decisions, is one of the most significant constraints on the exercise of regulatory power in the system.

<sup>3</sup> Bills or Acts of attainder are laws that declare a person or group of people guilty of a crime and punish them without a trial. Some countries (eg, the United States) have constitutional bans on acts of attainder.

## New Zealand Bill of Rights Act

The courts may also call on BORA in reviewing the conduct of regulators. BORA protects a range of civil and political rights from being infringed by the legislative, executive, or judicial branches of government, or by “any person or body in the performance of any public function, power, or duty conferred or imposed on that person or body by or pursuant to law” (s 3). The rights protected may be “subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society” (s 5).

Regulatory decisions are reviewable by the courts for breach of BORA, and may be struck down if:

- they intrude on a right or freedom;
- the intrusion is neither reasonable nor demonstrably justified; and
- no authorisation for the intrusion can be inferred from the empowering act.

The effect is that administrative decisions must be proportionate – justified in the circumstances, in a free and democratic society – to withstand BORA challenge through judicial review (see Chapter 11).

Section 7 of BORA requires the Attorney-General to report to Parliament on aspects of proposed legislation that appear “to be inconsistent with any of the rights and freedoms contained in this Bill of Rights” (BORA, s 7).<sup>4</sup> The aim of this requirement was to provide an “important set of messages to the machinery of Government itself...that certain sorts of law should not be passed, that certain actions should not be engaged in” (Sir Geoffrey Palmer, quoted in Butler, 2006, p. 3).

There are a range of opinions about the effectiveness of section 7 as a check on Parliament, with some arguing that it has been “a potent weapon”, creating “considerable hesitation about bringing to Parliament measures that require a negative report” (Palmer & Palmer, 2004, p. 325) and improving the overall legislative process (Keith, 2002, p. 15). Others, however, question whether the deterrent effect has worked as hoped, or worked at all (Joseph, 2007, p. 1174; Rishworth, 2005, p. 104; Geddis, 2009, p. 487).

BORA does not explicitly recognise the right to own property. The issue of how well property rights are protected in New Zealand has been frequently raised in the context of regulatory policy (see, for example, Regulatory Responsibility Taskforce, 2009; Evans, Quigley & Counsell, 2009). A recent report of the Constitutional Advisory Panel recommended that the Government set up a process, with public consultation and participation, to explore in more detail options adding property rights to BORA, as well as economic, social, cultural and environmental rights (Constitutional Advisory Panel, 2013).

## Parliamentary and administrative oversight and review

In addition to the courts, the regulatory system offers a number of opportunities to review draft and current regulations, or the conduct of regulators. These include the parliamentary Regulations Review Committee, review of bills by the LAC, performance reviews by the Office of the Controller and Auditor-General (OAG), monitoring of Crown entity regulators by departments and ministers, and reviews of regulatory frameworks by policy ministries.

Some of these organisations have considerable powers. The RRC, for example, reviews hundreds of regulations each year and hears complaints from the public about regulations. The RRC can draw the attention of the House to a regulation if it meets one of a number of specified grounds (Box 2.3) and can recommend changes to draft regulations or regulation-making powers in bills.

Members of the RRC can recommend to the House that a regulation be disallowed (overturned) by moving a motion of disallowance. This takes effect after 21 working days, unless the notice of motion is withdrawn, Parliament is dissolved or the House disposes of the motion (for example, votes it down) (Legislation Act 2012, s 43). Alternatively, the House can disallow a regulation by passing a motion (Legislation Act 2012, s 42). Each mechanism has been used once successfully, in 2008 and 2012.

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<sup>4</sup> Excluding appropriation bills.

**Box 2.3      Grounds on which the Regulations Review Committee can draw the House's attention to a regulation**

The grounds are, that the regulation—

- (a) is not in accordance with the general objects and intentions of the statute under which it is made;
- (b) trespasses unduly on personal rights and liberties;
- (c) appears to make some unusual or unexpected use of the powers conferred by the statute under which it is made;
- (d) unduly makes the rights and liberties of persons dependent upon administrative decisions which are not subject to review on their merits by a judicial or other independent tribunal;
- (e) excludes the jurisdiction of the courts without explicit authorisation in the enabling statute;
- (f) contains matter more appropriate for parliamentary enactment;
- (g) is retrospective where this is not expressly authorised by the empowering statute;
- (h) was not made in compliance with particular notice and consultation procedures prescribed by statute;
- (i) for any other reason concerning its form or purport, calls for elucidation.

*Source:* Standing Order 315.

A number of parties, including the RRC itself, emphasised that the small number of disallowances does not imply that the RRC is ineffective. Disallowance by the House is the ultimate sanction that allows the RRC to be effective, and it is valuable for its availability, rather than its use.

The Law Commission (acting on behalf of the LAC) has until recently reviewed all bills before Parliament, and provides comment to select committees where the draft legislation does not comply with LAC guidelines. The Commission heard from the Law Commission that, of the bills recently reviewed, about half of them included errors, mainly relating to the delegation of powers.

Other organisations can investigate the performance of regimes and agencies. The OAG can conduct performance audits or inquiries into “any matter concerning a public entity’s use of its resources” (Public Audit Act 2001, s 18(1)). Performance audits can examine a public entity’s efficiency and effectiveness, compliance with statutory obligations, probity and financial prudence and use of public resources. Similarly, the Office of the Ombudsman can investigate the administration and decision making of more than 4,000 organisations in the state sector. Neither organisation has the power to direct regulators or overturn decisions, but their outputs can carry considerable moral authority.

Several submitters identified weaknesses with a number of the formal oversight mechanisms:

In principle, Electricity Authority rules and other similar tertiary legislation is subject to review by the Parliamentary Regulations Review Committee and any rule can, potentially, be struck down or referred back to the rule-making body should it be found to be ultra vires or to have been incorrectly made. However, in practice, due to limited resources and time, the Committee can only review a relatively small number of regulations, rules or orders. (Powerco, sub. 14, p. 3)

Although the Controller and Auditor-General undertakes a number of performance audits annually, a lack of resources, among other factors, limits the extent to which regulators come under effective scrutiny. (Mortlock Consultants Ltd, sub. 31, p. 8)

Existing monitoring mechanisms under the Crown Entities Act are underutilised, possibly because they are viewed as weak accountability tools and/or because there are limited consequences for poor performance. (Vector, sub. 29, pp. 28-29)

The Minister does not appear to use existing powers to input into and/or amend the SOI or review operations and performance. (Genesis, sub. 48, pp. 5-6)

## Review of regulatory regimes

Strong mechanisms for reviewing regulatory regimes can help ensure that regulation is proportionate, well targeted and well implemented. New Zealand does not have strong processes for reviewing regulatory regimes. A 2013 review of New Zealand's regulatory management systems found "general weaknesses across agencies in undertaking and utilising review processes" and concluded that "[w]e tend to have a 'set and forget' mind set to regulation" (Offices of the Ministers of Finance & Regulatory Reform, 2013a; 2013b). The Ministry of Business, Innovation and Employment observed that there:

...is low use of business intelligence generally eg analysis of administrative data, drawing on front-line knowledge and experience, and drawing on experts and stakeholders' knowledge and experience. This can result in there not being...robust evidence on which to base a regulatory intervention, and also in determining whether regulatory regimes are, or continue to perform, effectively. (sub. 52, p. 3)

Gill and Frankel (2013) cited George Tanner, who observed that the:

...lack of any systematic process for post-enactment scrutiny means that routine maintenance of some very major pieces of legislation rarely happens. We paint our houses and service our cars, but we don't look after our laws in the same way. (p. 13)

Poor review and evaluation practices appear to be a wider issue across government. A 2011 review of expenditure on policy advice found that the "New Zealand policy advisory system's use of evaluation is limited in contrast with some governments", the "scope, methods and relevance of evaluation need reconsideration" and more "evaluation needs to be undertaken as part of the general process of improving the quality of policy analysis and advice" (Review of Expenditure on Policy Advice, 2011). Chapter 14 looks at options for improving regime review in New Zealand.

### F2.6

New Zealand does not have strong processes for reviewing regulatory regimes, leading frequently to a "set and forget" mindset to regulation.

## 2.8 The Executive's rules and processes to improve regulation

A number of rules and processes within the New Zealand regulatory system have been introduced to promote thoughtful consideration of whether and how to regulate, good and proportionate regulatory decisions, effective regulatory design and regular maintenance and repair of regulatory regimes. The rules and processes are designed to help lean against pressures for ill-considered regulation and support the effective operation of some existing constraints. They include:

- Regulatory Impact Analysis;
- the Minister for Regulatory Reform;
- regulatory scans and plans;
- regulatory stewardship expectations; and
- disclosure statements for new government bills.

### Regulatory Impact Analysis

Under current Cabinet rules, "any policy work involving regulatory options that may result in a paper being submitted to Cabinet" must be supported by Regulatory Impact Analysis (RIA).<sup>5</sup> RIA is designed to ensure:

<sup>5</sup> RIA requirements do not apply in a number of circumstances. These include proposals for technical revisions that largely re-enact current law, or proposals to remove or repeal redundant legislation. More detail on the exemptions is in New Zealand Treasury, 2013b.

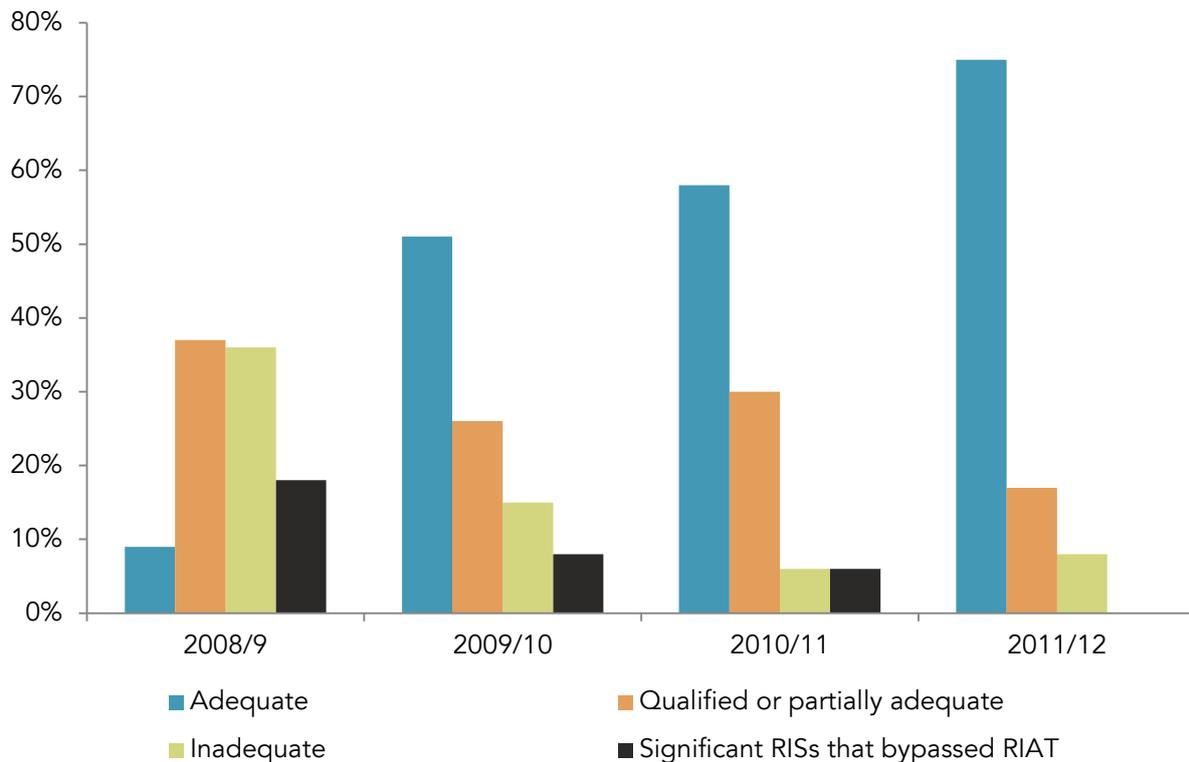
...that regulatory proposals are subject to careful and robust analysis. RIA is intended to provide assurance about whether problems might be adequately addressed through private or non-regulatory arrangements—and to ensure that particular regulatory solutions have been demonstrated to enhance the public interest. (New Zealand Treasury, 2013b, p. 4)

RIA falls outside the scope of this inquiry and the Commission therefore does not make any recommendations on it. However, it forms a central part of the regulatory system and needs to be included in any description of the system. The quality of RIA and underlying policy work also has a direct bearing on the ability to conduct post-implementation evaluation and regime review, which does fall within the inquiry's scope.

RIA requirements have been in place since 1998. Departments preparing regulatory proposals must prepare Regulatory Impact Statements (RISs), which are attached to Cabinet papers and published when any resulting draft legislation is introduced to Parliament. A RIS must be quality-assured, either by an independent panel within the authoring department or by the Treasury's Regulatory Impact Analysis Team (RIAT). RIAT carries out quality assurance for proposals that "have a significant impact or pose a significant risk" (New Zealand Treasury, 2013b, p. 10). To satisfy the quality assurance tests, a RIS must be complete, convincing, consulted, clear and concise.

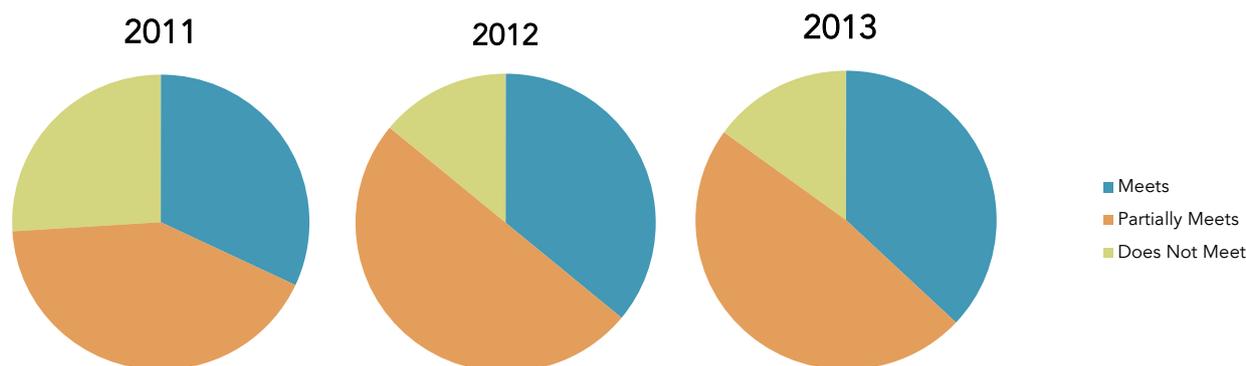
Successive governments have tightened RIA requirements. Responsibility for overseeing the RIA regime was transferred to the Treasury in 2008, and obligations on departments were introduced in 2009 to certify any RIS produced and to highlight "any key gaps, assumptions, dependencies and significant constraints, caveats or uncertainties regarding the analysis" (Offices of the Ministers of Finance and Regulatory Reform, 2009, p. 13). Treasury assessments of RISs have found departments are raising their performance, with the proportion of "adequate" RISs rising from 9% in 2008/9 to 75% in 2011/12 (Figure 2.7).

**Figure 2.7 Treasury assessments of Regulatory Impact Statements**



Source: Appendix to Offices of the Ministers of Finance and Regulatory Reform, 2013a.

However, external reviews of the RIA regime commissioned by the Treasury were less positive. The reviews found that quality-assurance processes conducted by authoring departments were too lenient, and that only a minority of RISs re-assessed by the external reviewers fully met the quality criteria (Figure 2.8).

**Figure 2.8** Independent reviewer RIS quality assurance scores

Source: NZIER, 2011, Castalia, 2012; 2013.

The Commission identified a number of issues with regulatory policy development in its inquiry into local government, particularly the quality of implementation analysis and engagement and the rigour of quality assurance processes such as RIA (NZPC, 2013a).

## Minister for Regulatory Reform

The ministerial Regulatory Reform portfolio was introduced in 2008, as part of the National Party's coalition agreement with the ACT Party. The specific responsibilities of the minister are not publicly available, but appear to include oversight of the regulatory management system (jointly with the Minister of Finance). The introduction of the portfolio has seen greater attention paid to regulatory management, with RIA requirements tightened, the introduction of new regulatory scanning and planning obligations on departments (see below), and parts of the existing regulatory stock tidied up by updating existing regimes and revoking redundant Acts and Legislative Instruments. Previous regulatory reform ministers have been sourced from coalition parties and have not been members of Cabinet. The portfolio was transferred to the current Minister of Finance in late 2013.

## Regulatory scans and plans

Regulatory management processes introduced in 2009 oblige departments responsible for regulatory regimes to more systematically plan for the introduction of new regulation and review the existing stock.

Departments are required to prepare yearly plans for their ministers, outlining "all regulatory instruments that departments anticipate will be changed (either by being introduced, amended, or repealed)" in the coming year (New Zealand Treasury, 2013c, p. 4). Regulatory plans are approved by portfolio ministers and submitted to the Ministers of Finance and Regulatory Reform. The intention is to promote discussion between ministers and departments about the scope, prioritisation and resourcing of planned work, to provide "early warning" to the wider system about upcoming work, and assist Cabinet decisions about future priorities (ibid). Departments must also regularly scan their stock of regulation "to identify possible areas for reform or further review" (Offices of the Ministers of Finance and Regulatory Reform, 2009, p. 8). Plans and scans are now inputs into the wider "regulatory stewardship" expectations on departments (see below).

A Treasury review of departmental regulatory plans for 2012 found that regulatory "policy activity is primarily driven by Government priorities and regulatory reform objectives. However, the quality of both drivers is questionable" (Appendix to Offices of the Ministers of Finance and Regulatory Reform, 2013a). The "regulatory reform" proposals included "a large volume of un-prioritised, often minor, activity", which Treasury commented was "of concern given the crowded order paper" (ibid).

Regulatory plans also do not cover tertiary regulation (ie, instruments made by regulatory agencies acting independently). In some instances, the volumes of tertiary regulation can be substantial. Proposals to improve the accessibility of tertiary regulation are discussed further in Chapter 15.

## Regulatory stewardship

Recent policy changes and legislative amendments have strengthened and formalised obligations on departments to only introduce regulation when necessary, and to effectively monitor and evaluate their existing stock of regulation. Under section 32 of the State Sector Act, as amended in 2013, chief executives of departments are now “responsible to the appropriate Minister for...the stewardship of the legislation administered by the department or departmental agency”. To complement this new legislative duty, the Cabinet agreed to a set of initial expectations for regulatory stewardship, spelling out in more detail what the obligation entails (Box 2.4).

### Box 2.4 Cabinet's Initial Expectations for Regulatory Stewardship

In March 2013, the Cabinet agreed to the *Initial Expectations for Regulatory Stewardship* (see below, in Offices of the Ministers of Finance and Regulatory Reform, 2013b). These expectations replace those outlined in the 2009 *Government Statement on Regulation: Better Regulation, Less Regulation* (Minister of Finance & Minister of Regulatory Reform, 2009).

Cabinet expects that departments, in exercising their stewardship role over government regulation, will:

- monitor, and thoroughly assess, at appropriate intervals, the performance and condition of their regulatory regimes to ensure they are, and will remain, fit for purpose;
- be able to clearly articulate what those regimes are trying to achieve, what types of costs and other impacts they may impose, and what factors pose the greatest risks to good regulatory performance;
- have processes to use this information to identify and evaluate, and where appropriate report or act on, problems, vulnerabilities and opportunities for improvement in the design and operation of those regimes;
- for the above purposes, maintain an up-to-date database of the legislative instruments for which they have policy responsibility, with oversight roles clearly assigned within the department;
- not propose regulatory change without:
  - clearly identifying the policy or operational problem it needs to address, and undertaking impact analysis to provide assurance that the case for the proposed change is robust, and
  - careful implementation planning, including ensuring that implementation needs inform policy, and providing for appropriate review arrangements;
- maintain a transparent, risk-based compliance and enforcement strategy, including providing accessible, timely information and support to help regulated entities understand and meet their regulatory requirements; and
- ensure that where regulatory functions are undertaken outside departments, appropriate monitoring and accountability arrangements are maintained, which reflect the above expectations.

*Source:* Offices of the Ministers of Finance and Regulatory Reform, 2013b.

The regulatory stewardship expectations are still in the process of being implemented.

## Disclosure statements

Another relatively new rule introduced to the regulatory system is disclosure statements, which must accompany all new government bills and substantive Supplementary Order Papers.<sup>6</sup> The requirement will

<sup>6</sup> Disclosure statements are not required for Imprest Supply and Appropriation Bills, Statutes Amendment Bills, Regulatory Reform (Repeal) Bills, Subordinate Legislation (Confirmation and Validation) Bills or Revision Bills.

be extended to disallowable legislative and other instruments in future. Disclosure statements are designed to more clearly reveal to Parliament and the public:

- the policy objective that the legislation is intended to achieve;
- the availability of “established quality assurance processes” (eg, RISs, advice on consistency with BORA, published reviews or evaluations);
- the nature of established quality assurance processes undertaken;
- the nature and extent of actions taken to meet existing quality assurance expectations (eg, consistency with the principles of the Treaty of Waitangi, consistency with international obligations, external consultation);
- significant features or powers conferred by the legislation (eg, powers to make delegated legislation; fees, levies and charges in the nature of a tax);
- “unusual” features warranting careful scrutiny (eg, provisions with a retrospective effect, compulsory acquisition of private property, executive powers to amend the effect of the Act); and
- key impacts of the policy (eg, estimates of major costs, savings and benefits; potential to cause material economic loss to an external party) (Offices of the Ministers of Finance and Regulatory Reform, 2013b).

The intention is to encourage greater scrutiny of proposed legislation by Parliament, promote more focus and attention to existing quality assurance processes and, over time, lead to “higher standards in the preparation of legislation” (Offices of the Ministers of Finance and Regulatory Reform, 2013b).

The requirement for disclosure statements was introduced as an administrative obligation in 2013, and the Government has recently introduced a bill to make them mandatory.<sup>7</sup>

## 2.9 How well does the system currently balance pressures and constraints?

The performance of New Zealand’s regulatory system has been the subject of considerable debate (see, for example, Wilkinson, 2001; Regulatory Responsibility Taskforce, 2009; Conway, 2011). Although some measures suggest New Zealand does not perform particularly poorly, a deeper analysis suggests that the current performance of the system presents risks to the community.

Some international commentary suggests that the system produces reasonable outcomes, particularly in terms of ease of doing business and investor protection. New Zealand tends to score highly on international surveys that evaluate national regulatory systems (eg, those run by the World Economic Forum (2013), World Bank (2013), Transparency International (2012) and the World Justice Project (Agrast et al., 2012). While some of these measures are blunt, they are used by a number of influential organisations and can provide a useful touchstone against which to assess performance.

However, the evidence collected in the course of this inquiry and the severity of recent regulatory failures also indicate that the system is not performing as well as it could, and is not delivering the protection, effectiveness and efficiency that New Zealanders deserve and expect. This can be seen when the regulatory system’s performance is assessed against the criteria in section 2.4.

### Proportionate and necessary new rules

The main mechanism for ensuring that new rules are actually needed is the RIA process (and underlying policy process). The RIA regime and the policy process fall outside the scope of this inquiry, although, as noted earlier, external reviews of RIA and the Commission’s inquiry into local government regulation have found significant weaknesses. The relatively heavy reliance on statutes and the limits on Parliamentary time

<sup>7</sup> Legislation Amendment Bill 2014.

mean that it can be difficult to introduce new and necessary rules (or replace unneeded rules), as reflected in the high proportion of chief executives who reported working with obsolete legislation.

The regulatory system provides other opportunities to test whether new regulations are proportionate, including the obligations on ministers proposing new regulations to check that they comply with BORA, Treaty principles, and LAC guidelines; “vetting” of draft legislation to reveal inconsistencies with BORA; and select committees and the Law Commission reviewing bills. Where they are used, these processes can have significant impact. However, the Commission found that a number of these quality checks are under strain (Chapter 16). In addition, most of these constraints depend on self-enforcement by ministers, officials and MPs. Incentives within the political system can act against consistent and robust self-enforcement.

### **Prioritised regulatory effort**

Given limited time and resources, prioritisation of effort is important to ensure that the most important regulatory issues and risks are managed. Experience with regulatory plans prior to the introduction of the stewardship expectations suggests that prioritisation efforts to date have not been particularly successful. Although creating a regulatory reform ministerial portfolio encouraged greater Cabinet attention on regulatory quality issues, the fact that the ministers have (until recently) sat outside Cabinet and come from smaller coalition partners is likely to have limited their ability to drive prioritisation. Chapter 16 discusses options for strengthening the regulatory management institutions at the centre of government.

### **Appropriately resourced implementation**

Effective regulation depends on having resources available within government agencies to implement the new rules. There are indications this could be improved. The 2013 independent review of RISs commissioned for the Treasury found that “many of those RISs failed to convince us that the implementation path was realistic or would succeed. As a result, many RISs fail to provide a useful basis for communicating policy decisions with affected stakeholders” (Castalia, 2013, p. 20).

Regulatory failures in mining and building also point to insufficient focus on implementation, and particularly capability. In the case of mining, the lack of specialised expertise, poor training opportunities and insufficient capacity among the mining inspectorate meant that the Department of Labour “could not properly do their job of ascertaining and taking reasonable steps to assure health and safety compliance in underground coal mines” (Royal Commission on the Pike River Coal Mine Tragedy, 2011, p. 278). In the case of building, responsibility for making decisions on the compliance of new buildings with regulatory standards “was devolved to actors who did not have the knowledge to make these judgments” (Mumford, 2010, p. 113). More broadly, the Compliance Common Capability Programme commented that organisational capability across the New Zealand sector was variable and that the sector “lacks mechanisms for: growing capability, enabling people to move easily between regulatory compliance functions within and between organisations, and sharing and optimising investment in training” (sub. 12, p. 2). Chapters 3 and 5 discuss regulator practice and capability in more detail.

### **Fair implementation**

The regulatory system provides a reasonable assurance that new regulations will be fairly implemented. The courts are a strong check against unreasonable or illegal behaviour by regulators, and unfavourable court decisions play an important role in signalling to other regulators what is acceptable. Chapter 11 considers the role of the courts in more detail.

The reach of the courts is, however, limited by a number of factors. Litigation is expensive, and the courts mainly become involved where regulated parties or other stakeholders have the means to seek judicial review or an appeal. Regulated parties and other stakeholders are also likely to seek review or appeals on issues where they consider they have the best chance of overturning a regulatory decision or action in the courts and where the potential benefits to them are high. These two factors mean that the judiciary may not consider some regulatory issues of wider public interest.

## Effective implementation, self-awareness and learning from experience

The delivery of effective regulation relies on all parts of the regulatory system working together. However, review and evaluation play a particularly important role in promoting effectiveness, by testing experience against expectations, identifying areas for improvement, revealing current or potential problems and allowing agencies to learn from experience. Monitoring of regulators also plays a role in identifying whether regimes are being effectively and efficiently implemented. The weakness of review and evaluation processes in the regulatory system is a cause for concern and a source of risk. Chapter 14 explores options for improving the review and evaluation of regulatory regimes in New Zealand and Chapter 13 discusses options for improving the monitoring and oversight of regulators.

The culture of a regulator affects how well it can learn and adapt. Chapter 4 discusses regulator culture in more detail, and outlines some of the Commission's findings about the extent that New Zealand regulators are "learning organisations".

### 2.10 Conclusion

All political systems face pressures for regulation that has not been subjected to public interest tests. New Zealand, like many other developed countries, has developed processes and institutions to manage these pressures, and to assess whether proposals for new regulation have merit. However, what emerges from an analysis of the dynamics of the New Zealand regulatory system is that, while there are a number of checks, constraints and rules in place, few of the controls are binding. Most:

- are self-imposed by the Executive and depend upon collective self-enforcement (eg, RIA, regulatory plans and scans, Cabinet Office requirements to disclose variations from BORA, the Treaty of Waitangi; review and evaluation); or
- can be overridden by the Executive, by calling on majority support in Parliament (eg, Select Committees, MMP, BORA, the Treaty of Waitangi).

With the exception of the courts, the constraints that are less easily overcome – especially limited resources and Parliamentary time – tend to undermine the production and implementation of effective regulation.

The regulatory system is a central and very important part of government in New Zealand. Along with taxation, spending and monetary policy, regulation is a key tool that governments use to achieve their policy goals. It helps ensure that markets work fairly and efficiently, prevents harm to citizens and consumers, and protects individual rights and the environment. The system's current performance indicates that there is clear room for improvement, in particular around prioritisation and effectiveness of regulatory efforts, the capability to support effective regulatory implementation, and the ability of the system to identify and resolve areas of risk and learn from experience.

Achieving these and other improvements will require action at two levels – regulatory practice; and design and system management. This report addresses each level in turn. The following chapters in Part 1 provide guidance on specific aspects of regulatory design and practice. Part 2 then focuses on options for improving the performance of the overall system.

# **Part 1: Better regulatory practice and institutional design**

## 3 Regulatory practice

### Key points

- Many factors are important for ensuring the effectiveness of regulation, none more so than the practices of the agency charged with implementing the regulatory regime. The regulator is at the “sharp end” when it comes to delivering on the objectives that Parliament intended.
- This is also where businesses and individuals experience regulation. Even where businesses and individuals understand and broadly agree with the need for regulation, it will often be the behaviours, practices and actions of the regulator that determine the level of compliance with the regime.
- Developments in the theoretical literature on regulatory practice have been influential in contemporary thinking about the role of the regulator and strategies and tools regulators use to achieve the objectives of regulation. In particular, regulators have tended to adopt:
  - Responsive regulation approaches, in which regulators select their compliance tool based on the attitude and motivation of regulated firms towards compliance. For firms that are willing to do the right thing, the regulator may select a low-cost tool (such as education); for firms that are unwilling to comply, the regulator may select high-powered tools (such as prosecutions).
  - Risk-based approaches, in which regulators focus on identifying and assessing the risk of harm from non-compliance and target their resources towards reducing the greatest harms. Risk-based regulation has become increasingly influential and is endorsed in Cabinet’s *Initial Expectations for Regulatory Stewardship* (Offices of the Ministers of Finance and Regulatory Reform, 2013b).
- Both responsive and risk-based approaches are evident in the strategies of New Zealand regulators, although agencies differ on how far they prioritise reducing harm or maximising compliance and to what extent the two objectives are integrated or treated separately.
- In practice, implementation of either approach presents considerable challenges. There is no single superior regulatory strategy. Different strategies and approaches have different strengths and weaknesses, with different levels of effectiveness, in different contexts. The key lies in understanding and adapting regulatory strategies to take account of the influences and dynamics of the many different contexts in which they are deployed.
- Irrespective of whether regulators practice responsive regulation (including variants such as smart regulation) or risk-based (including regulatory craft) approaches, or a mix of approaches, regulators still face considerable challenges. The regulator:
  - may be operating in an environment where they only have a partial view of the activities of regulated parties and where that environment is continually changing;
  - may have limited scope to influence the behaviour of regulated parties;
  - can be hampered by its own institutional environment.
- Modern regulatory practice requires a deeper more nuanced institutional analysis of the motivations, interactions and institutional environments of the regulatory actors in regulatory regimes. Being *really responsive* means recognising that a range of organisational and institutional factors influence the effectiveness of regulation. Importantly, attentiveness to these factors is also important in the design of new regulatory regimes and new regulatory institutions.

### 3.1 Introduction

Many factors are important for ensuring the effectiveness of regulation, none more so than the practices of the agency charged with implementing the regulatory regime. The regulator is at the “sharp end” when it comes to delivering on the objectives that Parliament intended.

This is also where businesses and individuals *experience* regulation. Even where businesses and individuals understand and broadly agree with the need for regulation – whether it is to safeguard the environment, or protect health and safety or ensure the efficient operation of markets – it will often be the behaviours, practices and actions of the regulator that are crucial in ensuring compliance with the regime.

The regulator’s resources are inevitably scarce, so effectively implementing a regulatory regime will require the regulator to prioritise its effort. How the regulator prioritises its effort will also be crucial to the success of the regime in meeting its intended outcomes.

This chapter is about what makes good regulatory practice. It concludes that a deeper institutional analysis of the motivations, interactions and institutional environments of the regulatory actors in regulatory regimes – regulators and regulated parties – is required. The chapter finds that attentiveness to these institutional factors is important when designing new regulatory regimes and new regulatory institutions.

### 3.2 A framework for compliance – responsive regulation

Developments in the theoretical literature on regulatory practice have been influential in contemporary thinking about the role of the regulator and the strategies the regulator should use to achieve the objectives of regulation. This literature has increasingly highlighted and sought solutions to the issues and challenges that regulators face in putting theory into practice.

#### Compliance and deterrence

In the early literature the two main models for achieving regulatory objectives were the compliance model and the deterrence model. The compliance model used the tools of persuasion and building trust and relied on an ongoing relationship between the regulator and regulated parties. The deterrence model described an arm’s length regulatory strategy in which regulated parties were required to meet regulatory requirements or face punitive sanctions (Reiss, 1984).

The key difference between these two models is the assumed motivations of regulated parties. The compliance model assumes that most people want to do the right thing in complying with regulations, but strategies by the regulator are still needed to help people comply. The deterrence model assumes that people weigh up the costs and benefits of breaching a regulation. The higher the likelihood of detection and the higher the punishment, the higher the expected cost of non-compliance and the more likely the costs of noncompliance will outweigh the benefits. The regulator uses its detection and enforcement strategies to influence the regulated parties’ costs and benefits of compliance (Becker, 1968; Stigler, 1970).

#### Responsive regulation

Since the 1990’s, Ian Ayres and John Braithwaite’s *Responsive Regulation* (1992) has been an important influence in the thinking about effective regulatory compliance (Etienne, 2013). Their approach recognises that regulators need a range of tools to respond contingently to the attitudes and conduct of regulated parties – assisting parties that want to comply and punishing recalcitrant parties.

Ayres and Braithwaite built on earlier work by Scholtz (1984). Scholtz’s “tit-for-tat” model assumes a rational economic actor, motivated solely by profit maximisation, in an ongoing regulatory relationship with a regulator. The regulated party reaps benefits over the long term by foregoing short-term opportunities to default in favour of consistent cooperation with the regulator. The regulator can optimise the long-term cooperation of regulated parties by setting a minimal level of compliance, and using cooperative strategies with regulated parties that do comply and punitive strategies against those that do not comply. The regulator will return promptly to a cooperative approach once a regulated party that is not complying signals they are willing to comply.

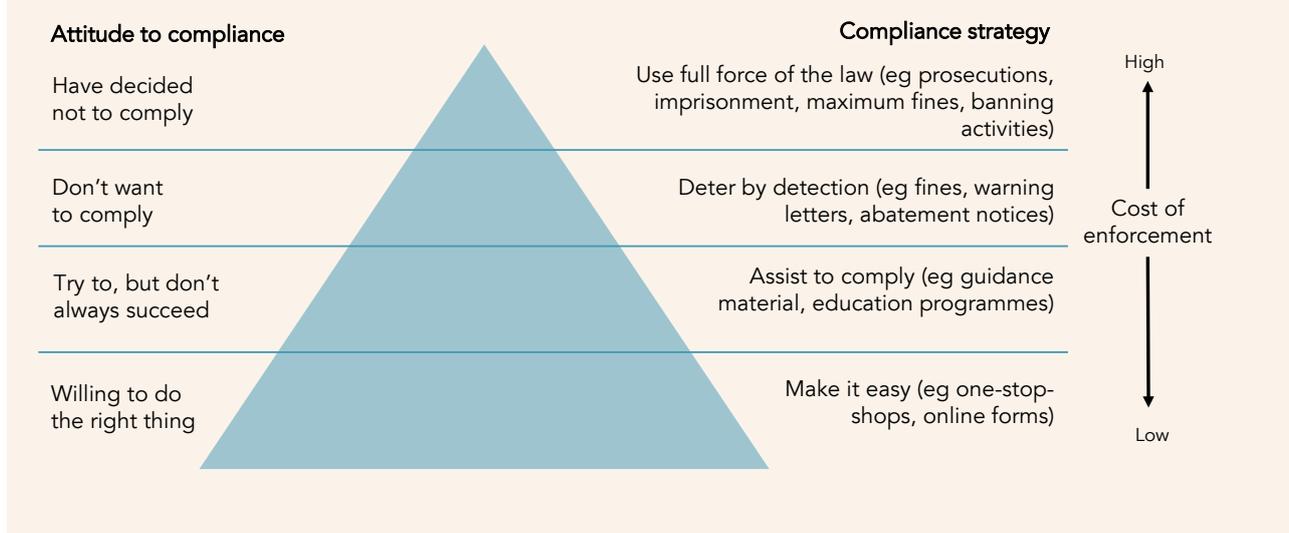
Ayres and Braithwaite (1992) undertook empirical research into a wide range of industries, exploring the dynamic interactions between regulators and regulated firms. Their findings supported “tit-for-tat” strategies for effective regulatory compliance. They developed an “enforcement pyramid” of regulatory tools, with a broad base of cooperative measures and increasingly punitive measures for non-compliance. The operating strategy of the regulator is to start at the base of the pyramid, seek compliance through persuasion and escalate up the pyramid when compliance is not forthcoming. Importantly, efforts by the regulated party to comply are met with regulatory de-escalation down the pyramid (Box 3.1).

### Box 3.1 An enforcement pyramid

At the base of the pyramid, compliance is encouraged by appealing to an individual’s social responsibility and leveraging cooperative approaches. This level recognises that most people want to do the right thing by complying with regulations. For these people the ideal strategy is to make compliance as easy as possible, such as implementing online application processes or having convenient opening hours for lodging paperwork.

Further up the pyramid are people who are willing to comply with regulations, but, for whatever reason, do not always succeed. These people need help to comply by, for example, providing guidance material or education programmes. Still further up the pyramid are those who do not want to comply. For these people, the strategy escalates to a deterrent threat (warning letters, fines, publicity around successful prosecutions). These actions appeal to an individual’s rational self-interest. Finally, at the top of the pyramid are a small number of individuals who decide not to comply. These people should face the full force of the law (Ayres & Braithwaite, 1992).

Figure 3.1 A typical enforcement pyramid



Ayres and Braithwaite (1992) summarise the important insights to consider when examining the efficiency and effectiveness of compliance regimes.

- A complex set of economic, psychological and sociological factors underpins regulatory compliance decisions. Individuals and firms have different motivations based on values, social responsibility, economic rationality and the desire or need to follow the law. These motivations play out in different contexts and situations.
- Some individuals and firms will comply with the law if it is economically rational for them to do so. Most individuals and firms will comply with the law most of the time simply because it is the law.
- A strategy based totally on persuasion will be exploited when actors are motivated by economic rationality.

- A strategy based totally on punishment will undermine the goodwill of actors when they are motivated by a sense of responsibility.
- Punishment is expensive; persuasion is cheap. A strategy based mostly on punishment wastes resources on litigation that would be better spent on monitoring and persuasion.
- A strategy based mostly on punishment fosters organised resistance by business and industry to regulation.
- Voluntary compliance is most likely when a regulator displays and applies an explicit enforcement pyramid with a hierarchy of graduated responses to non-compliance, moving to more coercive measures only when less coercive means fail.

## Responsive regulation in New Zealand

Responsive regulation is widely used as a compliance strategy in New Zealand. *Achieving compliance: A guide for compliance agencies in New Zealand*, developed by the Compliance Common Capability Programme (CCCP), says the Ayres/Braithwaite enforcement pyramid is a “valuable conceptual tool for regulatory agencies in achieving or improving compliance” (CCCP, 2011, p. 31).

The Commission looked at the compliance and enforcement strategies of a sample of national regulators and found that most took “attitude to compliance” into account in their compliance and enforcement strategies. For example, “the general attitude (or level of willingness) of individuals or groups to be compliant” is one of the criteria in Maritime New Zealand’s (MNZ) compliance strategy (MNZ n.d. (a)). The Civil Aviation Authority (CAA) takes into consideration “the attitudes and behaviour of aviation participants towards compliance, safety and reporting” (CAA, 2014, p. 5). DIA expects “everyone to comply with the law” and “the approach we take to compliant individuals or organisations will differ from the solutions we choose for those who are wilfully negligent or deliberately negligent” (DIA, 2012). The Ministry for Primary Industries (MPI) notes in its submission that it operates a regulatory pyramid:

The pyramid contains four stages... voluntary compliance; assisted compliance; directed compliance and enforce compliance (the VADE [voluntary, assisted, directed, enforced] compliance model). (sub. DR 102, p. 13)

### F3.1

Responsive regulation has been an important influence in the thinking about effective regulatory compliance worldwide over the last two decades and is widely used as a compliance strategy by New Zealand regulators.

The academic literature, submissions and other evidence reveals a number of challenges for regulators in applying the responsive approach.

## Challenges in implementing a responsive approach

According to Etienne (2013), responsive regulation places heavy reliance on the regulator – “not just any regulator but a skilled and resourceful one, presumably capable and willing to push regulatees into compliance by making good use of discretion and judgement” (p. 14). The reliance on the judgement of the regulator is reinforced by the Environmental Protection Authority (EPA):

The main challenge to applying the responsive approach to regulation is a heavy reliance on the regulator’s discretion and judgement when deciding on the level and type of response to failures in compliance. (sub. DR 103, p. 4)

The challenges of implementing the responsive/enforcement pyramid, however, extend beyond the skills of the regulator. These are discussed below under three broad themes:

- responsive regulation may not be in the interests of the overall objectives of the regulatory regime;

- responsive regulation makes assumptions about the nature of the relationship between the regulator and the regulated party and the frequency and importance of the interaction, which may not be what happens in practice; and
- regulators may face significant constraints in being able to use the responsive/enforcement pyramid as intended.

### **Responsive regulation, the risk involved, and the objectives of the regime**

Responsive regulation assumes that the regulator initially operates at the base of the pyramid, assuming a willingness to comply on the part of the regulated party. Escalation through the layers of the pyramid to more punitive types of enforcement occurs when there is demonstrated unwillingness to comply. However, where potentially catastrophic risks are being controlled it may not be feasible to escalate up all the layers of the pyramid. A more immediate reaction may be needed at higher levels, such as an immediate revocation of licence or a ban on operating to prevent the immediate threat of harm (Baldwin & Black, 2008).

In some situations, it may not be in the interests of the overall objectives of the regime to have the threat of punitive action such as prosecution looming over regulated parties. In some cases it is in the interests of the regime to encourage open reporting of incidents so that remedial action can be taken and lessons can be learned to prevent future harm. If there is a threat of punitive action such as prosecution, this can deter reporting of an incident. This was raised in a submission by Aviation New Zealand:

Aviation's safety system is predicated around information disclosure which facilitates and enables continuous learning. However in the HSE [health and safety in employment] environment there is a belief that it's best not to self-incriminate. The CAA has an understanding and appreciation of the importance of learning from accidents – the same cannot be said for agencies involved in HSE matters where investigations are conducted to determine whether to prosecute or not. If this prosecution culture crosses over into aviation then there will be a rapid deterioration in reporting. Even a loss of confidence in the robustness with which safety information is treated can lead to a loss of confidence in regulatory systems and processes and a reduction in reporting. (sub. 36, pp. 7-8)

### **Responsive regulation and the relationship between regulator and regulated parties**

Responsive regulation tends to assume a binary relationship between the regulator and the regulated party. But the regulated party will have information about how the operating strategy of the regulator has been applied to other parties and this can influence the behaviour of the regulated party towards the regulator.

The responsive model also assumes that it is the regulator that responds to the behaviour or attitude of the regulated party, but as the Aviation New Zealand submission shows, the behaviour of the regulated party is likely to be contingent on the behaviour and strategy of the regulator. A regulated party can have quite a different attitude toward cooperatively working with the regulator to investigate the causes of an accident or breach, if the regulated party is not under the threat of prosecution.

Baldwin and Black (2008) point out that in some regimes, messages about compliance behaviour between regulator and regulated parties may be weak or confused. This can happen where there are not enough repeat interactions between the regulator and regulated parties for a responsive/enforcement compliance strategy to operate (Baldwin & Black, 2008).

More significantly, responsive regulation assumes that regulated parties will actually *respond* to the pressure imposed by the regulator. But regulated party behaviour may be driven not by regulator pressure but by more pressing forces – such as the culture within an industry, intense competition, financial or other pressures on the regulated party (Baldwin & Black, 2008).

### **Constraints on the regulator**

Evidence presented to this inquiry suggests that regulators can be quite constrained in effectively operating a responsive compliance strategy. In some cases, regulators do not have the range of enforcement tools to move up and down the pyramid:

Good operation of regulators cannot overcome the inherent flaws in poor regulatory design. In these cases the outcomes intended by Parliament will never be achieved because the regulators have never been provided with the tools to effectively achieve these outcomes. (Air New Zealand, sub. 47, p. 5)

The Commission's case study of aged care regulation (NZPC, 2014c) found that the Ministry of Health has levers at the top and the bottom of the responsive/enforcement pyramid, but few in the middle. Under the Health and Disability Services (Standards) Act 2001, the Director-General of Health can order a provider to close, can cancel the provider's certification, or fine the provider \$50,000 for operating without the Ministry's approval. The Ministry can also add conditions to a provider's certification and providers are sometimes required to report on their progress in resolving identified problems. However, the Ministry cannot vary the term of a provider's certification in the middle of the period, nor are there powers to issue fines for non-compliance.

The Commission's inquiry into local government regulation noted the frustration of local authorities about a gap in the range of tools available – specifically a lack of access to infringement notices (NZPC, 2013a).

The New Zealand Food and Grocery Council (NZFGC) also noted limitations in the range of enforcement tools available under the Food Act 1981. The Food Bill<sup>8</sup> allows for much greater discretion and a wider range of enforcement tools (sub. 35, p. 8).

Responsive regulation as a compliance strategy relies on regulators being able to use a range of enforcement tools, but even if those tools are available there may be barriers that dissuade regulators from using them. Taking prosecutions represents quite a step up from lower level enforcement tools for many regulators. The factors that regulators need to consider in taking a prosecution are outlined in Box 3.2.

### Box 3.2 Factors to consider in taking prosecutions

In New Zealand, a number of institutional/structural factors may dissuade regulators from moving to the top end of the pyramid and taking prosecutions. The key factors are:

- the evidentiary requirements for prosecutions;
- reputational risks in taking prosecutions;
- the time, costs and resources involved in pursuing prosecutions;
- the public interest in prosecutions; and
- timeliness.

**Evidentiary requirements:** The further up the pyramid a regulator moves, the higher are the standards of evidence required to make a case for enforcement action. This reflects the weighty penalties that can accompany prosecution, such as large fines or imprisonment. Failure to meet evidentiary standards can limit a regulator's ability to undertake prosecution. Evidentiary standards have implications for the way a regulator organises and resources itself, including having:

- suitably trained investigatory staff who understand the extent and limits of their legal powers and who know how to collect sufficiently robust evidence;
- processes in place to store evidence in the appropriate manner; and
- access to legal skills to ensure that the case for enforcement is properly constructed.

**Reputational risks:** A second constraint on the use of prosecutions is the implications of a loss in the courts for a regulator's reputation. As a result, regulators may be less inclined to prosecute breaches without a high probability of success. The ability of a regulator to promote compliance with regulatory

<sup>8</sup> Now the Food Act 2014.

standards depends, at least in part, on their reputation among the regulated industry as a “credible threat” – that is, an organisation that is both willing and able to use its most punitive powers to punish and deter breaches. The regulator may take few prosecutions and make the choice to do so where there is likely to be a lot of publicity. Failure in the courts may undermine the level of perceived threat, and erode incentives for firms to comply voluntarily. It may also undermine internal agency morale.

**Time, costs and resource requirements:** The costs and time involved in taking prosecutions may dissuade regulators from operating at the top end of the enforcement pyramid. The regulator is likely to be working within a budget constraint that will influence the number and type of prosecutions taken.

**Public interest considerations:** Decisions on whether or not to undertake a prosecution are generally subject to a public interest test. The concept of the public interest in prosecutions is often attributed to UK Attorney-General Sir Hartley Shawcross, who argued that prosecution should take place “wherever it appears that the offence or the circumstances of its commission are of such a character that a prosecution in respect thereof is required in the public interest” (Shawcross, cited in Spencer, 2011, p. 29). The “Shawcross principle” has since been endorsed by Attorneys-General across the Commonwealth (Spencer, 2011). In New Zealand the Solicitor-General has issued guidelines for assessing whether a prosecution would be in the public interest (Crown Law Office, 2013).

**Timeliness:** Because of the need to engage legal counsel, meet evidentiary standards and test evidence and demand pressures on the court, prosecutions can take considerable time. In some circumstances, this may mean that prosecution will not provide a timely or satisfactory outcome for victims of regulatory breaches.

The cost of taking a prosecution was raised by a number of inquiry participants and as an issue in the Commission’s inquiry into local government regulation (NZPC, 2013a). Enforcement actions in the courts are expensive in New Zealand, and these costs increase with the severity of the breach in question. A 2011 review of public prosecution services (which many regulators use, either entirely or in part, to undertake prosecutions) found that average costs had increased between 2005 and 2010, with the average cost of an action in the High Court being about four times the cost of an action in the District Court (Spencer, 2011).

The inquiry into local government regulation *Towards better local regulation* (NZPC, 2013a) noted:

For some smaller territorial authorities, \$40,000 upwards in legal fees represents a percentage point or more of annual rates. Where the prosecutions budget is insufficient, staff must come to the council with a budget amendment to enable them to proceed. (p. 171)

For enforcement actions involving complex issues, the costs can be high. For example, the Commerce Commission often incurs more than \$3 million a year in costs investigating and pursuing cases of coordinated behaviour, such as cartels (Table 3.1). This is only one type of regulatory breach that the Commission investigates.

**Table 3.1 Commerce Commission expenditure on coordinated behaviour cases: 2008/2009 to 2010/11**

	2008/9 Actual	2009/10 Actual	2010/11 Actual
Expenditure on output class	\$3.679m	\$3.364m	\$1.759m

Source: Commerce Commission, 2011.

The Commerce Commission notes in its submission, however, that it does not resile from taking prosecutions:

The Commission has a history of taking successful prosecutions at the top end of the pyramid to egregious and detrimental breaches of the law. (sub. DR 95, p. 5)

Bell Gully suggested another impact of the significant time and resource requirements in taking a prosecution. Bell Gully suggests that regulators may be reluctant to negotiate a settlement as a means of resolving a regulatory disagreement once procedures have been initiated. This is because the costs of the regulator's investigation have already been incurred. Bell Gully noted that statements in enforcement policies sometimes indicate that the prospect of settlement is reduced once a regulator has determined to pursue an enforcement case (Bell Gully, sub. 38).

On this last point, Baldwin and Black (2008) explain that regulators may be tied to particular compliance approaches for a number of reasons:

...including their own organisational resources, tools, cultures and practices and the constraints of the broader institutional environment. The agency may fear the political consequences of progression and may not have the public, business or political support for escalation. It may lack the necessary information to judge the need to escalate its response and it may be disinclined to escalate unless it has sufficient evidence to make a case for the highest level of response (eg to prosecute or disqualify). There may also be legal problems in applying a responsive approach. (p. 64)

### Are the challenges overstated?

Mascini (2013), in a special issue of the journal *Regulation and Governance* devoted to the appraisal of 20 years of responsive regulation, concludes that institutional impediments have posed enormous challenges to implementing responsive regulation:

Communication problems between regulators and regulatees, as well as institutional impediments, pose difficult challenges to the implementation of the enforcement pyramid. Miscommunication can result from ambiguous, infrequent, and interrupted contacts between regulators and regulatees, from the lack of organizational or legal infrastructure or because of political or economic pressure rendering it impossible to apply the enforcement style deemed most suitable. (p. 53)

This view, according to one submission, is overly pessimistic. The Commerce Commission writes:

There is a risk... of being too dismissive... based on the academic articles cited. The analysis in our view undervalues the different models of compliance which can be successful if effectively implemented. (sub. DR 95, p. 5)

The Commission acknowledges that compliance models such as the responsive/enforcement pyramid can be successful if they are implemented effectively. Nevertheless the Commission believes that there is a need to more carefully consider the challenges they pose. Understanding the challenges of applying responsive regulation is particularly important where the challenges arise from issues in the design of regulatory regimes or regulatory institutions.

#### F3.2

The literature points to a number of impediments to successfully implementing responsive regulation. There may be instances where implementing a graduated compliance approach is not in the interest of the overall objectives of the regulatory regime and there can be significant constraints on the regulator in being able to use the responsive/enforcement pyramid as intended.

## 3.3 Risk-based regulation

The theory of responsive regulation has dominated regulatory practice since the early 1990s, but risk-based regulation has become increasingly influential since 2000. While the responsive model of regulation focuses on achieving compliance with regulation, risk-based regulation frameworks focus on identifying and assessing the risk of harm and on channelling resources to modify or reduce harm (Figure 3.2). Baldwin, Cave and Lodge (2012) explain that risk-based frameworks have a number of central elements.

- The regulator identifies the objectives of the regulatory regime and the risks that regulated parties present to achieving those objectives.

- The regulator develops a system for assessing and scoring risks, typically based on the gravity of the potential event and the probability of the event occurring. The assessment may also distinguish between “inherent risk” – the intrinsic risk in the site or activity – and “management and control” risks – the ability of a regulated party to mitigate or exacerbate the risk through its internal systems.
- Many risk-based strategies link the risk evaluation with the allocation of the regulator’s resources; that is, the risk scoring is a prioritisation mechanism.
- It is less usual for there be a direct link between the risk score given to a regulated party or parties and the intervention strategy (eg, whether to educate, persuade or sanction). Where a link exists, it is often through the resources that have been allocated based on risk – and once the prioritisation decision has been made, a decision is made about the cost of various enforcement strategies.
- Many risk-based frameworks have explicit processes to evaluate the impact of the strategy on reducing harm.

**Figure 3.2** Characterisation of a risk-based approach



Source: Adapted from Organisation for Economic Co-operation and Development (OECD), 2004a.

One version of risk-based regulation is Sparrow’s “regulatory craft” approach (Sparrow, 2000). Rather than focusing on the processes and instruments available to regulatory agencies to further their regulatory objectives, which is the starting point for responsive regulation, Sparrow advocates focusing on the problems to be solved. First nominate the problems for attention and define them precisely, then develop the solutions or interventions:

Central to Sparrow’s approach is the need to pick the most important tasks and then decide on the important tools, rather than decide on the important tools and pick the tasks to fit. (Baldwin, Cave & Lodge, 2012, p. 267)

### Endorsement for risk-based approaches

Risk-based regulation has found favour with both governments and businesses, and has been dominant in regulatory reform initiatives around the world. This is because it offers a framework that relates the activities of the regulator – targeting risk – directly to the objectives of the regulatory regime – reducing the risk of harm:

In its idealized form, risk-based regulation offers an evidenced-based means of targeting the use of resources and of prioritizing attention to the highest risks in accordance with a transparent, systematic, and defensible framework. (Black & Baldwin, 2010, p. 181)

The use of risk-based approaches was endorsed in the United Kingdom following the Hampton Review (2005), which recommended that all UK regulators should operate a risk-based system (Baldwin, Cave & Lodge, 2012).

## Risk-based regulation in New Zealand

In New Zealand, there are two main sources of official guidance on regulatory practice. Both put a strong emphasis on risk-based approaches.:

- Cabinet's *Initial Expectations for Regulatory Stewardship* (Offices of the Ministers of Finance and Regulatory Reform, 2013b); and
- the CCCP's *Achieving Compliance* guide (CCCP, 2011).

*Initial Expectations* was agreed in March 2013 and outlines "at a high level how departments should be thinking about designing and implementing regulatory regimes and their stewardship responsibilities in administering those regimes" (Offices of the Ministers of Finance and Regulatory Reform, 2013b, p. 3). The intention is to set clear standards for chief executives about regulatory management, with the aim that regulatory regimes "deliver a stream of net benefits to New Zealand over time ... and ... be managed with that idea in mind" (ibid).

In *Initial Expectations*, Cabinet expects that "departments, in exercising their stewardship role over government regulation, will maintain a transparent, *risk-based compliance and enforcement strategy*, including providing accessible, timely information and support to help regulated entities understand and meet their regulatory requirements" (ibid, emphasis added, p. 15).

The *Achieving Compliance* guide (CCCP, 2011) also endorses risk-based approaches:

...risk management is central to a successful and cost-effective compliance strategy. An intelligence-led, risk-based approach guides a compliance agency in choosing its compliance tools in individual cases or for particular segments of the regulated sector. It enables the agency to maximise its effectiveness, subject to the resources available to it. (CCCP, 2011, p. 25)

A systematic risk-management framework helps decision makers make informed choices and respond to compliance risks in appropriate and proportionate ways. It therefore helps the agency develop a cost-effective compliance strategy, where limited resources are allocated appropriately to ensure the best possible compliance outcomes. (ibid, p. 56)

### Who uses a risk-based approach?

The Commission looked at the published enforcement strategies of a sample of national regulators.

- *The CAA* – risk reduction is the main enforcement goal of the CAA – every industry participant is rated according to the level of aviation safety risk they pose, and CAA resources are allocated towards activities where the consequences of failure are highest (CAA, 2014).
- *The Commerce Commission* – prioritises resources "on matters where the greatest harm exists or may occur" (Commerce Commission, 2013a, p. 5; Commerce Commission, n.d.).
- *MNZ* – has an enforcement strategy based on "the magnitude of the consequence that would eventuate should an event occur... and the likelihood of that event occurring". MNZ concentrates its activities where it sees problems or issues, which may be with particular aspects of the maritime sector, types of vessels, types of practices or with particular operators (MNZ n.d. (b), p. 8).
- *The FMA* – takes a risk-based approach to monitoring and surveillance, with resources and enforcement action prioritised "to those participants and practices that present the greatest risk to fair, efficient and transparent markets" (FMA, n.d.).

#### F3.3

Risk-based regulation has become increasingly influential and Cabinet expects that "departments, in exercising their stewardship role over government regulation, will maintain a transparent, risk-based compliance and enforcement strategy" (Offices of the Ministers of Finance and Regulatory Reform, 2013b, p. 15).

## Challenges in implementing a risk-based approach

Risk-based approaches pose a number of conceptual and practical challenges.

- Assessments of risk are invariably dependent on theories or assumptions about how harm is caused and therefore also the points at which the regulator should intervene to mitigate the risk of harm.
- There may be a great deal of uncertainty about the nature of the risk and the regulator's ability to mitigate risk can be compromised by information problems or lack of capability.
- Stakeholders can have different understandings about risk and the objectives of risk-based regulation, potentially undermining the objectives of the regulator's strategy and the regulatory regime.

### How harm occurs

Underlying all regulations are assumptions and theories about the causes of harm. This holds true for quite diverse types of regulation. For example, economic regulation is founded on theories about competitive markets and the behaviour of firms with market power. Road safety regulation relies on theories about the safety of vehicles, factors that can impair driver ability, and road and weather conditions. Building regulation recognises that weathertightness is a product of building design, the properties of building materials and the skills of building practitioners.

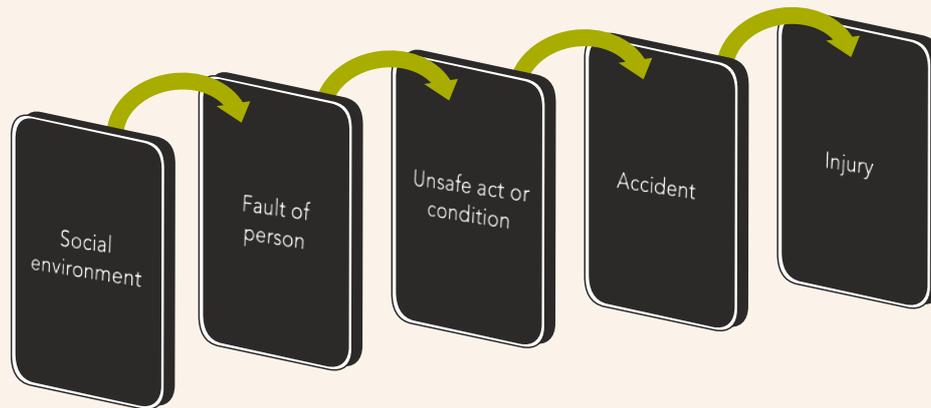
Early models of accident causation attempted to explain the causes of workplace injuries, but later were applied in other fields and are still widely used. In these models harm occurs by chains of directly related events, so accidents and risk can be best understood by looking at the chain of events leading to the loss (Box 3.3).

Single event chain models of how harm occurs are attractive because they show clear points of intervention for the regulatory system. Regulation can set standards for machinery and equipment, regulators can monitor firms to ensure that safety equipment is used and management and employees can be prosecuted for not having or not using safety equipment, or for not following safety procedures.

#### Box 3.3 The causes of harm – single event chain models

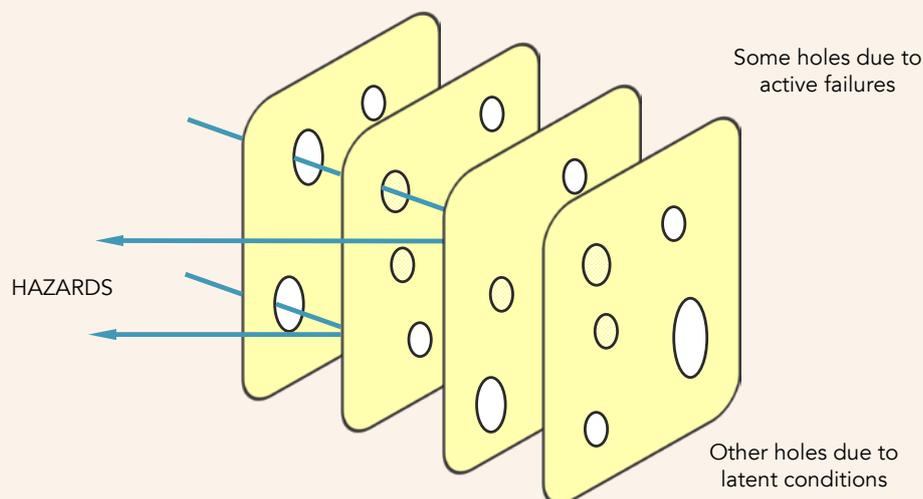
*Domino models* – The initial emphasis was on recognising and preventing the *unsafe conditions* that might give rise to an accident, such as open blades and unprotected machinery. Efforts were therefore focused on making equipment and machinery safer. Initially these efforts were very successful in reducing workplace injuries, but the decrease slowed as the hazards were eliminated. The emphasis then shifted to *unsafe acts*. Accidents could be someone's fault – for example the failure to use a safety frame or protective clothing – rather than as an event that could have been prevented by a change in the plant or the product. The domino model, which dates from the 1930s, describes a sequence of events (an unsafe act or unsafe condition) that leads to an accident which causes an injury. In the 1970s the basic domino model was extended to include management decisions as a factor in accidents (eg, the failure of the management to ensure that employees used the safety equipment available). These types of models of accident causality are called domino models because they describe a single chain of events: if there is an unsafe condition or an unsafe act at any point, the dominos will fall and the harm occurs (Figure 3.3).

Figure 3.3 Heinrich's domino model of accidents



Reason's "Swiss Cheese" model – widely used in the aviation, engineering and health care fields, is also a single event chain model. The defenses against harm are modelled as a series of barriers represented by layers of cheese. The holes in the cheese represent weaknesses in the individual parts of the system. The holes can vary in size and move position across the slices. When the holes align, a failure occurs (Figure 3.4). The Swiss Cheese model allows for active conditions that are directly related to the accident – like pilot error – and latent conditions which can be dormant for a long time until they contribute to the accident. A common criticism of the Swiss Cheese model is that often the link between active conditions and latent conditions can be very tenuous until the link becomes "obvious" when the accident occurs. All systems have latent conditions that may never contribute to an accident.

Figure 3.4 Reason's Swiss cheese model of successive layers of defences



Sources: Leveson, 2011; Reason, 1990; Young et al., 2004.

The causes of harm are more complicated than these simple models suggest. Incidents that cause major harm are more likely to be due to the interplay of multiple factors rather than to a single chain of events (Leveson, 2011). This was recognised by the Royal Commission into the Pike River mining tragedy:

In November 2010 Pike was still in start-up mode and considerably behind its development schedule. Market credibility, capital raising, higher coal production, increased ventilation capacity, methane management and upskilling the workforce were significant challenges facing the company. History

demonstrates that problems of this kind may be the precursors to a major process safety accident. (Royal Commission on the Pike River Coal Mine Tragedy, 2012, p. 17)

In a review of the literature on the causes of the 2007-2009 Global Financial Crisis, Davies (2010) identified 39 different factors, ranging from global imbalances and loose monetary policy to the practices of US mortgage brokers, credit rating agencies and bankers through to the contribution of financial regulation itself in causing the crisis (Davies, 2010). The finding that there were many actors and institutional factors at play in the crisis bears a striking similarity to the view of Lederer, who in 1968 was director of NASA's manned flight safety program for Apollo (Leveson, 2011):

System safety...involves attitudes and motivations of designers and production people, employee/management rapport, the relation of industrial associations among themselves and with government, human factors in supervision and quality control, documentation on the interfaces of industrial and public safety with design and operations, the interests and attitudes of top management, the effects of the legal system on accident investigations and exchange of information, the certification of critical workers, political considerations, resources, public sentiment and many other(s)... (p. 29).

If harm occurs as the result of the interplay of many factors in complex systems rather than in a single chain of events, then this has implications for the role of the regulator and regulation, and where and how the regulatory regime can exert influence to control harm.

### **Difficulties in assessing and mitigating risk**

In many cases, what the regulator faces is uncertainty about the nature of the risk and the potential for the harm that may be caused. Black (2012a) argues that the term "risk" is often a misnomer. Regulators and regulated parties frequently operate in an uncertain world, where many risks are unknown and/or unmeasurable: "What is often described as 'risk' is often better described as uncertainty" (p. 1053).

Low-frequency but high-consequence events in particular are hard to assess. In addition, focusing on large risks can overlook smaller risks that can accumulate into a significant threat. And because risk-based approaches tend to focus on known or familiar risks, regulators can fail to detect new and emerging risks and risk-creators that may be "off the radar" (Black & Baldwin, 2010; 2012).

Experience with regulatory failures in New Zealand suggests that some agencies have struggled to effectively identify and target risks. Chief among examples is the Pike River mine tragedy, where the relevant regulator had an explicit risk-based strategy. As the Royal Commission noted:

...although mining had the third highest injury rate, in contrast to the construction, agriculture, forestry, manufacturing and fishing industries, it was not seen as a priority area. This seems to be because of a focus on industries with 100,000 or more full-time equivalent workers. This approach was too blunt...

Interestingly, the highest risk sectors were identified primarily according to personal injury data – the consequences of individual accidents – but high-hazard industries are at risk of catastrophic process safety accidents, which are, by their nature, low frequency high consequence events. As the Pike River mine tragedy demonstrates, a focus on personal injury rates alone is not adequate to identify the ultimate workplace hazards. Until recently, there was no sign that catastrophic risk featured in the department's strategic thinking. (Royal Commission on the Pike River Coal Mine Tragedy, 2012, p. 295)

Aviation New Zealand commented that few regulators in New Zealand consistently undertook "high quality risk analysis and utilization of the risk management standard", which was "critical in building consensus". They attributed the lack of consistent good practice in part to "an absence of high quality analysts who understand the information" (sub. 36, pp. 28-29). In the case of regulated parties, the CAA observed that smaller organisations can struggle to keep up:

Having good ability to recognise risk, sector confidence and trust, sector knowledge, intelligence systems, and good training for staff are all factors in the adoption of risk-based approaches in New Zealand. Particular challenges related to the speed and competence with which smaller and sole operators will implement SMS [Safety Management Systems]. (sub. 6, p. 50)

The Council of Trade Unions noted that a significant barrier in adopting risk-based approaches (at least in the area of occupational health and safety):

...is sufficient data and information of the right quality and the right form to make the decisions necessary for risk-based approaches. In some cases there are privacy and confidentiality issues that must be addressed. Well-designed information systems are also necessary. (sub. 25, p. 24)

Aviation New Zealand concurred, noting that “we are a small country and thus our data sets are not rich” (sub. 36, p. 29). ANZ Bank observed that, in some cases, regulated parties may be better able to identify legitimate risks than the regulator (sub. 24, p. 6).

### **Different understandings about risk and risk-based regulation**

Differences in public and expert perceptions of risks can be problematic, create tensions and diminish trust in regulatory institutions (Baldwin, Cave & Lodge, 2012; Breyer, 1993). Public perceptions of risk (sometimes amplified by the media) can place pressure on regulators to increase monitoring above the level suggested by an objective risk assessment. In other cases, the public perception of risk can be lower than identified by the regulator, leading to the perception that the regulator is being over-zealous.

According to the Meat Industry Association (MIA), a key barrier to introducing and maintaining risk-based compliance systems is public and political understanding of risk:

Understanding of risk is generally lacking, including at a political level, and is a major challenge to risk-based regulatory approaches ... In New Zealand, with regards to biosecurity there is a public expectation that 100% inspection at the border will result in 100% security. In fact 100% border inspection may increase the risk, as it could mean spreading resources inappropriately and providing a false sense of security. (MIA, sub. 40, p. 7)

A lack of industry or sector understanding of a risk-based approach – which entails targeting resources on some activities and explicitly not others – can undermine the credibility of the regime. NZFGC suggests that non-enforcement under a risk-based approach raises issues about the appropriateness of regulation:

The issue in risk basing compliance raises the issue of non-enforcement and therefore appropriateness of regulation (if a regulation is not intended to be enforced, why have it and are there better ways of giving effect to the desired outcome or changing behaviours). (sub. 35, p. 8)

And where regulators manage to successfully implement compliance strategies, they risk sowing the seeds of their own undoing, by creating public and political complacency about risk:

...there is potential in a high-risk high-reliability industry that has had very few safety failures (such as aviation) of failure to maintain regulator relevance and public understanding of the sector and its risks. A consequence of this is loss of interest in the activities of the regulator, and progressive disinvestment and loss of priority for the agency. (CAA, sub. 6, p. 52)

Good compliance monitoring and enforcement can be expensive but the results are often not visible and tangible compared to when something goes wrong – so over time it can be devalued and underfunded compared to front end rule-making and decision-making processes. Investigation into ways to account for the intangible results of good monitoring and enforcement may help keep this politically fresh. (EPA, sub. 20, p. 3)

Ex ante and ex post perceptions of risk can be very different. Politicians and the public may have a limited understanding that some risks will be prioritised and some risks might not be monitored. There can be a perception that the regulator is not doing its job, or that if the risk is not monitored then it should not be regulated. The monitoring activities and the prioritisation of effort by a regulatory agency around particular risks may be politically accepted ex ante – until some event occurs that captures the media and public attention. Ex post, the regulator can be blamed for a lack of attention to the risk and for failing to prevent the harm caused.

There may be a lack of understanding about the distinction between the inherent risks in a particular activity and whether those risks are being exacerbated or effectively managed by the regulated party. The regulator’s assessment of how risks are being managed may lead to different types of enforcement action against different parties with the same inherent risk profile, and prompt charges that the regime is unfair or inequitable in its treatment (Black & Baldwin, 2010).

### Are the challenges insurmountable?

There are considerable challenges in implementing risk-based regulation. Black and Baldwin (2010) have argued that the hopes that risk-based regulation would provide “an evidenced-based means of targeting the use of resources and of prioritising attention to the highest risks in accordance with a transparent, systematic, and defensible framework”, as envisaged by Hampton (2005), is a “too easy” vision of risk-based regulation. It cannot be a mechanical or quantitative means of solving regulatory problems. They see a need to “apply risk-based regulation in a newly reflective manner and to conceive of it in a more nuanced way” (pp. 181-83).

#### F3.4

There has been widespread endorsement of risk-based approaches to regulation because risk-based approaches directly relate the activities of the regulator – targeting risk – to the objectives of the regulatory regime – reducing the risk of harm. But risk-based approaches pose a number of challenges in implementation. There can be a lot of uncertainty about the nature of the risk and at what point the regulator should intervene.

## 3.4 Integrating responsive and risk-based approaches in practice

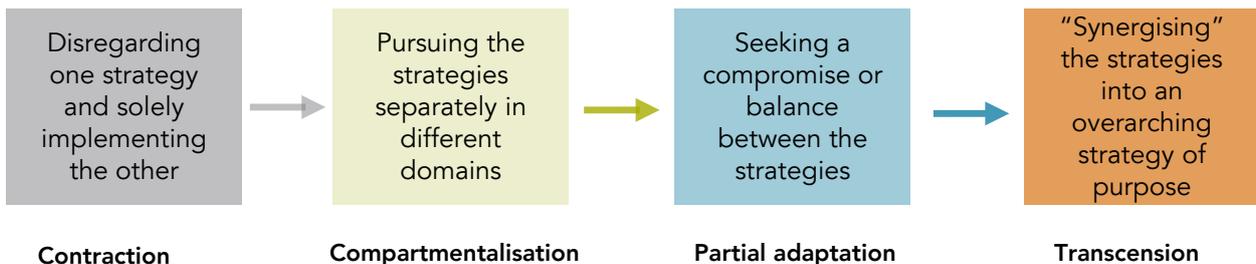
This section discusses how regulatory agencies reconcile different regulatory approaches in their operational practice, and whether responsive and risk-based regulation can be integrated in ways that can lead to a more effective regulatory strategy.

### How organisations can reconcile differing strategies

Responsive regulation and risk-based regulation represent different strategies that have been proposed for the modern regulator. How should a regulator reconcile the differences?

Research by Bednarek (2011) offers some insight into the challenges faced by organisations asked to accommodate different and apparently conflicting strategies. Bednarek’s review of the literature, drawing in particular on Kraatz and Block (2008), identifies four responses that organisations adopt in response to this challenge, with increasing levels of integration between the strategies (Figure 3.5).

Figure 3.5 Organisational responses to the challenge of implementing different strategies



Source: Adapted from Bednarek, 2011.

### **Contraction** – some regulators focus on the compliance pyramid

Despite calls for regulation to be more risk-based, Graeme Aitken submitted that many regulators in New Zealand exhibited *contraction* in their regulatory approaches, remaining focused on a compliance-oriented regulatory strategy:

Many regulatory/compliance agencies see their job as securing compliance with the law. They tend to respond to complaints. Whilst they may or may not have the ability to apply a responsive model (the compliance pyramid), often they do not understand or embrace a risk based approach, nor will they seek to develop the capability to gather the intelligence and do the analysis necessary to support a risk based approach. (sub. DR 60, p. 5)

## Risk-based and responsive strategies are *compartmentalised* in theory...

The academic literature has tended to treat risk-based and responsive strategies as discrete regulatory approaches rather than finding ways of integrating the strategies into an overarching strategy with a common purpose. Gunningham (2010), for example, considers that risk-based approaches are an evidenced-based means of targeting the use of regulatory resources towards activities that create the greatest risk, while the responsive/enforcement pyramid provides guidance about the types of enforcement and compliance tools to apply.

Baldwin, Lodge and Cave (2012) observe that in risk-based regulation, no direct link is drawn between the risk assessment and the intervention strategy. Where a link exists, it is through the resources that have been allocated based on the prior assessment of risk.

Black and Baldwin (2012) point to an unresolved “disconnect” between the risk-based assessment of sites and activities and the behaviour-based approach of traditional enforcement manuals. According to Bednarek’s framework (Figure 3.5) it seems that the academic literature *compartmentalises* regulatory strategies.

## ... and are often *compartmentalised* in practice

*Compartmentalisation* of the strategies is also evident in practice. Some regulators undertake risk assessments of particular segments of the regulated market but operate a compliance/enforcement pyramid at the level of particular firms. Some regulators undertake environmental scanning for risk as a separate activity. For example, the Reserve Bank of New Zealand publishes a 6-monthly Financial Stability Report that includes a systemic risk assessment, and the MPI monitors changes to New Zealand’s biosecurity risks.

## Is there evidence of *partial adaptation*?

A number of the published compliance and enforcement strategies that the Commission looked at considered both the harm caused by compliance breaches and the attitude/behaviour of those causing breaches when allocating resources and taking action. The agencies differed in the extent to which they prioritised harm reduction or compliance maximisation, and the extent to which the two objectives appeared to be integrated or treated separately.

While published strategies can only provide a limited view of how the approaches are actually balanced within each organisation in practice, the strategies of the CAA and MNZ appear to balance harm reduction and compliance maximisation most closely (Box 3.4).

### Box 3.4 The published strategies of the CAA and MNZ

#### The Civil Aviation Authority

Risk reduction is the main enforcement goal for the CAA: “A key driver for the CAA’s decisions on the type and level of its involvement with participants is the nature of their aviation activity and the impact on third parties of safety failure. In this regard the principle of public interest being paramount is a key consideration” (CAA, 2014, p. 7). Every industry participant is rated according to the level of aviation safety risk they pose, and CAA resources are allocated towards activities where the consequences of regulatory failure are highest.

However, in carrying out its regulatory activities, the CAA also takes into account the attitudes of participants and their willingness to comply with or correct behaviour. The key criteria considered are:

- “the life cycle of an aviation participant at the CAA’s role at each stage (entry, continued operation or exit);
- the nature of the activity (its inherent level of risk at a system level);
- the CAA’s assessment of the specific aviation safety risk presented by activities of the individual

participant; and

- the attitudes and behaviour of aviation participants towards compliance, safety and reporting” (p. 5).

Similarly, enforcement actions are taken based on the principles of public interest, proportionality (the level of action reflects the degree of culpability and harm caused, willingness to learn, and compliance history) and consistency (that is, the same response to similar cases).

### Maritime New Zealand

MNZ’s enforcement approach targets harm, “the magnitude of the consequence that would eventuate should an event occur” and “the likelihood of that event occurring” (MNZ, n.d.(b) p. 8). MNZ concentrates “our activities where we see a pattern of problems or issues. These patterns might occur in particular parts of the maritime sector, with types of vessels, types of equipment, or practices, or in particular geographic areas. They might also occur with particular operators” (ibid). To identify these patterns, MNZ draws on intelligence, including audits, inspections, investigations and their “knowledge of oil spills and security issues” (ibid). At the same time, MNZ will take into account the nature of the conduct and attitude to compliance of the individual or firm in question. Compliance tools are selected using the following criteria:

- *extent of harm or risk of harm*: for example, the scale of actual or potential harm to health and safety, security and the environment;
- *conduct*: “the behaviours, intent and capability of the person whose actions are being considered”;
- *public interest*: for example, “responsibility to victims, the need to clarify the law, and whether the matter at hand reflects a widespread problem that can be usefully addressed by highlighting the need for compliance”; and
- *attitude to compliance*: “the general attitude (or level of willingness) of individuals or groups to be compliant”.

Sources: CAA, 2014; MNZ n.d.(a); MNZ n.d. (b).

In summary, there is evidence of regulators adopting a range of responses to reconciling responsive and risk-based regulation, including *contraction*, *compartmentalisation*, and *partial adaptation* (Figure 3.5).

### F3.5

Regulators adopt a range of responses to reconciling responsive and risk-based approaches to regulation.

## A *transcendent* approach

In a 2012 paper, researchers Julia Black and Robert Baldwin proposed that a regulator’s intervention strategy should depend on both the nature of the risk – such as whether it is stable or unstable or likely to change or accumulate over time – *and* on the characteristics of the regulated party. The regulated party may be either well motivated or unmotivated to comply, or may have high or low capacity to comply. Indeed, the risk of harm and the behaviour, capability and attitude of regulated parties can be closely related. The ability of the regulated party to manage or mitigate the risk can lower the inherent riskiness of the activity, leading to a lower overall “net” risk.

The authors have developed a Good Regulatory Intervention Design (GRID) framework for low-risk activities to help the risk-based regulator choose the best enforcement approach based on the nature of the risk and the nature of the regulated party (Figure 3.6). The framework allows regulators to sort their regulatory activities in three different ways. The first way – shown on the left margin – is by the nature of the regulated

party. Regulated parties may be more or less willing to comply and more or less capable of complying. Regulated parties with different levels of motivation and capability will respond to different regulatory activities. For example, a willing regulated party with high capability to comply may respond to a mailout of information on regulatory obligations, while a less willing or capable regulated party may require further interaction.

Figure 3.6 Framework for dealing with low-risk activities

		2. Nature of the low-risk site/activity				
		Inherent lower risk (stable)	Net lower risk (stable)	Inherent lower risk (but may change or accumulate)	Net lower risk (but may change or accumulate)	
1. Nature of the regulatee Intensity of intervention increases according to regulatee type	Well motivated with high capacity to comply <i>Eg, information brochures</i>					Screening tools
						Monitoring tools
						Engagement and incentive mechanisms
		Low	Low	Low	Low	Regulatory intensity
	Well motivated with low capacity to comply					Screening tools
						Monitoring tools
						Engagement and incentive mechanisms
		Low	Low	Medium-Low	Medium-Low	Regulatory intensity
	Less motivated with high capacity to comply					Screening tools
						Monitoring tools
						Engagement and incentive mechanisms
		Medium	Medium	Medium	High	Regulatory intensity
Less motivated with low capacity to comply					Screening tools	
					Monitoring tools	
					Engagement and incentive mechanisms	
	Medium	Medium	High	High	Regulatory intensity	

Source: Black & Baldwin, 2012.

Second, regulatory activities can be sorted by the nature of the activity or site that is being regulated (the top margin). Regulated activities or sites can be “inherently” lower risk or “net” lower risk. The difference between “inherent” risk and “net” risk is the extent to which interventions can modify the risk. Regulated activities or sites can also be at a stable level of risk, accumulate steadily over time, or increase dramatically through a step-change.

Third, different regulatory tools can be allocated according to the nature of the risk and the nature of the regulated party. The three basic types of regulatory tools described on the right margin are screening tools, monitoring tools, and engagement and incentive mechanisms.

The boxes in the centre of the figure are for regulators to fill in according to their assessment of the risk, the characteristics of the regulated party and the types of tools the regulator has available. For example, a regulator could allocate its educational activities – such as information brochures – to well-motivated, highly capable regulated parties in regulatory areas of low and stable risk. These activities would be classified as “engagement and incentive mechanisms”. To illustrate this, the relevant box in Figure 3.6 has been filled out.

Figure 3.6 enables regulators to do one further piece of assessment. The regulator assesses the “regulatory intensity” depending on the type of regulated party and the risk. “Regulatory intensity” is short-hand for the amount of time and effort the regulator needs to spend on a particular type of regulated party and the risk. The figure provides a typical assessment of levels of regulatory intensity – the shade turns from light for low intensity to dark for high intensity. The level of intensity grows higher as the regulated party’s willingness and ability to comply diminishes, and as the risk becomes less stable and more amenable to regulator effort.

The framework was developed with low-level environmental risks in mind, because they are often neglected in risk-based approaches which tend to focus effort and resources on high risks. This approach recognises that low risk activities can accumulate over time to create significant environmental damage.

This integrated or *transcendent* approach, to use Bednarek’s terminology, appears to have been used by the Greater Wellington Regional Council in pest management strategy under the Biosecurity Act 1993 (Box 3.5).

### Box 3.5 A strategy to manage pests

Pest invasions can be relatively stable or quickly accumulating depending on the stage of the invasion. As the Council notes, many pest invasions accumulate slowly as the pest establishes itself, followed by “a steep rise as the pest finds suitable habitats, and then a flattening off as these habitats reach carrying capacity” (p. 36). The Council’s strategy reflects this by keeping early and relatively stable pest invasions under surveillance and focusing pest control by council staff or contractors on pests that have found habitats.

Council pest activities also vary depending on the level of capability and motivation of landowners or land occupants. For example, the Council encourages capable and highly motivated landowners and occupants to form community groups that undertake local pest management projects.

Finally, activities can be sorted into screening, monitoring and engagement/incentive tools. Screening tools take the form of regional surveys to determine what pests have taken hold and what stage of invasion these pests have achieved. Monitoring tools include site inspections by staff or contractors. Engagement and incentive mechanisms take a range of forms, from public engagement via stalls at horticultural shows, to direct control of pests on site by staff or regulations banning certain pests or mandating certain control activities by landowners or occupants. At the extreme end, council inspectors have the power to enter and inspect any place for the purpose of confirming the presence or absence of pests or pest agents (s109(1)(a), Biosecurity Act 1993).

Source: Greater Wellington Regional Council, 2009.

**F3.6**

An integrated approach to risk-based and responsive regulation can help the regulator choose the best intervention to meet the objectives of the regulation, based on both the nature of the risk and the nature of the regulated party.

### 3.5 The regulatory challenge

This chapter has examined responsive regulation and risk-based regulation. Both are grounded in academic theory and research and both have been influential in shaping the strategies that regulators use to achieve the objectives of regulation. Each has its challenges in implementation.

In the first decade of the twenty-first century the difficulties and challenges that regulators face in practice have led some scholars to believe that new strategies are required. New strategies can be beguilingly attractive to policymakers and regulatory scholars alike. It is tempting to believe that regulatory success is just a matter of finding the right tool (Black, 2012a). This is misguided. First, *there is no superior regulatory strategy*. Different strategies and approaches have different strengths and weaknesses, with different levels of effectiveness, in different contexts.

Second, responsive regulation and risk-based regulation are not discrete modes of control. It is not a matter of choosing one approach over the other; both have a place in the control strategies deployed by regulatory agencies. Even so, as section 3.4 explains, there is work to be done in integrating the risk-based assessment of sites and activities with the behaviour-based approach of responsive regulation to more effectively meet the objectives of a regulatory regime.

As Black and Baldwin (2012) observed, there has been

... a strategic gap between the risk-based assessment process and the enforcement process, with comparatively little development of strategies that might occupy the middle ground between these two stages of assessment and formal enforcement action. (p. 133)

Third, any regulatory strategy can fail, with disastrous consequences. The failure of compliance and enforcement, and the failure to understand and assess risk, were cited as contributing causes in many of the official reports of disasters analysed by the Commission (Chapter 1).

With no single, superior strategy on offer, the key lies in understanding and adapting regulatory strategies to take account of the influences and dynamics of the many different contexts in which they are deployed.

**F3.7**

There is no single, superior regulatory strategy. The key lies in understanding and adapting regulatory strategies to take account of the influences and dynamics of the many different contexts in which they are deployed.

### The perspective of the regulator

An important test of regulatory theory is whether it offers assistance in addressing the challenges that regulators face in practice (Baldwin & Black, 2008). This chapter now turns to the environment that many regulators face in implementing and administering their regulatory regimes.

#### The regulator's view is a partial one

Julia Black, the Sir Frank Holmes Visiting Professor in Public Policy at Victoria University, began a seminar at the Treasury in March 2014 by describing the regulator's view of the world. She described it as being like the view looking through a telescope.

- Depending on the nature of the regulated activity, the regulator may not have enough information about the regulated party to assess either the risk of harm or the attitude of the regulated party to compliance.

- The very parties that the regulator should be worried about are the very ones that are doing their best to avoid the scrutiny of the telescope. There can be a big difference between the outward face that the regulated party presents to the regulator and the real risk they pose and their internal attitude or culture towards compliance.
- The scope of the view through the telescope may be prescribed by the regulations or legislation the regulator administers, but the most harmful activity may be happening elsewhere as a result of changing technology, new products and new markets which can create new risks and new risk creators.
- How the regulator interprets what it sees through the telescope will depend on its underlying assumptions about how harm occurs.

The reality of this “partial view” is problematic for both responsive and risk-based regulatory strategies (and indeed any regulatory strategy).

### **The regulator is not in the centre of the picture...**

In both responsive and risk-based strategies, the actions of the regulator are central. In risk-based regulation the regulator assesses the risk the regulated party poses to the objectives of the regime and then decides on the action it will take. In responsive regulation the regulator’s actions can “push regulatees into compliance” (Etienne, 2013).

In reality the regulator may have very little influence over regulated parties, who may be subject to other more powerful influences. The regulated party is likely to be influenced by the culture of the industry it operates in (or for individuals, the social group they associate with), or the regulated party may be subject to financial or other pressures that lead to risky behaviour or lack of compliance. The chief executive of one New Zealand regulatory agency described the regulator as being not in the centre of a circle but on the edge – using what means it had to influence the firm or industry. In some cases this will mean working with other organisations that have influence over the risk-taking or non-compliant firm – such as trade associations, banks and insurers – organisations that also have an interest in reducing the risk of harm. The media can also be influential where regulated parties are concerned with reputational risk.

### **...but the regulator is part of the picture**

While the regulator is not in the centre of the picture, it is *part* of the picture. The behaviour of the regulated party – both in respect of the risks it creates and its attitude to compliance – can be contingent on the behaviour and actions of the regulator. For example the decision to prosecute in instances of serious harm can inhibit regulated parties from cooperatively disclosing information vital for understanding how harm was caused. The behaviour of the regulated parties is not “blind” to the regulatory stance of the regulator.

The actions of the regulator in focusing on one area of concern or risk can lead to displacement activity on the part of regulated parties – either to new activities not covered by the regulation or activities unknown to the regulator or to a jurisdiction not covered by the regulator.

One lesson from the Global Financial Crisis is that regulation and regulators themselves can be contributing factors in a failure of regulation to meet its objectives:

The crisis... illustrated the potential for regulation to create endogenous risk and negative feedback loops, amplifying the very risks it is meant to be controlling, with catastrophic results. (Black, 2012a, p. 1040)

### **The regulator’s actions are determined by its institutional environment**

Responsive regulation assumes that the regulator’s response is contingent on the behaviour and attitude of regulated parties. Similarly, risk-based regulation assumes the regulator’s response is based on the risk posed by regulated parties to the objectives of the regulatory regime. But, as outlined in the sections above, the regulator’s intelligence gathering, risk assessment and enforcement response is a function of a wide range of institutional factors not directly related to the regulated party, its compliance attitude or risk status. These institutional factors include:

- the regulator's capacity (resources) and capability and how it has prioritised its effort;
- constitutional, statutory and legal requirements; and
- its independence and ability to take decisions and the degree to which it is subject to political, public or other pressures.

## What does this perspective mean for regulatory practice and design?

Irrespective of whether regulators practice responsive regulation (including variants such as smart regulation) or risk-based (including regulatory craft) approaches, or a mix of approaches, regulators face considerable challenges. Further as Baldwin and Black (2008) emphasise, none of these theories has a great deal to say about

how a regulator should deal with resource constraints, conflicting institutional pressures, unclear objectives, changes in the regulatory environment, or indeed how particular enforcement strategies might impact on other aspects of regulatory activity, including information gathering, and how regulators can or should assess the effectiveness of their particular strategies when any of these circumstances obtain. (p. 61)

Baldwin and Black, drawing on the work of institutional theorists such as Oliver (1991), Scott (1995) and Powell and DiMaggio (1991), and regulatory scholars Gunningham, Grabovsky and Sinclair (1998), propose that a deeper institutional analysis of the motivations, interactions and institutional environments of the regulatory actors in regulatory regimes – regulators and regulated parties – is required. The researchers have coined the terms *really responsive* regulation (Baldwin & Black, 2008) and *really responsive risk-based* regulation (Black & Baldwin, 2010) to acknowledge that this is not a new regulatory strategy. Rather, it builds on and augments the approaches already being used in regulatory practice.

## 3.6 Being attentive to be effective

### Really responsive regulation

Being *really responsive* means recognising that a range of organisational and institutional factors influence the effectiveness of regulation. Box 3.6 elaborates on what it means to be really response.

#### Box 3.6 What it means to be really responsive

To be successful in achieving the objectives of regulatory regimes, regulators and those who design regulatory regimes must be responsive or attentive to the following factors.

**The attitudinal settings of regulated parties:** This goes beyond the question of the regulated party's attitude to compliance to consider the broader context that shapes the regulated party's response to the regulatory regime. Studies in the institutional theory of organisations emphasise that an organisation's response to its environment is a combination of rational and institutionalised factors, and the strategic actions of an organisation are shaped by a combination of internal and external institutional pressures. Such pressures include pursuit of profitability or reputation, market position, the alignment of regulatory demands with its own goals, the means by which regulatory demands are imposed and the perceived fairness of the regime.

For those designing a regulatory regime there is question about the extent to which regulated parties will accept the regulatory agenda. For the regulator, it will be necessary to consider what regulatory stance might change the "motivational posture" of regulated parties. This will inform the regulator's communication and engagement strategy. The regulator may have to be attentive to operational factors such as the procedural fairness of the regime's administration.

**Responsiveness to institutional environments:** Designers of regulatory regimes need to be aware of the constraints (and opportunities) that are presented by the institutional environments within which regulators act. The actions and decisions of regulatory agencies are determined by their organisational

form, their resources, their decision-making powers, the extent of political control (formal or informal) over the regulator, their role within a wider and possibly global regulatory system, the clarity of its objectives, mandate, and the broader legal and constitutional environment in which it operates.

**Responsiveness to the logics of different regulatory tools and strategies:** Different regulatory strategies have different “logics”. They embody, or place emphasis on, different understandings about the nature of the behaviour of regulated parties or the nature of the environment in which regulated parties operate. Regulatory objectives can be achieved through different means (eg, punishment or education) and their success will depend on how the regulator frames them and the regulated party perceives and receives them. What matters most is the coherence of the logic, because confusion detracts from effective regulation.

Problems arise when a regulator employs different logics in similar circumstances (a practice issue) or different regulators with overlapping jurisdictions use different logics (an institutional design issue). Careful consideration of what tools and strategies are used in what circumstances is a crucial element in the design of regulatory regimes and the practices of regulators.

**Responsiveness to the performance of the regime and regulator:** The regulator must be able to assess its performance, adapt its operations and strategies in light of performance assessments and modify its approaches to deal with new challenges to ensure the regime’s performance over time. Assessment and evaluation of performance is a difficult task and will require a culture of learning and evaluation, good assessment and evaluative tools and a regulatory management system that supports ongoing evaluation and performance assessment.

**Responsiveness to change:** The really responsive regulator must be sensitive to change. New risks and new risk creators can emerge or become recognised through events or new knowledge. Markets and technologies develop, institutional structures are often reformed, and political and public expectations can change over time.

A really responsive approach suggests that positive steps have to be taken to the challenges of encouraging sensitivity to performance and fostering the capacity of regimes and regulators to respond to changing circumstances. The regulator’s organisational culture and organisational dynamics need to be able to respond and adapt to the changes required to be effective. There are also implications for regime design, including having mechanisms for changing or updating regimes where required.

*Source:* Baldwin & Black, 2008; Black and Baldwin, 2010.

In their submission, the Treasury and SSC comment:

While we are not front-line regulators, we tentatively think that the work of Black and Baldwin provides very useful insights into the nature of the operational challenges that many regulators must confront... any regulator that takes a serious interest in how well the regime’s regulatory objectives are being met will be drawn to attend to the factors that define the really responsive approach described by Black and Baldwin. (sub. DR 97, p. 7)

To this comment, the Commission would add that attentiveness to the factors that define the really responsive approach is also important for the design of new regulatory regimes and new regulatory institutions. One insight of the really responsive approach is the importance of institutional factors for the successful implementation of regulation.

Using Bednarek’s (2011) language (Figure 3.5), being a really responsive regulator might be described as *transcendent* – “synergising” its strategies into “an overarching strategy of purpose” to effectively meet the objectives of the regulatory regime.

## 4 Regulator culture and leadership

### Key points

- The term “regulator culture” is used in this chapter to describe the shared norms, values and beliefs that influence the behaviour of staff working within a regulatory agency. These norms, values and beliefs are heavily influenced by:
  - the beliefs, values, assumptions and behaviours of the founding leaders of the organisation;
  - the shared experiences of staff in the performance of the duties; and
  - new beliefs, values, and assumptions brought in by new staff, particularly new leaders.
- From outside an organisation it can be hard to distinguish problems arising from a “dysfunctional culture” from those arising from more tangible factors such as the design of legislation or capability issues. When looking to improve regulator performance, it is important to understand if what is required is a change of *practice within a given culture*, or a change in culture.
- While making generic conclusions is hard, the Commission’s analysis suggests the following points.
  - There is poor internal communication within some regulators. Workers feel unable to challenge poor practices, contributing to the perception that regulatory bodies are unable to learn from their mistakes and successes.
  - Previous restructuring of regulatory organisations has required significant cultural shifts. These shifts have not always been well understood or managed.
  - Stakeholders often perceive the quality of engagement as a “window” to the culture of a regulator. In making this connection, it is important to assess whether the regulator’s approach to engagement is driven by its values and beliefs, or whether it is driven by some other factor – such as the legislative environment or available resources.
  - A common understanding of the purpose and mission of a regulatory body is the first step in developing culture. Yet, on average, central government regulatory workers do not perceive that senior managers communicate a clear organisational mission. Those workers that did perceive clear communication of a mission were more likely to feel emotionally attached to the organisation, be more loyal to the organisation, and be more committed to the organisation.
- The culture of a new regulatory body can be shaped in a number of ways.
  - Government can seed a “desirable” culture by appointing founding leaders with values, beliefs and experiences compatible with those it believes are most conducive to achieving the desired regulatory outcomes. However, selecting the “right people” does not guarantee that the “right” culture will emerge – the *actions* of founding leaders are the key to embedding culture.
  - Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.
- While legislative provisions can codify certain actions (such as consultation), they do not guarantee that a regulatory body will develop deeply held values around the importance of the behaviours. The culture of the organisation will evolve as its members discover what works and what does not.
- The chapter suggest practical strategies and actions to promote favourable regulator culture, and provides principles for effectively managing cultural change.

## 4.1 Introduction

Organisational culture affects how regulatory bodies undertake their duties and, as such, plays an important role in achieving regulatory objectives. However, while the importance of “culture” is widely recognised the concept remains ambiguous. An important aim of this chapter is to provide clarity around the concept of regulator culture in the hope of distinguishing “cultural problems” from the numerous other factors that incentivise and motivate regulator behaviour.

This chapter begins by drawing on the influential work of Schein (1984, 2010) to provide a framework through which the concept of organisational culture can be understood and analysed. The chapter then presents a set of cultural attributes that the Commission believes are conducive to high-performing regulatory agencies. These attributes build on the key messages of the previous chapter.

Steps that leaders can take to embed these attributes are then discussed along with tools for assessing the culture of an organisation. Finally, the chapter discusses the steps that government can take to promote an “appropriate” culture within a new regulator and principles for effective culture change.

## 4.2 What is regulator culture?

In this report, the term “regulator culture” is used to describe the norms, values and beliefs shared by staff working within a regulatory agency.<sup>9</sup> These include the norms of behaviour and commonly held notions around the factors that are important for organisational success and how success is best achieved. Schein (2010) notes that the concept of culture covers a wide range of factors that influence organisational behaviour. These include:

- competencies that are passed on to new staff without necessarily being formally articulated;
- mental models and cognitive frameworks that guide how tasks are to be approached; and
- policies and ideological principles that guide how staff interact with stakeholders.

Schein (2013) summarises the concept of culture as:

Culture is best thought of as what a group has learned throughout its own history in solving its problems of external survival in internal integration. ...It is best conceptualised at its core as *the shared, tacit assumptions that have come to be taken for granted and that determine the members' daily behaviour*. (p. 1) [Emphasis original]

Culture can be likened to a “psychological contract” that lays out the unwritten rules that govern how people within an organisation are expected to act, think and feel and how they can expect others to act, think and feel (Brewis & Willmott, 2012). So culture plays a key role in the internal coordination of staff and in how the organisation adapts to changes in its external environment.

The conceptualisation of culture as an organisational phenomenon is different, but inherently related, to the higher-level concept of *regulatory culture* that can exist at a level beyond an organisation (that is, the “regulatory culture of New Zealand”). Bohne (2011) argues that *regulatory cultures* are specifically characterised by:

- shared values and beliefs concerning the relationship between government, markets, and the individual;
- common legal and administrative traditions and principles;
- the extent to which public authorities enjoy regulatory discretion; and
- the distribution of regulatory competencies and related organisational structures (p. 258).

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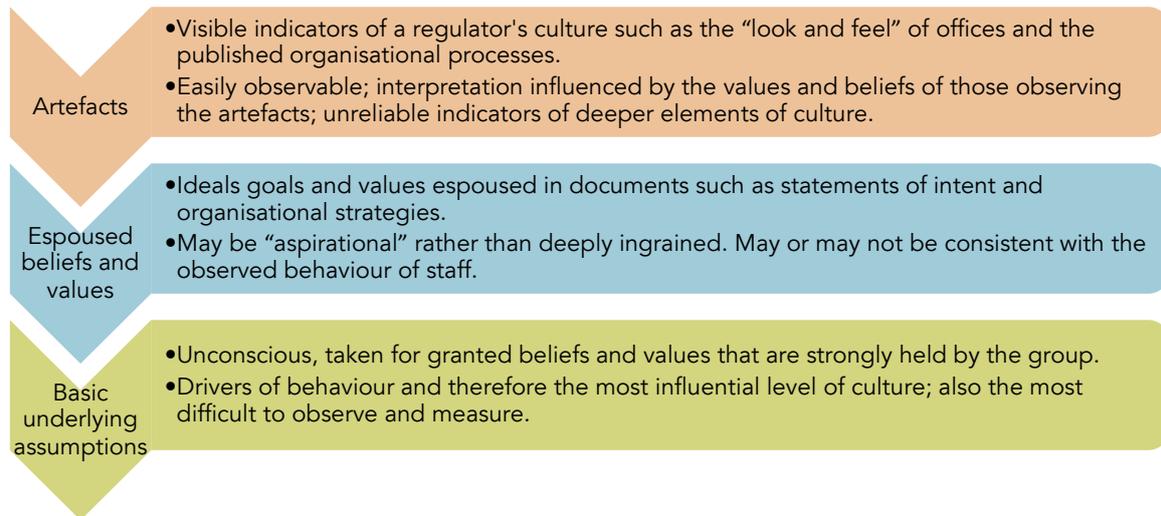
<sup>9</sup> Used in this way, the term “regulator culture” should be interpreted as short-hand for “the organisational culture of a regulatory body”.

These interconnected characteristics are the focus of other areas of the report and, as such, this chapter concentrates on the organisational culture of New Zealand’s regulatory bodies.

## Levels of regulator culture

Assessing the culture of an organisation is hard. At the most basic level, culture can be examined by looking at the visible attributes of a regulatory body – what some refer to as the “look and feel” of the organisation or the “artefacts” of the organisation (Figure 4.1). This includes, for example, the architecture of its offices, the design and style of its publications, the technology it uses, the language it embraces, its published organisational processes, and its style of interaction with external parties.

**Figure 4.1** Levels of regulator culture



Source: Schein, 2010, p. 24.

While these visible “artefacts” of organisational culture can be readily observed, they are difficult to decipher. That is, while an observer can describe the “look and feel” of an organisation, it is hard to know whether this reflects the *behaviour* of the organisation or, more specifically, the extent to which artefacts reflect deeply held values and beliefs that actually drive behaviour (Gagliardi, 1990; 1999). Further, the interpretation of artefacts will inevitably be influenced by the beliefs and values of the person observing the artefacts. As Schein notes:

[it is] dangerous to try to infer deep assumptions from artefacts alone because a person’s interpretation will inevitably be projections of his or her own feelings and reactions. For example, when you see a very loose informal organisation, you may interpret it as ‘inefficient’ if your own background is based on the assumption that informality means playing around and not working. Or alternatively, if you see a very formal organisation, you may interpret that to be a sign of ‘lack of innovative capacity’ if your own experience is based on the assumption that formality means bureaucracy and standardisation. (Schein, p. 25, 2010)

At a deeper level, culture can be analysed by looking at the espoused values and beliefs of a regulator – commonly found in corporate documents such as organisational strategies, annual reports and statements of intent.

For some organisations, espoused values and beliefs may have emerged through time as a set of “tried and tested rules”. However, for others the espoused values may be “aspirational” rather than deeply ingrained and widely accepted. This means they may not actually reflect the beliefs of those working within the organisation (Argyris & Schön, 1978; 1996). For example, a new regulator may espouse the importance of close relationships with other regulators while simultaneously rewarding actions that undermine the espoused value of “coordination” (such as by rewarding staff who “lay claim” to functions previously undertaken by an existing regulator). As the Ministry for Primary Industries (MPI) notes:

While engaging with staff to generate ‘core values’ is worthwhile, the values risk becoming just an expression of the desired culture, and not the culture that is actually present. (sub. DR 102, p. 7)

The deepest level of cultural analysis involves examining the basic underlying assumptions that guide the behaviour of regulators. These are “unconscious and taken for granted ways of seeing the world and are the source of the values and artefacts” (Brewis & Willmott, 2012, p. 378).

The underlying values and assumptions of a regulatory organisation ultimately guide behaviour, but these are the hardest elements of culture to measure and examine.

#### F4.1

The espoused values of new regulators may be “aspirational” rather than deeply ingrained and widely accepted. This means such values may not actually reflect the beliefs of those working within the organisation or be reflected in their actions.

## Subcultures within regulators

Regulator culture is influenced by the broader context in which the organisation operates and the interaction of subcultures within its workforce. The broader context includes the wider national culture and the institutions and laws that influence the formation of the regulator. Federated Farmers notes some of these broader forces in its submission:

New Zealand’s heritage, circumstances, culture and values, its size and geography, and its political environment all make for a unique regulatory “style”, which means that regulation that might be appropriate overseas may not be so in New Zealand. (Federated Farmers, sub. 11, p. 7)

Subcultures on the other hand emerge *within* regulators as subgroups develop their own assumptions and methods for undertaking specific tasks. These subcultures can reflect functional units, geographic groups, professional groups, or the place in the regulator’s hierarchy.

- **Functional units:** These are groups within a regulator that undertake common tasks or groups of tasks. For example, regulators that implement multiple pieces of regulation may find subcultures emerging within the different units responsible for the different pieces of legislation.
- **Geographic groups:** Many regulators operate in multiple regions. These regional groups face their own set of local conditions and challenges. Through time, subcultures can emerge in response to conditions. As a result, how the geographic groups implement regulation can vary according to the predominant subculture of the local group.
- **Professional groups:** Occupations can develop subcultures of their own based, for example, on common educational backgrounds or the requirements of occupational licences. As Schein (2010) notes “...engineers, doctors, lawyers, accountants ... will differ from each other in their basic beliefs, values, and tacit assumptions because they are doing fundamentally different things, have been trained differently, and have acquired a certain identity in practicing their occupation” (p. 261). Strong professional subgroups can create a situation where individuals have a stronger affiliation to their profession than to their organisation.
- **Place in the regulator’s hierarchy:** People working at the same level of an organisation’s hierarchy often undertake similar tasks. This shared experience can give rise to the development of a set of shared assumptions that can be thought of as the subculture of that group. For example, the “subculture of the senior management team” or the “subculture of inspection officers”.

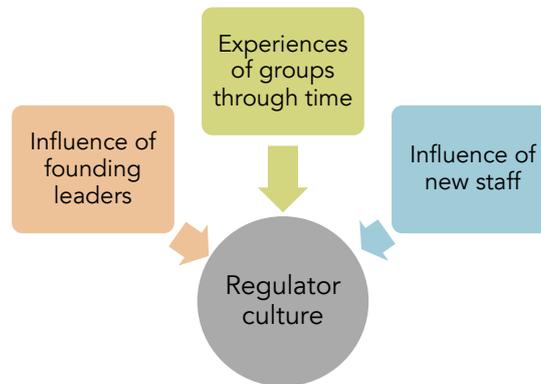
## 4.3 Forces shaping the culture of regulators

Schein (2010) has argued that organisational culture emerges from three sources:

1. the beliefs, values, assumptions and behaviours of the founding members of organisations – particularly its leaders;
2. the shared experiences of group members as their organisation evolves; and
3. new beliefs, values and assumptions brought in by new members and leaders.

While Schein’s model for culture formulation is derived with reference to the private sector, its theoretical foundations (rooted in psychological theories) hold for any group of people whose patterns of behaviour (and ultimate success) are informed by a history of shared learning and stable membership. Indeed, Schein argues that groups with a high turnover of staff and leaders, or that have not shared the experience of challenging situations, may not develop a set of shared assumptions (that is, the group may not develop a shared culture).

Figure 4.2 Sources of organisational culture



### Leaders as a source of regulator culture in new organisations

Founding leaders have a profound impact on the culture that emerges within a new regulatory agency.<sup>10</sup> These leaders are important because they set the values and the environmental context in which the new regulator will operate. They do this by drawing on their own experiences, convictions and assumptions to propose answers to the questions that young organisations face about how to interact with stakeholders and how best to achieve their statutory purpose (Schein, 2010). In this way, founding leaders provide a source of ideas and behaviour models that support the operation of the regulatory organisation.

Several inquiry participants noted the importance of leadership. The submission from Minter Ellison Rudd Watts was typical of the sentiments expressed:

... leadership has a significant influence on the culture of an organisation. A good leader of a regulatory agency will encourage a productive and collaborative multi-disciplinary team environment within the organisation, and effective two way communication with external stakeholders. This is a key building block to ensure regulation is informed by the best available evidence. (sub. 28, p. 46)

On a similar note, the Commission’s survey of chief executives found that 91% (21 out of 23 respondents) agreed that the senior leadership team in an organisation *drives* corporate culture. Chief executives also agreed that culture affects front-line staff, with 91% agreeing that corporate culture and values influence how front-line staff operate.

Leaders also affect the “tone” of an organisation through their recruitment decisions. By recruiting staff that leaders feel are likely to share their convictions and assumptions, they are able to embed patterns of behaviour into a new organisation. This commonly involves recruiting staff with similar experiences or professional backgrounds as the founding leader. The mechanisms through which leaders embed culture are discussed in section 4.5.

### Experiences as a source of regulator culture

As a regulator matures, the approaches of the founding leaders (and the values and assumptions that underpin these approaches) are tested through their repeated application. Successful approaches become embedded in the beliefs and values of the organisations (Schein, 2010). Unsuccessful approaches are re-examined and new assumptions evolve to take their place (or existing assumptions are modified). In this

<sup>10</sup> Founding leaders can be “formal” leaders in the sense of an organisational hierarchy and informal leaders within the organisation that lead groups in ways that lie outside the formal structure of the organisation.

way, the collective experiences of the groups within regulatory organisations combine to shape its culture. As Gordon (1991) notes:

“...culture formulation is neither a random event nor an action dependent solely on the personalities of founding leaders or current leaders, but it is, to a significant degree, an internal reaction to external imperatives”. (p. 404)

Problems can arise however if deeply embedded assumptions restrict the ability of an organisation to adapt to changes in its external environment, which is central to ‘really responsive regulation’ (discussed in chapter 3). For example, problems can arise if the established “ways of doing things” are a barrier to adopting new technology or more modern management practices. The Commission has previously found evidence of such workplace cultures at some New Zealand’s ports:

A major factor preventing the capture and sharing of additional value is the poor relationships between management, and workers and unions at some ports. These relationships resemble the ‘old school’ adversarial model of industrial relations, rather than the ‘productive employment relationships’ envisioned as the object of the Employment Relations Act...

...In such workplace environments, entrenched positions and cultures tend to view negotiations in terms of a ‘winner’ and a ‘loser’, rather than an opportunity to develop mutually beneficial outcomes. This is particularly prevalent where management and unions do not share a common view on what constitutes a successful port operation. This can result in resistance to changes that are perceived as being inconsistent with either party’s preferred view of the future. (NZPC, 2012a, p. 122)

While not a regulatory example, the above excerpt highlights how deeply embedded assumptions can have negative impacts on performance if they become outdated or inconsistent with the assumptions needed to promote success.

Similarly, problems can also arise if measures of “success” for a regulator (or subgroups within it) do not align with the intent of the regulation. This may arise, for example, if internal processes reward behaviour that promotes the interests of the organisation (or subgroup) at the expense of behaviours that promote good regulatory outcomes.

### **Injection of new members and leaders as a source of regulator culture**

Just as founding leaders bring with them their own experiences, beliefs and traditions, so too do new employees. This injection of new ideas, values and ways of doing things can influence organisational culture, particularly when they are the result of structural changes (such as the merging of two or more agencies) or the result of changes in key personnel such as the chief executive or members of the senior leadership team.

#### **F4.2**

The culture that emerges within a new regulatory agency will be influenced by:

- the beliefs, values, assumptions and behaviour of its founding leaders;
- the experiences of members of the organisation as it matures; and
- the injection of new beliefs, values and assumptions through new members.

## **4.4 Types of organisational cultures**

This section provides a brief overview of two influential frameworks for classifying organisational cultures:

- Hood’s (1998) examination of four styles of public management organisation (the grid and group framework); and
- Bradley and Parker’s (2006) Competing Values Framework (CVF).

The value of these frameworks does not come from classifying an organisation as having a single cultural type. Indeed attributes of several cultural types may be observable within the one organisation. The true usefulness of these frameworks comes from:

- a) assisting designers of regulation in thinking about the cultural mix best suited to the risk being managed; and
- b) helping public sector leaders understand the prevailing culture within an existing organisation so as to identify when a rebalance may be needed (O'Donnell and Boyle, 2008).

## Grid and Group framework

Hood's book *The Art of the State* (1998) is arguably the most comprehensive attempt to examine the influences of culture within the context of regulatory organisations. The book draws on the work of anthropologist Mary Douglas (1986) to argue that it is possible to understand how an organisation behaves by examining the extent to which two key dimensions influence behaviour. Hood labels these dimensions "grid" and "group".

The **grid dimension** refers to the extent to which public management is conducted according to well-understood and accepted rules. These rules reduce the extent to which behaviour is open to negotiation or individual discretion. The **group dimension** refers to the extent to which collective choice of the group constrains individual choice.

Hood combines these two dimensions into a matrix to illustrate four basic organisational approaches to public management: hierarchist, fatalistic, individualistic, and egalitarian (Table 4.1).

- **Hierarchist approach** – characteristic of organisations that are socially coherent (high "group") and strongly influenced by well-established rules (high "grid").
- **Fatalistic approach** – characteristic of organisations influenced by rules (high "grid") but which have low levels of social cooperation and cohesion (low "group"). Hood notes that this approach to management will arise when "cooperation is rejected, distrust is widespread, and apathy reigns" (p. 9).
- **Individualistic approach** – characteristic of organisations that stress individual negotiation and bargaining. These organisations have low levels of social cohesion (low "group") and are not strongly influenced by rules (low "grid"), preferring to handle decisions through negotiation rather than stipulated rules.
- **Egalitarian approach** – characteristic of organisations with a high level of social cohesion (high "group") that is not strongly influenced by rules (low "grid"). These organisations tend to have highly participatory structures within which each issue is debated individually.

**Table 4.1** Four styles of public management organisations

Grid	Group	
	Low	High
High	<b>The Fatalist approach</b> Low cooperation, rule bound approaches to organisations. Example: atomised societies sunk in rigid routines.	<b>The Hierarchist approach</b> Socially cohesive, rule-bound approaches to organisation. Example: stereotypical military structures.
Low	<b>The Individualist approach</b> Atomised approaches to organisation that stress negotiation and bargaining. Example: Chicago school doctrines of "government by the market" and their antecedents.	<b>The Egalitarian approach</b> High-participation structures in which every decision is "up for grabs". Example: "dark green" doctrines of alternatives to conventional bureaucracy.

Source: Hood, 1998, p. 9.

An important contribution of Hood's work is his analysis of the way that different organisational approaches respond to public management "disasters". He argues that "responses to scandal or catastrophe in public management ... are likely to be a key test of cultural bias" (p. 25). Specifically, Hood argues that these four organisational approaches will respond to disaster in the following ways.

- Hierarchist responses will tend to emphasise the problem as arising from a lack of coordination, poor procedures and accountability (or a failure to adhere to existing rules and procedures). The solution is therefore to tighten the rules and authority structures so the event will not happen again.
- Fatalistic responses will view the disaster as a unique (one-off) event that, while tragic or embarrassing, was only foreseeable in hindsight. A fatalistic response will therefore argue that the world is inherently uncertain, and that even the most complex rules and procedures are subject to unpredictable events beyond their control. Accordingly, a fatalistic organisation would resist blaming an individual or system for the disaster and would see any attempt to do so as arbitrary and potentially counter-productive to avoiding similar events in the future.
- Individualist responses will see the failure as stemming from a combination of too much collectivism and a misplaced faith in the value of rules, planning and authority structures (as opposed to price systems, tort law and well-designed incentive systems). From the individual perspective, the solution to disasters is to strengthen the incentives on individuals to perform. This means promoting competition between workers and organisations, and introducing mechanisms that resemble markets wherever possible.
- Egalitarian responses will tend to see rules and procedures as the *source* of the problem rather than the solution. They tend to view public management disasters as arising from the fact that public sector workers are forced to operate in rules-laden systems, where rules are often contradictory and there is a tacit expectation that they will be broken to "get the job done". Egalitarian organisations would therefore see a greater level of worker empowerment as the solution to public sector disasters. This would let workers at the lower end of the hierarchy challenge authority and professional self-interest and "blow the whistle" on matters of public concern.

These responses are summarised in Table 4.2.

**Table 4.2 Responses to public management disasters**

<p><b>Fatalistic response</b></p> <p>Emphasis on: unpredictability of events and unintended effects</p> <p>Blame: the "fickle finger of fate" (or chaos theory interpretation of how the world works)</p> <p>Remedy: minimal anticipation, at most ad hoc response after event</p>	<p><b>Hierarchist response</b></p> <p>Emphasis on: expertise, forecasting and management</p> <p>Blame: poor compliance with established procedures; a lack of professional expertise</p> <p>Remedy: more expertise, tighter procedures, greater managerial "grip"</p>
<p><b>Individualist response</b></p> <p>Emphasis on: individual as self-interested rational chooser</p> <p>Blame: faulty incentive structures through over-collectivisation and lack of price signals</p> <p>Remedy: market-like mechanisms, competitions and leagues, information to support choice (such as rating systems)</p>	<p><b>Egalitarian response</b></p> <p>Emphasis on: groups and power structures</p> <p>Blame: abuse of power by top-level government/corporate leaders, system corruption</p> <p>Remedy: participation, communitarianism, whistle blowing</p>

Source: Hood, 1998, p. 9.

## Competing Values Framework

Another prominent framework for categorising organisational culture is the CVF. Quinn and Rohrbaugh (1983) originally developed this framework. Bradley and Parker (2006) have used it more recently to examine the implications of culture in the context of “new public management” models.

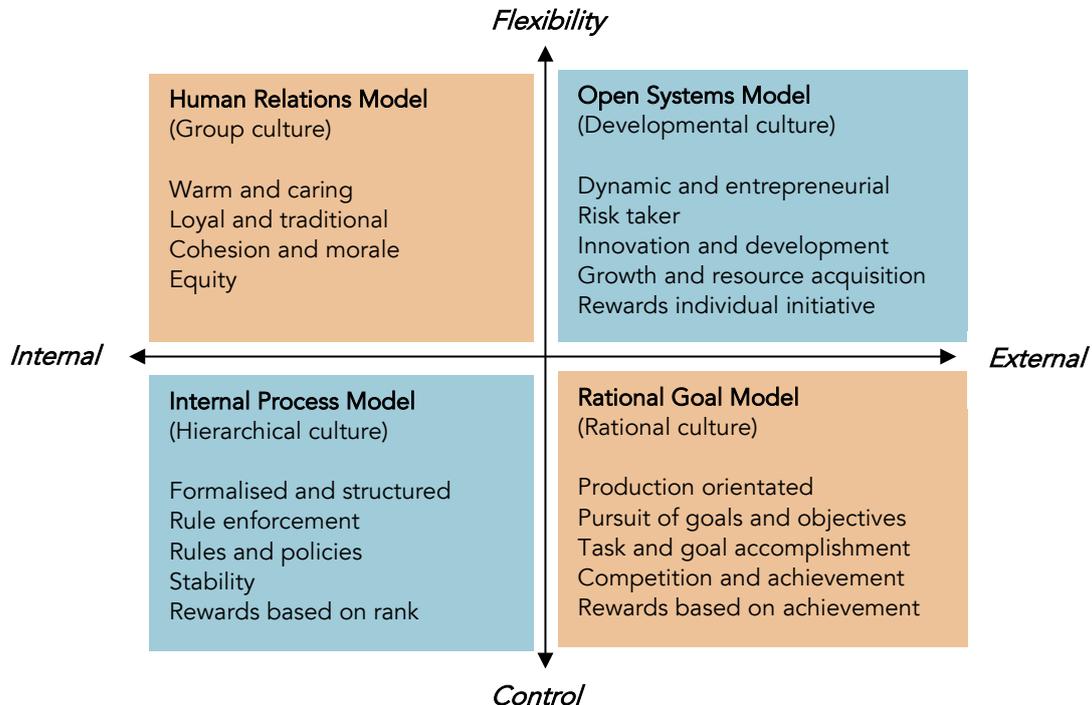
The CVF is based around two dimensions of competing values:

- the extent to which an organisation is *internally* or *externally* focused (the horizontal axis); and
- the extent to which an organisation is *flexible* or controlled by rules and procedures (the vertical axis).

Based on these dimensions, the CVF identifies four broad types (models) of cultures (Bradley & Parker, 2006).

- **The Human Relations Model:** Cultures where a high value is placed on training and the development of human resources. These organisations tend to have a high level of moral and social cohesion, and emphasise teamwork, with managers mentoring and encouraging staff.
- **The Open System Model:** Cultures with an emphasis on growth, innovation and entrepreneurship in which managers place a high value on individual initiative and effort.
- **The Internal Process Model:** Cultures typified by rule-based hierarchical structures in which managers encourage conformity and adherence to established rules and formal processes. Bradley and Parker (2006) note that this model is typical of traditional public sector organisations.
- **Rational Goal Model:** Cultures that are production focused and goal oriented in which managers tend to emphasise efficiency, productivity and outcomes.

Figure 4.3 The Competing Values Framework



Source: Bradley and Parker, 2006, p. 91.

## 4.5 Cultures conducive to good regulatory outcomes

The analysis in the previous chapter and submissions to the inquiry suggests a number of cultural attributes lead to achieving good regulatory outcomes. While some attributes, such as a belief in the importance of

transparency and rigorous decision making, are desirable for most (if not all) public sector institutions,<sup>11</sup> others relate specifically to the distinct functions of regulatory bodies. As Insurance Australia Group Limited notes, this distinction is important:

A key concern we have is that regulators do not always see themselves as discharging a distinct function. Where regulators have a self-perception that is similar to that of traditional bureaucrats, this may give rise to a culture of hierarchy, high levels of risk aversion, formal, rule-driven processes and exclusive focus on particular areas of policy.

This type of culture is particularly harmful in a regulatory context. Regulators need a different culture from other parts of the bureaucracy because the nature of their function can be, and often is, very different. (sub. DR 80, p. 5)

Table 4.3 provides a list of favourable cultural attributes. Not all attributes are applicable to all regulators or regulatory situations. Even so, the attributes provide a sense of the cultural characteristics that can assist regulators to achieve good regulatory outcomes.

**Table 4.3 Attributes of functional regulator culture**

Attribute of regulator culture	Description of attribute
Cultures that embrace the organisation's role as an educator and facilitator of compliance (rather than simply an enforcer of rules)	<p>As noted in the previous chapter, successful regulators adapt their compliance strategies to match the behaviour, attitudes and characteristics of regulated parties. To do this effectively requires a culture that values the role of the organisation as a facilitator of compliance (<u>as well as</u> an enforcer of rules). Such cultures require an educative and facilitative mindset that focuses on promoting the minimising social harm, rather than simply "catching offenders". As the Institution of Professional Engineers New Zealand (IPENZ) noted:</p> <p style="padding-left: 40px;">The culture of the organisation should educate, encourage and promote regulatory compliance, and avoid a pure compliance and process (box ticking) mentality. The regulators need to be able to engage at a tech 1 level with the regulated and seek to help the regulated to comply. In other words, an effective regulator can take a constructive leadership role. (sub. 21, p. 11)</p>
Cultures that place a high value on robust, evidence-based regulatory decisions	<p>The success of regulatory regimes (and ultimately the regulators that administer them) is dependent on the quality of decisions that regulators make. Robust analysis and reliable evidence not only helps achieve the objectives of the regime, but also promotes public trust in the regulator and the regulatory system.</p> <p>Cultures that place a strong emphasis on the robustness and evidential basis for their decisions (over, say, the expediency of a decision) help to shape public perceptions of the legitimacy of the regime. These cultures have high internal standards and an expectation that staff meet these standards.</p>
Cultures that value operational flexibility and adaption to changes in the regulatory environment	<p>Regulators seldom operate in a static environment. New technologies, changes in business practices, movements in market conditions and changing social preferences mean the landscape in which regulators operate is constantly shifting. These changes can alter both the profile of risks that need to be managed and the regulatory practices that a regulator needs to employ to manage them.</p> <p>Cultures that are flexible and adaptive are more likely to be able to efficiently respond to changes in the regulator environment. Conversely, rigid cultures that resist changes to the "way things are done" risk allocating resources inefficiently, missing opportunities to improve their internal processes, and creating a workforce fragmented by "old" and "new" ways of thinking.</p>

<sup>11</sup> It is arguable that the attributes such as transparency and rigorous decision making even more critical in the context of regulatory bodies due to their coercive powers and the discretion they often have around when these powers are used.

Attribute of regulator culture	Description of attribute
Cultures that value continuous learning at all levels of the organisation (ie, “learning cultures”)	<p>Learning organisations are those that hold a set of values, attitudes and norms of behaviour that support and encourage the process of continuous learning within the organisation. These values are held throughout the organisation – from front-line staff to the chief executive, managers and members of the board.</p> <p>For a “learning culture” to truly embed in an organisation, individuals need to believe that there is a strong link between the success of the organisation and the organisation’s ability to learn and improve. Such cultures are more likely to be successful when combined with other desirable cultural characteristics such as flexibility and adaptability. Learning cultures embrace experimentation and seek to gain insights from failure (rather than punish those that fail). Learning cultures will typically encourage “systems thinking” that goes beyond immediate roles of staff and emphasises the sharing of insights and experiences throughout the organisation. As Winston Churchill once noted: “The farther backward you can look, the farther forward you can see”.</p>
Cultures where internal debate is the norm and where a “speak-up” culture empowers staff to raise issues	<p>Related to the concept of a learning culture is the idea that staff and managers should be continuously challenging their own methods and ways of operating. This dynamic learning requires a working environment in which employees feel safe to “speak-up” when they observe poor practices or emergent risks. Indeed, the Ministry of Business, Innovation and Employment (MBIE) note that regulatory systems that are performing well tend to have</p> <p style="padding-left: 40px;">...a culture of being able to raise issues and risks with regulatory systems within government agencies and entities and clear procedures for working through these and addressing them... (sub. 52, p. 5)</p>
Cultures that stress the importance of being open, transparent and accountable	<p>Trust in the regulator and in the regulatory system will be strongest when the community is confident that regulators are following rigorous and fair decision making processes. Regulators that embrace transparency, openness and accountability are likely to engender a higher level of trust than those that resist public scrutiny. This point was raised by Carter Holt Harvey:</p> <p style="padding-left: 40px;">The opportunity for greater scrutiny of a regulator’s decisions may be a useful way of creating a culture of robust and evidence-based decision making. An expectation and measure of an efficient regulatory system should be that challenging decisions made by the regulator are not successfully appealed even where that opportunity exists. (sub. 8, p. 12)</p>
Cultures that place great value on organisational independence and impartiality	<p>Independent regulators are free from the direct control of politicians and regulated parties. Such independence prevents the bodies from being used for partisan purposes and promotes public confidence in regulatory decisions. Yet regulators can be subject to significant pressure from both politicians and the private sector.</p> <p>Where a high level of independence is required (see Chapter 9), organisational cultures that deeply value independence are likely to be resistant to political influence or industry capture. A culture of independence and impartiality also promotes consistent decisions that engender public trust and confidence in the regulatory body and regulatory system.</p>
Cultures that recognise the significance of the civic responsibility that comes with using the coercive powers of the state	<p>Regulatory officers are vested with legal powers over citizens and businesses to promote the wellbeing of the community. This authority must be used judiciously and in a manner that respects the rights of New Zealand citizens.</p> <p>It is important that regulatory bodies have a culture that acknowledges the responsibility that comes with regulatory roles, and that staff take this responsibility seriously. Staff should have a shared understanding of, and</p>

Attribute of regulator culture	Description of attribute
	<p>respect for, the constitutional context in which they operate.</p> <p>Such cultures will place a high value on honesty and integrity, and will engender a belief within staff that they are working for the good of the community. The Human Rights Commission notes:</p> <p style="padding-left: 40px;">It is important that regulators understand their obligation as part of the State to protect human rights and also that, in many cases, their customers or the beneficiaries of their work will be among the most vulnerable people in New Zealand. (sub. DR 96, p. 3)</p>
<p>Subcultures that align with the overarching objectives of the organisation</p>	<p>Subcultures within organisations are common, and to some extent inevitable (Bloor &amp; Dawson, 1994). They tend to arise in response to seemingly unique challenges facing identifiable groups within an organisation – typically regional offices or groups responsible for specific regulatory tasks or functions (such as inspection, legal, and management).</p> <p>The existence of subcultures is, in itself, not necessarily detrimental to the organisation. It is entirely possible to have many subcultures within well-functioning, highly successful regulators. This occurs when the values, beliefs and assumptions of the subgroup align with those needed for overall organisational success.</p> <p>However, subcultures can lead to a “silos mentality” where members become inwardly focused and detached from the organisation’s core principles, values and strategy. Such silos can restrict the flow of information through the organisation, reduce organisational flexibility and create an external perception that the regulator is inconsistent in its interpretation of regulations. Silos can also create unhealthy tension between groups within an organisation. For this reason subcultures need to be carefully monitored and actively managed.</p>

## How leaders promote desirable cultural attributes

Organisational leaders play a significant role in influencing the values, beliefs and assumptions of staff. They provide the model through which staff distinguish acceptable behaviour from unacceptable behaviour. For example, staff are more likely to be cooperative with other agencies if they observe their leaders acting in this way. Conversely, if staff see leaders stonewalling other agencies they may believe they have a licence to do the same.

Importantly, “leaders” can be both formal leaders (eg, the senior leadership team) and informal leaders (ie, staff who for one reason or another have the respect of other workers and who either consciously or unconsciously act as behavioural role models). Identifying informal leaders is a difficult but important step in embedding a desirable culture within regulatory organisations.

Good leaders understand that they need to be constantly aware of the messages that they are conveying to staff. They also recognise that cultural messages are sent through all their actions, and what they *don't* acknowledge as being important is as significant as what they *do* acknowledge (Victorian Public Sector Commission, 2013). As Steve Ballmer, former Microsoft CEO, once said

Everything I do is a reinforcement, or not, of what we want to have happen culturally... You cannot delegate culture<sup>12</sup>.

Leaders have several ways of promoting cultural traits that are conducive to good regulatory outcomes. Six of these approaches are noted below.

- **Regularly (and consistently) paying attention to and prioritising areas that leaders believe are important for success.** When leaders illustrate a strong commitment and interest towards organisation

<sup>12</sup> Steve Ballmer speech at Stanford Business School, March 15, 2007.

performance in a particular area, it sends clear signals to staff about the behaviours that leaders see as important. For example, if a leader believes “customer service” is important, staff may closely monitor customer satisfaction surveys or complaints from the public. Similarly, the casual comments, questions and remarks made by leaders can send powerful signals about the behaviours that leaders expect.

- **Allocating resources in a way that is consistent with the espoused values of the organisation.** The manner in which leaders spend scarce resources (including their own time) strongly reflects the importance they place on specific areas. For example, if a culture of public consultation is desired, then leaders can support the development of this cultural attribute by ensuring engagement activities are adequately funded. Conversely, failure to allocate sufficient resources (or not spending the funds allocated) can send the opposite signal to staff around the importance of consultation.
- **Deliberate role modelling, teaching and coaching of desired behaviours.** Leaders provide a key source of ideas and behaviour models for new organisations. By “walking the talk”, a leader can instil confidence that management encourages a given behaviour. This is particularly important in times of organisational crisis when anxiety among staff is high. How leaders behave during such periods can have a profound impact on the culture within the organisation. Related to this is investment in management and leadership training that is in line with the desired values of the organisation. Informal communications with staff are another important avenue through which leaders can communicate their assumptions, values and belief.
- **Allocating rewards and status to staff who demonstrate behaviour consistent with the desired culture of the organisation.** Leaders can send a strong message to staff by clearly linking reward and punishment to demonstrated behaviour. This is particularly important as “[o]nly by observing actual promotions and performance reviews can newcomers figure out what the underlying assumptions are by which the organisation works” (Schein, 2010, p. 249).
- **Organisational systems and procedures.** Systems and processes can be used to send a clear signal about the behaviours that leaders view as important for organisational success. For example, establishing processes for engaging with stakeholders emphasises the importance that management places on consultation. However, the existence of systems and procedures does not guarantee that staff will “buy into” the cultural message. For this to occur, leaders must continually and consistently reinforce the importance of these systems and processes (through, for example, linking them to reward and punishment, allocating appropriate resources and paying specific attention to their uptake).
- **Formal statements of organisational values and beliefs.** This is perhaps the most conspicuous avenue through which leaders can communicate the aspired values, beliefs and assumptions of the organisation. However, there is often a gap between the cultural traits espoused through organisational systems and those that occur in practice (“where the work gets done”). As Nica (2013) notes:

An organization’s culture is composed of one dimension that constitutes the official culture of what we do and how we do it, and the operating culture of how work is really done. The operating culture defines how things are really done and outlines where there is flexibility in following the official standards. (p. 181)

Leaders need to be aware that formal statements of organisational values can be dismissed as rhetoric if they are not consistently and regularly reinforced through the actions of leaders.

## Examples of measures to promote favourable attributes

Table 4.4 provides some examples of the practical measures that leaders can take to reinforce favourable cultural attributes. The table is not intended to be a comprehensive list of measures; rather it is intended to illustrate the range of activities that can be used to embed desirable cultural attributes. Importantly, no one action will embed a culture into an organisation. To do this requires consistent, repeated and mutually reinforcing actions over a period of time.

**Table 4.4 Practical actions to promote favourable regulator culture**

Cultural attribute	Actions leaders can take to promote the attribute
Cultures that embrace the regulator's role as an educator and facilitator of compliance	<p>Demonstrate a commitment to education and compliance facilitation by allocating sufficient resources to these tasks. Be aware that under-resourcing can send a signal that these tasks are peripheral to organisational success.</p> <p>Set the tone of the organisation by publicly and frequently emphasising the link between education and facilitating and organisational success.</p> <p>Work with regulated parties to identify where and in what form guidance is required. Demonstrate support for guidance material by publicly promoting its use and repeatedly communicating the expectation that all leaders do the same.</p> <p>Emphasise the importance of education and facilitation in corporate statements, planning documents, speeches and other public forums.</p>
Cultures where internal debate is the norm and where a "speak-up" culture allows risks to be identified	<p>Make it easy for staff to report emerging risks and gaps in current regulatory practices. Establish avenues for raising and escalating issues and regularly remind staff of the importance of raising concerns.</p> <p>Build trust in the reporting system by implementing policies and procedures that provide confidence to staff that their concerns will be given a "fair hearing".</p> <p>Initiate informal discussions with staff ("walk the floor") to gauge whether the organisation is being successful in creating a "speak-up" culture. Use these discussions to personally communicate the importance of raising concerns and identifying emerging risks.</p> <p>Initiate formal surveys to gauge the mood of the organisation. Sharing the results and follow-up actions from the surveys will send a message of commitment.</p> <p>Reinforce the importance of raising issues by developing recognition programmes for staff who identify compliance risks or improvements to regulatory practice.</p> <p>Foster the "telling of stories" that recall occasions when raising an issue resulted in an adverse incident being avoided.</p>
Cultures that place a high value on robust, evidence-based regulatory decisions	<p>Invest in obtaining new sources of evidence to support analysis and decision making.</p> <p>Create regular processes that expose internal thinking to external scrutiny and review (ie, before final decisions are made). Not being critical of staff if inadequacies are uncovered will foster an environment where staff embrace such reviews as opportunities to learn (rather than fear them as "performance reviews").</p> <p>Reinforce the importance of rigor by asking probing questions about the processes used to reach decisions, and the robustness of the data and assumptions on which decisions were made.</p> <p>"Walk-the-talk" by resisting pressure for a <i>quick</i> decision in favour of making a <i>good</i> decision.</p> <p>Recruit senior staff from agencies with a reputation for rigorous analysis.</p> <p>Nurture professional pride by formally and publicly rewarding staff for the quality of their analysis.</p>
Cultures that value operational flexibility and adaption to changes in the regulatory environment	<p>Allocate resources to gathering and analysing intelligence on developments in the regulatory environment. Publicly highlighting the importance of this expenditure will reinforce the message that the organisation needs to be responsive to these changes. Share the lessons from the intelligence with all levels of the organisation.</p> <p>Create opportunities for staff to share their views on how to respond to changes in the external environment. Lead by example by offering your own observations</p>

Cultural attribute	Actions leaders can take to promote the attribute
	<p>and suggestions and ask staff for input and comment.</p> <p>Recruit employees that are willing to adapt to changes in work requirements (ie, that aren't "set in their ways"). Inject new thinking into the organisation by recruiting staff with a mix of skills and backgrounds. Move leaders that resist change into positions that minimise their impact on the flexibility of the organisation (or remove them).</p> <p>Emphasise the importance of "staying current" by funding ongoing training for staff at all levels of the organisation. Reinforce this message in presentations, newsletters and speeches.</p> <p>Enable flexibility through empowering staff to use their judgement and experience on the causes of action that are in the public interest.</p>
Cultures that value continuous learning	<p>Provide opportunities for learning through formal training and informal mentoring.</p> <p>Share key learnings throughout the organisation, not just with senior leadership teams. Create multiple channels of communication that facilitate the ability for staff to connect with and learn from others. This is particularly important in cases where staff operate from multiple (regional) locations.</p> <p>Create working environments that encourage interaction and conversation between staff. Seek input from staff on the barriers to learning. Empower staff to come up with solutions and then act on these solutions. Encourage them to be pro-active problem solvers.</p> <p>Emphasise the importance of learning by linking the performance measures of managers to the steps they take to encourage staff learning and knowledge sharing.</p> <p>Allow staff to experiment with ways of solving problems. Treat unsuccessful experiments as learning opportunities rather than "failures". Reward staff for experimenting – even when experiments are unsuccessful.</p> <p>Personally encourage people at all levels to ask questions and share stories about what they have learnt from previous experiences.</p> <p>Seed a workforce that embraces learning by hiring and promoting on the basis of staff capacity for learning and ability to identify improvements in working practices.</p>
Open, transparent and accountable cultures	<p>Set the tone for the organisation by making internal processes and procedures publically available (eg, on websites) and ensuring that someone in the organisation is responsible for keeping the information up to date.</p> <p>Develop and publish statements outlining how the organisation interprets its regulatory roles and functions. Publish the rationale and assumptions behind major regulatory decisions.</p> <p>Use corporate value statements and other corporate documents to emphasise the importance of accountability and transparency. Reinforce these values by creating clear and unambiguous lines of accountability throughout the organisation, and by reiterating these lines of accountability with senior management.</p> <p>Establish clear expectations around how regulatory discretion is used. Institute unambiguous guidelines and make these guidelines visible to all staff. Repeatedly emphasise the link between the use of the guidelines and community trust in the organisation (and the legitimacy of the regulatory regime).</p> <p>Include information on the organisation's website around how the public can make complaints if they feel staff have acted improperly (eg, links to the Office of the Ombudsman website).</p>

Cultural attribute	Actions leaders can take to promote the attribute
<p>Cultures that place great value on organisational independence and impartiality</p>	<p>Use public statements by organisational leaders to stress the importance of political independence and impartiality. Ensure this message is delivered consistently by all leaders by developing a set of key messages to be delivered to staff and providing forums for leaders to deliver these messages.</p> <p>Mentor staff on the importance of independence and encourage them to take pride in the independence of the organisation.</p> <p>Emphasise the importance of independence within corporate value statements. Display these statements where they can be seen by staff (eg, on the staff intranet).</p> <p>Act swiftly and decisively if cases of capture emerge – set a “tone” that emphasises professionalism in all dealings with regulated parties.</p> <p>Draw attention to favourable comments in the media around the strength of the organisation’s commitment to independence. Use these comments to reinforce key messages around independence.</p>
<p>Cultures that recognise the significance of the civic responsibility that comes with using the coercive powers of the state</p>	<p>From the moment staff arrive at the organisation, emphasise the responsibility that comes with their role. This can be done formally through induction material, and informally through one-on-one discussions with managers or mentors. Inform staff of the consequences of failing to meet these responsibilities.</p> <p>Reiterate the message in presentations to staff by the chief executive and other key leaders within the organisation. These presentations should emphasise the seriousness of the responsibilities allocated to staff.</p> <p>Repeat the message at public meetings and at organisational events and milestone occasions.</p> <p>Acknowledge the responsibility of regulatory staff in corporate documents, value statements and through other media such as the organisation’s website.</p> <p>Foster an understanding of the link between each part of the organisation and the wellbeing of the community. Create a sense of importance around staff activity by highlighting the wider consequences if the organisation fails its mission (eg, loss of life, large economic loss, large environmental damage, etc).</p>
<p>Subcultures that align with the overarching values and mission of the organisation</p>	<p>Ensure that corporate values and mission are effectively communicated to all areas and office locations. Use locally relevant examples and stories to communicate the corporate values and mission to regional staff. This will increase the extent to which they are perceived as relevant (rather than just something coming out of “head office”).</p> <p>Foster a “professional culture” by promoting common language and processes throughout the organisation.</p> <p>Encourage teams to share their perspectives, assumptions and pre-existing beliefs with others in the organisation. This will help reduce misconceptions and overcome misunderstandings arising from the use of different language.</p> <p>Expose middle managers and staff to different working environments by mixing teams and encouraging short-term “job-swaps”.</p> <p>Provide opportunities for formal and informal interaction between teams and staff from different areas/offices locations of the organisation.</p> <p>Make a conscious effort to include regional groups in significant discussions impacting on the success of the organisation. Promote a sense of inclusion for these groups by devoting time to visit regional offices.</p>

## 4.6 The culture of New Zealand regulators

The inquiry timeframe does not allow for a detailed cultural evaluation of New Zealand regulators. Even so, the Commission has sought to use a range of information sources to gain some insights into the culture of these organisations. The primary information sources used are:

- previously published government reports and research papers;
- results from the Commission’s survey of chief executives of regulatory agencies (NZPC, 2014b);
- results of a survey of Public Service Association (PSA) members undertaken by the PSA and Victoria University of Wellington (see Chapter 1 for an overview of the survey: VUW IRC & PSA, 2014);
- results from the Commission’s survey of 1,526 businesses (Colmar Brunton, 2013);
- submissions to the inquiry; and
- engagement meetings with inquiry participants.

The key insights from these information sources are summarised below.

### Weak communication and learning cultures

Good communication can help a regulatory body respond rapidly to changes in its operating environment. These include:

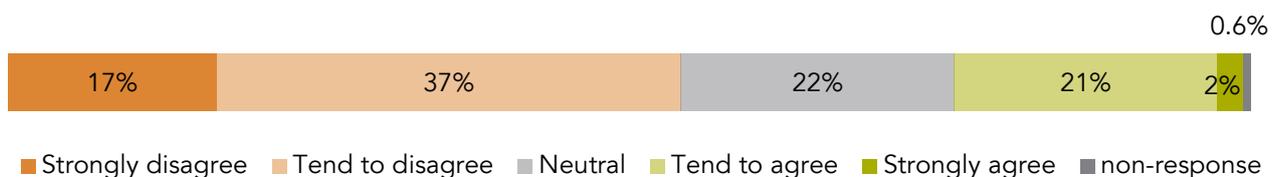
- *external* changes, such as the emergence of new risks or patterns of non-compliance; and
- *internal* changes, such as the emergence of capability gaps or dysfunctional subcultures.

Where the need for good internal communication is embedded in the culture of a regulatory body, its members share a belief that this flow of information is vital for the success of the organisation. If this underlying assumption exists, leaders will develop systems and processes to facilitate the flow of information throughout the agency, and will actively promote these networks by rewarding those that use them.

Yet results from a recent survey conducted by the PSA indicate that poor communication is an issue within some New Zealand regulators. For example, the survey found that (on average) regulatory workers in central government:

- disagreed that knowledge and information are shared throughout their organisations (Figure 4.4). These workers were significantly less likely than non-regulatory workers to perceive that knowledge is shared<sup>13</sup>; and
- disagreed that there is good communication across all sections of this organisation (Figure 4.5).

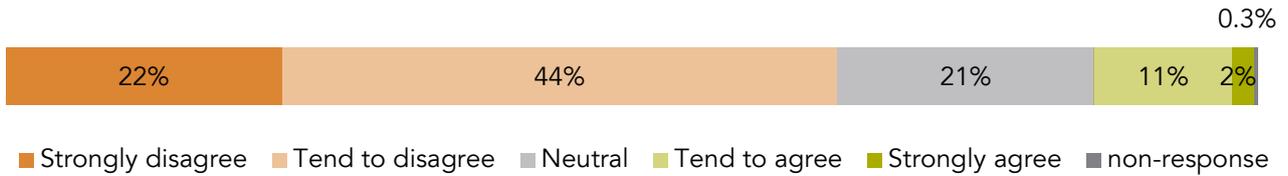
**Figure 4.4** Central government regulatory worker agreement with the statement “Knowledge and information are shared throughout this organisation”



Source: VUW IRC & PSA, 2014.

<sup>13</sup> When used in reference to the results of the PSA survey, the term “significantly” refers to statistical significance.

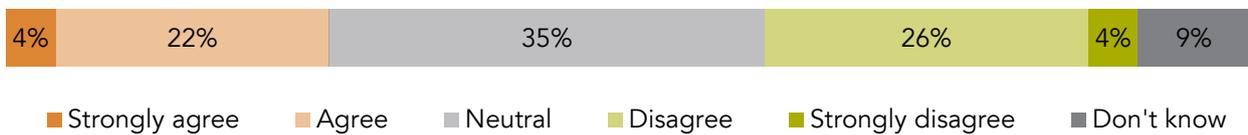
**Figure 4.5** Central government regulatory worker agreement with the statement “There is good communication across all sections of this organisation’



Source: VUW IRC & PSA, 2014.

The Commission’s survey of *regulator* chief executives also suggests that communication within some regulators is weak. The survey found that 30% of respondents either disagreed or strongly disagreed with the statement that “there are effective feedback loops between frontline regulatory staff and policy functions” (Figure 4.6).

**Figure 4.6** Chief executive agreement with the statement “There are effective feedback loops between frontline regulatory staff and policy functions”

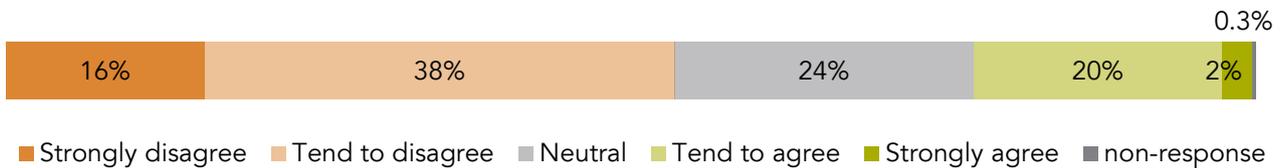


Source: NZPC, 2014b.

Related to good communication is the ability of an organisation to learn from practical experience. Again the PSA survey suggests some shortcomings in the current practices of regulators. For example, the survey found that (on average) regulatory workers in central government:

- disagree that management systems allow them to challenge poor practices (Figure 4.7);
- are significantly less likely than non-regulatory workers to perceive that they can challenge poor practices<sup>14</sup>;
- disagree that their organisation is good at learning from its mistakes and successes (Figure 4.8); and
- are significantly less likely than regulatory workers working in local government and district health boards to perceive their organisation is good at learning from its mistakes and successes.

**Figure 4.7** Central government regulatory worker agreement with the statement "The management systems in this organisation encourage people to challenge poor practice"



Source: VUW IRC & PSA, 2014.

<sup>14</sup> The Council of Trade Unions expressed similar views, noting that “[i]n reality it is likely to be very difficult for staff to go against the intended culture of the agency if a dissonant approach is required to provide sound advice and regulatory decisions” (sub. 25, p. 13).

**Figure 4.8** Central government regulatory worker agreement with the statement “This organisation is good at learning from its mistakes and successes”



Source: VUW IRC & PSA, 2014.

These observations appear consistent with the most recent *Getting to Great* report published by the State Services Commission (SSC), New Zealand Treasury and the Department of the Prime Minister and Cabinet (DPMC) (2014a) which notes:

Some leaders are worried about admitting to a backward step or a mistake and do not want to hear bad news. This will stop staff speaking truth to power; and inhibit them from owning up to their own missteps. (p. 12)

Further, MBIE makes the important observation that cultural and attitudinal barriers that prevent issues being raised and addressed are a possible indicator of future regulatory failure. They also note that

...the response to issues and risks being raised has resulted in a cultural tendency to work around systemic issues rather than addressing them. Given this seems to be a key component of all of our regulatory failures, we question whether these barriers may exist within a regulatory system, or may extend across the public service more generally. (sub. 52, p. 3)

Without in-depth analysis of each regulatory body, it is hard to know whether communication difficulties are the result of cultural factors or symptomatic of wider institutional or management problems. However, a number of cultural explanations are possible.

One explanation is that the increasingly technical nature of regulation has led to the need for modern regulators to employ people from a broad range of professional backgrounds. While today's regulatory bodies still rely on “traditional” compliance professionals, they also need specialised technical skills in areas such as forensic accounting, environmental science, or engineering. These professions have their own professional beliefs, tacit assumptions, and language. The results of the PSA survey may reflect difficulties in integrating these professional subcultures into a single regulatory body. (Professional subcultures are discussed further below.)

An alternative (cultural) hypothesis is that communication problems are the result of geographic subcultures. Regional subcultures may have developed inward-looking cultures that do not value communication outside their sphere of influence.

Finally, as suggested by MBIE, cultural resistance to communication may be the result of negative experiences in the past – where “raising issues” has negatively affected the “success” of a group. One example is where staff are criticised for the existence of a risk, rather than rewarded for making management aware of the risk. If this pattern is repeated, then (through time) the group will learn that communicating risks is detrimental to personal success.

The Commission notes that some regulatory agencies have strong learning cultures. For example, the 2012 Performance Improvement Framework Review of the New Zealand Customs Service indicated strengths in this area (SSC, New Zealand Treasury & DPMC, 2012a). Similarly, the Civil Aviation Authority (CAA) appears to have a strong culture of learning, which is evident by the emphasis it places on developing systems to identify emerging risks.

#### F4.3

Good internal communication is a catalyst for developing a culture of organisational learning. Yet central government regulatory workers are significantly less likely than non-regulatory workers to believe that there is good communication within their organisation.

**F4.4**

With some exceptions, New Zealand regulators do not appear to have a strong culture of learning from experience.

## A focus on institutional risk can distract regulators from core objectives

Regulators are assigned the task of managing risks of social harm. These risks can take many forms – risks to public health, to the environment, or to the financial security of individuals. Parliament decides which risks need to be actively managed and whether they are best managed by the private sector or public institutions.

Where government involvement is deemed necessary, regulatory bodies are tasked with managing the risk on behalf of society. Once provided with a mandate (and authority) to act, leaders of regulatory bodies make decisions about the activities that their body will undertake to effectively achieve the outcomes that Parliament expects. The discretion that regulators have around these activities is an important feature of all regulatory regimes and is discussed in detail in Chapter 3 and 10.

Yet even when regulators operate under highly prescriptive legislation, leaders within regulatory bodies must make operational decisions concerning how best to achieve their statutory objectives. Decisions such as the form and frequency of information supplied by regulated parties, how often inspections take place, and how breaches in compliance will be treated, are commonly driven by the judgements of regulatory staff. The prevailing culture of the organisation influences these judgements.

The Commission has heard that in some instances the judgements of regulatory staff are heavily influenced by cultures that emphasise managing institutional risk to the regulatory body, rather than the efficient management of potential social harm.

As noted by the Compliance Common Capability Programme (CCCP), such cultures can manifest themselves in a number of ways:

In respect to risk aversion in particular, being mainly concerned about risk to the regulator can either create a heavy handed approach (to avoid being seen not to do enough); or a light handed approach – to avoid being seen to be heavy handed and risk the possibility of “losing cases” ... the way to overcome this is to ensure that regulators are competent, well trained and professional in their approach – and that organisations that have, for example, heavy reliance on industry personnel, are “balanced” by having professional regulators in their midst as well. This also deals with the issue of professional capture. (CCCP, sub. 12, p. 10)

It is very difficult to generalise about cultures within New Zealand’s regulatory institutions. However, there is some evidence to support the notion that management of institutional risks is playing a role in the decisions of regulators. For example, the PSA survey found that, on average, central government regulatory workers were significantly less likely than workers in non-regulatory roles to perceive that their managers take prudent risks. Similarly, the Commission’s business survey found that 32% of businesses agreed with the notion that regulators were inflexible and adopted a letter of the law approach (20% disagreed) (see Figure 4.9).<sup>15</sup>

Arguably, the strongest indicator of institutional risk-aversion came from the results of the Commission’s survey of chief executives. This survey found that 48% (11 out of 23 respondents) of responding chief executives agreed with the statement “Agencies are often too risk averse when enforcing regulations” (26%, or 6 respondents, disagreed).

Of course, there may be instances where managing institutional risk aligns well with managing the broader risk of social harm. However, regulators that are highly averse to institutional risk are less likely to take the calculated risks needed to efficiently administer a regulatory regime. This point was raised by the *Better Public Service Advisory Group Report*:

<sup>15</sup> For details of these classifications, see Colmar Brunton (2013), available on the Commission’s website.

Our current and future public management challenges will require a greater onus on citizen voice, innovation and calculated risk-taking – not just because these cultural dimensions are valuable in their own right, but because they will be the only way to achieve improved results for New Zealanders while attaining year-on-year efficiency and effectiveness improvements. Chief executives, and their Ministers, will have to be able to effectively manage risk and distinguish those low-risk environments from areas where a willingness to provide “room to fail” is critical to fostering a culture of innovation. (SSC, 2011, p. 51)

A key question is why do some regulators develop a focus on institutional risk? One simple explanation is that regulators are punished harshly (and publically) for their mistakes. The media, politicians and the wider community are often quick to use the benefit of hindsight to highlight poor regulatory decisions. This is understandable given the powers that Parliament confers on regulatory bodies. Indeed, the Commission considered such scrutiny is an important element of New Zealand’s democratic system and an important avenue through which regulators are held to account for their actions.

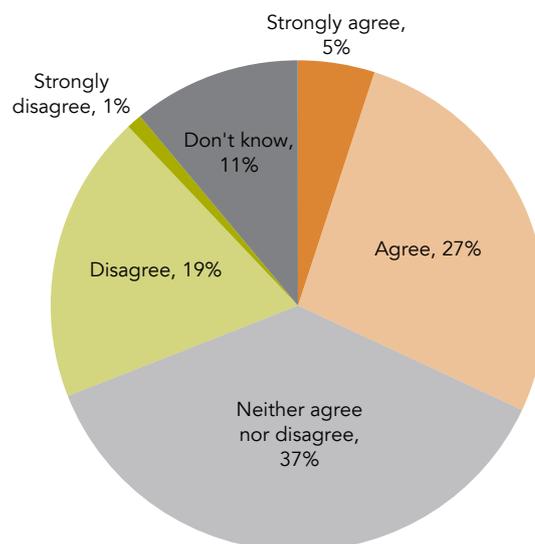
Even so, the response of some regulators has been to adapt to their mistake-intolerant environment by encouraging behaviour that minimises the “threat” of harsh criticism. Through time, this strategy has proven successful in reducing criticism, embedding a culture that places a high value on managing institutional risk.

This response is enabled, in part, by the weak evaluative culture at the system level. The prevailing “set and forget” approach to regulation means that (in the absence of other performance feedback) regulators are often judged on their mistakes rather than on their successes. A weak focus on evaluation therefore creates few signals that would contradict deeply held beliefs that risk-aversion is “good for the survival of the group”.

This observation suggests that institutional risk-aversion is as much about how (and how regularly) the success of the regulator is measured, as it is about the practices that regulators use. It also suggests that clarifying how regulators are expected to perform and reshaping their views of success are important steps to addressing institutional risk-aversion.

Of course, clarifying performance expectations will not change society’s intolerance for errors. It will, however, help to create a more constructive view of organisational success that is more resilient to short periods of intense public criticism. For some regulatory bodies, this will require significant changes to existing cultures. This change will only occur if internal processes and the actions of leaders reinforce the new interpretation of organisational success. A discussion on culture change is provided in section 4.9 while Chapter 13 provides a detailed discussion on monitoring of regulator performance.

**Figure 4.9 Business survey results – “Regulators were inflexible and adopted a letter of the law approach”**



Source: Productivity Commission; Colmar Brunton.

**F4.5**

The culture of some New Zealand regulatory bodies appear to place significant weight on managing risks to the organisation, at the expense of the efficient management of social harm. Such cultures can resist innovation in regulatory practices.

**F4.6**

Clarifying how regulators are expected to perform and reshaping their views of success are important steps to addressing institutional risk-aversion within regulatory bodies.

## Adopting new approaches to compliance often requires cultural shifts

Adopting new approaches to monitoring and enforcement can result in tension between the cultures of “traditional” enforcement staff and organisational leaders. This tension arises because of deeply held assumptions around what is required to manage a given risk. For example, inspectors who believe that “successful regulators” monitor all regulated parties equally may find it hard to adjust to an approach based on monitoring high-risk parties only.

A number of submissions highlighted the need to manage this culture change. For example, the Meat Industry Association (MIA) notes:

The MIA supports the VADE (voluntary, assisted, directed, enforced) model of regulatory compliance. The industry has very powerful incentives for voluntary compliance ... so the most appropriate compliance measures from regulatory agencies should be engagement with industry, clearly articulated risks and outcomes, and performance reporting to companies. In some cases, this means the cultures and behaviours of regulatory agencies have had to change from a rigid inspection and zero-tolerance enforcement approach. The MIA applauds Verification Services in MPI for their ongoing efforts to create a culture of working with and alongside processors, rather than take a rigid inspectorial approach. (MIA, sub. 40, p. 9)

Comments from the CAA also allude to the need to actively manage resistance to change:

The CAA is moving from being a technocratic organisation to being much more a risk-focused regulator. That has required a culture change internally which, while retaining the strengths of the technocratic approach, utilises a much more risk-based approach to its role. This requires the CAA to focus on which risks are to be targeted rather than which technical problem is to be addressed. The change in operating mode also requires questions of internal resourcing and priority setting to be addressed. (CAA, sub. 6, p. 65)

Aviation New Zealand also comment on cultural changes within the CAA:

Recent changes in leadership at the CAA have improved perceptions of the regulator and its rapport with industry. As with many organisations however, there is an ability to resist change throughout the organisational structure – a reflection that many staff are deeply entrenched. (DR 61, p. 2)

The experiences of the MPI’s Verification Services and the CAA suggest that some regulators have deep experience in managing the cultural impacts of a shift from traditional to new approaches to monitoring and enforcement. There are likely to be lessons from these exercises that could be shared with other regulatory agencies looking to adopt similar changes to the way they operate.

**F4.7**

Adopting new approaches to monitoring and enforcement can result in tension between the cultures of “traditional” enforcement staff and organisational leaders. This tension can act as a barrier to regulators improving how they operate.

**F4.8**

When implementing new regulatory practices, leaders within regulatory agencies should assess the extent to which advocates of existing practices will resist any new practices. Strategies to manage cultural changes should be factored into the broader change management process.

## Professional subcultures have positive and negative impacts

Regulators often rely extensively on having a large number of technical staff to carry out specialist regulatory functions. Professions bring with them ways of thinking about problems, and value sets for deciding what is the “right” thing to do. Regulators often draw staff from a limited number of professional backgrounds –such as engineers, scientists, lawyers, economists, or public health specialists.

Having staff with common professional backgrounds can have a hugely positive influence on the performance of a regulator where the culture of the profession strongly aligns with the objectives of the organisation. Under such circumstances, common backgrounds can help develop mutual (unspoken) expectations around the level of quality and professionalism that is demanded of staff. For example, a 2011 performance review of Statistics New Zealand noted:

Statistics NZ has a strong set of professional values embedded in its DNA. The traditional professional values were clear in all contacts throughout the organisation. These are statistical excellence, integrity, confidentiality and data security. (SSC, New Zealand Treasury & DPMC, 2011a, p. 29)

However, homogeneity in the professional backgrounds can have a down side. The more homogenous regulatory staff are, the more likely it is that the views of that profession will be privileged over others and that other legitimate options or ideas will be passed over. In this way, strong professional cultures can work against adopting new ideas and practices.

Mighty River Power raised this issue in its submission:

Regulatory staff working in the electricity sector tend to have backgrounds in economics or engineering, particularly in the economic regulation of network businesses. ... This can lead to a reliance on quantitative assessment methodologies and economic theory rather than consideration of more qualitative impacts which are more uncertain. For example, what the longer term dynamic response will be from market participants to the proposed reform or how the electricity market reform plays out in the real world where New Zealand’s geography, generation mix and small dispersed population pose significant challenges that are arguably not duplicated elsewhere in the world. (sub. 30, p. 13)

The existence of a dominant occupational culture may also affect the relationship and interface between the regulator and regulated parties. Where a regulator has a particularly strong professional culture, tensions may arise when engaging with parties that share a completely different set of underlying assumptions. For example, it is common to hear regulated parties accuse regulators of not understanding the “commercial realities” of their industry.

Further, the CCCP notes that the need for regulators to have staff with industry experience creates the potential for “certain professional or industry cultures [to] ‘clash’ with state sector values and cultures” (CCCP, sub. 12, p. 10). If not adequately managed, this clash of cultures can impair internal communication and delay action, raising the risk of systemic problems in regulatory regimes going unnoticed until major regulatory failures occur.

**F4.9**

The likelihood that systemic failures in regulatory regimes will go unchecked is higher when regulators have poor internal communication, lack the ability to learn from experience and have professional subcultures that resist change.

**F4.10**

It is important for regulatory bodies, as far as possible, to gain an understanding of the culture and motivations of regulated parties, and for regulated parties to gain an understanding of the culture and motivations of the regulatory body.

## Cultural implications of changing the functions of a regulator

The culture (and subcultures) of regulatory agencies are heavily influenced by shared experiences of success. These successes give rise to a common set of assumptions about how success is achieved. The

assumptions are in turn passed on to new members of the organisation as the “the way things are done around here”.

Yet, as discussed in Chapter 9, government agencies can be subject to relatively frequent shifts in their structure, roles and functions<sup>16</sup>. Restructures are often accompanied by changes in operating procedures, management approaches or accountability arrangements. Such changes can be met with resistance where they challenge the existing ways of doing things. As Schein (2010) explains:

...any challenge or questioning of a basic assumption will release anxiety and defensiveness. In this sense, the shared basic assumptions that make up the culture of a group can be thought of, both at the individual and group level as psychological cognitive defence mechanisms that permit the group to continue to function. At the same time, culture at this level provides its members with a sense of identity and identifies the values that provide self-esteem. ... Recognising these critical factors make us aware why “changing culture” is so anxiety provoking. (p. 29)

In such situations, elements of the “new” culture that are consistent with the pre-existing culture will likely be adopted. Tasks, approaches or methodologies that run counter to the existing culture will be met with resistance. This can become problematic if the approaches needed to be “successful” in achieving the new functions are not consistent with the existing culture.

For example, a regulator whose organisational culture has emerged around policing “bright line” rules<sup>17</sup> may not have developed a culture that is consistent with new functions that require a greater level of discretion and collaboration/cooperation with regulated parties. Here it is important to separate capability from culture. While the agency may be able to hire people with the required skills, these people may be constrained in their effectiveness if their new ways of operating run counter to the established way of doing things.

Evidence suggests that in the past entities and individuals have not fully understood such cultural impacts prior to changing the function or structure of regulatory agencies. For example, Box 4.1 highlights that the changes required when the New Zealand Transport Agency (NZTA) was created were “more significant than [was] initially apparent” (SSC, New Zealand Treasury & DPMC, 2011b, p. 26).

The example of NZTA highlights a number of important points.

- Even with targeted measures, subcultures can be difficult to change.
- Organisations working in seemingly similar areas can develop very different cultures.
- Geography can play a strong role in forming and, importantly, maintaining subcultures.
- When new organisations are created, elements of each subculture are likely to be valuable to the new organisation – so are worth retaining.

The SSC, New Zealand Treasury and DPMC (2014a) also note that, in “better performing” agencies:

...culture change is thought about early in the change programme: Too often we lead change through technology implementation, cost reduction, process redesign etc and say “we’ll worry about that soft values and behaviours stuff later”. Later is too late to effect meaningful shifts. Culture change should not be a drag on strategy but an energiser and accelerant to purpose and strategy... (p. 20)

#### F4.11

Evidence suggests that previous changes to the functions and structure of regulatory agencies have been made without a sophisticated understanding of the cultural implication of change.

<sup>16</sup> Table 9.4 in Chapter 9 provides a timeline of structural changes to MAF and MPI since 1972.

<sup>17</sup> Rules in which the distinction between compliance and non-compliance is clear.

**F4.12**

Prior to contemplating changes to the structure and functions of regulatory bodies, the Government should undertake a substantive assessment of the cultural issues associated with change. Strategies for managing potential cultural issues should be explicitly included in change management plans.

**R4.1**

The State Services Commission should develop guidelines to assist regulatory bodies to manage cultural changes associated with restructures and changes in functions. Monitoring agencies should use this guidance as the basis for assessing whether cultural issues are adequately reflected in broader change management strategies.

#### Box 4.1 **An example of cultural changes associated with restructuring – creating the New Zealand Transport Agency**

NZTA was created in 2008 as an amalgamation of three organisations – Land Transport New Zealand (LTNZ), Transit New Zealand (Transit) and the Land Transport Safety Authority (LTSA). Each of these organisations brought into the new agency their existing set of norms, values and beliefs – creating three distinct subcultures within the new entity.

Management recognised the need to bring these subcultures together and put measures in place. Yet a performance review of the agency undertaken in 2011 found evidence of subcultures persisting three years after NZTA was formed. The review noted:

NZTA is an organisation of three cultures brought together ... Those three cultures persist in the three operational groups. Management has been active in bringing the organisations together:

- the regional director role is significant in ensuring that there is a more seamless external presentation, and an internal agent to promote regional integration
- the previously separate LTNZ and Transit offices in Auckland, Wellington and elsewhere are or are being co-located
- there is extensive investment in management and leadership training
- there is a high commitment to management review of structure and organisation performance.

As a result, staff are tending to think of themselves as NZTA. However, the subcultures of the old organisations persist, with a possible distancing of regions from national office added to the mix.

On the other hand, some of the old cultures are quite useful – the get on and do it attitude to road building, the measured approach to investment appraisal and a concern for safety. These aspects of the old culture need to be retained in the developing NZTA culture. (p. 26)

*Source:* SSC, New Zealand Treasury and DPMC, 2011b.

## Engagement is the “face” of regulator culture

It is clear from submissions to the inquiry (and the Commission’s engagement meetings) that many inquiry participants feel that regulator culture is strongly linked to the way it approaches consultation. For example, the IPENZ notes:

The organisation’s culture can be evident (or not) from the type and extent of stakeholder engagement mechanism used in the design of regulation. The engagement process should be inclusive, collaborative, be prepared to listen, and ensure appropriate expertise is used in the deliberations on the input. (sub. 21, p. 11)

Similarly, the New Zealand Bankers Association (NZBA) notes:

An example to consider is the Reserve Bank. Its need for independence in regards to monetary policy is without question. However, there is a sense that this culture of independence also influences the way

that the Reserve Bank has approached prudential policy and its role as a regulator. This has perhaps understandably resulted in a culture where at times the regulator appears reluctant to engage with the banking industry. (NZBA, sub. 43, p. 8)

There is little doubt that culture can influence how a regulator engages with stakeholders. Even so, it is important to ask whether a perceived lack of engagement is driven by the regulator's deeply held values, or whether it is driven by some other factor – such as the legislative framework, time constraints, resourcing requirements, the level of information that the regulator already has, and so on. As such, engagement is as much about good process and institutional design as it is about the culture of a regulator.

That said, regulators should be aware of the strong public perceptions of engagement as a “window” to the culture of an organisation. The topic of engagement is examined in Chapter 6.

#### F4.13

The way in which a regulator engages with stakeholders is often perceived as a “window” to the organisation's culture. It is important to assess whether the quality of engagement is driven by the regulator's deeply held values and beliefs, or whether it is driven by some other factor – such as the legislative framework or available resources.

## Corporate missions and front-line staff

A common understanding of the purpose and mission of a group is a key step in developing a common culture. The mission of an organisation provides a shared sense of direction for staff and an aspirational goal against which success and failure can be measured. Developing this shared sense of purpose is widely accepted to be a key role of leaders within regulatory agencies. For example, the SSC's Leadership Strategy for the State Services (2013b) notes:

*Getting to Great*, a report of the 21 Performance Improvement Framework (PIF) agency reviews completed between 2010 and 2012, found that if agency purpose and strategy is unclear, then most other elements of organisational performance are weak, especially in the people dimensions. A strong purpose and clear strategy are the starting point for effective leadership and all other elements of people management. (p. 5)

The *Getting to Great* report also notes:

It seems that how well agency leaders set strategy and purpose determines how well staff 'get' the strategy and then align their day to day activities with this collective ambition. Lead Reviewers have found through interviews and focus groups that a feeling of alignment with the agency's purpose directly impacts on culture, engagement and productivity. (SSC, New Zealand Treasury & DPMC, 2014a, p. 10)

This conclusion is supported by the results of the PSA survey, which found that regulatory workers who perceive their managers clearly communicated the organisational mission were more likely to:

- feel emotionally attached to the organisation;
- be more loyal to the organisation; and
- be more committed to the organisation.

However, the PSA survey also found that, on average, regulatory workers do not perceive that top managers communicate a clear organisational mission. Again, these results are consistent with the findings outlined in the *Getting to Great* report, which notes:

PIF findings suggest that agencies struggle with defining purpose and with creating a galvanising collective ambition that reflects the value the agency creates for New Zealanders. (SSC, New Zealand Treasury & DPMC, 2014a, p. 11)

These findings are a concern, because without a common sense of purpose it is hard for staff to know what constitutes success and therefore what behaviours will be rewarded (SSC, New Zealand Treasury & DPMC, 2014a).

**F4.14**

Regulatory workers who perceive their managers clearly communicated the organisational mission are more likely to feel emotionally attached to the organisation, be more loyal to the organisation, and be more committed to the organisation. However, generally central government regulatory workers do not perceive that senior managers communicate a clear organisational mission.

## 4.7 Towards a fuller understanding of regulator culture

As noted above, chief executives of regulatory agencies strongly believe culture is driven by senior leadership, and that culture influences how front-line staff operate. Yet outside the top tier of management, there appears to be less appreciation for the role that leaders play in shaping the culture of an organisation or, indeed, the steps that they can take to translate espoused corporate values into functional working cultures. This is illustrated by the results of the PSA survey and, more broadly, through the PIF reviews carried out across the public sector (suggesting that the issue is not confined to New Zealand's regulatory agencies, some of which are among the better performers in this area).

In considering why leaders across the public sector find cultural issues difficult, the SSC, New Zealand Treasury and DPMC (2014a) note:

We suspect the State services struggles with this element because some dismiss cultural change as something involving 'soft skills', and as less important than strategy, policy or operational delivery... Many do not see the link between values, behaviour and culture and performance, and do not hold managers and staff to account for behaviours as well as for more formal tasks and targets. (p. 19)

The Commission believes that a richer understanding of culture is needed if organisations are to embed the cultural attributes required of a modern regulator, and if the observed weaknesses in existing cultures are to be effectively addressed.

A fuller understanding of culture will also help managers distinguish between issues arising from dysfunctional cultures from those arising from (for example) poor internal processes or a lack of capability. In other words, it will assist managers to assess whether what is required is a *change in regulatory practice within a given culture*, or a change in culture.

The above discussion suggests that improvements are needed in two areas.

1. Managers within regulatory agencies need a greater appreciation of the psychology and anthropological foundations underpinning contemporary cultural management literature. This will give managers a richer understanding of both why organisations develop certain cultural attributes, and how they are able to influence these attributes.
2. There needs to be a more conscious and consistent effort to gauge the status of organisational culture within regulatory agencies. Methods for doing so are discussed in the next section.

**F4.15**

When looking to improve the performance of a regulator, it is vital to understand whether what is required is a *change in regulatory practice within a given culture*, or a change in culture. This requires specific assessment of the culture within a regulatory agency and the institutional factors that impact the way it operates.

### How can organisational culture be assessed?

Tools and methods for assessing organisational culture are many and varied. Indeed, a study undertaken by Jung et al. (2007) identified over 70 different approaches – the oldest of which dates back to the 1950s. The

variety of approaches reflects the complex nature of cultural analysis and the divergent philosophical and theoretical views of scholars studying the area.<sup>18</sup>

The appropriate method of analysis is highly dependent on the context in which it is to be applied and the research question to be answered. At the broadest level, methods for cultural analysis can be separated into those that use quantitative surveys and those that use qualitative research techniques (such as interviews, workshops or case studies).

Table 4.5 provides a summary of the pros and cons of these two broad approaches. The points in the table illustrate that, generally speaking, qualitative approaches allow a deeper, narrower understanding of the organisational culture, while quantitative approaches allow a shallower, broader understanding.

Some scholars have argued that the richest picture of organisational culture is obtained when quantitative approaches (such as “Gallop Q<sup>12</sup>” surveys and others) are supplemented by qualitative analysis. Yauch and Steudel (2003) for example advocate that organisations at first use qualitative methods to gain insights into the key aspects of culture that warrant further quantitative analysis.

While this approach is likely to provide far greater insights into organisational culture, it is also likely to be timely and resource intensive. As such, it is most likely to be appropriate:

- where performance of a regulatory body has reached critically low levels, necessitating a major review and rethink of its form and function;
- where major changes to large, complex regulatory institutions are being contemplated, and where cultural analysis is needed to inform the broader change management strategy; and
- when a new chief executive is appointed who is seeking to understand the existing culture of the organisation.

While such events are not uncommon in the public sector, they are (relatively) infrequent. As such, a more pragmatic, practical and pro-active approach is necessary. This could involve chief executives placing greater emphasis on the role that second and third tier managers play in shaping the organisation’s culture. For example, managers could be asked to undertake qualitative self-reviews using a standardised set of questions to guide their conversations with staff. Such health checks could be supplemented with periodic quantitative surveys, designed specifically to the needs of the regulator.

Standardised questions could also be used by external reviewers (such as PIF reviewers) to gauge the effort that the organisation is making to promote specific cultural attributes. Examples of such questions are provided in Appendix C.

**Table 4.5 Methods for assessing organisational culture**

Approach	Pros	Cons
Quantitative surveys (eg, Gallup Q <sup>12</sup> Engagement Survey, the Competing Values Framework),	<p>Generally less time and resource intensive than qualitative approaches</p> <p>In large organisations surveys allow for a wider range of views to be canvassed</p> <p>Often more pragmatic; information from across a large organisation can be administered and evaluated relatively quickly</p> <p>The quantitative nature of the data allows comparisons across organisations and between groups within an</p>	<p>The broader range of views comes at the expense of deeper analysis. Have been accused of only resulting in superficial assessments of culture.</p> <p>Given surveys contain predetermined questions, important elements of culture that are not addressed in the survey may go unnoticed</p> <p>As there is no information on the respondents reasoning behind answers, it is difficult to be sure that the questions</p>

<sup>18</sup> For a good discussion of these divergent philosophical positions, see Schneider, Ehrhart & Macey (2012).

Approach	Pros	Cons
	<p>organisation. This allows identification of problem areas within the organisation.</p> <p>Often thought to be more systematic and repeatable than quantitative approaches, allowing for changes in attitudes to be more easily detected over time</p> <p>Can be used to assess specific cultural attributes such as staff engagement, trust and job satisfaction</p>	<p>was interpreted the correctly</p> <p>Unless all staff are to be surveyed, assumptions need to be made ex ante around the homogeneity of cultures within the organisation. If subcultures exist that are not known about, then results may not truly reflect those of the wider population.</p> <p>The focus on particular specific cultural attributes can give the impression that culture is static and given (rather than dynamic and evolving)</p>
<p>Qualitative approaches (eg, interviews, case studies, workshops, observations and analysis of material manifestations of culture, Critical Incident Techniques)</p>	<p>Interactive process allows greater insight into underlying values, beliefs and assumptions. As a result a richer insight into cultural dynamics and complexity can be examined.</p> <p>Researchers receive responses immediately, enabling them to adjust questions to “probe deeper” and explore specific assumptions, values and beliefs</p> <p>Provides a picture of culture that is grounded in “organisational reality” and is therefore likely to be more easily identifiable to staff</p>	<p>Time consuming and resource intensive (both in terms of gathering and analysing data)</p> <p>Because it is more sensitive to the subtleties and complexities of organisations, it is more difficult to design</p> <p>Generally less coverage of staff views (particularly in large organisations). As such, the applicability to the wider organisation can be limited.</p> <p>Have been criticised for a lack of objectivity, in that the researcher’s personal and professional experiences and biases can influence the interpretation of the information received</p>

Source: Information drawn from Jung et al., 2007.

## 4.8 Shaping the culture of a new regulator

The Commission has been asked to provide guidance that can be used to inform the design and establishment of new regulatory regimes and regulatory institutions. This raises the question of what steps (if any) the government can take to promote an “appropriate” culture within a new regulator.

At this point, it is important to note that within the academic literature:

- there is general agreement around the link between organisational performance and culture;
- there is general agreement around the role that leaders play in establishing the culture of new organisations;<sup>19</sup> and
- there is far **less** agreement around the extent to which managers can modify a culture that is embedded within an existing organisation.

This section looks at how the government may be able to promote a “desirable” culture within new regulatory agencies. The following section takes a closer look at the debate around whether embedded cultures in existing regulators can be managed and changed.

<sup>19</sup> For some empirical studies on the relationship between culture and performance, see Berson and Oreg, 2008; Ogbonna and Harris, 2000; and Tsui et al., 2006.

## Selecting the “right” leaders

The (formal and informal) actions of a regulator’s founding leaders will heavily influence its culture. This suggests that governments can “seed” the culture of a new agency by appointing founding leaders who have values, beliefs and experiences that are consistent with the favourable cultural attributes discussed in section 4.5. To do this requires a deep understanding of the type of culture that is most likely to be effective given factors such as:

- the nature of the risk being regulated;
- the pace of change in the technology impacting either the risk or the regulator’s ability to monitor the risk;
- the professional skills needed to administer the regulation;
- the characteristics of the regulated parties; and
- the political environment.

For example, regulation of infectious diseases may require a regulator that will promote a dynamic, open culture in which issues are quickly communicated through informal channels to enable new risks to be assessed and workshopped. Other forms of regulation, such as border security and customs, may require a regulator to promote a greater level of formality and adherence to structured hierarchies.

Yet the factors that shape culture are many and varied. Selecting the “right people” – even if they can be effectively and accurately described, identified and appointed – does not guarantee that an appropriate culture will emerge. It is the *actions* of the appointed leaders that are important, not their espoused values.

### F4.16

Government can “seed” the culture of a new regulatory agency by appointing founding leaders who have values, beliefs and experiences that are consistent with its vision of the “ideal” culture. However, selecting the “right people” does not guarantee that the “right” culture will emerge – the actions of founding leaders are the key embedding mechanism.

### F4.17

When establishing a new regulator, it is important to have founding leaders in place from the start of the organisation. This will provide the leader with the opportunity to influence the cultural foundations of the organisation. The use of “interim leaders” should be avoided where possible.

## Signalling the desirable processes within legislation

Parliament can use legislation to signal the importance of specific actions or behaviours of a regulator. For example, requirements on regulators can convey different levels of importance and compulsion. Phrases such as “the regulator **must** consider X” or “the regulator **should** have regard to Y” provide signals of the significance that a regulator should assign to actions or behaviours.

Seen through the lens of cultural analysis, such provisions offer markers against which to measure the “success” of the (formal or informal) organisation. As such, legislative provisions give clues to the types of culture that are conducive to good performance. This is separate from their legal purpose.

Legislative provisions, however, do not guarantee a specific culture will emerge. As noted previously, culture exists outside formal rules and processes. For example, a legislative requirement to consult does not guarantee that an agency will develop deeply held values around the importance of public consultation. On the contrary, if staff view consultation as adding cost and delaying decisions (and so hindering performance), then a culture of “going through the motions” may emerge. Measures aimed at promoting a given culture will therefore likely be undermined unless these measures are consistent with how the success of the organisation will be measured.

Of course, none of this is to say that culture is the only driver of organisational behaviour. Individuals respond to any number of incentives and motivations – many of which are outlined in this inquiry report.

#### F4.18

While legislative provision can codify required actions, they do not guarantee that a regulator will develop deeply held values around the importance of those actions.

### Demonstrating support for the values of founding leaders

Monitoring bodies and central agencies can influence the culture of new regulators by demonstrating public support for favourable values and behaviours. Just as founding leaders of new organisations embed culture by rewarding and modelling behaviour, leaders of oversight bodies can reinforce favourable values by expressing approval for them.

For example, support for a new regulator's engagement processes can help to embed a culture of partnership and collaboration. Similarly, public support for the independence of a regulator can help to embed a culture of impartiality.

These informal measures can serve to confirm the assumptions and beliefs of founding leaders. This is particularly important during the early stages of a regulator's existence when cultural norms are formed. Of course, such measures are imprecise and their impact will be secondary to more powerful embedding mechanisms such as those outlined section 4.5. The role of monitoring agencies is discussed further in Chapter 13.

#### F4.19

Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.

## 4.9 Changing culture of an existing regulator

The previous section looked at what the government can do to promote the development of culture within a new regulatory agency. This section explores whether culture can be changed and, if so, how.

### Culture change – the academic debate

There is debate in the academic literature around the extent to which embedded organisational cultures can be changed. Commenting on this debate O'Donnell et al. (2008) note:

The literature on culture change ... is somewhat ambivalent on this point. On the one hand, examples can be identified where interventions can influence culture. But on the other hand, some academics warn of the danger of attempting to influence the more superficial aspects of culture such as symbols and ceremonies, while ignoring the more pervasive and deep-seated aspects of culture such as values and beliefs. These more deep-seated aspects of culture are much more difficult to influence. (p. ix)

It is possible to distinguish two broad views within the literature on organisational culture. Brewis and Willmott (2012) label these theoretic views as the "has" perspective and the "is" perspective of organisational culture.

The "has" (or mainstream) perspective likens organisational culture to an input into production which, as with any other input, managers can shape and modify. This perspective is popular with management consultants and sees culture as something that is "driven from the top" and disseminated throughout the organisation by senior management. In doing so managers are able to narrow the scope for unfavourable behaviour by narrowing the discretion that employees have over decisions (Jackson & Carter, 2000).

The "has" perspective can be illustrated by the following quote from Peters and Waterman (1982):

All that stuff you have been dismissing for so long as the intractable, irrational, intuitive, informal organisation *can* be managed. Clearly, it is as much or more to do with the way things work (or don't) around your companies as the formal structures and strategies do ... (p. 11)

It appears from the survey results that chief executive of New Zealand regulatory bodies share this view.

An alternative position is presented by proponents of the “is” perspective. This perspective views organisational culture through an anthropological lens (as opposed to a management lens). It argues that culture is something that emerges organically as workers learn to make sense of their work environment. This perspective places greater focus on culture as a product of collective thinking and, as such, is sceptical about the management of culture – particularly the ability to change culture quickly.

The fact that experts are divided about the extent to which culture can be “managed” highlights the importance of promoting the development of an “appropriate” culture from the start of the organisation. It also reaffirms the importance of founding leaders in setting the cultural foundations on which the organisation will operate. Foundations, once established, are hard, if not impossible, to fully remove.

#### F4.20

There is disagreement in the academic literature around the extent and pace at which embedded cultures can actually change. This debate reaffirms the importance of promoting an “appropriate” culture from the inception of a regulatory body.

### Some principles for effective culture change

Despite the conflicting views among theorists, a considerable amount of literature exists on the topic of change management. This literature typically focuses on three different areas (Anderson & Ackermann-Anderson, 2010):

- *developmental* changes impacting day-to-day operations such as change processes, skills and internal procedures;
- *transitional* changes such as periodic changes to organisational structure or corporate strategies; and
- *transformational* changes addressing “big picture” issues that impact the underlying assumptions of an organisation and that tend to be ongoing and adaptive.

The line between these forms of change can be hard to determine. A simple transitional change (such as a change in how regulated parties are monitored) may end up requiring transformational change if the new practice runs counter to the existing assumptions and beliefs of the workforce.

Lewin’s (1947) influential theory of change places emphasis on diagnosing a system before introducing significant changes. His approach focuses on psychological processes, and advocates that individuals and groups must go through a process of “unlearning” their existing views and beliefs and then “relearning” beliefs that are consistent with the desired change. Lewin refers to this process as “unfreezing, changing and refreezing” (p. 34).

Building on Lewin’s model, Schein (2010) has suggested five principles for managing culture change. These principles are set out below.

1. Survival anxiety must be greater than learning anxiety. That is, the fear that something bad will happen to the group if they **do not** change must be greater than the group’s fear of learning new ways of operating.
2. Leaders should look to motivate change by reducing fear of learning new things, rather than increasing survival anxiety.
3. The change goal must be clearly defined in terms of the specific operational problem to be fixed (as opposed to the culture problem that must be addressed).
4. Old cultural elements can be destroyed by removing the people who carry those elements. But new cultural elements can only be learned if the new behaviour leads to success.

5. Cultural change is always transformative change that requires a period of unlearning and psychological pain.

Katzenbach, Steffen and Kronley (2012) also provide principles for achieving cultural change.<sup>20</sup>

- **Match strategy and culture:** Executives often underestimate how much the effectiveness of a strategy depends on it aligning with an organisation's culture. Strategies that run counter to the existing culture are likely to take longer to implement, and cost more, than those that capitalise on current cultural strengths.
- **Focus on a few critical shifts in behaviour:** This requires a good understanding of what behaviours the current culture (positively and negatively) affect, and identifying key areas where cultural changes are likely to have the largest impact on performance.
- **Integrate formal and informal interventions:** While leaders often address the formal change mechanisms (such as reporting lines, decision lines and processes), they often overlook informal mechanisms (such as networking, ad hoc conversations and peer interactions). These mechanisms can be powerful catalysts for cultural change.
- **Honour the strengths of the existing culture:** It is highly likely that elements of the existing culture align with the vision for change. Leaders must be aware of these cultural strengths, publicly acknowledge them and use them to achieve the desired organisational change. Change strategies are most effective when "positive" cultural attributes are leveraged against "negative" attributes to achieve the desired behaviour change.
- **Measure and monitor cultural evolution:** This will allow leaders to identify backsliding and undertake corrective action if needed. Evidence of improvements can also help to reaffirm that the benefits of the change and help to maintain momentum.

The above principles highlight the need for leaders to be acutely aware of the psychological factors that both help with and resist change. Reliance on "template" change management solutions (or consultants that use them) can underplay the importance of these factors. This may lead to both a superficial assessment of organisational culture and management strategies that struggle to have lasting impacts on staff behaviour.

The Commission's analysis of the formation of MPI also provides a number of lessons relevant to a discussion of cultural change. These are set out in Box 4.2.

#### Box 4.2 Culture and leadership lessons from the formation of the Ministry for Primary Industries

##### Expect and plan for having to manage for a range of views

A restructuring or merger impacts on managers/staff and stakeholders in different ways. Staff and stakeholders may perceive the change differently given their backgrounds, experience and so on. There is likely to be a range of views on the restructuring or merger that may take some time to change. This should be expected. Ensuring an effective response to such a range of views points to the need to be systematic, planned and consistent about change, and to communicate continuously throughout the process.

##### Having a clear organisational strategy

There are benefits to having a single clear organisational strategy that provides a clear focus. This is an essential step with any major restructure or merger.

The strategy needs to truly reflect and encapsulate the core purpose(s) of the organisation so as to ensure the management focuses its attention on the right issues. A misaligned strategy can risk

<sup>20</sup> For further examples of change principles, see Fernandez and Rainey (2006) and associated references.

diverting senior management attention rather than focusing it. The strategy must reflect, rather than conflict with, the organisation's legislative or regulatory functions. If it does not, staff will be left trying to resolve the tension between the two functions.

While a restructuring or merger can formally bring functions together, aligning actual thinking and developing deeper relationships can take much longer. Exercises that involve staff in setting the overall organisational strategy and determining its values can prove very helpful for starting to align thinking, build new relationships and make staff feel included in the new organisation. In other words, the way such strategy work is brought together is also important. MPI appears to have received quite positive internal feedback for its strategy and values exercises.

#### **New managers can bring new ideas**

New managers can bring refreshing new approaches to some challenging projects and gain traction on them as a result. New managers can bring more open minds and a willingness to try new approaches that existing managers might be less open or willing to try.

#### **Understanding work already under way**

That said, ideas are not always new and are not always better. The key to success seems to be adapting and aligning new thinking with what is going on currently. Changes introduced without a sufficient understanding of the status quo risk unnecessarily undermining existing change efforts or repeating past mistakes.

These effects risk proving more destructive the more times changes are made (for example, with restructurings). This risks staff cynicism about how long any new initiatives might last, for example. In other words, if managers move quickly to replace existing incomplete projects/initiatives with new ones, they risk sending an implicit message about the longevity of the new ones as well.

This also emphasises the need to ensure new managers are properly inducted into the new organisation. This should involve providing them with sufficient background to truly understand the systems and functions they will be responsible for – particularly before they make any major decisions.

## **4.10 Conclusion**

Throughout the inquiry the Commission has found near universal agreement on the importance of organisational culture to the performance of regulatory agencies. Yet outside the top tier of management, there appears to be only a shallow understanding of the concept of organisational culture as simply "the way we do things around here". Such an interpretation is too simplistic and fails to acknowledge the complexity and subtlety of organisational culture.

The Commission believes that a richer understanding of culture is needed if organisations are to embed the cultural attributes required of a modern regulator, and if the observed weaknesses in existing cultures are to be effectively addressed.

There is a need for central agencies to improve the assistance they provide to regulatory bodies in helping them understand and manage the cultural factors that impact their operations. Similarly, there is a need for monitoring agencies to take a greater interest in the steps that regulators take to monitor and manage the culture within their organisation. This is particularly important in light of the role that dysfunctional culture has played in numerous regulatory failures in the past – both in New Zealand and overseas (see Chapter 1).

Cultural change is not easy. By definition it involves challenging the deeply held beliefs and assumptions of staff. Such a challenge can (naturally) result in anxiety, defensiveness and resistance to change. Leaders within a regulatory body need tools and knowledge to help them get staff past their anxiety so that the regulatory body can improve its organisational performance.

## 5 Workforce capability

### Key points

- It is estimated that between 10,000 –14,000 people work in regulatory roles in New Zealand. Workforce capability matters for the successful achievement of regulatory outcomes. While major regulatory failures usually have complex and multi-dimensional causes, the capability of the regulatory workforce can be a contributing factor. Gaps in capability can undermine the credibility of regulation and the achievement of regulatory outcomes.
- Of the 23 chief executives of regulatory agencies surveyed, only 5 agreed there are significant skill gaps among regulatory staff. This is in contrast to a survey of Public Service Association members and the Commission’s business survey, which both indicated considerable concern around the level of skill, knowledge and training of central government regulatory workers.
- The environment regulators operate in is constantly changing, requiring flexibility and adaptation on their part. New technologies, new risks and new risk creators may require new skills and the upskilling of regulatory staff. Changing regulatory practices can also require different sets of skills or mixes of skills.
- An important finding of this inquiry is that the increasing sophistication of regulatory regimes requires an increasingly professionalised regulatory workforce. Professionalisation involves creating a workforce where staff:
  - possess a core set of theoretical practical and contextual knowledge;
  - are recognised and respected by others in the profession and by the broader community for the knowledge they hold;
  - have opportunities to meet, network with and learn from others undertaking similar tasks;
  - are continually challenged to stay up to date with the latest developments in their field;
  - share a world view about the role and purpose of their profession and are guided by a common code of professional conduct; and
  - share a “professional language” and culture that instils a sense of “belonging to the regulatory profession”.
- It is the responsibility of individual regulatory agencies to identify the required mix of skills and to develop strategies and programmes to lift capability. But central agencies also have a role and some system-wide responses are required.
- To meet the capability challenges facing regulatory agencies requires a purposeful, structured and integrated approach to professionalising New Zealand’s regulatory workforce. The Commission recommends a package of measures, including:
  - improving guidance on regulatory practice;
  - increasing support for professional networks;
  - strengthening the responsibility on individual agencies to focus on their workforce capability;
  - emphasising workforce capability in performance reviews; and
  - promoting intellectual leadership and good regulatory practice.

## 5.1 Introduction

The preceding chapters have highlighted the importance of regulators being attentive to a range of institutional and organisational factors that impact on the effectiveness of the activities that they undertake. The chapters also highlight the need for regulators to develop organisational cultures that encourage knowledge sharing, continuous learning and adaptation to changes in the regulated environment. Regulatory agencies must also keep up with new developments in regulatory practice.

This chapter focuses on a key aspect of the effectiveness of regulatory agencies in New Zealand – the capability of the regulatory workforce. This chapter uses the terms “skills” to describe the abilities, knowledge, and expertise required of regulatory staff in effectively carrying out their roles. The combined skills of regulatory staff across a regulatory agency and the regulatory system as a whole are its “workforce capability”.

Information about the characteristics of the regulatory workforce is patchy. Estimates of the size of the regulatory workforce depend on the definition of regulatory roles, but could be upwards of 10,000 to 14,000 workers (Appendix D). The Commission has relied on engagement meetings with those working on workforce capability issues, including the Compliance Common Capability Programme (CCCP), the Leadership Development Centre (LDC), the Skills Organisation and a number of training providers. Information from these organisations has been supplemented by submissions and survey responses. The Commission has also looked at official reports following major incidents, which point to inadequacies in the training or competence of regulatory staff as a contributing cause.

The increasing sophistication of regulatory regimes requires an increasingly professionalised regulatory workforce. Professionalisation involves creating a workforce where staff:

- possess a core set of theoretical, practical and contextual knowledge;
- are recognised and respected by others in the profession and by the broader community for the knowledge they hold;
- have opportunities to meet, network with and learn from others undertaking similar tasks;
- are continually challenged to stay up to date with the latest developments in their field;
- share a world view about the role and purpose of their profession and are guided by a common code of professional conduct; and
- share a “professional language” and culture that instils a sense of “belonging to the regulatory profession”.

This requires a more active role by central agencies, such as strengthening the responsibility on regulators to focus on workforce capability and increasing the emphasis on workforce capability through performance reviews. Other system-wide responses are also needed to professionalise and lift the capability of the regulatory workforce, such as developing and promoting system-wide guidance material.

### Why capability matters

It is easiest to explain why workforce capability matters for achieving regulatory outcomes by considering what happens when the combination of skills or level of skill within an organisation is deficient.

The CCCP (sub. 12) considers that workforce capability is variable across New Zealand’s regulatory system. This, combined with the broader problem of variable organisational capability, can:

- create integrity and reputation risks for regulators, both individually and collectively;
- mean activities are not always performed to an acceptable standard, resulting in poor compliance outcomes/regulatory failure;
- create inefficiencies through poor use of resources, as work is not performed efficiently and effectively;

- add to the cost of compliance, because of the high cost of system failures compared with effective performance;
- contribute to harm, including serious harm to people, the environment and the economy;
- indicate missed opportunities to share innovative ideas and best practice solutions; and
- lead to inconsistent approaches to carrying out regulatory compliance functions that create public confusion about the purpose of regulatory compliance and the role of regulation.

While major regulatory failures usually have complex and multi-dimensional causes, inadequate workforce capability can be a contributing factor (Box 5.1).

#### Box 5.1 Findings of the Royal Commission Report on the Pike River Coal Mine Tragedy

Following structural changes within government, the mining inspectors who were responsible for all 1000 or so coal and metalliferous mines, tunnels and quarries fell within a department responsible for inspecting almost all New Zealand workplaces. They became part of the body of approximately 140 warranted health and safety inspectors, who were mainly generalist inspectors but could access technical expertise.

The inspectors were not required to have expertise in the mining method used by the mines they inspected. This meant that neither mechanical inspectors nor those with expertise in workplace fatigue were inspecting underground coal mines. The department did not have enough expertise to inspect the range of major hazards in underground coal mines, including geological, geotechnical, strata, spontaneous combustion, poor ventilation, methane and electrical.

Mining inspectors were required to meet prescribed qualification and experience criteria that are not specific to underground coal mining. They were required to hold a first class mine manager's certificate of competence and initial training was provided in such topics as legislation, compliance assessment and prosecution. This did not focus on underground coal mines and was not taught by people with mining expertise. Ventilation training was "based on ventilation principles in normal workplaces like factories or warehouses". The compliance training did not focus on complex mine systems.

There was no requirement for ongoing professional development. There were training deficiencies in hazard identification, auditing, workplace culture, management practices, emergency response, inspections and investigations. A review undertaken for the Royal Commission stated that "the mines inspectors felt particularly disadvantaged, seeing themselves as specialists within a generalist inspectorate which did not see the need to equip them with mining specific skills they needed".

*Source:* Extracts from the Royal Commission on the Pike River Coal Mine Tragedy, 2011, pp. 273-75.

Of course, capability is not a static concept. To be effective, regulators must understand and be attentive to changes in the regulated environment – the emergence of new risks and new risk creators, new markets and new technologies. Indeed, Baldwin and Black (2008) argue that being a *really responsive* regulator means being very attentive to the environment that shapes the response of regulated parties to the regulatory regime. Regulators need be responsive to their performance and have the flexibility to respond to and adapt to these changing circumstances.

Regulatory practice is also evolving. As outlined in Chapter 3, regulators are increasing applying risk-based approaches to their regulatory practice, requiring new skills in risk assessment and a redefinition of priorities and roles. Baldwin and Black (2008) argue that a move to risk-based regulation inevitably means that priorities and work schedules will change – "it means not doing things that were done before" (Baldwin & Black, 2008, p. 66). The Productivity Commission (2012a) noted in its inquiry into international freight transport services, for example, that a move to risk-based border control meant a change from a "check everything" philosophy to a "check the things that matter" approach. This can be difficult for regulatory staff who have taken great pride in doing their jobs, believing that their efforts have fulfilled the objective of the regulatory regime. It can be difficult to retrain staff to make the change from a purely compliance model

of regulation to a risk-based approach to regulation, and the agency may have few resources to “change manage” the evolution in approach.

The Civil Aviation Authority (CAA) pointed out that:

...aspects of regulatory practice are rapidly evolving (e.g., the moves to risk-based regulatory systems). Competencies that are rooted in older systems and approaches will have increasingly less relevance in the future. (sub. DR 64, p. 7)

An evolving regulatory environment can have implications for the mix of skills in a regulatory agency, the recruitment of new staff and the retraining of existing staff. Regulators therefore need to be attentive to both changing practices and the implication of new practices on the capability requirements of the organisation. This can be difficult for managers when the focus is on day-to-day activities. As such, regulator forums and other professional development mechanisms are an important source of information about new practices.

### F5.1

The regulated environment is constantly changing, requiring regulators to be flexible and able to adapt. New technologies, new risks and new risk creators may require new skills and upskilling of regulatory staff.

## 5.2 Do all regulators need a generic set of capabilities?

A recurring question throughout the inquiry was whether all regulators require a common set of capabilities. This question is important as a common set of capabilities raises the value of common training platforms and generic professional qualifications. More broadly, a common set of capabilities suggests there is value in further developing professional networks through which regulatory staff can share experiences and learn from each other.

The Commission has encountered a range of views on this topic. On one hand the CCCP notes:

There is a considerable body of shared knowledge, practice, policy and process relating to regulatory compliance. Each agency invests (or can't afford to invest) in its own training regarding this. Consequently, there is duplication of effort, potential waste, inconsistent standards of people development and missed opportunities for cross-sector knowledge sharing. (CCCP, sub. 12, p. 2)

On the other hand, some regulators have argued that the specialist nature of the regimes they administer make their skill requirements unique. The Commission is not convinced by these arguments as they underplay the importance of the regulatory functions that are common to the majority of regulatory agencies.

It is the Commission's view that most regulators share a set of core functions, and that these functions create demand for a set of capabilities that are the foundation of regulatory practice. Additionally, regulatory agencies employ intelligence gathering and risk assessment strategies that have common elements requiring core skills.

Importantly, this does not mean that common functions are implemented in the same way. Specialist knowledge of the subject matter is often required to perform core functions in a manner that is appropriate to the regulatory task at hand. This situation is not unique to the regulatory profession. The medical profession, for example, shares a common set of knowledge (physiology among others), yet this knowledge is applied in vastly different ways. The existence of different applications does not reduce the validity of core competencies and skills.

This view is supported by the growing number of highly respected education facilities that are offering training in the field of regulation. For example:

- Monash University (Melbourne) offers a Master of Regulatory Studies (Box 5.2);

- the Australian and New Zealand School of Government (ANZSOG) offers an Executive Workshop programme on Managing Regulation, Enforcement and Compliance (Box 5.3); and
- the London School of Economics offers a Master of Science in Regulation (Box 5.4).

**F5.2**

Most regulators share a set of core functions, and these functions create demand for a set of foundational capabilities. However, specialist knowledge of the subject matter is often required to perform these core functions in a manner that is appropriate to the regulatory task at hand.

**Box 5.2 Monash University – Master of Regulatory Studies**

The Master of Regulatory Studies is offered by the Faculty of Law in conjunction with the faculties of: Arts; Business and Economics; Medicine, Nursing and Health Sciences; and Pharmacy and Pharmaceutical Sciences. The Masters programme was specifically designed to address the nature, extent and implications of the regulatory environment in a broad, cross-disciplinary approach. The study of regulation is a relatively new discipline that links and transcends the boundaries between economics, law, politics, criminology, sociology, psychology, organisational theory and public administration. This unique degree is designed to provide practitioners and scholars with a core set of ideas, theories and skills to apply to their regulatory activities and manage regulatory challenges. Students must complete eight coursework units made up of three core regulatory studies units and any five units from the approved range of regulatory studies elective units.

*Source:* Monash University, 2014.

**Box 5.3 ANZSOG’s Managing Regulation, Enforcement and Compliance Executive Workshop**

This workshop examines the distinctive strategic and managerial challenges that surround government’s regulatory and enforcement functions, recognising that the quality of life in a democracy depends heavily on when and how government agencies exercise their coercive power over individuals and institutions.

The course mainly covers social regulation (the abatement or control of risks to society), although economic regulation is also considered. The course focuses on the operations and management of regulatory and enforcement agencies rather than on reforms of the legal frameworks under which they operate. Current prescriptions for reform (such as those oriented toward customer service and process improvement) are examined in light of the distinctive character of the regulatory task, which values broader public purposes more than satisfying individuals or corporations.

*Source:* ANZSOG, 2014.

**Box 5.4 London School of Economics Master of Science in Regulation**

The MSc Regulation programme has a multidisciplinary core combining studies in law, political science and institutional economics. The programme concentrates on institutional issues and behaviour in regulation – regulatory bureaucracies, interest groups, legislators and courts – in addition to the economic aspects of regulation. The course brings together the contrasting North American and European perspectives on regulation, and to juxtapose experience of regulatory practice with

theoretical ideas about how regulation works.

Teaching staff are leading researchers in the field; several are involved at the highest level in advising government and regulatory agencies. The core course is taught across all members of the MSc Regulation team: Robert Baldwin, Julia Black, Martin Lodge and Kira Matus.

Regular talks are arranged from practitioners in the field and there are many opportunities to participate in seminars and conferences inside and outside the School. The London School of Economics Centre for Analysis of Risk and Regulation also offers opportunities to take part in leading edge research.

*Source:* London School of Economics and Political Science, 2014.

## Core regulatory activities

The National Compliance Qualifications Project (NCQP) (2009) found that nearly all New Zealand's regulators carry out one or more of the following compliance activities.

- gathering intelligence;
- licensing and certification processes, to ensure entities have the capacity to comply with regulations, usually before they are permitted to operate in a sector;
- education and persuasion, to inform people about regulations and encourage them to comply with regulations;
- audit, monitoring and surveillance, to assess compliance with regulations;
- investigations, to determine the facts of a matter, whether rules have been broken or not; and
- sanctioning non-compliance, to encourage future compliance.

To undertake these activities, people who work in regulatory roles need skills in how to conduct an inquiry into an incident, gather information to make a case, conduct interviews, produce reports, and present evidence in court. Communication skills are often important.

The CCCP suggests that "modern compliance thinking" is about "problem solving and risk management" (sub. 12, p. 9). Increasingly regulators focus on identifying and assessing the risk of harm, and prioritising their efforts based on an assessment of the risk that regulated parties pose to the regime's objectives.

Risk-based regulation involves a number of activities that require skills in:

- acquiring intelligence about hazards and the risks they pose;
- making an assessment of the risk and the extent to which it can be managed by the risk-creator, requiring both quantitative assessment and qualitative judgement;
- assigning scores or ranking to risk sites to prioritise regulatory effort; and
- determining the appropriate intervention, that is, matching the enforcement strategy to the risk.

*Really responsive* regulators (Chapter 3) will also have an understanding of the motivations of regulated parties and other significant influences on their behaviour, gathered through a range of techniques and skills including environmental scanning.

Maritime New Zealand (MNZ) suggests that:

...the core capabilities required for regulators include an understanding of the machinery of government, application of law, objective decision making, analytical thinking, knowledge of investigation and a clear focus on the regulatory objective. (sub. 15, p. 3)

To the core capabilities noted by MNZ, the Commission would add other generic requirements such as understanding the New Zealand's constitutional context, the rule of law, and the principles of regulation.

## Regulators require core capabilities but apply them in unique ways

While these capabilities are expressed as generic skills, each area of regulation is different, requiring tailored application in each unique regulatory environment.

Regulatory agencies need people with specialised skills such as legal skills, forensic accountancy skills, engineering skills, veterinary skills or skills in microbiology and food science. These people are likely to belong to and identify with their own professional grouping – the legal, accounting, or engineering professions, for example. They are required to apply their professional expertise and knowledge to a particular set of circumstances – to meet the objectives of the regulatory agency.

Technical skills become more important as regulatory regimes become more sophisticated, demanding more of regulated parties but also more of regulators. The Ministry for Primary Industries (MPI) points out that where regulatory regimes seek to achieve outcomes rather than forbid or prevent behaviours – such as the new Food Act 2014<sup>21</sup> – the regime relies “on a high degree of technical competence among both food producers and regulators...” (sub. DR 102, p. 14). Similarly, Mumford (2010) pointed to the extra skills and capabilities required of designers and builders and also of front-line regulators when New Zealand adopted performance-based building regulation.

Regulatory agencies also need people who understand or have a background and experience in the area they are regulating. Deep sector knowledge can be very important for the credibility of the regulator and for the acceptance and legitimacy of the regulatory regime by regulated parties (New Zealand Council of Trade Unions, sub. 25). Further, submitters argued that regulators with area-specific knowledge are less likely to impose inconsistent and impractical demands (Meat Industry Association, sub. 40, p. 12).

The New Zealand Food and Grocery Council indicated that it:

...strongly supports much greater experience by public servants of business issues and suggests that such experience form the base for, or be given, weight in, future recruitment activity in areas regulating industry activity. (sub. 35, p. 7)

And Vector suggested that the Commission includes a recommendation improving:

...internal capability by requiring or expecting regulators (potentially by way of performance criteria) to employ some staff with commercial expertise and/or an industry background. (sub. 29, p. 34)

## 5.3 Challenges to meeting the capability needs of regulators

Regulatory agencies face a number of challenges in meeting their needs for skilled regulatory staff, and the regulatory system faces challenges in ensuring that New Zealand has a capable regulatory workforce.

### Recruitment of specialist expertise

Engagement meetings emphasised the link between regulators possessing specialist knowledge and how credible regulators are perceived to be by regulated parties. Only 23% of the firms surveyed agreed or strongly agreed with the proposition that “regulatory staff are skilled and knowledgeable” (Figure 5.1) and only 25% agreed or strongly agreed that “regulators understand the issues facing your organisation” (Figure 5.2). The results for the rural sector are notable: 40% of the businesses from the agriculture, forestry and fishing sector surveyed, and 38% of all rural businesses surveyed, disagreed or strongly disagreed with the statement that “regulatory staff are skilled and knowledgeable”.

<sup>21</sup> When MPI's submission was received, the Food Bill was still being considered by Parliament.

**Figure 5.1 Regulatory staff are skilled and knowledgeable**



Source: Productivity Commission; Colmar Brunton.

**Figure 5.2 Regulators understand the issues facing your organisation**



Source: Productivity Commission; Colmar Brunton.

However, the Commission’s survey found a more encouraging situation in relation to other skills required of a regulator, such as communication skills. In the last two years, 40% of the businesses surveyed spent significant time and resources on finding out about regulatory requirements and 25% applied for consents and approvals. Of those surveyed, 43% said that interactions with regulatory compliance officers were friendly and not combative (Figure 5.3) and 37% of those surveyed agreed with the statement that “regulators communicated well with your organisation”.

**Figure 5.3 Interactions with regulatory compliance officers (such as inspectors) were friendly and not combative**



Source: Productivity Commission; Colmar Brunton.

The need for specific knowledge and credibility can sometimes be solved by employing people from the regulated sector.

The Australian Productivity Commission (APC, 2013a) found that about 50% of Australian regulators surveyed have hired people who have worked in a business in the area that the agency regulates. This may also be common in New Zealand. MNZ pointed out that “many regulators employ individuals from the industries they regulate” (sub. 15, p. 3). And:

The Commerce Commission employs many people with private sector and/or industry backgrounds. In fact of the last 15 appointments made in the Regulation Branch of the Commission, 12 are from the private sector and/or industry. Alongside this, all Commissioners have come from the private sector and three of the four members of the senior leadership team have strong private sector backgrounds. (sub. DR 93, p. 7)

BusinessNZ considers that there needs to be more regulators with private sector experience as this brings insight to the regulator’s role. It suggests that secondments could be helpful:

We believe the public sector as a whole requires a greater number of employees with significant private sector experience so they can bring their own insights into regulatory decision making and pick up on potential unintended consequences. A halfway house for this might be the increased use of secondments between the private and public sector, whereby private sector experts from certain entities are brought in to assist on issues from a market perspective. (sub. 19, p. 12)

The regulated sector can be a fruitful ground for recruiting regulatory staff and some regulators operate a successful revolving door policy – recruiting from industry but also encouraging movement out into the regulated sector again. However where secondments or revolving doors between industry and the regulator occur it is likely due to the advantage in having regulatory or government experience on a professional curriculum vitae. It can be hard for regulators to recruit from some professions and industries as the regulatory experience may not be an advantage in the marketplace and regulatory roles can be more poorly remunerated than similarly skilled roles in the private sector.

One disadvantage of the high premium attached by regulated parties and regulatory staff to deep sector knowledge, is that talented and experienced regulatory officers in one field can find it hard to progress their regulatory careers by moving between regulatory agencies across the activities that government regulates. Where sector knowledge is needed, a regulator will prefer to hire from the sector and train them in the regulatory skills required of the specific role.

## Attracting and retaining technical skills

Some regulators operate in a global market for talent. This is particularly the case in the finance sector, where the Reserve Bank of New Zealand (sub. 9, p. 7) and the Financial Markets Authority (FMA) (sub. 53, p. 7) referred respectively to their vulnerability to losing specialist staff and difficulty in attracting people from overseas. It is also the case in the aviation sector, where the CAA and Aviation New Zealand noted that the aviation regulator must sometimes match private sector or international salaries (sub. 6, p. 39; sub. 36, p. 29). The Institution of Professional Engineers New Zealand also noted that, particularly in technical areas, the government is competing in a global marketplace (sub. 21, p. 8). The Ministry of Transport pointed out that it can be hard to maintain technical skills and knowledge in areas such as road safety or aviation design, particularly where there are skill shortages in the relevant industry and market salaries are high (sub. 39, p. 6).

Being part of a broader job market creates challenges for regulators, to train people from different backgrounds and to offer career pathways and rewards that attract and retain qualified staff. These rewards might not be able to be in the form of competitive remuneration. Regulatory agencies can offer stimulating and rewarding work that is in the public interest, a strong sense of professionalism and a culture of on-going learning.

## Enforcement roles

Regulatory agencies that have a strong compliance/enforcement focus have been able to recruit from the ranks of former police officers. In Australia, about 50% of regulators surveyed by the APC reported hiring staff with skills or experience in law enforcement (APC, 2013a). While the Commission has not found similar data for New Zealand, it has heard that it is common for regulators, particularly in the customs and biosecurity control areas, to recruit people from the police, and that people with law enforcement backgrounds often become trainers. For example, there are 206 FTEs in MPI's Compliance Directorate. Of these 170 staff work in the Inspectorate/Investigation area, 45 of which have a police background. At the L 4/5 level of management (Regional Managers/District Compliance Managers) former police hold 8 of the 19 management positions.

Where a large number of specialist staff come from a similar background, they often come with and perpetuate cultures and ways of working from their previous profession. Where many staff have a law enforcement background, the APC found that this tends to be associated with a stricter and less flexible approach to compliance (APC, 2013a). This can create challenges for a regulator trying to change the organisational culture and introduce new approaches, attitudes and beliefs.

## The scope of regulatory positions

The skills needed at different levels of a regulatory agency will differ. Typically, the closer to the front line the greater the focus on day-to-day activities, while supervisors and managers have a longer time horizon, and a more strategic focus. Those who design jobs need to understand the skill and ability needs at each level of the organisation. One aspect of the design of regulatory roles that warrants particular attention is the amount of discretion to be given to front-line officers. On one hand, limiting discretion can ensure

consistency of approach; on the other hand, regulators at the front-line are often expected to show initiative when responding to varying circumstances and emerging risks. There is a significant literature (see Gallie, Felstead & Green 2004 for a summary) that shows that the degree of “task discretion” – the initiative that employees can exercise over their work – has implications for the effectiveness of the organisation as well as the job satisfaction of employees.

When front-line jobs are “dumbed down”, there is a risk that the people working on the front line will not have the skills, or be empowered, to consider the broader picture of what the regulation is trying to achieve and to see and report new risks. These feedback loops are important if a regulator is to be really responsive to the changes in the regulated environment.

The Victoria University of Wellington survey of Public Service Association (PSA) workers (VUW IRC & PSA, 2014) found that on average, workers report that they are given enough authority to act and make decisions about their work. There were no significant differences between regulatory and non-regulatory workers in the responses. The submission from Insurance Australia Group Limited (IAG), however, suggests that regulatory roles are different from other parts of the public sector because their function is different. IAG argues that regulators need to manage risk, they cannot be rule driven, they must establish what is effective in the circumstances, and they must be aware of the dynamic context in which regulation is required to apply (sub. DR 80, p. 5).

The question for regulatory agencies is how to scope and design regulatory positions such that regulatory workers at the front line understand the broader objectives of regulation and have the discretion to respond to changes in the regulated environment.

## Turning skilled, knowledgeable and technically competent people into regulators

The challenge is to turn skilled and technically competent individuals into regulators.

Reflecting on the CAA’s own journey over the last five years, a significant issue has been (and is) ensuring that its people are sufficiently skilled and competent to discharge the breadth of their roles. Often this means building their knowledge of regulatory practice and finding ways to combine that knowledge with the technical knowledge each brings to their role. As new regulatory approaches come into vogue (e.g., risk-based regulation), this requirement in-effect increases. (sub. DR 64, p. 8)

### F5.3

Regulatory agencies face challenges in training people with specialist industry knowledge and technical skills (and who may bring with them their own professional cultures and attitudes) to become regulatory professionals with a core set of generic skills and competencies required of the role.

## Do regulators understand their capability requirements?

The regulatory agency is responsible for ensuring that its staff are trained adequately to carry out their regulatory roles. The first step is to recognise the agency’s skill needs; the second step is to find ways of addressing those needs.

People who work in regulatory roles and their chief executives seem to have different views about the adequacy of staff skills and the need for training. The Commission’s survey of 23 regulator chief executives found that only 5 agreed with the statement that there are “significant capability or skill gaps among regulatory staff”, while 10 disagreed with the statement, 7 neither agreed nor disagreed and 1 didn’t know (NZPC, 2014b). But the survey of PSA workers found that (compared with local government and district health board regulatory workers and non-regulatory workers) central government regulatory workers:

- tend to disagree that they are given a real opportunity to improve their skills through training;
- are less likely to perceive that they have sufficient job-related training;

- show lower levels of agreement that their supervisors have helped them get extra job-related training or that they receive ongoing training that helps them do their jobs better;
- are less satisfied with the number and quality of training and development programmes available;
- tend to disagree that the training and educational activities they have received enable them to perform their jobs more effectively.

However, this finding did not accord with the view of the Commerce Commission who reported:

The PSA survey results are not consistent with the Commerce Commission's internal engagement survey results. Our 2014 engagement survey found that 82% of our staff agreed or strongly agreed that "this organisation ensures that I am adequately trained for the work I do" and over 75% agreed or strongly agreed that "there are learning and development opportunities for me". (sub. DR 93, pp. 7-8)

#### F5.4

Only 5 of the 23 regulator chief executives surveyed agreed there are significant skill gaps among regulatory staff. This is in contrast to the results of a PSA survey and the Productivity Commission's business survey which both indicated considerable concern around the level of skill, knowledge and training of central government regulatory workers. These results may indicate that some regulator chief executives do not fully appreciate the skill gaps within their organisation.

### A range of qualifications is available... but completion rates are low

Being qualified is not the same as being competent. People without qualifications may have learnt from experience how to perform competently, and people with qualifications may perform poorly if they lack other skills. Even so, qualifications are an indicator of the capability of the workforce and regulators need to be able to access training for their staff.

People working in the compliance sector can access a wide variety of qualifications, ranging from masters-level degrees to lower-level certificates. In 2009, the National Compliance Qualifications Project (NCQP) found that these include:

- a range of national qualifications, some of which directly address practitioner needs;
- specialist qualifications, such as law and taxation degrees; and
- 27 New Zealand national qualifications that have some form of compliance-related purpose.

In addition to these qualifications, the NCQP identified 38 generic and 130 agency-specific, compliance – related public sector unit standards as potentially useful for creating further qualifications – either directly in new qualifications or as reference material to support the writing of new standards (NCQP, 2009, p. 10).

Kimberley (2012) lists 22 national certificates, certificates or diplomas available to the compliance sector in New Zealand, and notes that the NCQP identified additional qualifications that could be relevant for compliance roles.

Completion rates of some compliance and regulatory control qualifications were very low over the six years to 2012:

Two of these qualifications have only been completed one time over the past six years, with three others ranging from 6 to 14. This shows a lack of current demand by the industry in these qualifications as they stand. (Kimberley, 2012, p. 29)

More popular were the Level 2 Animal Control Qualifications (averaging 15 completions each year), the Level 3 Parking Enforcement Qualification (peaking at 29 completions in 2009, although dropping to 6 in 2011), and the Level 3 Foundation Qualification (152 completions by November 2012) (Kimberley, 2012, pp. 29-30). More recent data provided by The Skills Organisation indicates that 65 trainees from central and

local government (excluding New Zealand Police trainees) completed qualifications within the public sector compliance field between August 2012 and January 2014 (The Skills Organisation, 2014a, p. 6).

**F5.5**

Compared to the size of the regulatory workforce, the number of people completing qualifications within the compliance sector (excluding Police trainees) is very low.

## Balancing general skills training with their specific application

A survey by the NCQP of the prerequisites for employees at different levels in 16 agencies found that the most important prerequisite for senior practitioners is evidence of experience in the compliance sector, although a qualification in a compliance discipline is also valued for some roles. However, there is no general requirement for people working in regulatory compliance roles to be trained or qualified to an industry-wide standard (CCCP, sub. 12, p. 2). This is likely to limit the demand for qualifications.

While there is a clear case for developing qualifications based on core competencies, the Commission also heard a common message from regulatory agencies that training for regulatory staff is not sufficiently tailored to their specific needs.

Some training providers have responded to the demand for more situation-specific training by carefully targeting generic skills such as evidence gathering and report writing to the specific operation and legislative requirements of each regulatory agency.

Graeme Aitkin however, observes that in his experience:

...many if not most regulatory/compliance agencies are very focused on their own legislation. They tend to be weak in the generic competencies – because they see knowledge of their own legislation and industry as being more important than, for example, well developed investigative or intelligence skills. (sub. DR 60, p. 5)

It could be that the focus on managing specific regulations has crowded out more strategic thinking by regulators about the core capabilities needed for an effective implementation of regulation. That said, there will always be a challenge when designing and delivering training to impart generic skills in a way that is relevant and accessible for those using them in specific contexts.

## Training – a problem for the regulatory system

The Commission found there was considerable debate in the sector about the development of national qualifications and the value of training in core competencies. The issue is not just academic. If new generic qualifications are developed and not taken up by regulatory staff – because they are not seen as valuable by staff and individual employers – two types of efficiency loss can result. On one hand, there is a waste of effort in developing qualifications that are not seen as relevant for individual agencies; on the other hand, the potential benefits in creating common qualifications for the regulatory sector as a whole will not be realised.

While the responsibility for ensuring that staff in regulatory agencies have the skills needed to effectively undertake their regulatory roles, regulators need to be able to access high-quality, relevant training opportunities for their staff that cover a breadth of skills at different levels. This is a regulatory system issue.

**F5.6**

A range of training opportunities seem to be available but some evidence indicates that those opportunities do not meet the needs of regulatory agencies or their staff. This could be because the training is insufficiently tailored to the specific needs of regulatory agencies or that generic training in core competencies is not required of staff working in regulatory roles. In any event, the completion rates for compliance and regulatory control qualifications appear to be low.

## 5.4 Current measures that address some of these challenges

### Towards a framework of national compliance qualifications

As outlined in the previous section, regulatory staff can currently access many different qualifications but because most regulators carry out similar activities, there is a case for developing qualifications based on core competencies. This, it is argued, would lead to common standards being articulated across the compliance sector, creating a more cohesive and integrated workforce and helping agencies work more effectively together (NCQP, 2009, p. 24). The sector (through the CCCP) and the Industry Training Organisation (ITO) began work on developing a set of national qualifications however these qualifications were overtaken by the Targeted Review of Qualifications (TROQ) that began in early 2011.<sup>22</sup>

The Skills Organisation (which is the designated ITO for the regulatory sector)<sup>23</sup> has been leading the change process, creating representative groups to review and rationalise current qualifications, to move from the task-oriented focus of previous qualifications to a focus on learning outcomes that learners need to demonstrate to achieve a standard. (Box 5.5 provides an example of graduate outcomes.)

#### Box 5.5 Outcomes from the New Zealand Certificate in Regulatory Compliance (Level 3)

The Skills Organisation describes the outcomes of completing this course for:

- graduate profile (graduates will, for example, be able to “apply fundamental knowledge of operating in a regulatory compliance environment”);
- education pathway (this qualification “may be regarded as an early step along a career path to become a fully-fledged regulatory compliance officer”); and
- employment pathway (such as, “graduates have skills relevant to a range of entry level roles in local and central government organisations”).

*Source:* The Skills Organisation, 2013.

The first stage of the TROQ review has been completed and the New Zealand Qualifications Authority (NZQA) has granted The Skills Organisation approval to develop new qualifications. But progress appears to be slow:

The qualification development activities are planned to be launched in the second half of 2014, and are unlikely to conclude by the end of 2014. These are anticipated to be listed on the New Qualifications framework in 2015. (The Skills Organisation, sub. DR 71, p. 2)

The qualifications will be at different levels, so one challenge is to define the standards required at each level and to establish pathways for moving from one level to the next level. The transition arrangements for candidates, including credits for existing qualifications, will be determined during qualification development (The Skills Organisation, 2014a). Once these qualifications are developed, they will be re-submitted to the NZQA for accreditation.

The Skills Organisation offers two types of assessment for its national qualification programmes: workplace assessment and assessment of prior learning. Workplace assessment enables employees to gain credits for a unit standard, based on evidence that is collected and recorded in the workplace. Assessment is carried out by assessors, who are registered, trained and moderated by The Skills Organisation. Assessment of prior learning involves a formal evaluation of previously unrecognised skills and knowledge, achieved outside the formal education and training system, against the requirements of unit standards and

<sup>22</sup> The approach to developing competencies in the regulatory compliance sector is happening in the context of a broader review of New Zealand’s qualifications framework. The review found that the national qualifications system as a whole was hard for learners, employers and industry to understand.

<sup>23</sup> The 14 Industry Training Organisations (ITOs) have each been allocated a number of industries. The Skills Organisation – formed in late 2012 – has a legislated mandate to facilitate workplace-based education for central and local government, including regulators, and for other industries. Funded by government, The Skills Organisation helps central and local government organisations develop their workforce, and has access to government-funded industry training providers (The Skills Organisation, 2014a, p. 3).

qualifications (The Skills Organisation website). This provides a pathway for people who have learnt “on the job” to transform their experience into qualifications. Box 5.6 provides one example.

#### Box 5.6 Competence requirements for financial advisers

When legislation was introduced to regulate financial advisers, The Skills Organisation worked with the FMA (and formerly the Securities Commission) to help it to understand the NZQA framework and the associated risks and safeguards. The Skills Organisation worked with the group that set the minimum standards of competence for authorised financial advisers, to understand the existing unit standards. Where gaps were found between these standards and the new competence requirements, The Skills Organisation facilitated a discussion between the industry and the regulator to agree on the content of the new unit standard. The qualification was then set by the regulator (as a minimum standard for authorisation).

As some financial advisers held other qualifications, The Skills Organisation helped to link these to the qualification and the regulator used this to inform exemptions. At the request of the regulator, two groups of unit standards were reserved for assessment through a common assessment. The Skills Organisation worked with the industry to create the assessments and ensure the system met the needs of the regulator. It also encouraged training providers to meet the training needs, and it quality assured their assessments.

Achievement of the groups of unit standards and of whole qualifications is reported on a set schedule to the FMA, so they can process applications for authorisation.

*Source:* The Skills Organisation, 2014b.

## The Compliance Common Capability Programme

The CCCP is a collective of local and central government agencies, which has recognised an opportunity to improve the quality, effectiveness and efficiency of compliance work across central and local government agencies by building the capability of organisations and people. The CCCP is currently managed out of MNZ. In line with its voluntary nature, the CCCP’s project management is “club funded” by 10 agencies through to June 2014. In addition, various agencies provide financial and in-kind contributions to support its activities.

The CCCP:

- commissioned a guide for regulatory agencies on regulatory practice: *Achieving compliance: a guide for compliance agencies in New Zealand*, published in June 2011, which brings together good practice organisational and operational design, strategy and practice for operational regulation and compliance work. The target audience includes senior managers, operational managers and compliance officers in central and local government agencies;
- is working with The Skills Organisation, the Police, the Open Polytechnic, and UNITEC to develop new qualifications; and
- has established a Regulatory Compliance Learning Council to create and share material to support learning and development opportunities (through its activities the CCCP has developed a community of practice among regulatory agencies).

## Providers of training

Training is available from a variety of providers. The Skills Organisation contracts the services of five accredited providers for public sector compliance and compliance and regulatory control qualifications. It also works with several regulators that have their own internal assessor for compliance qualifications. The CCCP also has a list of 11 recommended providers for compliance qualifications (The Skills Organisation, 2014a, p. 2), some of which may offer training in courses not accredited by the NZQA. (Box 11.8 describes some of the training provided by one of these providers.)

**Box 5.7 An example of a private sector provider of training**

Compliance, Enforcement, Regulatory (C.E.R.T) Systems is a private sector provider of training and assessment services, as well as advisory services. C.E.R.T Systems offers training in staff safety and tactical communications, general compliance and enforcement, and in compliance qualifications accredited by the NZQA. Training on general compliance and enforcement covers topics such as:

- operating within the regulatory environment/framework;
- exercising enforcement powers;
- gathering and recording information (such as the use of notebooks);
- identifying, gathering and managing evidence;
- report writing;
- operational planning;
- interview skills (basic and advanced);
- intelligence;
- case file preparation and management; and
- giving evidence in court.

*Source:* C.E.R.T Systems, 2014.

Employers can also send staff to universities and polytechnics for professional training that is outside the national qualifications framework. Some larger regulators provide in-house training, particularly in general compliance and enforcement skills and in skills specific to their area of regulation. For example, the Waikato Regional Council told the Commission that it had decided some years ago that it needed to provide its own in-house training to meet its specific needs.

Professional organisations may also provide training (Box 5.8).

**Box 5.8 Involvement of professional organisations in training regulators**

The New Zealand Institute of Environmental Health represents those engaged in environment and health protection. One objective is to arrange opportunities and facilities for members to meet and exchange knowledge and information.

The Building Officials Institute of New Zealand has represented Building Control Officials in New Zealand since 1967. Its goal is to improve their competency. Through its Diploma and Continuous Professional Development based courses, the Institute provides training for the Diploma in Building Control Surveying and further qualifications, to enable those in the profession to maintain, upgrade and update their skills throughout their working life.

The New Zealand Institute of Animal Control Officers is an incorporated society consisting of practising animal control officers from throughout New Zealand. It organises yearly training conferences.

The objectives of the New Zealand Parking Association (Inc.) include ensuring that enforcement officers are trained to the highest possible standard nationwide, and to collect and disseminate information that will keep member authorities and individuals well informed.

*Sources:* New Zealand Institute of Environmental Health website, [www.nzieh.org.nz](http://www.nzieh.org.nz); Building Officials Institute of New Zealand website [www.boinz.org.nz](http://www.boinz.org.nz); The New Zealand Institute of Animal Control Officers website, [www.animalcontrol.org.nz](http://www.animalcontrol.org.nz); and The New Zealand Parking Association (Inc.) website, [www.nzparking.com](http://www.nzparking.com)

## Legislative change

Recent changes to legislation should provide a stronger foundation for an effective system-wide effort to develop capability (CCCP sub. 12, p. 2). For example, the purpose statement of the State Sector Act 1988 includes a requirement to promote and uphold a state sector that, among other things, is supported by effective workforce and personnel arrangements, meets good-employer obligations, and is driven by a culture of excellence and efficiency (s 1A).

The Leadership Development Centre (LDC) observed in an engagement meeting that, anecdotally, it appears that changes to the State Sector Act have had some impact on improving the focus on developing leadership and capability. The PSA considered that recent changes “offered some potential”, but felt that they would not adequately address fragmentation between agencies: “More needs to be done and strong leadership from the centre will be required” (sub. 26, p. 12).

## Collaboration between agencies

Regulators can join forces with other agencies with similar or complementary competency requirements. For example, the Border Sector Governance Group and the Wildlife Enforcement Group are formal alliances between agencies seeking common outcomes. Other agencies have memoranda of understanding about how they work together. Less formal arrangements include networking and information-sharing opportunities fostered through professional organisations (NCQP, 2009, pp. 26-27).

Sometimes the collaboration is international. For example, the Australasian Environmental Law Enforcement and Regulators Network (AELERT) is a collective of environmental regulatory agencies from the Australian Government and New Zealand Government at local, state, and federal levels. AELERT provides platforms for environmental regulators to work together and exchange information and knowledge. For example, “thematic cluster groups” undertake projects based on needs identified by members, who also participate in online forums and have access to a resource library ([www.aelert.com.au](http://www.aelert.com.au)).

## 5.5 Are these measures adequate?

While there has been considerable activity towards developing the regulatory workforce, the Commission agrees with the CCCP that current arrangements are inadequate:

There is no requirement for people working in regulatory compliance roles to be trained or qualified to any kind of accepted sector wide standard, even though these people often work in high risk environments, and/or have statutory powers and carry out activities that deeply affect people and businesses.

The sector as a whole lacks mechanisms for: growing capability, enabling people to move easily between regulatory compliance functions within and between organisations, and sharing and optimising investment in training...

Standards of performance vary across similar regulatory activities. In some cases people are not prepared or supported to carry out their roles adequately.

In terms of resourcing, many agencies do their best on limited budgets. When financial resources get strained, training is often the first area to be cut or deferred. Fundamentally, people capability development is not always supported as a necessary and important long term investment to ensure good organisational performance. (sub. 12, p. 2)

The Commission also agrees with the CCCP that the current arrangements are unsustainable. It is notable that the driving force behind developing capability and sharing good regulatory practice has come from a voluntary forum of regulatory leaders. While this approach has strengths it also has weaknesses. The CCCP writes of the club model:

The strength of this approach is its entirely voluntary basis – which means that those who engage do so because they explicitly see the benefits for their agencies, their people and the system as a whole. The weakness is that it is an arrangement that depends on the interest of individuals who are in positions that are relevant to the purpose of the Programme and there is no institutional/system wide commitment to the success of the Programme – which to succeed, by its nature, needs to be long term. (sub. 12a, p. 2)

Section 5.6 sets out the five areas of focus to raise the capability and promote making the regulatory workforce more professional.

## 5.6 Moving towards a professionalised regulatory workforce

Given the common activities and skills required of many regulatory positions, the regulatory workforce should be viewed as a profession, in much the same way as lawyers, accountants, nurses and engineers. The CCCP notes that a professional identity does not appear to have emerged within staff in regulatory roles:

Even those who work in the regulatory compliance sector do not necessarily appreciate that they are part of a sizeable (12,000+ member) community of professionals. Equivalent industries (real estate agents, building practitioners, accountants, lawyers) are recognised professions with associations or networks to support the industry. The regulatory compliance sector does not have that same level of professional identity and support. (sub. 12, p. 3)

The potential benefits of professionalisation include:

- greater consistency and quality in the delivery of regulatory services;
- greater public confidence in the regulatory system (as a result of improved consistency and quality);
- development of a “professional culture” and a common code of professional conduct;
- efficiencies in training and recruitment across the system; and
- opportunities for the workforce to take responsibility for its own standards and development (eg, through the development of professional bodies).

### Actions for central agencies

The Commission believes there are a number of areas where focused effort could help raise capability and promote the professionalisation of the regulatory workforce. Some of these areas involve specific action by central agencies:

- strengthening the responsibility on agencies to focus on workforce capability; and
- increasing emphasis on workforce capability in performance reviews.

### Strengthening the responsibility on agencies to focus on workforce capability

Recent amendments to the State Sector Act 1988 gives the State Services Commissioner and chief executives of agencies and departments greater responsibility for developing senior leadership and management capability throughout the state sector. Anecdotal evidence suggests that these amendments have already had an impact on the demand for leadership training.

Similarly, section 141 of the Crown Entities Act 2004 provides an obligation on Crown entities to include in their statement of intent of information on “how the entity proposes to manage the organisational health and the capability of the entity”.

Strengthening agency responsibility for regulatory capability could increase demand for recognised courses and so promote the further development of regulatory qualifications. Responsibility could be strengthened in a number of ways. One option would be for the State Services Commission (SSC) to develop a set of minimum expectations around the promotion of regulatory capability, and require that Crown entity statements of intent demonstrate how the Crown entity will meet those expectations.

The expectations could include, for example, a requirement that an entity demonstrate:

- the steps it is taking to provide regulator staff with opportunities to meet, network with and learn from others undertaking similar tasks;

- the steps it is taking to ensure regulatory staff stay up to date with the latest developments in regulatory practice; and
- the steps it is taking to ensure that all regulatory staff meet a minimum standard of theoretical and practical knowledge in the field of regulation.

**R5.1**

The State Services Commission should develop a set of minimum expectations around the promotion of regulatory capability, and require Crown entity statements of intent to demonstrate how the Crown entity will meet those expectations.

### Increasing emphasis on workforce capability in performance reviews

Performance reviews can identify and spread good practices, discover areas for potential improvement, and strengthen regulators' incentives to focus on developing their staff's skills and competencies. Publishing the reviews would let other regulators benefit from relevant findings. Such reviews could be undertaken in a number of ways. They are more likely to be effective if the sector is the driving force behind them, as regulators would more likely take on "ownership" for the findings and respond to them.

The Performance Improvement framework (PIF) is an existing process used to test an agency's "fitness-for-purpose" that could be used to review their approaches to building staff competencies. The PIF already includes questions about capabilities, and developing staff is one of the four areas considered under the topic of organisational management. The compliance sector already recognises that PIF reviews could be undertaken of regulators: the *Achieving Compliance* guide is intended to help agency managers meet the expectations set out in the PIF (CCCP, 2011, p. 23). Chapter 13 discusses the potential to extend the PIF model to include a regulator-specific module.

### System-wide measures

The Commission considers that other system-wide responses are needed to professionalise and lift the capability of the regulatory workforce. These system-wide measures include the development and promotion of information and activities that will assist a wide range of regulatory bodies (public goods) and where efficiency gains (costs savings) can be achieved through coordinating the efforts of individual regulators.

Examples of activities with "public good" attributes include developing generic best-practice guidance and the promotion of professional forums through which agencies and regulatory staff share knowledge and exchange best practice. Examples of activities where there is likely to be efficiency gains from coordination include arranging visits from overseas scholars<sup>24</sup> and tapping into professional regulatory networks overseas. These could be either led by a central agency or by another institution (either within or outside government), and could be channelled through an intellectual leader in regulatory practice.

### Improving guidance on regulatory practice

An important part of any profession is that members are able to demonstrate a theoretical and practical knowledge of the relevant subject matter. One key avenue for disseminating this knowledge is through the use of guidance documents. These documents not only improve the quality and consistency of regulatory practice, they can help to embed a common professional language – which in turn contributes to the development of a professional culture.

The main source of guidance on compliance and enforcement in New Zealand is the CCCP publication *Achieving compliance: A guide for compliance agencies* (CCCP, 2011). The document has been well received by a number of regulatory agencies, and has been cited as "best practice" by the Ministry of Transport and Pike River Royal Commission (Ministry of Transport, 2012; Royal Commission on the Pike River Coal Mine Tragedy, 2012) and by MNZ in their compliance strategy (MNZ n.d.(b)).

<sup>24</sup> The Commerce Commission, Financial Markets Authority and Civil Aviation Authority have hosted visits by Harvard Professor Malcolm Sparrow, and during the course of this inquiry, Victoria University of Wellington hosted London School of Economics Professor Julia Black, as the Sir Frank Holmes Visiting Fellow.

*Achieving Compliance* was a step forward for regulatory practice in New Zealand, bringing together key regulatory concepts, lessons and principles in a format that a wide range of users can access. The guide was seen as “a foundation and starting point for capturing and sharing knowledge”, and the intent in developing it was:

...to provide easy access to information about specific topics or matters of interest; as well as, in total, providing a comprehensive view of options for designing effective compliance organisations and strategies... This guide will support compliance agencies to develop and constantly improve the way they work by capturing and sharing information that enables this to occur. (CCCP, 2011, p. 3)

*Achieving Compliance* was also aimed at a cross-section of the regulator community:

It is intended to be of interest to the most experienced and skilled leaders who have the capability and resources available to them to be at the cutting edge of operational compliance work through to those managers and staff who have limited experience of compliance work, or time to devote to it, but find that it is part of their portfolio of responsibilities. (ibid)

While the broad focus of *Achieving Compliance* was appropriate as a starting point, what is needed now is more detailed and sophisticated guidance that reflects the:

- practical challenges in implementing and integrating risk-based and responsive compliance and enforcement strategies, and in regulating *really responsively*;
- different information needs at different levels of a regulatory agency – for example, managers may need help to set and review regulatory strategies or improve organisational processes, while enforcement staff may need help to assess the risk posed by an incident.

Based on the discussion in Chapter 3, the Commission believes that areas that should be focused on include guidance on:

- defining and targeting risk;
- selecting intervention tools that appropriately reflect both the risk and compliance attitudes of regulated parties;
- establishing strong internal feedback loops within regulatory agencies for intelligence gathering and assessing how well enforcement strategies are working; and
- tools and strategies that enable the regulator to understand the significant influences that shape regulated parties’ responses to the regulatory regime.

#### R5.2

Guidance on regulatory practice should be updated to provide additional information on:

- how to define and target risks;
- how to select compliance tools that reflect both the risk and compliance attitudes of regulated parties;
- how to establish strong internal feedback loops for gathering and assessment of how well enforcement strategies are working; and
- tools and strategies to enable the regulator to understand the wider influences that shape the response of regulated parties to the regulatory regime.

### Supporting networks to promote professionalisation

As noted in section 5.4, New Zealand has several professional networks that aim to increase coordination between agencies with similar competency requirements. These include the CCCP, the Wildlife Enforcement Group and the Border Sector Governance Group.

The government could consider increasing its support for such networks. However, the Commission does not believe that being a member of a professional network should be mandatory or that the Crown should fully fund any network's activities directly. The reasons for this view are:

- requiring agencies to meet at least some of the costs of membership encourages them to pay attention to the activities of the network and hold its leaders to account;
- mandatory membership of one network would weaken incentives on the network to deliver value for members; and
- while a network may well have demonstrated leadership and expertise, alternative networks and arrangements may provide superior value to some regulators.

Yet clearly the ability of regulator networks to promote better practice and information-sharing is constrained by limited time and limited resources, and by a lack of incentives on individual agencies to participate. Further options for the government to strengthen its support of existing networks include:

- partial government funding for a period (for example, 3-5 years) for established or new regulator networks or forums, tied to a business case and performance measures; and
- revisions to Cabinet's *Expectations for Regulatory Stewardship*, to clarify that regulatory agencies should seek to raise their own performance and the sector's performance by sharing experiences and participating in communities of practice.

The point is not to require membership of groups and networks *per se*, but to find cost-effective ways of helping regulators – many of whom are small, and face scale issues – to improve their practice by learning from each other.

### R5.3

The government should provide partial direct funding of regulator communities of practice (subject to a suitable business case and performance measures) and strengthen its expectations about regulatory agencies participating in these networks (for example through revising Cabinet's *Expectations for Regulatory Stewardship*).

## Creation of an intellectual leadership role in regulatory practice

Regulatory practice and theory is a rapidly evolving field. Failure to keep up with the latest advances can result in regulators missing opportunities to improve the way they administer regulation. While New Zealand's regulators work hard to ensure their practices and knowledge remain current, it can be difficult for managers to maintain visibility of the latest advances in regulatory practice. This suggests there is value in channelling the latest developments through a focal point or intellectual leader. This position could also provide leadership around the system wide improvements recommended above.

The leader would be responsible for:

- disseminating information on the latest developments in regulatory theory and practice;
- coordinating the development of professional development pathways and accredited qualifications;
- working with chief executives of regulatory bodies to identify common capability gaps and strategies for filling these gaps across the system;
- working with research organisations to investigate regulatory issues of importance to New Zealand agencies;
- developing and maintaining good practice guidance;
- promoting a common "professional language" throughout New Zealand regulatory agencies;

- coordinating study tours and visits by international experts and leading academics in the field of regulatory studies; and
- leading and managing professional forums of regulators.

Importantly, the appointment of a specific intellectual leader would not reduce the accountability or duties of chief executives. Rather the aim would be for the position to provide institutional stability for important tasks that would otherwise be reliant on ad hoc leadership by committed individuals and voluntary membership of “clubs” such as the CCCP.

At least two existing models provide ways for enhancing intellectual leadership within government, the “Head of Profession” model and the “Functional Leader” model. The key features of these models, and their pros and cons of applying them to regulatory practice are outlined in Box 5.9 and Box 5.10.

#### Box 5.9 Head of Profession model

Intellectual leadership could be provided through the appointment of a “Regulatory Head of Profession”. There is some precedent for this approach with Heads of Profession being trialled in 2011. The purpose of the trial was to:

...test the concept of professionalising policy advice across the state sector by appointing Heads of Profession to set expectations for analytical and advisory competencies, lead professional networks, and develop professional learning programmes. (SSC, 2012, p. 1)

The Treasury has created the role of Head of the Government Finance Profession with the mandate to lift financial management capability across the state sector (New Zealand Treasury, 2014a). This newly created strategic role will have a team of five direct reports, be located in the Treasury, and co-ordinate activities to lift financial capability across the state sector.

A “Head of the Regulatory Practice Profession” could be located within the Treasury, the SSC or a major regulatory agency. The person selected for the role would need to have a deep understanding of regulatory institutions and practices, be recognised and respected as a thought leader.

A Head of Profession for regulatory practice will inevitably not have a deep specific knowledge of *all* New Zealand’s regulatory regimes. This creates the possibility that some regulatory agencies will perceive the person as lacking technical credibility in their specific area of regulation. There is a risk that this may undermine any initiatives led by the Head of Profession. Nevertheless, the position holder should have strong credibility (based on skill and experience) across the profession, in order to successfully work across the government regulatory sector.

#### Box 5.10 Functional leader model

Regulators across the state services undertake a common set of compliance functions. This raises the possibility of appointing a “Functional Leader for Compliance” who would take on responsibility for intellectual leadership of the compliance functions of regulators. This model has received some support by the CCCP (sub. 12a).

There is precedent for this approach. In other areas of government activity efforts have been taken to drive performance across the state services by appointing selected departmental chief executives as functional leaders of specific areas. To date, three functional leadership roles have been allocated: information and communication technology (ICT); government procurement reform; and government property management.

The aim of Functional Leaders is to maximise the benefits and minimise the cost of common

government business activities in ways that may not be achievable for individual agencies acting on their own. Depending on the approach taken, the appointment of a Functional Leader could provide strong incentives for a wide range of regulators to participate in shared and coordinated activities. For example, Functional Leaders can, with Cabinet agreement, be given the power to impose mandatory requirements on other departments. Further, the Ministers of Finance and State Services can direct Crown entities “to support a whole of government approach by complying with specified requirements” aimed at developing expertise and capability.<sup>25</sup>

The Functional Leader for Compliance could be given to the Treasury (as the department with responsibility for the government’s regulatory management system), the SSC or one of the departments with a significant and broad role in implementing regulation (possible candidates include the Ministry of Business, Innovation and Employment or DIA).

However, while there are some potential benefits from appointing a functional leader, there are also costs and limitations.

- Unlike ICT, procurement and property management, compliance activities are not a generic and common input to other public services. As such, it may not be as easy for a central “leader” to drive performance improvements.
- Establishing new leadership arrangements for regulatory practice could cut across existing networks and may create disruption, at least in the short term.

A Head of the Regulatory Profession would have a wider mandate than a Functional Leader who would focus on the compliance functions of government. Another option within government would be the appointment of a “Chief Regulatory Advisor” along the lines of the Chief Science Advisor.

In addition to these government models, it would also be possible for intellectual leadership to come from outside the public sector. The most obvious option would be for the government to fund a university academic to undertake this role however other options could include a respected former regulator or former chief executive of a regulatory agency.

#### R5.4

A position should be created to provide intellectual leadership in the area of regulatory practice. The position would be responsible for:

- disseminating information on the latest developments in regulatory theory and practice;
- coordinating the development of professional development pathways and accredited qualifications;
- working with chief executives of regulatory bodies to identify common capability gaps and strategies for filling these gaps across the system;
- working with research organisations to investigate regulatory issues of importance to New Zealand agencies;
- developing and maintaining good practice guidance;
- promoting a common “professional language” throughout New Zealand regulatory agencies;
- coordinate study tours and visits by international experts and leading academics in the field of regulatory studies; and
- leading and managing professional forums of regulators.

<sup>25</sup> Crown Entities Act 2004 (s. 107).

Options for this position and its location are discussed further in Chapter 16.

## 5.7 Conclusion

This chapter began with the observation that the increasing sophistication of regulatory regimes requires an increasingly professionalised regulatory workforce – one that is able to adapt to new challenges and risks and evolving regulatory practice. The Commission has formed a view that current efforts are not going to achieve the professionalisation needed. The Commission’s recommendations in this chapter are designed to build on the hard work and dedication of those individuals who see the practice of being a regulator as important, and who have sought to improve the capability of regulatory agencies and those that work within them.

## 6 Consultation and engagement

### Key points

- When implementing regulation, engagement can help to reassure the community that good regulatory process is being followed and that the decisions of regulators are robust, well-informed and well-reasoned.
- The choice of engagement mechanism should be influenced by the goal of the interaction, and by the relative efficiency of alternative engagement mechanisms. Goals can range from *informing* stakeholders of their regulatory obligations, to *involving* them in regulatory decisions, to *empowering* them to make decisions.
- In general, the greater the level of public participation the more critical it becomes to ensure a common understanding of the goals of the engagement process. Failure to do this can result in unrealistic expectations around the extent to which participants can affect regulatory decisions.
- When developing engagement strategies, regulators need to examine the fairness and proficiency of alternative mechanisms. In practice, the way a mechanism is implemented and the capability of the regulator influence both proficiency and fairness.
- In designing legislation, officials need to consider whether to leave engagement strategies to the discretion of the regulator or whether statutory consultation provisions are required. This decision should be made in the context of other features of the regulatory regime – particularly the extent of discretionary powers the regulator will hold, their level of independence, and the strength of accountability mechanisms.
- Inquiry participants have raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement processes with predetermined views, and concerns that some regulators lack the capacity to engage effectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably the New Zealand Transport Agency (NZTA) and the Environmental Protection Authority (EPA).
- Some inquiry participants called for more extensive use of collaborative decision-making processes such as “constructive engagement” and “negotiated settlements”. The chapter identifies five factors that are central to the success of any collaborative process:
  - a shared understanding of the boundaries of influence of the group;
  - commitment to implementing the outcomes of the collaborative process;
  - understanding the information needs of all parties and reducing information imbalance;
  - selecting participants that represent the wider interests of the community; and
  - establishing clear and transparent processes.

### 6.1 Introduction

Effective engagement is important for both the design and implementation of regulations. This chapter explores the link between consultation and engagement and the ability of regulators to deliver good regulatory outcomes. The use of statutory consultation provisions is discussed along with common law principles that influence the legal requirements for consultation. The chapter then explores the views of inquiry participants on current engagement practices, before exploring their suggestions for improvement.

It is important to recall that the inquiry terms of reference ask for “system-wide” recommendations for improvement. As such, this chapter does not make specific recommendations on how *individual* regulators can improve their engagement strategies. Rather, the discussion seeks to provide guidance on how to effectively implement the suggestions for improvement raised by stakeholders.

#### Box 6.1 Note on terms used in this chapter

This chapter uses the generic term “engagement” to describe a wide range of interactions between regulators, regulated parties, stakeholders and consumers. This inclusive definition covers a spectrum of activities ranging from one-way communication and information delivery, to consultation on key decisions, to the empowering of group decision making. As used here, engagement activities are not motivated by a need to comply with a legal requirement, but are undertaken as “good practice”.

The chapter uses the specific term “consultation” to reflect the exchange of ideas and views between a regulator and relevant stakeholders. A key feature of consultation (as opposed to engagement) is that all parties have a genuine opportunity to influence the decision. Unlike engagement, consultation occurs in response to common law or statutory requirements. These issues are discussed in section 6.5 and section 6.8 respectively.

The chapter uses the term “consumers” to refer to people who use and pay for a regulated service, such as electricity users. The term “stakeholders” is used to refer to a broader constituency, including suppliers, employees, environmental groups, political representatives, and citizens.

## 6.2 Why engagement is important

When implementing regulation, effective engagement helps to reassure the community that good regulatory process is being followed, and that the decisions of regulators are robust, well-informed and well-reasoned. This promotes confidence that the decisions of regulators are in the public interest and that they are evidenced-based and impartial. This in turn helps build trust in both the regulatory regime and in the regulator. It also helps strengthen the legitimacy of the regime and improve the durability of regulator decisions.

Conversely, insufficient engagement can weaken community confidence and trust in both the regulatory regime and in the regulator’s ability to make sound decisions. Low community confidence can undermine the objectives of regulation by deterring compliance or making the decisions of regulators more likely to be judicially reviewed. As Seafood New Zealand notes:

If submitters have no confidence in the consultation and engagement processes, they will have no confidence in the resultant regulations. (sub. DR 72, p. 3)

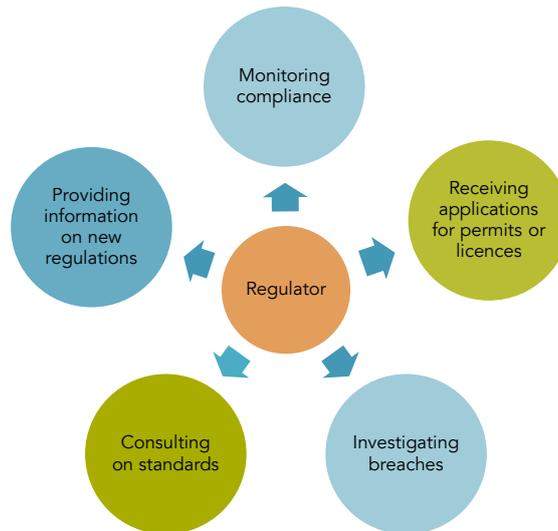
This sentiment is also expressed in the Legislation Advisory Committee (LAC) guidelines:

A well designed and implemented consultation programme can contribute to higher quality legislation, identification of more effective alternatives, lower administration costs, better compliance, and faster regulatory responses to changing conditions. Just as important, consultation can improve the credibility and legitimacy of Government action, win the support of groups involved in the decision process, and increase acceptance by those affected. (LAC, 2012a, pp. 29-30)

At a more fundamental level, common law principles highlight that consultation is not only important for efficient design and implementation of regulations, but also for protecting the right of New Zealanders to natural justice.

## 6.3 The regulatory relationship

Regulators undertake a number of activities that involve interacting with regulated parties and the wider community. These range from passive interactions (such as the provision of information on a website) to more active forms of interaction (such as site inspections and formal consultation processes).

**Figure 6.1** Points of interaction between regulators and regulated parties

The nature of the regulation and the characteristics of the regulated population both impact the form and frequency of interaction.

Some regulations, such as the issuing of a vehicle registration, require little interaction between the regulator and a regulated party. These tend to give rise to “distant” regulatory relationships based on formal processes and procedures.

Other forms of regulation require frequent interaction between the regulator and regulated parties. This frequent interaction provides an opportunity for each side to develop an understanding of the reasons that underpin the other side’s position. Frequent interaction also provides a greater potential for interpersonal relationships to develop between key staff and for a positive relationship to evolve between the two parties. Walshe and Boyd (2007) note:

When a positive relationship exists, there is some shared sense of purpose, and mutual recognition of each other’s expertise and contribution; a negative relationship is characterised by a clash of values or ways of working, distrust or even hostility, and adversarial behaviours. (p. 21)

Where regulation focuses on an industry with relatively few firms, it is generally easier for the regulator to identify regulated parties and to develop closer regulatory relationships with them. This allows more opportunity for the regulator to gauge the regulated party’s attitude to compliance. Conversely, where a regulation covers a large number of diverse parties, developing a detailed understanding of each participant is more difficult. In this situation regulators need to rely on more formal channels for monitoring a party’s attitude for compliance (eg, compliance databases).

The Commission’s business survey supports this assertion. The survey found that businesses with more than 50 employees and businesses with a yearly turnover of more than \$10 million were more likely than smaller businesses to agree that regulators listened to their views and considered those views when making decisions.

Comments from the Civil Aviation Authority (CAA) inquiry submission further highlight how the characteristics of the regulated party can influence the interface with regulatory agencies:

A particular issue for the CAA is the dichotomy it faces in consulting its stakeholders. There is a significant difference between consulting the big (almost monopoly players) versus, say, the recreational (i.e., the non-commercial flier), versus the small (often under-capitalised) entities in the sector. The ability to reach out to these various groups, using language that each understands, and then develop and apply a common set of rules ensures a complicated consultation and regulatory change process. (CAA, sub. 5, p. 52)

Of course, regulators also need to consider their relationship with a broader set of stakeholders, particularly those that benefit from regulation, such as end-users of network utility services and people whose lives are made safer by regulation. The CAA notes this point in its submission:

The relationship a regulator has with its regulated sector is very important, but is only one of a number of relationships with key stakeholders that must be considered. These relationships are dynamic, shifting and developing in terms of importance and form...

The regulator must consider the impact of its compliance decisions on all of its stakeholders, not just the regulated sector it oversees. (CAA, sub. 6, pp. 53-54)

Similarly, the Council of Trade Unions (CTU) notes:

Our emphasis is on representation of those needing protection. We recognise that there can be advantages in consulting the parties being regulated. However, that should not be allowed to give them unbalanced access to or influence over the regulator. This is a difficult task particularly when the regulated parties are large, wealthy, influential and powerful. Great care must be taken to ensure that 'consultation' does not in the end mean regulatory capture. (CTU, sub. 25, p. 26)

### F6.1

The "regulatory relationship" is influenced by both the nature of the regulation and the characteristics of regulated parties and beneficiaries. When designing new regulatory regimes, careful thought must be given to the relationships that should exist between the regulator, regulated parties and those who are the beneficiaries of regulation.

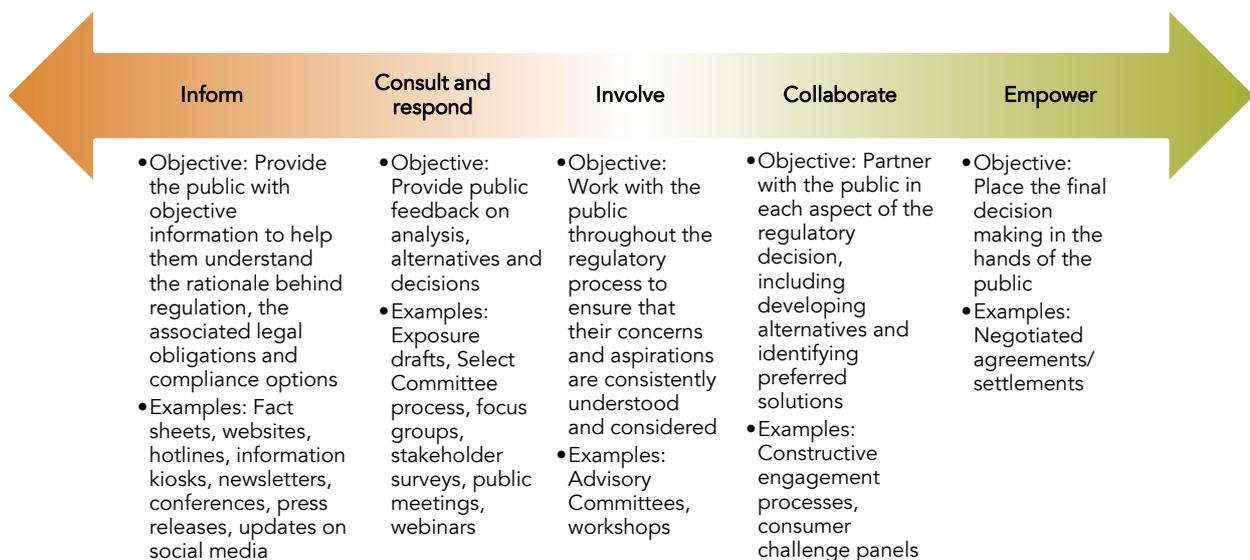
## 6.4 Selecting engagement strategy

Engagement can be used to achieve a range of regulatory goals. At its most basic level, it can inform stakeholders of their regulatory obligations, and provide information to help them comply. At the other end of the spectrum, engagement can be used as a means of collaborating with stakeholders over regulatory decisions (or even empower them to reach the decisions). This range of goals is present in Figure 6.2 and raised in the submission from the CTU:

We would also distinguish between *consultation* on one hand and *involvement* or *participation* on the other. In occupational health and safety, there are well-established international principles in favour of the latter. (sub. 25, p. 25)

Each end of the spectrum implies a significantly different role for the regulator. On the left side (low levels of public participation), the regulator's role is to make decisions and keep stakeholders informed of the decisions they make. On the right side (high levels of public participation), the role of the regulator is to facilitate public decision making and to implement the decisions of stakeholders.

Figure 6.2 Public participation in decisions – a spectrum of engagement goals



Source: Adapted from International Association of Public Participation, 2007.

In general, the greater the level of public participation the more critical it becomes to ensure a common understanding of the goals of the engagement process. Failure to do so can result in unrealistic expectations around how much participants can influence the decisions of regulators. Failing to ensure a common understanding can also undermine confidence in the engagement process and, indeed, confidence in the capability of the regulator. As Rothstein (2007) notes:

Conflicts can arise, for example, if regulators have an instrumental conception of participation as a useful ad hoc resource that can contribute procedural legitimacy to policy processes, but participants conceive of such processes as having a more substantial role in shaping regulatory outcomes and holding regulators to account. (p. 604)

## F6.2

In general, the greater the level of public participation, the more critical it becomes that there is a common understanding of the scope for stakeholders to influence regulatory decisions. Failure to do so can undermine public confidence in engagement processes and in the competence of the regulator.

## Efficient and effective engagement

Regulators have a range of engagement tools at their disposal. A stocktake by Rowe and Frewer (2005) found more than 100 different engagement mechanisms used in the United Kingdom and United States alone.

Regulatory bodies must decide which mechanism (or combination of mechanisms) will be most effective in meeting the specific goal of engagement. As the Regulatory Impact Analysis (RIA) Handbook notes, “good consultation is fit for purpose and tailored to both the nature and magnitude of the proposals, and the needs of stakeholders” (New Zealand Treasury, 2013b, p. 32).

The “effectiveness” of a mechanism consists of two dimensions:

1. *Fairness*: Fairness is the ability of the mechanism to meet society’s expectations of transparency, representativeness, and equity. This dimension of effectiveness is inherently linked to principles of natural justice (discussed further below).
2. *Proficiency*: Proficiency is the ability of the mechanism to achieve the specific engagement goal of the regulator. A key element of proficiency is whether the mechanism will collect and transfer the required information with minimum distortion or reduction in accuracy.

Importantly, the proficiency of a mechanism is situation specific. A mechanism that is proficient in collecting information from one group of stakeholders may be inadequate for collecting information from another. For example, an online survey may not be appropriate for groups with low internet access, or a neighbourhood meeting may not be suitable in sparsely populated areas where attendance would require travelling long distances.

This means regulatory bodies need to consider not only the appropriate tool to match the goal, but the appropriate tool to match the characteristics of the group being consulted. For example, Box 6.2 provides some insights on communicating with small businesses on regulatory issues. The submission by the Ministry for Primary Industries (MPI) provided insights into how MPI was adapting its engagement processes to meet the specific needs of relevant stakeholders.

We are learning to move beyond the standard discussion document consultation process, and increasingly, have direct ongoing engagement with interested parties to discuss problems and options face to face. For instance, during the policy development phase for the Biosecurity Law Reform Bill in 2012, MPI convened several stakeholder workshops at which problems were shared and possible solutions developed...Another example comes from the animal welfare area. We used a traditional discussion paper to consult the pest management industry on phasing out the use of glue boards as a pest management tool. The industry considered this consultation to be neither genuine nor meaningful.

This led to a workshop with the industry, a joint approach to problem definition and a sharing of ideas on next steps.

... Meetings and social media are providing alternative means to reach wider and different audiences. In the fisheries area, we consult with Tangata whenua through regional forums, which are formed by iwi themselves. (sub. DR 102, p. 9)

In practice, the way a mechanism is implemented influences its proficiency and fairness. A seemingly fair mechanism can be implemented unfairly. For example, questions in a stakeholder survey may have an inherent bias. Similarly, if poorly implemented, a mechanism that initially seemed the most proficient at collecting information may turn out to provide inaccurate or misleading information.

How well the mechanism is implemented is innately linked to the capability of the regulatory body. Capability issues are explored further in Chapter 5.

In addition to effectiveness, regulatory bodies must also consider the *efficiency* of a mechanism. Efficiency is the ability of the mechanism to deliver the required information in a cost-competitive manner when compared with alternative mechanisms (Rowe & Frewer, 2000). Again, the way a mechanism is implemented will significantly impact on how efficient a mechanism actually is.

### F6.3

When developing engagement strategies, regulators need to examine both the fairness and proficiency of alternative mechanisms. Both proficiency and fairness are influenced by the manner in which mechanisms are implemented.

#### Box 6.2 Regulator communication with small business

A recent inquiry by the Australian Productivity Commission (APC) into regulatory engagement with small business makes a number of observations relevant to this report, such as those noted below.

- The time that businesses spend understanding regulations can substantially reduce, and the likelihood of regulators' activities delivering good outcomes increase, when regulator communication is effective, and advice and guidance are accessible.
- Given the growing number and range of regulations that businesses need to be aware of, a premium should be placed on brevity and clarity.
- Small businesses are much more likely than large businesses to rely on third parties, including industry and professional associations and intermediaries such as tax agents, to receive information on regulatory requirements (leading practice regulators are reflecting this in their communication strategies).
- Regulators should provide ready access to advice and guidance via a multi-channel strategy, including printed guidance, websites, seminars, help desks and face-to-face interaction.
- Websites tend to be the first line of communication with business and third parties. If websites are well set out and maintained, comprehensive and easy to navigate, they can be particularly helpful to small businesses, many of which undertake compliance activity outside business hours.
- Regulators should tailor their delivery approach to reflect the diversity of small businesses – such as those that are regionally dispersed or have a high proportion of owners from non-English speaking backgrounds – subject to an assessment of the costs and benefits.
- Effective complaints handling and grievance processes – which have a degree of independence from the enforcement activities of the regulator – build business confidence in regulatory arrangements and promote better regulatory outcomes.

Source: APC, 2013a, p. 141.

## Pros and cons of different approaches

The wide variety of engagement mechanisms makes it impossible to review every mechanism. This section groups engagement mechanisms into four broad approaches (Decker, 2013). These approaches are consult-and-respond, advisory committees and panels, stakeholder dialogue, and negotiated agreement.

### Consult-and-respond

This group captures a broad range of mechanisms perhaps described as the “traditional” approaches to engagement. These approaches give stakeholders the opportunity to respond to engagement documents and issues raised by the regulator, with the regulator making the final decision.

Consult-and-respond approaches have the advantage that all interested parties can participate. They therefore canvass opinions from a wide range of perspectives. This can help regulators get the “full picture” rather than just the collective views of specific interests. Consult-and-respond approaches also tend to be relatively easy and inexpensive to implement.

On the down side, consult-and-respond mechanisms may be less effective in dealing with issues that are highly technical or that require specialist knowledge. In such situations, reliance on these approaches can result in large, well-resourced stakeholders dominating consultation processes. In addition, participants involved in consult-and-respond processes may find it hard to see the impact they are having on decisions, leading to disenchantment with the process.

### Advisory committees and panels

Advisory approaches commonly involve groups of experts and/or stakeholder representatives who are brought together to advise the regulator on decisions. They can be established by statute or on the initiative of the regulator. Again, the regulator makes the final decision.

The advantage of advisory committees over normal consult-and-respond approaches is that they allow for experts from outside the regulator to provide input into regulatory decisions. They can also provide an avenue for non-expert stakeholders to gain a fuller understanding of the issues and so enable them to represent the views of the wider community more effectively.

Yet it can be hard to ensure that the panel or committee is sufficiently representative of all stakeholders. For instance, it can be unclear whether “institutionalised” advocacy bodies represent the needs of all stakeholders or only certain types of stakeholders. Further, it can be hard to find participants with the requisite skills to contribute to complex decisions.

### Stakeholder dialogue

In recent years, approaches that promote dialogue between regulated parties, consumers and other stakeholders have become more popular. These approaches are based on the idea that complex regulatory problems are often best addressed by encouraging stakeholders to develop a mutual understanding of each other’s views, opinions and preferences.

Two such approaches are constructive engagement and consumer challenge panels – most commonly used in the regulation of network utilities. Broadly speaking, these mechanisms involve regulators requiring regulated parties to consult formally with consumers/stakeholders on aspects of their operation. The aim of the consultation is to agree on regulatory solutions that reflect both the views of the regulated company and the preferences of their customers or wider stakeholders. These solutions are presented to the regulator to consider when making its determinations. The key difference between these mechanisms and that of negotiated agreements (discussed below) is that decision rights remain with the regulator.

These mechanisms encourage regulators to build relationships with stakeholders and, in doing so, to develop a deeper understanding of their preferences and willingness to pay for different activities. These mechanisms can also remove misunderstandings that act as a barrier to mutually agreeable outcomes. This was a key lesson from the Land and Water Forum (LWF), whose chair (Alastair Bisley) has noted:

That is the essential (though not the only) thing to understand about collaboration. You talk to the people you disagree with. Not just once, but again and again ... And if you do listen carefully to what

they say, you may come to realise that they are not the idiots that you thought they were! You may even stop entirely believing your own propaganda! And if these things do happen, your creative juices can start flowing, and you can begin to find common ground, and to come up with answers ... (Bisley, 2013)

Yet (as can be the case with advisory bodies) stakeholders can lack the technical expertise to engage effectively in some regulatory decisions. This can result in questions around the fairness of the process, and concerns around whether all interests are adequately represented. These approaches can also be costly for regulators to oversee and for consumers to participate in.

### **Negotiated agreements**

Negotiated agreements may be applied in a broad range of regulatory situations – from setting access prices for natural monopolies to establishing environmental planning provisions in local plans. Broadly, the approach involves regulated parties and relevant stakeholders negotiating aspects of regulatory compliance. If an agreement is reached, the regulator approves the outcomes of the process, avoiding the need to go through the full regulatory procedure.

When negotiated settlements are used, the role of the regulator fundamentally changes from decision maker to overseer of the negotiating process and facilitator of an agreement. That is, the regulator transfers some aspects of decision making to the parties participating in the agreement. The LWF has advocated such a process (Box 6.3).

#### **Box 6.3 Land and Water Forum**

The LWF is made up of representatives from a range of industry groups, electricity generators, environmental and recreational non-governmental organisations, iwi, scientists, and other organisations with a stake in freshwater and land management. Central and local government observers attend the LWF. The LWF's role is to develop a common direction for freshwater management and to provide advice to the Government.

Since 2009, the LWF has conducted stakeholder-led collaborative processes to consider reform of New Zealand's freshwater management system. It has produced three reports identifying outcomes and goals for freshwater management and making recommendations on the methods, tools and governance processes required for setting and managing limits on water quality and quantity. It has also undertaken public engagement on its recommendations.

In its second report, the LWF recommended the implementation of collaborative processes for setting freshwater objectives and limits at a regional level through regional policy statements and related plans made under the Resource Management Act 1991 (RMA). It also recommended changes to how national instruments are developed.

The LWF proposed that regional councils be able (after appropriate engagement with their respective communities) to elect to follow a collaborative process when making policies and plans. A collaborative stakeholder group would work together with the council and community to develop the provisions in freshwater policies or plans, consider public submissions, and commission independent evaluations. The LWF also recommended a collaborative process, at the national level, for developing freshwater-related National Policy Statements and National Environmental Standards.

#### **The Government's response**

In March 2013 the Government released a paper "Freshwater Reform 2013 and Beyond" (MfE, 2013). It stated that the RMA will be amended to provide a collaborative planning process that councils may choose when preparing, changing, and reviewing freshwater policy statements and plans. Councils will have a choice about whether to use the existing process or the proposed new collaborative planning model.

In August 2013, the Minister for the Environment, Amy Adams, said, during debate on the third reading of the Resource Management Amendment Bill, that she intended to introduce a further resource management reform bill later that year that would introduce collaborative freshwater planning (New Zealand Parliamentary Debates, 2013). To date, this bill has not been introduced.

It is important to draw a distinction between *negotiated agreements* and *negotiation of settlements*. *Negotiated agreements* are deliberate, *ex ante* negotiations aimed at achieving a desired regulator outcome in an efficient, flexible and mutually beneficial manner. *Negotiation of settlements* aims to remedy a regulatory breach in an efficient and cost-effective manner, such as once non-compliance has occurred.

Advocates of negotiated agreements argue that the approach increases economic welfare because the parties can reach compromises that may not be available to regulators (for example due to rigid statutory requirements). This can result in efficiency gains, as regulatory outcomes more closely represent stakeholder preferences. Advocates also argue that the approach produces more durable and politically acceptable regulatory outcomes.

As with all engagement approaches, negotiated agreements have potential drawbacks. For example, there is a risk that not all relevant views will be adequately represented during negotiations. This can raise questions about the legitimacy of the agreement reached. Negotiations also raise the possibility that groups may have an incentive to do “side deals” that are not in the public interest. Further, concerns over transparency can arise when an agreement is presented as a “package” of measures without presenting the detailed assumptions upon which the agreement was reached. This can create a perception of negotiated agreements being a “black box”<sup>26</sup> (see Littlechild, 2010).

## 6.5 The use of statutory provisions in New Zealand

The use of statutory requirements to consult is a common feature of New Zealand regulation. These requirements vary considerably in terms of:

- the level of prescription around who should be consulted and how consultation should take place; and
- the extent to which consultation with specific groups is discretionary or mandatory.

Figure 6.3 provides a high-level typology of current statutory provisions. The typology highlights four broad categories of provisions.

- *Low-discretion/high-prescription*: These provisions create a clear obligation on regulators to consult (low-discretion) and specify either the party to be consulted or the mechanisms of consultation (high-prescription).
- *High-discretion/high-prescription*: These provisions list specific groups or methods of consultation (high-prescription), but leave the decision on whether to consult to the discretion of the regulator (high-discretion).
- *Low-discretion/low-prescription*: These provisions create a clear obligation on regulators to consult (low-discretion) but do not specify which parties to consult or which mechanisms to use (low-prescription).
- *High-discretion/low-prescription*: These provisions leave the decisions on when and how to consult to the discretion of the regulator.

<sup>26</sup> For example, the negotiated settlement process overseen by the US Federal Energy Regulatory Commission allows parties to propose “black box settlements” where the rates or revenue are specified, but are not linked to particular assumptions. In these circumstances, each party will make their own preferred assumptions about the parameter values (Littlechild, 2010).

Figure 6.3 Examples of consultation provisions in New Zealand legislation

Low-discretion/high-prescription	High-discretion/high-prescription
<p>Examples:</p> <p>Civil Aviation Act, s 38 (4): “Fees and charges in respect of the use of any airport operated or managed by an airport authority shall not be prescribed, except on the advice of the Minister given <b>after consultation with that airport authority.</b>”</p> <p>Hazardous Substances and New Organisms Act 1996, s 49F: In determining whether to approve or decline an application under s 49D to use agricultural compound or medicine in special emergency, the Environmental Protection Agency <b>must “consult, and have particular regard to the views of, the Department of Conservation; and consult and consider the views of any other interested government agency.”</b></p>	<p>Examples:</p> <p>Reserve Bank of New Zealand Act 1989 s 121A: “A statutory manager <b>may consult</b> a prescribed <b>Australian financial authority</b> about whether an action the statutory manager proposes to take is likely to have a detrimental effect on financial system stability in Australia”.</p> <p>The Inspector-General of Intelligence and Security Act 1996 s 12: “The Inspector-General ... <b>may consult</b> with the <b>Controller and Auditor-General</b> in relation to any matter with a view to avoiding inquiries being conducted into that matter by both the Inspector-General and the Controller and Auditor-General”.</p>
Low-discretion/low-prescription	High-discretion/low-prescription
<p>Example:</p> <p>Telecommunications Act 2001 s 156O: “In deciding whether to take the action referred to in subsection (2)(b)(i), the Commission <b>must consult with interested parties</b>”.</p> <p>Animal Welfare Act 1999 s 41: “Before publishing guidelines under this section or any amendment (other than a minor amendment) to any such guidelines, the Director-General <b>must consult</b> with those persons <b>considered by the Director-General to be representative of the classes of persons having an interest in the guidelines</b> or the amendment”.</p> <p>Financial Markets Authority Act 2011s 69: “The FMA <b>must, ...consult about that request with—</b></p> <p>(a) the persons or organisations <b>that the FMA considers</b> are able to represent the views of those specified persons who are liable to pay a levy under that section; and</p> <p>(b) <b>any other</b> representatives of persons whom <b>the FMA believes</b> to be significantly affected by a levy.”</p>	<p>Example:</p> <p>Overseas Investment Act 2005, s 14: the Minister, in considering whether or not to grant consent to an overseas investment transaction, “<b>may consult with any other person or persons, as the Minister or Ministers think appropriate...</b>”</p> <p>Biosecurity Act 1993, s 7A: “Before making a decision under subsection (1), the responsible Minister—... (b) <b>may consult</b> such other persons as the responsible <b>Minister considers are representative</b> of the persons likely to be affected by the eradication attempt”.</p> <p>Transport Act s 99A: “When approving a programme, the Agency <b>may consult with any persons</b> that <b>the Agency considers</b> appropriate having regard to the nature of the programme and the persons to whom it is targeted”.</p>

*Notes:*

1. Emphasis added by the Productivity Commission.

There appear to be no “hard and fast rules” to when and how consultation provisions are used in legislation. Given the breadth of issues covered by this inquiry, this is to be expected. However, some general observations are possible.

- Low-discretion/high-prescription provisions tend to be used when there are a small number of stakeholders whose views are central to good decision making. These stakeholder groups tend to have relatively stable memberships.
- High-discretion/low-prescription provisions tend to be used to *enable* the regulator to consult with certain groups, rather than specify that those groups *should* be consulted.
- Low-discretion/low-prescription provisions tend to be used when consultation is central to the decision, yet the groups to be consulted are variable and therefore hard to predict *ex ante*.

While these general observations provide some insight into how consultation provisions have been used historically, a far more important question is whether the provisions are fit for purpose. The inquiry issues paper raised the topic of consultation requirements. While the Commission received numerous submissions on the way that consultation is undertaken, the adequacy of statutory provisions has not emerged as a major issue.

While statutory requirements can be a useful tool, they should not be seen as a substitute for regulators adopting good regulatory practices. That is, regardless of the existence of a formal legal requirement, engagement and consultation should be seen as “core business” for an effective modern regulator.

Further, the absence of a statutory provision does not relieve a regulator from their obligation to consult. Common law principles of natural justice are still relevant. Indeed, even when legislation provides a statutory provision, the courts may supplement the provision by reference to common law standards of fairness (Joseph, 2007, pp. 957-58). As an English case decided in 1863 famously declared, “the justice of the common law will supply the omission of the legislature”.<sup>27</sup>

## 6.6 Engagement and common law principles

New Zealand common law, such as case law, contains a number of important legal principles that affect how and when regulators must engage with stakeholders. These principles are part of the rules of natural justice, which the New Zealand Bill of Rights Act 1990 affirms.<sup>28</sup>

The two main aspects to natural justice are:

1. parties should be given adequate notice and opportunity to be heard; and
2. the decision makers should be disinterested and unbiased.

The application of these principles is highly dependent on the particular context. In general, their application will depend on:

- the nature of the power exercised: for example, the court will apply a higher standard to a decision maker who discharges a judicial function than, say, a decision maker within a business;
- the nature of the interest affected: for example, where a decision may affect liberty, livelihood, or reputation of an individual, higher standards of natural justice are applicable; and
- the severity of the sanction a decision maker may impose: for example, higher standards are likely to apply where a decision may constrain the liberty and livelihood of an individual.

Another relevant principle is the doctrine of “legitimate expectation”. This refers to a situation where the government or public body creates a reasonable expectation that they will behave in a certain way or undertake certain courses of action. A legitimate expectation to consult could arise:

- where a public body has given a promise or assurance to consult (this could be express or implied);
- from statements of intent;
- from a regular practice giving rise to a reasonable implication that a practice will continue; or
- from the creation of machinery for a hearing process.

Further, the principles of natural justice hold that adverse findings must not be made against people without them first being given an opportunity to reply to the alleged wrongdoing.<sup>29</sup>

New Zealand case law also lays down certain requirements for proper consultation. The courts have stressed as a central theme the genuine possibility for consultation to influence decisions. For example, McGechan J in the High Court in *Air New Zealand and others v Wellington International Airport Limited and others* (1992) stated:

<sup>27</sup> *Cooper v Wandsworth Board of Works* (1863).

<sup>28</sup> The New Zealand Bill of Rights Act 1990 affirms the right to natural justice whenever a decision maker has power to make a determination of an “adjudicative character” about a person’s “rights, obligations, or interests protected or recognised by law” (s 27(1)).

<sup>29</sup> This principle is often referred to by the Latin phrase *audi alteram partem* (“hear the other side”).

Consultation must allow sufficient time, and a genuine effort must be made. It is in reality not a charade. The concept is grasped most clearly by an approach in principle. To consult is not merely to tell or present. Nor, at the other extreme is it to agree. Consultation does not necessarily involve negotiation toward an agreement, although the latter not uncommonly can follow, as the tendency in consultation is to seek at least consensus. Consultation is an intermediate situation involving meaningful discussion.

Elaborating on the consultation principles and their application, McGechan J goes on to say:

Implicit in the concept is a requirement that the party consulted will be (or will be made) adequately informed so as to be able to make intelligent and useful responses. It is also implicit that the party obliged to consult, while quite entitled to have a working plan already in mind, must keep its mind open and be ready to change and even start afresh. Beyond that, there are no universal requirements as to form. Any manner of oral or written interchange which allows adequate expression and consideration of views will suffice. Nor is there any universal requirement as to duration. In some situations adequate consultation could take place in one telephone call. In other contexts it might require years of formal meetings. Generalities are not helpful.

McGechan J in *West Coast United Council v Prebble* (1988) succinctly explained:

Consultation involves the statement of a proposal not yet fully decided upon, listening to what others have to say, considering their responses and then deciding what will be done.

These common law principles mean that the absence of specific statutory provisions requiring consultation does not necessarily relieve a regulator of its obligation to consult. While the extent of this obligation is context specific, it is important that both regulators and officials designing regulation are aware of these fundamental principles of law when considering their engagement strategies.

#### F6.4

New Zealand common law, such as case law, contains a number of important principles that affect how and when regulators have an obligation to consult and what constitutes proper consultation.

## 6.7 Stakeholder views on current engagement practices

Inquiry participants have highlighted a number of concerns around the way engagement is currently undertaken in New Zealand. This section provides a summary of the key themes emerging from participants, namely concerns about:

- the time allowed for consultation;
- the impact from the pre-existing opinions of regulators;
- the capability of regulators to engage effectively; and
- consultation overload.

The section then discusses stakeholder views on advisory groups.

### Time allowed for consultation

Arguably the most common criticism of current engagement practices is that they provide too little time or opportunity for consultation. For example, the New Zealand Bankers Association (NZBA) notes:

A recent example of this was the Consultation Paper on Housing Capital requirements issued by the Reserve Bank. The paper was released on 26 March and submissions closed on 15 April, giving banks just over three weeks to respond, during a period in which three of the four banks being consulted would have been working on half yearly reporting. Furthermore, it was one of four papers released in a three-week period, most of which required the same staff members to respond, causing practical difficulties for banks. (NZBA, sub. 43, pp. 4-5)

Minter Ellison Rudd Watts expressed similar concerns about the pace of engagement:

The policy making process contains a number of distinct phases, and care needs to be taken not to rush the consultation process by producing an omnibus paper which moves rapidly from “problem definition” to “applicable solutions”, “costs benefit analysis of solutions”, “implementation process”, and “legal drafting”. (Minter Ellison Rudd Watts, sub. 28, p. 43)

And Mighty River Power stated:

The time pressures placed on the Electricity Authority for recent reform have led to pressure to conflate the stages of the traditional regulatory impact assessment process and reduce the role of engagement primarily to a proposal/respond model.

This can be expedient where there is general consensus around problem definition and the need for reform, or where issues are technical in nature and largely uncontroversial. But it can have draw backs. For example the introduction of significant revisions to the Transmission Pricing Methodology after some limited consultation with Transpower meant that time and resources had to be devoted by a range of stakeholders to understand the very complex proposals, initially over a relatively short period of time. The Authority has recognised the limitations of this approach and has sought to consult further which we support. (Mighty River Power, sub. 30, p. 13)

In contrast, Federated Farmers praised NZTA for their engagement during the development of transport rules:

The Federation was satisfied with the way in which both the Ministry and NZTA consulted with it while developing the new rules [for the use of agricultural vehicles on-road]. We were consulted throughout the development period and were given a heads up on regulatory decisions before they were made. Officials from the Ministry and NZTA were always willing to listen to our suggestions even...when they did not agree and we always felt we understood the reasons things couldn't be done as we wished...

... Importantly, both the Ministry and NZTA have continued to engage with Federated Farmers in a positive and constructive way and to show this is not a “flash in the pan”, officials have taken a similar approach when consulting on the Vehicle Licensing Review. (Federated Farmers, sub. 11, p. 14)

BusinessNZ and others expressed similar, positive sentiments about the EPA's approach:

The EPA has taken an open and consultative approach to the development of its regulatory framework and has listened to (though not always agreed with) industry views. This conversation, which commenced even before the EEZ [Exclusive Economic Zone] law had been passed, has been viewed extremely positively by industry who feels that they have had the chance to influence the attainment of mutually positive outcomes, rather than the usual sense of regulators simply shedding all of the possible risks they can on to industry. (BusinessNZ, sub. 19, p. 24)

Mighty River Power praised the collaborative approach of the Commerce Commission:

Another example of good practice is provided by the Commerce Commission, which generally takes a collaborative approach to problem definition. When considering its approach to information disclosure for Transpower the Commission held a workshop to get industry participants' views ahead of formulating its approach. The Commission contacted industry participants directly and actively encouraged workshop attendance. (sub. 30, p. 13)

Importantly, consultation processes can be affected by legislative provisions specifying the time available for regulators to make a decision. Designers of legislation need to appreciate the implications of such provisions, particularly where regulators deal with complex, high-risk issues. As the EPA explains:

Much of the regulatory work undertaken by the EPA is of high public interest and is often controversial in nature (e.g. petroleum exploration, genetic modification, or new infrastructure) and so a great deal of emphasis is placed on the need for appropriate consultation and engagement with a range of interested parties. It is important for the EPA to reassure both the applicant and the general public that good regulatory process is being followed, and that the decisions of the EPA are robust, transparent well informed and in the public interest. This can be a challenge under tight statutory timeframes. (sub. DR 103, p. 4)

## Impact from pre-existing opinions

Engagement can appear to be “policy advocacy” if used to justify a decision that has already been made. If regulated parties believe the regulator has already made up its mind, the engagement process may be

seen as disingenuous. This appears to be the perception of some inquiry participants. For example, NZBA and Genesis Energy questioned the sincerity of some engagement processes:

Regulators frequently appear to view engagement as a ‘box ticking’ exercise rather than a genuine effort to gain feedback, timeframes for the engagement process are often unworkable, and in general consultation practices run counter to the expectations set out in the Government statement on regulation. (NZBA, sub. 43, pp. 4-5)

While engagement with the advisory groups works well, consultation with stakeholders, in our view, needs to be improved. There is an increasing perception that the Authority is unwilling to change its initial position in response to submissions. As a result, the consultation process is seen as formulaic rather than meaningful. (Genesis Energy, sub. 48, p. 14)

Similar views are expressed by the ANZ:

If a regulator is to be criticised from time to time, it will typically be for not being sufficiently transparent in its decision-making or for exhibiting confirmation bias – for example, not being willing to alter an initial view in the light of consultation responses. (sub. 24, p. 6)

The Commission’s business survey provides mixed evidence around the extent to which similar views are held within the wider business community. For example, 26% of businesses surveyed agreed that regulators were willing to listen to their views and take them into account. This compares to 24% that disagreed (39% neither agreeing nor disagreeing and 11% didn’t know).

## Capability of regulators to engage effectively

Inquiry participants have suggested that regulators appear not to have the technical capability to understand and respond to information they receive during engagement processes. The submission of Insurance Australia Group Limited (IAG) notes:

It is important to note that meaningful stakeholder engagement also relies on a regulator having the capability to translate stakeholder messages and views into considerations that inform regulatory outcomes. Appropriate transparency and accountability mechanisms are also needed to ensure that there are incentives to do so. In this way, many of the core elements of high-quality regulation are interconnected and self-reinforcing, and should be considered in a holistic sense. (IAG, sub. 10, p. 6)

Conversely, the EPA has taken specific steps to develop internal capability to engage with Māori. These steps are discussed in Chapter 7. A broader discussion of regulator capability is provided in Chapter 5.

## Consultation overload

While some stakeholders lamented the absence of effective engagement, others highlighted the risk of too much engagement slowing down decision making. For example, KLR Investments believes that the level of consultation required under telecommunication regulation has slowed industry development. It also notes that consultation often occurs on a matter-by-matter basis as opposed to parallel processes addressing several matters.

Inquiry participants highlighted the cost of consultation and the fact that the pace of regulatory change can make it hard for companies to “keep up” with numerous processes occurring across a range of government agencies.

## Stakeholder views on existing advisory groups

In general, inquiry participants supported the use of advisory groups and other collaborative approaches to engagement. Aviation New Zealand notes their value in the exchange of ideas:

We value these [advisory] groups as they enable ideas to be exchanged and better understanding developed. (Aviation NZ, sub. 36, p. 33)

Similarly, the CAA notes the role of advisory groups in improving the regulators’ understanding of the markets they regulate:

An advisory board can add value by exposing the management (and the main board) to new thinking, thereby broadening horizons, improving understanding of the organisation’s markets, risks and future

drivers of growth, challenging assumptions and guarding against groupthink. Advisors can directly benefit organisational performance. (CAA, sub. 6, p. 59)

The CAA also notes the fundamental importance of clearly specifying the remit of any advisory board:

To be effective, an advisory board needs a clear remit. An advisory board can support the board or the CEO by providing expert insight or contacts, but it must be clear where ultimate decision-making authority and collective responsibility lie. The advisory board must have an unambiguous mission and definition, with the structure, background and financial arrangements clear. The commitment must come from an appropriate point in the organisation. (sub. 6, p. 59)

Yet, a number of submitters cautioned about the potential for capture:

Advisory boards may work well where broader public consultation is not viable because of [the] technical (specialist) nature of the material. They will not work well when impartiality is impractical due to fundamental commercial conflicts. (Transpower, sub. 32, p. 10)

Advisory boards can work well if an appropriate range of people are appointed. However they can be captured by board members' individual interests. They have limitations as they only have a limited number of members, which can mean certain perspectives are not heard until late in [the] process when consultation is undertaken. (IPENZ, sub. 21, p. 11)

While advisory boards may have a place, they cannot be seen, as they too often have, as substitute for effective involvement of interested parties in decision making. When they have a marginal influence they can disillusion people rather than encourage their involvement. We consider that New Zealand has moved much too far down the path of stripping governance boards of representatives of those affected. That should be reversed. In addition there should be requirements that where regulations, codes of practice, compliance strategies and the like are being developed or reviewed, their involvement is mandatory. (CTU, sub. 21, p. 26)

Other stakeholders raised concerns around the manner in which advisory groups are implemented. Genesis Energy notes:

The advisory group process works very well when utilised. The Authority appears to fully engage with the advisory panels, gives appropriate weight to their papers and often adopts their recommendations. However, in our view the advisory groups are not used often enough, particularly in relation to material matters. (sub. 47, pp. 8-10)

Both KLR Investments and Aviation New Zealand noted the limited involvement with consumers:

... there is no requirement for the Commerce Commission to use industry advisory groups and it tends to instruct experts from academia. There are also limited processes for consumer engagement. (KLR Investments, sub. 18, p. 9)

However there is a limit to which a small industry can engage with multiple advisory boards as we still have businesses to run. We think good high quality dialogue in terms of communication and consultation with the industry as opposed to an advisory Board probably works best in this industry. (Aviation NZ, sub. 36, p. 33)

### F6.5

Inquiry participants have raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement with predetermined views and concerns that some regulators lack the capacity to engage effectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably NZTA and the EPA.

## 6.8 Suggestions for improving engagement

As noted, the inquiry terms of reference call for “system-wide” recommendations. It is therefore beyond the scope of this report to make recommendations on how individual regulators can improve their engagement strategies. Inquiry participants have, however, suggested a number of measures to improve engagement

practices of specific regulatory bodies. This section provides a general discussion of the three commonly suggested measures:

- increased use of statutory requirements;
- greater use of collaborative approaches; and
- better communication of the rationale for decisions.

### Increased use of statutory requirements

Several stakeholders have raised the need for greater use of statutory provisions to consult. For example, the Insurance Council of New Zealand notes:

We believe there should be an enhanced statutory requirement for regulators to consult on proposals, particularly with industries such as the insurance industry where issues are highly technical in nature. (sub. DR 67, p. 2)

Similar views were expressed by the New Zealand Bankers Association.

We endorse and see merit in the development of minimum standards for consultation on regulatory proposals (as was suggested by the case study). For these standards to be effective NZBA agrees that they should include minimum periods for consultation and a requirement the views of key stakeholders be considered. (sub. DR 86, p. 3)

There are a number of situations in which statutory requirements to consult may be necessary. For example, where a regulator has been given wide discretionary rule-making powers a requirement to consult may form an important “check and balance” on the use of these powers. That is, requiring the regulator to consult can be a means of promoting transparent, informed and accountable decision making.

Statutory requirements may also be useful in situations where a failure to consult would breach natural justice principles – for example, where regulation involves a significant use of the state’s coercive powers in a manner that may impact the civil liberty, livelihood or property rights of individuals.

There may be social equity reasons for specifying the consultation processes that should be followed for a specific group – for example where the affected group may not have the resources or capacity to effectively participate in a conventional consultation process.

Finally, statutory requirements to consult may be beneficial where the affected community holds information on trade-offs and technical issues necessary for the regulator to make sound decisions.

Yet, statutory requirements can have practical implications for how a regulator operates. For example, the details of a provision can affect:

- the cost of decisions and the speed with which they are made (this is particularly relevant in emergency situations where a rapid response to an event is required);
- the weight a regulator gives to the views of specific stakeholders;
- how the regulator allocates its budget (and the budget flexibility the regulator has); and
- the skills and capability that a regulator needs.

It is vital that considerable thought be given to these issues when contemplating the use of statutory provisions. Five questions to help officials consider the need for statutory consultation provisions are presented below. The questions are not a “checklist”, but rather a guide for deeper analysis and thought.

### Will other institutional arrangements provide adequate incentive to consult?

Statutory provisions to consult create an obligation on regulators to undertake certain processes. Failure to undertake these processes makes the regulator’s decisions vulnerable to judicial review.

Consultation is not an end in itself; rather it is a tool that regulators use to achieve a specific goal. Officials therefore need to consider whether the broader institutional environment provides adequate incentives to use this tool efficiently and effectively, or more specifically, in a way that is consistent with efficiently achieving the desired regulatory outcomes. Such incentives arise from transparency and accountability arrangements, performance review regimes, and the potential for judicial review of decisions.

In light of the incentives that these elements of regulatory design create, officials need to consider whether the potential costs of the statutory provision outweigh the benefits. The costs of the provision may include adding (unnecessarily) operating cost and delays into the system, or drawing the regulator's resources away from higher-value uses.

### **Has the regulator been allocated discretionary law-making powers?**

In democratic systems, elected representatives (often ministers) are empowered to weigh up society's competing objectives and to make decisions that they believe promote the public interest.

Where Parliament has delegated these decisions to a regulator, it is important that the necessary checks and balances are in place to promote transparent, informed and accountable decision making. One way to promote informed decisions, and greater scrutiny of decision making, is through statutory requirements to consult with parties affected by the decision. Conversely, prescriptive regimes that provide few discretionary powers may require fewer obligations on the regulator to consult during implementation (but may require a greater level of engagement during the design of the regulation).

### **Does other legislation provide a requirement to consult?**

Often the actions of regulators are bound by multiple pieces of legislation. In considering the use (and extent) of consultation provisions, officials need to be aware of the existing requirements for regulators to consult, and the consistency of these requirements with those being proposed in the new regulatory regime.

One example of a seemingly inconsistent requirement was highlighted in the Commission's recent work on local government regulation. The Commission found that often local authorities are bound by the Local Government Act 2002 to undertake community consultation on issues over which they have very little discretion. For example, despite the fact that local authorities have little discretion in making some bylaws, there is a blanket requirement that all new bylaws or changes to bylaws go through the Special Consultative Procedure (NZPC, 2013a).

### **Are there specific parties whose interests may be overlooked?**

Regulations typically affect a diverse range of stakeholders. In some instances, there may be potential for the interests of certain groups to be overlooked and for important views to go unheard. Such a situation may arise, for example, if the views of well-funded and well-organised stakeholders are given prominence over less-coordinated, poorly resourced interests.

Where failure to consult constitutes a breach of natural justice, stakeholders may have recourse to the courts. However, judicial processes are typically costly and complex. This may present a barrier to diffuse, poorly resourced parties taking such action. In these circumstances, statutory provisions may be required to promote consideration of the views of these groups.

### **Is some information critical to avoiding large social losses?**

The case for statutory provisions to consult may be stronger when:

- successful implementation of the regulation is dependent upon critical information held by stakeholders; and
- regulatory failure would result in significant and irreversible costs to society.

If these two conditions exist, then the need for statutory certainty may be higher than in normal regulatory circumstances.

As noted, statutory provisions vary greatly in terms of the level of prescription and discretion given to regulators. Therefore, having decided a provision is necessary, officials need to think carefully about the form that the provision will take – particularly about the trade-offs associated with alternative wording of the provision. Issues that should be considered include (PCO, sub. DR 88):

- the specific matters that must be consulted on;
- whether the provisions should specify the methods and timeframes required, and what these methods and timeframes should be; and
- whether the act should include any exceptions, such as for emergencies or minor non-substantive changes.

The Commission notes that while the PCO can assist agencies with technical drafting issues, it is incumbent on agencies, not the PCO, to undertake thorough analysis of the costs and benefits of such provisions.

#### F6.6

Statutory consultation requirements are potentially most useful:

- when there is a likelihood that failure to consult would breach natural justice principles – for example regulation that involves a significant use of the state’s coercive powers that could impact the civil liberty, livelihood or property rights of individuals;
- when regulators have wide, discretionary rule-making powers that involve making judgements about what is in the public interest;
- when there are social equity reasons for specifying the consultation processes that should be followed for a specific group – for example where the affected group may not have the resources or capacity to effectively participate in a conventional consultation process; and
- where the affected community holds information on trade-offs and technical issues necessary for the regulator to make sound decisions.

#### F6.7

The structure of statutory consultation requirements can have a significant impact on the cost and speed of regulatory decisions, the weight a regulator gives to the views of specific stakeholders and how the regulator allocates its budget (and the budget flexibility the regulator has). As such, it is important that officials give considerable thought to the likely trade-offs associated with an alternative wording of the provision.

## Greater use of collaborative approaches

Inquiry participants have also expressed the view that better outcomes could be achieved if regulators adopted more collaborative approaches to decision making. In particular, the Commission heard calls for greater use of constructive engagement and negotiated agreements in the area of economic regulation.

As noted above, these approaches have advantages and disadvantages. Their suitability therefore depends on the specific circumstance under consideration.

Drawing on the lessons from the LWF and overseas jurisdictions, the Commission has identified five factors that are central to the success of any collaborative process:<sup>30</sup>

- a shared understanding of the boundaries of influence of the group;

<sup>30</sup> For a discussion on experiences with constructive engagement and negotiated settlements, see, for example, Littlechild, 2011, 2012; Decker, 2013; and Owen, 2013.

- commitment to implementing the outcomes of the collaborative process;
- understanding the information needs of all parties and reducing information imbalance;
- selecting participants that represent the wider interests of the community; and
- establishing clear and transparent processes.

Each of these factors is discussed below.

### **Factor 1: A shared understanding of the boundaries of influence of the group**

The success of collaborative approaches will largely depend on participants sharing an understanding of what the process can and cannot deliver. One of the first tasks of the convenor, therefore, is to clearly communicate the objectives of the group and the institutional and legal boundaries that they must work within. Failure to establish the group's boundary of influence can result in unrealistic expectations about how much the group can influence decisions. This in turn can undermine confidence in the decision-making process.

In practice, the statutory duties of regulators can limit the scope of potential influence (Ofwat, 2010). Statutory duties allocated by Parliament cannot simply be "passed on" to a third party to execute (unless provision is made in legislation that allows for it).<sup>31</sup> The existence of statutory duties may restrict the ability of the regulator to be "flexible" on certain issues, therefore taking potentially agreeable outcomes "off the table". This limits the topics of discussion to areas where the regulator has discretionary powers. Owen (2013) comments, in the context of the Australian Energy Regulator (AER), that

...there is an important question as to how much influence consumers can have on network costs through the AER price review process, which will depend upon the extent to which the regulator is working within constraints brought about by standards and legal requirements that have already been determined. (p. 25)

Rothstein (2007) makes similar observations in his study of participatory approaches in the United Kingdom:

...the substantive contributions of participative processes to policy knowledge are shaped by the design and organization of regulatory regimes. The scope, architecture, and operating rules of regulatory frameworks, for example, structure questions that can be asked, the kinds and standards of evidence that can be considered, and the policy solutions that can be pursued. Information supplied by participative processes, therefore, may get filtered out if it is hard to fit with regulatory requirements, expectations, and remits. (p. 601)

### **Factor 2: Commitment to implementing the outcomes of the collaborative process**

Collaborative approaches commonly involve a significant commitment of a participant's time and resources. For participants to make this commitment, they must have a clear mandate from the relevant government agency and a reasonable expectation that the agency will act on the outcomes. The LWF notes:

Participants will not reach a consensus unless they feel that their responsibility to do so is real, inescapable and not constrained. They must feel that the decision-makers will have serious regard for it, and will not allow it to be subverted. Parties to a collaborative process must feel that they have been asked to lead. (Land and Water Forum, 2011)

### **Factor 3: Understanding the information needs of all parties and reducing information imbalance**

Making informed regulatory decisions commonly requires specialist knowledge of complex areas (such as environmental science, engineering or financial accounting). While some parties to a collaborative process may possess this knowledge, others will not. This creates the possibility that the collaborative processes will result in inefficient or inequitable outcomes. As the Major Energy Users' Group notes:

<sup>31</sup> Littlechild (2010) notes that in the United States, the Federal Energy Regulatory Commission (FERC) is required by statute to offer the possibility of settlements. Further, under FERC's regulations "failure of a party to attend a settlement conference will constitute a waiver to all objections to any order or ruling or agreement arising out of it" (p. 8).

The main challenge is how to communicate and therefore have effective dialogue and feedback on often complex technical, economic, legal and commercial issues with all classes of electricity users... Discussion papers written in “regulatory-speak” may not resonate with affected consumers. (sub. DR 77, p. 1)

It is important that information imbalances are well understood and that steps are taken during the design of collaborative approaches to minimise the extent to which imbalances create inefficiencies in the process.

Three possible ways to minimise any imbalance are technical assistance via an independent body, close supervision of the information provided in the process, and using “expert stakeholders”.

An independent public body can provide technical assistance. For example, in the United States an independent body called the Office of Administrative Litigation (OAL) is charged with representing the public interest in cases involving the price of interstate gas pipeline and electricity transmission. The OAL provides a team of experts to work on settlements (Littlechild, 2010). In a similar way, the LWF was supported by expertise from both the National Institute of Water and Atmospheric Research and Landcare Research.

Another way to manage information asymmetries is through the regulator closely supervising the information provided to the process. For example, the regulator can specify the information that parties must supply and the form that information is to take. The regulator can also ensure that the participants have access to technical experts to help them interpret the information. For example, Ofwat has raised the possibility of it requiring companies to provide “evidence of understanding and informed and fruitful discussion on major topics” (Ofwat, 2010, p. 36).

Finally, it may be possible for the regulator to select “expert stakeholders” – people drawn from relevant professional fields with expertise in a specific area. These experts take on the role of consumer/stakeholder advocates in negotiated agreements or constructive engagement processes. One example of this approach is the Consumer Challenge Panel that the AER recently established. The panel consists of 13 members with “significant local and international expertise, spanning a range of fields including economic regulation, energy networks and consumer representation” (AER, 2013).

#### **Factor 4: Selecting participants that represent the wider interests of the community**

For negotiated agreements and constructive engagement processes to be successful, the wider community must view them as legitimate. Perceptions of legitimacy are influenced, among other things, by the extent to which consumer advocates are seen as representative of a broad range of interests.

Eppel (2013) summarised the approach adopted by the LWF:

The LWF took the view that the process needed to have around the table all the people who could effectively say ‘no’. Moreover, ... you need the person who is going to carry the flag for the organisation they represent and bring the commitment of their organisation with them, which might not always be an easy pathway to agreement when organisations are coming from very different positions, but will ensure [that] if and when a position is reached that the member does speak for the support of their organisation.

To promote a wide exchange of views, some jurisdictions allow interested parties to be admitted as “interveners”. These parties generally participate in discussions on a specific subset of issues of particular interest to them (Littlechild, 2010). More broadly, representation can occur through industry bodies, chambers of commerce and social advocacy groups, where each of these organisations will have different levels of technical knowledge. The process of selecting representatives must be carefully managed to prevent representation being seen as merely token.

#### **Factor 5: Establishing clear and transparent processes**

The success of collaborative approaches hinges on having well thought-out processes. These processes need to be in place from the start of discussions. Overseas experience suggests that these processes should clearly articulate:

- the scope of decisions up for negotiation or discussion;

- how the group will be resourced and funded;
- the roles, responsibilities and accountabilities of each party involved in the discussion;
- the procedures and timeline for the discussion;
- the information that must be exchanged by the parties;
- a mechanism for monitoring the accuracy and quality of the information exchanged;
- the conditions under which the regulator will intervene in the process;
- the processes should agreement not be reached; and
- the regulator's expectations around the range of interests that should be considered.

**F6.8**

Collaborative approaches have the potential to improve the decisions of regulators. Factors central to the success of any collaborative process include:

- a shared understanding of the boundaries of influence of the group;
- commitment to implementing the outcomes of the collaborative process;
- understanding the information needs of all parties and reducing information imbalance;
- selecting participants that represent the wider interests of the community; and
- establishing clear and transparent processes.

## Better communication of the rationale for decisions

Just as a regulator has incomplete information about the commercial decisions of regulated parties, regulated parties have incomplete information about how regulators make decisions. As IAG notes in its submission, this can make regulatory decisions appear uninformed or arbitrary.

One particular area of concern is that regulators do not always reveal the reasoning behind their decisions. In our view this is poor process that can lead to poor outcomes, but it also impacts on the legitimacy of regulatory decision-making. While there is generally no legal obligation on a regulator to give reasons (unless provided for expressly by statute), unsupported decisions raise concerns of arbitrariness or caprice as they undermine the principles of natural justice. (IAG, sub. DR 80, p. 7)

The Commission's business survey confirms that a significant proportion of the wider business community holds these views, with 35% of businesses surveyed disagreeing with the statement that "the reasons behind regulator's decisions are clear" (25% agreeing, 35% neither agreeing nor disagreeing)<sup>32</sup>.

Of course, regulators must balance a wide range of community interests. This can, on occasions, result in decisions being made that some stakeholders see as being contrary to the majority of views expressed in submissions to the regulator. As the Electricity Authority explains:

Meetings can help parties to understand why the Authority's original proposal may remain unchanged, even if a substantial number of submitters raise similar points representing the views of one or more group of submitters. Where that happens, it may indicate that the Authority needs to consider unrepresented points of view as well as those represented in submissions...

The Authority would not change its position only on the basis that the majority of submitters supported or opposed the proposition. The Authority would take into account submissions that are consistent with its statutory objective, which includes considering the long-term benefits of consumers. (sub. DR 70, p. 10)

<sup>32</sup> Five percent 'don't know'.

The Commission believes regulators should make every effort practicable to explain their decisions to affected parties. Further, the more transparent a regulator is around its processes for making different types of decisions, the more predictable these decisions will become.

Regulators can improve the transparency of their decisions in a number of ways – some of which regulators currently use. These measures include:

- meeting with affected parties to explain the decision;
- making publically available the data and analysis used to reach a decision;
- making publically available the principles used to guide decision making (for example, the principles used to guide trade-offs between competing interests);
- publishing newsletters and discussion papers that outline the regulator’s approach to different types of regulatory issues; and
- giving presentations to industry bodies or at industry conferences.

Measures such as these will help to improve the transparency and predictability of regulatory decisions. Further, more formal engagement, before and after legislation is passed, can be used to clarify the objective of regulatory bodies. This issue is discussed further in Chapter 8.

#### F6.9

Failure to adequately explain the rationale behind regulator decisions can create the impression that consultation processes are insincere and that regulators are simply “going through the motions”. It is important that regulators make every effort practicable to clearly explain the logic of their decisions.

## 6.9 Conclusions

Effective engagement plays an important role in reassuring the community that regulators are following good regulatory processes, and that their decisions are robust, well-informed and well-reasoned. Conversely, poor engagement practices can undermine confidence in both the regulatory regime and in the regulator. At a more fundamental level, New Zealand common law contains a number of important legal principles that affect how and when regulators must engage with stakeholders. These principles are part of the rules of natural justice, which the New Zealand Bill of Rights Act 1990 affirms.

Inquiry participants have highlighted several areas where the engagement practices of some regulators are below expectations. These include insufficient time for engagement, a perception that regulators enter engagement processes with predetermined views, and concerns that some regulators lack the capacity to engage effectively. The Commission notes that practices vary widely across regulatory bodies, and that participants can have conflicting views on the practices of any one regulator.

While the terms of reference prevent recommendations on how specific regulators can improve engagement, a number of approaches are possible. These include greater use of statutory provisions to consult, more extensive use of collaborative processes and better communications of the rationale behind regulatory decisions.

These approaches however have a cost – both in terms of the time taken to make a decision and the opportunity cost of resources that the regulator places into consultation activities. Careful consideration of the net benefits of these approaches is therefore required.

# 7 The Treaty of Waitangi in regulatory design and practice

## Key points

- Regulators work within a constitutional, statutory and legal context that can change and evolve over time. The continuing evolution of the relationship between the Crown and Māori as partners to the Treaty of Waitangi, can generate considerable uncertainty for those applying the principles of the Treaty in the design and implementation of New Zealand's regulatory regimes.
- References to the Treaty and Treaty principles can be found in statutes which regulate features (eg, land, water, important sites, wāhi tapu and other taonga) where Māori have strong iwi and hapū relationships. Statutes with "Treaty clauses" can create obligations on parties that are not the Crown.
- A Treaty clause is a legal acknowledgement of Māori interests and rights, and provides a more specific definition of the Crown's responsibility with respect to those rights (that in the absence of a specific clause might be interpreted more generally).
- A set of factors that officials should consider in recommending the inclusion of Treaty clauses in statutes that establish regulatory regimes or regulatory agencies is proposed.
- Excellence in regulatory practice cannot be legislated for. Good practice in upholding Treaty principles of partnership, mutual respect and good faith depends on leadership, good internal policies and processes, and guidance for staff and stakeholders.
- The Commission has reviewed 10 examples from government agencies of guidance on how to apply Treaty principles. The overall quality of guidance material can be improved.
- The assessment framework used in reviewing the guidance material could be used as a tool to help regulatory agencies develop their own guidance about the application of Treaty principles.
- Sharing good regulatory practice is one way to raise the standard of practice among regulators. Lessons from the experience of the Environmental Protection Authority (EPA) have been identified. An important lesson for other regulators is that investing in good relationships to develop trust can pay off in reduced costs and better regulatory decision making.
- A *really responsive* regulator is responsive and attentive to the institutional environment in which it operates. Māori interests are acknowledged in the regulatory system, and there are specific statutory requirements on some regulators in administering particular regulatory regimes. The EPA fulfils its regulatory objectives within a framework that explicitly incorporates the principles of the Treaty of Waitangi. The EPA monitors how well its processes work to meet its Treaty obligations, looking to where further improvements can be made.

## 7.1 Introduction

Chapter 3 highlighted the challenge for regulators in responding to the constitutional, statutory and legal environment in which they are required to operate. An important issue in establishing regulatory regimes in New Zealand is ensuring that the principles of the Treaty of Waitangi are appropriately taken into account both in design and in practice. Statutes that have regulatory provisions or confer regulatory powers and responsibilities can also contain references to the Treaty of Waitangi or to the principles of the Treaty. However, even where "Treaty clauses" are not present, the particular context may require the Crown to have regard to the principles of the Treaty of Waitangi. The continuing evolution of the relationship

between the Treaty partners, and of the interpretation of the principles of the Treaty, can generate considerable uncertainty for those applying Treaty principles in the design and implementation of regulation. This chapter provides some guidance about the use of Treaty clauses in legislation. It provides a set of criteria to help regulatory agencies when developing guidance material about applying Treaty principles in their area of regulation. The chapter illustrates how “attentiveness” – to use the language of *really responsive regulation* (Baldwin & Black, 2008) – to the Crown’s responsibility to take account of the principles of the Treaty of Waitangi, has influenced the regulatory practice of the Environmental Protection Authority (EPA).

## 7.2 A Treaty between the Crown and Māori

The Treaty of Waitangi (Te Tiriti o Waitangi) was signed by representatives of the Crown and various Māori chiefs at Waitangi on 6 February 1840 (Box 7.1).

### Box 7.1 The Treaty and its Articles

The Treaty is one of New Zealand’s key founding documents. It is an agreement between the British Crown and more than 500 Māori rangatira and was signed in 1840. On the day it was signed, the Treaty had English and Māori versions.

#### English text

HER MAJESTY VICTORIA Queen of the United Kingdom of Great Britain and Ireland regarding with Her Royal Favor the Native Chiefs and Tribes of New Zealand and anxious to protect their just Rights and Property and to secure to them the enjoyment of Peace and Good Order has deemed it necessary in consequence of the great number of Her Majesty's Subjects who have already settled in New Zealand and the rapid extension of Emigration both from Europe and Australia which is still in progress to constitute and appoint a functionary properly authorised to treat with the Aborigines of New Zealand for the recognition of Her Majesty's Sovereign authority over the whole or any part of those islands – Her Majesty therefore being desirous to establish a settled form of Civil Government with a view to avert the evil consequences which must result from the absence of the necessary Laws and Institutions alike to the native population and to Her subjects has been graciously pleased to empower and to authorise me William Hobson a Captain in Her Majesty's Royal Navy Consul and Lieutenant-Governor of such parts of New Zealand as may be or hereafter shall be ceded to her Majesty to invite the confederated and independent Chiefs of New Zealand to concur in the following Articles and Conditions.

#### Article the first

The Chiefs of the Confederation of the United Tribes of New Zealand and the separate and independent Chiefs who have not become members of the Confederation cede to Her Majesty the Queen of England absolutely and without reservation all the rights and powers of Sovereignty which the said Confederation or Individual Chiefs respectively exercise or possess, or may be supposed to exercise or to possess over their respective Territories as the sole sovereigns thereof.

#### Article the second

Her Majesty the Queen of England confirms and guarantees to the Chiefs and Tribes of New Zealand and to the respective families and individuals thereof the full exclusive and undisturbed possession of their Lands and Estates Forests Fisheries and other properties which they may collectively or individually possess so long as it is their wish and desire to retain the same in their possession; but the Chiefs of the United Tribes and the individual Chiefs yield to Her Majesty the exclusive right of Preemption over such lands as the proprietors thereof may be disposed to alienate at such prices as may be agreed upon between the respective Proprietors and persons appointed by Her Majesty to treat with them in that behalf.

### Article the third

In consideration thereof Her Majesty the Queen of England extends to the Natives of New Zealand Her royal protection and imparts to them all the Rights and Privileges of British Subjects.

(signed) William Hobson, Lieutenant-Governor.

Now therefore We the Chiefs of the Confederation of the United Tribes of New Zealand being assembled in Congress at Victoria in Waitangi and We the Separate and Independent Chiefs of New Zealand claiming authority over the Tribes and Territories which are specified after our respective names, having been made fully to understand the Provisions of the foregoing Treaty, accept and enter into the same in the full spirit and meaning thereof in witness of which we have attached our signatures or marks at the places and the dates respectively specified. Done at Waitangi this Sixth day of February in the year of Our Lord one thousand eight hundred and forty.

### Māori text

KO WIKITORIA te Kuini o Ingarani i tana mahara atawai ki nga Rangatira me nga Hapu o Nu Tirani i tana hiahia hoki kia tohungia ki a ratou o ratou rangatiratanga me to ratou wenua, a kia mau tonu hoki te Rongo ki a ratou me te Atanoho hoki kua wakaaro ia he mea tika kia tukua mai tetahi Rangatira – hei kai wakarite ki nga Tangata Maori o Nu Tirani – kia wakaaetia e nga Rangatira Maori te Kawanatanga o te Kuini ki nga wahikatoa o te wenua nei me nga motu – na te mea hoki he tokomaha ke nga tangata o tona Iwi Kua noho ki tenei wenua, a e haere mai nei.

Na ko te Kuini e hiahia ana kia wakaritea te Kawanatanga kia kua ai nga kino e puta mai ki te tangata Maori ki te Pakeha e noho ture kore ana.

Na kua pai te Kuini kia tukua a hau a Wiremu Hopihona he Kapitana i te Roiara Nawi hei Kawana mo nga wahi katoa o Nu Tirani e tukua aiane amua atu ki te Kuini, e mea atu ana ia ki nga Rangatira o te wakaminenga o nga hapū o Nu Tirani me era Rangatira atu enei ture ka korerotia nei.

### Ko te tuatahi

Ko nga Rangatira o te wakaminenga me nga Rangatira katoa hoki ki hai i uru ki taua wakaminenga ka tuku rawa atu ki te Kuini o Ingarani ake tonu atu – te Kawanatanga katoa o o ratou wenua.

### Ko te tuarua

Ko te Kuini o Ingarani ka wakarite ka wakaae ki nga Rangitira ki nga hapu – ki nga tangata katoa o Nu Tirani te tino rangatiratanga o o ratou wenua o ratou kainga me o ratou taonga katoa. Otiia ko nga Rangatira o te wakaminenga me nga Rangatira katoa atu ka tuku ki te Kuini te hokonga o era wahi wenua e pai ai te tangata nona te Wenua – ki te ritenga o te utu e wakaritea ai e ratou ko te kai hoko e meatia nei e te Kuini hei kai hoko mona.

### Ko te tuatoru

Hei wakaritenga mai hoki tenei mo te wakaaetanga ki te Kawanatanga o te Kuini – Ka tiakina e te Kuini o Ingarani nga tangata Maori katoa o Nu Tirani ka tukua ki a ratou nga tikanga katoa rite tahi ki ana mea ki nga tangata o Ingarani.

(signed) William Hobson, Consul and Lieutenant-Governor.

Na ko matou ko nga Rangatira o te Wakaminenga o nga hapu o Nu Tirani ka huihui nei ki Waitangi ko matou hoki ko nga Rangatira o Nu Tirani ka kite nei i te ritenga o enei kupu, ka tangohia ka wakaaetia katoatia e matou, koia ka tohungia ai o matou ingoa o matou tohu.

Ka meatia tenei ki Waitangi i te ono o nga ra o Pepueri i te tau kotahi mano, e waru rau e wa te kau o to tatou Ariki.

*Source:* Ministry for Culture and Heritage, 2012a; 2012b.

## What is the Crown?

The Treaty between the Crown and Māori opens up the question of “what is the Crown?” The answer is not simple. The Law Commission, in its paper *To bind their kings in chains* noted:

... it is a fundamental difficulty that the Crown is a metaphor lacking precise definition. (Law Commission, 2000, p. 10)

Professor Philip Joseph writes: “It is not always possible to say exactly who, or what, *is* the Crown” (Joseph, 2014, p. 609).

Crown entities may or may not qualify as part of the Crown. Most designated Crown entities are public bodies discharging independent functions outside the service of the Crown. Crown agents are the only Crown entities falling squarely under the Crown’s umbrella. State-owned enterprises are not part of the Crown. Similarly, local authorities are also “not the Crown and are therefore not the Treaty partner”. (NZPC, 2013a, p. 177)

A recent discussion paper by the Parliamentary Counsel Office (PCO, 2013) offers this description:

“The Crown” means, in its strict legal sense, the Queen in her public capacity as the bearer of governmental rights, powers, privileges and liabilities in New Zealand. The Crown has the legal personality of an individual and is able to own property, to spend money, or to make contracts. The Crown is commonly described as the executive branch of the New Zealand government and may be called the executive, the government, or the administration. (p. 23)

Joseph (2014) concludes:

The Crown might be best described as an umbrella concept, encapsulating the key machinery of executive government. It includes: the Sovereign and the Sovereign’s personal representative (the Governor General); ministers of the Crown; the central government ministries and departments delivering public services in accordance with government policy; and public bodies that operate under the close control of a minister or the minister’s department. (pp. 618 and 623)

The Crown is defined in specific pieces of legislation, although there are differences in the definitions used in different Acts. Some commentators have recommended including a default definition of the Crown in an Act, such as the Interpretation Act 1999, in order to improve consistency. However, for current purposes it is sufficient to rely on the statutory definitions made in specific pieces of legislation relevant to the Treaty context. The Public Finance Act 1989 is of particular relevance as Treaty settlement legislation adopts the Public Finance Act definition of the Crown. It says that “the Crown or the Sovereign—

- (a) means the Sovereign in right of New Zealand; and
- (b) includes all Ministers of the Crown and all departments; but
- (c) does not include—
  - (i) an Office of Parliament; or
  - (ii) a Crown entity; or
  - (iii) a State enterprise named in Schedule 1 of the State-Owned Enterprises Act 1986; or
  - (iv) a Schedule 4 organisation; or
  - (v) a Schedule 4A company; or
  - (vi) a mixed ownership model company.”

### F7.1

While a precise definition of the Crown is lacking, it is generally accepted as encapsulating the key machinery of executive government.

## Nature of the Crown's Treaty duties

The Treaty partners are the Crown and Māori. But what happens to the Crown's duties and obligations under the Treaty when it delegates its regulatory functions to non-Crown bodies? There is general agreement that the Crown cannot avoid or modify its Treaty obligations by delegating its regulatory powers or Treaty obligations, and the Crown is under a continuing obligation to ensure that its Treaty duties are fulfilled.

In *Towards better local regulation*, the Commission wrote (in the context of a discussion of the Crown's Treaty duties when it has delegated functions and powers to local authorities):

it is generally accepted that when the Crown statutorily delegates regulatory functions, it retains a responsibility to translate its related Treaty duties into procedural and policy requirements for the local authorities that carry out those regulatory functions. Central government needs to take an ongoing interest in whether the procedural and policy requirements it has placed on local authorities are effectively delivering on its Treaty duties. (NZPC, 2013a, p. 177)

## 7.3 Treaty clauses in legislation that establish regulatory regimes

This section examines the characteristics of the statutes that contain references to the Treaty of Waitangi or to Treaty principles (see Box 7.2 for the views of the Executive, the Court of Appeal and the Waitangi Tribunal about the nature of the Treaty principles).

### Treaty clauses in statutes

The Commission has identified 36 Principal Acts<sup>33</sup> with references to the Treaty or Treaty principles. (Table 7.1)

**Table 7.1 Primary legislation that references the Treaty of Waitangi**

Statute	Treaty reference
Auckland War Memorial Museum Act 1996	"The duties, functions, and powers of the Board shall be... to observe and encourage the spirit of partnership and goodwill envisaged by the Treaty of Waitangi, the implications of mana Māori and elements in the care of Māori cultural property which only Māori can provide".
Climate Change Response Act 2002	"In order to recognise and respect the Crown's responsibility to give effect to the principles of the Treaty of Waitangi ... Māori are to be consulted prior to a number of specified decisions being taken.
Conservation Act 1987	"This Act shall so be interpreted and administered as to give effect to the principles of the Treaty of Waitangi".
Crown Minerals Act 1991	"All persons exercising functions and powers under this Act shall have regard to the principles of the Treaty of Waitangi".
Crown Pastoral Land Act 1998	"In acting under this Part, the Commissioner [of Crown Lands] must (to the extent that those matters are applicable) take into account ... the principles of the Treaty of Waitangi".
Education Act 1989	"It is the duty of the council of an [tertiary education] institution, in the performance of its functions and the exercise of its powers ... to acknowledge the principles of the Treaty of Waitangi".
Employment Relations Act 2000	"The parties must recognise and support Part 3 of the New Zealand Public Health and Disability Act 2000 which, in order to recognise the principles of the Treaty of Waitangi and with a view to improving health outcomes for Māori, provides mechanisms to enable Māori to contribute to decision-making on, and to participate in the delivery of, health and disability services".

<sup>33</sup> The table does not include Treaty Settlement Acts or references to Waitangi Day.

Statute	Treaty reference
Energy Efficiency and Conservation Act 2000	"In achieving the purpose of this Act, all persons exercising responsibilities, powers, or functions under it must take into account ... the principles of the Treaty of Waitangi".
Environment Act 1986	"An Act to ... ensure that, in the management of natural and physical resources, full and balanced account is taken of ... the principles of the Treaty of Waitangi".
Environmental Protection Authority Act 2011	"In order to recognise and respect the Crown's responsibility to take appropriate account of the Treaty of Waitangi ..." the act provides for, among other things, the establishment of a Māori Advisory Committee.
Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012	"In order to recognise and respect the Crown's responsibility to give effect to the principles of the Treaty of Waitangi for the purposes of this Act ..." a number of sections provide for Māori consultation, recognition and notification.
Fisheries Act 1996	"The object of sections 175 to 185 is to make, in relation to areas of New Zealand fisheries waters (being estuarine or littoral coastal waters) that have customarily been of special significance to any iwi or hapū ... [through] better provision for the recognition of rangatiranga and of the right secured in relation to fisheries by Article II of the Treaty of Waitangi".
Hauraki Gulf Marine Park Act 2000	"Subject to subsections (2) and (4), the provisions of Part 3 relating to the Park must be so interpreted and administered as to give effect to the principles of the Treaty of Waitangi".
Hazardous Substances and New Organisms Act 1996	"All persons exercising powers and functions under this Act shall take into account the principles of the Treaty of Waitangi".
Historic Places Act 1993	"This Act must continue to be interpreted and administered to give effect to the principles of the Treaty of Waitangi, unless the context otherwise requires".
Human Rights Act 1993	<p>"The Commission has ... the following functions ... to promote by research, education, and discussion a better understanding of the human rights dimensions of the Treaty of Waitangi and their relationship with domestic and international human rights law".</p> <p>"In recommending persons for appointment as Commissioners or alternate Commissioners, the Minister must have regard to the need for Commissioners and alternate Commissioners appointed to have among them knowledge of, or experience in ... the Treaty of Waitangi and rights of indigenous peoples".</p>
Judicature Act 1908	"If the appeal involves ... an issue affecting ... the Crown's obligations under the Treaty of Waitangi ... the Judge may direct that the Solicitor-General be served with the notice of appeal and with documents subsequently filed in the appeal".
Land Transport Management Act 2003	"In order to recognise and respect the Crown's responsibility to take appropriate account of principles of the Treaty of Waitangi ..." a number of mechanisms are available to help Māori participate in the process of making decisions about land transport.
Local Government Act 2002	"In order to recognise and respect the Crown's responsibility to take appropriate account of the principles of the Treaty of Waitangi ..." two parts provide principles and requirements for local authorities that are intended to help Māori participate in the processes of local authorities to make decisions.
Local Government (Auckland Council) Act 2009	"[Part 7] establishes a board whose purpose is to assist the Auckland Council to make decisions, perform functions, and exercise powers by ... ensuring that the Council acts in accordance with statutory provisions referring to the Treaty of Waitangi".
Local Legislation Act 1989	"Nothing in subsection (1) affects the validity of, or affects or prevents the making of, any claim under the Treaty of Waitangi or based on a right arising or alleged to arise out of the Treaty (whether under the Treaty of Waitangi Act 1975 or otherwise)".

Statute	Treaty reference
Māori Fisheries Act 2004	"The Māori Fisheries Act 1989 was enacted to make better provision for the recognition of Māori commercial fishing rights secured by the Treaty of Waitangi ..."
Māori Language Act 1987	"Whereas in the Treaty of Waitangi the Crown confirmed and guaranteed to the Māori people, among other things, all their taonga: And whereas the Māori language is one such taonga".
Māori Television Service (Te Aratuku Whakaata Irirangi Māori) Act 2003	"In recognition that the Crown and Māori together have an obligation under the Treaty of Waitangi to preserve, protect, and promote te reo Māori the purpose of this Act is to provide for ..." a number of functions, duties, rights, accountabilities and governance arrangements.
Marine and Coastal Area (Takutai Moana) Act 2011	"In order to take account of the Treaty of Waitangi, this Act recognises, and promotes the exercise of customary interests of iwi, hapū, and whānau in the common marine and coastal area ..."
Museum of Transport and Technology Act 2000	"In carrying out its functions under section 13, the Board must recognise and provide for, in such manner as it considers appropriate, the following: biculturalism and the spirit of partnership and goodwill envisaged by the Treaty of Waitangi".
New Zealand Geographic Board (Ngā Pou Taunaha o Aotearoa) Act 2008	"In order to recognise and respect the Crown's responsibility to take appropriate account of the Treaty of Waitangi ..." the Act confers on the Board the function of collecting, and encouraging the use of, original Māori names of geographic features on official charts and maps. Two members of the Board are appointed on the recommendation of the Minister of Māori Affairs.
New Zealand Public Health and Disability Act 2000	"In order to recognise and respect the principles of the Treaty of Waitangi, and with a view to improving health outcomes for Māori, Part 3 provides for mechanisms to enable Māori to contribute to decision-making on, and to participate in the delivery of, health and disability services".
Ngā Wai o Maniapoto (Waipa River) Act 2012	"A guiding principle is the Treaty of Waitangi, because Maniapoto and the Crown are partners under the Treaty of Waitangi and the agreements in the deed in relation to co-governance and co-management of the Waipa River, which are given effect through this Act, are sourced in this Treaty relationship".
Public Finance Act 1989	"Nothing in [the Mixed ownership model companies Part of the Act] shall permit the Crown to act in a manner that is inconsistent with the principles of the Treaty of Waitangi".
Public Records Act 2005	"In order to recognise and respect the Crown's responsibility to take appropriate account of the Treaty of Waitangi ..." requires the Chief Archivist to ensure, among other things, consultation with Māori and that at least two appointments to the Archives Council have knowledge of tikanga Māori.
Resource Management Act 1991	"In achieving the purposes of this Act, all persons exercising functions and powers under it, in relation to managing the use, development, and protection of natural and physical resources, shall take into account the principles of the Treaty of Waitangi".
Royal Society of New Zealand Act 1997	"The Council may co-opt members ... if, in the opinion of the Council, it is necessary to do so having regard to the desirability of giving effect to the principles of the Treaty of Waitangi".
State-Owned Enterprises Act 1986	"Nothing in this Act shall permit the Crown to act in a manner that is inconsistent with the principles of the Treaty of Waitangi".
Supreme Court Act 2003	"The purpose of this Act is ... to establish within New Zealand a new court of final appeal comprising New Zealand judges ... to enable important legal matters, including legal matters relating to the Treaty of Waitangi, to be resolved with an understanding of New Zealand conditions, history, and traditions".

Statute	Treaty reference
Te Ture Whenua Māori Act 1993	“Whereas the Treaty of Waitangi established the special relationship between the Māori people and the Crown: And whereas it is desirable that the spirit of the exchange of kawanatanga for the protection of rangatiratanga embodied in the Treaty of Waitangi be reaffirmed”.

Table 7.1 reveals that:

- almost all statutes with Treaty clauses contain regulatory provisions of some kind;
- most references to the Treaty or to Treaty principles are in statutes governing physical resources and the environment, where Māori have strong iwi and hapū relationships, often involving kaitiaki relationships<sup>34</sup> – including land, water, important sites, wāhi tapu and other taonga;
- some references are made to Treaty principles in legislation governing other areas in which Māori have an interest, for example, taonga such as the language (te reo) and health (hauora) and Māori protocol;
- the statutes create obligations on a range of parties, and many are not the Crown, such as obligations on local government, Crown entities, Officers of Parliament and a Body Corporate.
- The wording of clauses, where there is similar intent, varies. For example, “take account of” (Marine and Coastal Area Act, 2011), “take into account” (Hazardous Substances and New Organisms Act, 1996) “take appropriate account of” (New Zealand Geographic Board, 2008).
- There appears to have been a trend towards the inclusion of more specific Treaty clauses that specify the action to be taken in satisfaction of Treaty principles instead of broadly stated Treaty clauses, in more recent legislation. For example, to recognise and respect the Crown’s responsibility to take account of the Treaty of Waitangi, the Environmental Protection Authority Act 2011 established a Māori Advisory Committee to advise the Authority on policy, process, and decisions. The Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012 (EEZ Act) is another example of legislation with more specific statutory provisions.

#### F7.2

Statutes with references to the Treaty of Waitangi or to Treaty principles often contain regulatory provisions and create obligations on a range of parties that are not the Crown.

## 7.4 Role of the courts and the Waitangi Tribunal

### Role of the courts

Breaches of the Treaty by the Crown were not justiciable – capable of being decided by a court – until 1975.

Only customary rights were enforceable at law not Treaty rights *per se*. It is instructive to consider why that was so, not in an attempt to atone in some way for past breaches by the Crown of its obligations, but to understand why there was no effective remedy at law for the breaches.

<sup>34</sup> Kaitiakitanga forms one of two foundational and interlinked concepts within Māori thinking on environmental management. The first is whanaungatanga – the organisation of concepts and relationships through whakapapa or familial connections. As the Waitangi Tribunal explains:

Kaitiakitanga is really a product of whanaungatanga – that is, it is an intergenerational obligation that arises by virtue of the kin relationship. It is not possible to have kaitiakitanga without whanaungatanga. In the same way, whanaungatanga always creates kaitiakitanga obligations. (Waitangi Tribunal, 2011, p. 105)

Because the relationship Māori have with the environment is described in terms of whakapapa, the claim that particular Māori groups have to kaitiakitanga is based on this sense of relationship. In Māori cosmology, there is little or no distinction between human ancestors and whenua, maunga or awa from which one descends (or to put it in the appropriate cultural context “can whakapapa to”).

In fact the reason why the Treaty was not justiciable in the courts can be simply stated. It has long been a principle of the law that the executive branch of government, that is to say the Cabinet and the departments of state, should not be able to make law: law-making is a matter for Parliament alone. Treaties normally involve international relations, and these are the preserve of the executive rather than of the Parliament. Accordingly, any treaty entered into by the executive of New Zealand has never been enforceable in the domestic courts unless and until its terms had statutory recognition. (Graham, 2001, p. 21)

Developments in the last 25 years have changed the role of the courts in respect of the Treaty. In 1986 the Government determined that all future legislation should be enacted against the backdrop of the Treaty. Cabinet agreed that at the policy approval stage for legislation, attention would be drawn to any implications for Treaty principles. References to Treaty principles began appearing in statutes, with early examples including the Environment Act 1986, the State-Owned Enterprises Act 1986 and the Conservation Act 1987, beginning a new Treaty jurisprudence.

The watershed case was *New Zealand Maori Council v Attorney-General* (the *Lands* case) 1987, which arose under the State-Owned Enterprise Act 1986 ("SOE Act"). Section 9 of the Act declares: "Nothing in this Act shall permit the Crown to act in a manner that is inconsistent with the principles of the Treaty." The New Zealand Māori Council contested the transfer of Crown land that was subject to (or likely to become subject to) a claim before the Waitangi Tribunal. The Court addressed the spirit of the Treaty, the textual differences between the English and Māori language versions, past breaches of the Treaty, and the interpretative approach on statutory recognition of Treaty principles (Joseph, 2014, p. 76). The Court rejected a strict or literal interpretation of the Treaty and declared the Treaty must be viewed as a living instrument capable of adapting to new and changing circumstances: "What matters is the spirit." (*Lands* case (1987), p. 663).

Since the landmark decision in the *Lands* case, the courts have built upon its findings and developed Treaty jurisprudence as a distinct body of administrative law. Most of the decisions on Treaty matters deal with statutory provisions that require a decision maker to consider the Treaty or Treaty principles in some way. In these cases the courts have determined: the relevance of Māori customary rights in judicial review; Māori rights of preference in matters touching Māori ancestral lands; that any special obligations owed to Māori do not warrant the courts imposing unreasonable burdens on the Crown; that any substantive obligations owed by the Crown under the Treaty must be balanced against the Crown's wider responsibilities; and the impact of Māori spiritual beliefs on the exercise of statutory discretions. (See Joseph, 2014, pp. 77-81 for summaries of these cases.)

The general rule is that a decision maker is under a legal requirement to take the Treaty into account only when it is referred to in legislation. However, in certain contexts the courts may find that the Treaty and its principles are a consideration that a decision maker must take into account even if the empowering statute does not require it (*Huakina Development Trust v Waikato Valley Authority*, 1987). This is called "contextual review": the context of decision making imports Treaty considerations (Joseph, 2014, p. 921).

In some contextual review cases the courts apply the Treaty on conventional administrative law grounds, while in others Treaty principles are elevated "to a status approximating a constitutional instrument" (Joseph, 2014, p. 923). The key requirements for contextual review are relevance and context. The courts have said that the Treaty was "designed to have general application" and therefore "colour[s] all matters to which it has relevance" in the application of public powers (*Barton-Prescott v Director-General of Social Welfare*, 1997, p. 189). It is "part of the fabric of New Zealand society [and] is part of the context in which legislation which impinges upon its principles is to be interpreted" (*Huakina Development Trust v Waikato Valley Authority*, p. 210).

In *Huakina*, the leading decision on contextual review, the High Court imported Māori spiritual and cultural values as criteria governing the Planning Tribunal's functions. In another case the promotion of Māori language and culture was held to be a mandatory relevant consideration in the allocation of radio frequencies under the Radiocommunications Act 1989, even though the Act was silent as to Treaty principles (*Attorney-General v New Zealand Maori Council*, 1991). In that case, it meant that the Government had to take account of Waitangi Tribunal recommendations on Māori broadcasting and the protection of Māori taonga. In another case, the High Court held that the principles of the Treaty governed

the application of the Guardianship Act 1968 although the Act did not refer to the Treaty or Treaty principles. The familial organisation of Māori was considered taonga and therefore guaranteed under article 2 of the Treaty and entitled to protection under the Act:

Since the Treaty of Waitangi was designed to have general application, that general application must colour all matters to which it has relevance, whether public or private and that for the purposes of interpretation of statutes, it will have a direct bearing whether or not there is a reference to the Treaty in the statute (*Barton-Prescott v Director General of Social Welfare*, p. 184).

In addition to the application of Treaty considerations in judicial review, the courts also apply a general presumption of statutory interpretation that Parliament will legislate in line with the principles of the Treaty (Legislation Advisory Committee, 2012a). Presumptions of interpretation are used where there is ambiguity in how the law is to be applied in a given situation. If the provisions of the statute are not inconsistent with Treaty principles, but more than one interpretation is possible, then in the process of determining what Parliament intended, the courts will endeavour to interpret statutes in a manner consistent with the Treaty. This is similar to how the courts might take into account any number of factors external to the legislation, including the social, economic and environmental context, other statutes such as the Bill of Rights Act 1990, documents created during the legislation's inception, and the common law (*ibid*).

## Role of the Waitangi Tribunal

The Waitangi Tribunal was established by the Treaty of Waitangi Act 1975. The Tribunal inquires into claims that the Crown has breached the principles of the Treaty, causing prejudice to Māori (Treaty of Waitangi Act 1975, s 6(2)). The Tribunal has no binding powers of decision, but may recommend to the Crown that it make reparations where a claim is upheld (Treaty of Waitangi Act 1975, s 6(3)-s 6(4)). The Tribunal's interim and final reports often facilitate the claimants and the Crown entering into direct negotiations for Treaty settlements.

When first enacted, the Treaty of Waitangi Act covered only acts or omissions of the Crown from 1975. The Act was amended in 1985 to extend the Tribunal's jurisdiction to the signing of the Treaty on 6 February 1840. Most of the Tribunal's work concerns historical grievances.

The Tribunal has been pivotal for the airing of Māori grievances and facilitating redress for historical Treaty breaches. Some claims are substantial and complex. The Ngāi Tahu claim hearing covered 73 separate grievances and extended for more than two years and resulted in a 1,200 page report. The Tribunal determines its own procedure.

## 7.5 Analysis of existing Treaty provisions

### References to the "Treaty" and the "principles of the Treaty"

Sometimes legislation refers to the "Treaty", sometimes it refers to the "principles of the Treaty". Several reasons have been advanced in support of reference to Treaty principles. First, Palmer (2001) explains that referencing Treaty principles "indicates it is the spirit and intent of the Treaty which is important, rather than its bare words...consistent with the constitutional significance of the Treaty and the broad, open textured reading of such documents" (p. 208).

Second, reference to the Treaty principles better copes with the historical nature of the Treaty. New issues and ways of managing them emerge, and the Treaty relationship between the Crown and Māori has evolved and will continue to evolve.

Third, the Treaty has Māori and English versions. The two versions have a number of important differences. The Waitangi Tribunal has determined that both versions should be taken into account when interpreting the scope of the Treaty. Principles more easily allow this to be done than a literal interpretation of the words.

Finally, principles should promote a more positive relationship between Māori and the Crown by allowing a focus on the spirit of the agreement rather than a more limiting and legalistic focus on the literal meaning of the terms.

The PCO submitted that it would be preferable for statutory references to be to the Treaty itself rather than to Treaty principles. It argued that the Treaty is able to adapt to change and that uncertainty is created by referring to the “principles of the Treaty”. Omitting “the principles” from statutory provisions would remove the need for interpretation of possible principles. The preferable approach, according to the PCO, would be to take a “living”, evolving approach to the interpretation of Treaty obligations (PCO, sub. DR 88).

It may be that in practice there is little material difference between the PCO’s preferred approach and how the courts and the Tribunal have approached the interpretation of the “principles of the Treaty”. Both focus on the nature of the relationship between the Treaty parties and the obligations that flow from that relationship. Both also require interpretation to apply the Treaty or its principles to the particular situation.

## What are Treaty Principles?

The Courts, Waitangi Tribunal and the Executive have all offered their views on the nature of Treaty principles (Box 7.2).

### Box 7.2 Treaty principles – three views

#### The Executive<sup>35</sup>

- The Government’s right to govern
- The right of iwi to manage their resources
- Redress for past grievances
- Equality – all New Zealanders are equal before the law
- Reasonable cooperation by both parties.

#### The Court of Appeal

- A relationship of a fiduciary nature that reflects a partnership imposing the duty to act reasonably, honourably and in good faith
- The Government should make informed decisions
- The Crown should remedy past grievances
- Active protection of Māori interests by the Crown
- The Crown has the right to govern
- Māori retain rangatiratanga over their resources and taonga and have all the rights and privileges of citizenship.

#### The Waitangi Tribunal

- Partnership
- Fiduciary duties
- Reciprocity – being the cession of Māori sovereignty in exchange for the protection of rangatiratanga, leading to the duty to act reasonably, honourably and in good faith
- Redress for past grievances
- Equal status of the Treaty parties

<sup>35</sup> First expressed by the Fourth Labour Government.

- The Crown cannot evade its obligations by conferring its authority on another body
- Active protection of Māori interests by the Crown
- Options – the principle of choice
- The courtesy of early consultation.

*Source:* Parliamentary Commissioner for the Environment, 2002.

These lists are neither exhaustive nor conclusive. The Courts are an important authoritative source on the meaning of the principles, but have also said that in interpreting the principles weight should be given to the opinions of the Waitangi Tribunal (*New Zealand Māori Council v Attorney-General*, 1992).

## Are there key principles?

The Court of Appeal has stated that the Treaty of Waitangi enacts a relationship akin to a partnership and its central obligation is to act in good faith and work out answers in a spirit of honest cooperation (*Lands* case). The principle of consultation can be regarded as particularly important. Without it, Māori interests and values can be overlooked when developing and implementing legislation. In 1989 the Court of Appeal found that the principle of good faith “must extend to consultation on truly major issues” (*New Zealand Māori Council v Attorney-General*, 1989). In some circumstances the Crown’s obligations will go beyond consultation to include “active steps to protect Māori interests” (*Ngāi Tahu Māori Trust Board v Director-General of Conservation*, 1995).

## Explaining the differences in wording

Current Treaty provisions are divisible into two main types: those directed towards the decision-making process and those directed towards the substantive decision outcome. Most existing Treaty provisions are of the former, process-focused type. They require a decision maker to take the Treaty or Treaty principles into genuine consideration when making certain decisions, but do not require that the decision outcome be consistent with or give effect to the Treaty or Treaty principles. There a limited number of statutory provisions that are focused on the decision outcome. They require a decision maker to give effect to or act consistently with the Treaty principles.

### Process requirements

Most Treaty provisions are process-focused. The decision maker must take a mandatory consideration into account. However, the requirements to “have regard to” or “take into account” do not import a requirement “to give effect to”. They also do not establish a presumption that the decision will be made consistently with the mandatory consideration (*Liu v Chief Executive of Department of Labour*, 2012). A decision maker may properly conclude that a mandatory consideration was not of sufficient significance to outweigh other relevant considerations:

The tribunal may not ignore the statement. It must be given genuine attention and thought, and such weight as the tribunal considers appropriate. But having done that the tribunal is entitled to conclude it is not of sufficient significance either alone or together with other matters to outweigh other contrary considerations which it must take into account in accordance with its statutory function (*New Zealand Co-Operative Dairy Company v Commerce Commission*, 1992, p. 611).

The process-focused Treaty provisions use various wordings to express how the decision maker must consider the Treaty or Treaty principles. Existing Treaty provisions in legislation include requirements for decision makers to:

- give particular recognition to the Treaty or Treaty principles (eg, the now repealed s 10 of the Royal Foundation for the Blind Act 2002, stated that one object of the Foundation is to “give particular recognition to the principles of the Treaty of Waitangi and their application to the governance and services of the Foundation”);

- take into account the Treaty or Treaty principles (eg, s 3 of the Resource Management Act 1991 requiring that the exercise of functions and powers under the Act “take into account the principles of the Treaty of Waitangi”);
- ensure full and balanced account of the Treaty or Treaty principles (eg, the Preamble to the Environment Act 1986, stating that one purpose of the Act is to “ensure that, in the management of natural and physical resources, full and balanced account is taken of ... (iii) The principles of the Treaty of Waitangi”);
- have regard to the Treaty or Treaty principles (eg, s 4 of the Crown Minerals Act 1991, requiring that the exercise of functions and powers under the Act “shall have regard to the principles of the Treaty of Waitangi”); and
- acknowledge the Treaty or Treaty principles (eg, s 181 of the Education Act 1989, stating that one duty of a council of a tertiary education institution in exercising its functions and powers under the Act will be to acknowledge the Treaty principles).

These various phrasings have different emphases, imposing different statutory imperatives as to how a decision maker must deal with Treaty principles<sup>36</sup>. On the face of it, “give particular recognition to” is a stronger imperative than “acknowledge”. However, the choice of statutory wording might be of more symbolic than legal importance.

First, administrative law principles require a decision maker to give genuine consideration to all mandatory considerations. Mandatory considerations “must be taken into account, considered and given due weight, as a guide in the decision making process” (*Staunton Investments v CE Ministry of Fisheries*, 2004, at para [19], citing *Ishak v Thowfeek*, 1968; *New Zealand Co-Operative Dairy Company v Commerce Commission*, 1992).

Second, the weight to be given to mandatory considerations is a matter for the decision maker. The courts have emphasised that the weighting and balancing of relevant considerations is an integral part of the exercise of decision-making discretion and a value judgement for the decision maker to make, not the courts (*Alex Harvey Industries Ltd v Commissioner of Inland Revenue*, 2001). In a judicial review the courts will be wary of finding that a decision maker has given the wrong weight to a particular consideration.

There might be two possible exceptions to this (Joseph, 2014, p. 953). The first exception is that some judicial decisions suggest that the courts may intervene on judicial review if a decision maker gives “excessive weight” to some factor or “patently inadequate weight” to another (*Alex Harvey Industries Ltd v Commissioner of Inland Revenue* at para [14]). In addition, one judicial decision suggests that the court might intervene where the statute specifies the weight to be given to a particular mandatory relevant consideration. In *Ye v Minister of Immigration* (2009),<sup>37</sup> the decision maker was required to take into account the best interests of the child as a primary consideration. Glazebrook J held that the weight to be given to that consideration had to be appropriately assessed and was not left to the decision maker’s discretion.

Third, an applicant faces significant evidential hurdles in trying to prove that a decision maker failed to give appropriate weight to a particular consideration.

In addition to such broadly worded phrases that are of general application to a decision maker’s exercise of powers, some statutory provisions impose more specific requirements on decision makers to give effect to principles of the Treaty. There has been a trend in recent years towards these types of more specific provisions. They might, for example, require decision makers to:

- consult with Māori before making specified decisions (eg, s 3A of the Climate Change Response Act 2002: “In order to recognise and respect the Crown’s responsibility to give effect to the principles of

<sup>36</sup> Some of the cases discussed in this section refer to considerations a decision-maker must weigh, other than Treaty principles.

<sup>37</sup> The decision was reversed on appeal in the Supreme Court.

the Treaty of Waitangi ...” before recommending the making of an Order in Council, the Minister must consult, or be satisfied that the chief executive has consulted, representatives of iwi and Māori that appear to the Minister or chief executive to be likely to have an interest in the order); or

- take specified actions to facilitate participation by Māori in decision-making processes (eg, ss 4, 14, 81 of the Local Government Act 2002).

### Substantive requirements

Some Treaty provisions are directed towards the decision outcome. They require a decision maker to give effect to or act consistently with Treaty principles. There are relatively few of these types of provisions. Two prominent examples are the Conservation Act 1987 and the SOE Act. Section 4 of the Conservation Act states: “This Act shall so be interpreted and administered as to give effect to the principles of the Treaty of Waitangi”. Section 9 of the SOE Act provides that the Crown must not act under the Act inconsistently with the principles of the Treaty. The Hauraki Gulf Marine Park Act 2000 is another example of an Act with a provision requiring that the Act is administered consistently with the principles of the Treaty.

In this context, the next section proposes factors that officials should consider when advising on including a Treaty clause in legislation that establishes a new regulatory regime. The section then discusses an alternative approach to the current case-by-case approach to referencing Treaty principles in legislation.

## 7.6 Guidance for officials – getting Treaty clauses right

Considerable care is required when deciding the circumstances when legislation should include reference to Treaty principles. By including a Treaty clause in statute, it will be clear that legal provision is being made for Māori rights. It also signals the Crown’s intent, compared to the absence of such a clause. But the nature and magnitude and implications of those rights may not be clear to the regulator, Māori, other stakeholders, and even the courts.

Legislation Advisory Committee guidelines (Chapter 5: Principles of the Treaty of Waitangi) provides advice for officials on consultation, managing conflict between Treaty principles and the legislation, and common law rights.

The Crown Law Office should be consulted on legislative issues involving Treaty of Waitangi matters. It advises on the likely impact of particular wording. It does not advise on whether that impact is appropriate in the circumstances. This is the responsibility of the departmental officials most familiar with the subject areas and the nature of stakeholders. Officials are responsible for formulating their best advice to ministers on whether to introduce a clause, and the form it should take.

Te Puni Kōkiri should be consulted on all proposals that might have implications for Māori “as individuals, communities or tribal groupings”. Te Puni Kōkiri provides advice to government agencies on effective engagement with Māori, and on Treaty principles, on a case-by-case basis and more generally.

The advice of officials should take into account the perspectives of stakeholders interested in the policy being developed. However, a minister need not take the advice of officials, and may deal directly with stakeholders to arrive at a preferred position. A wider discussion of any Treaty clause can be expected at Cabinet before a government bill is introduced. Further opportunities exist for consideration first by a select committee after the bill’s first reading, and then by Parliament as the bill travels through the legislative process.

### Factors to consider when advising on Treaty clauses

The Commission proposes that the following factors should be considered by officials when developing their advice (Box 7.3).

**Box 7.3 Incorporating Treaty clauses in legislation establishing regulatory regimes****Māori**

- Whether Māori have a strong, relatively unified and legitimate interest in the policy being developed and/or how it will be subsequently implemented.
- Whether Māori would have the capability, capacity and incentive to effectively litigate to protect their rights. If the legal rights are unenforceable, they may have little value.
- The extent to which the clause might negatively impact Māori or some groups of Māori (for example, strengthening rights to traditional kai moana could be at the expense of Māori recreational and Māori commercial take).
- Whether Māori trust the Government to deliver appropriately on their Treaty interests in the absence of a Treaty clause.
- The extent to which a Treaty clause might be valued in its own right, for example, as an acknowledgement of mana or partnership.

**Stakeholders**

- The ability of stakeholders to meet any additional standards required of them, and the cost of their doing so. This requires considering the range of stakeholders likely to be affected, their interests and capabilities.
- The degree of uncertainty likely to be generated for stakeholders, and the ability of those stakeholders to manage that uncertainty.

**The Crown**

- Where it is desirable that legal provision be made for Māori rights and where the Crown wishes to signal how this is to be done.
- Whether the rights are deemed to be better defined and protected by the Executive through statute rather than by the Judiciary (as customary rights).
- Whether the agency administering the legislation is formally part of the Crown or not.
- The nature and extent of Crown risk (legal and more generally) taken on or reduced as a consequence of the clause.

Not all factors need to be present. Any one factor may be sufficient justification for a Treaty clause, although in practice a number of factors combined would provide a more compelling case. There are also trade-offs to consider. For example it might be hard for Māori to effectively litigate to enforce their rights in statute (bullet point 2), but a Treaty clause would be valued as an acknowledgment of mana or partnership (bullet point 5). There are also trade-offs to be made between the interests of Māori, stakeholders and the Crown. And while the capacity of stakeholders to meet the standards required of them is a consideration (bullet point 6), including a Treaty clause may be a catalyst for stakeholders to develop the capability required. Whether a Treaty clause should be included in legislation requires careful judgement. It is not a decision to be made in a formulaic fashion. Instead it requires the careful balancing on a case-by-case basis of key considerations relating to the regulatory area and the likely impact on Māori, other stakeholders, and the Crown. If a decision is made that including a Treaty clause is appropriate, the next step is to decide on the form of that clause – whether it is specific or broad and whether it provides direction about the process to be undertaken or the substantive content of the regulatory decision.

**An alternative approach**

In the course of the inquiry, a number of participants expressed the view that putting Treaty clauses in legislation on a case-by-case basis implied that the Crown could be selective in choosing when and how it

would be bound in legislation to uphold the principles of the Treaty of Waitangi. An alternative approach could be to have an overarching Treaty provision in legislation, separate from the jurisdiction the Treaty of Waitangi Act 1975 confers on the Waitangi Tribunal to investigate actions inconsistent with Treaty principles. The Bill of Rights Act or the State Sector Act 1988 had been suggested as suitable locations for such a clause. This “chapeau” legislative provision would mean that all agencies administering Acts would be required to incorporate the principles as appropriate. It would not necessarily preclude including specific Treaty clauses in Acts to provide more guidance on how to apply the principles in specific circumstances. Specific clauses, however, should not diminish the obligations in the “chapeau” clause.

The Ministry for Primary Industries submitted that specific Treaty clauses are “useful as they enable legislators to specify how the statute provides for Treaty principles ... thus providing greater clarity and certainty to users and sector parties”. It expressed concern that a generic overarching Treaty clause would “be at the detriment of the more detailed and flexible bespoke Treaty clauses” (sub. DR 102, p. 10).

The Treasury and SSC also supported a case-by-case approach because “it is necessary to consider what the clause means in each regulatory context and it is better to determine this before creating legal obligations under particular regulatory regimes” (sub. DR 97, p. 17).

The PCO’s submission observed that for an overarching Treaty clause to be applicable in all contexts “it would necessarily be drafted in non-contextual language, exposing decision makers to litigation risk”. This enhanced risk could lead to the unintended outcome of “straightjacketing the consideration given by decision makers to purely legalistic concerns ...” This would not, in the PCO’s submission, “be conducive to a healthy and co-operative relationship between the Treaty parties” (sub. DR 88, p. 21).

The Ministry of Justice however, supported further consideration of the proposal:

With over 60% of historical Treaty of Waitangi settlements completed, consideration of an overarching Treaty clause is a timely contribution to the Crown-Māori relationship as it moves into a post settlement environment. (sub. DR 87, p. 2)

A key consideration for the Commission, in the context of this inquiry, is whether an overarching Treaty clause would improve the operation of regulatory regimes in New Zealand compared to the status quo drafting of Treaty clauses on a case-by-case basis.

It is difficult for all parties if the Crown, in engaging with Māori on regulatory issues, is obliged to “take account of”, “take into account”, “take appropriate account of” or ensure a “full and balanced account is taken of” the Treaty or the principles of the Treaty. These differences can add complexity and cost for regulators, regulated parties and other stakeholders with an interest in the regulator’s decisions. That is not to say that the design of regulators or regimes should be uniform and that all differences are unjustified, but careful consideration needs to be given to the impact of the differences to ensure *that they are justified*. As outlined in more detail later in this chapter, the EPA has a Treaty clause in its own legislation and in four of the Acts it administers, with different wording in each case – a difficulty the EPA has to manage carefully. Careful legislative drafting should ensure that differences are justified and that the wording chosen is in the interests of providing clarity and specificity around the operation of a regulatory regime.

The Commission has not heard a compelling case for an overarching Treaty clause, but more attention needs to be given to ensuring that differences in wording are justified. Differences in drafting legislation should not add unnecessary complexity and cost to regulatory processes.

### F7.3

When drafting legislation, greater care to ensure that differences in wording are both intended and justified, with respect to Treaty principles, would reduce the complexity and cost of regulatory processes.

While the Commission is not recommending an overarching Treaty clause, it does note the views of the Ministry of Justice on the evolving nature of the Crown-Māori relationship as it moves into a post settlement phase. The Ministry of Justice’s submission demonstrates that, as outlined in Chapter 3, regulatory regimes operate in – and must be cognisant of – a changing institutional environment.

## 7.7 Guidance for good practice

While legal rights and obligations are enforceable in a court of law where behaviour falls below a minimum standard, excellence cannot be legislated for. Providing guidance on how to apply Treaty principles and sharing good practice can improve the practices of regulators, as appropriate for their area of regulation.

In the submission from Environment Canterbury, Dame Margaret Bazley offers insight on effective approaches, and also points to the weaknesses of relying on legislative requirements:

Environment Canterbury has experience and insight to offer on effective approaches to working in partnership with Māori... in terms of its *Tuia* partnership with Ngai Tahu. This partnership has been built from the ground up, and has been progressed from identifying and respecting past issues and grievances to working shoulder to shoulder to set in place new ways of working focussed on solutions and practical outcomes. *Tuia* is premised on mutual good faith and commitment to do what is right and in the best interest of the iwi and the region, not on narrow legislative requirements. (sub. 4, p. 1)

Good practice from regulators in upholding Treaty principles of partnership, mutual respect and good faith starts at the top. It depends crucially on the attitudes and behaviours of the chief executive and senior management. It will require putting internal policies, processes and practices in place, and offering guidance for staff about how to apply the principles in their work.

This section looks at what guidance has been produced for applying Treaty principles in a range of contexts and for a range of purposes. The section also provides a framework for assessing Treaty guidance material.

### The quality of guidance available

A number of government agencies have developed guidance about applying Treaty principles. The Commission located 10 examples for review:

- Best practice guidelines: Tangata whenua effects assessment – a roadmap for undertaking a Cultural Impact Assessment (CIA) under the Hazardous Substances and New Organisms Act 1996 (HSNO Act) (Environmental Risk Management Authority, 1996);
- He tirohanga o kawa ki te Tiriti o Waitangi (Te Puni Kōkiri, 2001);
- Guidelines for cultural safety, the Treaty of Waitangi and Māori health in nursing education and practice (Nursing Council of New Zealand, 2011);
- New Zealand coastal policy statement 2010 guidance note policy 2: The Treaty of Waitangi, tangata whenua and Māori heritage (Department of Conservation, 2010);
- Guidelines for consulting with tangata whenua on the Resource Management Act 1991 (RMA): An update on case law (Ministry for the Environment, 2003);
- Guidelines for cultural assessment – Māori Under the Intellectual Disability (Compulsory Care and Rehabilitation) Act 2003 (Ministry of Health, 2004);
- Good practice guidelines for working with tangata whenua and Māori organisations: Consolidating our learnings (Landcare Research, 2005);
- Guidance on the Marine and Coastal Area (Takutai Moana) Act 2011 (Ministry of Justice, n.d.);
- Ngā Ara Tohutohu Rangahau Māori guidelines for research and evaluation with Māori (Ministry of Social Development, 2004);
- Consistency with the Government's Treaty of Waitangi obligations (in New Zealand Treasury, 2013a).

Some of the guidance has been written to help with policy development or with research, some by regulatory agencies to help with applications, and some for capability building. Not all of the guidance relates to regulation making or regulatory practice.

Guidance on any topic ought to cover what needs to be covered, be accurate and relevant, and meet stakeholders' needs. A number of sources provide tips and advice for producing guidance material. For example, the RMA quality planning resource website ([www.qualityplanning.org.nz](http://www.qualityplanning.org.nz)) advises councils on how to produce pamphlets and guidance material about resource consents. It advises that the material should be non-technical, readily available, and current.

In this section a framework is offered for assessing Treaty guidance material (Box 7.4). The framework is then applied to the guidance documents listed above. It makes transparent the criteria on which the guidance is being assessed, promotes assessment consistency across the different types of guidance material, and is able to identify specific areas where the material could be improved.<sup>38</sup>

#### Box 7.4 Framework for assessing Treaty guidance material

##### Content

- Comprehensive: Covers the things that need to be covered:
  - for policy development: Problem definition, identification and assessment of options, consultation, implementation and review;
  - for policy implementation: The purpose of the relevant legislation, the key Māori interests (iwi and non-iwi), how they are to be identified and built into the regulatory function, how to assess whether this is being done appropriately.
- Accurate and up to date: The information should be based on contemporary thinking in the subject area, and should be accurate and internally consistent.
- Relevant: The purpose of the guidelines should be clear. The information should be relevant to the regulatory subject area: the issues likely to arise, the nature of the stakeholders (including their interests and capabilities) and the purpose and objectives of the legislation.
- Accessible: The guidance material should be appropriate to guiding officials in their work. It should also be accessible to stakeholders to promote a shared understanding, manage expectations, reduce uncertainty and promote agency accountability for their performance against the guidelines.
- Excessive prescription should be avoided: Māori are not a single homogenous group. Interests, values, historical circumstances capability and capacity vary widely across Māori communities. So there is no standard process for determining whether proposed regulation or its implementation will raise Treaty of Waitangi issues, or how those issues are best managed.
- Promotes best practice: While it is important that the guidelines help officials to identify and manage legal risk as appropriate, it is even more important that the guidance promote regulatory best practice.
- Good practice example: This helps to make the theory real for officials and stakeholders, aiding learning, acceptance and demonstrating relevance.
- Spill-over benefits: Where appropriate, the relevance of the approach outlined for other stakeholders should be identified. For example, issues focused on cultural sensitivity are relevant to many groups beyond Māori.

##### Process

- Well promoted: The guidance should be accessible and well publicised. In some cases, training in its use should be available.

<sup>38</sup> There are of course limitations to the assessment framework – it sheds no light on how well the guidance is being applied and it does not identify areas of government activity that need, but do not have, guidance material.

- Further information: The guidance should identify further relevant sources of information and contacts to aid officials (and others) in applying the information.
- Reviewed: There should be periodic reviews of the guidance, involving officials, experts and stakeholders to keep the guidance current and relevant.

An overall assessment is made about the quality of the material produced, with comments on a number of aspects noted below.<sup>39</sup>

### Overall assessment

Nearly all of the guidance reviewed promoted best practice over simple legal compliance (7 out of the 10 examples reviewed). No guidance was considered so bad that it would not add value to stakeholders, although the difference between the best and the worst was significant. The guidance was rated on a scale of “passable” to “excellent”. Overall, the quality of the guidance was too low. The reasonable expectation of the Commission is that guidance should have rated “very good” or better on the assessment criteria, but only three of the examples reviewed achieved this standard.

### Meets the needs of stakeholders

The guidance prepared by the Ministry of Justice on the Marine and Coastal Area (Takutai Moana) Act 2011 was the only guidance reviewed that had sections specifically targeted to different stakeholder groups (Māori claimants, local authorities and business). In contrast, the guidance for cultural assessment under the Intellectual Disability (Compulsory Care and Rehabilitation) Act (2003) was not targeted to the range of stakeholders identified (a number of mental health professionals, a specialist in tikanga, and whānau). Different stakeholder needs could have been better met by providing a range of guidance products (for example, a pamphlet for the patient/whānau, a formal document for the health professionals, and another for the specialist in tikanga focusing on expectations and boundaries).

### Accurate

While a few errors were detected in the guidance reviewed, it is of concern that at least one example appears inaccurate and misleading. Guidance prepared for the Environmental Risk Management Authority (ERMA), now the EPA, to help applicants prepare a CIA, says applicants are expected to consider whether Treaty principles are “impacted by the proposed application, and if so how?” But the principles apply to Māori and the Crown. The applicant will usually be neither. The regulator and affected Māori should make making judgements on whether the application, if approved, would impact Treaty principles. This is not the role of the applicant. The guidance should have tried to more precisely articulate the nature of Treaty principles from the regulator’s point of view. This would have been more useful for the applicant and Māori.

### Up-to-date guidance

The guidance on the Marine and Coastal Area (Takutai Moana) Act 2011 is up to date. And because applications under the Act are possible only up to 2017, it is unlikely to need further review/updating. There is a named contact for enquiries. In contrast, the guidance to improve research (undertaken for the Ministry of Social Development and its contractors), where that research requires input from Māori, seems not to have been kept current. Nor are the identified contacts current.

### The Treaty

Where taken head on, the Treaty section often appeared somewhat forced and contrived – in many guidance documents it represented something of a “judder bar”. Typically, the Treaty was dealt with through referencing court decisions and Waitangi Tribunal opinions. Those documents that did not deal with the Treaty explicitly appeared to have the best logical flow and clarity.

<sup>39</sup> Assessment notes are in Appendix E. The Commission did not interview any agency that produced the guidance to seek their views. The guidance was taken and assessed as it was found. The Commission took the view that the target audience should be able to make use of the guidance without needing further explanation or clarification.

**F7.4**

Overall the quality of guidance to help apply Treaty principles could be improved. Some guidance was misleading or inaccurate.

The framework was developed as a means of formally assessing the quality of guidance on how to apply Treaty principles according to a consistent set of criteria. But the framework could help regulatory agencies develop their own guidance as to how Treaty principles apply to their area of regulation. Agencies developing guidance material can use the criteria as a checklist to ensure that the guidance is accurate and covers what needs to be covered, is relevant and accessible to the range of stakeholders it is intended for, and promotes good practice. The framework reinforces the importance of guidance being readily available, easily found, and kept up to date.

The two examples that the Commission rated as “excellent” (Appendix E) also provide useful models for other agencies to look at when developing their own guidance about the application of Treaty principles.

**F7.5**

The framework for assessing guidance material proposed by the Commission could be used as a tool to help regulatory agencies develop guidance about applying Treaty principles in their area of regulation.

## 7.8 Sharing good practice – the experience of the EPA

Sharing good regulatory practice is one way to raise the standard of practice among regulators. This section reviews the approach to and results achieved by the EPA in incorporating the principles of the Treaty of Waitangi into its decision making. The purpose is to distil lessons for other regulators to help them improve their performance against Treaty principles. This is taken from the full case study prepared for this inquiry (Pickens, 2014).

### The Environmental Protection Authority

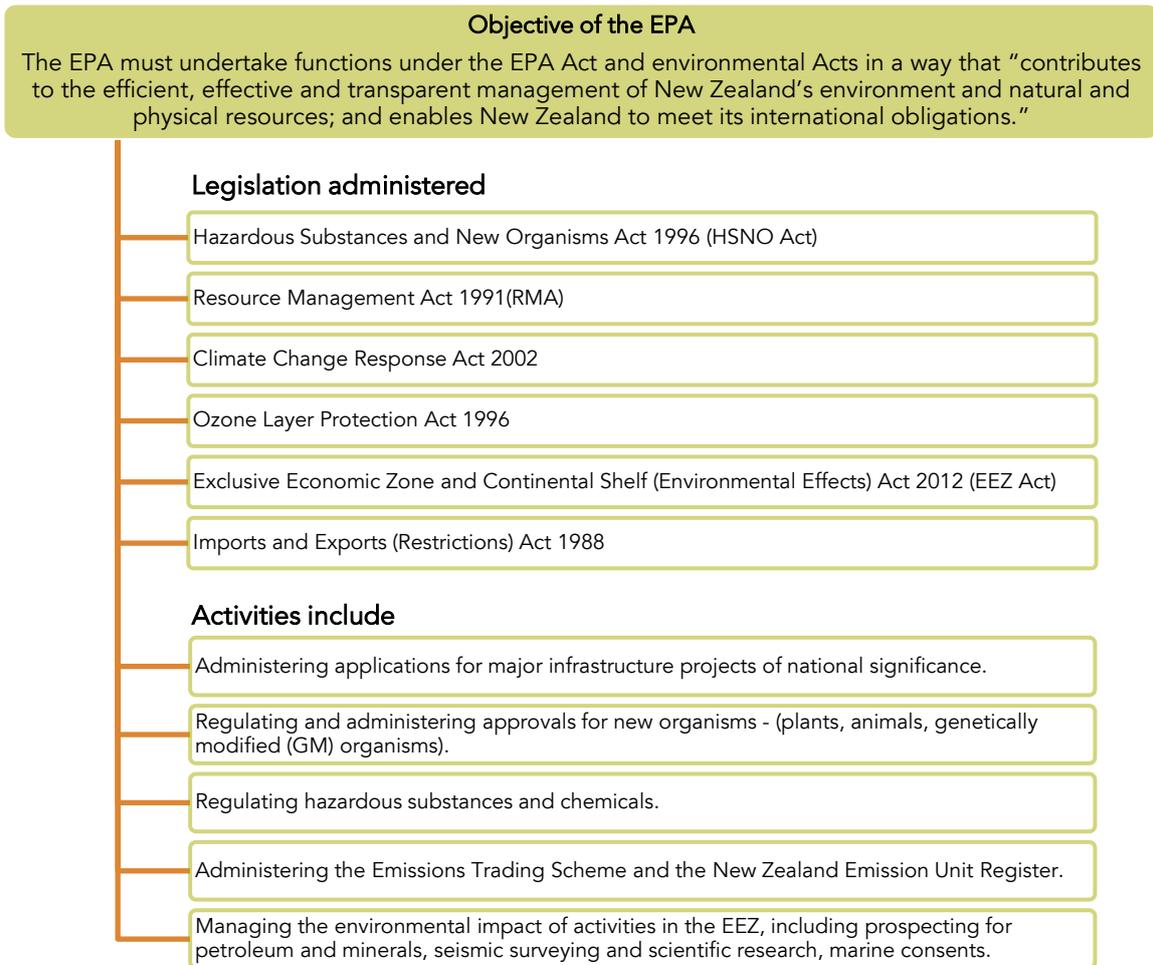
The EPA was established on 1 July 2011 by the Environmental Protection Authority Act 2011 as a Crown Agent (Figure 7.1).

The EPA is a quasi-judicial body of 6–8 people appointed by the Minister for the Environment who are selected to represent a “balanced mix of knowledge and experience” in the appropriate areas. The Authority is supported by the staff and infrastructure of the government Agency and together the Authority and the Agency form the EPA. Much of the EPA’s work is spent facilitating the decision-making process for proposals from applicants for nationally significant resource management proposals under the RMA and administering proposals for new applications under the HSNO Act.

### Recent history

While the EPA is a relatively new body, at its core are the responsibilities carried forward from ERMA. To these have been added new responsibilities such as regulating activities in the Exclusive Economic Zone (EEZ).

With respect to incorporating the principles of the Treaty of Waitangi into its decision making, ERMA had a strong culture of identifying, understanding and incorporating, as appropriate, Māori views into its processes. This had not always been the case. The 2001 Report of the Royal Commission on Genetic Modification found many Māori believed they were disenfranchised from ERMA’s processes. Specifically, the Commission found “Māori concerns that consultation is being carried out too late, is too brief and that, on occasion, isolated individuals have been expected to respond on behalf of one or more hapū or iwi, and even on a national basis”(chapter 11, p. 303). It was not only Māori who were dissatisfied with the process. Applicants requiring consent for activities found it hard to know who they should consult with, and there were complaints of the cost of doing so.

**Figure 7.1 The EPA**

In response to the Commission’s findings, the Government agreed to establish Ngā Kaihautū (the Māori Advisory Committee) to advise ERMA on issues relating to Māori. Further, in 2003 ERMA established Te Herenga (a national network of Māori representatives). Both bodies were carried forward into the EPA, although only Ngā Kaihautū has statutory backing.

The amalgamation of a number of regulatory functions previously undertaken by other agencies, and the addition of new functions, within the EPA was almost universally supported by stakeholders interviewed. Māori stakeholders spoke of amalgamation better accommodating the “big picture” perspective they favoured, in preference to having to navigate the different bureaucracies to settle issues that stretched across multiple agencies. The EPA had also “gone the extra mile” by facilitating Māori access to other regulators by, for example, inviting relevant regulators to hui and helping to build Māori capacity for engaging with those regulators.

### The EPA’s approach to decision making

Consistent with the purpose statements of the legislation the EPA administers, the Authority takes a net-benefit approach to decision making. This means that if the expected benefits of an application are expected to outweigh the expected costs, then the application is approved. For example, the purpose of the RMA is to promote the sustainable management of natural and physical resources. This means managing the use, development, and protection of natural and physical resources in a way or at a rate that enables people and communities to provide for their social, economic, and cultural wellbeing (section 5). The EEZ Act is similarly focused on sustainable management (section 10(2)). Section 9(1) of the HSNO Act states that “the Governor-General may from time to time, by Order in Council, establish a methodology (which includes an assessment of monetary and non-monetary costs and benefits) for making decisions ... and the Authority shall consistently apply that methodology when making such decisions”.

HSNO (Methodology) Order 1998 articulates the principles to take into account when assessing costs and benefits (Box 7.5).

#### Box 7.5 The HSNO Act – a consideration of costs and benefits

The purpose of the Act is to protect the environment, and the health and safety of people and communities, by preventing or managing the adverse effects of hazardous substances and new organisms. Principles to be recognised and provided for in the legislation include safeguarding the life-supporting capacity of air, water, soil, and ecosystems. Matters to be taken into account in relation to the purpose of the Act include the sustainability of all native and valued introduced flora and fauna, intrinsic value of ecosystems, public health, relationship of the Māori people with the biophysical state, economic and related benefits and costs, and New Zealand's international obligations. The Authority is required to take into account the need for caution in managing adverse effects, where there is scientific and technical uncertainty about those effects.

*Source:* Barratt et al., 2007.

A balanced and even-handed approach to stakeholders and their interests was commented on by most interviewees. This is enabled by the net-benefit approach to decision making. The EPA's approach is striking in that it does not limit its role to ensuring applicants comply with the regulatory standards required before an application is approved. EPA staff are able to help applicants prepare their applications. The conflicts of interest that would normally arise in this situation are minimal – the Authority acts autonomously, advised (but not instructed) by its staff, with input from experts if required. This independence allows the Authority to better resist activist and other political influences that might affect the decision-making process. Conflicts or perceptions of bias are further minimised as the EPA also helps those affected by applications, including Māori, to engage in processes relating to applications. Further, the HSNO Act requires the application and evaluation process to be open, transparent and public – features that promote accountability and better performance by the regulator. The pre-application stage involves applicants identifying all significant impacts and issues, and engaging with affected parties. During the application phase, the application is open to public submissions to ensure concerns have been adequately addressed. A public hearing may be called for; if called, it must be held.

#### F7.6

The EPA does not limit its role to ensuring that applicants comply with regulatory standards before an application is approved. Applicants are helped in preparing their applications and the EPA also helps those affected by applications. Conflicts of interest are minimised because the application process is open, transparent and public.

## The principles of the Treaty of Waitangi

The EPA's Act provides that "in order to recognise and respect the Crown's responsibility to take appropriate account of the Treaty of Waitangi, a Māori Advisory Committee will advise it on policy, process and decisions" (s. 4a) and "the EPA and any person acting on behalf of the EPA must comply with the requirements of an environment Act in relation to the Treaty, when exercising powers or functions under the Act" (s. 4b). Further, the RMA and HSNO, Climate Change and EEZ Acts administered by the EPA also contain provisions relating to the principles of the Treaty of Waitangi and the interests of Māori.

Notably, the EPA takes Treaty principles into account *within* the parameters provided by a net-benefit, decision-making approach (the assessment of expected costs and benefits as described above).

Stakeholders were universally supportive of the way the EPA was discharging its Treaty responsibilities under its legislation, with some even pointing to the Act as simply codifying what was the best approach for the EPA. Others pointed to the value of the Treaty clauses in cutting across what they viewed as unhelpful debate from stakeholders resisting incorporating Māori interests into the process.

However, there was also concern from some interviewees that the “narrow” Treaty clause in the EPA Act could result in a minimalistic interpretation of the EPA’s responsibilities. It was noted, for example, that while Ngā Kaihautū has statutory backing, the widely supported Te Herenga does not and so could be disbanded.

While incorporating Treaty clauses in legislation can be an important catalyst for change, its success is highly dependent on the motivation, incentives and capability of those who work within it. It also depends on goodwill, trust and a shared commitment to making it work. While some Māori stakeholders have been able to point to risk with respect to the Treaty clauses, to this point without exception those risks do not appear to have eventuated. This is in no small part due to the EPA’s investment in establishing and maintaining good relationships with its stakeholders.

## **An investment in good relationships**

This section considers four mechanisms that the EPA uses to incorporate the Treaty principles into its decision making (Figure 7.2).

### **Ngā Kaihautū (Māori Advisory Committee)**

The Ngā Kaihautū members interviewed see their role as mainly that of “process guardians”. This means their role is to ensure Māori have adequate opportunity to contribute their views into the EPA decision-making process. Ngā Kaihautū also contributes its own views in a “safety valve” role, in particular if it considers the decision makers have not accessed the information they need through the consultation process. The Ngā Kaihautū interviewees were very clear that, while they do offer a Māori perspective, they do not represent the views of Māori.

Māori stakeholders interviewed valued the role played by Ngā Kaihautū, in particular its oversight role within the process that contributed to building trust. Applicants also valued the role it played in putting context around, and promoting an understanding of, submissions by Māori stakeholders on applications.

### **Te Herenga (Māori National Network)**

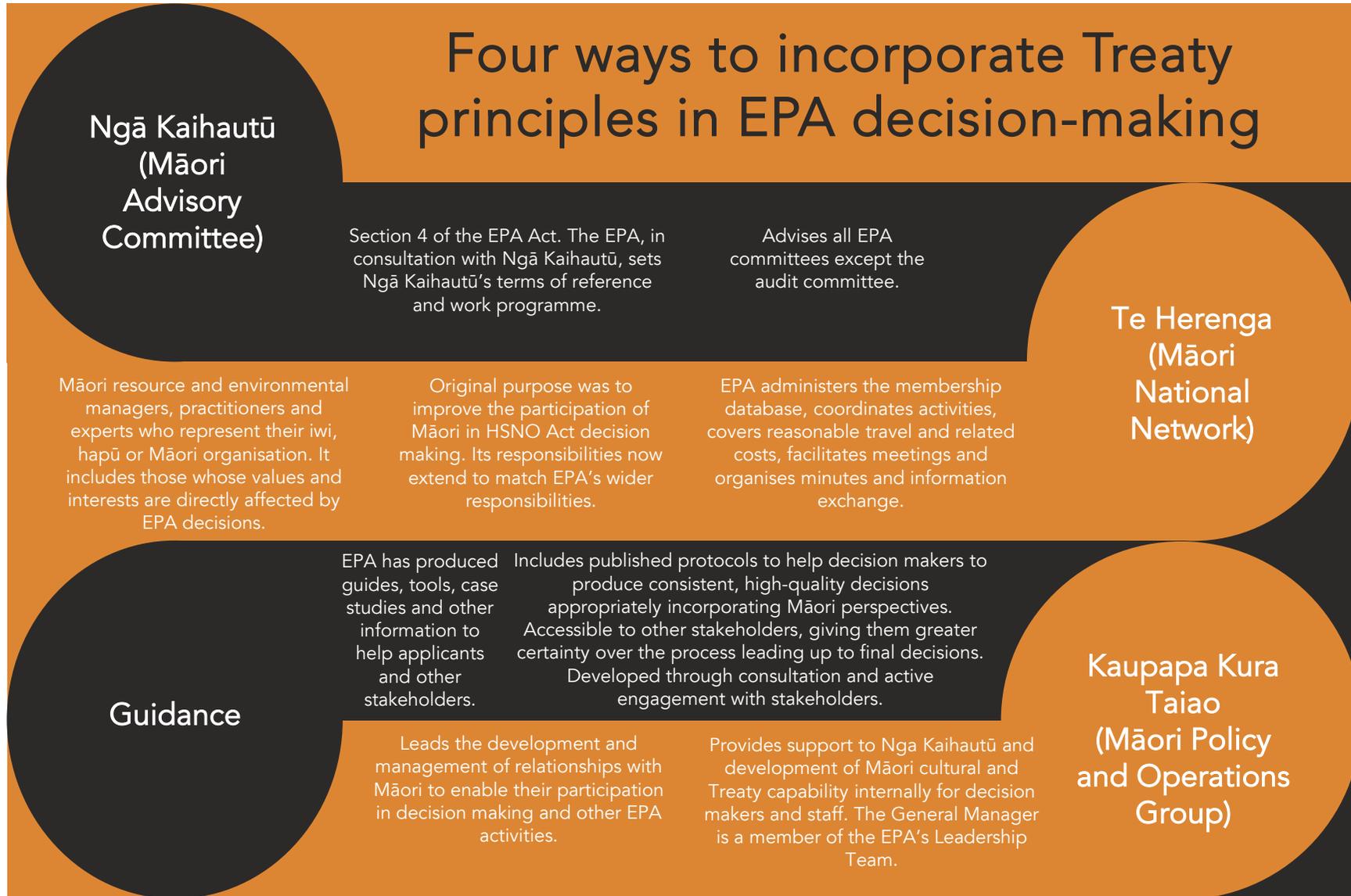
On its establishment, there was an identified risk that Te Herenga might become a liability. For example, it might be captured and discredited by a few dominant personalities, see its role as combative, or might not be accepted by other stakeholders or by Māori more widely. These risks have not materialised. Of the mechanisms identified as driving EPAs success, none were spoken of more highly than Te Herenga, in particular from the Māori perspective.

Te Herenga has provided the face-to-face (kanohi ki te kanohi) relationship needed across all levels of policy development and implementation. Its permanent and formal structure has made it easier to build capability and trust and realise the associated benefits. For example, the growing trust of Māori in Te Herenga is realising savings for Māori, as it has increasingly been relied on to accurately and effectively bring the views of Māori to the table on their behalf. A number of interviewees were also positive about Te Herenga being more hapū than iwi based. The protocols around how it operates and the involvement of Kāhui Kaumātua were believed to have worked to moderate extremes, promoting consistency across the network and managing risks more generally.

From the perspective of applicants, Te Herenga has provided a useful filter for views on their applications and has promoted the right information getting to the right people, so reducing risks and costs to applicants.

From a system-wide perspective, it was noted that Te Herenga, and Māori more widely, were sometimes the only submitters on some applications, and that their involvement in these cases was necessary for the integrity of the system and promoting robust decision making.

Figure 7.2 Mechanisms to incorporate Treaty principles in EPA decision making



Notes:

1. Inspired by Gordon Walters

Some stakeholders spoke of the importance of adequately resourcing Māori to participate in consultation on applications. Some reimbursement of direct costs is made available to Māori stakeholders. However, some Māori thought obtaining Māori cultural information should be funded on a similar basis to contracting experts reviewing, for example, the impact of an application on the biota of a region. This is a difficult issue. The two situations are not directly comparable. A contractor is directly accountable to the funder for the product provided, and their services will be discontinued if the funder does not consider their advice is adding value. Māori stakeholders would not find these restrictions acceptable.

It should be acknowledged that Māori have additional steps and costs to incur when developing submissions, which need to be accommodated. At least to a point, the EPA appears to have done this. But the EPA appreciates that regulators need to monitor these expenses carefully, having regard to the capability of respective stakeholders and the importance of gaining their perspectives. Any funding must be directly related to gaining those perspectives.

#### F7.7

Māori have additional steps and costs to incur when developing submissions, but care is needed when considering funding, having regard to the capability of respective stakeholders and the importance of their perspectives, and ensuring funding is directly related to gaining those perspectives. Regulators need to monitor these expenses carefully.

### Guidance

The Commission has reviewed the quality of a number of guidance documents across the public sector (section 7.7). The quality of the EPA's documents is with the best of those reviewed, being well balanced, comprehensive, accessible, and focused on best practice rather than being legalistic. EPA's documents use practical examples, are relevant, and provide good links to extra information, including EPA contacts. Consistent with the other Treaty guidance reviewed, the Treaty section appears forced. It is unclear what it adds to the rest of the document. Rather than as a separate section, the Treaty might instead have been presented as the foundation within which the guidance is provided. Alternatively, it could be used to communicate directly with applicants about the nature of Treaty principles from the EPA's perspective.

#### F7.8

Providing guidance for applicants and other stakeholders about navigating the process is considered a core part of the EPA's role as a regulator.

### Kaupapa Kura Taiao (Māori Policy and Operations Group)

At this point, having Kaupapa Kura Taiao – a separate Māori Policy and Operations group – is regarded by the EPA as a superior model to using those resources to build Māori capability and capacity within the other units (integration). But a number of stakeholders thought that full integration would be the natural end point.

All stakeholders spoke very highly of the EPA staff, and in particular of Kaupapa Kura Taiao. In particular, they commented on its open and timely communication, accessibility, balanced approach, pro-active work, capability and credibility. Less tangibly, but importantly, stakeholders commented that its approach was promoting a necessary culture of respect and understanding between parties, and a shared desire to protect a system that stakeholders believed was serving their interests well. Nearly all stakeholders emphasised "good relationships" and "trust". To a large extent, this must be credited to the work and attitude of the EPA's staff and its leadership. The EPA's staff are the common ingredient across all the EPA's systems and processes used to build Treaty principles into the EPA's decision making.

Having produced a suite of guidance material, the EPA has shifted to working directly with stakeholders. This makes it even more important that the EPA has access to excellent staff. An obvious risk for the EPA to manage is retaining, motivating and training its staff.

**F7.9**

Open and timely communication, accessibility, a balanced approach, pro-activity and a culture of respect and understanding, comes from the leadership of the organisation, through to its staff, and is demonstrated in the behaviour and actions of the EPA.

## Challenges from the EPA perspective

The EPA has avoided a legal and minimalist approach to Treaty principles in its legislation and in the legislation it administers, favouring an approach that facilitates achievement of its regulatory objectives through building strong relationships and trust.

The EPA was candid about the challenges it faces in maintaining its approach to incorporating Treaty principles in its decision making. The Authority is expecting that its decision making approach will increasingly face legal challenge at some point either by applicants or stakeholders, and that this may undermine the non-legalistic approach taken by the EPA. It was also noted that while cultural impacts are included in the net-benefit approach to decision making, as with all qualitative assessments, they carry less weight than quantitative assessments of costs and benefits.

There was some nervousness expressed about the recent addition of the EEZ legislation to EPA's responsibilities, and whether the EPA's current approach to applicants and stakeholders could be maintained under the EEZ legislative framework. This is despite the provisions in the EEZ Act for Māori consultation, recognition, and requirements to notify affected Māori groups of consent applications that may affect them.

EPA staff are justifiably proud of the EPA's organisational culture and approach. Staff noted that the EPA's reputation, with respect to the way the organisation incorporates the principles of the Treaty of Waitangi in its processes and in its decision making, is a result of the leadership of the Board and the Chief Executive. Changes in leadership can have a significant impact on attitudes, practices and processes (Chapter 4), but the Treaty clause in the EPA's legislation can provide some protection.

## Lessons

All interviewees identified the EPA as the standard setter with respect to incorporating Treaty principles into its decision making, with a number commenting they believed this was also more widely acknowledged by their respective stakeholder groups.

The institutional structures and processes that the EPA uses have clearly worked for it in achieving its regulatory functions and meeting the diverse range of interests of its stakeholders. Some features of these arrangements might prove useful for other regulators. Even so, the arrangements should not be blindly copied. Rather, it should be acknowledged that the arrangements are a model that has brought the EPA positive change so that today it enjoys a high level of stakeholder support.

In designing their own arrangements to build Treaty principles into their decision making, regulators should focus on their own regulatory responsibilities and functions, and the capabilities, capacity and incentives of their stakeholders. To do this successfully is challenging, with significant risks and costs, in particular in the early years. But for many regulators, retaining the status quo is also a risky and costly strategy, and one which may become unsustainable and compromise the overall objectives of New Zealand's regulatory regimes.

**F7.10**

In designing institutional arrangements, processes and practices to incorporate Treaty principles into their work, regulators should focus on their own regulatory responsibilities and functions, and the capabilities, capacity and incentives of their stakeholders.

Looking to the EPA example, perhaps the most important lesson for other regulators is that the investment in developing good relationships reaps benefits. For the EPA, that investment has been in the form of:

- the cost of establishing and supporting Te Herenga and Ngā Kaihautū;

- holding hui;
- developing and promulgating high-quality guidance;
- ensuring the EPA is accessible to enquiries where the guidance by itself is insufficient;
- the cost of EPA's Māori Policy and Operations group, and integrating its work with the rest of the EPA;
- having the General Manager of the Māori Policy and Operations Group on the leadership team; and
- promoting information exchange, and training opportunities.

Beyond this, and perhaps just as important, the EPA has actively developed a culture that promotes within its relationships, respect, openness, honesty, fair dealing and dignity for all. In turn, this has produced a strong dividend in the form of trust – a word emphasised by most stakeholders interviewed.

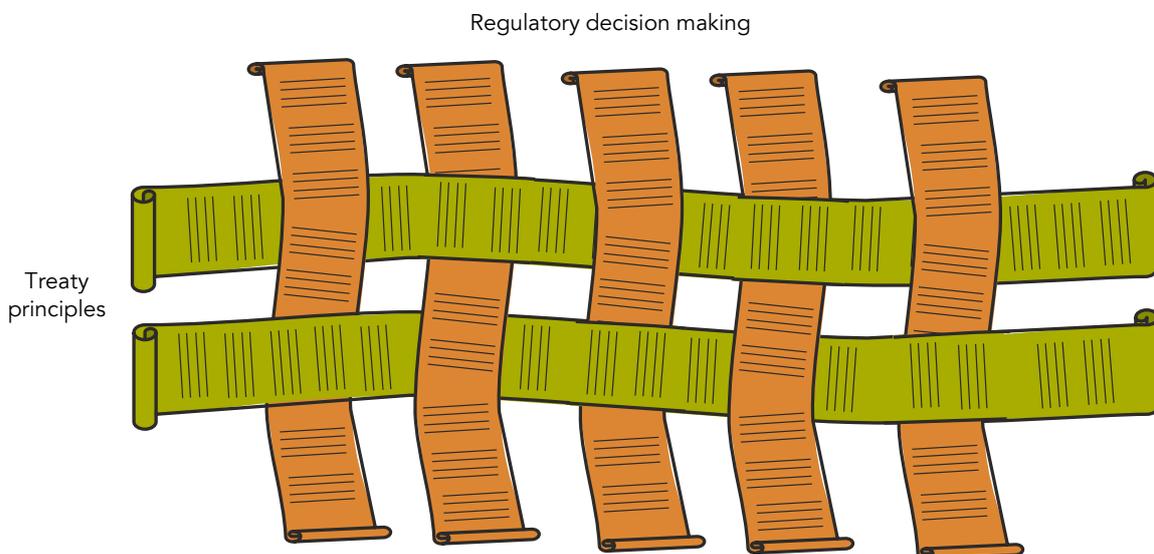
Stakeholders believe this investment has been reducing the cost on all parties involved in the application process (for example, litigation, consultation and ongoing coordination), while improving the quality of engagement and the resulting decisions. Such investment has also brought buy-in to the success of the EPA approach and a shared commitment to making it work. Further, when decisions go against stakeholders, those decisions are now more readily accepted and are less likely to be contested or breed unhelpful cynicism. These dividends are expected to continue to accrue over time, although stakeholders identified a few risks that may require active management.

#### F7.11

An important lesson from the EPA's experience for other regulators is that the investment in developing good relationships pays off in the form of reduced cost on all parties involved in the application process, while improving the quality of engagement and the resulting decisions. Such investment has achieved buy-in to the success of the EPA approach and a shared commitment to making it work. When decisions go against stakeholders, those decisions are now more readily accepted and are less likely to be contested.

Finally, the EPA appears to have successfully built the Treaty framework into its broader decision-making framework, which is strongly grounded in a public welfare approach – maximising expected benefits relative to expected costs (Figure 7.3). Too frequently the Treaty and public policy frameworks are treated as competing rather than complementary and reinforcing paradigms. These tensions were not found here.

**Figure 7.3** Weaving Treaty principles with a net-benefit decision-making approach



## 7.9 Summing up

It is important that the principles of the Treaty of Waitangi are appropriately taken into account when designing and implementing regulatory regimes. The continuing evolution of the relationship between the Treaty partners, and the interpretation of Treaty principles by the courts, can generate considerable uncertainty for those applying the principles in regulatory regimes. This chapter has provided some guidance to help work through the issues.

“Treaty clauses” – references to the principles of the Treaty of Waitangi – are in about 36 statutes. Treaty clauses are often in statutes where Māori have a relationship with the land, water, important sites, wāhi tapu and other taonga. Most of the statutes contain regulatory provisions and create obligations on a range of parties that are not the Crown. The inclusion of Treaty clauses is a legal acknowledgement of Māori interests and rights, and a clearer definition of the Crown’s responsibility with respect to those rights (that, in the absence of a specific clause, might be interpreted more broadly).

Yet the legislative route does have drawbacks. A legalistic approach may be at odds with the central Treaty principle of good faith. It is in this context that this chapter provides a set of factors that officials should consider in recommending the inclusion of Treaty clauses in statutes that establish regulatory regimes or regulatory agencies.

Excellence in regulatory practice with respect to Treaty principles, however, cannot be legislated for. Good practice in upholding Treaty principles of partnership, mutual respect and good faith depends on senior leadership, good internal policies and processes, and guidance for staff and stakeholders.

A number of examples of guidance about how to apply Treaty principles have been reviewed against a set of criteria. While the assessment criteria the Commission has used reveals that the overall quality of existing guidance material can be improved, the real value in the assessment framework is as a tool to help regulatory agencies develop their own guidance about how to apply Treaty principles in their area of regulation.

Sharing good regulatory practice is one way to raise the standard of practice among regulators. Lessons from the experience of the EPA are identified. In particular, investing in developing trust through good relationships can pay off in reduced costs and better regulatory decision making. Other regulators can adopt the lessons learned to improve their regulatory practice with respect to the principles of the Treaty of Waitangi.

Chapter 3 emphasises the importance of being *really responsive* to the institutional environment in which both regulator and regulatees operate. A really responsive regulator is able to evaluate its performance and adapt its strategy over time, and this is no less important with respect to Treaty obligations.

This chapter illustrates how the EPA fulfils its regulatory objectives within a framework that explicitly incorporates the principles of the Treaty of Waitangi. The EPA monitors how well its processes work to meet its Treaty obligations, looking to where further improvements can be made.

## 8 Role clarity

### Key points

- Clear regulatory roles are critical to regulator accountability and focus, compliance by regulated firms, predictable decisions and enforcement, and regime legitimacy. Poor role clarity can lead to a regulator's scope expanding beyond its original mandate; duplicative or contradictory regimes; gaps in regulation, monitoring or enforcement; and inconsistent enforcement.
- Regulatory regimes may lack clarity because:
  - the standards used do not fit the industry or activity being controlled;
  - policymakers give insufficient guidance about the desired objectives;
  - regulators have functions that create conflicts of interest; or
  - the regime does not recognise the role of other regulators or the interaction of different regimes on regulated firms.
- Actions to improve the clarity of regulator roles, functions and objectives include:
  - choosing the right regulatory standard (outcome-, principle-, process- or input-based);
  - applying greater discipline in designing regulatory regimes;
  - avoiding perverse incentives when allocating regulatory functions to agencies; and
  - establishing processes to minimise or resolve problems from overlapping regimes.
- If a range of capability levels exists within a regulated industry, "deemed-to-comply" models may be useful. Deemed-to-comply models allow more capable firms to develop their own compliance strategies, while also providing detailed guidance for other firms on how to comply.
- Legislative frameworks that minimise the number of objectives and conflicts and provide a clear hierarchy of objectives help to support consistent and predictable decision making by regulators.
- To promote better engagement with industry about the definition and interpretation of regulatory objectives, the Commission recommends that:
  - the Cabinet Manual be amended to encourage more use of exposure drafts, before significant regulatory legislation is introduced; and
  - new regulators, or agencies implementing new regimes, should consult on and publish statements outlining how they will give effect to their new mandates.
- Before new regulatory functions are allocated to an existing agency, policymakers should assess whether the mission of the agency is compatible with the objective of the new regime, and whether the agency is likely to give sufficient resources and attention to the new functions.
- Exemptions and memoranda of understanding (MoUs) can help manage issues with overlapping regimes.
  - To be most effective, MoUs should be regularly reviewed, publicly available, empowered by legislation and should provide clear guidance to regulated firms and individuals.
  - Exemption powers should be specified in primary legislation, including their purpose, criteria for their issue, requirements for regulators to give reasons for exemptions, and sunset clauses. Exemptions, and their rationales, should be published.

## 8.1 Introduction

Studies of the performance of regulatory regimes and agencies often dwell on the issue of mandate – that is, what the agency was authorised or tasked to do by ministers or Parliament (see, for example, Baldwin, McCrudden & Craig, 1987; House of Lords Select Committee on Regulators, 2007; Organisation for Economic Co-operation and Development (OECD), 2013b). The studies emphasise that a clear set of roles, duties and objectives is important if regulatory regimes are to be effective. Regulatory regimes with clear objectives are more likely to enjoy high levels of compliance and credibility, and regulators with clear and well-understood roles can more easily be held to account. But achieving “clarity” may not always be a simple or straightforward task due to the complex issues regulation often deals with, the multiple stakeholders in any regulatory regime, and the large amount of existing regulation.

This chapter discusses the impacts and causes of poor role clarity, and outlines steps to remedy these problems:

- Section 8.2 discusses why clear roles, objectives and functions are important if regulatory regimes are to function efficiently and effectively;
- Section 8.3 describes how poor role clarity is seen in regulatory regimes or the actions of regulators; and
- Section 8.4 outlines the main causes of poor clarity and discusses responses to those causes.

## 8.2 The importance of a clear mandate

A clear mandate can help promote accountability, compliance, focus, legitimacy, and predictability.

- **Accountability:** with clear objectives and functions, Parliament, industry and the wider public can more easily assess a regulator’s performance.
- **Compliance:** clear objectives and functions better allow regulated firms or individuals to understand what they need to do to meet regulatory standards, and so promote voluntary compliance.
- **Focus:** an agency with a clearly-defined mandate is more likely to be well run and well organised.
- **Legitimacy:** with clear objectives – and agency commitment to those objectives – regulated firms and the public will see the agency as more legitimate.
- **Predictability:** with a clearer mandate, the agency is more likely to apply its powers consistently, and individuals and firms are better able to predict how decisions will be made in the future.

A corollary of these principles is that clarity is defined by more than one party: the regulators and the regulated need to understand the job of regulators and how they should do their job. In addition, the test of clarity is not just in how roles, functions and duties are laid out in statute or policy frameworks, but in how the agency’s actions align – and are perceived to align – with these purposes.

## 8.3 Examples and effects of poor role clarity

### Regulatory creep

One possible outcome of unclear roles and objectives is regulatory creep – the extension of the scope or impact of regulation in a non-transparent manner, either deliberately or unintentionally. Regulators may take on functions not considered when the regulation was established, or may increase the range of activities and firms subject to control. The affected firms and the wider community then face an increase in the cost of regulation.

Regulators may have in-built incentives to expand the scope of their activities. Niskanen (1971; 1991) argued that bureaucracies seek to maximise their discretionary budgets (defined as the “difference between the total budget and the minimum cost of producing the output expected by the political

authorities"). The discretionary budget can then be "spent in ways that serve the interest of the bureaucrats and the political authorities" (Niskanen, 1991, pp. 18-19). This can happen because of lack of market disciplines on bureaucracies (for example, only one "purchaser", no competition for the provision of services, and no independently-determined prices). It can also happen because of the low value (relative to cost) that politicians derive from holding bureaucracies to account for their spending and activities. As a result, agencies can have larger budgets than they need to produce their services, and may seek to create the fiscal room to pursue other objectives.

How regulators interact with business can drive regulatory creep. "Cat-and-mouse" games between regulators and some regulated firms – which involve repeated exchanges where firms test the boundaries of regulation, and regulators respond – may convince regulators that they need to expand their jurisdiction to effectively deliver on their objectives (Berg, 2008).

As discussed in Chapter 2, regulators also often face external pressure to respond to new issues or changing public views about acceptable risk levels. The Australian Productivity Commission (APC)'s review of regulator engagement with small business described these pressures.

Growth in regulation is testament to the importance society now places on mitigating risks. As society becomes less tolerant of exposure to risks, regulators are under increasing pressure to justify their activities, and demonstrate how they are efficiently managing risks. ...Regulators are frequently faced with calls to 'do something' in response to what is publicly perceived as unacceptable. (APC, 2013a, pp. 60-61)

In such circumstances, a regulator can find it hard to resist pressures to expand the scope of its activities.

However, regulatory creep may be a well-intentioned response to gaps in the policy framework.

High level goal-setting objectives may need further clarification. Goal-setting regulation can leave a vacuum that Government, regulators and industry will seek to fill with guidance. The guidance may stray beyond the original intention and/or it may be applied prescriptively by regulators and those being regulated. (Better Regulation Taskforce, 2004, p. 11)

Regulatory creep is not specific to goal-based regulation. The inherent inflexibility of prescriptive regulation means that regulators need to regularly update and refresh the mandatory standards. Over time, or without sufficient checks and balances, this could see the scope of activities subject to control expand. Similarly, with process-based regulatory standards (such as food safety plans) the definition of what constitutes an "adequate" risk management system or process can change over time.

Julia Black, Martyn Hopper and Christa Band's assessment of principles-based regulation in UK financial markets found that "high-level Principles have been used to extend the FSA's [Financial Services Authority] scrutiny into areas such as 'product design', which had not previously been thought to be the subject of regulatory requirements" (2007, p. 198). The reluctance of the FSA to "identify a bright line between what is acceptable or unacceptable" also left firms "to work out standards for themselves", leading to a risk that they would "set them either uncomfortably high or too low" (ibid).

Gaps may also arise because the underpinning legislative framework is outdated and no longer meets public expectations. As noted in Chapter 2, regulatory legislation in New Zealand can easily become obsolete, because of the heavy reliance on statutes, high demand on parliamentary time, and the lack of a strong review and evaluation culture. Regulators can feel pressure to move beyond their legal mandate.

The result can be that entities feel compelled to interpret their law in a strained or unexpected manner to meet expectations causing them to breach the law and/or breach rights which in turn results in a diminished level of public confidence and in some cases can cause social harms. (Maritime New Zealand, sub. 15, p. 2)

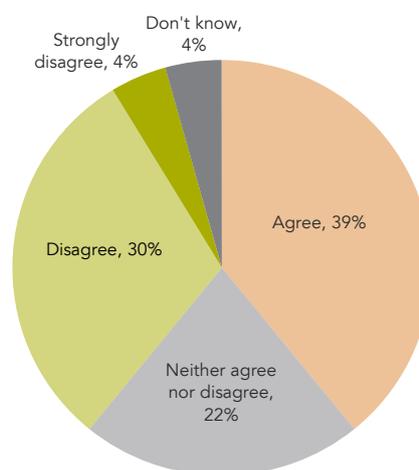
## Duplicated or contradictory regimes

Regulatory regimes may overlap with each other, lack clear boundaries, duplicate processes and create contradictory obligations on firms. Overlaps are particularly likely to occur where general and industry-specific regulations cover the same issue (VCEC, 2011). These tensions create unnecessary costs for regulated firms and cause confusion about which regulatory obligation or agency has priority.

We have previously sought clarification from the Ministry for the Environment as to the priority afforded the Commerce Act in seeking to give effect to the presumption in the Waste Minimisation Act, that manufacturers demonstrate 'Extended Producer Responsibility' (EPR). One interpretation of EPR is that it includes an obligation to discuss with manufacturers of similar products the possible means and arrangements whereby those products can be recovered and recycled. It is conceivable that concerted efforts to give effect to the statutory/regulatory expectation for EPR could be misconstrued as an unintended or deliberate breach of laws intended to prevent cartel or collusive behaviour. (Carter Holt Harvey, sub. 8, p. 9)

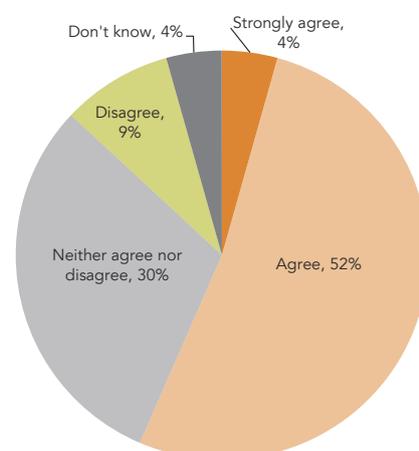
Evidence that the Commission collected revealed differing views on the scale and significance of overlaps in New Zealand. On one hand, some submitters argued that overlap "is relatively limited" (Genesis, sub. 48, p. 7; Reserve Bank of New Zealand (RBNZ), sub. 9, p. 3). Others argued that regulators managed overlaps well (New Zealand Food and Grocery Council (NZFGC), sub. 35, p. 5; Aviation New Zealand, sub. 36, p. 11). Of regulator chief executives (9 out of 23), 39% agreed with the statement that "regulatory regimes often have competing regulatory objectives", while 34% (8 respondents) disagreed or strongly disagreed. In addition, more than half (56%; 13 out of 23 respondents) of regulator chief executives agreed or strongly agreed that "agencies usually manage competing regulatory objectives effectively".

**Figure 8.1** Chief executives who agree with the statement "Regulatory regimes often have competing regulatory objectives"



Source: NZPC, 2014b.

**Figure 8.2** Chief executives who agree with the statement "Agencies usually manage competing regulatory objectives effectively"

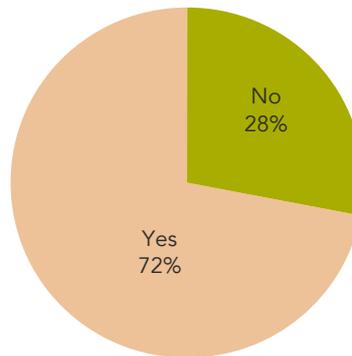


Source: NZPC, 2014b.

On the other hand, 90% of the 1,526 businesses surveyed by the Productivity Commission believed that regulatory requirements in New Zealand were “sometimes”, “mostly” or “always” contradictory or incompatible with each other (Figure 2.1).

In response to a Commission request for information, 18 of 25 regulators reported that they implemented at least one regulatory regime that overlapped with those run by other agencies (see Figure 8.3).

**Figure 8.3** Regulators who report that they implement at least one regulatory regime that overlaps with regimes run by other agencies



Source: Information collected by the Productivity Commission.

Roughly half of the businesses that the Commission surveyed believed that regulators “rarely” or “never” work with each other to reduce the paperwork/effort on firms (Figure 8.4).

**Figure 8.4** Businesses that agree with the statement “Regulators work with each other to reduce the paperwork/effort on organisations”



Source: Productivity Commission; Colmar Brunton.

### F8.1

Many firms that the Commission surveyed saw contradictory or incompatible regimes, and regulators poorly managing duplicated compliance requirements, as issues in New Zealand.

One possible explanation why surveyed businesses perceived a higher degree of incompatibility and contradiction in regulatory regimes and lower regulator effectiveness in managing duplicated compliance requirements is that firms face a much wider range of regimes than regulators appreciate. In addition, 80% of survey respondents were small firms (19 or fewer full-time equivalent staff). Such firms are likely to lack the regulatory management staff of large businesses.<sup>40</sup> This means that smaller firms may feel the burden of regulatory compliance more keenly.

A number of submitters identified specific regimes where boundaries were perceived as unclear, or where firms experienced conflicting requirements (see Box 8.1).

<sup>40</sup> 43% of respondents had 1-5 FTEs.

### Box 8.1 Key overlapping regulatory regimes that submitters identified

The areas of regulatory overlap most commonly identified in submissions were electricity, financial markets, and health and safety.

#### Electricity

A number of submitters highlighted the roles of the Commerce Commission and Electricity Authority (EA) in regulating electricity lines businesses (for example, Powerco, sub. 14, pp. 4-5; Wellington Electricity, sub. 17; Electricity Networks Association, sub. 27, pp. 12-15; Minter Ellison Rudd Watts, sub. 28, pp. 17-21; Vector, sub. 29, p. 14 & p. 23; Transpower, sub. 32, p. 7). Most of the commentary focused on the potential for problems to arise, but some cited cases where they considered the overlap had created actual issues.

Electricity networks are regulated by both the Commerce Commission under Part 4 of the Commerce Act 1986 and the Electricity Industry Participation Code 2010 (code). Decisions made by either regulator often have direct implications for the functioning and effectiveness of the regime implemented by the other regulator. For example, changes to the Code which result in increased costs and/risk to distributors that were not known at the time the Commission determined the Default Price-quality Path. (Wellington Electricity, sub. 17, p. 1)

...there have been occasions when the industry regulator has made policy recommendations that are not aligned with the [Commerce] Commission's regulatory regime. For example:

- The EA released a transmission pricing methodology (TPM) that would have given rise to volatility in transmission costs to ENBs [electricity network businesses]. Transmission costs are a pass-through for non-exempt ENBs, and the way the DPP [default price path] is structured for pass-through costs does not allow for volatility. This meant that the proposed TPM would not work with another part of the regulatory regime; and
- The EA proposed using the structure of its levy to create incentives for participants, without understanding that these are a pass-through cost for non-exempt ENBs. This means that ENBs are not directly affected by EA levies.

Such disconnects between the regulatory regimes impose costs and impair overall effectiveness for no apparent advantage. (Electricity Networks Association, sub. 27, p. 15)

Minter Ellison Rudd Watts argued that different approaches taken by the two regulators affected regulatory certainty:

There is no single correct process to address grid upgrades or renewal allocation. However, it does not enhance regulatory certainty if one regulator uses an ex ante approval process for grid upgrades, and the other regulator uses an ex post process for the allocation of the costs of the same upgrades. (sub. 28, p. 17)

However, the EA disagreed with these portrayals of the interface between the two regulators, noting that the two agencies have a Memorandum of Understanding (MoU) in place, meet and consult regularly, and coordinate their decisions:

The Authority would not make proposals affecting electricity networks and other industry participants whose activities are regulated by both agencies if it considered changes in the Commerce Commission's regime, required to achieve the intended effect of the Authority's proposals, were not feasible. (sub. DR 70, pp. 8-9)

The EA also argued that some of the issues identified by the Electricity Networks Association and Wellington Electricity were a function of the statutory frameworks, rather than multiple regulators (ibid, p. 6).

The Commerce Commission similarly commented that the "boundaries between regulatory functions are relatively clear and were worked through in some detail during the electricity sector reforms in 2011", and said that it "liaises closely with the Electricity Authority to mitigate the risk of unintended consequences" (sub. DR 93, p. 3).

### Financial markets

Submitters identified two main areas of overlap in financial market regulation. The first was the large number of organisations involved in regulation, unclear boundaries between many of them, and the lack of guidance on how and when the different organisations would work together. In some areas, submitters believed there were conflicting requirements.

An example is the overlap between the NZX [New Zealand Stock Exchange] and the FMA [Financial Markets Authority]. NZX firms are regulated under the NZX Participant Rules. The same firms are also 'brokers' for the purposes of the Financial Advisers Act and must comply with the broking requirements in the legislation. Currently, the rule sets (and each regulator's interpretation) conflict with each other, so that compliance with one set... [of]...rules could potentially be a breach of the other. It is unclear which regulator's views will prevail in the event of conflicts between the NZX and the FMA. (ANZ, sub. 24, p. 3)

Bell Gully argued that the MoU between the Serious Fraud Office and the FMA allowed for "concurrent investigations in relation to a single set of circumstances", which could create significant costs and legal complications (sub. 38, p. 2).

The second issue identified was two organisations (the Commerce Commission and FMA) having responsibility for preventing and prosecuting misleading and deceptive conduct in the financial markets (Insurance Council of New Zealand, sub. 5, pp. 3-4; Insurance Australia Group Limited (IAG), sub. 10, p. 13; ANZ, sub. 24, p. 10; New Zealand Bankers Association, sub. 43, p. 8). In the case of financial advisers, the Insurance Council of New Zealand argued that such conduct could be potentially covered by three different regimes – the Financial Markets Conduct Act 2013, the Financial Advisers Act 2008, and the (recently passed) Consumer Law Reform Bill.

### Health and safety

Comments about health and safety focused on the number of agencies involved in regulatory implementation and the weak leadership in some areas (Council of Trade Unions, sub. 25, p. 16; Institution of Professional Engineers New Zealand, sub. 21, p. 6).

Aviation New Zealand said that different standards were applied to safety issues in the aviation industry.

...there is only one state of safe and that is people are not hurt or injured, but we have different definitions of 'safe'. We have different definitions of serious harm. We have different threshold tests. We have very different ways of investigating incidents and accidents – we have different definitions of accident.

To place some semblance of accountability into this complex confusing and conflicting regulatory regime, an artificial line was drawn between which regulatory agency is accountable for investigation. Not only was the line drawn at a point that makes little or no sense to some operations in industry, but also the conflicting regulatory philosophies have taken years to rationalise their way through the operational environment. (sub. 36, p. 10)

Aviation New Zealand further noted that there are "two statutory systems which govern 'safety' in the aviation environment" and that "[c]ompliance with one i.e. the Civil Aviation Act does not guarantee compliance with the other. Aviation companies are required to comply with both including their significant differences" (sub. 36, pp. 12-13).

## Gaps in regulation, monitoring or enforcement

Gaps may appear either within or between regulatory regimes, leaving some activities uncontrolled or ineffectively overseen. Prescriptive or input-based regulatory standards are arguably most prone to this problem, as technological changes outpace the ability of detailed rules to control risks.

The risk of gaps appearing is higher when multiple regulatory agencies operate within an industry without one agency being a clear leader. This has been a particular issue with financial market regulation during the past decade, both here and overseas. The Commerce Select Committee inquiry into finance company failures found that:

...the supervisory framework was fragmented and insufficiently rigorous. ...The several regulators operated under relatively narrow legislative mandates. Overlapping responsibilities and inadequate funding led to things slipping through the cracks. (House of Representatives Commerce Committee, 2011, p. 11)

Similarly, financial market regulators in the United Kingdom faced strong criticism from the UK Parliament for failing to prepare adequately for crises such as the failure of the Northern Rock bank; resolve weaknesses in the legislative framework (when these weaknesses had been identified earlier), and respond quickly enough to Northern Rock's difficulties. The parliamentary inquiry identified as a key problem the absence of a clear leadership structure within the financial regulators (House of Commons Treasury Committee, 2008).

### Inconsistent decisions or enforcement

The last manifestation of poor role clarity is where regulators enforce their regimes inconsistently. This may discourage investment or innovation, as firms are unsure how regulators will treat their activities. Inconsistency can also be perceived as unfair and undermine the regime's credibility.

Inconsistent enforcement can occur when regulatory objectives or principles are not adequately defined, where conflicting objectives exist, or where an industry has multiple regulators.

The Resource Management Act creates a mandate for broad interpretation of "sustainable management" of the environment by Regional and District government. Our experience over the last 20 years has been that 'Sustainable management' of forestry operations has been interpreted differently by different regulators sufficiently often to justify greater national direction. (Carter Holt Harvey, sub. 8, p. 2)

The New Zealand energy market includes regulation by the Commerce Commission, Electricity Authority, GIC [Gas Industry Company], Energy Efficiency and Conservation Authority and the Energy Safety section of MBIE [Ministry of Business, Innovation and Employment]. There is some overlap between these bodies in particular areas. Additionally, regulated firms can find different regulators taking inconsistent or opposing positions on the same issues. (Vector, sub. 29, p. 23)

Responses to a business survey undertaken for the Commission indicated that inconsistent regulatory decisions are a problem in New Zealand. While 39% of surveyed firms felt that organisation across their industry were "mostly" or "always" treated fairly and consistently, 45% believed this was only "sometimes" the case. A further 15% believed organisations in their industry were "rarely" or "never" treated fairly.

**Figure 8.5** Businesses that agree with the statement "Organisations across my industry are treated fairly and consistently by regulators"



Source: Productivity Commission; Colmar Brunton.

## 8.4 Causes of poor role clarity, and responses to it

A regulator or regulatory regime may lack clarity for a number of reasons, including that:

- the regulatory standards used do not fit the industry or activity being controlled;

- policy makers provide insufficient guidance about the desired objectives of regulation;
- regulators have been given functions that conflict with their regulatory obligations; and
- insufficient attention was paid (when designing the regime) to the role of other regulators, or to the impact of different regimes on regulated firms.

Each of these reasons, and possible responses, is discussed in turn. Steps can be taken at all points on the regulatory “value chain” to improve role clarity, including decision review and appeal processes, accountability and performance assessment mechanisms, and engagement systems. This section focuses on actions related to a regulator’s mandate, in particular its founding legislation and functions.

## Regulatory standards

Regulatory regimes need to fit the industries or activities being controlled, and have the appropriate capability available to interpret and enforce them. At a high level, there are four main regulatory standards: principles-based; performance/outcome-based; input-based/prescriptive; and process or system-based.

**Table 8.1** Types of regulatory standard

Regulatory standard	Definition	Example
Principles-based regulation	Sets high-level qualitative principles or rules that entities must follow in their conduct (such as “reasonable care”)	Occupational health and safety
Performance/outcome-based regulation	Specifies the outcomes/goals to be met, but not the way to meet them	Pollution emission limits
Input-based/prescriptive regulation	Specifies the precise inputs that must be used to achieve regulatory compliance	Occupational regulation has traditionally been input-based (such as requiring certain educational qualifications), but it is now moving towards performance-based approaches
Process or system-based regulation	Requires regulated entities to introduce processes or systems with specified elements	Food safety Hazard Analysis and Critical Control Point requirements

The four standards are not mutually exclusive. For example, the Hazardous Substances and New Organisms Act 1996 (HSNO) is a performance-based regime that aims to “protect the environment, and the health and safety of people and communities, by preventing or managing the adverse effects of hazardous substances and new organisms” (s 4 of HSNO). But it is underpinned by a series of detailed expectations that may require holders of hazardous substances to prepare emergency response plans or ensure that storage and transport facilities have specific characteristics. Similarly, principles-based occupational health and safety regulatory regimes are often supported by system or process requirements (eg, risk management plans).

Each regulatory standard has strengths and weaknesses, and each suits a different set of circumstances. The selection of the appropriate regulatory standard depends on:

- the ease in defining and measuring the desired outcome(s) from regulation;
- the degree to which regulators and regulated entities trust each other;
- the degree of change or diversity within the regulated industry or activity;
- the level of capability in the regulators and regulated entities; and
- the extent to which standardisation is desired or required.

Selecting an inappropriate standard may introduce unnecessary costs for regulated firms, lead to poor levels of compliance, or leave important hazards or risks insufficiently controlled. MBIE observed that this had been an issue with some of the regulatory frameworks it (and its predecessor agencies) oversaw.

...with the benefit of hindsight, poor judgments or inappropriate policy assumptions have been made about the approach to take to regulatory systems (eg whether prescriptive or principles based regulation is more appropriate), or the approach may have been the right one but not implemented effectively. For example, principles based regimes often require a level of prescription in regulation or guidance, in the case of both the health and safety and building standards systems, this was not provided, which contributed to the regulatory failures in those systems. (sub. 52, p. 4)

The Meat Industry Association argued that inappropriate regulatory standards had hampered the move to a properly risk-based compliance and enforcement approach.

In an ideal world the New Zealand regulatory standards and those imposed by importing countries would be the same and they would be based on risk and describe the meat hygiene outcomes that must be achieved to address those risks. However, prescriptive requirements remain.

Review and removal of prescriptive requirements should continue, as should challenging importing countries requirements where there is no scientific justification and/or risk-based outcome that requirement is designed to achieve. The converse of this is to continue work on providing the processing sector with outcome-focused performance targets that allow for flexibility in companies' ability to innovate and achieve the ends required. (Red Meat Regulatory Strategy, cited in sub. 40, p. 20)

### **Selecting the right standard**

Table 8.2 outlines the advantages and disadvantages of the different standards and the circumstances in which each standard works best. Some have argued that government should prefer the more enabling regulatory standards (principles-based, outcome-based, or process-based regulation), on the grounds that they are better able to deal with changes in technology or business practice, allow for innovation in compliance, and permit firms to find the lowest-cost means of complying (see, for example, Business Council of Australia, 2013; Government of Victoria, 2010; OECD, 2012a; US Department of the Treasury, 2008). However, as seen in Table 8.2, there are circumstances where input-based standards are more suitable.

**Table 8.2 Advantages and disadvantages of different regulatory standards**

Regulatory standard	Advantages	Disadvantages	Works best where...
Principles-based regulation	<p>Allows firms in dynamic industries to adjust to changing circumstances</p> <p>Can enable firms to find least-cost means of complying</p> <p>Can provide a basis for open dialogue between the regulator and those regulated that are supportive of substantive (rather than “tick box”) compliance</p>	<p>May lead to uncertainty as to whether a firm’s compliance actions meet the required standards. This may unnecessarily increase costs for that firm. Uncertainty may also discourage innovation.</p> <p>Can require high levels of guidance from regulators</p> <p>Diversity of compliance approaches may create a higher risk that firms do not comply or regulators undertake inconsistent enforcement</p> <p>Can require high levels of capability within a firm to achieve compliance</p>	<p>Outcome/goal of regulation can’t be easily and objectively measured</p> <p>Other parties (such as consumers, workers) have the capability to monitor compliance</p> <p>A high degree of trust and good communication exists between the regulator and regulated entities</p> <p>The regulator is well-resourced and capable</p> <p>The industry/regulated activity is diverse, and acceptable practice is likely to change over time</p> <p>Competition/innovation is likely to drive more efficient compliance</p> <p>Greater innovation in meeting regulatory objectives is desired</p> <p>Non-compliance by firms or mistakes by regulators do not create high levels of public harm</p>
Performance/outcome-based regulation	<p>Allows firms in dynamic industries to adjust to changing circumstances</p> <p>Can enable firms to find least-cost means of complying</p>	<p>Few cases where outcome/goal can be tightly defined and easily measured</p> <p>If outcome/goal is <b>not</b> clearly defined or easily measured, may lead to uncertainty as to whether a firm is actually complying or requires high levels of guidance</p>	<p>Outcome/goal can be tightly defined, and targeted output can be easily and objectively measured (for example, quantitatively)</p> <p>Targeted output (such as emissions) has a strong link to the desired regulatory outcome (such as cleaner air)</p> <p>Firms are better placed than regulators to choose the best way to comply (for example, due to dynamic industry/technical complexity), and have the necessary capability</p> <p>Competition/innovation is likely to drive more efficient compliance</p> <p>Greater innovation in meeting regulatory objectives is desired</p>

Regulatory standard	Advantages	Disadvantages	Works best where...
Input-based/prescriptive regulation	<p>Can provide a high degree of consistency and certainty for regulated firms</p> <p>Objective criteria can inform decisions to prosecute/enforce</p>	<p>Can have high administration and compliance costs</p> <p>Leaves a firm little room to comply in other, more efficient ways</p> <p>Does not keep up well with rapid changes in technology – may become obsolete or require frequent adjustments (which increase the cost and complexity of compliance)</p> <p>Because of its “one-size-fits-all” approach, can be under-inclusive (missing some hazards or risks) or over-inclusive (unnecessary in some situations)</p> <p>Can be used to create barriers to entry or unnecessary costs</p>	<p>Little trust exists between regulators and regulated entities</p> <p>Standardisation is very important</p> <p>Regulated entities have neither the ability nor need to be innovative in complying</p> <p>Stable risks exist that need a high degree of certainty</p> <p>The level of harm from non-compliance is unacceptable, and a high level of certainty is desirable</p>
Process or system-based regulation	<p>Can promote innovation in risk mitigation/management practice</p> <p>Can promote firms to own and be accountable for risk mitigation</p> <p>Allows firms in dynamic industries to adjust to changing circumstances</p>	<p>Can be costly to administer</p> <p>Potential for scope of risks covered or standards of control required to increase over time (so raising compliance costs to firms)</p> <p>In some circumstances, may create overlaps with other regulatory regimes (such as occupational health and safety, and environmental regulation)</p>	<p>A number of substantial risks must be managed simultaneously</p> <p>A range of management measures are available</p> <p>Regulated firms have the capability to effectively assess risk and develop solutions to manage those risks under their control</p> <p>Regulators have the capability to assess the adequacy of processes or systems</p>

Sources: Government of Victoria, 2011; Mumford, 2010; New Zealand Treasury, 2011b; Black, Hopper & Band 2007; Black, 2008; Coglianesi, Nash & Olmstead, 2003; Ministry of Economic Development, 2010.

## Implementing regulatory standards to fit the industry

Enabling standards (that is, principles-based, outcome-based, or process-based) work best where the regulated firms have the capability to interpret the regulatory frameworks and develop suitable compliance strategies. This can create a bias towards larger firms.

Large organisations are more likely to have the resources and capacity to prepare for and respond to regulatory interventions and interactions – they may have dedicated regulatory compliance staff whose job it is to understand the regulatory regime, and can spread the costs of regulatory interactions across a broader business base. This may make them more able to comply with regulatory requirements (or, indeed, more able to find ways to avoid or subvert them). In contrast, small organisations are likely to be less knowledgeable about regulatory requirements and to find it more difficult to make capacity to respond to regulatory interactions. (Walshe & Boyd, 2007, p. 19)

For smaller organisations that lack the necessary capability, the breadth of possible compliance strategies can be daunting. They may prefer the certainty of more prescriptive standards. The Environmental Protection Authority (EPA) noted that in “some circumstances, there may be a better overall outcome (i.e. higher compliance with basic protections) if individuals/small businesses are given clear, simple obligations to keep themselves and others safe, and to protect the environment, despite the trade-off of less flexibility” (sub. 20, p. 2).

Enabling regulatory standards can be designed to provide flexibility for larger, more capable firms and certainty for smaller entities through such models as “deemed-to-comply”. Deemed-to-comply models combine high-level objectives or principles (usually in primary legislation) with voluntary, detailed rules (usually in guidance documents) that spell out how firms can comply with the objectives or principles. Firms are free to develop their own compliance strategy, but if they follow the rules they are “deemed” to comply.

The Building Act 2004 is one example of a regulatory regime that employs deemed-to-comply. All building work in New Zealand must comply with the Building Code (the Code, a regulation made under the Building Act). The Code sets out the minimum structural and safety standards building work must perform to (such as protection from fire, durability and moisture control), but not how the building should meet them. Building practitioners can comply with the Code by using prescriptive guidelines known as “Acceptable Solutions” that MBIE has prepared. Building consent authorities must approve any designs based on the Acceptable Solutions. Alternatively, building practitioners can propose other ways (“Alternative Solutions”) to meet the requirements of the Code. Where an Alternative Solution is used, the burden is on the practitioner to demonstrate how their solution complies with the Code.

Deemed-to-comply models can help shift regulatory regimes from prescriptive/input-based approaches to more enabling approaches where desired: the existing input-based guidance becomes the detailed rules, but firms are allowed to seek other options. Deemed-to-comply models can also allow regulatory systems to adapt to changes in technology or shocks. Rather than having to change the underlying statute and regulatory framework, the detailed rules can be updated to reflect new developments. Deemed-to-comply models depend, however, on the regulator having the capability to administer more than one system, and multiple systems may confuse some entities and consumers.

Other models that provide a different balance of flexibility and certainty are menu-based or comply-or-disclose models.

- **Menu-based** regulatory models allow regulated firms to choose from a menu of compliance options. This approach is used in the Trans-Tasman Mutual Recognition Agreement.
- **Comply-or-disclose** models lay down rules or standards, but allow firms/individuals to diverge from the standards, provided the firms disclose where and why they have diverged.

A comply-or-disclose model is arguably more permissive than other models, as firms or individuals do not need to find other ways to meet the standards. They may choose to ignore the standards, provided they disclose this. Even so, it is only suitable for some circumstances, particularly where non-compliance (such as

divergence from the rules or standards) does not create high risks and where consumers or other institutional players are able to judge the performance of regulated firms.<sup>41</sup>

### F8.2

“Deemed-to-comply” systems can let regulatory regimes adapt to changes in technology or shocks. They also permit different firms to find the compliance approach that best suits them. This lets regimes more effectively cover industries where the capability among regulated firms varies.

Enabling regulatory standards must be implemented and enforced with care, if they are to deliver on their potential. As Julia Black has found, regulators may need to strike a number of balances between competing goals, such as clarity and flexibility (see Box 8.2). Black’s paradoxes also highlight the importance of ensuring that the regulatory standard selected is appropriate for the industry (for example, see the explanations of various paradoxes below):

- Paradox 7 reinforces the point that principles-based regulation is unlikely to fit an environment where a low level of trust exists between the regulator and firms.
- Paradox 5 highlights the importance of having sufficient capability within industry to implement the regime.

#### Box 8.2 The paradoxes of principles-based regulation (PBR)

Julia Black’s work on UK financial markets regulation has shown that some tensions must be managed when introducing principles-based regulation:

- **Paradox 1: the interpretative paradox – principles can be general yet precise.** Regulatory principles are often cast at a general level (for example, “reasonable care”), giving firms flexibility in how they comply. Despite this, firms and regulators sometimes interpret the principles narrowly. As a result, PBR can, in practice, “be almost indistinguishable in places from a regime characterized by detailed rules”.
- **Paradox 2: the communicative paradox – principles can facilitate communication but can also hinder it.** Too much communication or guidance from regulators can make it harder for firms to figure out exactly what is expected (they struggle to figure out which statement has precedence).
- **Paradox 3: the compliance paradox – principles provide scope for flexibility in compliance yet can lead to conservative and/or uniform behaviour by regulated firms.** Uncertainty about how regulators will interpret principles “can result in firms adopting conservative behaviour, as if they were bound by detailed rules”. The use of consultants to help firms comply may also encourage “convergence on a set of broadly common practices”.
- **Paradox 4: the supervisory and enforcement paradox – principles need enforcement to give them credibility but over-enforcement can lead to their demise.** A heavy reliance by regulators on tough or punitive enforcement may drive out flexibility in complying, as “firms seek the comfort of detailed rules”.
- **Paradox 5: the internal management paradox – PBR can provide flexibility for internal control systems to develop but can overload them.** PBR can empower a firm’s internal control systems, by giving them (rather than external inspectors) a greater role in assessing whether or not the firm is meeting regulatory requirements. But if internal control systems are not robust, this responsibility can weaken rather than strengthen them.

<sup>41</sup> For example, comply-or-disclose forms part of the listing rules of the Australian Stock Exchange, where firms are subject to regular and high levels of scrutiny by investors and analysts.

- **Paradox 6: the ethical paradox – PBR can facilitate a more ethical approach but it could erode ethics.** PBR aims to “develop a responsible and ethical culture focused on achieving certain outcomes”. Yet firms may respond by reducing what should be ethical judgements to mechanistic processes or by making risk/cost trade-offs that consider non-compliance a valid option.
- **Paradox 7: the trust paradox – PBR can give rise to relationships of trust, mutuality and responsibility but these are the very relationships that must exist for PBR to be effective.**

*Source:* Black, 2008.

## Guidance from policymakers

The underlying legislative or policy frameworks may not guide regulators or regulated entities clearly enough on how the regime should operate. As a result, firms may struggle to understand how to comply, and regulators may expand their activities beyond the scope originally intended by Parliament, or make inconsistent decisions. These issues can arise where:

- the outcome(s) or principles guiding the regulatory framework are imprecise; or
- the regulatory framework has multiple objectives or principles.

### Imprecise outcomes or principles

The outcomes or principles guiding regulatory frameworks may be vaguely worded or open to wide interpretation. Black (2012b) noted that “the overall outcomes that regulators are meant to achieve are usually expressed in highly general terms: for example, to protect consumers or the environment, to ensure competition, to maintain financial stability or to uphold the rule of law” (p. 9).

Some submitters believed that the legislative drafting approach in New Zealand contributed to imprecise regulatory objectives:

...our style of statutory drafting often relies on broadly phrased “purpose statements”, which are intended to guide regulator discretion but in practice are often imprecise or call for the regulator to make difficult trade-offs. (IAG, sub. 10, p. 8)

In some cases, the primary legislation lacks sufficient specification of the overall objectives or purposes for which powers may be exercised; there is a tendency for the objectives or purposes to be stated at a very generalised level. (Mortlock Consultants Ltd, sub. 31, p. 2)

The NZFGC considered that legislative drafting had improved over time.

NZFGC finds that the more recent the regulatory regime, the clearer the objectives. ...An example is the current Food Act and the prospective Food Bill. The latter has very clear objectives, the former difficult to locate. (sub. 35, p. 4)

But Aviation New Zealand and Maritime New Zealand (MNZ) said that recent amendments had eroded the clarity of their legislative frameworks.

In aviation we had a very clear objective of safety at reasonable cost. All participants in the aviation community could apply a cost benefit test to regulatory changes. We had a common mantra and a common way of addressing issues. On November 30 2004 the Act was amended by amending the objective of the Minister to now be “to undertake the Minister’s functions in a way that contributes to the aim of achieving an integrated, safe, responsive and sustainable transport system”. Nobody understood what the change meant or how it impacted on the functions of the Authority. However one thing did become clear: that the quite precise tests which we previously applied to decisions became diluted at least at the regulatory level. (Aviation New Zealand, sub. 36, p. 5)

The clarity around the objectives for MNZ has over time been eroded by amendments to the law. When the Maritime Transport Act was first made the objective of safe, secure and effective marine pollution prevention was premised only “at a reasonable cost”. This was replaced in 2004 by the current objective which has reduced the singular clarity that existed before. Words like “sustainable” are not

defined and increase the risk of reduced clarity around the regulatory objectives although in practice this has not presented material challenges. (MNZ, sub. 15, p. 6)

### Multiple objectives

Multiple objectives or principles can undermine clarity where regulators lack guidance from policymakers or lawmakers on how they should prioritise objectives, or which processes they should use to reach decisions. In these circumstances, regulators may fail to decide consistently or may place more weight on one objective than another. BusinessNZ cited the now-disestablished Electricity Commission as a case where multiple regulatory objectives can cause problems.

...the Electricity Commission had multiple and confused objectives which was complicated by the fact that it had no clear ex ante or transparent definition for making the trade-offs between them. In fact, they were so diverse and complex in the context of the electricity market that there was no obvious way in which the trade-offs could be made. ...Ultimately, the Electricity Commission used its judgement to make the trade-offs in a non-transparent manner. This resulted in a regulatory outcome akin to a lottery, and as a result, the industry adjusted upwards its risk adjusted rate of return and investment slowed to the point that the then government was required to procure stand-by plant (it purchased Whirinaki thermal plant in the Hawkes Bay) to ensure sufficient security of supply. (sub. 19, pp. 23-24)

### More disciplined design is needed

Greater discipline at the design and drafting stage is an important way of avoiding unnecessary conflicts and creating regimes that are manageable for regulators and the regulated.

Multiple or conflicting objectives are not necessarily poor practice. Parliament may have valid reasons to establish a regulatory regime with conflicting goals. Lawmakers may decide that they lack the time, information or expertise to take optimal decisions or make consistent decisions, especially where regulation deals with technical issues or dynamic industries. In delegating some of these difficult decisions to other parties, lawmakers may be trying to constrain problematic incentives in the political system. For example, the electoral cycle:

may induce Congress to prefer trade-offs that achieve short-run benefits at the expense of incurring costs in the distant future and to avoid short-run costs even if it means passing up future benefits. Congress may reduce this bias in policy making by assigning conflicting policies to a long-lived regulatory agency that does not place as high a discount on future costs and benefits. (Wall & Eisenbeis, 1999, p. 140)

Policymakers may also introduce more than one objective into a regime to ensure that regulators take a balanced approach. The RBNZ observed that this can be the case with its two financial stability objectives: "where there is a potential trade off, the efficiency objective can also work as a useful check on the soundness objective" (sub. 9, p. 3).

Even so, delegating decisions to regulators is not without risk. Delegation can create principal-agent problems, where regulators fail to act in line with the intent of Parliament. This is particularly likely where the decisions involve trade-offs between competing values. Before deciding to give decision-making powers to regulators, policymakers should be certain that the issues in question would best be considered by officials rather than elected representatives. As the APC noted in its recent report on major projects, some decisions are more appropriately taken by ministers, rather than regulators.

When approval decisions can be made by applying objective, measurable rules, experts in those rules are well placed to make decisions. ...However, primary approval decisions about whether and how major projects should proceed often involve tradeoffs between competing environmental, social and economic values that a technical body is not equipped to assess. (APC, 2013b, p. 207)

The issue of how to allocate decision-making powers is discussed in more detail in Chapter 10.

Where policymakers decide that there would be a net benefit in regulators having decision-making powers in regulatory regimes with multiple or competing objectives, principal-agent issues and other related risks can be reduced by:

- keeping the number of objectives or conflicts in the regulatory regime to the lowest-possible number;

- providing clear signals about the relative priority of regulatory objectives; and/or
- establishing more robust processes for clarifying the meaning and interpretation of regulatory objectives.

### **Minimise the number of regulatory objectives and conflicts**

Several submitters argued that problems had arisen where policymakers had not confronted difficult policy trade-offs or attempted to achieve too many goals through one vehicle.

Where policy makers fail to make difficult policy choices about priorities and areas of focus for regulatory outcomes, they create risks to achieving regulatory outcomes. This is because the policy failure results in a lack of clarity or purpose for the regulator. ...This results in operational regulatory bodies grappling with the issue and seeking to achieve potentially conflicting outcomes in whatever way they think is expedient. (MNZ, sub. 15, p. 2)

The regulatory regimes set up as a result of electricity and gas industry inquiries in the early 2000s contained "kitchen sink" objectives. As a consequence, the regulatory objectives provided little practical guidance on the trade-offs which needed to be made in the regulatory process. (Minter Ellison Rudd Watts, sub. 28, p. 8)

With a growing tendency to specify principles in primary legislation, there is a danger that Parliament will provide a smorgasbord of outcomes that are to be achieved. The Resource Management Act is a very good example, but there is little guidance given as to how decision makers should decide between potentially conflicting outcomes. (Tasman District Council, sub. 1, p. 2)

Participants are more likely to understand, and regulators will more effectively manage, a legislative framework with the least possible number of objectives and conflicts. As the Auckland Energy Consumer Trust noted:

...to be able to adequately monitor the balancing of objectives it is always easier when there are fewer objectives to be taken into account. Indeed, two is a good number. Aside from the obvious ease of understanding, one reason for this is that with two objectives there is only one trade-off [a v b]. With three, there are three pairwise matches [a v b, b v c, a v c]. And such trade-offs are complex social judgements, in which the elements typically change at different rates. They frequently involve hard-to-establish data and values, and are unlikely to be social constraints; so they may have different values depending on scale and incidence. (sub. 22, p. 4)

### **Provide a clear hierarchy, where multiple objectives are being pursued**

Although delegating the management of difficult trade-offs to regulatory authorities can be a legitimate strategy, policymakers should provide guidance about which goals have priority when there is a conflict (OECD, 2013b). Vodafone cited the UK Communications Act 2003 as an example:

It is not the case that a regulator can never be charged with promoting multiple objectives. This can be done successfully, provided that there is a clear hierarchy of objectives and a primary objective should exist to provide a 'guiding principle' as to how the regulator should proceed where there is conflict between objectives. This model exists in the UK Communications Act 2003, which established the independent communications regulator Ofcom. The Communications Act assigns an extremely broad range of duties to the regulator. However, it makes clear that Ofcom has two principle duties in carrying out its functions, which all other objectives are subject to. ...In general, this framework works well with little debate as to how Ofcom ranks and promotes different objectives. (sub. 46, p. 7)

A clear hierarchy in legislation helps to ensure that the trade-offs will be made in a consistent and predictable manner over time. Establishing a hierarchy in legislation also ensures that decisions about the relative importance of one goal or value over another are taken by those who are best placed and accountable for such choices.

#### **F8.3**

Legislative frameworks that keep the number of objectives and conflicts to the lowest possible number, and provide a clear hierarchy of objectives, help to support regulators in making consistent and predictable decisions.

## More formal engagement, before and after legislation is passed

Uncertainty about the meaning of objectives undermines the credibility and effectiveness of regulatory regimes. Some submitters believed that there was too much vagueness in key regulatory concepts.

In the absence of clear definitions of subjective terms such as ‘public good’ and ‘fairness’ there is little or no benchmark against which the worth of regulation can be assessed. The absence of a clear and agreed definition of these outcomes makes it difficult to examine the claims of those promoting regulation that their proposals are indeed worthwhile and cost effective. (Carter Holt Harvey, sub. 8, p. 3)

Guidelines could help to ‘flesh out’ and aid the interpretation of the regulatory objectives in legislation such as the Commerce Act 1986. The legislated objectives are necessarily broad and consequently open to multiple interpretations, which can create uncertainty for regulated entities. (PowerCo, sub. 14, p. 2)

However, it is notable that in several cases submitters had opposing views on whether a specific statute had clear objectives (see Box 8.3).

### Box 8.3 Is clarity in the eye of the beholder?

#### The Civil Aviation Act 1990

The Civil Aviation Authority (CAA) and MNZ (sub. 15, p. 6) cited the Civil Aviation Act as a regime with a clear objective.

There is a real need for a regulatory body to have a clear purpose (e.g. safety) which can be discharged in a way that is mindful of (or supports) other Government policy goals: In the CAA’s case, maintaining a safe civil aviation system is the primary goal, and this can be achieved whilst being mindful of other Government policy imperatives. (CAA, sub. 6, p. 5)

Even so, as noted above, Aviation New Zealand said that 2004 amendments, which “nobody understood”, had eroded the clarity of the Act (sub. 36, p. 5).

#### Reserve Bank Act 1989

The RBNZ said that its legislative mandates (the Reserve Bank Act 1989, Reserve Bank Amendment Act 2008, Insurance Prudential Supervision Act 2010)

...are sufficiently clear as regards the Reserve Bank’s regulatory objectives while providing flexibility for interpreting the mandate in accordance with contemporary circumstances. The Reserve Bank’s mandate as regards prudential regulation of banks, for instance, is to promote the soundness and efficiency of the financial system. Although there are at times trade offs between soundness and efficiency and the interpretation of efficiency can in certain circumstances be ambiguous, the comparatively narrow role of the Reserve Bank’s mandate supports the clarity of its role. (sub. 9, p. 2)

However, Mortlock Consultants Ltd argued that the Act had internal tensions.

...the Reserve Bank of New Zealand Act 1989 ... sets out the purposes for which banking supervision may be exercised (see section 68 of the Act). One aspect of these purposes is to promote ‘the maintenance of a sound and efficient financial system’. The Act provides no guidance as to whether, in the event that there may be a conflict or inconsistency between these purposes in relation to a particular matter (eg the exercise of a particular power), the Reserve Bank should place primacy on soundness over efficiency, or vice versa. (sub. 31, p. 3)

#### Commerce Act 1986

Transpower identified Part 4 of the Commerce Act as having “plain English clear objectives” (sub. 32, p. 6). The Auckland Energy Consumer Trust and New Zealand Airports Association disagreed:

Simplicity and clarity of objectives should be included in the design of regulation and applied as a test of the quality of regulation. The Commerce Act Part 4 does not rate well on this test requiring four complicated purposes to be balanced. (Auckland Energy Consumer Trust, sub. 22, p. 6)

Regulated suppliers have consistently argued that the policy and legislative history of Part 4

supports a preference for promoting incentives to invest and innovate whenever the objectives may potentially be in conflict. In general, airlines and the Commerce Commission have disagreed. All parties have pointed to policy materials and Parliamentary debates to support their respective positions. However the trade-offs are managed, the divergence in opinion demonstrates there is limited guidance and a lack of clear and transparent frameworks in place for how the Commerce Commission is required to balance its competing objectives. (New Zealand Airports Association, sub. 33, p. 13)

Disagreement over whether or not a regime's objectives are clear may reflect the different perspectives that various players bring to regulatory enforcement. Black (2008) noted that "regulators and lawyers have a different interpretative schema, even though both are interpreting legal norms ... regulatory practices, understandings and reasoning can be very different from those of the legal interpretive community, even though the rules in question have legal status" (p. 447). Similarly, Kalderimis, Nixon and Smith (2013) observed that lawyers and economists often apply different frameworks to the issues of regulatory certainty and discretion.

On a classical legal account of rule of law values, the tendency has been to place certainty and discretion as diametric opposites. Economic literature, in contrast, has not been so dogmatic. (p. 2)

Tanner (2010) argued that the "clarity" and "accessibility" of a law is context-dependent.

To whom must legislation be clear: a specialist in the field? A highly intelligent person? Someone of average intelligence? Is 'clear' directed at the drafting or the policy, or both? Legislation has multiple audiences: law makers, users, scholars, judges and administrators. It can be difficult to lay down hard-and-fast rules in this regard. Much depends on the subject matter. (p. 23)

Given the number of groups affected by the regulation and the diversity of perspectives, one way to improve the clarity of regulatory regimes is to make more use of formal consultation processes before and after regulatory regimes are confirmed, to test whether:

- the regulatory objectives are clear and understandable; and
- their interpretation by regulators is appropriate.

Two particular processes for clarifying roles could be used more frequently and consistently. The first process is consultation on exposure drafts of bills before their introduction to Parliament. Although the select committee process provides considerable opportunity for the public to comment on draft legislation, earlier consultation with affected parties can help identify and resolve problems, especially where the proposed regimes are complex or technical.

The current Cabinet Manual guidance on consulting on draft legislation places significant weight on confidentiality:

...in some circumstances releasing an exposure draft of the legislation may be helpful. In considering consultation with organisations outside the public sector, Ministers should consider the confidentiality constraints. ...At every stage of its development, draft legislation is confidential and must not be disclosed to individuals or organisations outside government, except in accordance with the Official Information Act 1982 or Cabinet-approved consultation procedures. Any such release or disclosure must first have the approval of the Minister concerned. Unauthorised or premature disclosure of the contents of a draft bill could embarrass the Minister, and imply that the role of Parliament is being usurped. Cabinet, government caucus(es), and Parliament must always retain the freedom to amend, delay, or reject a bill. (Cabinet Office, 2008, 7.42-7.44)

While in some cases it clearly would not be appropriate to circulate draft legislation for comment,<sup>42</sup> the current rules appear unduly restrictive. Public consultation on draft bills need not limit the ability of Cabinet or Parliament to change, defer or decline the proposed legislation. Subject to such caveats as necessary to

<sup>42</sup> For example, it may not be appropriate to release exposure drafts where this could enable individuals or firms to arrange their affairs in a way that evades the new regulatory regime.

protect Cabinet flexibility and the public interest, the burden in the Cabinet Manual should be reversed to make exposure drafts a standard step in consulting on significant changes to regulation.

### R8.1

The Cabinet Manual should be amended to set a general expectation that exposure drafts will be published and consulted on before introducing into Parliament legislation that creates a new regulatory regime or significantly amends existing regimes.

Exposure drafts are not a “panacea for imperfectly considered and developed regulatory regimes” and to be most effective, they should be part of a wider consultation and engagement process, including the policy development stage (Parliamentary Counsel Office, sub. DR 88, p. 6).

The second process is more use by regulators of ex ante statements about how they will interpret and carry out their legislative mandates, including how they will make trade-offs. Publishing and consulting on such statements can encourage engagement with regulated firms, and provide greater clarity and certainty to those firms about how the regulator will give effect to the regime’s objectives. This can be especially beneficial where regulators or regulatory regimes are new.

One example was the initiative of Electricity Authority in late 2010 (shortly after its establishment) to publish and seek feedback on a draft interpretation of its statutory mandate. The aim of this consultation process was to “assist the Authority Board to make consistent decisions, and ... assist staff and advisory groups to develop Code amendment and market facilitation proposals for the Authority Board’s consideration” (Electricity Authority, 2011, p. 1). The Electricity Authority also noted in its submission that the interpretation helps promote a high-performance culture among its staff (sub. 50). As Mortlock Consultants Ltd noted, some regulators:

...are required by statute to publish statements of their approach to regulation...[h]owever, this requirement is not consistently applied across regulators; many are under no parallel obligation. Partly as a result of this, there is a lack of transparency in the policy framework applied by some regulators in interpreting their responsibilities and in exercising their powers. This impedes the accountability of regulators and makes it more difficult for regulated entities to interpret the actions of their regulators. (sub. 31, p. 6)

Although regulators already publish a range of information, such as statements of intent and annual reports, these documents are primarily intended for ministers and Parliament, rather than regulated parties. As a result, they tend not to include detailed information about the regulator’s implementation approach.

There are a number of ways in which regulators can provide greater up-front clarity about their roles and approaches. The Commerce Commission, for example, provides detailed guidance on the criteria and approach it takes to assessing mergers or acquisitions (Commerce Commission, 2013b), anti-competitive agreements (Commerce Commission, 2012) and potential breaches of fair trading legislation, amongst other things.

### F8.4

New regulators, and regulators implementing new regimes, should publish statements outlining how they will interpret and give effect to the regime’s objectives, and engage with regulated parties on these statements.

## Functions of regulators

Giving some functions to regulators or placing regulators within some types of agencies can affect how effectively regulatory regimes are enforced and reviewed. Functions identified as potentially conflicting with regulatory management and enforcement include policy development, industry promotion and revenue collection.

- **Policy development:** Organisations with policy development and regulatory functions may be more subject to lobbying by regulated firms, may have incentives to use the policy process to expand the scope of their regulatory roles, may be drawn into political processes and be seen as less able to make impartial decisions. The close proximity of regulators to industry may lead to a narrower perspective

being applied to policy than a public service department might apply (VSSA, 2009, p. 35). Involving regulators in developing policy may also encourage an excessive reduction of risk (VCEC, 2005b, p. 305).

- **Industry promotion:** Organisations that are tasked with regulating an industry and promoting its development may be less inclined to rigorously enforce compliance or may view the interests of regulated firms and the public as synonymous.
- **Revenue collection:** An agency responsible for regulating and collecting revenue from an industry could have incentives to take a weak enforcement approach. For example, the National Commission for the BP Deepwater Horizon Oil Spill (2011) found that the combination of regulatory and royalty collection functions in one agency “led inevitably to internal tensions and a confusion of goals that weakened the agency’s effectiveness and made it more susceptible to outside pressures” (p. 255).

The Victorian State Services Authority concluded that non-regulatory functions such as service delivery should be separated from significant regulatory functions, to avoid confusion about agency responsibilities (VSSA, 2009).

### Aligning incentives in organisational design

Regulators find it hard to carry out some activities. For example, having an agency regulate an industry’s conduct and collect revenues from that industry for the government is likely to create real conflicts or perceptions of conflict that will undermine the agency’s legitimacy. Ideally, regulatory and revenue collection functions should be separate. If they are carried out by the same agency, then there should be clear and strong distinctions between the teams carrying out the functions and their reporting lines (OECD, 2013b).

Giving a regulator the functions to promote an industry can create similar tensions to those that arise with revenue collection, although the extent and severity of the tension depends on the nature of the industry and regulatory system. The key issue with giving regulators the functions to promote industry is whether the industry’s growth is compatible with the objectives of the regulatory regime.

The NZFGC argued that the dual role of the Ministry for Primary Industries as market access negotiator and safety regulator did not present obvious conflicts, as safety was generally a condition of access.

MPI [the Ministry for Primary Industries] is responsible for market access of food products and for their regulation as was the New Zealand Food Safety Authority. The nexus worked excellently in terms of focussing the regulations on the bottom line for population safety and identifying those aspects that are not safety related and are worthy of negotiation. (sub. 35, p. 4)

Aviation New Zealand commented that the CAA’s role in promoting New Zealand offshore reinforced its safety and security objectives, as the ability of New Zealand aviation firms to grow depends on the robustness of our regulatory regime (sub. 36, pp. 6, 8-9).

### The importance of agency mission and culture

The principle of compatibility should also be applied before decisions are taken on agency mergers or new regulatory functions are allocated to an existing agency. In particular, the mission and culture of the existing or new agency must be compatible with the objectives of the new regulatory regime. The New Zealand Council of Trade Unions (CTU) and MBIE highlighted this point in their submissions.

A much more important matter than whether policy and implementation should be split is the objective of the organisation carrying out the policy and/or implementation role. The Objective (such as being ‘business-facing’) can threaten the independence, or perception of independence, of either role. (CTU, sub. 25, p. 15)

From our experience indicators that a regulatory system is not meeting its objectives or may be at risk of systemic regulatory failure include ... organisational norms and values which are not fully aligned with regulatory systems’ objectives. (MBIE, sub. 52, p. 4)

By way of example, the CTU cited Australian research that found that “the location of an OHS [Occupational Health and Safety] inspectorate in a government agency whose primary responsibility is the

economic success and productivity of the very industry it purports to regulate is a prescription for disaster” (CTU sub. 25, pp. 12-13). Regulator culture is discussed in more detail in Chapter 4.

One example where policy advisers did explicitly analyse which agency should be given responsibility for a regime is the Psychoactive Substances Act 2013, where the Ministry of Health assessed six possible agencies against the criterion of “suitability” – that is, “there needs to be an appropriate ‘fit’ between the new regulator and the agency where it sits” (Ministry of Health, 2012, pp. 13-15).

In giving a new regulatory function to an existing agency, care should also be taken to ensure that the new obligations will get sufficient resource and attention. As a Victorian government policy statement on the governance of regulators noted:

Given that regulatory agencies have limited staff and financial resources there will always be competition between various functions for priority. It is important for regulators to ensure their obligations to promote regulatory compliance are given sufficient focus. (Government of Victoria, 2010)

This was one of the issues that the Pike River Royal Commission identified in the Department of Labour’s occupational health and safety role.

Health and safety in New Zealand was not led by a body for which improving health and safety was its sole, or even major, objective. Health and safety was just one of the responsibilities of a department with many responsibilities. This diluted the attention paid to health and safety and contributed to an unwieldy structure in which senior officers had limited opportunities to develop health and safety expertise. (Royal Commission on the Pike River Coal Mine Tragedy, 2012, p. 291)

### F8.5

Before new regulatory functions are allocated to an existing agency, policymakers should assess that the mission of the agency is compatible with the objectives of the new regime, and whether the new functions will get sufficient resource and attention.

## Regulators and the provision of policy advice

Most regulators need policy functions so they can interpret and implement their legislative obligations. As the Victorian Competition and Efficiency Commission observed:

...while elected governments, not regulators, should determine policy objectives ... these objectives are typically identified only in general terms (for example, achieving ‘safety’ and ‘amenity’) and may evolve over time as circumstances change. Many decisions (sometimes by the regulator rather than the government) influence how and to what extent policy objectives are pursued, and the development of new policies. (VCEC, 2005b, p. 303)

Much debate about regulator involvement focuses on strategic policy – that is, developing legislation and subordinate legislation, advising government on how to deliver government programmes, and reviewing legislation or government programmes (see Box 8.4).

### Box 8.4 Submitters’ views on regulators having policy responsibilities

#### **For CAA**

In order to achieve the CAA’s policy obligations, our operational delivery and policy-making needed to be appropriately ‘engaged’, one with the other and with the Ministry of Transport. Regardless of form, an agency such as the CAA needs some policy capability in order to be able to engage with policy agencies – otherwise it is rather like two different language speakers trying to communicate without a translator. The CAA also needs an internal policy capability to develop the systems interventions and internal policy and procedures for its own operations. From the CAA’s perspective, for a regulatory agency not to have some policy capability would reduce the agency’s ability to properly engage in government processes in three ways:

- When it wishes to advocate for a change in policy settings, which might not result in rule (regulatory) changes;

- When being asked by Government to provide advice on policy issues; and
- When engaging in the international arena and seeking to influence international standards beyond simply 'technical requirements'. (sub. 6, p. 17)

### **RBNZ**

Prudential regulation is a highly-specialised and technical area and in practice there is a lot of interaction between the individual teams. This interaction exists in the policy-making stage as well as when it comes to supervision and enforcement of regulatory requirements. The Reserve Bank believes that having all of these functions unified albeit spread across different, specialised teams is the correct approach to prudential supervision. It allows for synergies and economies of scale to be exploited which leads to more efficient regulation and policy-making than other constellations would. Separating policy-making and compliance functions can lead to duplication of effort and raises the scope for misinterpretation of policy aims. (sub. 9, p. 3)

### **CTU**

The experience of implementing and working day-to-day with policies must inform their development or they will be forever repeating previous mistakes. That is much easier done in one organisation, with 'Chinese wall' separation where necessary. In addition, in a country of the size of New Zealand, finding the expertise and experience required for effective policy advice as well as for effective implementation can often be difficult or impossible without thinning both to an unwise level. We believe that the principle of a policy/implementation split should be reviewed. (sub. 25, p. 15)

### ***Against***

#### **ANZ Bank Ltd**

Our primary concern is to ensure that policy-making and regulation are kept distinct in order to improve regulatory processes and outcomes. ...The risks where a regulator has such a role include a number of regulatory shortcomings:

- it affords a regulator discretion as to the objectives it should achieve and how it should achieve those objectives, which can promote unpredictable and inconsistent regulation;
- it limits the role of external accountability mechanisms as regulatory objectives have not been set by an external party to which the regulator is directly responsible; and
- it can frustrate parties that engage in regulatory processes as consultation on policy decisions may not be as open and transparent as for regulatory decisions where the primary concern is implementation to a particular factual context. (sub. 24, p. 8)

#### **Mortlock Consultants Ltd**

There is a fundamental conflict between promoting legislation (and preparing Cabinet requests for approval and drafting instructions) and administering the same legislation. This arrangement reduces the accountability of the legislative-making process, weakens the effective scrutiny of the proposed legislation and creates a significant risk of over-regulation and too much power being vested in the regulatory agency. (sub. 31, p. 7)

### ***Mixed***

#### **Federated Farmers**

Federated Farmers can see advantages and disadvantages from having a split between policy-making agencies (usually a government department) and regulatory agencies (often a separate Crown entity of some sort). (sub. 11, p. 10)

Involving regulators, as the implementers of regimes, in developing strategic policy is critical for good quality outcomes. As Scott stated:

...for strategic policy to have such influence it must be integrated with, and have its foundation in, the regular flow of detailed policy and organisational operations. Otherwise, the grounding of strategy in the practicalities of the daily work of government is lost. Vital information and advice lies with customers and the people who deal with them, in addition to the information from more formal processes of analysis and consideration at the top levels of management. With processes of this kind,

the strategic policy is not only more likely to be robust, but also more likely to be implemented, because the operational managers understand it and have the opportunity to make inputs. (2001, p. 335)

The question is how that involvement should take place, and where the limits are. Ideally, strategic policy development should be structured in a way that taps the expertise and experience of regulators while also providing a dispassionate and balanced assessment of the issue. Regulators providing strategic policy advice as part of a contestable process may also be beneficial.

Problems can arise where regulators have the sole or main responsibility to review underpinning legislative or policy frameworks. Regulators – as the people involved on a daily basis in managing a regime – may be less able than others to step back and coolly assess whether the regime is still required and fit for purpose. As the New Zealand Airports Association observed, regulators may also be less inclined than external parties to identify any problems that their approach to implementation had created (sub. 33, p. 14).

#### F8.6

Regulator involvement in providing strategic policy advice is important for effective regulatory outcomes. Strategic policy should be developed so that it taps the experience of regulators and provides a dispassionate assessment of the issue. To ensure this balanced assessment, regulators should not have the sole or main responsibility for reviewing underpinning frameworks.

### Separating making rules from enforcing rules

A related issue is whether a regulator should have the twin functions of making rules and enforcing them.

A number of submitters, mainly from firms in the energy sector, argued that these functions should be allocated to separate regulatory organisations (Genesis, sub. 48, p. 3; Mighty River Power, sub. 30, p. 11; Vector, sub. 29, p. 27; Minter Ellison Rudd Watts, sub. 28, pp. 12-13; Electricity Networks Association, sub. 27, p. 9; Powerco, sub. 14, p. 3; and Trust Power, sub. 7, p. 4). Possible benefits that submitters cited for separating the two functions included:

- elimination of potential conflicts of interest and encouragement of “the drafting of clear rules that could be readily interpreted and applied by a disinterested body” (Powerco, sub. 14, p. 3);
- enhanced “policy credibility” and reduced uncertainty (Minter Ellison Rudd Watts, sub. 28, p. 13);
- cost savings, due to less need for expensive appeal and merits review processes (Vector, sub. 29, p. 27).

A number of submitters referred to the Australian Energy Regulator (AER) – which monitors and ensures compliance with the regulatory regime – and the Australian Energy Market Commission (AEMC) – which develops and sets rules for energy markets – as examples of a split between those making the rules and those enforcing them.

The question of whether separating the functions would yield net benefits depends on a number of factors.

The APC has considered the question of separation in a number of its inquiries.<sup>43</sup> Although it has often preferred separation, the APC noted that the question of which “governance model is best depends on circumstances. Regulatory separation is justified where gains from increased probity, increased transparency, reduced scope for regulatory error and any other gains in better governance are warranted by the loss of economies of scope or timeliness” (APC, 2001a, p. 305).

The nature and scale of gains from separation are likely to vary, depending on issues such as the details of the regime and the capability of governors and staff in both agencies. For example, the Australian energy regime has structural separation and merits review options; whether separation has created savings through less recourse to merits review is unclear. Similarly, an assessment of the Australian energy merits review

<sup>43</sup> Examples include the review of telecommunication competition regulation (APC, 2001a), price control legislation (APC, 2002a), the national access regime (APC, 2002b), the gas access regime (APC, 2004), and electricity network regulation (APC, 2013c).

process found that the “rule changes currently under consideration by the AEMC tend to have the effect of affording the AER greater discretion in its decision making” (Yarrow, Egan & Tamblyn, 2012a, p. 52). Greater discretion is not necessarily a bad outcome, but it does bring into question arguments that separation inherently reduces uncertainty for regulated firms.

Structural separation often slows down decision-making processes. While slower processes will be beneficial in some cases, in others it will create net costs. In some instances of New Zealand regulation (in particular transport), separating rule-making and rule-enforcement functions appears to have unnecessarily hampered the ability of regulation to keep pace with technology or community expectations. This aspect is described more fully in Chapter 9. In the case of telecommunications regulation, the APC preferred keeping the functions together, on the grounds that a dynamic industry needed prompt regulatory procedures and other remedies would better manage the risks of regulatory creep and bias (APC, 2001a, pp. 305-306).

### **Structural separation is one approach; there are others**

Transparency, probity and good decisions are clearly critical regulatory outcomes. While they are of general importance, they are especially important in regimes where regulatory errors can significantly affect the public.

As the APC’s recommendation on telecommunications regulation indicates (2001a), structural separation is just one way to deliver these outcomes. Other possible options include:

- clear statements of regulatory objectives, with conflicts between objectives eliminated or minimised (as discussed above);
- obligations on regulators to explicitly state how they will interpret their mandate (as recommended above);
- organisational or governance arrangements that give a regulator more independence in decision making (Chapter 9);
- stronger consultation obligations (consultation requirements and regulator engagement more broadly are discussed in more detail in Chapter 6);
- clear review and appeals avenues (Chapter 11); and
- systematic reviews of regulatory regimes, to check they are still fit for purpose and performing efficiently and effectively (Chapter 14).

A combination of these other options may provide equivalent levels of transparency, probity and accuracy, with lower costs or less disruption than a structural solution.

#### **F8.7**

Creating separate bodies so that one body is responsible for making rules and the other for enforcing them can have benefits, such as greater transparency, probity and good decisions. Even so, whether structural separation creates net benefits will depend very much on the details of the regulatory regime. Combinations of other regulatory design options (such as clearer regulatory objectives, stronger reporting and consultation obligations) may provide equivalent benefits, with lower costs and less disruption.

### **Balancing the benefits and costs of distributed regulatory regimes**

In several regulatory regimes in New Zealand, functions are distributed across a number of organisations. While the distribution of functions can ensure that decisions are taken by those with the best information, it can also increase the costs of running the regime and lead to accountability issues.

Examples of distributed regimes include:

- **Hazardous Substances and New Organisms:** the Ministry for the Environment has responsibility for policy and legislation. The EPA assesses requests to import, develop or trial new organisms, sets

standards for the use of hazardous substances and (in some circumstances) issues approvals for the use of these substances. EPA has a role in enforcing HSNO (including through prosecutions), as does:

- WorkSafe for workplaces;
  - Maritime New Zealand for ships;
  - the Civil Aviation Authority for aircraft;
  - New Zealand Customs Service, for imports;
  - the New Zealand Transport Agency and Police for motor vehicles, roads and rail;
  - the Ministry of Health for issues of public health; and
  - local authorities for land use under the Resource Management Act.
- **Anti-Money Laundering (AML)/Countering Financing of Terrorism (CFT):** the Ministry of Justice is responsible for the AML/CFT Act 2009. The Police collect and analyse intelligence on suspicious transactions. Enforcement is primarily divided between three agencies:
    - the RBNZ oversees banks, life insurers and non-bank deposit takers;
    - the FMA oversees issuers of securities, trustee companies, futures dealers, collective investment schemes, brokers, and financial advisers; and
    - the Department of Internal Affairs (DIA) oversees casinos, non-deposit taking lenders, money changers, and any other financial institutions not supervised by other agencies.

The New Zealand Customs Service also has an enforcement role.

There can be good reasons for distributing functions across agencies, including reducing compliance costs for regulated parties and supporting subsidiarity. Where firms or individuals have an existing and regular relationship with a regulator (eg, shipping firms and MNZ), then it may be more efficient to allocate a new regulatory function to that agency to avoid duplicative inspections. Distributing regulatory functions may also promote better decision making and more effective enforcement practice. Regulators with detailed knowledge and regular contact with a sector or occupation are more likely to understand where the risks lie, and target inspections appropriately.

However, distributed regimes can create costs and challenges. To work effectively, distributed regimes require good communication flows between the component parts and high degrees of coordination. These factors are not always present; in its inquiry into local government regulation, the Commission found inadequate feedback loops and poor interaction between central and local government regulatory actors (NZPC, 2013a). Similarly, the recent taskforce into health and safety found a lack of coordination between the “plethora of regulating agencies working in the injury prevention and enforcement space” (Independent Taskforce on Workplace Health and Safety, 2013, p. 21). Distributed enforcement can also lead to inconsistent approaches across different sectors, regions or firms.

Distributed regimes may pose challenges for accountability and the ability to keep regulation up to date, as noted by DIA.

References to the “Minister” and the “Secretary” in the [Films, Videos and Publications Classification] Act refer to the Minister of Internal Affairs and the Secretary for Internal Affairs. This means that the Minister and Secretary are responsible to Parliament for operational aspects of the legislation (including monitoring of OFLC [Office of Film & Literature Classification]), but possess no corresponding ability to propose changes to the legislation when required, as this is the responsibility of the Ministry of Justice. DIA endeavours to work closely with the Ministry of Justice to take a system-wide view of classification issues. However, the priorities of agencies and Ministers may not always align. A separation of powers also raises issues of accountability, as no one agency has a full system perspective, or all the regulatory ‘levers’ at their disposal. (sub. DR 63, p. 2)

DIA concluded that “the default ‘system design’ principle should be consolidation of policy and regulatory accountabilities as far as practicable under one agency and Minister, unless there are particular reasons that merit separation” (sub. DR 63, p. 2).

In general, the Commission agrees that clear accountability lines under one agency and minister are preferable, and this appears to be the practice in many of New Zealand’s regulatory regimes. The Commission also agrees with the implicit assessment in DIA’s submission that separating policy advice and responsibility for legislation between agencies and ministers is unlikely to create more benefits than costs.

Even so, there are likely to always be situations where factors such as compliance costs, specialised expertise and the need for effective inspection argue for a distribution of functions.<sup>44</sup> Where distribution is judged to provide net benefits, design elements can be included to improve the operation and accountability of the regime, including:

- **formal or informal coordination mechanisms, such as MoUs:** these are discussed further below; and
- **a single ministerial point of accountability, supported by appropriate institutions and powers:** one minister should be responsible for the regime, and their ministry should be responsible for policy advice and administration of the legislation. Where coordination or harmonisation of practice is required across multiple agencies, the minister responsible should have clear powers in legislation to issue directions (subject to the constraints that the Crown Entities Act 2004 places on ministers who direct independent bodies).

## Regulatory overlaps and conflicts

Regulatory regimes may not adequately take account of the role of other regulators, or the compliance burden that multiple agencies and regimes place on regulated entities. In part, this reflects the structure of government; regulation that “tends to be developed within individual portfolios or jurisdictions, with those inside a particular ‘silo’ less aware of, or concerned about, outside regulation, or whether information/reporting requirements overlap with those of another portfolio or jurisdiction” (Taskforce on Reducing Regulatory Burdens on Business, 2006, p. 166). The gradual growth of regulatory roles or functions over time is another source of trouble.

Where legislators or governments incrementally add on roles and functions ... there is a blurring of roles and functions which can create a significant barrier to effective regulatory operation due to conflicting mandates. (MNZ, sub. 15, p. 3)

Regulatory overlaps and conflicts appear to be more widespread in countries with federal systems, where the different levels of government may find it hard to coordinate. In this respect, New Zealand’s centralised constitutional system may be beneficial, as it offers more scope to control and reduce regulatory overlap.<sup>45</sup>

Improving underlying frameworks and coordination and management practices can reduce overlaps and conflicts.

### Improving underlying frameworks

The best way to reduce regulatory overlaps is to review the relevant legislative frameworks, as these are the direct cause of conflict. New Zealand regulatory systems can struggle to stay current and coherent, due to a weak review and evaluation culture and difficulties in gaining access to time at Parliament in the absence of a crisis. A more strategic approach is needed when revisiting regulatory regimes, and the Commission sees a case for periodic, systematic and independent reviews of regulation. This case is outlined in Chapter 14.

### Improving coordination and management practices

Coordination and management practices can also help to manage issues that arise from overlapping regulatory regimes. At the less formal end are practices such as regular meetings of agencies acting in a

<sup>44</sup> In its local government inquiry report, the Commission provided a framework for deciding how regulatory responsibilities should be allocated (NZPC 2013a, pp. 103-36).

<sup>45</sup> Even so, the Commission has previously identified coordination problems between central and local government in New Zealand. These problems have impaired the effective operation of regulatory regimes (NZPC, 2013a).

common sector. One example is the Council of Financial Regulators, which brings together the Treasury, RBNZ, FMA and MBIE on a quarterly basis to share information, consider financial market issues and trends, and coordinate responses as needed. More formal practices include cooperative agreements and exemptions.

### Cooperative agreements

Cooperative agreements can help to reduce the conflicting or duplicated obligations of firms by:

- delineating respective roles and responsibilities;
- establishing processes by which regulators will handle cases where more than one agency has an interest; or
- agreeing to common principles or approaches that agencies will apply in enforcing their regimes.

Examples of such agreements include MoUs and shared guidance notes.

New Zealand regulators already use MoUs to manage regulatory overlaps. Of the 18 regulators that the Commission surveyed who identified that their roles overlapped with others, 14 (78%) had formal arrangements such as MoUs in place.

Even so, a formal agreement such as a MoU,

even one recently reviewed, does not guarantee the administration of regulation will improve (that is, reduce costs and/or improve effectiveness), and does not necessarily maximise the opportunities for improvement. Rather, the key determinants of an agreement's benefits are (1) the content of the agreement, (2) the extent to which it adequately addresses areas of shared interest, and reduces overlap and duplication, and (3) the extent to which it is followed in practice. (VCEC, 2009)

To be most effective, cooperative agreements should:

- **be regularly reviewed**, to ensure that they are still fit for purpose and being used effectively;
- **be publicly available** (such as on agency websites), so that the nature of the relationship is clear. Transparency also means that any shortcomings in the agreement "would be more readily recognised", aiding any subsequent review (VCEC, 2009);
- **provide clear guidance to regulated firms and individuals:** agreements such as MoUs are often expressed in terms of high-level principles that the two agencies will follow. To reduce confusion and improve compliance by regulated firms and individuals, plain English guidance material should also be provided, outlining how the agencies will respond in specific circumstances.
- **be empowered by legislation:** ideally, legislation "should explicitly empower regulators to cooperate with other agencies and bodies in pursuit of the regulator's objectives. This will allow regulators to simplify their dealings with business and other entities through delegation, information sharing, joint regulation, and co-regulation" (Government of Victoria, 2010).

Cooperative agreements such as MoUs should not be viewed as a permanent substitute for a clear and efficient distribution of functions, but they can help manage issues until the regulatory regime is more substantively reviewed. The more complicated a cooperative arrangement is, the more likely the underlying regimes will need reviewing.

#### F8.8

Cooperative arrangements like Memoranda of Understanding play an important role in managing regulatory overlaps. To be most effective, they should be reviewed regularly, be publicly available, provide clear guidance to regulated firms and individuals, and be empowered by legislation.

## Exemptions

Exemptions are another way to manage overlaps. One regulator explicitly permits a firm or individual to not comply with their regime, on the grounds that their compliance with another, similar regulatory system provides sufficient assurance.

A New Zealand example of an exemption power is section 148 of the Financial Advisers Act 2008, which allows the FMA to exempt people or services (or classes of people or service) where it is satisfied that:

- (a) the costs of compliance with the relevant obligation—
  - (i) would be unreasonable; or
  - (ii) would not be justified by the benefit of compliance; or
- (b) the relevant person, service, or transaction is subject to the regulations of an overseas jurisdiction and the FMA is satisfied that, in the circumstances, the protection of the New Zealand public is unlikely to be prejudiced. (s 148(2))

The Parliamentary Counsel Office (PCO) identified a number of circumstances where exemptions may be appropriate (Box 8.5).

### Box 8.5 Factors that may indicate there are good reasons for using an exemption power

- *Unforeseeability*: If an area is so complex or is rapidly changing and evolving, it can be difficult to design fixed and certain rules that will work well in all of the circumstances. Issues that were not reasonably foreseeable at the time of the enactment can undermine the effectiveness of the legislation. In these areas, a mechanism for providing some flexibility, built into the legislation, can allow it to respond to changing circumstances and ensure that the underlying policy intent of the legislation is not frustrated.
- *Urgency*: The fact that an area involves unforeseeability is usually not enough on its own to justify an exemption power. In some cases, the most appropriate response to a new situation is to amend the legislation in question. However, in other cases the need for a flexible response within the policy intent of the regulatory legislation is urgent. In these cases, the ability to grant an exemption quickly is important. For example, the exemption regime in the Securities Act 1978 (to be replaced by the Financial Markets Conduct Act 2013) is essential in the context of rapidly changing financial markets.
- *Frequency of change*: An exemption power is more likely to be justified in regulated activities that change frequently. If an area changes infrequently, normal amendment legislation is likely to be the more appropriate response.
- *Unduly onerous or burdensome requirements*: An exemption power is more likely to be justified in areas where participants may be subject to overlapping or even inconsistent legal requirements (whether within New Zealand or overseas). For example, exemptions granted under section 35A of the Financial Reporting Act 1993 recognise that a requirement for an overseas issuer to prepare financial statements in line with New Zealand law may be unjustified where the overseas issuer is required to prepare equivalent financial statements under overseas law.
- *Matters of technical detail*: If a matter involves a significant or controversial change to the law, the decision on the matter should be made by Parliament. If, however, the law needs to be modified in a technical or relatively trivial way (still within the broad policy parameters of the Act), there is a good case for arguing that a regulator should make the decision via an exemption. Examples include technical modifications made by way of exemptions under the Financial Markets Conduct Act 2013 or the Non-bank Deposit Takers Act 2013.

*Source*: Parliamentary Counsel Office, sub. DR 88, pp. 3-4.

**F8.9**

Exemptions can help a regulatory regime adapt to changing circumstances and manage overlaps. They may be appropriate where:

- unforeseeable circumstances may undermine the effectiveness of primary legislation;
- there is a need for urgent action;
- regulated activities change frequently;
- regulated parties are subject to overlapping or inconsistent requirements; or
- there is a need for technical or trivial changes to the law.

Because exemptions can operate like “Henry VIII clauses” (delegated powers that change, repeal or otherwise affect statutes agreed by Parliament), they need to be designed with care. The Regulations Review Committee has recommended that the following safeguards be applied.

An exemption empowering Act should set out clear purposes for the granting of exemptions.

An exemption empowering Act should set out clear criteria for the granting of exemptions. Those criteria should expressly include, at least, a requirement that granting the exemption is consistent with the objectives of the empowering Act, and ideally further guidance.

There should be a requirement to give reasons when an exemption is granted and to state them in the exemption instrument itself.

All exemption-empowering provision should state that exemption instruments granted under them should expire within five years. Exemption instruments should contain a sunset clause to that effect. (Regulations Review Committee, 2008, p. 14)

The Commission agrees with these recommendations, noting comments from PCO that the sunset provision would not prevent a regulator from issuing a new exemption with the same provisions. Rather, it is intended to ensure that exemptions are subject to regular review (PCO, sub. DR 88, p. 6).

Exemptions should be published, unless they are “just a limited concession to an individual” (PCO, sub. DR 88, p. 4). Generally speaking, exemptions are subject to disallowance under the Legislation Act 2012 and should be presented to Parliament for scrutiny by the Regulations Review Committee.

**F8.10**

Exemption powers in new regimes should be specified in primary legislation, including purposes for the granting of exemptions, criteria for their issue, requirements for regulators to give reasons for an exemption, and sunset clauses. Where exemptions are granted by regulators, they (and the reasons for the decision) should generally be published.

## 8.5 Summing up

Clear regulatory roles, duties and objectives are important for operating regulatory regimes effectively and efficiently. But there are a number of reasons why clarity may be lacking, including:

- poor choices of regulatory standards;
- insufficient attention by policymakers to the definition of regulatory objectives;
- placing regulatory responsibilities in agencies that also have functions, missions or cultures that act counter to the objectives of the regime; and
- inadequate consideration by advisers or policymakers in designing a regime to the roles of existing agencies and regimes.

This chapter laid out possible actions to minimise these problems.

While the actions outlined in this chapter will help to reduce the prevalence and impact of poor role clarity, they will not eliminate it. There are at least two structural reasons why clarity is unlikely to ever be fully achieved across all regimes:

- **The sheer volume of legislation already on the statute books works against clarity:** The US Government Accountability Office commented in 1981 that it is “virtually impossible for the Congress not to enact laws whose goals will not compete with other goals previously enacted into law” (US GAO, 1981, p. 23). Similar issues are likely to apply in New Zealand, especially given the country’s comparatively heavy reliance on statutes.
- **Different participants in regulatory regimes bring different perspectives:** As noted above, lawyers, regulators and economists can apply “different interpretative schema” to the same principle or concept. Other stakeholders may bring other views. Although greater efforts to work through these perspectives in the design phase – as recommended in this chapter – should increase the likelihood of reaching consensus on regulatory principles and concepts, they do not **guarantee** agreement.

This is not to say that policymakers should give up the pursuit of clear regulatory roles, duties and objectives. But it is worth viewing this pursuit as an ongoing process – much like the “policy cycle” of design, implement and review – rather than a journey with a fixed destination.

## 9 Regulatory independence and institutional form

### Key points

- There is widespread agreement of the importance of regulation being undertaken by independent regulators. Independence is multi-faceted and is more than a matter of legally designating an agency as “independent”.
- Independence is a key institutional factor that supports regulators adopting effective regulatory strategies. Designers of regulatory regimes must carefully appraise the arguments for and against independence. Arguments for political control must be weighed carefully against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.
- Regulators often have to work with legislation that is outdated or not fit for purpose. Their independence could be enhanced by the greater use of secondary legislation (including that made by regulators), and ensuring greater consistency in allocating legislative material between primary legislation and secondary legislation.
- Submitters had mixed views on who should be delegated authority to make secondary legislation. Regulations made by Governor-General in Council have more checks, but this still relies on policy departments and Cabinet giving high priority to the routine maintenance of often highly technical matters. The Legislation Advisory Committee could expand its guidance on this issue.
- It is inevitable that political imperatives will sometimes diverge from the objectives of independent regulators. While political interference is undesirable, providing transparent mechanisms for political intervention is preferable to undertaking more fundamental and ad hoc regulatory reform to solve political problems. Providing such mechanisms can actually enhance the independence of regulators. This also allows ministers to be properly held to account for their actions.
- Government often uses its contractual levers instead of regulatory powers to manage concerns about the quality of government-funded services. While this may mean any quality concerns are quickly resolved, it can obscure issues about system performance.
- In practice, choices around institutional form are more important because of what they signal about expected independence rather than for the legal constraints and freedoms associated with particular agency forms. As such, careful attention must be paid to establishing clear expectations, norms and cultures in new independent regulators.
- Government has signalled that a new type of institutional form known as a departmental agency could be used to undertake some regulatory functions currently undertaken by Crown entities (which are operationally independent). The Commission is concerned at the potential for confusion around the respective roles and responsibilities of the chief executives and ministers of departmental agencies and host departments.
- Such agencies are not operationally independent, so careful attention will need to be paid to the appropriate degree of independence required of individual regulatory powers as they are transferred.
- Regardless of the advantages or disadvantages of particular institutional forms, the disruptive effect of institutional change on the smooth operation of regulatory functions must be acknowledged. During periods of institutional change, leaders need clear strategies for maintaining the effective operation of regulatory functions.

## 9.1 Regulatory independence

Independent regulators are free from the direct control of politicians and regulated parties. Independence prevents a regulator being used for partisan purposes, and promotes public confidence in the decisions of the regulator. Independence is not a binary condition: regulators can be more or less independent in a range of ways.

The Organisation for Economic Co-operation and Development (OECD, 2013b) says that some of the consequences from a more independent regulator are:

- more credible commitments from government to the administration of regulation over the long term;
- more consistent and stable decision making;
- the avoidance of many potential conflicts of interest; and
- the development of expertise in the regulatory field.

Most submitters agreed that independence was an important feature of regulators.

Carter Holt Harvey supports those aspects of the discussion document which highlight the value of regulatory independence, particularly where the determination of compliance with regulation is a matter of subjective judgement. (sub. 8, p. 8)

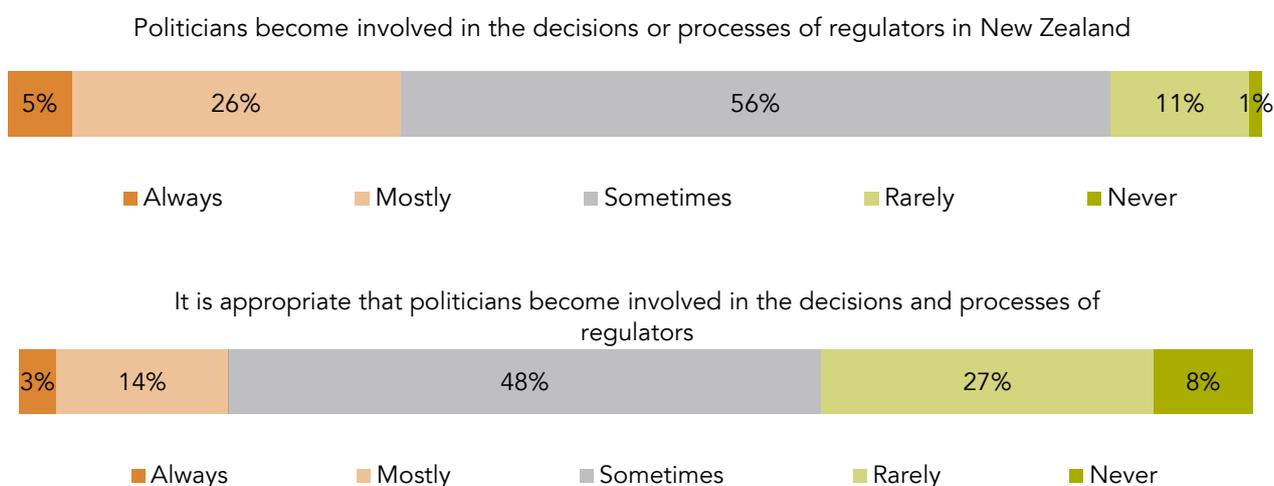
Regulators should be independent both from political interference and from capture by those being regulated. (Federated Farmers, sub. 11, p. 10)

Independence from political interference is viewed as critical in the economic regulation of infrastructure in particular and Ministers should be limited in their ability to direct the regulator. The appropriate mechanism for policy direction by government is by way of legislation, and refining regulatory design arrangements. (Vector, sub. 29, p. 16)

However, submitters were careful to emphasise that independence needed to be accompanied with commensurate accountability.

The Commission's survey of New Zealand businesses (Colmar Brunton, 2013) revealed an overwhelming perception that politicians are involved in regulatory decisions and processes, with 87% believing this is always, mostly, or sometimes the case. Opinion on the appropriateness of this involvement is slightly more divided, but almost two-thirds (65%) indicate it is at least sometimes appropriate (Figure 9.1).

**Figure 9.1 Businesses' perceptions of political involvement in regulatory decisions and processes**



Source: Productivity Commission; Colmar Brunton.

It can be inferred that businesses believe there is more political involvement in regulatory processes than is desirable. Notably, firms in the electricity, gas, water and waste industries were most likely to believe

politicians become involved in regulatory decisions and processes, with 55% reporting this is “always” or “mostly” the case.

However, businesses are clearly comfortable with a reasonable level of political involvement in at least some regulatory decisions and processes. This is a surprising finding that stands in contrast to the views expressed in submissions to the Commission.

## When is independence needed?

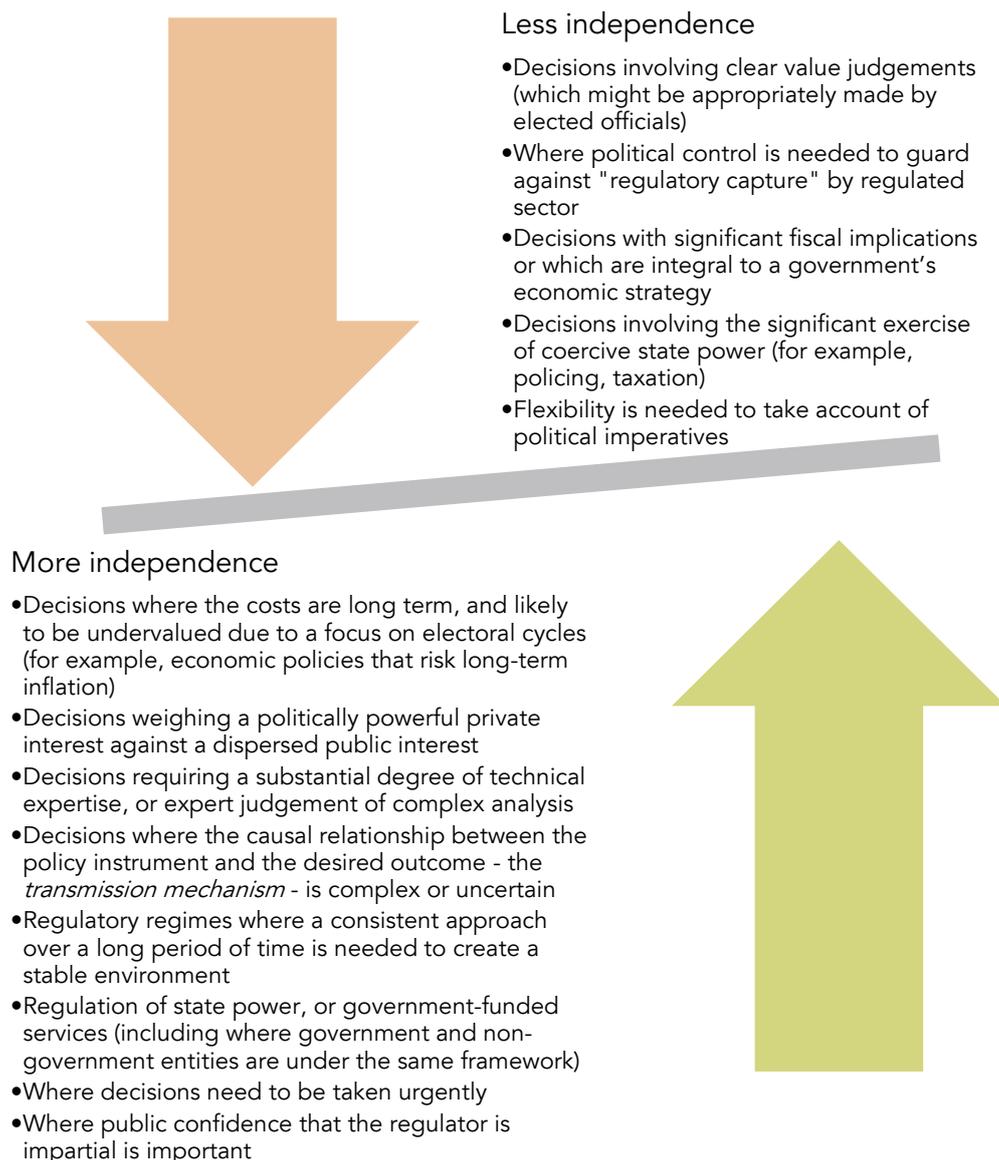
There is a lot of literature about when independent regulators are desirable. Figure 9.2 presents two different views, with the OECD focusing on formal considerations and the Victorian State Services Authority (VSSA) taking a more practical view of the outcomes of independent regulators.

**Figure 9.2** Two views on when independent regulators are desirable



The Commission has developed a framework that draws on a range of sources. It highlights the circumstances that would indicate a need for less or more independent regulation (Figure 9.3).

Public confidence is highlighted by the OECD principles (Figure 9.2), and is also a key factor indicating a need for an independent agency form in the State Services Commission (SSC)’s guidance on machinery of government (2007). As such, public confidence in the impartiality of the regulator has been included in the framework.

**Figure 9.3** Features indicating a need for less or more regulatory independence

This framework also reflects a number of comments and suggestions from submitters on the draft framework presented in the Commission's issues paper (Box 9.1).

#### Box 9.1 Submitters' view on when independence is less or more required

There was general support for the draft framework as a tool for considering when independence should or should not be provided for in the design of regulatory regimes. A number of submitters suggested changes to the framework:

- The Financial Markets Authority (FMA) said: "We support the model, and would perhaps add more independence (but with retrospective review) where a decision must be taken with urgency in the public interest". (sub. 53, p. 4)

The Commission agrees that where there is a need to act swiftly to mitigate a significant identified risk, the ability to respond independently would be necessary.

- Air New Zealand argued there were a number of circumstances where a "NZ Inc." approach should be taken to shaping regulation. It provided the example of authorising international airline alliances, where it thought ministerial decision making was appropriate, because a pure competition approach could not take account of the "diplomatic, international legal and market

distortion considerations”, particularly given the tendency for state ownership in international airlines. (sub. 47, p. 3)

The Commission is wary of this line of argument. Malyshev (n.d., p. 19) argues that independent regulators “shield market interventions from interference from political and private interests” and are particularly necessary for “marking out the separation of the state’s roles as policy-maker and owner of productive assets”, especially where the state has a significant ownership interest in network industries. While the Commission agrees that decisions with significant fiscal implications or which are integral to a government’s economic strategy should not be taken independently of political control, state ownership of firms alone should not justify less independent regulation.

- The New Zealand Food and Grocery Council (NZFGC) took issue with a number of the features that tended to indicate a need for less independence:

NZFGC does not believe that the framework for determining regulatory independence can be considered in isolation. We suspect that “Where political control is needed to guard against regulatory capture” should not feature as an indicator of a regulator needing less independence ... Neither do we agree that less independence should allow for political imperatives nor that government-funded services necessarily warrant more independence ... It is about what works best for a sector and New Zealand rather than hard and fast rules or, in this case, frameworks. (sub. 35, pp. 5-6)

This is an important point: frameworks are a useful guide for the designers of regulatory regimes, but they need to be combined with careful analysis about the particular circumstances rather than being applied in a rote way.

In response to the Commission’s issues paper, submitters also commented on dangers associated with a lack of independence:

- Internet New Zealand argued that political decision making over whether regulation should be applied to services has been lobbied by firms seeking to avoid regulation, to the detriment of the public interest:

Under schedule 3 of the Telecommunications Act, the Telecommunications Commissioner has to recommend to the Minister any new regulated service and the Minister/Government has to accept the recommendation for the regulation to be introduced. This lack of independence was initially considered to be a safety net to allay fears about overzealous regulators. There are instances where those proposed to be regulated have used this safety net to game and significantly delay the regulatory process. (sub. 45, p. 9)

- BusinessNZ noted that a lack of regulator independence can encourage regulated firms to lobby at a political level, rather than engaging with the regulator directly, with the effect of weakening the regulator. Discussing the old electricity regulator, they said:

The Electricity Commission ... combined the worst practice of having multiple and confused objectives, a board appointed exclusively by the Government of the day and a requirement to have regard to government policy statements. In other words, the industry had absolutely no long-term certainty. Ironically, this led to the explosion in the growth of the political market, as industry turned away from trying to influence the design of the electricity market, and instead lobbied Government rather than apply its effort at influencing the regulator. (sub. 19, p. 12)

Defining “value judgements” is difficult. The framework indicates that less regulatory independence may be appropriate for decisions involving clear value judgements, while more independence is appropriate for decisions requiring a substantial degree of technical expertise, or expert judgement of complex analysis. Many such technical decisions will also entail value judgements. In these circumstances it is appropriate to have more independence so that the value judgements can be informed by a proper understanding of the technical matters at stake. The OECD notes:

For example, controversial planning decisions involving weighing up policy objectives are typically made by elected councillors or by a Minister. In contrast, decisions with objective decision criteria, even if they require a degree of judgement, may be most appropriately allocated to a public servant. Where technical or legal expertise is needed, and the decision maker is not an expert, it should be provided in the form of advice, and the appropriate institutional mechanisms should be provided to allow for this. (2013b, p. 35)

Taking into account these features, for most regulatory regimes in New Zealand the scales will be weighed towards more independence, although there will be a number of regimes where less independence is warranted. Given the preponderance of features supporting more independence, and the clarity with which the countervailing considerations can be established, there should be a presumption that regulatory regimes should be administered independently of political control.

In its submission Vodafone argued that:

...a well-informed independent regulator is almost always best able to make dispassionate, technical decisions on issues relating to the regulation of telecommunication markets. ... Independent and well-informed regulators are integral to high quality decision making and a consistent and predictable approach to regulation. (sub. DR 75, pp. 4-5)

2degrees submitted that “[a] credible independent regulator and best practice regulatory framework is fundamental to ensuring a stable and predictable regulatory environment that provides the certainty required to make long term investment decisions” (sub. DR 84, p. 1).

Independent regulation provides a credible long-term commitment to an impartial and stable regulatory environment. This outcome should not be lightly discounted.

### F9.1

Designers of regulatory regimes must carefully assess the arguments for and against regulator independence. Arguments for political control must be weighed against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.

### F9.2

There are a number of situations when it is likely to be appropriate for regulatory regimes to be established independently of political control, including:

- where the costs are long term, and likely to be undervalued due to a focus on electoral cycles;
- where powerful private interests are weighed against a dispersed public interest;
- where a substantial degree of technical expertise, or expert judgement of complex analysis is required; or
- where the causal relationship between the policy instrument and the desired outcome is complex or uncertain.

## Supporting effective regulatory practice

Chapter 3 of this report discusses the factors that influence the behaviour of regulators and regulated parties and ultimately the effectiveness of regulation. Drawing on Baldwin and Black (2008), Chapter 3 emphasises the influence of the broader institutional setting the regulator operates within, in shaping the regulator’s actions and decisions. This broader setting comprises:

... the role of the political and legal infrastructure in which the regulator (state or non-state) is situated in shaping actions and decisions: the patterns of formal and informal control over the regulator, of veto points in decision making ... (Baldwin & Black, 2008, p. 70)

Baldwin and Black (2008) argue that the institutional arrangements under which the regulator is established and operates have an important bearing on its practices.

Guerin (2003) identifies how in the New Zealand context political pressures can lead to the adoption of regulatory regimes or approaches that are poorly targeted at managing risks:

Both ministers and officials tend to be held more accountable for failing to regulate than for regulating at excessive cost, as the former is more transparent and can be held up as the reason for any negative outcomes in the activity to be regulated. Excessive regulation, however, is much harder to detect and the costs will be dispersed among those who are regulated, or those to whom the costs can be passed on.

...

Both ministers and officials face strong incentives to “get something done” and weak incentives to “do it well” or take a longer term perspective (eg, develop improved policy capabilities). The popularisation of concepts such as market failure encourage this approach, while the risk of government or regulatory failure is much harder to explain or is seen as an excuse for inaction. (p. 7)

There will always be uncertainty about risks. Regulators can and do make mistakes in assessing risks, with sometimes tragic results. Even so, with appropriate institutional settings and by adopting effective regulatory strategies, expert regulators will be better at assessing risks and managing them than the media, politicians or the general public.

Institutional arrangements can support or undermine a regulator’s ability to deploy effective regulatory strategies. Misplaced public and political perceptions of risk, and the ability of the public and politicians to pressure regulators into adopting sub-optimal enforcement strategies, threaten a regulator’s effectiveness.

### F9.3

To be effective, an expert regulator must operate within institutional arrangements that let it assess risks objectively and manage risks.

## How is regulator independence achieved?

Malyshev (n.d.) identifies the key mechanisms to protect independence. The four mechanisms are governance structure, transparency of procedures and guarantees for due process, the selection and nomination process, and the financing of the agency.

The OECD (2013b) emphasises that legal status is not a guarantee of actual independence, but that appropriate culture, leadership and relationships are essential components of independent regulatory behaviour. It says independence in decision making can be fostered by:

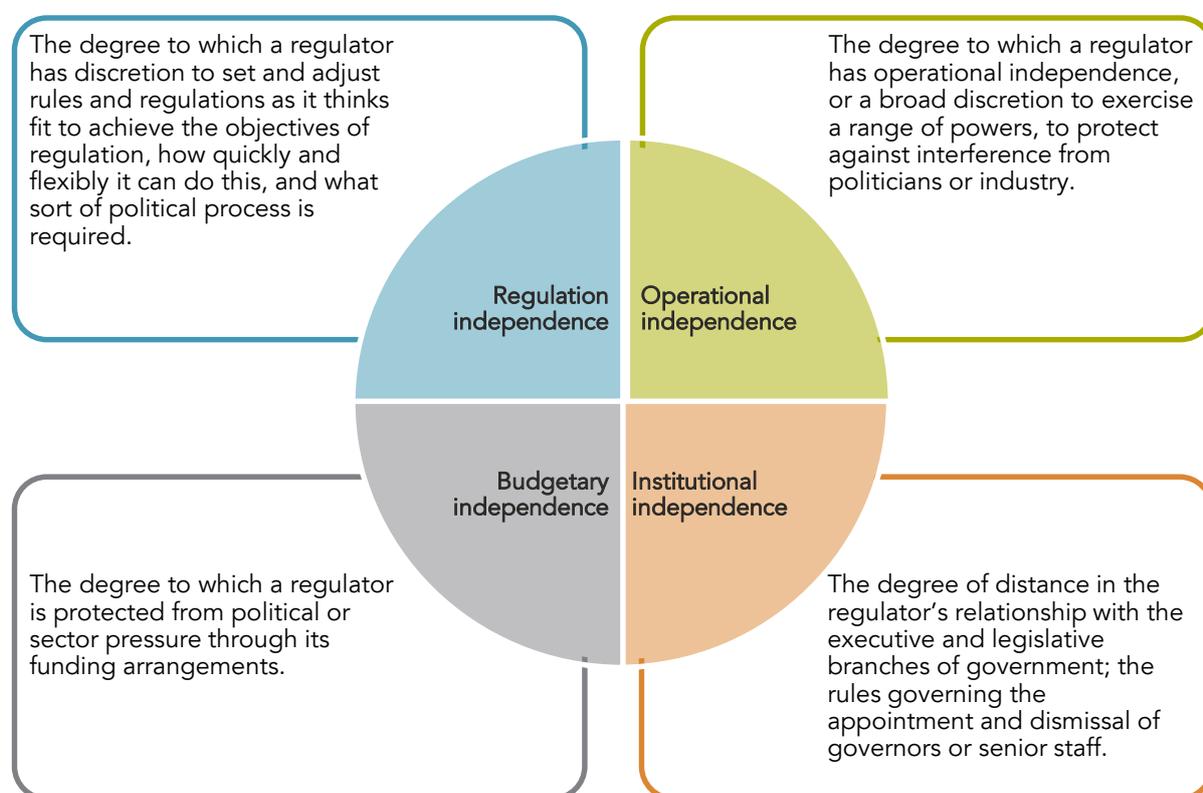
- operational clarity;
- clear articulation of decision-making powers in legislation;
- clarity about requirements to report to the minister;
- definition and clarity around ministers’ power of direction;
- an adequate resource base;
- staffing flexibility (to recruit and retain appropriate staff);
- transparent processes for appointing members of governing bodies and chief executives, and for terminating appointments;
- explicit provisions covering performance criteria and review; and
- limitation on the “post-separation activities” of governors (eg, restrictions on employment in sectors they previously regulated).

VSSA (2009) provided a more concise list, saying that the major requirements for regulatory independence include:

- a statutory foundation for the independence;
- an adequate resource base;
- staffing flexibility;
- operational clarity;
- uncompromised enforcement decision making; and
- transparent methods and terms for appointing governors and senior managers.

Figure 9.4 illustrates the point implicit in the criteria offered by Malyshev, the OECD and VSSA: that independence is multi-faceted and covers significantly more than formal legal designation. A regulator can be independent according to one or more of these dimensions in Figure 9.4, but may have its independence constrained in other dimensions.

**Figure 9.4** Dimensions of regulator independence



*Source:* Adapted from the International Monetary Fund (Quintyn & Taylor, 2004).

Submitters generally thought this framework was helpful in thinking about how New Zealand regulators are independent. The view of Minter Ellison Rudd Watts was typical: "It is not hard to think of examples under each head which would have a serious adverse impact on the ability to deliver a stable and coherent regulatory regime" (sub. 28, p. 24). However, the NZFGC again cautioned against applying the framework too strictly noting: "It is about what works best for a sector rather than hard and fast rules or, in this case, frameworks" (sub. 35, p. 5).

**F9.4**

“Independence” is multi-faceted and covers significantly more than formal legal designation, including:

- the ability to adjust the regulatory settings and rules (regulation independence);
- the ability to undertake functions without interference (operational independence);
- funding arrangements that protect the regulator from external pressure (budgetary independence); and
- formal distance from the Executive and security of tenure for governors and senior management (institutional independence).

Legal independence does not automatically lead to independence in practice. In particular, an agency’s reputation and capability will influence the degree of independence it is accorded, regardless of legal designation. A regulator that is formally within ministerial control will, in practice, be able to act independently if it is held in high regard. A regulator that is formally independent but held in poor esteem by government or regulated firms will find their independence under threat, even with legal protections.

Independent agencies need high quality governance (see Chapter 10), should be as transparent as possible about their activities (see Chapter 8), engage and consult widely (see Chapter 6) and should be subject to robust and proportionate performance monitoring and accountability arrangements (see Chapter 13). Indeed, de facto independence is only sustainable with robust accountability and transparency provisions.

**F9.5**

The independence of regulators needs to be balanced with commensurate obligations to consult and operate transparently. Independent regulators require strong governance, and should be subject to robust and proportionate performance monitoring and accountability arrangements.

Institutional independence will be considered in section 9.2 alongside a discussion of the institutional forms that regulators can take. The other dimensions of independence are considered below.

## Regulation independence

Chapter 2 of this report highlights a tendency for politicians to “set and forget” regulatory regimes, with the only opportunity for revision often occurring in the wake of high-profile regulatory failures (at which point reform may occur too hastily). One regulator told the Commission that they had a standing instruction not to bring legislative problems to their minister. Many submitters – particularly, but not exclusively, regulators – noted the desirability of being able to more easily update regulations than is common in many New Zealand regulatory regimes.

In the course of its engagement the Commission was told that one barrier to maintaining regulatory frameworks is the often inconsistent and inefficient allocation of material between primary legislation and the different types of secondary legislation (regulations made by Governor-General in Council or delegated to ministers and agencies).

For example, the FMA has many regulatory requirements determined through government regulations made by Governor-General in Council, while the Reserve Bank of New Zealand (RBNZ) is able to determine regulatory requirements of a similar significance administratively without requiring approval from ministers or Cabinet:

- The FMA has powers to determine specific requirements for particular regulated entities, but the main requirements are set out in government regulations made by the Governor-General in Council on the recommendation of the Minister of Commerce. The main responsibility for advising on these regulations rests with the Ministry of Business, Innovation and Employment (MBIE), as the policy agency, rather than the FMA.

- In contrast, in the case of the RBNZ, most of the regulatory requirements imposed on affected entities are exercisable by the RBNZ via conditions of registration. Relatively few requirements on regulated entities supervised by the RBNZ are specified in regulations made by Executive Council. Examples are disclosure requirements for banks and prudential requirements for non-bank deposit takers. Unlike the FMA, where MBIE is the government agency with primary responsibility for advising the Minister of Commerce on regulations administered by the FMA, the RBNZ is the principal adviser to the Minister of Finance in respect of regulations it administers. (Indeed, as discussed in Chapter 8, the RBNZ is also the principal adviser to the Minister of Finance in respect of legislation administered by the RBNZ – which is very unusual in any OECD country.)

While there may be sound reasons in some cases for the variation in approach between regulatory regimes, in other cases there appears to be no obvious reason for the different allocation of powers and different levels of regulation independence between them.

The RBNZ submitted that its ability to make rules worked well for itself and regulated entities. It proposed that the difference in powers between itself and the FMA may be because:

...as articulated in the legislation, the Reserve Bank is required to have a sectoral or systemic focus, rather than the consumer protection mandate of the FMA. For this reason, the Reserve Bank needs to be responsive to risks it sees developing in the sector as a whole and vary requirements for individual institutions as necessary to mitigate these risks. (sub. DR 99, p. 2)

This appears to over-state the differences between the institutions' regulatory objectives:

- "promoting the maintenance of a sound and efficient financial system" (section 1A (1)(b) of the Reserve Bank of New Zealand Act 1989); and
- "promot[ing] the confident and informed participation of businesses, investors, and consumers in the financial markets" and "promot[ing] and facilitat[ing] the development of fair, efficient, and transparent financial markets" (section 3 of the Financial Markets Conduct Act 2013).

The Commission does not see a principled or practical reason why the FMA should need to be less responsive to risks than the RBNZ.

As noted in Chapter 2, almost two-thirds of chief executives of regulatory agencies who participated in a Commission survey either agreed or strongly agreed with the proposition that agencies with regulatory functions "often have to work with legislation that is outdated or not fit for purpose" (Figure 2.6). This was also a strong message from the Commission's engagement meetings and in submissions on the issues paper about the regulatory landscape. The case study of New Zealand's regulatory regimes in transportation sectors is illustrative (Box 9.2).

#### Box 9.2 Case study: inflexible regulatory frameworks in the transportation sector

New Zealand transportation regimes are internationally credible and have achieved good safety outcomes. For example, road fatalities have dropped by 47% since 2000. Since the mid-1990s the rate of aviation accidents in the agriculture sector has halved, and aviation accidents in other commercial sectors has declined by almost 90%. The rate of maritime accidents and fatalities has remained relatively steady.

Even so, submissions by the Civil Aviation Authority (CAA), Maritime New Zealand (MNZ), the Ministry of Transport and Aviation New Zealand all highlighted the prescriptive and inflexible nature of the legislative regimes regulating transportation, emphasising that the regimes, because of their legislative structure, were not able to adequately keep pace with technological developments that could improve safety and efficiency.

The general consensus across government and industry is that rules take too long to make, they do not keep pace with changing circumstances, and they discourage efficiency-enhancing innovation. (Ministry of Transport, sub. 39, p. 2)

The CAA noted that, in terms of the Commission’s framework for considering independence, the CAA was weakest in its ability to independently adjust aviation rules (*regulation independence*, according to the framework in Figure 9.4). It noted that technical issues (such as the type of equipment that an aircraft must carry) are only able to be changed through political processes, and that this inhibits the CAA’s ability to ensure that the rules remain “technically current” (sub. 6, p. 21).

Aviation New Zealand agreed: “The Civil Aviation Act was world class and leading edge when written in 1990. It has not been modernized since”. This has had a “debilitating impact on the sector’s productivity” (sub. 26, p. 2).

Similarly, MNZ noted that:

In the transport sector the delegated legislative regime rests with the Minister of Transport, leaving little or no ability for the statutory regulators to issue standards that routinely change to meet technological advancements or changes in international requirements. This results in outdated, inefficient and sometimes harmful regimes that cannot maintain pace with industry and community expectations. (sub. 14, p. 2)

In the view of MNZ, this type of legislative framework can force entities to behave in ways that are wholly undesirable:

Entities feel compelled to interpret their law in a strained and unexpected manner to meet expectations causing them to breach the law and/or breach rights which in turn results in a diminished level of public confidence and in some cases can cause social harms. (sub. 14, p. 3)

These concerns are echoed in the 2013 Performance Improvement Framework review of the Ministry of Transport. The review notes that the respective roles and responsibilities between the Ministry and transport sector Crown entities lack clarity, with the Ministry focusing unduly on what it describes as the “retail” level of regulation where other agencies have a competitive advantage, and not enough on the strategic regulatory framework:

The Ministry needs to exit the ‘retail’ level of regulation, leaving much of this to the Crown entities. It should focus on the quality and effectiveness of frameworks of regulation and the promotion of good regulatory practices and sound advice on the subject. But this requires a sound and reliable process of engagement with the Crown entities that will take more of the detailed responsibilities for regulations and rules. It is not simply a matter of exiting the activity as there have been instances where Crown entities put forward rules for adoption that had not been sufficiently developed.

An area frequently raised in our interviews was the process used for the development of rules. Some of the comments we received were that the demand for rules is well above what the Ministry can deliver. It was recognised that urgent rule changes can be put in place quickly but the process for non-urgent rules still takes far too long. This reflected the fact that the system was not working properly. (SSC, New Zealand Treasury & DPMC, 2013a, pp. 24-25)

*Source:* Subs. 6, 14, 26, 39; SSC, New Zealand Treasury & DPMC, 2013a.

The Ministry of Transport notes that a regulatory reform programme, including a project to improve the quality of rules in the transport sector, has been underway since 2010 (sub. 39). However, a review of the rules will not address the underlying causes of the outdated arrangements, and so it is likely that the rules will again in the future fail to provide for improved safety and efficiency measures as technology continues to advance.

The Ministry of Transport is also currently reviewing the Civil Aviation Act 1990 to assess how “fit for purpose” the regime is, and has commissioned research to identify where regulations, or their application, may be exacerbating market inefficiencies. The Commission supports this work.

A more flexible legislative framework will also fail to keep pace with developments if there is insufficient funding for maintaining the regime. Aviation New Zealand notes that resource constraints are also a driver of outdated regulation in the aviation sector (sub. DR 61).

**F9.6**

As regulatory legislation is reviewed, designers should consider how the regime can be flexible enough to take account of ongoing technological developments.

Delegating authority to the Minister of Transport to make rules under the transportation sector regulatory regimes has been effective in allowing urgent rule changes to be made swiftly. However, to the extent that regulations made by the Minister are in practice subject to Cabinet processes (Box 9.3), this offers few advantages compared to government regulations made by the Governor-General in Council.

**Box 9.3 Cabinet Manual rules on items that Cabinet should consider**

5.11 As a general rule, Ministers should put before their colleagues the sorts of issues on which they themselves would wish to be consulted. Ministers should keep their colleagues informed about matters of public interest, importance, or controversy. Where there is uncertainty about the level and type of consideration needed, Ministers should seek advice from the Prime Minister or the Secretary of the Cabinet. Similarly, departments should seek advice from the office of the portfolio Minister, or from the Cabinet Office.

5.12 The following matters must be submitted to Cabinet (through the appropriate committee):

- a. significant policy issues;
- b. controversial matters;
- c. proposals that affect the government's financial position, or important financial commitments;
- d. proposals that affect New Zealand's constitutional arrangements (see paragraph 5.72);
- e. matters concerning the machinery of government;
- f. discussion and public consultation documents (before release);
- g. reports of a substantive nature relating to government policy or government agencies;
- h. proposals involving new legislation or regulations (see Chapter 7 and the CabGuide);
- i. government responses to select committee recommendations and Law Commission reports (see paragraphs 7.108 - 7.111, and the CabGuide);
- j. matters concerning the portfolio interests of a number of Ministers (particularly where agreement cannot be reached);
- k. significant statutory decisions (see paragraphs 5.31 - 5.35);
- l. all but the most minor public appointments (see the CabGuide);
- m. international treaties and agreements (see paragraphs 5.73 - 5.74);
- n. any proposals to amend the provisions of the Cabinet Manual.

5.13 Matters that should not, as a general rule, be brought to Cabinet include:

- a. matters concerning the day-to-day management of a portfolio that have been delegated to a department;
- b. operational (non-policy) statutory functions;
- c. the exercise of statutory decision making powers (within existing policy) concerning individuals.

It may, nonetheless, be appropriate to bring an item in this list to Cabinet's attention if it is significant or likely to be controversial.

*Source:* Cabinet Office, 2008.

On one hand it appears that a conservative approach is taken to bringing regulation-making decisions to Cabinet, compared to the requirements of the Cabinet Manual. On the other hand, there is a risk that

regulation-making powers delegated to ministers might be exercised yet more cautiously where ministers are not able to formally seek the approval of colleagues to proposed changes.

## Operational independence

Operational independence is the degree to which the regulator can flexibly undertake its powers and functions.

In the course of its engagement, the Commission's attention was drawn to an example of where a regulator was unable to flexibly undertake its functions, not because of political interference but because legislation is overly prescriptive about the exercise of those functions (Box 9.4).

### Box 9.4 Legislative requirements about how the Real Estate Agents Authority must manage public complaints

The Real Estate Agents Act 2008 introduced government regulation of real estate agents following a loss of public confidence in the self-regulatory regime under the old Real Estate Agents Act 1976 and government dissatisfaction at the profession's proposals to improve self-regulation.

In particular, the Associate Minister of Justice expressed concern at the unsatisfactory handling of complaints by the Real Estate Institute of New Zealand (REINZ), noting that in 2004 the REINZ received 132 complaints but none were referred to the Licensing Board, and in 2005 only seven of the 163 complaints it received were referred to the Board. Other concerns raised by the Minister included long delays in processing complaints, and allegations of poor quality investigations (Cosgrove, 2007).

As a result, the 2008 Act established very detailed and prescriptive requirements for the handling of complaints. Section 74 of the Act requires that every complaint be referred to a Complaints Assessment Committee (CAC), and sections 75-96 describe how the CAC will handle those complaints. Even if a real estate agent acknowledged the merit of a complaint and acceptable restitution was made, it appears that the legislation would still require the complaint to go through this process.

This is an understandable reaction to the deficiencies identified in the old regime. However, the requirement that every complaint be considered by CAC does not appear to be conducive to the swift resolution of complaints in a way that will best protect members of the public, and appears not to support the regulator achieving the desired outcomes of the regime in an effective and efficient way.

*Source:* Cosgrove, 2007; Real Estate Agents Act 2008.

## Budgetary independence

VSSA (2009) citing OECD (2003) says that funding mechanisms can have a significant impact on independence. Where a regulator is dependent on government funds, its independence can be compromised; where dependent on fees and levies, it can be susceptible to lobbying and capture.

The Council of Trade Unions (CTU) said there was "an argument for longer term funding of regulators. It would give them greater independence, and allow them to take the longer term view that is frequently required" (sub. 25, p. 23).

Few submitters identified significant concerns around the budgetary independence of New Zealand regulators. 2degrees considered that funding constraints were preventing the Commerce Commission from properly discharging some of its powers and functions under the Telecommunications Act (sub. DR 84).

Chapter 12 discusses the funding of regulators more generally.

## Improving regulation and operational independence

### There is scope for the greater use of delegated legislation

The problems of *operational independence* experienced by the Real Estate Agents Authority and the outdated legislative frameworks that other regulators grapple with due to their lack of *regulation independence* are both related to the drafting of legislation. A particular issue is the allocation of legislative material between primary legislation and the types of secondary legislation (government regulations made by the Governor-General in Council or deemed regulations made by ministers or officials).

Commonly accepted principles guide the appropriate use of secondary legislation. The Cabinet Manual 2008 summarises the principles as

Regulations usually deal with matters of detail or implementation, matters of a technical nature, or matters likely to require frequent alteration or updating. ... Regulations should not, in general, deal with matters of substantive policy, have retrospective operation, purport to levy taxes or contain provisions that purport to amend primary legislation. (Cabinet Office, 2008, cl 7.77)

The Legislation Advisory Committee (LAC) guidelines (2012a) provide useful advice on what material is suited to primary legislation or secondary legislation, including an important warning that some things will almost always need to be in primary legislation, including:

- significant policy matters;
- provisions that affect fundamental rights and freedoms;
- rights of appeal;
- provisions that vary the common law;
- the creation of offences and significant penalties;
- the imposition of taxes;
- the creation of new agencies or offices; and
- retrospective changes.

Despite these guidelines, it is clear from the submissions and the Commission's research that the practice in allocating material between primary legislation and secondary legislation is inconsistent. Burrows (2011) provides two examples:

First, the Transport Rules ("the Rules"), which are of course delegated legislation, contain some of the most important legal rules in our community. We must abide by them every day. The rule that we must drive on the left hand side of the road is part of the Rules. However, the rule that I must tie a load on a trailer securely was enacted by Parliament in s 9 of the Land Transport Act 1998. I have no idea why. Then, in our corrections legislation, the rules about treatment of prisoners are oddly divided between Act and regulations. The rule confining the use of batons by prison wardens is in reg 123 [of] the Corrections Regulations 2005. Yet the rule that a prisoner's bedding must be laundered regularly is in s 71 of the Corrections Act 2005. I cannot explain that distinction either. (pp. 67-68)

The Regulations Review Committee (RRC) "examines all regulations", "may consider any matter relating to regulations and report on it to the House" and "investigates complaints about the operation of regulations, in accordance with Standing Order 316, and may report on the complaints to the House" (Standing Order 314). It looks at all bills being considered by other select committees, and advises those select committees on whether the allocation of material between primary legislation, government regulations and deemed regulations is appropriate and consistent with LAC guidelines. Officials who provide support to the RRC told the Commission that such advice is rarely accepted. This is regrettable. The chair of the RRC was more optimistic about its influence on other select committees. Similarly, Carter, McHerron and Malone consider that the RRC is "mostly successful in persuading subject select committees to adopt its recommendations" (2013, p. 167). Systematically tracking which of the RRC's recommendations were taken up by select committees would require more resource than is available to support the RRC.

The Parliamentary Counsel Office (PCO) agreed that there is inconsistent allocation of legislative provisions between primary legislation and types of secondary legislation. It says there are a number of reasons for this inconsistency, including:

- the legislative history and drafting style of New Zealand;
- legislative drafting trends;
- the particular subject area and its jurisprudential history (both in the courts and in legislation);
- the speed with which the primary legislation is required to be drafted for enactment;
- the level of policy development that has occurred before primary legislation is drafted;
- the need to follow Cabinet policy decisions that have been made. (sub. DR 88, p. 8)

The speed of the policy and legislative process emerges from PCO's submission as a major driver of this:

...the opportunity for revision of regulatory regimes often occurs only in the wake of high-profile regulatory failures at which point reform tends to occur too hastily. Both primary and secondary legislation is often made in circumstances that respond to political and media-drive pressures, particularly around time frames and the desire for piecemeal amendment in order to provide an immediate "fix" rather than comprehensive reviews. In these circumstances, there is usually not time (or patience) for thorough regulatory and legislative design work.

In our experience, decisions about the overall legislative scheme are usually made well before instructions are sent to the PCO, or, perversely, it is not considered until after a Bill has been enacted, resulting in legislation that is drafted in independent tiers (primary, secondary and tertiary). (sub. DR 88, p. 10)

We note that some of the reasons for the differences (eg part of the policy not developed until long after primary legislation is passed) will be difficult to overcome by ordinary mechanisms. (sub. DR 88, p. 8)

PCO's submission expresses the view that leadership from the minister with responsibility for regulatory management could contribute to a more sensible allocation of provisions (see Chapter 16). Other recommendations in this report that seek to promote a more considered policy, drafting and legislative process, including the use of exposure drafts (see Chapter 8) and more regular cycles of regime review (Chapter 14) could also assist. There may also be possible improvements to the Regulatory Impact Analysis and Legislative Design Committee processes (see Chapter 16).

Greater consistency in allocating legislative material between primary legislation and the types of secondary legislation would promote the efficient and effective administration of legislative regimes. PCO noted that the overall coherence and design of the legislative scheme is more important than the allocation of provisions between types of legislation, but submitted that

... having the Minister [for Regulatory Reform] undertake a principle-based review of regulatory legislation could be a useful exercise and would hopefully form a platform from which the Minister could provide stronger leadership and better mechanisms to ensure greater consistency in the approach that is required to be taken in allocating material between primary legislation and secondary legislation. (sub. DR 88, p. 9)

#### F9.7

There is inconsistent allocation of legislative provisions between primary legislation and types of secondary legislation in regulatory regimes. There is evidence that existing mechanisms to promote greater consistency are ineffective.

#### R9.1

The minister with responsibility for regulatory management should coordinate a principle-based review of regulatory legislation to ensure greater consistency in allocation of legislation material between primary legislation and types of secondary legislation.

Geiringer, Higbee and McLeay provide evidence of New Zealand's extreme preference for primary legislation:

For example, the United Kingdom House of Commons passes fewer bills each year than does the New Zealand House of Representatives, despite the disparities in the sizes of the two countries, but relies far more heavily on delegated legislation. To illustrate, in the year ending 30 June 2010 the Office of the Clerk of the New Zealand House of Representatives prepared 95 bills for royal assent. The United Kingdom government website lists only 41 public general acts and five local acts enacted by the United Kingdom Parliament that year. On the other hand, the New Zealand government website lists 223 new pieces of delegated legislation published in the Statutory Regulations Series in 2010. In contrast, the United Kingdom government website lists 2,801 statutory instruments for that year. Based on these figures, the ratio of primary to secondary legislation was approximately 1:2 in New Zealand and 1:70 in the United Kingdom. (2011a, pp. 128-129)

Replicating this data over a longer time period confirms their general finding (Table 9.1).

**Table 9.1 Annual legislation in New Zealand and the United Kingdom**

Year	Number of Public Acts passed in New Zealand	Number of Regulations introduced in New Zealand	Number of UK Public and General Acts passed	Number of UK Statutory Instruments promulgated (excluding deemed regulations)
1996	161	389	63	2073
1997	110	377	69	1840
1998	123	467	49	1826
1999	69	432	35	1974
2000	96	286	45	1865
2001	106	422	25	2285
2002	86	424	44	1955
2003	129	398	45	1844
2004	116	476	38	1803
2005	126	351	24	1877
2006	91	400	55	1776
2007	113	408	31	1854
2008	111	456	33	1664
2009	70	424	27	2008
2010	139	491	41	2947
2011	98	433	25	3131
2012	124	425	23	3327
2013	150	499	33	3292

Source: Data provided by the New Zealand Treasury; [www.legislation.gov.uk](http://www.legislation.gov.uk)

Raw numbers do not tell the whole story; for example, more pieces of legislation are passed by the Commonwealth of Australia each year than New Zealand. A number of Parliamentary and public service officials who have worked in other countries, including Australia and the United Kingdom, confirmed to the Commission that New Zealand is an outlier in terms of its preference for the degree of detail contained in primary legislation, and for its relative reluctance to use delegated legislation.

Guidance in the United Kingdom and Australia acknowledges that the likelihood of needing to adjust legislative requirements is a factor to be considered in deciding whether to include provisions in primary or secondary legislation (Box 9.5)

### Box 9.5 Overseas guidance on delegated legislation

#### United Kingdom

There has been delegated legislation in England since the fourteenth century.

The UK Cabinet Office's *Guide to Making Legislation* (2013) gives guidance as the factors to consider when deciding whether to make provision in primary or secondary legislation:

- the matters in question may need adjusting more often than it would be sensible for Parliament to legislate for by primary legislation;
- there may be rules which will be better made after some experience of administering the new Act and which it is not essential to have as soon as it begins to operate;
- the use of delegated powers in a particular area may have strong precedent and be uncontroversial;
- there may be transitional and technical matters which it would be appropriate to deal with by delegated powers.

On the other hand:

- the matters, though detailed, may be so much of the essence of the bill that Parliament ought to consider them along with the rest of the bill;
- the matters may raise controversial issues running through the bill which it would be better for Parliament to decide once in principle rather than arguing several times over (and so taking up scarce parliamentary time).

The guidelines advise that the government will need to justify any delegated powers and the chosen level of parliamentary scrutiny (whether they should be subject to parliamentary control and, if so, in what form of control – negative or affirmative). The government would outline this in a Delegated Powers Memorandum submitted to the House of Lords Delegated Power and Regulatory Reform Committee.

#### Canada

In Canada, primary legislation is used to set out the framework and principles of a regulatory scheme. The details and procedure to implement that scheme is set out in secondary legislation. Official guidance provides that “[m]atters of fundamental importance should be dealt with in the bill so that parliamentarians have a chance to consider and debate them”.

The *Guide to Making Federal Acts and Regulations* advises that most legislative schemes depend on regulations to make them work, “so an Act and the regulations should be developed together to ensure a good match”.

Specific drafting authority and justification is required to draft certain regulation-making powers, including powers that substantially affect personal rights and liberties, involve important matters of policy or principle, are retroactive regulations, exclude the court’s jurisdiction, impose a charge on the public, or set penalties.

#### Australia

The *Legislation Handbook* (2000) produced by the Department of the Prime Minister and Cabinet advises some matters should only be implemented through primary legislation. They include:

- appropriation, taxes, or levies;
- significant questions of policy;
- rules that significantly impact on individual rights and liberties;
- procedural matters that go to the essence of the legislative scheme;
- provisions that impose offences or administrative penalties.

Matters of detail and matters liable to frequent change should be dealt with by subordinate legislation.

The *Legislation Handbook* notes however that the decision as to whether a particular matter should be included in primary or secondary legislation may be influenced by the nature of the subject matter and a variety of other factors.

*Source:* Cabinet Office, UK, 2013; Privy Council Office, Canada, 2001; Department of the Prime Minister and Cabinet, Australia, 2000.

### F9.8

Overseas guidance acknowledges that a need to regularly adjust legislative provisions can support placing those provisions in secondary legislation.

The six reasons traditionally cited to justify delegated legislation are:

- the pressure of parliamentary time;
- the technicality of the subject matter;
- any unforeseen contingencies that may arise during the introduction of large and complex schemes of reform;
- the need for flexibility;
- an opportunity for experiment; and
- emergency conditions requiring speedy or instant action. (Donoughmore Committee (UK) 1932 report on ministerial powers, quoted in Malone & Miller, 2012, p. 3)

The key countervailing consideration is one of democratic legitimacy. In 1929 Lord Hewart of Bury wrote that, in the United Kingdom, secondary legislation had become “a persistent and well-contrived system, intended to produce, and in practice producing, a despotic power which [...] places government departments above the sovereignty of Parliament and beyond the jurisdiction of the courts” (Malone & Miller, 2012, p. 5).

One of the clearest examples of broad regulation-making power in New Zealand was the Economic Stabilisation Act 1948. Its purpose was “to promote the economic stability of New Zealand”, and section 11 allowed the Governor-General to make regulations “as appear to him to be necessary or expedient for the general purposes of this Act”. Through section 11 the Executive could, in the words of Sir Robert Muldoon, “do anything provided you can hang your hat on economic stabilisation” including implementing wage, price and rent freezes (Malone & Miller, 2012, p. 4).

PCO submitted that:

There is a worrying trend for primary legislation to be overly-prescriptive and to address matters in increasing detail. This removes flexibility and results in more amendments being required over time.

For example, procedural processes should not be set out in detail in primary legislation. ...

In our view, a lot of this over-prescription is due to increasing pressure to achieve certainty, often in an attempt to ensure there is a “stable, predictable and effective regulatory environment that encourages investment” (to use the words from page 107 of the draft report). There is an increasing unwillingness to leave unsaid things that don’t need to be said. We are frequently pressured to cover-off things that are already provided for in the Interpretation Act 1999, or “for the avoidance of doubt”, or that are simply not necessary.

We are also noticing a worrying trend emerging where we are being told to put non-legislative material into primary legislation. Accordingly, the issue is wider than simply whether material should be allocated to primary or secondary legislation. The first questions to ask is, does the matter need to be dealt with by legislation at all? Could it be dealt with by other means? ...

In our view, it would be useful if primary legislation was more focussed on matters of policy and principle, rather than the detail. We don’t think greater consistency in allocating legislative provisions between primary and secondary legislation would reduce complexity (as stated on page 103 of the draft report), but we agree that it will promote the efficient and effective administration of legislative regimes (as the draft report goes on to say). (sub. DR 88, pp. 8-9)

PCO notes that New Zealand has a particularly strong aversion to Henry VIII clauses (provisions in secondary legislation that allow the amendment of primary legislation) compared to the United Kingdom. “It is worth noting that the need for a Henry VIII clause does tend to raise the question, would the matter that is to be amended have been better placed in secondary legislation to begin with?” (sub. DR 88, p. 23)

Given the pressures on parliamentary and ministerial time, there appears to be significant scope for greater use of secondary legislation, subject to a number of controls. This was supported by a number of submitters.

...in principle, legislation should be designed in a way that is flexible enough to accommodate changing circumstances, with matters of administration or technical detail delivered through secondary legislation whenever possible. (DIA, sub. DR 63, p. 3)

### F9.9

There is scope for the greater use of delegated legislation, subject to stronger controls discussed in this report, to ensure regulation can keep pace with technological and other developments. Designers of regulatory regimes need to consider whether delegation could help future-proof the regime, particularly in areas subject to technological or other changes.

## Who should have powers to make delegated legislation?

The Commission was told by regulators who have worked in New Zealand and foreign jurisdictions that New Zealand uses regulations that can be amended by regulators themselves relatively infrequently. It appears, for example that Australia and the United Kingdom make significantly greater use of regulations that a regulator can set, but which a parliamentary committee can disallow. Gill (2011) notes that Cabinet government is stronger and more active in New Zealand than in Australia at the federal, state or territory level. Where Parliament delegates legislative powers, it mainly creates government regulations made by Governor-General in Council. This requires ministerial leadership to steer changes to regulations through the Cabinet and Executive Council processes.

Despite the broad agreement that there is scope for the greater use of delegated legislation, a number of submitters expressed the view that while delegating more to Executive Council might be desirable, delegating to regulatory Crown entities would be a bridge too far. This view was commonly expressed by departments.

The Ministry of Transport was only comfortable delegating rule-making powers to regulators where there would be “no or very limited regulatory impact, and where a regulatory impact assessment would not be required” (sub. DR 94, p. 9).

The Treasury and the SSC noted that

... greater use of delegated legislation does not have to mean greater delegation of legislative powers to regulators themselves. Legislative instruments made by Order in Council are not subject to the same bottlenecks as primary legislation, but are generally subject to more disciplines (e.g. regulatory impact analysis, Cabinet consultation requirements, legislative drafting by Parliamentary Counsel) than is normally the case with instruments made by regulators. (sub. DR 97, p. 11)

The Ministry for Primary Industries (MPI) was more cautious about the value of Cabinet oversight.

Currently, Cabinet exercises a unifying control over and coordination of most regulatory activities in New Zealand. Cabinet requirements (as set out in the Cabinet Manual) contribute to regulatory quality that is absent from some of the lower-level regulation that is not subject to Cabinet scrutiny. On the other hand, much regulation is of a highly technical nature and New Zealand's Cabinet is extremely busy in comparison to its overseas equivalents. Cabinet scrutiny in its current form may, therefore, not be adding as much value to the regulatory process as it could. (sub. DR 102, p. 4)

Some Crown entities were more positive about delegating responsibility to regulators. The New Zealand Transport Agency (NZTA) submitted that "appropriate monitoring by oversight agencies (the Ministry of Transport in our case)" would "enable Crown agencies like the Transport Agency to better prioritise their resources to ensure technical rules are up to date and fit for purpose". NZTA noted, though, that the major barrier at present is not the mechanism to update rules, but "the lack of available policy development capacity to refresh primary legislative settings" (sub. DR 85, p. 1).

MNZ "strongly supported" more delegated legislative authority:

We consider the majority of maritime regulation to be narrowly focused on a specialist sector that seeks a more responsive regulatory regime and we consider this finding vital in advancing an appropriate solution to that problem. (sub. DR 95, p. 5)

The FMA submitted:

We share the Commission's concern that regulatory regimes have been allowed to go stale, and struggle to keep pace with industry changes. We have seen this with financial markets regulation in the past. We agree that greater use could be made of tertiary rule-making powers vested in regulators. (sub. DR 90, p. 3)

PCO agreed that there is scope for greater delegation of authority to regulators to make tertiary legislation, subject to controls. But they also noted risks, including the proliferation of subordinate legislation as a result of poor regime design: "Put simply, there is something wrong with the design if the outcome is 439 tertiary instruments" (sub. DR 88, p. 11). This means more time and attention needs to be paid to the structure of the entire legislative framework (see Chapter 16).

Reports by the RRC have identified four principles that should be taken into account when delegating responsibility for making secondary legislation to ministers or officials (deemed regulations), and have described the circumstances in which deemed regulations may be justified (Figure 9.5).

While there are benefits to the additional scrutiny associated with regulations made by Governor-General in Council, many regulations are highly technical and better delegated to expert agencies.

The Commission remains persuaded that primary legislation in New Zealand is overly detailed, and that part of the solution lies in making greater use of delegated legislation. This will inevitably include a combination of regulations made by Governor-General in Council and by regulatory agencies.

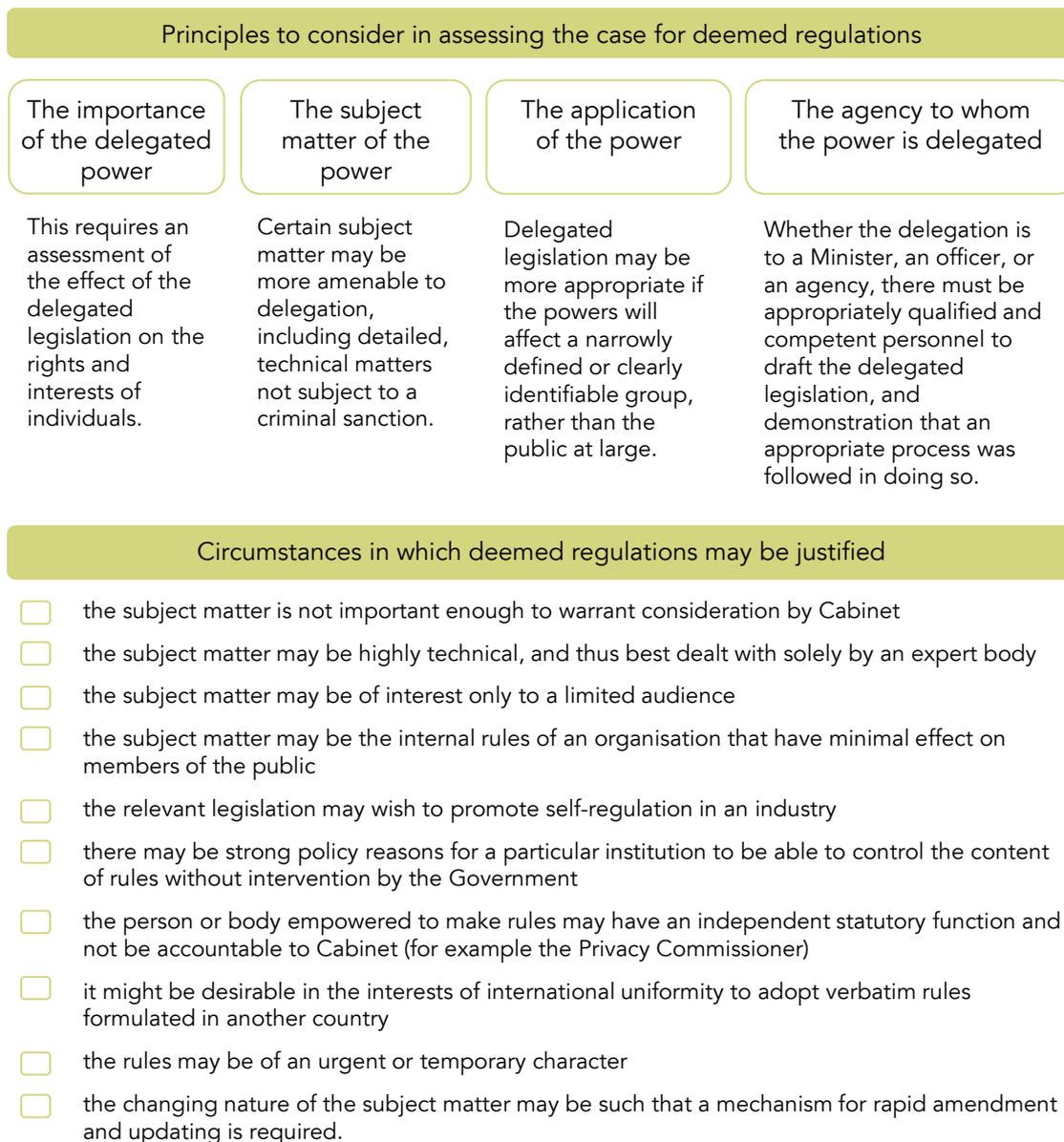
The Commission heard from regulators (whether departments or Crown entities) who reported significant frustration where other departments are responsible for maintaining the legislative framework. The regulators reported a lack of priority being given to necessary legislative fixes not just by Parliament but also the policy department, including a lack of investment in necessary policy capability.

But the Commission is not best placed to advise on the precise circumstances when delegating authority to the Governor-General in Council or to regulatory agencies might be more appropriate. There is a gap in the available guidance:

The guidance currently available from the Legislation Advisory Committee focuses on the distinction between primary and secondary legislation, and the guidance of the Regulations Review Committee focuses on the distinction between 'regulations' and 'deemed regulation', but not other instruments that are not subject to oversight by that committee. (MPI, sub. DR 102, p. 4)

The LAC could usefully elaborate its guidelines on this point.

**Figure 9.5 Regulations Review Committee guidance on use of deemed regulations**



Source: Regulations Review Committee, 1999 and 2004.

### R9.2

The Legislation Advisory Committee should expand its guidelines to describe the situations where different types of delegated legislation are appropriate, including delegating authority to the Governor-General in Council and to regulators.

## There need to be appropriate checks on delegated legislation

As noted above, in practice regulators' independence relies on them maintaining ministerial and public confidence in their capability and expertise. This will also be the case in delegating to them greater authority to make regulations. Regulators will need to understand and articulate the trade-offs between continuity and change in the rules, and benefits and costs to regulated parties and the wider public. Sound processes and consultation requirements can make sure these are taken into account.

Appropriate controls include obliging the agency delegated the regulation-making power to consult on proposed changes, ensuring the regulations are gazetted, ensuring they are reviewed by the RRC, and ensuring that the RRC is adequately resourced (see Chapter 16). In its submission the CAA provided advice on this point:

Technical adjustment of rules would be useful – bearing in mind that Rules are essentially tertiary legislation and sound processes in which both Government and public can have confidence in are in place. There is also a need to ensure that Rule making processes are not captured (eg by the sector, or by technocrats or policycrats, etc), such that technical adjustments are appropriate, do not create unreasonable burdens, and maximise safety or other benefits. (sub. 6, p. 20)

PCO notes there is a proposal for a national register of disallowable instruments. The Commission supports this proposal (see Chapter 15).

The RRC reviews hundreds of draft regulations and numerous bills every year, and may draw the attention of the House to a regulation if it meets one of a number of specified grounds (see Box 2.3). The RRC works best when it has capable and experienced members and is able to operate in a non-partisan way. If the recommendations in this report are accepted, parliamentary oversight of regulations will need to be stronger. A discussion of options to improve parliamentary oversight of regulations and legislative processes generally can be found in Chapter 16.

## Providing for political intervention

It is difficult to predict in what circumstances “flexibility is needed to take account of political imperatives” (Figure 9.3).

The duties of independent regulators and the interests of elected politicians will periodically diverge. It is undesirable for politicians to interfere in the decisions of independent regulators. Political intervention in independent regulators will undermine the authority of the regulator, encourage lobbying and special pleading, and contribute to an uncertain environment that deters foreign investment and harms businesses by increasing the cost of borrowing.

Independent regulators are never truly separate from the political process. They operate under the authority and according to laws which Parliament can change. All branches of government – Parliament, courts and other agencies in the Executive – monitor the activity of the regulator (see Chapter 13). Political intervention in regulatory decisions can be legitimate, and it can be exercised for good or ill.

Absolute constraints on ministers may not lead to a more stable regulatory environment. Ad hoc legislation to substantially reform or override regulatory regimes as a result of temporary political frustration is deleterious to a stable, predictable and effective regulatory environment that encourages investment. There is also a risk that without clarity about how to manage such political imperatives, a regulator will be subject to more informal and insidious political pressures.

## Direct powers of intervention

For example, it has been argued that by providing clear ways for government to direct the RBNZ, the Bank’s independence is enhanced rather than undermined.

Notoriously, the Reserve Bank regime doesn’t stop a government changing the bank’s inflation target. But it can’t do so secretly, as happened when the government rather than the bank used to manipulate the country’s money supply. What the act ensures is not low inflation, but transparency. (Caygill, 2010, p. 54)

The Reserve Bank of New Zealand Act 1989 provides the Minister of Finance with considerable powers to direct the Governor of the RBNZ, including to:

- formulate and implement monetary policy for any economic objective, other than the standing objective to achieve price stability (s. 12);
- fix the prices at which the bank may engage in foreign exchange (s. 18); and
- have regard for government policy objectives (s. 68B).

In each case the direction must be gazetted. Sections 12 and 18 require an Order in Council; section 68B requires the direction to be tabled in the House of Representatives.

The draft OECD guidance (2013b) on the governance of regulators suggests that where powers of ministerial direction are provided for, they should be constrained and exercised transparently. However, it also states that “in the case of economic regulators, legislation should not permit powers to direct by Ministers” (p. 8).

Where such powers of intervention are transparently provided for, it can strengthen the hand of regulators to resist informal political pressure. It also means that where politicians do intervene, they can be properly judged by Parliament and the public and held to account.

The hurdles for such intervention should be high. For example, legislation could require ministers intervening to do so in writing, with reasons, and table such documents in the House.

### **Parliamentary override**

An alternative to providing ministerial powers of intervention is to rely on the supreme powers of Parliament to intervene, as in the case of the creation of Fonterra Co-operative Group.

By the mid-1990s there were only two major dairy cooperatives: New Zealand Dairy Group and Kiwi Co-operative Dairies. Both sold their milk through the government-appointed New Zealand Dairy Board. Proposals to merge the firms in 1999 were declined clearance by the Commerce Commission, which considered that the merger proposal had moderate to large detriments and small public benefits. The vast majority of the detriments were associated with the loss of productive and dynamic efficiency as a result of the loss of effective competition for the merged entity.

However, there was a bi-partisan political consensus that “trading in domestic competition for international clout through one massive exporter leader would be better for NZ Inc” (Malpass, 2014). Another merger proposal was announced in December 2000. The Dairy Industry Restructuring Bill was passed in September 2001, allowing this merger to avoid Commerce Commission scrutiny and deregulating the dairy industry while creating safeguards against abuse of Fonterra’s position.

Parliamentary override of regulatory decisions has the advantage of ensuring broad political support for the intervention, and allows for significant scrutiny as legislation progresses.

### **Designers need a plan for dealing with political imperatives**

Designers of regulatory regimes need to consider how the political imperative to intervene in regulatory regimes will be managed. That may or may not require providing direct powers of intervention.

Vodafone submitted that political intervention in independent regulators is undesirable:

Setting the functions and duties of a regulator, and the framework within which those duties are performed, is clearly a matter for politicians. However, having done so, it is not appropriate for politicians to play a role in operational decisions (including intervention to alter or set aside operational decisions). Where this type of intervention is possible, it is likely to perpetuate a short term, expedient approach to market intervention that is inconsistent with any principle of good regulatory practice. (sub. DR 75, p. 5)

The Commission agrees that intervention is undesirable. But the consequences of frustrating political imperatives by not providing such mechanisms may be higher, such as encouraging improper pressure on regulators or precipitating more disruptive fundamental regulatory reform.

Whatever avenue is provided for such political intervention, it should as far as possible occur in a way that maintains the regulator’s role and authority, and that does not encourage future interventions.

**F9.10**

Political pressures to intervene in the decisions of independent regulators are inevitable from time to time. Providing transparent mechanisms for political intervention in the decisions of independent regulators is preferable to wholesale regulatory reform designed to resolve short term political frustrations. It can also strengthen a regulator's ability to withstand informal political pressure.

**F9.11**

Designers need to plan for how to manage the political imperatives to intervene in regulatory decisions. Where direct powers of intervention are provided, they should be infrequent and there should be transparency obligations around their use. The design and exercise of any powers of intervention should seek to mitigate the risks that:

- precedent is set for future intervention;
- the regulator's authority is undermined;
- regulated parties are encouraged to work around the regulator.

## Regulation of government activity

In its issues paper (2013b), the Commission asked whether some aspects of regulatory independence are more or less important in regulating the exercise of state power or the regulation of government-provided or government-funded services.

The CTU considered that it was desirable for public service providers to influence their regulator, expressing the view that it would lead to higher quality standards (sub. 25).

A systematic review of the regulatory systems of six sectors in the United Kingdom found that regulation by quasi-autonomous agencies was suitable where the regulated organisations were private for-profit or not-for-profit entities. However, where the regulated sector was comprised of public services directly managed or influenced by government (such as schools or prisons) regulators seemed to have less independence from government, and there was some evidence of a conflict of interest between the government's role as regulator and its role in service provision (Walshe & Boyd, 2007).

While there may be some merit in arguing for greater independence for regulators who also regulate the government (such as health and safety in employment law), it could be argued that increasingly the distinction between matters in which the government may have an interest (and therefore a possible conflict) or not is more and more difficult to make. The public sector reach has expanded so far into the private sector that it may not be helpful to attempt to identify regulatory aspects that are more suited to independence than others. (MNZ, sub. 15, pp. 6-7)

Where publicly-funded services are being regulated, the government will have two levers to respond to problems – the regulatory system and the funding contract. In establishing a regulatory regime for public services, it is important to think through the relative roles of the funding and regulatory arrangements.

Contractual and funding levers may permit faster action. The Commission found in its case study of regulation of the aged care sector (NZPC, 2014c) that the Ministry of Health was more likely to call on District Health Boards to trigger the Aged-Related Residential Care Services funding contract for enforcement, rather than use its own regulatory powers, in part because action through the contract required fewer legal processes and could therefore be taken more quickly.

Enforcement using the funding lever is also potentially more powerful, in that it can put the viability of a provider at risk. However, funding-based interventions tend to target individual providers and so may be less useful for raising performance across the whole system in the absence of substantial failures, or for revealing information to consumers about relative performance.

**F9.12**

Designers of regulatory regimes to assure quality in public services need to consider how they expect the funding and regulatory levers will be exercised to manage performance issues across the whole system. They also need to ensure that regulatory requirements are appropriate for publicly-funded and privately-funded services.

## 9.2 Institutional form

### Machinery of government in the New Zealand state sector

The independence, accountability, efficiency and effectiveness with which regulatory functions are undertaken is strongly influenced by decisions around the institutional form in which to locate those functions. The trade-offs and tensions are neatly described by Schick (2002):

Every democratic government must both connect and separate its political and administrative organs. It must connect them so that managers and other service providers comply with the policies and rules laid down by political leaders. But it must also disconnect administrative matters from direct political involvement so that managers are free to act in a fair and efficient manner, without regard to political considerations. No democracy can abide governing arrangements which free managers to disregard the policies made by duly selected leaders, and no democracy can allow politicians to intrude in administrative matters without regard to the rights of interested parties. The first criterion justifies the placement of operating units within departments headed by ministers or by senior managers appointed by them; the second dictates the operational independence of administrative units. (pp. 10-11)

He argues that resolving those tensions is a delicate act, and one that is never settled for all time:

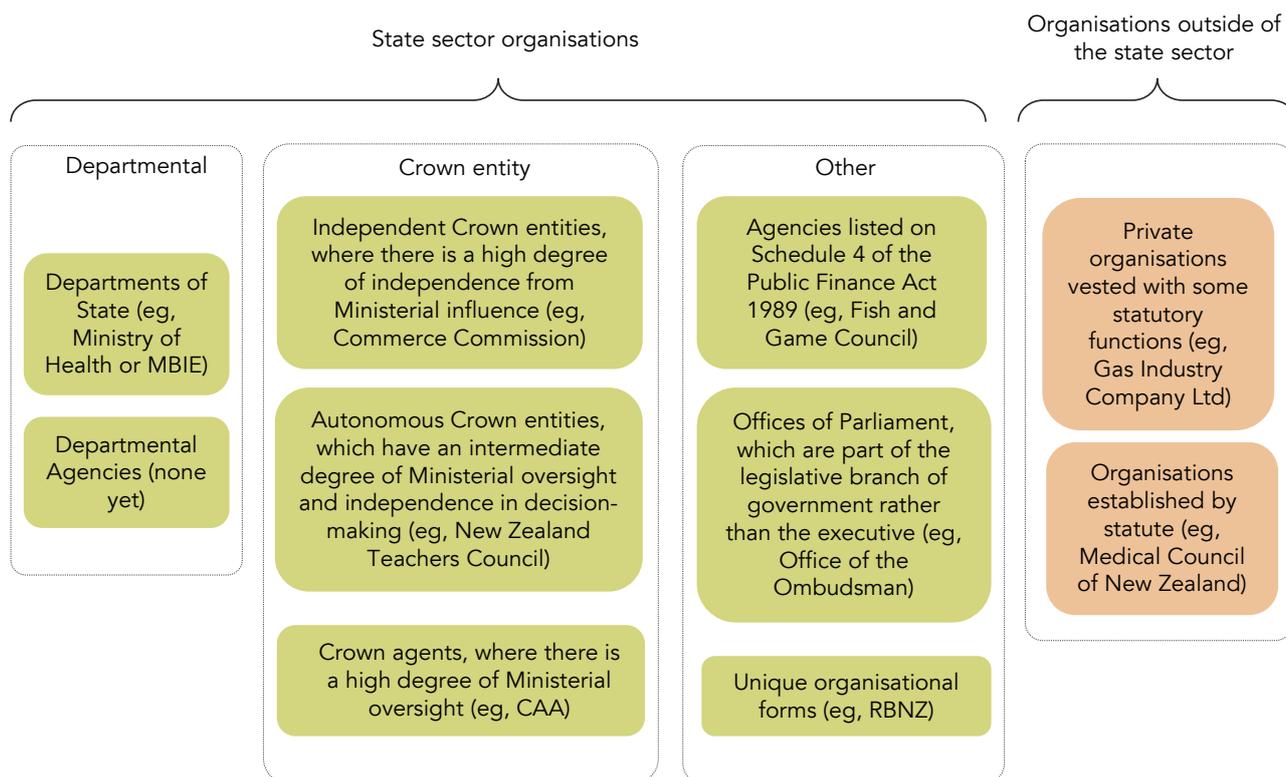
Striking the right balance between co-ordination and subordination on the one hand and independence and flexibility on the other requires that politicians and managers be both empowered and restrained. Each must have authority and resources to carry out basic responsibilities, and each must be deterred from acting in ways that encroach on the other's domain. The result is an organisational map that is repeatedly restructured through legislation and practice to promote one or the other vision. (p. 11)

The SSC describes the structure and governance of state institutions as the "machinery of government":

Machinery is an apt metaphor for the structures and systems of government. A machine is an instrument that exists in order to fulfil a purpose beyond itself. The parts in a machine move and change, and can be replaced or improved. (SSC, 2007, p. 3)

There is a complex range of institutional forms which a government regulator might take (Figure 9.6).

Despite this diversity, in most cases designers of regulatory regimes will need to consider whether to establish the regulatory functions in a department or a Crown entity. If a Crown entity, they will need to decide what type of Crown entity is most appropriate.

**Figure 9.6** Typology of institutional forms for a government regulator

## Departments

Departments are listed on the first schedule of the State Sector Act 1988. They form the core of the state sector, undertaking a wide range of functions. They are legally part of the Crown.

The SSC guidance on the machinery of government notes:

There is a close and hierarchical relationship between Ministers and departments, with the governance arrangements centred on a direct Minister-chief executive relationship. Ministers have extensive powers to direct departments, as long as such directions are consistent with the law (e.g. there are relatively numerous statutory requirements for officials to act independently in some matters – which can be quite significant). (SSC, 2007, p. 13)

The guidance indicates that departments should be the default choice of organisational form for the following functions and powers:

- activities that are in some sense an inherent function of the State such as the conduct of foreign policy, and national defence;
- the exercise of significant coercive powers of the State such as policing, prisons, and tax collection;
- other special powers, such as the substantial powers of the Director-General of MPI under the Animal Products Act 1999;
- policy advice;
- the undertaking of multiple functions, particularly where those functions potentially conflict;
- activities that are so complex it is difficult to “contract” for their provision by a Crown entity, such as where the objectives/outputs are inherently difficult to specify, or may need to be changed frequently;
- activities where constitutional conventions indicate a need for close ministerial oversight or direct responsibility such as citizenship; or
- there is a ministerial desire to control the process and outcome of an activity, including frequently reviewing its objectives, as may be indicated by:

- the significance and importance of the activity to the government;
- the high public and political expectations associated with the activity, or
- the nature of the risks posed to the Crown (for example, strategic or financial risks).

The chief executive of a department is employed by the State Services Commissioner for a fixed term.

### **A new piece of machinery – departmental agencies**

The new Departmental Agency model in New Zealand aims to reduce fragmentation in the state sector by providing an organisational vehicle within a department for functions that might otherwise be carried out by Crown entities. Departmental agencies are legally part of, but operationally separate from, “host” departments, with their own chief executive appointed by the State Services Commissioner. The Treasury and the SSC consider that departmental agencies are “a valuable addition to the possible range of governance and accountability arrangements for the delivery of executive government functions” (sub. DR 97, p. 14).

The Better Public Services Cabinet paper on departmental agencies indicates that they offer a potential means to:

- incorporate certain operational and/or regulatory functions presently delivered by separate Crown entities into the legal Crown;
- consolidate currently separate operational and policy departments into a single department, with departmental agencies; and
- deliver new operational and/or regulatory functions that may have otherwise led to the creation of a separate department or Crown entity.

The Cabinet paper on departmental agencies says that “departmental agencies are designed to have a strong service delivery focus and therefore operate with a high degree of autonomy (over day-to-day operations) from both the host department and Minister/s” (Office of the Deputy Prime Minister and Office of the Minister of State Services, 2012, p. 3). The close relationship between the host department and the departmental agency provides for improved efficiency through the sharing of back office or corporate functions.

However, this operational autonomy is not provided for in the amended State Sector Act 1988. The new section 27B reads:

(a) the functions, duties, and powers of a departmental agency may be determined by the appropriate Minister of the departmental agency in conjunction with the appropriate Minister of the host department; and

(b) the working arrangements between a departmental agency and its host department must be agreed by their respective chief executives and approved by their appropriate Ministers.

The departmental agency is legally part of the host department; it is still required to follow any lawful instruction of ministers; the chief executive is appointed and removed by the State Services Commissioner; and it is subject to the policy and funding framework of the host department.

In this sense they are similar to existing “branded business units” or semi-autonomous bodies. The key difference is that the chief executive is employed by the State Services Commissioner, and has a direct relationship with the responsible minister independently of the host department.

In considering possible institutional forms for a new workplace health and safety regulator, the regulatory impact statement canvasses a significant debate between departments on the desirable form of a new regulator, concluding:

The choice between a departmental agency and a Crown agent is not clear cut and turns on how the different objectives are weighted and views about what will occur in practice under each of the models.

A departmental agency is likely to operate more efficiently as there will be less duplication of government activity. In this way, it better aligns with the government's objective of better public services. However, while SSC and Treasury consider that a departmental agency provides sufficient independence, MBIE considers there is a risk that a departmental agency will not be seen as sufficiently independent or a significant enough change from the status quo to regain public confidence in New Zealand's workplace health and safety regulatory system. There is a further risk that its credibility and focus could diminish over time as a result of changing departmental and government priorities. The departmental agency structure is new to New Zealand (while recognising that it is an evolution of existing structures), the legislation enabling it has yet to be enacted, and it is largely untested. MBIE does not share SSC's and Treasury's level of confidence that the outcomes under this structure are largely predictable and consider it is therefore difficult to assess the likelihood of these risks materialising. (MBIE, 2013, p. 20)

Worksafe was established as a Crown agent by the WorkSafe New Zealand Act 2013.

SSC told the Commission that the departmental agency model is based on executive agencies in the United Kingdom (Box 9.6).

#### Box 9.6 Executive agencies in the United Kingdom

Like departmental agencies, executive agencies are legally part of their host department. The rise of executive agencies in the United Kingdom was accompanied by a drop in the number of executive non-departmental agencies – the rough equivalent of Crown entities – from 2,167 in 1979 to 760 in 2009. Despite being described as operating quasi-autonomously or at arm's length from ministers, there are no particular protections for this autonomy. The former Second Permanent Secretary at the Office of the Minister for the Civil Service, Sir Peter Kemp, said this was by design:

[Agencies] were left within government partly because it was recognised that there were or could be particular cases when ministers would want to get more involved – hence the word “normally” which qualifies the minister's usual role of standing back. (Wall & West, 2002, p. 212)

Key to the success of departmental agencies in the United Kingdom is a civil service mandarin (known as Fraser figures) trusted by both the minister and chief executive, who liaises and coordinates between them and acts as the main source of advice on agency performance to each.

An evaluation of the executive agency model in 2002 concluded that it had been an overall success, and should continue, with agencies meeting or exceeding over 75% of their performance targets. Other evaluations found that most (but not all) executive agencies reduced their administrative costs. (Mosely, Petrovsky & Boyne, 2011)

However, Mosely, Petrovsky & Boyne (2011) identify a number of concerns around the accountability and control of executive agencies in the United Kingdom:

- a lack of clarity around the degree of ministerial responsibility for the operational performance of executive agencies;
- much variation in the extent to which Parliament holds agencies to account;
- performance systems used by agencies have been criticised for an inadequate focus on output and outcome targets, and for incomplete coverage of agencies' objectives;
- a focus on their own narrow performance targets, rather than on wider systemic effectiveness; and
- a lack of coordination with the host department and other parts of government.

A recent investigation into UK border checks undertaken by a departmental agency highlighted concerns about confused accountability:

Overall, I found poor communication, poor managerial oversight and a lack of clarity about roles and responsibilities. There was no single framework setting out all potential border security checks, which of these could be suspended, in what circumstances and the level of authority

required at Agency or Ministerial level to do so. There is a fundamental question of how free the Agency should be to decide its own operational priorities. These are important issues that need to be considered in order to define and agree the boundaries between the Home Office and the Agency. (Independent Chief Inspector of the United Kingdom Border Agency, 2012, p. 5)

One of the architects of executive agencies, reflecting in 2011, described significant failures by the Rural Payments Agency without any accountability for that failure:

The fallout from the calamity raises serious questions as to whether ministerial accountability for executive agencies works in practice. ... The agency was effectively used as a smokescreen for policy failure. (Jenkins & Gold, 2011, p. 24)

A select committee inquiry into the Rural Payments Agency's failings said that:

A culture where ministers and senior officials can preside over failure of this magnitude and not be held personally accountable creates a serious risk of further failures in public service delivery. (Quoted in Jenkins & Gold, 2011, p. 24)

*Source:* Office of the Deputy Prime Minister and Office of the Minister of State Services, 2012; Wall & West, 2002; Mosely, Petrovsky & Boyne, 2011; and Jenkins & Gold, 2011.

In recommending the creation of the departmental agency form, the Better Public Services Advisory Group "considered that a smaller number of Crown entities and separate departments would reduce costs and improve system coherence" (Office of the Deputy Prime Minister and Office of the Minister of State Services, 2012, p. 3). Moving functions from Crown entities to departments will require legislative change, and moving those functions from the host department to the departmental agency requires the agreement of responsible ministers.

Any autonomy that a departmental agency is expected to have will be highly dependent on:

- its culture;
- norms established and agreed between the chief executive of the departmental agency and host department, and between the chief executive of the departmental agency and the responsible minister; and
- the statutory independence specifically associated with any powers which ministers delegate to it.

### F9.13

The expectation that departmental agencies will operate with a high degree of autonomy is dependent on agreements between ministers and between chief executives and any provisions for statutory independence, rather than any legal protections associated with this institutional form.

As Parliament and government consider moving specific regulatory functions from Crown entities (which are operationally independent) to departmental agencies (which are not), it will need to carefully consider whether the individual functions and powers transferred have sufficient statutory independence associated with them, in an environment that is otherwise subject to high degrees of ministerial control. The Treasury and the SSC note that many statutorily independent functions are held in departments, as provided for by legislation (sub. DR 97).

### F9.14

Government has indicated that departmental agencies offer a means to incorporate regulatory functions currently carried out in Crown entities into the legal Crown. By itself, this would serve to reduce the formal operational independence with which those functions are undertaken. As a result, Government will need to review any functions that are transferred to consider whether they should be undertaken in a statutorily independent way.

The OECD (2013b) notes potential risks still exist where statutorily independent decision makers are supported by departmental staff, including:

- risks to perceived and actual independence;
- risks to quality arising from lack of control of the quality and quantity of support services or other resources; and
- risks of inappropriate information exchange between regulatory staff and other staff in the host department.

The Government of Victoria (2010) also considers these arrangements to involve a risk that staff will be conflicted between the different interests of the regulator and the Secretary or host department.

These risks may be particularly acute in an environment where public servants view ministers as a client to be pleased, rather than served.

In the Commission's view, the departmental agency form is not fundamentally new to the New Zealand state sector, apart from the innovation that the State Services Commissioner will employ the chief executive. While semi-autonomous bodies have worked well in some cases, there are also recent examples where re-integration or separation has been considered necessary to improve performance:

- the Government's decision to merge NZ Aid into the Ministry of Foreign Affairs and Trade in 2009;
- the Secretary for the Treasury's decision to merge the Crown Company Monitoring Authority Unit into the Treasury in 2009 as the Crown Ownership Monitoring Unit;
- the New Zealand Food Safety Authority (NZFSA), which was:
  - formed as a semi-autonomous body attached to Ministry of Agriculture and Fisheries (MAF) in 2002 by consolidating food safety functions undertaken by MAF and the Ministry of Health;
  - separated from MAF to become a public service department in 2007;
  - re-integrated back into MAF in 2010.

In its 2012 inquiry into housing affordability the Commission found that the structure of the Social Housing Unit as a semi-autonomous body within the Department of Building and Housing left room for unclear priorities, mixed purposes and misaligned accountabilities, despite clarity about its formal objectives (NZPC, 2012b).

The Cabinet paper proposing the departmental agency model noted that the form is most suited to delivering functions that "are readily defined or measurable". Most regulatory activity does not fall into this category (see Chapter 3).

Where these arrangements have succeeded in the New Zealand public sector, they have done so largely because of effective relationships between the head of the agency and the chief executive of the host department. It is possible that the changed employment relationships of the head of the agency may undermine, rather than support, the effective operation of such agencies. The working arrangements agreement between chief executives of departmental agencies and host departments will therefore be particularly important.

The revised State Sector Act 1988, which provides for the departmental agency model, says at s 32(2):

- the chief executive of a department is not responsible for the performance of functions or duties or the exercise of powers by that part of the department that comprises any departmental agency hosted by the department; and

- the chief executive of a departmental agency is responsible only for the performance of functions or duties or the exercise of powers by that part of the department that comprises the departmental agency.

The Treasury and the SSC consider that the State Sector Act and the Public Finance Act provide for “certainty” in institutional accountability arrangements between the relevant ministers and chief executives (sub. DR 97, p. 15).

The Commission is concerned that this division of responsibilities may be hard to sustain, and that there is potential for confusion and conflict around the respective roles and accountability of ministers (of the host department and departmental agency) and chief executives (of the host department and departmental agency). Clarity around roles, responsibilities and mandate is a necessary pre-condition for effective regulators (see Chapter 8). Some external review of the agreements between ministers that divide functions between host departments and departmental agencies, and the agreements between chief executives on working arrangements, may reduce the potential for confusion and conflict.

### F9.15

There is the potential for confusion about the accountability arrangements of departmental agencies, and the respective roles and responsibilities of:

- the minister responsible for the departmental agency;
- the minister responsible for the host department;
- the chief executive of the departmental agency; and
- the chief executive of the host department.

### R9.3

The Minister of State Services should review agreements between ministers to establish and allocate functions to departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear and, where appropriate, in statute.

The Treasury and the SSC consider that this will happen as a matter of course, because of the Cabinet Manual requirement that the Minister of State Services is consulted on machinery of government issues (sub. DR 97).

### R9.4

The State Services Commissioner should approve agreements between the chief executives of host departments and departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear, and that there are appropriate formalities in place to preserve the independent exercise of statutorily independent powers.

## Crown entities

Crown entities are stand-alone agencies, governed by a board. They are not legally part of the Crown (see the discussion in Chapter 7). The SSC guidance on machinery of government notes:

The legal separation from the Crown establishes an ‘arm’s length’ distance between the Minister and the entity. The channels of Ministerial direction or instruction are considerably more formalised than the interactions between Minister and department. The governance arrangements are centred on the Minister-board relationship. (2007, p. 14)

“Arm’s length” means an organisation is “not subject to the direction on individual regulatory decisions by executive government” (OECD, 2013b). However, there are different degrees of formal distance from ministers within the three main types of Crown entity that might undertake regulatory functions: Crown agents, autonomous Crown entities and independent Crown entities. They differ in terms of the degree to

which they are subject to ministerial direction, and the mechanisms by which their boards are appointed and removed (see Table 9.2).

However, these differences are important as ultimate safeguards against abuse by ministers, and because of the signals they send, rather than because of their practical value. In fact there have been only two ministerial directions to “give effect to government policy” (Crown agent) or “have regard to government policy” (autonomous Crown entity) under the Crown Entities Act. Neither of these related to a regulatory regime.<sup>46</sup> The Cabinet Manual notes that “these powers of direction are likely to be used infrequently because other tools such as letters of expectation work well to convey Ministers’ expectations”. Only once has a board members of a regulatory Crown entity been removed from office before the end of their term.<sup>47</sup>

This is consistent with evidence from Europe which finds politicians generally do not use the formal controls over independent regulatory agencies that are available to them. Thatcher (2005), using a principal–agent framework, proposes two possible explanations.

- “Independent” regulators have structured incentives to act in accordance with politician’s preferences, meaning there are no agency losses and no need for sanctions. These incentives may include increased powers and budgets, renomination, or they may result from informal relationships.
- Although there are agency losses, politicians choose to accept these because they are outweighed by the benefits of independent regulators and the costs of applying the sanctions. Those costs may be political or damage done to the regulatory framework’s credibility.

Scott has argued that:

A common justification for creating Crown entities is the substance, or perception, of greater independence from ministerial direction by comparison with departmental heads. The presence of a board in many Crown entities, as a governance layer between the minister and the chief executive, contributes to the perception that Crown entities have a greater degree of independence from political intervention in the management of their affairs. The separate legal form of a Crown entity does indeed give the appearance of independence. The practice has been that the entities are more independent generally than departments, but this is not immutable or inherent in the organisational form.

...

There is evidence of some Crown entities holding strongly to positions in the face of pressure from the government. There is not, however, something inherent in the constitution or functioning of Crown entities that means they are necessarily more independent than government departments. Rather, their independence is variously established in statute, earned via the competence of the organisation and the standing of their leadership, or results from a hands-off style on the part of the minister. Broadly, the same applies to departments. The principle of accountability of ministers is unaffected by the creation of Crown entities. (2001, pp. 275-77)

The experience of Roy Hemmingway, former Chair of the Electricity Commission is illustrative (Box 9.7).

#### Box 9.7 Electricity Commission and regulatory independence

Roy Hemmingway became inaugural Chair of the Electricity Commission (a Crown agent, predecessor to the Electricity Authority) in 2003. He claims he was promised the Electricity Commission would be independent.

<sup>46</sup> One ministerial direction in 2006 directed the then Foundation for Research, Science and Technology to give effect to government policy to “improve the effectiveness and stability of the Vote Research, Science and Technology funding environment” (notice 3128), and one ministerial direction in 2010 revoked that direction (notice 5193). (Source: search of words “direction” and “directive” in DIA online database of the *New Zealand Gazette*, 9 October 2013). Other powers of direction provided for in regulatory legislation may also be used. For example, legislation frequently provides that a Minister may direct an entity to undertake additional functions; MNZ has been so directed on at least four occasions. Sometimes regulatory legislation also provides for very general powers of direction, such as section 35 of the Overseas Investment Act 2005, which has been used at least twice.

<sup>47</sup> In December 2010 two board members of the Energy Efficiency and Conservation Authority were removed from office by Hon Gerry Brownlee. There are other instances of board members being removed from non-regulatory Crown entities, including from the Crown Health Financing Authority and District Health Boards. (Source: search of words “remove” and “removal” in relation to the Crown Entities Act 2004 in the DIA online database of the *New Zealand Gazette*, 10 January 2014).

However, tensions arose after the Electricity Commission decided not to approve Transpower's application to upgrade the transmission network between Waikato and Auckland. Hemmingway claims he was under pressure from ministers to negotiate an approval of the upgrade application.

The then Minister of Finance Michael Cullen was reported as saying that the Electricity Commission's decisions raised concerns about New Zealand and Auckland's future economic welfare that ministers had a legitimate interest in: "In that situation we reserve a perfect right to say to people that we expect you to come to a sensible conclusion here and encourage them rather strongly to do so".

In 2006 the Government declined to reappoint Hemmingway to the Electricity Commission. Minister of Energy David Parker was reported as saying "I make no apology for the fact that when security of supply gets ropy there is political accountability in New Zealand and politicians step in. And I did". The former Minister of Finance, David Caygill, was appointed as the new chair. Transpower's proposed upgrade was approved by the Electricity Commission in July 2007.

In a presentation to the Harvard Electricity Policy Group soon after leaving office, Hemmingway argued that many design features of the Electricity Commission contributed to a lack of independence, and claimed that regulated firms had heavily lobbied politicians, who in turn put pressure on him.

It is clear that, despite ministers' frustration with the Electricity Commission's decisions, they did not feel the need to resort to formal mechanisms of control over this Crown agent. When informal pressure was unsuccessful, Hemmingway was simply not reappointed. Clearly ministers and Hemmingway did not have a shared understanding of the respective roles of ministers and the Electricity Commission, or of the degree of independence that was signalled by the Electricity Commission's form as a Crown agent.

*Source:* Bennett, 2006; Hemmingway, 2006.

Interviews conducted for the Commission with board members of regulatory Crown entities revealed variation in the level of contact between responsible ministers and the entity, with much depending on the personal interest of the minister. In some cases, entities reported weekly meetings between their chief executive and the minister. With this degree of contact, formal instruments to influence the entity (such as letters of expectation) are unlikely to be required to make a minister's expectations clear.

#### F9.16

The three types of statutory Crown entity are distinguished by the ease with which board members can be appointed and removed, and whether the entity is obliged to "have regard to" or "give effect to" ministerial policy directions made under the Crown Entities Act 2004. However, it is very rare for ministers to issue policy directions or remove members of regulatory Crown entities.

## Independence and agency type

Applying the Commission's framework for regulatory independence (as outlined in Figure 9.4) to the major types of institutional form reveals that these forms are not strongly differentiated (Table 9.2).

**Table 9.2 Institutional forms and dimensions of independence**

Dimension of independence	Department	Departmental agency	Crown agent	Autonomous Crown entity	Independent Crown entity
Regulators <sup>48</sup>	Customs	None yet	CAA	Commission for Financial Literacy and Retirement Income	BSA
	DIA		EECA	Historic Places Trust	Commerce Commission
	DOC		EPA	Lotteries Commission	
	LINZ		Fire Service Commission		Drug Free Sport New Zealand
	MCH		Maritime New Zealand		EA
	MfE		NZQA		Financial Markets Authority
	MBIE		NZTA		HDC
	MoE		Walking Access Commission		OFLC
	MoH				Privacy Commissioner
	MoT				Takeovers Panel
	MPI				
	Statistics NZ				
Institutional independence	Governed by chief executive, appointed and removed by State Services Commissioner	Governed by chief executive (separate from chief executive of host department), appointed and removed by State Services Commissioner	Governed by board, which can be appointed and removed at minister's discretion	Governed by board, which can be appointed and removed for just cause by minister	Governed by board, which can be appointed and removed for just cause by Governor-General on advice of minister, after consulting Attorney-General
Operational independence	Required to follow any lawful ministerial direction	Required to follow any lawful ministerial direction	Operationally independent; must give effect to government policy when directed	Operationally independent; must have regard to government policy when directed	No ministerial powers of direction <sup>49</sup>
Regulation independence	Each organisation has whatever powers are provided for by Parliament				
Budgetary independence	Usually parliamentary appropriation, except where Parliament provides otherwise, such as the power to issue levies and charges.				

*Notes:*

1. Excludes the RBNZ and Gas Industry Company, which have unique institutional forms among regulators.

Coupled with the Commission's earlier finding that the differences in institutional and operational independence do not (in the way that they are actually used) distinguish between organisational forms, this leads to a number of preliminary conclusions:

- the choice of institutional form is important because of what it signals about the expected independence of the regulator, rather than the legal differences between them;

<sup>48</sup> According to the Commission's criteria for inclusion in its mapping exercise (see Chapter 1 for criteria for inclusion).

<sup>49</sup> Except for whole-of-government directions.

- the culture that is established within the regulator, and the norms established between the agency and the responsible minister, will in practice be strong influences on the agency's independence;
- the legislation establishing a regulatory regime is particularly important in establishing its independence, because this establishes whether:
  - the regulator has powers that need to be operated independently;
  - the regulator has the ability to set and adjust rules and regulations to effectively achieve the objectives of the regime;
  - the regulator will have independent sources of revenue.

Such a culture is important in terms of establishing how the regulator thinks about what its task is (to please a minister?; to please regulated firms?) rather than as a protection against active threats to the regulator's independence. An in-depth discussion on the importance of culture, particularly in new organisations, is in Chapter 4.

**F9.17**

The choice of institutional form will be important as much in terms of what it signals around expected levels of agency independence, as for the legal protections associated with particular agency forms.

**F9.18**

Ministers and the founding governors and leaders of new agencies need to pay particular attention to the norms and cultures established around independence, in terms of the relationships between them, and the agency's operations.

## The trend towards agency consolidation

The views of the Better Public Services Advisory Group, and the emergence of the new departmental agency form, continue a trend over the past decade towards greater amalgamation of public service entities in New Zealand, leading to policy and regulatory functions being placed within one agency<sup>50</sup> and the merger of regulators in related industries.<sup>51</sup> New Zealand's public management approach has shifted from one "which advocated that organisations should have 'simple and clear purposes', particularly the separation of policy, delivery and regulation in order to align incentives for officials and reduce 'opportunistic' behaviour" to one where "the structural focus is to 'shift the burden of proof towards amalgamation'" (Norman & Gill, 2011, p. 5).

The establishment of WorkSafe New Zealand as a Crown agent, discussed above, is a notable exception to the trend.

A similar shift can be seen in how regulator design has been considered overseas. The United Kingdom Hampton Review (2005) and VSSA's review of regulatory governance (2009) both recommended the gradual consolidation of existing agencies to improve efficiency and effectiveness. Hampton went further and proposed that:

- "no new regulator should be created where an existing one can do the work" (p. 13);
- "new tasks should be given to existing regulators unless there is a compelling reason to create a new body" (p. 55).

Jordana and Levi-Faur (2010) have detected an international "trend towards the creation of multi-sector regulatory agencies". The Blair Labour government in Britain consolidated a number of its economic

<sup>50</sup> For example, the merger of the Charities Commission with the Department of Internal Affairs, and the merger of the New Zealand Food Safety Authority into the Ministry for Primary Industries.

<sup>51</sup> For example, the creation of the Ministry for Primary Industries out of the Ministry of Agriculture and Forestry, Ministry of Fisheries and New Zealand Food Safety Authority.

regulators, creating the Office of Gas and Electricity Markets (Ofgem) out of its gas supply and electricity agencies in 2000 and the Office of Communications (Ofcom) out of five different regulators covering media and communications sectors in 2003.<sup>52</sup> The scope of Germany's network regulator<sup>53</sup> has been progressively expanded from telecommunications to include utilities and infrastructure. The Netherlands has recently merged its consumer, competition and telecommunications regulators to form an Authority for Consumers and Markets (OECD, 2013b).

#### Box 9.8 Submitters' views on agency consolidation

A number of submitters argued that New Zealand's regulatory landscape was too cluttered and that reducing the number of agencies and regimes could improve the efficiency and effectiveness of regulatory enforcement:

The size of NZ's population, the similarity of many regulated activities (e.g. building, farming, roading, etc) and the limited availability of specialist expertise justify greater aggregation of regulatory powers, particularly where regulation involves a greater degree of discretion and expert judgement. (Carter Holt Harvey, sub. 8, p. 11)

...we think the amalgamation of agencies operating in the same part of the market with similar or overlapping responsibilities, is not only more economically efficient but also more likely to generate consistent regulatory outcomes. (FMA, sub. 53, p. 2)

There should be more consideration given to the need for a single market conduct regulator ... There would be clear benefit in amalgamating knowledge within one market conduct regulatory body, as in Australia, so that insurance conduct matters could be dealt with consistently and effectively. Having a single market conduct regulator also encourages a better working relationship between government and stakeholders, as market participants are not required to commit resources across a number of different bodies. It would also reduce the risk of inconsistent policy and regulatory practice between the agencies, which is a risk under the current framework. (Insurance Council of New Zealand, sub. 5, p. 4)

Mighty River Power considers there could be merit in the Productivity Commission considering whether there could be efficiencies in concentrating industry specific regulator functions in an umbrella regulator like the Commerce Commission ... An alternative approach would be to consider concentrating regulatory functions in the Commerce Commission as an umbrella regulator but with some industry specific technical expertise ... The benefits of this approach would be to provide sector specific rule-makers with more resource to focus on industry development rather than regulation, compliance and enforcement. (sub. 30, pp. 5 and 11)

...we would recommend that a principle of regulatory design be that a single industry should have a single regulator unless a cost-benefit analysis is able to identify clearly why this should not be the case. (Powerco, sub. 14, p. 5)

There are gains to be made by combining regulatory agencies, where this can be done in a way that ensures resources are distributed according to the needs of the system. These gains include enhanced regulatory expertise, stronger regulatory systems, and, in the case of a catastrophic event, a far greater ability to respond to the event. (MPI, sub. DR 102, p. 5)

Others argued that some regulatory functions should be disaggregated.

- Vector said that some forms of regulation, especially economic regulation of infrastructure, require "a greater level of constructive engagement" to work and so should be managed separately from the more adversarial types of regulation, such as consumer protection or competition policy (sub. 29, pp. 15-17, 21, and 28-32).
- The NZFGC argued that combining regulators is not necessarily the best way to improve capabilities. Approaches such as bilateral agency communication and cooperation may be more effective (sub. 35, p. 8).

<sup>52</sup> Ofcom's scope was expanded in 2011 to also cover postal regulation.

<sup>53</sup> The Bundesnetzagentur (Federal Network Agency).

- The Electricity Authority was concerned that combining regulators to improve capability could compromise an agency's focus on their statutory objective. Establishing links with other regulators may be a better approach (sub. 50, p. 6).

- The FMA also noted that

fast and responsive is not necessarily correlated with big, and it is the former that is important in the twenty first century. While there have been opportunities explored by FMA in the past 2-3 years to combine regulatory activities across agencies under one umbrella, none of these have been implemented either due to an absence of provable material economic benefit or diffuse levels of political support. (sub. 53, p. 7)

A number of submitters argued that rule-making and rule-enforcement functions should be allocated to separate regulatory organisations, to provide greater checks and external scrutiny over the development of new rules. This issue is discussed in Chapter 8.

In its report on the rationalisation and governance of state regulators, VSSA identified the following criteria for when regulatory functions should be consolidated in, or separated from, a department (Table 9.3).

**Table 9.3** VSSA framework for location of regulatory functions

Regulators might be better located within a department where...	Regulators might be better located outside a department where...
<ul style="list-style-type: none"> <li>• the environment being regulated is subject to rapid change and there is a need for the regulator to access technical knowledge of the department</li> <li>• political/strategic importance requires ministerial oversight</li> <li>• minor or incidental functions do not justify a stand-alone body</li> </ul>	<ul style="list-style-type: none"> <li>• functions are easily described and measured</li> <li>• perception of political independence is necessary</li> </ul>

Source: VSSA, 2009.

### Benefits of consolidation

Consolidating regulatory agencies may offer the following benefits.

- *Greater efficiency, arising from economies of scale and scope:* Larger and broader-based agencies are likely to be most efficient to run. A survey of British regulators as part of the Hampton Review found that smaller agencies were more expensive to run, with higher average per-staff and per-inspection costs (Hampton, 2005). Larger organisations may also be better placed to attract, retain and develop capability, apply more sophisticated risk assessment and compliance approaches, and allocate scarce professional resources more effectively (VSSA, 2009; Jordana & Levi-Faur, 2010). Assertions that larger regulators are more efficient are not universally accepted. A 2007 survey of British regulatory regimes concluded that:

... there is no evidence necessarily that the much larger regulators ... are either more efficient or effective, certainly beyond a certain scale. Indeed, it could be argued that the larger regulatory agencies, like OFSTED, often resort to subdividing their activities into separate regulatory divisions dealing with different sectors or activities to deal with the complexity that comes with size. (Walshe & Boyd, 2007, p. 119)

- *Reduced administrative burdens, inconsistency or complexity for regulated entities:* A reduction in the number of regulatory agencies may create opportunities to streamline audit processes and reduce other duplicated processes, so that firms face fewer inspections and forms (Hampton, 2005). Bringing multiple regimes and sectors under one agency also enables sharing of practice across similar regulatory issues and sharing of risk information across regimes. Applying common principles or approaches across similar issues may improve regulatory predictability (Jordana & Levi-Faur, 2010).

- *Independence:* Larger agencies that cover a range of sectors may be less prone to capture by regulated industries (VSSA, 2009; Jordana & Levi-Faur, 2010; OECD, 1999a).
- *Greater policy focus and connection with operations:* MNZ submitted that where regulatory functions are established in a Crown entity, there can be weak incentives for the policy departments to review and maintain the regulatory regime or even maintain specialist capability in the area of regulation.

### Disadvantages of consolidation

- *Loss of focus:* Multi-sector or multi-regime agencies may focus less on some industries or regimes than single-sector regulators, and so be less effective. The Electricity Authority made this point in its submission:
 

...combining regulators to improve capability risks compromising the focus that regulatory agencies have on their statutory objective. In the Authority's case ... this focus is extremely sharp and is key to the successful performance of its functions and its overall effectiveness. (sub. 50, p. 6)
- *Loss of perspective:* The regulation of certain types of rare but catastrophic risks can be at particular risk of loss of focus within a consolidated agency. The Royal Commission on the Pike River Coal Mine Tragedy (2012) noted that:
 

History demonstrates that lessons learnt from past tragedies do not automatically translate into better health and safety practice for the future. Institutional memory dims over time. (p. 264) ...

Health and safety in New Zealand was not led by a body for which improving health and safety was its sole, or even major, objective. Health and safety was just one of the responsibilities of a department with many responsibilities. This diluted the attention paid to health and safety and contributed to an unwieldy structure in which senior officers had limited opportunities to develop health and safety expertise. (p. 291) ...

Interestingly, the highest risk sectors were identified primarily according to personal injury data – the consequences of individual accidents – but high-hazard industries are at risk of catastrophic process safety accidents, which are, by their nature, low frequency high consequence events. As the Pike River mine tragedy demonstrates, a focus on personal injury rates alone is not adequate to identify the ultimate workplace hazards. Until recently, there was no sign that catastrophic risk featured in the department's strategic thinking. (p. 295)
- *Loss of institutional support:* The Compliance Common Capability Programme (CCCP) submitted that in organisations where regulation is only one of many areas of activity, such as MBIE or the Department of Internal Affairs (DIA), "the regulatory compliance business can sometimes fail to get leadership attention amidst a range of competing priorities" (sub. 12, p. 3).
- *Less accountability:* The narrower an organisation's set of responsibilities, the less likely it is to get diverted or conflicted, and the easier it will be to hold it to account for its performance. This was one of the rationales underpinning New Zealand's state sector reforms in the 1980s (Ayto, 2001). Agencies managing multiple regimes may be more prone to conflicting objectives, and have to make trade-offs between which regime(s) they commit resources to. These trade-offs may not be made in a transparent or consistent manner. This may make it difficult to hold the agency to account. Greater discussion on role clarity can be found in Chapter 8.
- *Loss of capability:* Contrary to the view that larger agencies are better placed to attract and retain talent, some have argued that multi-sector organisations are prone to lose sector-specific expertise that is necessary for effective regulation (Jordana & Levi-Faur, 2010).
- *Cost and disruption:* Merging existing agencies can be costly, as Environment Canterbury commented:
 

Our experience leads us to the view that amalgamation or mergers involve their own costs and unintended consequences. Collaboration, transfer of functions and delegation of responsibilities will often be preferable. (sub. 4)

These risks are neatly summarised by Julia Black (2012b):

If regulatory functions are simply swallowed up into large departmental behemoths, there is no clear organisational structure for their performance; tasks are fungible, as are the departmental units performing them; opportunities for meaningful stakeholder participation are limited in the absence of dedicated advisory committees; and the scale of Departments combined with the weaknesses of Ministerial responsibility is such that accountability is lessened, not enhanced. For example, in commenting on the coalition government's Public Bodies Bill, the PAC [Parliamentary Public Administration Committee] argued that 'bringing functions back into sponsor departments is likely to undermine other channels of accountability, particularly with relevant stakeholder groups, and risk leaving policies fighting numerous other priorities for ministerial attention. This will mean less effective accountability and challenge on a day-to-day basis'. (p. 14)

Kevin Currie of Paradox Consulting submitted that many of the disadvantages of consolidation would not apply, or could be more easily mitigated, if regulatory functions were consolidated in a large organisation focused only on regulation, rather than a department that also had other policy and service delivery functions, and that this would make the regulatory system simpler to operate (sub. DR 74).

Existing SSC guidance on machinery of government decisions properly focuses on the formal and legal accountability arrangements that are appropriate for certain types of functions, and the degree of ministerial oversight that is appropriate. However, the guidance could usefully be enhanced by discussing some of the practical benefits and risks of consolidation, such as those outlined above.

**F9.19**

Regulation designed to prevent low-frequency, high-consequence (catastrophic) events is less likely to suffer from loss of focus or institutional support over time if located in stand-alone agencies.

**R9.5**

Updated State Services Commission guidance on machinery of government choices should discuss the practical benefits, costs and risks associated with allocating functions to a department or stand-alone agency, as well as the accountability and governance considerations.

Chapter 8 discusses issues that can arise where policy responsibility for a regulatory regime is located in a different department to the departments with responsibility for operating or monitoring the regime.

There is no optimal allocation of functions between organisations, and in some cases organisational structure continues to change over time as priorities and fashions change (see, for example, Table 9.4).

**Table 9.4** Timeline of structural changes to MAF and MPI

Date	Change	Reasons for change
1972	The Fisheries Management and Fisheries Research Divisions of the Marine Department are combined with the Department of Agriculture to form the MAF	
1987	Amalgamation of 10 functional Divisions of MAF into 4 Business Groups (MAF Technology, MAF Quality Management, MAF Fisheries and MAF Corporate Services)	In response to requirements from Government to become more business-like and generate third party revenue
1990	Separation of MAF Policy (Agriculture and Fisheries) from service delivery functions in the other Business Groups	
1992	Science restructuring – MAF Tech is split among Crown Research Institutes (CRIs); Agriculture New Zealand (farm consultants) is kept, but moved over time to full cost recovery	Reform of the science system and creation of CRIs

Date	Change	Reasons for change
1992	Policy restructuring – creation of Regulatory Authority (a stand-alone business group)	Policy/operations split
1994	Policy restructuring – separation of agricultural and fisheries policy	
1995	Sale of Agriculture New Zealand to Wrightsons	
1995	Ministry of Agriculture and Fisheries is split into Ministry of Fisheries and Ministry of Agriculture (the MAF brand is retained, although the F doesn't stand for anything)	Split is considered necessary to provide focus in overseeing a new fisheries management regime
1998	Ministry of Agriculture and the Ministry of Forestry merge to become the Ministry of Agriculture and Forestry	To create efficiency gains, and allow the tighter coordination of government services to the agriculture, forestry and horticulture sectors, including a more integrated policy and service delivery approach to these sectors
1998	MAF Quality Management is replaced by two state-owned enterprises: Asure New Zealand Ltd and AgriQuality New Zealand (Verification Agency, Quarantine Service and Animals and Plants Laboratories stay within MAF)	To separate the service delivery arm from the core government tasks of policy advice and regulatory standards, and to improve the efficiency and performance of both businesses to ensure their viability
1998	Forestry Export Certification is transferred to AgriQuality	
1999	Sale of Forest Health to Forest Research	
1999	Separation of Regulatory Authority into Biosecurity Authority and Food Assurance Authority	To provide greater focus and coordination of biosecurity risks
2002	NZFSA becomes a semi-autonomous body attached to MAF, merging MAF Food Assurance Authority and some parts of the Ministry of Health	Considered necessary to separate food safety functions from the department's export promotion role
2004	MAF Biosecurity Authority becomes Biosecurity New Zealand, incorporating some functions from Department of Conservation and Ministry of Health	The agency reflects MAF's expanded mandate and responsibilities in the biosecurity area. It aims to provide a fresh start to biosecurity in New Zealand, as envisaged by the Biosecurity Strategy.
2007	NZFSA separates from MAF to become a public service department	It was considered that the focus of NZFSA on public safety did not sit comfortably with MAF's focus on producer regulation, economic growth and trade promotion. Establishing NZFSA as a new public service department would give the Authority the responsibility for maintaining effective relationships with all its partners and not prioritise relationships with MAF.
2010	NZFSA merges back with MAF	To provide an end-to-end view of the value change between producers and consumers, in New Zealand and overseas
2011	MAF and Ministry of Fisheries merge to create a new ministry covering the primary sector	To reduce costs and provide a single ministry to be an efficient and coordinated voice for all New Zealand's primary industries
2012	The new ministry becomes Ministry for Primary Industries	

Over the history of MAF/MPI a number of functions have been transferred to separate semi-autonomous bodies or departments, and then transferred back. However, the key relationships required to effectively lead and regulate the primary industry sectors remain of critical importance regardless of where they are located. For example, the agriculture department chief executive and the head of the food safety agency or biosecurity agency need to work together closely, whether those functions are located in the department, attached to it, or outside the department. Similarly, biosecurity and food safety functions operate within a common international World Trade Organization (WTO) framework, and the relationship between the heads of those agencies is important.

### F9.20

Coherence problems between executive functions cannot be resolved by co-locating those functions alone. Designers of regulatory regimes need to identify what functional, personal and professional relationships are key to the effective operation of a regulatory regime, and assess which of those relationships are best managed within an organisation and which are amenable to management between separate organisations. This should inform decisions around the location of regulatory functions.

## Structural change

Structural change within government departments has been described by Norman and Gill (2011) as “an addiction” (p. 2). They report that internal restructurings are seen by chief executives as a way to:

- improve the mix of capabilities within a department and shore up capability gaps;
- “reboot” an organisation from a non-performing past;
- clarify performance expectations within the department;
- change the shared values and organisational culture; and
- get different people onto a management team.

However, Norman and Gill find the costs of restructuring to be significant and there are immediate productivity dips. The limited evidence on effectiveness suggested that the benefits of restructuring take at least two years to emerge. The authors conclude that restructuring is used to create a perception of being decisive and in charge, and to avoid formal processes of performance management which may be more subject to legal challenge. They recommend that restructuring “should be subject to the same scrutiny as major investment decisions such as roads, information technology systems and buildings” and that departmental chief executives need to act “more like stewards of their organisations and less like owners” (pp. 15-16).

Mergers can lead to a loss of focus on core accountabilities during the transition process, particularly as experienced staff leave and new staff arrive. This can cause gaps in service delivery or inadequate risk management. It can also cause projects underway to lose momentum. Where management layers are restructured, staff are continuing their usual functions without the usual oversight and risk management.

The merger of NZFSA, MAF and the Ministry of Fisheries in 2010-11 disrupted the smooth operation of some regulatory regimes. The Meat Industry Association (MIA) attributed problems with export certification to capacity issues.

Nevertheless, this year has seen issues emerge which have left the Ministry (and their Minister) embarrassed by failings within MPI, most notably over exporter access to China. Essentially, the creation of MPI, with its new name, entailed changing official export certificates. This task was undertaken on top of the existing work within MPI. In this case, staff were focussed on their very busy market access tasks, and the additional job of getting new export certificates approved by the Chinese authorities was overlooked. The MIA had been warning for some time over how the very capable staff in the MPI market access team were having to deal with an enormous array of market access issues beyond their capability to meet. Because [of] the absence of capability, what was a simple bureaucratic

mistake relating to changed documentation turned into a significant block on New Zealand meat exports.

...as the MPI Review makes clear, there was an organisational culture and a lack of resources that allowed a simple mistake to occur and prevented rapid escalation of the issue to senior management and the Minister. (sub. 40, p. 12)

The Public Service Association considered that “structural changes, including mergers of agencies, frequently lead to loss of capability rather than its improvement” (sub. 26, p. 2). MAF noted this in the course of its 1998 Financial Review:

... the extent and duration of the capability loss is extended if restructurings follow one on the other with no period of stability to develop and rebuild systems. (MAF, 1998, p. 2)

Institutional changes occur not only for functional reasons. The FMA was established in 2011, combining the functions of the Securities Commission and Government Actuary which were disestablished, and incorporating other regulatory functions from the Ministry of Economic Development.

In deciding to establish a new financial markets authority, rather than merging the relevant regulatory functions of the Ministry of Economic Development and the Government Actuary into the existing Securities Commission, the main consideration was to signal value in making a change – to the regulator and the wider markets. Advice to Cabinet at the time noted that “it sends a clear signal to both market participants and the regulator that Government is looking for a different approach than currently taken by regulators” (Office of the Minister of Commerce, 2010, p. 1).

**F9.21**

While structural changes in regulatory agencies can be necessary from time to time, the benefits of change can take time to emerge, and the operation of regulatory regimes may be disrupted in the interim.

**F9.22**

Chief executives of regulatory agencies undergoing structural change should ensure that change management strategies discuss how the effective operation of regulatory functions will be maintained during the change.

# 10 Governance, decision rights and discretion

## Key points

- The exercise of regulatory powers and functions is constrained by rules, institutional and cultural factors, and governance arrangements. There are strengths and weaknesses in these institutional arrangements in New Zealand.
- Governors of regulatory Crown entities are accountable to ministers for the performance of the regulator, and need to be empowered to govern. Their strategic leadership is important to the success of the regulator.
- Having a highly capable board with the right mix of skills is critical to good governance. But appointment and reappointment processes are of variable quality. More central support to departments would improve the quality of appointment processes and, in turn, the quality of governance.
- Sector or industry experience can be an important voice in governance. There is some confusion about the role that Crown entity board members nominated by industry are expected to play as governors. The belief that these board members are representatives of industry is erroneous but appears to be widely held.
- The variety of internal governance arrangements and allocation of decision-making rights in regulators appears to be ad hoc rather than based on sound governance principles.
- Ministerial decision making is appropriate in the case of decisions with:
  - significant value judgements, involving trade-offs that are not readily amenable to analysis; and
  - significant fiscal implications, or which are integral to a government's economic strategy.
- Multi-member decision-making bodies offer the potential to produce better quality decisions than individuals. Whether they do depends on the quality of members and decision-making processes, highlighting the importance of robust appointment processes.
- In any system of authority there is tension between certainty and flexibility: between having definite rules and applying them consistently and even-handedly, and enabling decisions to be made according to the specific circumstances of the case and within a broader framework of goals and values.
- The exercise of discretion is subject to legal and non-legal methods of control, including judicial review and the common law principles of administrative law, guidance and policy that the decision maker adopts to guide the exercise of discretion, cultural and institutional constraints and transparency requirements. In particular, there are strong protections where those decisions intrude on the civil and political rights enshrined in the New Zealand Bill of Rights Act 1990.
- Many regulatory agencies also develop policies and guidelines for decision makers who exercise discretion, and publish information about their decision-making processes. These policies and guidance help to ensure that decisions with similar circumstances are made consistently and fairly. All regulators should publish such information.

## 10.1 Introduction

This chapter covers three inter-related concepts: the internal governance of regulatory entities; who has decision-making rights; and how much discretion is able to be exercised. In each case the powers, duties and responsibilities of governors and decision makers are bound by important rules and protections. This chapter discusses the strengths and weaknesses of these institutional arrangements in the New Zealand regulatory context.

## 10.2 The internal governance of Crown entities

Laking (2002) says:

The role and function of top-level internal governance in all cases is to protect the interest of the state in the public organisation by ensuring compliance with all applicable law, agreements or directives; proper performance (economy, efficiency and effectiveness) in the operations of the organisation; and protection of the rights and lawful interests of stakeholders. (p. 275)

Chapter 9 discussed the range of institutional forms which carry out regulatory functions in the New Zealand context. The focus of this section of the report is on the governing role of boards in one of the common institutional forms for regulators: Crown entities.

### The role of boards

The Crown Entities Act 2004 outlines the collective and individual duties that board members of Crown entities owe to the minister responsible for the Crown entity (State Services Commission (SSC), 2013a).

The board is the governing body of the entity. It exercises the powers and functions of the entity, and decisions about the operation of the entity must be made by or under the authority of the board (s 25).

A board's collective duties are to ensure that the entity:

- acts consistently with its objectives, functions, Statement of Intent, and Output Agreement;<sup>54</sup>
- performs its functions efficiently and effectively, consistently with the spirit of service to the public, and in collaboration with other public entities, where practicable;
- operates in a financially responsible manner; and
- complies with the Crown Entities Act requirements relating to its subsidiaries and other interests.

The individual duties of board members are to:

- comply with the Crown Entities Act and the entity's enabling legislation;
- act with honesty and integrity, in good faith and not at the expense of the entity's functions as permitted or required by law; and
- exercise the care, diligence and skill that a reasonable person would exercise in the same circumstances, taking into account the nature of the entity and of the action, the position of the member and the nature of their responsibilities.

Section 26 requires board members to comply with their collective and individual duties (as well as any applicable directions), and makes clear that board members are accountable to the responsible minister for undertaking their duties.

Together this means that boards are accountable to ministers for the performance of the entity. Boards have a legal duty to provide information to ministers, and the enduring letter of expectations from the Ministers of Finance and State Services to statutory Crown entities (2012) emphasises that the board is

<sup>54</sup> "Statement of performance expectations" will replace "Output Agreement" from 1 July 2014.

responsible for being aware of and advising ministers of issues that may be discussed in the public arena or may require ministerial involvement (the “no surprises” policy). It also makes clear that the Government expects boards to undertake effective self-monitoring:

Your board is the most important monitor of entity performance. We expect boards to provide to responsible Ministers high quality information and analysis on entity performance against plan, implications for future performance, and risks and opportunities facing the entity. We also expect you to have a constructive working relationship with your monitoring department.

The respective roles of a Crown entity’s responsible minister and board are complementary (Table 10.1). In undertaking their functions, the minister is supported by a monitoring department. The existence of monitoring by departments to support ministers does not displace or diminish a board’s primary role in providing assurance to ministers about, and its responsibility for, the performance of the entity (see Chapter 13).

**Table 10.1 State Services Commission guidance on roles of ministers and boards of Crown entities**

Role of the minister	Role of the board
Oversees and manages the Crown’s interests in and relationships with the entities that are within their portfolio	Sets the entity’s strategic direction
Represents the public interest in the entity (and, in private sector terms, is the de facto “shareholder”)	Exercises the entity’s powers and functions itself or through delegation, empowering the CEO and others to implement the board’s policies
Ensures an effective board is in place to govern the entity	Appoints and oversees performance of the CEO
Influences the entity’s strategic direction	Ensures the entity’s functions are performed efficiently and effectively
Monitors and reviews Crown entity performance and results	Manages risk and ensures compliance
Manages risks on behalf of the Crown	Provides assurance of fiscal responsibility
Carries out any statutory responsibilities	Maintains appropriate relationships with key stakeholders

*Source:* SSC, 2008.

The Commission contracted a series of structured interviews with chairs or members of eight regulatory Crown entities and officials in their five monitoring departments (Spencer, 2014). Interviews indicated a general consistency between board chairs and monitors in describing their tolerance of risk and their understanding of regulatory failure:

However, if anything, boards appeared to have a lower tolerance for risk than monitors. One monitor commented that the regulators in their sector were “hard-wired to consider and address risks. They are probably tougher on themselves than we would ever be.” (Spencer, 2014, p. 13)

The greater concern expressed by regulatory Crown entities (compared to policy departments; see Chapter 9) about the problem of outdated legislation also illustrates different attitudes to risk:

Monitors, while sometimes acknowledging particular regimes as ‘archaic’, were much less concerned about this. In part, this reflected monitors’ closer relationship to ministers and greater awareness of the difficulties of getting legislation onto the legislative timetable. However, the main reason for boards being more concerned about out-dated legislation appeared to be their narrow focus on, and primary responsibility for, the outcomes of the regulations they administered. (Spencer, 2014, p. 13)

Given the information asymmetries involved, it is important for all parties to be clear that boards of regulatory Crown entities are appropriately responsible to ministers for performance of the regime within the limits of the law.

**F10.1**

Boards of Crown entities, not departmental monitors, are accountable to ministers for the performance and effectiveness of the organisation.

Boards and monitors generally saw the role of the board in the same way: "...the board is directly accountable to the minister for the entity's performance". This was achieved through formal accountability arrangements, regular reporting (quarterly, and sometimes as regular as weekly), and meetings with the minister:

Discussions at these meetings were focused on both strategy and issues of the day. The frequency of meetings between chairs and their responsible ministers ranged from monthly to 6-monthly. For each entity the frequency of this engagement was subject to change according to the preferences of the particular minister (eg one board used to meet its minister monthly but meets its current minister only twice a year).

While the responsible minister's relationship is formally with the board, it was common for chairs to be accompanied by the CE [chief executive] and possibly other senior managers when meeting the minister. In some cases the minister had more regular contact with the entity's CE than with the chair. For example, in one case the minister met the entity CE monthly and the chair less often. In another case there was a weekly meeting between the minister and the monitoring department, attended also by the entity's CE, while the chair saw the minister only every 6-8 weeks.

In all but one case, the monitor was also represented at meetings between the entity and the minister. The monitor who was not included in these meetings commented this was a long-standing arrangement, believed to stem from the board's interpretation of its independence (in this case, a Crown agent).

Chairs frequently mentioned the need to avoid any 'surprises' for their minister, some saying they were able to pick up the phone to the minister as needed to ensure this. (Spencer, 2014, p. 6)

SSC guidance to Crown entities on the preparation of governance manuals (2014) notes that:

While a relationship between the Minister and the board is through the chair, this is not always practical given geographical differences. Board members and the chief executive must be clear about who has contact with the Minister and the Minister's office. Where a chief executive is meeting regularly with the Minister, protocols should be set in place around this including feedback given to the board on all meetings. (p. 13)

Chapter 9 discusses how institutional forms vary in terms of their independence and how arm's length they are from the responsible minister. The degree of ministerial interest in the regulators clearly differs depending on the regime, and frequently depending on the personal interest of the minister. For two of the Crown entities whose chairs were interviewed, the minister was meeting the chief executive of the entity much more frequently than the chair. This could indicate:

- a breakdown in the effective governance or oversight of the entity; or
- that the institutional form of the entity is not right (see Chapter 9).

Ministerial confidence in the governance of a regulator is important. It will allow a minister to step back and let the entity get on with its functions. A lack of confidence will inevitably lead to closer contact and oversight from the minister, and more monitoring.

**F10.2**

A high degree of interaction between a minister and the chief executive of a regulatory Crown entity, without the participation of the board chair, can be a signal that the governance, oversight or form of the entity may need to be reviewed.

## What makes boards effective?

A report from the SSC, the Treasury and the Department of the Prime Minister and Cabinet (DPMC) highlighted findings from the Performance Improvement Framework (PIF) with relevance to Crown entities (Box 10.1).

**Box 10.1 Getting to Great – lessons for Crown entity governance****What does the literature and PIF findings tell us about Crown entity governance?**

The Crown entity sample for PIF is small. However, our experiences from working with private sector boards suggest the following areas may require careful attention:

- The Board's role in the development of strategy and purpose may be unclear,
- Boards may be somewhat invisible to staff and their governance role unclear,
- Boards suffer with information asymmetries and can be overly influenced by Chief Executives (CEs), and
- Boards can see monitoring processes as bureaucratic impediments rather than as catalysts to embark on the necessary strategic narrative for their organisation with a minister and the organisation.

From literature we reviewed, the best Board/CE leadership partnerships are forged where there is mutual respect, energetic commitment to the future success of the enterprise and strong bonds of trust. As the filmed roundtable discussion amongst Lead Reviewers and senior leaders section suggests, great Boards support smart entrepreneurial risk taking with prudent oversight, wise counsel and encouragement. (p. 15)

**Why is [Leadership and Governance] important?**

In the first Getting to Great report, we stressed that the key finding of PIF was that if agency purpose and strategy is unclear, then most other elements of organisational performance are 'weak', especially in the people dimensions. We found that a strong purpose and clear strategy were the starting point for effective leadership and all other elements of people management.

Effective leadership teams, including Boards, will develop with their organisation a clear purpose and reason for being ('why we are here') and a strategy to support it ('what we'll do and how'). They will be engaged on a dynamic 'strategic narrative' and regularly review and develop strategy, as well as monitor and report on results ('how we know we're getting there'). Whereas in the past, purpose and vision might have been driven from a negative positioning (cost reduction, burning platform, etc) the most effective approach, particularly in the current environment, with its greater emphasis on results, appears to be a more positive purpose (which Lead Reviewers often call 'the-light-on-the-hill').

The literature also suggests the best leadership teams work with their people to develop a powerful collective ambition and hold themselves to account for specific results and targets in realising it. When leadership and governance operate in this way, they are reminding staff of why they come to work, every day. Staff see the future for their agency as one of boundless possibilities and find real meaning in their work. Under these conditions, it is much more likely staff will be impelled to focus on results, be creative about the ways to get there, give great service to customers, add value to the public service brand and find strong personal satisfaction as a result. (p. 10)

*Source:* SSC, New Zealand Treasury and DPMC, 2014a.

Strategic leadership emerges as a key theme from the PIF analysis. In its submission Chorus emphasises the importance of getting boards right:

Tone comes from the top. Governance and leadership are key vehicles to drive culture, talent, evaluation and performance towards high quality regulatory decision making. (sub. DR 90, p. 4)

The type of appointments made will filter through the organisation, the talent appointed and decision-making approaches. (p. 6)

**F10.3**

The quality of strategic leadership from the board of a regulatory Crown entity strongly influences the effectiveness of the organisation.

Interviews conducted for the Commission with board chairs of regulatory Crown entities and their monitors revealed that two factors were seen to be critical to effective strategic leadership: a meaningful set of performance measures and a competent board.

### Performance Measures

Interviews with board chairs revealed wide variation in how boards assessed the (non-financial) performance of entities. Some chairs were very satisfied with their performance measures and relied heavily on them to assess the entity's performance. For example, one chair noted that they had a "suite of input and output measures, with targets set by the board." But this was far from the norm.

In contrast, a number of chairs were still actively working on getting a meaningful set of KPIs [Key Performance Indicators] established for their entity's substantive functions:

- One chair commented there was insufficient board focus presently on the entity's strategic objectives with the monthly board meetings being focused on financials and progress on a range of projects. This entity was working on developing risk profiles to help them to better target their regulatory activity. The chair felt these profiles should have already been in place when s/he took up their role, but weren't.
- One chair had struggled to get management buy-in to targets and had not been pushed on this by the monitoring department. S/he commented that measures and target-setting is generally weak across the public sector.
- One was 'playing catch-up' to get measures in place with work underway to expand measures beyond financial and into operational areas.
- One was struggling to develop measures to capture the entity's impact and noted that they may need to take a longer-term (multi-year) perspective.

Two chairs mentioned meaningless or 'waste of time' measures included because the monitoring department or OAG [Office of the Controller and Auditor-General] required them. These were volume measures which counted activity but said nothing about the quality of performance. (Spencer, 2014, pp. 10-11)

Measuring the performance of regulators is inherently more difficult than measuring the performance of service delivery agencies. So it is not surprising that board chairs reported difficulty devising meaningful performance measures, or difficulty generating internal or external agreement over measures and targets.

#### F10.4

Boards of regulatory Crown entities report difficulties in developing and gaining agreement on meaningful performance indicators. Activity measures by themselves are not effective indicators of regulatory performance.

### Board skills and appointments

Monitors interviewed expressed the view that ministers need to know how to select a board, but they are not necessarily "hard-wired" with the right skills for this. It was suggested in the course of interviews with board chairs and monitors that the Commission should consider a more transparent and robust process for board appointments. One suggestion was to change from the current practice of effectively ministerial appointments (and in the case of Independent Crown Entities, appointments by the Governor-General on ministerial advice), to a model where ministers and board chairs would be able to veto appointments made via a bureaucratic process (presumably entailing something like an expert governance appointments panel). This would be similar to the process for appointing the Governor of the Reserve Bank of New Zealand (RBNZ). The RBNZ Board nominates the Governor to the Minister of Finance; the Minister can reject the nomination, in which case the RBNZ Board will provide another nomination.

Other countries have grappled with the appropriate extent of ministerial involvement in appointments:

Despite the existence of the code [of practice governing ministerial appointments], there has been a continual, and often heated, debate in the United Kingdom about the degree to which ministers should be involved—a tension between those that argue for a system completely independent of ministers as the only way to ensure appointment on the basis of merit and public confidence in the system, and

those that argue that ministers must be involved in the process in line with the principle of representative democracy. (Edwards et al., 2012, p. 215)

Both the United Kingdom and Canada have introduced parliamentary scrutiny of public sector governance appointments, in response to various scandals (Edwards et al., 2012).

While reducing the role of ministers in appointments could have some benefits in New Zealand (because ministers do not necessarily have the requisite skills for building high-functioning boards and there is a risk of patronage rather than merit-based appointments), this is outweighed by other disadvantages:

- if a board wants to be empowered to govern (as they reported in interviews), then their minister must first trust it; and
- reducing the input of ministers to appointments could weaken political/ministerial accountability for entity performance: ministers must remain accountable to Parliament for their Crown entities.

The Commission was told of weaknesses in the processes that support capable regulatory boards:

- appointments are generally managed by policy analysts in the monitoring department, with often little or no input from specialists in human resources or governance appointments;
- variation in the quality of departments' analysis of the skills required on a board;
- variation in candidate identification and appraisal processes (for example whether positions are advertised, or whether interviews are held and written up);
- variation in whether an understanding of regulation (see Chapter 3) is identified in board member position profiles as a required or desirable attribute;
- a lack of evidence that potential influence on regulator culture (see Chapter 4) is a factor in appraising candidates;
- less effort/scrutiny of reappointments than new appointments; and
- variation in the quality of induction board members receive (even given the availability of SSC-produced generic material to support induction) and access to professional development.

In its report on Crown entity monitoring, the OAG (2009a) noted deficiencies.

- In a few cases the departments reviewed did not carry out satisfactory planning for appointment processes. In one case, a department did not identify that a board member's term had expired until five months after the event. In other cases the process did not occur in a timely way, resulting in a gap of 13 months between one member's term ending and their reappointment. Departments did not take into account the conventions constraining appointments in the pre-election period.
- Departments did some work to assess the knowledge, skills and experience needed on boards, but the quality of the work varied.
- Departments did not collect all the disclosure information as required under the Crown Entities Act 2004.
- One department did little work to ensure that new board members received induction information.

The varying quality of appointment processes is also evident in papers to the Cabinet Appointment and Honours Committee that the Commission examined. The CabGuide currently indicates that appointment papers should:

- present, succinctly and accurately all the information that ministers need to consider the proposed appointment properly; and
- explain what process has been followed for the proposed appointment.

Ministers are required to certify that an appropriate appointment process, consistent with the SSC guidelines, has been followed.

In practice, it appears that certification is all that is usually included in appointment papers, along with a list of agencies from which nominations were sought. There is usually a discussion of the skills proposed candidates would bring, but less often analysis of what skills a board has and what skills are needed. The certification that a proper process has been followed appears to be a mere formality – rarely is any substantive information about appointment processes provided, as envisaged by the CabGuide. This does not provide enough information for ministers to critically assess appointment processes or proposals.

#### F10.5

There is a wide degree of unjustified variation in the processes used to appoint, re-appoint, induct and support the development of board members of regulatory Crown entities.

In making appointment decisions (or recommendations to the Governor-General), ministers need to be supported by quality appointment processes undertaken in their department. The Crown Ownership Monitoring Unit (COMU) in the Treasury has a comparative advantage in handling appointment processes in Crown company boards because of the volume of appointments it is required to manage. This has allowed it to develop expertise in appointment processes (including identifying the skills needs of company boards) and cultivate a pool of potential directors. By contrast, officials in departments undertake appointments far less frequently, contributing to much of the variation described above.

Crown entity appointments must continue to be managed by the portfolio department because it has subject matter expertise (the objectives of regulatory Crown entities vary far more than the role of Crown companies) and because it is the agent of the minister responsible for the appointment.

The starting point in effective board appointment processes is a thorough analysis of the knowledge, skills, and experiences that are necessary for the board to be effective. Being a board member of a regulatory Crown entity requires an overlapping but different set of skills to other sorts of boards, including other non-regulatory Crown entities. Boards of regulatory Crown entities need to grapple with the comparative difficulty in defining performance measures, require a conceptual understanding of regulation, and will frequently need to take different and frequently far more complex decisions than boards in other contexts.

Board chairs should play an important role in appointment and reappointment processes, and in particular should be central to analysis of skill needs and gaps. Officials will need to analyse what knowledge, skills and experiences are present on the board, and what the gaps are. In doing so, the officials will need to engage closely with the chair of the Crown entity.

This sort of appointment analysis requires more than generic policy capability. While some departments do carry out appointment processes to a high standard, in general officials in departments could be better supported by a centre of expertise to undertake the appointment processes. Maintaining a register of appointments, this centre could work with the policy department to ensure that appointment processes are well planned, begin in a timely way, are informed by the centre's expertise in governance skills assessment, and that new members received high quality induction. It would work with the policy department and the chair to ensure a robust assessment of skill needs and gaps is undertaken.

Such a function could be developed in a number of places. The SSC already produces good generic appointment guidelines and induction material that departments should be drawing on. COMU has a wealth of experience and insight into managing high quality appointment processes in a commercial context. If the recommendations in Chapter 16 are accepted, a strengthened agency supporting the minister with responsibility for regulatory management would bring a particular understanding of the business of governing regulators.

Such a centre would have a better understanding of the particular skills required to govern regulatory Crown entities than either COMU or the SSC. This centre would also be better placed to leverage COMU's expertise in Crown company appointments than SSC. The number of regulatory Crown entity boards means

it will be able to develop expertise in regulatory governance appointments and develop a wider pool of prospective board members.

The centre should agree with policy departments on the degree to which it will support the department in running the appointments. There should be an expectation that the centre is consulted on all papers proposing appointments and reappointments to regulatory Crown entities, in the same way that the Treasury is consulted on all papers with financial implications, and an expectation that the centre will comment on the quality of the appointment process undertaken.

Better-managed appointment processes, informed by higher-quality analysis of the skill needs and gaps on Crown entity boards, will deliver better candidates who better meet a given board's skill needs to ministers for consideration. In turn, more capable boards will improve the governance and performance of regulatory Crown entities.

#### R10.1

The centre supporting the minister for regulatory management should actively support departments in managing appointments and reappointments to regulatory Crown entities. It should particularly assist departments in analysing the knowledge, skills and experiences required on the board of each regulatory Crown entity, and work with the department and the board chair to analyse the current skills on the board.

#### R10.2

The Cabinet Office should require that agencies consult with the centre supporting the minister with responsibility for regulatory management, before submitting papers proposing the appointment of members to regulatory Crown entities. The centre should be able to insert a comment in appointment papers about the quality of appointment processes undertaken.

#### R10.3

The State Services Commission and the Treasury should evaluate the effectiveness of more active support of regulator board appointments, and advise the Government on whether a similar process should apply to non-regulatory board appointments.

There also appear to be unrealised opportunities to leverage the expertise of some individuals in governing one field of regulation to improve the governance of other areas of regulation. The process of ministerial appointments means that some of the barriers to developing a cross-sector professional regulatory workforce need not apply at the governance level, providing departments are assisted to identify capable governors who have developed particular expertise in regulatory governance in another regulator.

The SSC and the Treasury should be well placed to identify such individuals if the recommendations identified in Chapters 13, 14 and 16 of this report are adopted.

Cross-appointments between boards would provide a mechanism for governors to apply lessons learned in one sector of regulation to others, and help support the spread of effective regulatory governance strategies. For example, cross-appointments between members of the Commerce Commission and the Australian Competition and Consumer Commission have been valuable in considering trans-Tasman merger clearances. Given the degree to which many areas of regulation involve the domestic enforcement of international standards, there are likely to be benefits from exploring further opportunities like this.

#### F10.6

Opportunities exist to enhance the capability of boards overseeing regulatory Crown entities by leveraging the regulatory expertise developed by board members in other fields of regulation. This could be done by cross-appointing members of regulatory Crown entities, and by exploring further opportunities for international cross-appointments.

## The interests of board members

There are good reasons to have individuals with experience in the sectors being regulated on the board of regulatory organisations. A common complaint in submissions from businesses to the Commission was that regulators can lack a genuine understanding of regulated businesses. In the Commission's survey of 1,526 businesses, 37% disagreed that "regulators understand the issues facing your organisation", with 25% agreeing (Colmar Brunton, 2013).<sup>55</sup>

The Civil Aviation Act 1990 and the Maritime Transport Act 1994 provide for the relevant Minister to appoint board members of the Civil Aviation Authority (CAA) and Maritime Safety Authority respectively. Members must be individuals whom the Minister considers will "represent the public interest" in civil aviation or maritime matters. Before appointing two of the members, the Minister must request, from organisations representing the relevant industry in New Zealand, the names of persons those organisations consider proper candidates for appointment to the relevant Authority.

In its submission, the CAA says: "...however, in the CAA's case, the Civil Aviation Act 1990 (at s 72A) expressly provides for two of the Authority Board members to be representative of the industry" (sub. 6, pp. 23-24).

Aviation New Zealand notes that there are two industry "representatives" on the CAA board, but complains that in "recent times there has been no consultation with industry in terms of nominating potential candidates" (sub. 36, p. 38).

These references to industry representatives on boards appear to misstate the situation in two key respects.

- The Minister has no apparent obligation to appoint candidates nominated by organisations representing the relevant industry. This may be common practice, but the Minister's only obligation is to seek nominations.
- If appointed, those board members are not industry representatives. Their clear function is to represent the public interest, and to fulfil their duties under the Crown Entities Act 2004.

There is clearly some confusion about the role those members, that industry may have nominated, are expected to play as governors. The belief that these board members are representatives of industry is erroneous but appears to be widely held.

### F10.7

There is evidence of confusion around the role that some members of Crown entity boards with industry backgrounds are expected to play.

## The potential for conflicts of interest

Maritime New Zealand notes the potential for real or perceived conflicts of interest arising from having industry participants in governance roles:

If the Board exercised the powers of the Director (i.e. made decisions about the privileges an organisation or individual holds), then arguably Board members should not have interests in, or be from, the civil aviation industry. (sub. 6, p. 24)

The SSC's recently revised Board Appointment and Induction Guidelines (2013a) notes that:

New Zealand's comparatively small population and the limited number of people who possess particular combinations of skills and experience, mean it is always possible that questions of interests will arise. This will tend to put a focus on identifying and managing interests, rather than disqualifying all those who have interests. (p. 19)

<sup>55</sup> Among the sub-categories of business most likely to agree that regulators understand the issues facing their business were transport, postal and warehousing firms (44% agreed). This may indicate some success in having individuals with expertise in aviation or maritime matters on the boards of those respective regulators. Firms most likely to disagree included those involved in agriculture, forestry and fishing (47% disagreed), rural businesses (46% disagreed) and exporters (45% disagreed).

The Commission is also concerned that in a small country like New Zealand the risks of governance members having to deal with potential conflicts of interests in the course of their work is heightened. If a large number of board members are unable to participate in individual decisions, the quality of those decisions may be jeopardised or the effective governing of the agency undermined.

### Mechanisms for dealing with conflicts of interest

Acquiring the benefits of appropriate sector expertise on the governance of regulators, while avoiding perceived or real conflicts of interest, requires a number of mechanisms:

- comprehensive declaration of potential conflicts of interest, before candidates are appointed to boards;
- appropriate management of potential conflicts of interest of board members; and
- a clear understanding of the role expected of board members.

Existing guidance material appears to comprehensively provide for the first two mechanisms. The SSC's guidance (2013a) describes an extensive range of interests to be considered and declared by candidates for appointment, and advice for how ministers should assess those interests when considering appointments. The SSC's induction material for new members of Crown entity boards (2008) also provides a practical discussion of managing real or perceived conflicts of interest.

**F10.8**

There is good SSC guidance on managing conflicts of interest for members of Crown entity boards.

This guidance is given effect through corporate policies about conflicts of interest within each regulator. Given the heightened risk of conflicts in New Zealand, such policies should be publicly available on the websites of all regulators.

**R10.4**

Regulators should make their conflict of interest policies available on their website.

The Crown Entities Act 2004 states that board members have an individual duty to act with honesty and integrity, and to act in the entity's interests and not in their own interests (ss 54-55). While board members may be appointed for their particular backgrounds, experiences or expertise, they should not act in their governance capacity as "representatives" of any particular sectoral group.

The Organisation for Economic Co-operation and Development (OECD, 2013b) notes that where industry stakeholders are members of a regulator's governing body, it is important to be clear that they are participating as experts rather than as representatives. It says that the risk of governors acting as representatives is heightened where the regulator has an explicit "industry development" objective.

The Government of Victoria's principles for the governance of regulators (2010) make a similar point: industry stakeholders on governing bodies are there to take decisions in the public interest rather than as representatives. It also states that where there is a need for formal representation of specific stakeholders, this should be addressed by establishing an advisory or consultative committee rather than through representation on the board.

### Issues in the New Zealand context

The Council of Trade Unions (CTU) considers that:

...the independence, effectiveness and public confidence in a regulator can be enhanced by having balanced representation of affected interests in its governance structures. The balance is essential to prevent any suggestion of capture, but the presence of such parties can give assurance that the regulator is constantly reminded of the realities on the ground and there is monitoring of undue political influence or influence from any one party. It can also assist in creating a cooperative atmosphere for ongoing work despite differing interests. ... New Zealand has moved much too far

down the path of stripping governance boards of representatives of those affected. That should be reversed. (sub. 25, pp. 19 and 26)

The Commission endorses the view of the OECD and the Victorian government. The CTU is right about the importance of different perspectives and the value that those with practical expertise and experience can bring. However where governors are framed as *representing* sectional interests, tensions will inevitably arise between the governance and representative roles. Board members should not be described as, or act as, sectoral representatives, to help ensure that this tension is resolved in favour of ensuring an agency effectively and lawfully exercises its functions and powers to achieve its statutory objectives.

Exceptions to this should be rare. One example might be where government established co-management arrangements with Māori or other groups.

#### F10.9

No board member of a Crown entity should be appointed to act as a representative of any external group. Regardless of their background, experience and prior or ongoing association that make them valuable as a board member, their duty should always be to ensure the entity acts in a manner consistent with its statutory objectives and functions, and not as the representative or agent of any external group. The exception is where co-management arrangements are expressly intended.

The particular framing of the Civil Aviation Act 1990 and the Maritime Safety Act 1994, which provide for candidates for board membership to be nominated by representatives of the respective industries, has given rise to confusion about whether some board members are acting as *representatives* of external groups on the board of the regulator. Board induction guidance should be amended to emphasise that they are not.

#### R10.5

The State Services Commission's guidance about appointing board members to Crown entities and its induction material for new board members provide good information on the duties of members. But it should update these documents to emphasise that a member is neither appointed nor should act as the representative or agent of any external group.

In its submission, the Treasury and the SSC indicated there would be an opportunity to "add some wording" to this effect (sub. DR 97, p. 16).

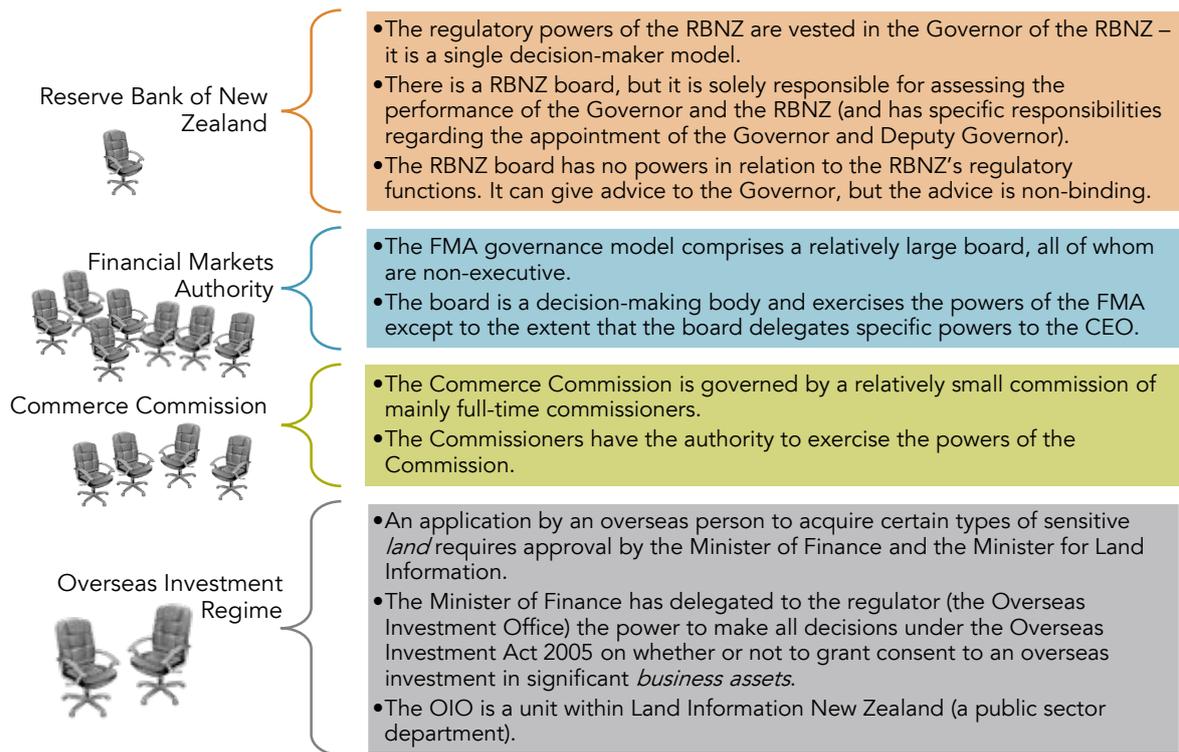
### 10.3 The allocation of decision rights

There are a wide variety of decision-making models within New Zealand regulatory regimes, even among similar regulators such as those that regulate the financial and investment sectors (Figure 10.1).

There are also hybrid models in the allocation of decision rights. For example, in the CAA the Board takes decisions about policy and procedures, and the Director of Civil Aviation takes decisions about individual regulated parties.

This variety partly reflects that each regulator was established at different times and in different contexts. It also reflects a tendency for regulatory functions to be grafted onto existing regulatory agencies without the governance arrangements necessarily changing. This is the case with the RBNZ, for example, where its governance arrangements were established in 1989 and largely designed for its primary function of monetary policy. Little specific regard was given then to the governance issues applicable to its regulatory functions. Moreover, since 1989, its regulatory functions have expanded substantially, but its governance arrangements have not changed. The RBNZ notes, however, that its accountability requirements have increased over time (sub. DR 99).

Figure 10.1 Decision rights in selected sector regulatory regimes



The variety of governance, funding and accountability arrangements also reflects that some are constituted as independent Crown entities (the Commerce Commission), some as government departments (the Overseas Investment Office) and some as entities of a unique institutional form – as with the RBNZ.

There may be sound reasons for some differences in governance arrangements across these regulators, given the different scale and scope of their respective regulatory functions, and their other responsibilities (for example, as with the RBNZ’s monetary policy role). RBNZ submitted that the current model was appropriate and had allowed it to function well (sub. DR 99). However, at least in some respects, the differences do not appear to be well anchored to sound regulatory governance principles.

### F10.10

The variety of internal governance arrangements and allocation of decision-making rights in regulators appears to be ad hoc rather than based on sound governance principles.

## Ministerial decision making

Ministerial decision making in regulatory regimes is inherently less independent of the political process. In Figure 9.3 the Commission outlined features that indicate a need for less or more independence when establishing regulatory regimes. These features are salient not only to whether the regulatory functions are established in an agency close to or at arm’s length from ministers, but also who in the regulatory regime should be allocated decision-making powers.

### Box 10.2 Submitters’ views on the role for ministers in decision making

Value decisions were those most commonly cited by submitters as being appropriate for ministerial decision making. These sorts of decisions usually entail a balancing of trade-offs which are not easily resolved on a technical basis. In these situations, “good” decisions should reflect community valuations, and ministers are elected to reflect those values.

Tasman District Council considered that it would be useful to have “some criteria around contentiousness, costs implications, sensitivity, that might assist in determining where the locus of

decisions rests with an elected representative or a public official" (sub. 1, p. 3).

Carter Holt Harvey was of the view that "regulation requiring value judgements should be retained at the highest reasonable 'political' level rather than devolved, to encourage accountability for subjective interpretation" (sub. 8, p. 8).

The Financial Markets Authority (FMA) said: "In our experience, matters that are reserved to Ministerial decision-making are likely to be sensitive or in the national interest, and therefore may require a broader array of advisory inputs than purely that of the regulator. We would prefer that this type of decision-making be the exception rather than the rule, given that a Minister may be challenged over perceptions of independence" (sub. 53, p. 4).

By contrast, Aviation New Zealand considered that decisions which should be the preserve of the Minister included "where matters are akin to tertiary legislation ... Rule making; policy decision which may not end up in a Rule; delegation of powers to external groups or individuals; international treaties, extensions of emergency rules; fees and charges" (sub. 36, p. 15).

2degrees said that New Zealand was an outlier in terms of some of the decisions allocated to Ministers: "Unlike in other jurisdictions such as in the UK, decisions regarding spectrum management/allocation continue to be made by the Minister rather than the independent regulator. This risks complex issues such as the consideration of competition issues under the Commerce Act not being given due consideration prior to decisions on allocation. In addition, in the case of a spectrum auction, there exists an inherent conflict in that the Crown is also the vendor of the spectrum under the Commerce Act" (sub. DR 84, p. 2).

Ministerial decision making is appropriate in the case of decisions with:

- significant value judgements, involving trade-offs that are not readily amenable to analysis; or
- significant fiscal implications, or which are integral to a government's economic strategy.

Such circumstances will be rare. The Commission prefers mechanisms that allow for the transparent intervention of ministers (see Chapter 9), to the broad allocation of decision-making power to ministers.

#### F10.11

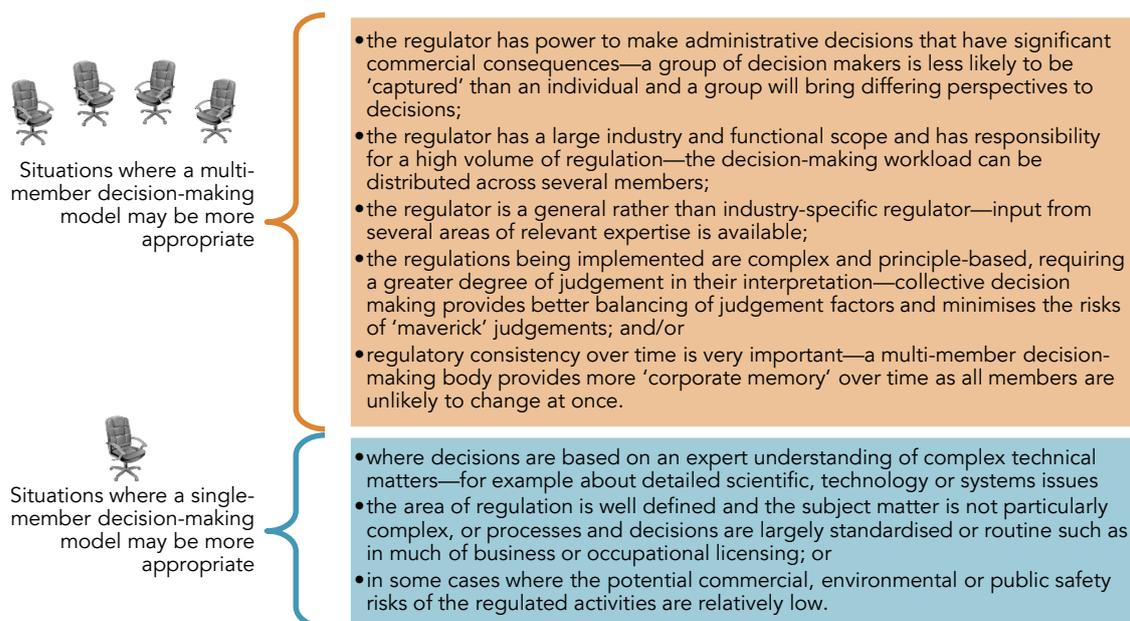
Ministerial decision making is likely to be appropriate where decisions involve:

- significant value judgements, where trade-offs are not readily amenable to analysis; or
- significant fiscal implications, or which are integral to a government's economic strategy.

## Single-member decision making or multi-member decision making?

In many circumstances, multi-member decision making can offer significant advantages (Figure 10.2).

In its submission Chorus also argued in favour of boards rather than individuals taking decisions: "The perception and actual decisions of an informed diverse group is likely to be more robust than the potential risks involved in individual judgements and personalities. This can also mitigate any concerns about regulatory capture while still enabling individuals to be informed and connected to the real world" (sub. 51, p. 11).

**Figure 10.2** When single-member or multi-member decision making is appropriate

Source: Adapted from Victorian State Services Authority, 2009.

The CAA submitted that decisions about complex subject matter requiring expert knowledge may be more appropriate for single-member decision-making models: “Where those decisions are dependent on technical understanding (e.g. of technology or complex systems, etc.) then there is merit in using single-member decision-making models with appropriate accountability and governance frameworks” (sub. DR 64, p. 5).

A prominent example of an individual being vested with significant decision-making power is the Governor of the RBNZ (Box 10.3).

### Box 10.3 Decision making at the Reserve Bank of New Zealand

In its submission, the RBNZ said that it had “functioned well under the single decision-maker model since the late 1980s” (sub. 9, p. 5). The single decision-maker model provides for strong accountability for the RBNZ’s decision:

The principal, and we think considerable, advantages of a single decision-maker structure model are the strong accountability and the coherence in decision-making and policy communication that it makes possible. (Non-Executive Directors of the RBNZ, 2000, p. 3)

In the course of the Commission’s case study into regulation of the financial sector, interviewees raised some concerns about the single decision-maker model in the RBNZ. Some thought it concentrates too much power in one person and creates a risk of poor-quality decision making, including because of over-confidence.

Many favoured a model in which the governance of the RBNZ and other regulators is vested in a small (4–5) member full-time executive board, with a view to deriving the benefits of diversity of skill and experience and reducing the risk of dominance by one person. Some stakeholders noted that this governance structure is commonly applied in other countries, including in Australia in respect of the Australian Prudential Regulatory Authority and the Australian Securities and Investments Commission.

Indeed the Governor of the RBNZ is moving tentatively in that direction, as he noted in a speech in 2013:

In order to assist with major policy decisions, we recently introduced a Governing Committee, comprising the Governor, the two Deputy Governors and the Assistant Governor, under the chairmanship of the Governor. The Governing Committee will discuss all major monetary and financial policy decisions falling under the Bank’s responsibilities, including decisions on monetary

policy, foreign exchange intervention, liquidity management policy, prudential policy (both micro and macro) and other regulatory policies. To date, individual Governors have taken responsibility for particular areas of the Bank, such as operations, monetary policy and financial stability. Going forward Governors will have more individual and collective involvement in key decisions taken across all areas of the Bank. This is the same decision-making framework adopted by the Bank of Canada, which also has a single decision-maker model. As with the Bank of Canada, the Governor retains the right of veto on committee decisions. The Committee formalises and expands past practice. (Wheeler, 2013)

This development in decision making at the RBNZ is a welcome evolution. In time, lessons about the effect of the Governing Committee on regulatory (and other) decisions would provide evidence about the benefits of different decision-making models in other areas of regulation.

Single decision makers do not operate in a vacuum. Typically, decisions are taken on the basis of analysis and advice. Individual decisions, whether taken by a minister or chief executive, reflect a judgement about the arguments of others for and against the decisions.

Additionally, as the CAA notes, there can be a relationship between the decisions taken by single-member and multi-member decision makers. In the case of the CAA, the board sets policy and the Director of Civil Aviation (the chief executive) takes decisions as they relate to individual parties. In this way the board influences how the director's decisions are taken, but not in a way that constrains those individual powers (sub. 6, sub. DR 64).

#### F10.12

In practice, the distinction between single-member and multi-member decision making is not always sharp. Overarching policies can control, and colleagues/staff are likely to inform, the actions of individual decision makers.

Both single-member and multi-member decision making processes entail risks (Figure 10.3).

**Figure 10.3 Drawbacks of single-and multi-member decision making processes**



#### Drawbacks of single-member decision making processes

- bias that arises from having a single perspective
- bounded rationality (limited information, time, and capability to process information)
- an overreliance on heuristics (decision-making shortcuts)
- the particular incentives that apply to individuals, whether political, reputational, or financial

#### Drawbacks of multi-member decision making processes

- less timely and more costly
- risk of 'groupthink', particularly among homogenous groups
- decision can be affected by the relative status or personality strength of group members
- may be more difficult to hold the group accountable for decisions than the individual
- where group members are inclined the same way, consensus may form around a more extreme decision than if the decisions were taken by any individual ('group polarisation')
- where group members disagree, consensus may form around the most acceptable or lowest risk decision, rather than the best decision

The academic literature supports the proposition that multi-member bodies have the potential to reach better decisions than individuals, reducing the likelihood of error or maverick judgments (Bainbridge, 2002). Their ability to bring a broader range of skills and perspectives to bear on decisions is a distinct advantage:

Team production is imperfect, whether the product is a manufactured good or a corporate decision. Teams are subject to unique cognitive biases, such as groupthink, and unique sources of agency costs,

such as social loafing. With respect to the exercise of critical evaluative judgment, however, groups have clear advantages over autonomous individuals. Not only do groups clearly out-perform average individuals in a given sample, there is considerable (albeit contested) evidence that the process of group interaction has synergistic effects allowing groups to outperform even the best decisionmakers in the sample. (Bainbridge, 2002, p. 54)

Whether multi-member bodies deliver on their potential for better decisions depends on the quality, diversity and skills of members in the body, and the quality of the decision-making processes followed. This reinforces the importance of ensuring that the board is equipped with the necessary range of skills and experiences to manage effective decision-making processes on relatively complex issues.

### F10.13

Multi-member bodies offer the potential to produce higher-quality decisions than individuals because of the wider range of skills and perspectives. Whether they do deliver better decisions depends on the quality of members and the quality of the body's decision-making processes.

The Commission asked government regulators who within their organisation took decisions about a range of activities: approval of activities; frequency and targeting of monitoring; issuing warnings; seizing property or contraband; and initiating prosecutions.

- Regulators appear to make extensive use of delegation, including from ministers to chief executives, boards to chief executives, chief executives to managers, boards to senior managers, and from one management tier to another.
- Overwhelmingly, regulators told us that these decisions were taken by governors or management (often senior management). Areas where decisions were taken by front-line staff included:
  - approval of activities pursuant to the Gambling Act 2003 by the Department of Internal Affairs;
  - monitoring and approval of energy efficiency regulations by the Energy Efficiency and Conservation Authority;
  - monitoring activity undertaken by the New Zealand Walking Access Commission;
  - seizing property/contraband under the Climate Change Response Act 2002 by the Environmental Protection Authority
  - issuing warning by Health and Safety inspectors of the Ministry of Business, Innovation and Employment;<sup>56</sup> and
  - monitoring and approval of activity undertaken pursuant to the Cadastral Survey Act 2002 by Land Information New Zealand.

The Commission's impression is that this understates the amount of decisions taken by front-line staff, in part because not all agencies responded to the information request. There are no clear patterns in terms of who makes different types of decisions.

Chapter 5 points to concerns on the part of regulatory staff about training and support for skills development. It also reports strong perceptions on the part of businesses that regulatory staff lacked skills and knowledge.

### F10.14

There is extensive delegation of regulatory decisions within New Zealand regulatory regimes. In practice, decisions are taken by a range of compliance staff, managers, chief executives, boards and ministers.

<sup>56</sup> WorkSafe New Zealand now has this responsibility.

## Multi-member decision-making bodies and governance

The preference for multi-member decision-making bodies means that in many circumstances the decision-making body is also the governance body. This does create challenges in how a group of individuals properly holds itself accountable.

The dual role of a board making regulatory decisions as well as governance decisions has both advantages and disadvantages. The advantages are that a board is connected to the business in an operational sense through understanding the issues and constraints that decision makers face. The disadvantage is that the time, costs and technical knowledge requirements of acting in the decision maker and governance roles are a challenge for Board members. (EPA, sub. DR 103, p. 4)

This overlap of responsibilities is different to that in traditional corporate governance. However it is not unusual in a public sector context. Such overlap occurs to a greater or lesser degree in the Commerce Commission, Human Rights Commission, FMA, Takeovers Panel, Broadcasting Standards Authority, the Law Commission and the Productivity Commission, among others.

Where decision rights are vested in a multi-member decision-making body that is also a board (for example, where rights are vested in members of a regulatory Crown entity), it is important to recognise the distinct roles to be played. This distinction can be acknowledged by, for example, ensuring that board meetings are held distinctly separate from meetings that make regulatory decisions.

Similarly, the respective roles and relationship between the board, board chair, and chief executive will need to be clearly defined, either in legislation or internal governance manuals.

### F10.15

Internal governance manuals should describe how a board will recognise the distinction between the exercise of regulatory functions (including taking regulatory decisions) and internal governance (including oversight and assurance) functions in its operation.

## 10.4 Discretion

Discretion arises when an official is empowered to exercise public authority and afforded scope to decide how to exercise that authority in particular circumstances (Pratt & Sossin, 2009, p. 301). Regulatory discretions typically require the decision maker to exercise their own judgement within the parameters of legally acceptable options.

### Discretionary powers have increased

Reasons why regulation has increasingly involved the use of discretionary decision-making include:

- the increasing span of regulatory control;
- increasingly technical regulation;
- providing for unforeseen events; and
- more principle/outcome-based regulation.

### Span of control issues

As the modern state has encroached into more areas of life, discretionary powers have increased. Legislatures, with their limited capacities and resources, manage the growth in the size, diversity, and complexity of regulation by delegating specific problems and undertakings to subordinate and specially created authorities. Control over a wide range of matters such as social welfare, public order, land use and resources planning, economic affairs, and licensing is delegated to officials with varying degrees of guidance as to the policy goals to be achieved or the standards by which they are to be achieved (Galligan, 1986).

## Increasingly technical regulation

Discretion is not an inevitable consequence of delegation. However, a related explanation is the increasing belief that many regulatory activities are to be approached as technical or scientific problems to be dealt with by specialist agencies (Galligan, 1986). A rule maker's lack of expertise or information about complex technical issues will tend to drive delegation to those who do have expertise in the field. Chapter 5 discusses the relationship between a worker's task discretion, their job satisfaction and organisational effectiveness. Of course the increase in technical regulation does not mean that judgments by regulators should only be judged against technical and scientific criteria.

## Providing for unforeseen events

John Locke, in his *Second Treatise of Civil Government* (1689), recognised the inevitable place of discretion in governmental decision making. He wrote: "Where the legislative and executive power are in distinct hands (as they are in all moderated monarchies and well-framed governments) there the good of society requires that several things should be left to the discretion of him that has the executive power". This was necessary because legislatures could not "foresee and provide by laws, for all that may be useful to the community" (Locke, 1689, Chapter XIV, s 159).

## A move to principle-based/outcome-based regulation

The change in the nature of the tasks undertaken by the state has led to the regulation being judged by its outcomes, not whether the decisions have been made by the impartial application of fixed rules. This naturally leads to a tendency towards the use of discretion (Galligan, 1986).

In New Zealand, the Public Service Act 1912 set up a professional career public service. Public servants were managed and employed by a permanent commission that was independent of political control. Walsh (1991) has argued that this situation introduced a bureaucratic, rule-based model of public service to combat political patronage and corruption. As Hughes and Smart note:

Prescribing a rigid set of processes, rules and hierarchies achieved equity, integrity and procedural due process in the public service. In practice, this meant hard constraints on managers. Control was centralised at the top of a strict hierarchy, with input control as a strong focus. As the Treasury argued (1987, p. 58), 'the tendency [was] to keep managers' discretion at a minimum'. (2012, pp. 3-4)

One feature of the state sector reforms during the 1980s was to provide managers with greater control over employment and mix of inputs so as to allow the more effective and efficient delivery of outputs and outcomes within a stronger performance management framework. Reform of specific regulatory regimes tended to provide more discretion to support the focus on outputs and outcomes.

Regulators submitted that the expectation on them to be risk-based inevitably entails the exercise of discretion. It follows that capability is a key consideration for regulators that exercise discretion:

The key issue here is the need for a more comprehensive understanding of the business of compliance in the sense that it's about changing behaviour. Modern compliance thinking suggests this is about problem solving and risk management – involving the use of soft and hard interventions with the right tool needing to be chosen at the right time to address the right problem. The key to risk based approaches is in having effective information management (intelligence) systems to collect, collate and analyse information. This involves investment in people and technology beyond that used to undertake individual regulatory transactions. (CCCP, sub. 12, p. 9)

### F10.16

Administrative discretion is a feature of many regulatory regimes. Principle-based or outcome-based regulatory regimes inherently involve the exercise of discretion, as do risk-based approaches to implementing regulation.

## Does discretion lead to uncertainty?

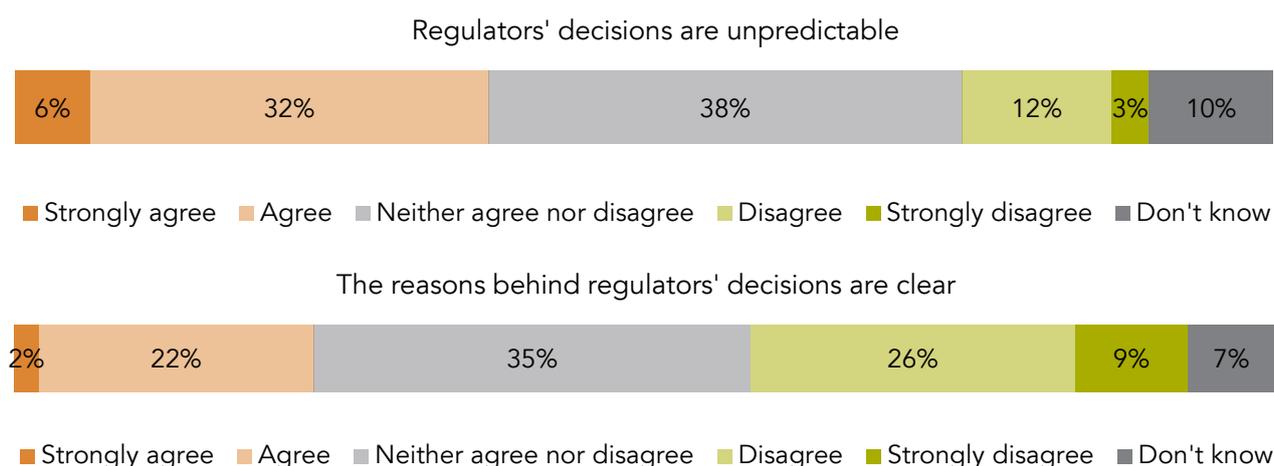
In any system of authority there is tension between certainty and flexibility: between having definite rules and applying them consistently and even-handedly, and enabling decisions to be made according to the specific circumstances of the case and within a broader framework of goals and values (Galligan, 1986).

Rules that are narrowly drawn and strictly applied offer consistency and predictability in the way powers are exercised. They also provide a system of control on officials that minimises the opportunity for the arbitrary or unpredictable exercise of power.

Certainty and predictability as to how regulatory agencies will apply and enforce a given regulation can also be desirable from an economic perspective. The more certain and predictable the actions of institutions and their treatment of property and other rights, the more confidence business has to invest and develop ways of doing things better (Kalderimis, Nixon & Smith, 2013).

The Commission's survey of businesses revealed that more than a third of businesses considered regulators to be unpredictable, and the reasons for their decisions to be unclear (Figure 10.4).

**Figure 10.4 Business perceptions of the predictability and clarity of regulator decisions**



Source: Productivity Commission; Colmar Brunton.

### **Certainty is not the only consideration**

Overly detailed and complex rules may also in practice have the effect of undermining the achievement of policy objectives. An OECD report observed that “[p]eople lose confidence in regulators and governments if they are required to comply with technical rules that do not appear to relate to any substantive purpose” (2000, p. 16). The report highlighted the following features of strict rule-based approaches as particularly problematic:

- regulatory unreasonableness;
- imposition of uniform, detailed, and stringent rules in situations where they do not make sense; or
- regulatory unresponsiveness or failure to consider arguments by regulated enterprises that exceptions to the technical rules should be made.

The OECD report cited studies that show the negative effects of rigid and unresponsive rules on compliance rates. A study by Bardach and Kagan (1982) found that when business people felt that regulators were being overly legalistic when applying rules and imposing fines, they would tend to respond by scaling down their efforts to comply with the intent of the law. They would instead aim to achieve only the minimal level of compliance that the rules required. Other studies have shown that relying on strict, coercive strategies to achieve compliance often breaks down the goodwill and motivation of those actors who were already willing to be social responsible (Braithwaite, 1993).

Narrow and strictly applied rules can impose rigidity and an inability to accommodate new, unforeseen, complex, or unusual situations. The RBNZ's submission recognised the necessity of its discretionary enforcement powers over financial regimes, “where issues that arise are often not ‘black and white’ and discretion in relation to the exercise of enforcement powers is necessary” (RBNZ, sub. 9, p. 8). The Electricity Authority (sub. 50) made a similar point about the desirability of discretion in dealing with complex situations or highly event-specific scenarios.

Rules also restrict what a decision maker may properly consider in making a decision. This may prevent making decisions that provide the best accommodation of values and purposes and which achieve the best result in the particular case (Galligan, 1986). ANZ's submission stated that "the key benefit of regulatory discretion is that it can better align the operation and effect of regulation with the specific factual context in which it applies" (sub. 24, p. 9).

Certainty is important, but is not the only objective of regulation. Other general criteria – such as legitimacy, efficacy, and fairness – also need to be balanced in regulatory design.

### **Discretionary decision-making need not lead to uncertainty**

As recognised by submitters, certainty and flexibility in regulatory rules each offer benefits and drawbacks. Tasman District Council submitted:

The term "risk-based" is just another way for exercising a discretion as to whether or not to make a decision in a particular way. ... There are situations where prescription and certainty is appropriate and equally there are situations where flexibility and discretion should likewise be possible. It is not a question of one without the other. (sub. 1, p. 4)

Kalderimis, Nixon and Smith (2013) argue that certainty and discretion should not be seen as diametric opposites or as the same type of concept. Certainty is an objective of regulatory design, while discretion accorded to institutions is a mechanism that can be used to achieve various objectives of regulatory design. As they note:

Thus, the use of discretion will, in some circumstances, increase certainty; in other cases, discretion may reduce certainty but serve other objectives (such as flexibility or durability), and the reduction in certainty caused by the presence of discretion may be mitigated by other mechanisms. (p. 2)

For example, the Reserve Bank of New Zealand Act 1989 vests considerable discretion in the Governor, but the Governor exercises those powers in such a way that preserves tolerable levels of certainty. In monetary policy this is done by having transparent objectives, providing comprehensive information on the economic context, providing regular statements that signal future policy intentions, and taking a usually incrementalist approach to the use of policy instruments.

A range of legal constraints and non-legal constraints on the exercise of discretion help to prevent uncertainty.

### **Constraints on discretion**

The exercise of discretion is constrained by legal and non-legal methods of control, including judicial review and the common law principles of administrative law; guidance and policy that the decision maker adopts to guide the exercise of discretion, cultural and institutional constraints and transparency.

The arbitrary exercise of excessive discretion would subvert the rule of law by making rule-making retroactive, "as the manner in which such discretion will be exercised is never knowable prospectively..." (Salembier, 2002, p. 172).

The central principle of the rule of law is that state power, to the extent that it affects individuals, must be exercised according to binding general rules made and known in advance, and must be of sufficient specificity to allow individuals to know with tolerable certainty their rights, obligations, and liabilities (see Chapter 2).

The range of legal and non-legal constraints means that the exercise of discretion need not be at odds with the rule of law. There are strengths and weaknesses on these constraints in the New Zealand context.

### **Legal constraints on discretion**

Public sector decision makers do not have unfettered discretionary power. Although Parliament often confers wide discretions when empowering public authorities, discretionary power has legal limits:

“[D]iscretion is not absolute or unfettered”.<sup>57</sup> When a statutory provision provides, for example, that “the Minister may make such orders as he or she thinks fit”, it does not literally mean what it says because that would enable arbitrary decision making (Joseph, 2007, p. 849). However unlimited the decision maker’s discretion may appear to be, there are legal limits on the exercise of that discretion.

Some limitations on the exercise of discretion may be explicit: for example, the purposes for which a particular power was given or the criteria to be applied in exercising it may be set out in the legislation. Other limits will be implied by the other parts of the legislation. And other limits will derive from general rule of law principles in the particular context of administrative law and the exercise of decision-making powers (Figure 10.5).

**Figure 10.5 Administrative law principles about the exercise of discretion**



In exercising discretionary powers, administrative law principles require decision makers to:

- use discretionary powers in good faith and for a proper purpose;
- base their decision on logically probative material (rational reasons, information that proves the issues in question, relevant and reliable evidence);
- consider only relevant considerations;
- give adequate weight to a matter of great importance, but not give excessive weight to a relevant factor of no great importance;
- exercise their discretion independently and not act under the command of any third person or body;
- give proper, genuine, and realistic consideration to the merits of the particular case, and not apply policy inflexibly; and
- observe the basic rules of procedural fairness.



Other principles of administrative law preclude public officials from:

- making decisions in matters in which they have an actual or reasonably perceived conflict of interest;
- improperly fettering their discretion (or that of future of decision makers) by, for example, adopting a policy that prescribes decision making in certain circumstances;
- exercising a discretion in a way that is so unreasonable that no reasonable person would have exercised the power in that way;
- exercising a discretionary power in such a way that the result is uncertain;
- acting in a way that is biased or conveys a reasonable perception of bias
- making decisions that are arbitrary, vague or fanciful;
- refusing to exercise a discretionary power in circumstances where the decision maker is under a duty to do so; and
- unreasonably delaying the making of a decision that the decision maker is under a duty to make.

Source: Office of the Ombudsman, 2004.

Chapter 11 more fully describes the role of judicial review as a check on the exercise of discretionary powers. It notes that judges undertaking judicial review will scrutinise administrative decisions more closely

<sup>57</sup> *Wellington City Council v Woolworths (NZ) Ltd (No 2)* [1996].

where those decisions infringe on fundamental rights. As the Legislation Advisory Committee guidelines note:

As the public powers to interfere with individuals' rights and interests grow, many statutes have required greater procedural protections (sometimes using the phrase "principles of natural justice"). The courts have long shown themselves willing to "supply the omission of the legislature" if a statute which confers public power to affect rights and interests is silent about procedural protections. (2012a, p. 169)

The New Zealand Bill of Rights Act 1990 (BORA) also offers protection against certain rights being infringed in regulatory decision making, unless the intrusion can be reasonably justified or is authorised by legislation (see Chapter 2). Regulatory decisions are reviewable by the courts for breach of BORA via judicial review. Decisions will be struck down by the courts if:

- they intrude on a right or freedom;
- the intrusion is neither reasonable nor demonstrably justified; and
- no authorisation for the intrusion can be inferred from the empowering Act.

The effect is that administrative decisions must be proportionate – justified in the circumstances, in a free and democratic society – to withstand any BORA challenge.

Legal constraints on the exercise of discretionary power are important to ensure that decisions are taken consistently with Parliament's objectives in establishing the regime, and actually contribute to the effectiveness of the regime by protecting decision makers from tunnel vision:

From the perspective of an administrative agency, this proposition may seem counter-intuitive. Rule of law norms limit discretion, and thus, can be perceived as obstacles to effectiveness. They restrict the ability of agencies to "do whatever it takes" to get the job done, whatever that job may be. From the perspective of government officials, those restrictions make the achievement of policy objectives seem more difficult because problems cannot be tackled directly and independently. Instead the agency must share the enterprise with other state organs—relying upon the legislature to formulate effective general rules; and upon courts or tribunals to interpret rules properly and produce sensible results in particular cases. But in spite of this perception, these limitations make the actions of state actors more effective, not less so. They improve decisions by insulating decision-makers from compromise, politics, and their conviction that they alone know what is best. (Pardy, 2008, p. 4)

#### F10.17

There is a range of legal constraints on the exercise of discretionary decisions. Decisions must be taken in accordance with principles derived from the common law, and not unjustifiably infringe the civil and political rights enshrined in the New Zealand Bill of Rights Act 1990. The courts can enforce these constraints.

### Cultural and institutional constraints

An official exercising power does so within a particular cultural and institutional context that materially shapes the exercise of power.

The attitudes, values, and behaviours of the individual and the institution within which they operate are critical to the process and outcome of decision making. Some writers have labelled these internal institutional constraints as the "inner check" (Waldo, 1984) or checks based on institutional professionalism and moral standards (Finer, 1941).

Certain features of an institution's "decision architecture" (the institutional framework for determining how and by whom powers are exercised) will "channel" discretion and make it more (or less) likely that decisions made are fair and rational. One public administration academic identified the following features of an institution's "decision architecture" as critical to ethical decision making (Cox, 2000, p. 249):

- fairness and equity are of paramount concern;

- “good” management is a product of capacity and desire;
- an ethic of “doing what is right”;
- multiple participants;
- articulated value statements (used to preview and review decisions); and
- accountability systems (grievance procedures).

The importance of a regulator’s culture is discussed in Chapter 4.

In addition to institutional constraints, underlying frameworks of legal and political principles shape the way that discretion is exercised. They also underpin the justification and legitimation of decision outcomes (Carter, 2009). These frameworks define the boundaries of behaviour and the capacity to act (Arendt, 2003). Levy and Spiller (1994) refer to these frameworks as the customs and other informal but broadly accepted norms that are generally understood to constrain the action of individuals or institutions.

Writing in the context of examining discretion in Anglo-Saxon jurisdictions, Galligan (1986) argues that the underlying framework of legal and political principles in these countries directs officials to exercise their discretionary powers in compliance with standards of rationality, purposiveness, and morality. These shared values and norms exist and operate independently from formal legal constraints. The frameworks help to:

- ensure that the exercise of power is based on reasons and that those reasons are applied consistently, fairly, and impartially;
- eliminate decision making by whim, chance, or caprice;
- develop general standards in making decisions/fair procedure; and
- open decision-making processes to external public scrutiny.

In the absence of institutional constraints and underlying frameworks that promote ethical decision making, explicit legal restraints on discretion may be ineffective. Levy and Spiller (1994) observe that the institutional and cultural realities of some countries may mean that the only way to constrain administrative arbitrariness is to almost totally withdraw administrative discretion.

### F10.18

Institutional and cultural constraints on the exercise of discretionary power support legal constraints by promoting ethical decision making.

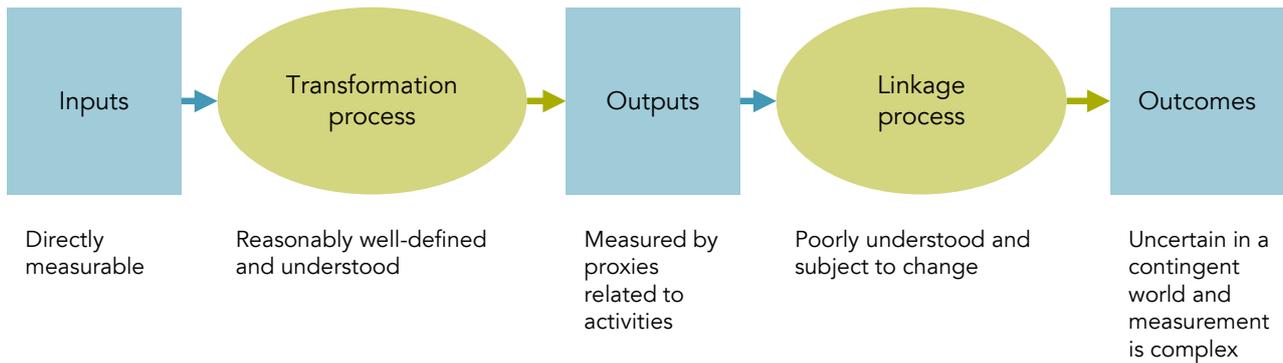
## Transparency can shed light on the exercise of discretion

Hood (2006) notes that “transparency is a term that has attained quasi-religious significance in debate over governance and institutional design” (p. 3). Transparency has a long pedigree. Writing in the 1790s, the English philosopher Jeremy Bentham declared:

I do really take it for an indisputable truth, and a truth that is one of the corner-stones of political science – the more strictly we are watched, the better we behave. (quoted in Hood, 2006, p. 9)

Heald (2006) describes the different application of transparency to different steps in the public sector production process (Figure 10.6):

It adopts the standard framework of distinguishing between inputs, outputs, and outcomes. Each of these is characterized as ‘events’ and represented by a rectangle. ‘Events’ represent points/states that are externally visible and – at least in principle – measurable. Events are lined by ‘processes’, with the three rectangles being connected by two ellipses, labelled as ‘transformation’ (inputs into outputs) and ‘linkage’ (outputs into outcomes). Processes are not measurable in the same way as events, though they can be described, if the information is available. Generally, transformation processes are better understood than linkage processes, not least because intervening variables are more important and unpredictable in the later. (p. 30)

**Figure 10.6 Public sector production process**

Source: Adapted from Heald, 2006.

In New Zealand, as elsewhere, control of state activities has traditionally focused on inputs, with more recent focus on measuring public sector outputs (and an often-expressed desire to measure the elusive outcomes).

Ex post accountability mechanisms are designed to provide transparency around inputs and outputs. However, real-time mechanisms are needed to provide transparency around the transformation process and linkage process.

In a regulatory context, this means that regulators need to be transparent in two main ways: transparency of decisions and procedural transparency:

- transparency of decisions – the regulator gives clear reasons when making a decision about a particular individual or firm (addressing the transformation process); and
- procedural transparency – the regulator provides clear justification and useful extra information about its regulatory processes more generally in terms of how those processes contribute to the desired outcomes of the regulatory regime (addressing the transformation and linkage processes).

Insurance Australia Group Limited (IAG)'s submission notes a number of benefits to transparency, reinforcing the value of transparency to a range of participants in a regulatory regime:

Regulated market participants have a valid interest in the process, rationale and outcome of regulation. In a complex sector, or where there is complex regulation, it is especially important that the rationale for a regulatory decision is made apparent and is justified.

Further, transparency in the regulatory process is recognised as having a number of benefits, including:

- protection against regulatory capture and bias;
- mitigating inadequate public sector information availability;
- counterbalancing rigidity in regulatory style;
- addressing market uncertainty based on policy risk; and
- promoting meaningful accountability to affected parties. (sub. 10. p. 6)

Regulator transparency is required by law. The Official Information Act 1982 provides for making official information available to the public. Section 23 of the Act provides an express right to be given reasons for decisions that affect a person (including a business). In addition, regulators may be required under their own Acts to make certain information publicly available. For example, section 62 of the Commerce Act requires the Commerce Commission to prepare and send key stakeholders a draft determination about restrictive trade practices, before it makes a final decision. Table 10.2 provides an indication of the types of information that New Zealand regulators make publicly available.

**Table 10.2 Public availability of documentation on regulatory practices and principles**

Regulator	Which regulatory practices and principles are documented and made publicly available?
Broadcasting Standards Authority	Decisions are made public and reasons are provided in all decisions.
Civil Aviation Authority	Much of the information on the CAA's approach to regulatory compliance is in its regulatory operating model. This is supported by other material that is available through the CAA's website. Other detailed operations policy and procedural guidance is not generally publicly available. However, the CAA can make copies of relevant documents available if required.
Commerce Commission	Major regulatory decisions typically have full reasons published with them. Also available are enforcement response guidelines, criminal prosecution guidelines, enforcement criteria, written reasons for merger clearance and authorisation determinations, merger and acquisitions guidelines (including process guidelines), authorisation and streamlined authorisation guidelines (both including process guidelines), fact sheets, and guidance on compliance issues for information disclosure.
Commission for Financial Literacy and Retirement Income	Analysis of submissions received on any new or varied Code of Practice, and the Retirement Commissioner's recommendations are available.
Department of Conservation	Decision-making processes for significant regulatory decisions, policy on who to consult and when; reasons for significant regulatory decisions and guidance material for regulated parties in meeting regulatory obligations are available.
Department of Internal Affairs	Censorship policy and gambling compliance policy are publicly available, along with enforcement action and gambling regulations. Also available are anti-money laundering codes of practice, guidelines and supervisory framework, reasons for significant charities regulatory decisions, and guidance material for charities in meeting regulatory obligations.
Electricity Authority	The Authority's Consultation charter is available (Code amendment principles are on pages 4-6 of the Charter).
Energy Efficiency and Conservation Authority	Factsheets and website information are available on how to comply with regulations, compliance and enforcement Policy and website information on how to comply with regulations.
Environmental Protection Authority	Decision-making processes for significant regulatory decisions; policy on who to consult and when; reasons for significant regulatory decisions and guidance material for regulated parties in meeting regulatory obligations are available.
Financial Markets Authority	Decision-making processes for significant regulatory decisions; reasons for significant regulatory decisions; guidance material for regulated parties in meeting regulatory obligations; and an enforcement policy and compliance focus guide are available.
Gas Industry Company Limited	The Gas Industry Company makes few regulatory decisions. Where it does, it has little discretion. The decisions it can make are defined by specific processes in rules and regulations. The process for recommending regulations is set out in the Gas Act 1992.
Health and Disability Commissioner	Decisions are published online, as is guidance material for complaints management in line with the Health and Disability Commissioner Act 1994.
Land Information New Zealand	Decision-making processes and guidance material for all parties (staff and regulated parties) are available.
Maritime New Zealand	Maritime New Zealand's compliance operating model (including prosecution policy) is available.

Regulator	Which regulatory practices and principles are documented and made publicly available?
Ministry of Business, Innovation and Employment	<p>Decision-making processes for significant regulatory decisions are made publicly available through the publication of regulatory impact statements, and sometimes Cabinet papers online. For approved codes of practice, the public is notified of the decision when it is published in the Gazette. The two processes also set out the reasons for significant regulatory decisions for the public.</p> <p>Guidance material to help regulated parties meet their regulatory obligations is made publicly available through MBIE's website, as is the enforcement policy, which is a guide about when different enforcement mechanisms are to be used (for example, when warnings should be issued instead of fines). The Health and Safety Group has a publicly available compliance strategy that outlines expectations and decision principles.</p> <p>Reasons for significant regulatory decisions are generally made publicly available through the publication of regulatory impact statements and Cabinet decisions on MBIE's website. MBIE provides guidance material on its website to help those involved in building work comply with their obligations under the Building Act 2004, Building Regulations and the Building Code.</p>
Ministry of Transport	The reasons for significant regulatory decisions are documented and some are made publicly available.
New Zealand Historic Places Trust	Decision-making processes for significant regulatory decisions, policy on who to consult and when; reasons for significant regulatory decisions, and guidance material for regulated parties in meeting regulatory obligations are available. Operational policies that guide when different enforcement mechanisms are to be used (for example when warnings should be issued instead of fines).
New Zealand Qualifications Authority	Some New Zealand Qualifications Authority rules are available.
Office of Film & Literature Classification	Decision-making processes for significant regulatory decisions; reasons for significant regulatory decisions and guidance material for regulated parties in meeting regulatory obligations are available.
Office of the Privacy Commissioner	The office issues transfer prohibition notices.
Reserve Bank of New Zealand	A broad overview of the Bank's supervisory approach is available. Likewise, the supervisory approach to insurers and non-bank deposit-takers is available. An overview of the Bank's supervisory approach is available on the Bank's website, with further details provided in a recently published Bulletin article.
Statistics New Zealand	The overarching regulatory practices and principles are outlined on the Statistics New Zealand website and contained within information that is provided to all survey respondents.
Takeovers Panel	Public guidance material, statutory enforcement decisions and exemptions from compliance with the Takeovers Code are available.

### Limited access to information about regulatory approaches and reasons for decisions

Despite the statutory and common law arrangements that require regulator transparency, several submissions raised concerns about inadequate access to information about regulatory approaches and reasons for decisions. Mortlock Consultants commented on the lack of requirements to publish statements of regulator approaches:

Some regulators are required by statute to publish statements of their approach to regulation – such as section 75 of the RBNZ Act, which requires the Reserve Bank to publish the principles on which it acts, or proposes to act, in determining applications for bank registration, and in imposing, varying, removing, or adding to conditions of registration. However, this requirement is not consistently applied across regulators; many are under no parallel obligation. Partly as a result of this, there is a lack of

transparency in the policy framework applied by some regulators in interpreting their responsibilities and in exercising their powers. (sub. 31, p. 6)

IAG considers this criticism also applies to the transparency of regulatory decision making:

In our experience, transparency and stakeholder engagement often ends with formal consultation processes. The reasoning process of the regulator and the factors that have ultimately influenced its decision are not always made available to interested parties. (sub. 10, p. 6)

To the extent that lack of transparency is a concern, it may contribute to the perception by some businesses that regulatory decisions are unpredictable and unclear. Lack of clarity and unpredictability of regulatory decisions can in turn heighten investment uncertainty.

[Lack of transparency in the policy framework applied by some regulators in interpreting their responsibilities and in exercising their powers] impedes the accountability of regulators and makes it more difficult for regulated entities to interpret the actions of their regulators. (Mortlock Consultants, sub. 31, p. 6)

The Civil Aviation systems vests considerable discretion in the Director. In general we think this is appropriate however equally we believe the regulator must back decisions made with a high level of transparency and analytical capability. (Aviation New Zealand, sub. 36, pp. 30-31)

Chapter 8 discusses the potential benefits of requiring new regulators to publish a statement about how they will interpret and give effect to the regime's objectives, noting the general (but not universal) support for the Electricity Authority's *Interpretation of the Authority's statutory objective* (2011). One aim of the Electricity Authority's statement is to support consistent decision making.

Table 10.2 indicates that publishing the reasons for decisions is common. Many regulatory agencies also develop policies and guidelines to decision makers that must exercise discretion, and information about their decision-making processes. These policies and guidance help to ensure that similar decisions are made consistently and fairly. Unlike legislation, policies and guidelines do not have the force of law and decision makers should be able to depart from them where appropriate.

The Office of the Ombudsman's *Guide on good decision making* (2012a) advises that policies and guidelines should:

- be straightforward and contain a clear purpose statement;
- be flexible to cover a range of circumstances;
- set out how they relate to the relevant legislation;
- set out the relevant considerations that the decision maker must take into account;
- be communicated to relevant staff; and
- be made available to the public.

The development of policy and guidelines about how decisions are to be taken can promote good decisions and good regulatory outcomes. Making these available to the public enables interested people to learn about the processes and potential outcomes of the decision-making process. It also helps to reduce any tension between certainty and discretion.

#### R10.6

All regulators should publish and maintain up-to-date information about their regulatory decision-making processes, including timelines and the information or principles that inform their regulatory decisions.

## 10.5 Summing up

Getting the internal governance of regulators right is critical to the effectiveness of a regulator and the quality of regulatory regimes. Designers of regulatory regimes need to think carefully about the allocation of decision rights. While there are important legal and non-legal constraints on the exercise of discretionary decision making by regulators, effective governance of regulatory agencies requires high-quality boards. With help, departments could do a better job of helping ministers appoint boards with members who have the right mix of skills and experiences to effectively oversee the complex business of regulation.

# 11 Decision review

## Key points

- Appeals of regulatory decisions involve the courts scrutinising the **merits and correctness** of those decisions. Judicial review involves the courts scrutinising the **process and legality** of decision making. These are distinct processes. “Merits review” are appeals that look at the correctness of a decision.
- Appeal rights of administrative decisions exist only where Parliament expressly provides for them. There is a perception that New Zealand statutes provide limited access to appeal of regulatory decisions, but this is not supported by research undertaken by the Commission. Most regulatory regimes provide for appeals, and only a small minority of regimes provide limited or no access to appeals.
- Judicial review is an inherent power of the High Court, and so does not need to be provided for in statute. There is no evidence that judicial review is ineffective in ensuring the lawfulness and reasonableness of the Executive’s actions.
- Judicial review is an important constitutional check on the exercise of state power, and protects the right of New Zealanders to be treated fairly and in accordance with the law. Attempts in legislation to exclude judicial review of the Executive are wholly undesirable.
- The breadth of judicial review and appeals can vary widely, but in practice significant overlap exists between judicial review and appeal in New Zealand. In New Zealand the scope of judicial review is comparatively broad and can sometimes include scrutinising the substantive merits of the Executive’s decisions.
- The overlap between judicial review and appeal means that judicial review already adequately provides many of the advantages that submitters ascribed to merits review or appeals in many areas of regulation. This includes sharpening the incentives on decision makers to come to the correct decisions.
- In scrutinising the decisions of expert regulators, the courts will examine the legality and process of decisions via judicial review. But they will typically defer to expert regulators about the substantive merits of the decision, requiring a higher threshold to establish unreasonableness. This means the availability of merits review may provide some stronger performance incentives.
- Appeal rights should be provided where the designers of regimes are confident the appeals will improve regulatory outcomes and support the objectives of the regulatory regime. This requires taking into account the costs and uncertainty that appeal rights create.
- In deciding whether to provide for appeal rights of complex or highly technical regulatory regimes, designers need to critically assess the institutional capability and expertise of the court or tribunal reviewing the decision, relative to the decision maker at first instance.
- A range of mechanisms are available that may support the institutional capability of the appellate body to deal with appeals of complex and highly technical decisions. Two mechanisms are using technical experts as lay judges and providing for more inquisitorial processes.
- The Legislation Advisory Committee (LAC) guidelines on review and appeal provide a good list of considerations to take into account when designing review and appeal provisions in regulatory regimes. The LAC notes that appeals can correct individual decisions, providing redress, and contribute to public confidence and high standards of public administration.
- Even so, the LAC notes that the value of appeals needs to be balanced against the considerations of cost, delay, significance of the subject matter, competence and expertise of the decision maker at first instance, and the need for finality.

## 11.1 Introduction

New Zealand is fortunate to have a judiciary that its citizens have confidence in – the second highest regarded in the Organisation for Economic Co-operation and Development (OECD, 2013a). In New Zealand, the courts have a constitutionally important role in supervising the actions of the Executive, ensuring that it acts reasonably, fairly, and within the bounds of the laws established by Parliament. Unlike other countries, New Zealand courts have no role in supervising Parliament. Courts have no ability to strike down or invalidate legislation passed by Parliament.

Judicial scrutiny of the exercise of Executive power is particularly important in the area of regulation, given the coercive nature of those powers.

Where Parliament provides for appeals, courts also provide a forum for parties to test that regulators have made “correct” decisions.

The courts also perform an essential role in interpreting legislation. What does it mean for a regime to promote competition for “the long-term benefit of consumers”?<sup>58</sup> Who is “a fit and proper person” to run certain businesses?<sup>59</sup> Ultimately, the courts decide what these terms mean in practice.

Judicial review and appeals are distinct processes.

- Judicial review is concerned with the legality of the decision. A reviewing court must examine the process and procedures of decision making and ask whether the decision should be allowed to stand.
- In contrast, appeals involve adjudication on the merits and may involve the court substituting its own decision for that of the decision maker (Joseph, 2007).

This chapter discusses the review of regulatory decisions, with a particular focus on judicial oversight of regulators in areas that are highly complex and technical.

- Section 11.2 outlines the types of decision review, and compares judicial review with merits review.
- Section 11.3 describes the types of appeal provided for in regulatory regimes in New Zealand.
- Section 11.4 provides a framework for thinking about access to judicial review and appeals.
- Section 11.5 assesses calls for greater access to merits review of regulatory decisions in regimes where this is limited or not provided for.
- Section 11.6 considers alternative ways of achieving the outcomes sought from merits review of regulatory decisions.
- Section 11.7 summarises the Commission’s guidance on access to review and appeal of regulatory decisions.

This chapter is intended to provide a useful degree of detail about review and appeal to inform designers of regulatory regimes, supported by the Legislation Advisory Committee (LAC) guidelines. As always, designers should seek expert advice where necessary. Readers interested in greater levels of detail on the issues discussed here may wish to review *Constitutional and Administrative Law in New Zealand* (Joseph, 2014), and *Judicial Review: A New Zealand Perspective* (Taylor, 2014).

## 11.2 Types of decision review

Types of appeals and reviews of regulatory decisions include:

- judicial review;

<sup>58</sup> Commerce Act 1986, s 1A.

<sup>59</sup> Insurance (Prudential Supervision) Act 2010, s 18.

- appeal to a tribunal or court;
- internal review; and
- ombudsmen.

Each type has different processes, focuses and outcomes.

## Judicial review

Judicial review is the exercise of the High Court's inherent jurisdiction to rule on the legality of public acts (Joseph, 2014, pp. 846-47). Over centuries, the English courts developed a doctrine of common law which established that courts had the inherent jurisdiction needed to administer the law, independently of any statutory power:

The inherent jurisdiction of the Court arises in relation to and for the purpose of giving proper support for the functioning of the Court as a Court of justice. It is part not of the substantive but of the procedural law: and in such a case as the present it is exercisable for the purpose of controlling not only the actions of persons associated with the proceedings but the world at large. That sort of judicial power obviously could not be used for purposes of individual or group convenience nor even for the public interest in general. Instead, as one experienced officer of the Court in England has said, "The juridical basis of [the inherent] jurisdiction is ... the authority of the judiciary to uphold, to protect and to fulfil the judicial function of administering justice according to law in a regular, orderly and effective manner." (*Taylor v Attorney-General*, 1975, at 689)

The High Court's jurisdiction derives from the instruments that established the High Court (then called the Supreme Court) in New Zealand and provided that the New Zealand High Court exercised the jurisdiction of the common law and equity courts in England, including their inherent powers of judicial review. The Judicature Amendment Act 1972 simplified the procedure for obtaining judicial review remedies, but did not extinguish or limit the common law right of review.

The three main grounds of judicial review are procedural impropriety, illegality and unreasonableness. *Procedural impropriety* focuses on the compliance of the decision-making process with the rules of natural justice, or with the prescribed procedural requirements. *Illegality* is concerned with whether the decision maker has correctly understood and given effect to the law that regulates its decision-making power. *Unreasonableness* is concerned with the fairness or reasonableness of a decision, including the exercise of discretion. The courts used to apply a very high threshold in assessing unreasonableness, only intervening where a decision was outrageous or perverse. Now the courts apply a sliding threshold and varying intensities of judicial review depending on the context. This is discussed further below.

## Appeal

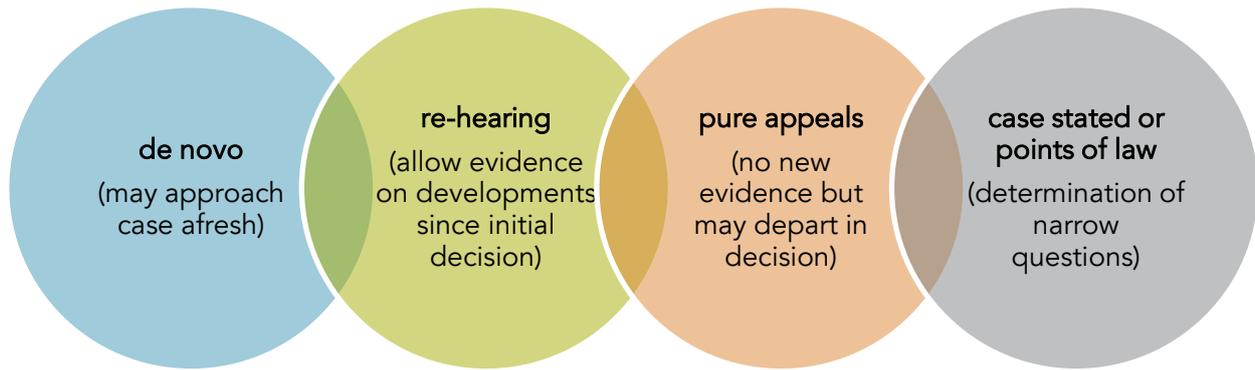
The courts lack any inherent appellate jurisdiction over regulatory authorities: "Appellate powers are purely statutory. There is no such thing as a common law right of appeal" (*Guy v Medical Council of New Zealand*, 1995, at 93).

Not all appeals are of the same type or scope. Appellate review is a continuum of different types with a variable intensity of review. The intensity of appellate review depends on how Parliament has conferred that jurisdiction. It depends particularly on the type or form of the appeal and other procedural and evidential rules that shape the courts' approach (Thwaites & Knight, 2011).

The LAC categorises appellate procedures across four broad types (2012a, pp. 285-86). The types offer a structure to anchor analysis on the legal scope of appeals.

Figure 11.1 illustrates these broad appellate procedures on a continuum according to the breadth and depth of allowing further, or new, evidence to be presented to the court. To the left is the relatively broad approach, which then narrows as one moves to the right.

Figure 11.1 Legal scope of appeals – a continuum



Source: Productivity Commission, drawing on LAC, 2012a, pp. 285-86.

### De novo appeal or hearing

At one extreme is a de novo appeal. In a de novo appeal, the appellate body stands in the shoes of the primary decision maker and hears the matter afresh. The appellate body is not bound by the presumption that the decision appealed from is correct and therefore may approach the case afresh. This is the most intensive form of judicial supervision, allowing the appellate body to form its own view on the law, fact, and policy involved in the regulatory decision. The LAC guidelines note that de novo hearings are “more costly” than available alternatives (2012a, p. 284).

### Appeals by way of re-hearing

Appeals by way of re-hearing are normally heard on the record of evidence before the primary decision maker, with often an ability to re-hear or receive more evidence. The appellate body may reach its own findings on the evidence, including about developments since the initial decision. But there are some presumptions about the circumstances in which the appellate court can differ from the decision maker under review.

### Pure appeals

In pure appeals (or appeals *stricto sensu*), the appellate body may depart from the lower body’s conclusions if consistent with the evidence available to the lower body. But the appellate body cannot hear new evidence. The LAC guidelines note that “this category of appeal is very restrictive and should not be enacted” (2012a, p. 284).

### Appeals on questions of law or appeal by way of case stated

At the other extreme are appeals on questions of law. The supervising court may only intervene to correct an error of law or to determine a legal question. Where an appeal is restricted to points of law, the court’s approach is very similar to the approach adopted in judicial review. Sir Kenneth Keith has written that “the distinction between appeals, especially appeals on law alone, on the one hand, and judicial review on the other can and often does disappear” (1969, p. 159).

### Choices between the types of appeals

Civil procedure rules adopt appeal by way of re-hearing as the default if legislation provides for appeal but doesn’t specify the type (High Court Rules, r 20.18; District Court Rules 2009, r 14.17). The LAC guidelines state that an appeal by way of re-hearing is the most appropriate procedure in most contexts (2012a, p. 286). It is more expeditious than a hearing de novo because it focuses on specific alleged errors. It is not as narrow as an appeal on a question of law only.

The LAC (2012a) explains that the choice of procedure turns on the type and purpose of the appeal and the nature of the appellate body, and offers these general observations:

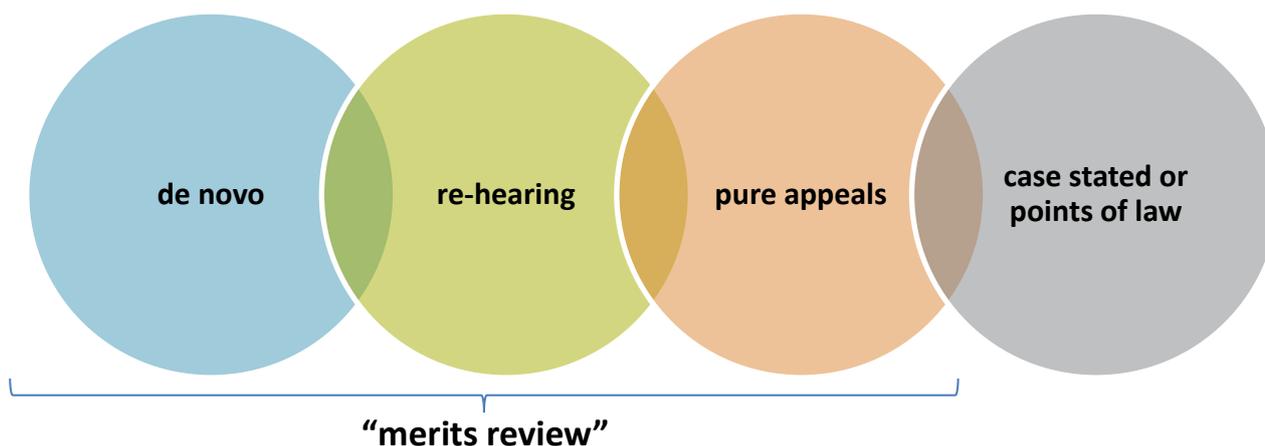
An appeal by way of re-hearing is the appropriate procedure in most contexts. It is more expeditious than a hearing *de novo* because of its focus on specific alleged errors, but not as restrictive as an appeal *stricto sensu*. Indeed, an appeal should focus on specific alleged errors. In general, there is no need to provide an opportunity to re-litigate the whole matter, as in a hearing *de novo*, unless there is good reason not to presume that the first instance decision-maker correctly ascertained the facts. The

added cost of a complete re-hearing generally counts against this procedure. An appeal should not be by way of case stated unless there is some reason why this option is preferable to an ordinary appeal limited to questions of law. (p. 286)

### What is merits review?

The terms merits review and appeal are often used interchangeably. But merits review is any process that lets all of a decision be scrutinised, including process and substance. Using this framework, merits review would include de novo appeals, re-hearings, and pure appeals (Figure 11.2). Appeals on points of law/case stated would not be a merits review. A court need not undertake a merits review; specialist tribunals are sometimes established to do so.

Figure 11.2 Merits review within the legal scope of appeals



Source: Productivity Commission, drawing on LAC, 2012a, pp. 285-86.

## Difference between judicial review and appeal

### The orthodox approach

The orthodox approach is that judicial review involves sitting in judgment on the correctness of the decision-making process, whereas appeal involves sitting in judgment on the correctness of the decision itself. A judge in the United Kingdom House of Lords described the difference this way:

Judicial review is concerned, not with the decision, but the decision-making process. Unless that restriction on the power of the court is observed, the court will in my view, under the guise of preventing the abuse of power, be itself guilty of usurping power ... Judicial review, as the words imply, is not an appeal from a decision, but a review of the manner in which the decision was made. (*Chief Constable of the North Wales Police v Evans*, 1982, at 154-55)

The courts will often strongly proclaim the distinction between judicial review and appeal. In *Brannigan v Davison* (1997) at 148, the Privy Council observed:

In these proceedings the court is not exercising an appellate jurisdiction. It is exercising its supervisory, review jurisdiction. The distinction is not a piece of empty formalism.

The distinction drawn between the two forensic processes is a self-serving reminder and discipline that a judge does not have unfettered licence in judicial review. The courts must not trespass, they say, on the merits of the decision or the policies it implements. Those matters are for the mandated decision maker, not the courts.

In *Waitakere County Council v Lovelock* (1997, at 397), the Court of Appeal reiterated that review was not an appeal on the merits and that the court “could not substitute its own opinion for that of the [decision maker]”. The proper concern on review was “with the decision-making process, not the decision itself” (*R v Sloan*, 1990, at 479). In *Qiong v Minister of Immigration* (2005, at 30) the Court was adamant that “an attack on the merits of the decision ... is not the purpose of a judicial review proceeding”. The Supreme Court ventilated similar sentiments in *Unison Networks Ltd v Commerce Commission* (2008, at 54). It observed that the courts are concerned to identify the legal limits of the power rather than assess the merits of its exercise: “They must be careful to avoid crossing the line between these concepts”. In *Hopper v North*

*Shore Aero Club Inc* (2007, at 16), the Court of Appeal stated: “merit review of the decision ... would be appropriate in an appeal, rather than a review of the process in the more traditional judicial review sense”. There are many such statements in the judgments of the courts.

### An outdated distinction?

Notwithstanding the courts’ professed commitment to the appeal/review distinction, the processes of appeal and review inevitably overlap and merge at the margins. This is occasionally acknowledged by the courts. Professor Joseph comments:

At times, the courts are disarmingly frank. In *Shaw v Attorney-General*,<sup>60</sup> the High Court conceded that reasonableness review was merits based, and was ‘the very antithesis of judicial review’. In *Isak v Refugee Status Appeals Authority*,<sup>61</sup> the same Court conceded that unreasonableness ‘focuses on the substantive outcome rather than the processes of decision-making’. Challenges of unreasonableness necessarily envisage a ‘qualitative assessment’, entailing ‘an element of subjectivity’ in balancing public benefits and private rights.<sup>62</sup> Challenges of proportionality likewise entail qualitative assessments, requiring courts ‘to review the balance struck by the primary decision-maker between the conflicting considerations’.<sup>63</sup> (2014, at 22.3.5)

Over the past few decades, developments in judicial review have undercut the claim of a substantive distinction between review and appeal. In many judicial review cases, the review is based on the merits, with the court focusing not on how the process was made but on the actual decision.

The courts cross the appeal/review divide when they evaluate the decision maker’s policy role and discretion. They also engage in merits-based review where they proceed from remitting decisions for re-consideration to reversing decisions. Certain grounds of review enable greater scrutiny of the substance of the decision: the ground of irrationality or unreasonableness, for example, is inherently merits-based.

### Judicial review can include scrutinising the merits of a decision

In 1985, New Zealand’s pre-eminent jurist Sir Robin Cooke (later Lord Cooke of Thorndon) said that “the time has probably come to emphasise that New Zealand administrative law is significantly indigenous” (*Budget Rent A Car Ltd v Auckland Regional Authority*, 1985 at 418). Lord Cooke is responsible for broadening the scope of judicial review in New Zealand jurisprudence, particularly the ground of “unreasonableness” (Knight, 2008).

Unreasonableness is the principal ground of challenge that inherently enables merits review. In practice, unreasonableness is subordinate to the grounds of illegality and procedural impropriety. In many cases a finding of unreasonableness will be reached only after other reviewable errors in the decision making have been unearthed on those grounds.

The seminal British case establishing unreasonableness as a ground is *Associated Provincial Picture Houses v Wednesbury Corporation (Wednesbury)* (1948). In that case, Lord Greene said that a public authority acts unreasonably when a decision it makes is “so absurd that no sensible person could ever dream that it lay within the powers of the authority”. *Wednesbury* unreasonableness set a high test for a decision to be set aside.

It is true to say that, if a decision on a competent matter is so unreasonable that no reasonable authority could ever have come to it, then the courts can interfere. That, I think, is quite right; but to prove a case of that kind would require something overwhelming, and, in this case, the facts do not come anywhere near anything of that kind. (*Wednesbury*, 1948)

The Australian courts have “conclusively adopted” the high test of *Wednesbury* unreasonableness, according to the President of the Australian Administrative Appeals Tribunal, the Hon Justice Garry Downes. Justice Downes notes the limited application of unreasonableness as a ground for judicial review

<sup>60</sup> *Shaw v Attorney-General* (2003).

<sup>61</sup> *Isak v Refugee Status Appeals Authority* (2010).

<sup>62</sup> *Carter Holt Harvey Ltd v North Shore City Council* (2006).

<sup>63</sup> *Huang v Minister of Immigration* (2008).

in Australia, citing evidence that “there are not many decided cases in which the principle has been successfully raised” (Downes, 2008).

By contrast, in New Zealand Lord Cooke led a “rejection of legal formalism in the area” (Knight, 2008, p. 100).

It is no longer sufficient for decision-makers to assert that their decision is not absurd or irrational; it is necessary for them to consider whether the circumstances in which the decision was made and its consequences mandate closer scrutiny of the logic and substantive merits of the decision. (Knight, 2008, p. 107)

First, in *Thames Valley Electric Power Board v New Zealand Products and Paper Ltd* (1994) the Cooke Court held that substantive unfairness was a stand-alone ground of review. This set a review threshold considerably lower than the *Wednesbury* threshold. Substantive unfairness, by definition, focuses on the substantive merits of the impugned decision.

There have been few decisions where challenges on the ground of substantive unfairness have succeeded. The most likely scenario for a successful challenge would be a series of errors that cumulatively have the effect of substantive unfairness.<sup>64</sup>

Second, the courts might also lower the threshold in individual cases to engage with the substantive merits of decisions. This is known as the “variable intensity” or “sliding threshold” approach. The level of scrutiny varies depending on the circumstances of individual cases, as does the degree of deference the courts will grant to decision makers in the Executive.

Joseph notes that “bodies exercising public regulatory functions may expect more intensive judicial scrutiny than decision-makers entrusted to develop and apply policy, such as government Ministers and elected councils” (2007, p. 939). Joseph notes that “the sliding scale of review is part of the legal tapestry” (2007, p. 936).

At the extreme, courts will take a “hard look” at decisions that impinge on human rights<sup>65</sup> (the UK courts review these decisions with “anxious scrutiny”). More intensive review invariably entails a court evaluating the merits of the decision.

Finally, other principles that the courts may consider under the head of unreasonableness – including proportionality, consistency of decision making, and the innominate ground – also entail a substantive review of the merits of a decision.

In the course of oral arguments, Justice Tipping expressed most plainly where the court will intervene:

I would hope I would always have a hard look, the question is more, isn't it, to the standard to which you hold the decision making? ... the more fundamental the right, the more reasonable the decision must be ... And the Court must interfere where it must ... you interfere if you think you should. (*Ye v Minister of Immigration*, 2008)

### **Despite the overlap, significant differences remain**

Although review and appeal overlap, key differences exist. For example, in assessing a decision on the judicial review ground of unreasonableness, the court will evaluate whether the substantive decision is reasonable, applying a review threshold appropriate to the particular context. But the court’s task in judicial review is not to determine whether the decision or the particular is the “most correct”, unlike in appeals by way of re-hearing or de novo appeals.

Another important difference between review and appeal is that in an appeal the appeal body can consider all aspects of a case. In a judicial review the court focuses just on the issues based on the grounds of the judicial review.

<sup>64</sup> *Taiaroa v Ministry of Justice* (1994); and *Shaw v Attorney-General* (2003).

<sup>65</sup> *Pharmaceutical Management Agency Ltd v Roussel Uclaf Australia Pty Ltd* (1998); and *Discount Brands Ltd v Northcote Mainstreet Inc* (2004).

The outcome of a successful challenge is also a key difference. Successful appeals involve the court substituting its decision for that of the regulator. Successful judicial reviews typically involve referring the decision back to the decision maker to re-consider, with or without express directions from the court. This has led to the claim that a successful judicial review only leads to the same decision being confirmed – a claim discussed in section 11.5.

### A spectrum of review and appeal

Judicial review and appeal are both pluralistic mechanisms, “each representing variable forms of judicial methodology and intensity depending on the context and circumstances” (Thwaites & Knight, 2011, p. 223). The court’s approach will depend upon many complex contextual factors: the particular legislative provisions, the subject matter of the decision, and the suitability of the particular questions to judicial adjudication.

Commentary from academics and practitioners acknowledges the overlap between review and appeal. Joseph calls the appeal/review distinction an outdated dichotomy that no longer explains what the courts are doing, or should be doing, when exercising their review jurisdiction (2007, pp. 830-31). Professor Taggart wrote that “many of the dichotomies upon which administrative law has rested – appeal/review, merits/legality, process/substance, discretion/law, law/policy, and fact/law – are no longer seen as giving as much guidance as they once did” (Taggart, 2006, p. 83). The last edition of *Judge Over Your Shoulder* acknowledges that, in practice, it is sometimes “difficult to completely sever” process from the merits (Crown Law Office, 2005, at 12).

This overlap of judicial review and appeals at the margin stands in contrast to the situation in Australia, where there is a “significant division between merits review and judicial review” (Downes, 2008) and where strict *Wednesbury* unreasonableness is still the standard of review.

#### F11.1

In New Zealand there is significant overlap between the scope of judicial review and appeal in practice.

#### F11.2

Judicial review in New Zealand is much wider in scope than in Australia, and can include greater scrutiny of the merits of decisions.

### Deference to expert regulators in highly technical fields

The question of whether and when judges will defer to decision makers is not settled. Knight (2010) provides a useful discussion of the varied approaches taken within the New Zealand courts. The current Chief Justice has stated that she considers deference to be a “dreadful” word (Knight, 2010, p. 408).

Even so, the courts will generally defer to the decisions of expert regulators of highly complex and technical areas, such as the Commerce Commission. The courts will generally not entertain a review of the merits under the substantive unfairness or sliding scale/variable intensity principles. Courts will only entertain intervening on narrower grounds:

Often, as in this case, a public body, with expertise in the subject-matter, is given a broadly expressed power that is designed to achieve economic objectives which are themselves expansively expressed. In such instances Parliament generally contemplates that wide policy considerations will be taken into account in the exercise of the expert body’s powers. The courts in those circumstances are unlikely to intervene unless the body exercising the power has acted in bad faith, has materially misapplied the law, or has exercised the power in a way which cannot rationally be regarded as coming within the statutory purpose. (*Unison Networks Ltd v Commerce Commission*, 2007, at 55)

The Supreme Court reiterated those cautionary remarks the following year in *Z v Dental Complaints Assessment Committee* (2008). They are emphasised in the submission from Chapman Tripp: “Courts often express considerable concern at entering into analysis of expert judgment in the context of judicial review proceedings” (sub. DR 68, p. 2).

For example, Taylor outlines that courts have declined to determine issues of fact in judicial review including:

- matters of scientific dispute;<sup>66</sup>
- whether something is a navigation hazard;<sup>67</sup>
- the health hazards of burning fossil fuels in the home; and<sup>68</sup>
- the merits of Resource Management Act<sup>69</sup> or Building Act<sup>70</sup> issues.

Taylor notes that courts have found that the National Institute for Water and Atmospheric Research (NIWA)'s structure of climate change statistics is judicially reviewable:<sup>71</sup>

The Court considered that it should be "cautious" in reviewing the decisions of a specialist body acting within its own sphere of expertise and not intervene unless there were some defect showing that the decisions were "clearly wrong in principle or in law". It was held that there were not. There are, however, different ways of approaching issues, and a point may be seen to be one of scientific opinion if viewed within certain parameters, and not a scientific issue if viewed within others.

In other contexts, the courts regularly determine expert matters based on the evidence before them. There is no obligation to accept uncontradicted expert evidence even where the decision-maker decided "on the papers" ... factual matters, even expert ones, are open to determination. (Taylor, 2014, pp. 65-67)

As a result, the overlap between judicial review and appeal does not apply to economic regulation or generally to other highly technical areas of regulation. A court undertaking judicial review of a decision taken by an expert regulator in a complex or technical field will apply a high threshold in assessing whether a decision is unreasonable.

### F11.3

Courts will generally defer to the decisions of expert regulators of highly complex or technical areas. In these areas of regulation, there is still a clear distinction between judicial review and appeals, and judicial review is less likely to scrutinise the substantive merits of decisions.

## Proposals for reform in the United Kingdom and Australia

In the course of the Commission's engagement, attention was drawn to three recent reviews of decision review frameworks in the United Kingdom and Australia.

In the United Kingdom, reforms proposed in 2013 would limit the scope of judicial oversight in regulatory and competition appeals. A discussion document presented two options to do this. Both would introduce standards of appeal that are similar to the scope of judicial review in New Zealand.

Additionally, in February 2014 the UK Government announced reforms of judicial review (Box 11.1).

### Box 11.1 Reform of decision review in the United Kingdom

#### Proposed reform of regulatory and competition appeals

In June 2013 the British Government published a consultation paper seeking submissions on options for reform of the appeal regime for regulatory and competition appeals. The report focused on

<sup>66</sup> *SmithKline Beecham (New Zealand) Ltd v Minister of Health* (2002).

<sup>67</sup> *Fullers Group Ltd v Auckland Regional Council* (1999).

<sup>68</sup> *Coal Producers Federation of New Zealand Inc. v Canterbury Regional Council* (1999).

<sup>69</sup> *Pring v Wanganui District Council* (1999).

<sup>70</sup> *Kelvin Grove Residents Association Inc v Palmerston North City Council* (1999).

<sup>71</sup> *New Zealand Climate Science Education Trust v National Institute of Water and Atmospheric Research* (2012).

appeals from decisions of economic regulators and competition authorities on the basis that they are materially different from non-economic regulators.

The report identified concerns about the appeals regime in some sectors and for some types of decisions. These concerns include:

- that the current framework can impose significant time and costs on all parties, which slows down efficient regulatory decision making and can create regulatory uncertainty;
- the length and scale of some appeals, involving large volumes of evidence and legal and technical arguments; and
- the lack of consistency across sectors and across different types of decisions, which has a number of consequences, including that, in certain sectors, there appear to be strong incentives on parties to appeal decisions.

The UK Government considered that reforming the appeal regimes for regulatory and competition decisions might be desirable so that:

- it is more focused on identifying material errors;
- appeal bodies' expertise is applied in the most appropriate way and appeal routes are more consistent across sectors to provide greater certainty and better use of resources;
- it is more accessible to all affected parties;
- incentives in the system are aligned with government's objectives for the appeals framework; and
- appeals processes are as efficient and cost effective as possible.

The UK Government was of the opinion that the grounds of appeal should be defined more clearly and narrowly and focused on clear errors by the decision maker. "Merits review" can result in different levels of scrutiny and having more well-defined grounds of appeal will provide greater clarity and certainty up front (Her Majesty's Government, 2013, [4.21], p. 29).

The UK Government proposed that the scope of appeal available to challenge these decisions should be narrowed and no longer be on all aspects of the merits. It proposed two options for limiting the scope of appeals.

- Appeals should be heard to an (English) judicial review standard. The grounds of review would be largely limited to procedural irregularities.
- Appeals should be allowed on a slightly wider basis than the (English) judicial review standard, including:
  - material error of law (an error of law that is significant enough to have an impact on the ultimate decision);
  - material error of fact (an error of fact that is significant enough to have an impact on the ultimate decision so that it might be different);
  - material procedural irregularity (a procedural irregularity that is significant enough to have an impact on the ultimate decision so that the decision might be different);
  - unreasonable exercise of discretion (decision maker exercised its discretion in a way that no reasonable regulator would act); and
  - unreasonable judgments or predictions.

In addition, the UK Government proposed additional measures to discourage unmeritorious appeals and improve the efficiency of handling cases.

Most responses to the proposals have been hostile, with the Competition Appeal Tribunal itself saying that “no case at all is made out in the Consultation for altering or reformulating the standard of review in competition appeals”. The UK Government is analysing submissions on the proposals.

### Reform of judicial review

The number of applications for judicial review each year in the United Kingdom tripled between 2000 and 2013. In 2013 a number of reforms were introduced to limit judicial review in planning and procurement cases, and transfer judicial review of immigration and asylum cases to a specialist tribunal.

In February 2014 the UK Government also announced further reforms to judicial review proceedings, including:

- introducing a specialist Planning Court to deal with nationally significant infrastructure proposals;
- introducing a lower threshold for a court to find that a procedural defect would not have made a difference to the original decision;
- allowing appeals to “leapfrog” to the Supreme Court in a wider range of circumstances to expedite appeals of judicial review decisions;
- only providing legal aid for judicial review applications that the court agrees to hear; and
- a range of other reforms which mean unsuccessful applicants, their backers, and third parties who choose to intervene in proceedings are likely to bear more of the cost of the review.

In outlining the reforms, the UK Government indicated it wanted to “speed up planning cases and tackle the abuse of judicial review by those seeking to generate publicity or delay implementation of decisions that had been properly and lawfully taken” (UK Ministry of Justice, 2014, p. 18). “The proposals limit abuse and affect weak cases ... [and] should speed up consideration of these stronger cases by focusing scarce taxpayer resources on them” (p. 19).

In April 2014 the House of Lords and House of Commons Joint Committee on Human Rights (JCHR) published a report critical of the reforms, saying:

The number of judicial reviews has remained remarkably steady when the increase in the number of immigration judicial reviews is disregarded. We therefore do not consider the Government to have demonstrated by clear evidence that non-immigration related judicial review has “expanded massively” in recent years as the Lord Chancellor claims, that there are real abuses of the process taking place, or that the current powers of the courts to deal with such abuse are inadequate. (JCHR, 2014, p. 3)

The committee said that changes to the procedural defect threshold were incompatible with the rule of law, the changes to legal aid constitute “a potentially serious interference with access to justice” (p. 4), and that some of the recommendations regarding costs would “undermine effective access to justice” (p. 4).

A Criminal Justice and Courts Bill to implement some of the reforms had its third reading on 17 June 2014.

*Source:* Her Majesty’s Government, 2013; Competition Appeal Tribunal, 2013; UK Ministry of Justice, 2014; JCHR, 2014.

In Australia, proposed changes would broaden the scope for review of decisions from the Australian Energy Regulator (AER), while instituting less adversarial review processes (Box 11.2).

### Box 11.2 Proposed reform of review of decisions from the Australian Energy Regulator

From 2008 the Australian Competition Tribunal has been able to undertake limited merits review of decisions by the AER under the National Electricity Law and National Gas Law. The review is described as “limited” because an applicant is required to establish one of four grounds of review based on regulatory errors of fact or discretion (rather than establishing any “preferable” decision). An applicant must also persuade the Tribunal that there is a serious issue to be heard. The grounds are:

- the AER made an error of fact in its findings of facts, and that error of fact was material to the making of the decision;
- the AER made more than one error of fact in its findings of facts, and that those errors of fact, in combination, were material to the making of the decision;
- the exercise of the AER’s discretion was incorrect, having regard to all the circumstances; and
- the AER’s decision was unreasonable, having regard to all the circumstances.

There was a requirement to review the limited merits review regime within seven years. In October 2012 an independent expert panel published its final report on the effectiveness of the regime and recommended changes.

The panel findings are noted below.

- There was a lack of evidence of major improvements in the way the AER conducted its activity as a result of the regime. Decisions were routinely appealed, and the appeals were generally successful.
- Applicants have most often been successful in claims establishing that the regulator’s decisions were unreasonable or an incorrect exercise of discretion, rather than the grounds relating to errors of fact.
- Not all stakeholders’ views were taken into account. Consumer and user groups were “inconvenient guests”, largely disengaged from participating in the appeals process due to the high risks and costs, and the hostile environment.
- The Tribunal used an overly legalistic approach. Its focus on error correction has not supported the objectives of the regime, in part because only errors detrimental to the interests of applicants are subject to correction (while errors in their favour are unchallenged).
- Consistent with this, there was evidence that the appeals resulted in allowed revenues 8% higher than the determinations of the AER.
- The regime had adversely affected consumer interests in the short run through higher network charges and retail energy prices, without any evidence of countervailing consumer benefits over the longer term, consistent with the objectives of the regimes.
- Regulatory certainty over the long term was undermined, as the upward pressure on energy costs generates political pressures to reform the regime.

The expert panel’s recommendations included:

- replacing the four grounds of appeal with a single, broader, ground that “there is reason to believe that a materially preferable decision exists”;
- a review which is investigative rather than adversarial in nature (“review should not be a contest between interest groups, but an exercise in seeking to discover whether or not there exists a decision that better serves the long-term interests of consumers”);

- an obligation to seek out consumer views at the review stage; and
- a new, wholly administrative body (that is, not a court, and not a judge-led tribunal) to undertake the reviews.

The Standing Council on Energy and Resources is consulting on reforms arising from the expert panel's recommendations.

*Source:* Yarrow, Egan & Tamblyn, 2012a, 2012b; Standing Council on Energy and Resources, 2012.

A report by the Australian Consumer Action Law Centre and Consumer Utilities Advocacy Centre (CUAC) identifies similar problems in the review of AER decisions but goes further in its conclusions. It also argues that merits review allows distributors to "cherry-pick" which parts of a determination are appealed, and that the barriers to meaningful consumer participation in appeals are "insurmountable". The report highlights the increase in allowed prices and volume of appeals as signals that the current arrangements are not working (Consumer Action & CUAC, 2011, pp. 8-9).

Ultimately Consumer Action and CUAC believe the only workable solution to this problem is to ensure that Distributors do not have access to apply for a merits review of the AER's electricity price determinations. The risk of significant regulatory error, they argue, is adequately managed by replacing the right to a merits review of the AER's electricity price determination with a right to a judicial review. (Consumer Action & CUAC, 2011, pp. 9-10)

## Internal review

Internal review is where a decision of an officer in an organisation is reviewed by another person in the organisation. Some regulatory organisations have a formal system of internal review; others have more ad hoc systems. Internal review may be established by legislation or through administrative and policy processes within the organisation.

Internal review is available under the following Acts:

- Agricultural Compounds and Veterinary Medicines Act 1997
- Animal Products Act 1999
- Animal Welfare Act 1999
- Biosecurity Act 1993
- Civil Aviation Act 1990
- Health Act 1956
- Maritime Security Act 2004
- Retirement Villages Act 2003.

In most cases the requirements to provide internal review apply to very specific decisions, rather than providing for review of regulatory decisions generally. In some cases there is a requirement that the agency's chief executive conducts the review where the chief executive's decision-making powers have been delegated within the agency.

The Commission has not been able to identify significant literature on the value of internal review of regulatory decisions, or any guidance in New Zealand on their application. Canadian guidance (Administrative Justice Office, 2005) notes the potential for internal review as an easily accessible, quick and cheap way of resolving errors, and points to the benefits of providing direct and immediate feedback to original decision makers. It says that internal review may be most appropriate where administrative decisions are made against clearly articulated criteria, with little discretion exercised.

No regulatory agency that responded to the Commission's information request mentioned internal review as a method available to review their regulatory decisions. In its submission, NZTA said that it had operational policies that provided for internal review, with more formalised and senior review for more significant decisions. But NZTA said it had recently reorganised its internal review processes to improve transparency and consistency, and had not formally evaluated the effectiveness of the internal review processes (sub. DR 85).

In its submission BusinessNZ commented negatively on the internal review of New Zealand Qualifications Authority decisions in regulating English language providers in the private tertiary education sector (sub. 19). The Ministry of Justice notes that internal review is available for decisions on an application for legal aid, and comments that internal reviews "are suitable for low level decisions rather than complex economic regulation" (sub. DR 87, pp. 2-3).

Chapter 10 noted that there is greater potential for errors or poor-quality decisions where individuals rather than bodies take those decisions. Where individuals take day-to-day administrative decisions, internal review processes can be a relatively inexpensive and swift check to ensure such decisions are being exercised in a consistent way.

#### F11.4

Designers of new regulatory regimes should consider providing for the internal review of day-to-day administrative decisions taken by individuals.

## Ombudsmen

The Ombudsman is an independent Officer of Parliament who can investigate (upon complaint or its own motion) the decisions and actions of central and local government and Crown entities.<sup>72</sup>

The Ombudsman's procedures are informal, flexible, and free for complainants. It also has significant powers if required, including requiring the provision of information and the ability to question employees of state agencies under oath.

Following an investigation, the Ombudsman can issue a report and make recommendations. Although its recommendations are not binding, the Ombudsman is considered an effective "constitutional watchdog" (Chen, 2010). It is a regulator and an important check on the actions of other regulators.

In a recent report Transparency International New Zealand highlighted concerns about resourcing of the Office of the Ombudsman:

The Chief Ombudsman is of the view that since about 2009, the Ombudsmen have been seriously under-resourced and a substantial backlog of complaints is awaiting investigation. ... From 2008/09 to 2011/12, the number of complaints on hand at any one time increased from about 1,000 to about 1,700, a 59 per cent increase. In contrast, the Ombudsmen's annual appropriation from Parliament increased only 6.3 per cent. In 2011/12, only 53 per cent of complainants considered the ombudsman process to be timely and overall satisfaction with their standard of service has dropped ... Senior lawyers say that although the Ombudsmen's investigations are thorough and fair, they are no longer referring clients to the Ombudsmen if there is an alternative. (2013, pp. 214-15)

The appropriation for the Office of the Ombudsman increased by 36% from 2008/09 (\$6.854 million) to 2013/14 (\$9.320 million). The number of complaints received more than doubled from 2008/09 (6757 complaints) to 2012/13 (13,684 complaints).

These constraints weaken an important check on the exercise of state power, particularly for members of the public who do not have the resources or wherewithal to challenge decisions through other means. As Transparency International New Zealand notes, a weakening of the Ombudsmen will encourage recourse to more expensive processes where an aggrieved party has sufficient resources.

<sup>72</sup> The organisations subject to the Ombudsman's jurisdiction are listed in the First Schedule to the Ombudsmen Act 1975.

Transparency International New Zealand recommends that the adequacy of funding for the Office of the Ombudsman be reviewed in 2014/15. The Commission agrees.

**R11.1**

The Officers of Parliament Committee should review the adequacy of funding for the Office of the Ombudsman to undertake its statutory functions to a high standard.

In addition to the Ombudsman with general jurisdiction over the administration, there are also subject-specific and industry-funded Banking Ombudsman and Insurance and Savings Ombudsman schemes.

### 11.3 What types of appeal are available in New Zealand regulatory regimes?

In its issues paper, the Commission noted calls from legal practitioners and academics for access to greater merits review in New Zealand (2013b). Some of these views on merits review may no longer be current. Articles cited in the Commission's issues paper by Professor David Round and David Goddard QC both date from 2006, pre-dating the 2008 amendments to the Commerce Act which made merits review the norm for most parts of the regime. The Commission had noted a perception that, in general, New Zealand provided less access to merits review of regulatory decisions than other countries such as Australia, with a comparative reliance on judicial review as the main mechanism to challenge the decisions of regulators.

Research undertaken by the Commission does not support this perception (see Appendix F). In its submission, BusinessNZ correctly notes that "full rights of appeal are embedded in much New Zealand legislation" (sub. 19, p. 15).

#### Stocktake of appeal rights in New Zealand regulatory regimes

The Commission undertook a stocktake of the 94 pieces of legislation that involved regulation which were identified in the course of mapping New Zealand's regulatory environment (see discussion of this inquiry's scope in Chapter 1).<sup>73</sup> Table 11.1 lists the 26 pieces of legislation that provide no access to appeal.

**Table 11.1** Regulatory legislation that provides no access to appeals

Legislation		
Anti-Money Laundering and Countering Financing of Terrorism Act 2009	Human Tissue Act 2008	Primary Products Marketing Act 1953
Atomic Energy Act 1945	Imports and Exports (Restrictions) Act 1998	Reserve Bank of New Zealand Act 1989
Climate Change Response Act 2002	Land Transfer (Computer Registers and Electronic Lodgement) Amendment Act 2002	Reserves Act 1977
Corporations (Investigation and Management) Act 1989	Marine Mammals Protection Act 1978	Securities Transfer Act 1991
Energy Efficiency and Conservation Act 2000	National Animal Identification and Tracing Act 2012	Shipping Act 1987
Financial Reporting Act 1993	National Parks Act 1980	Statistics Act 1975
Flags, Emblems and Names Protection Act 1981	Native Plants Protection Act 1934	Unit Trusts Act 1960
Health and Disability Commissioner Act 1994	Overseas Investment Act 2005	Walking Access Act 2008
Human Assisted Reproductive Technology Act 2004	Ozone Layer Protection Act 1996	

Source: Productivity Commission research.

<sup>73</sup> Other regimes were excluded from the definition of "regulation" used in this inquiry, such as immigration, accident compensation, social welfare or employment (see Chapter 1). Although not investigated in the course of this stocktake, it is likely that these types of regimes make more use of internal review mechanisms and appeals to tribunals.

Based on the stocktake conducted, the view that access to merits review is limited is incorrect. Most appeals provided in regulatory regimes are general appeals conducted by re-hearing. First appeals restricted only to questions of law are uncommon; second appeals restricted to questions of law are much more common. The Ministry of Justice notes that *de novo* appeals may be common where the matter under appeal enters the court system for the first time and there might be no reliable record of the proceedings by the first instance decision maker, citing appeal proceedings in the Employment and Environment Courts (sub. DR 87). Appeals on questions of law are provided for under the following statutes (12 out of 94 statutes examined):

- Commerce Act 1986
- Crown Pastoral Land Act 1998
- Dairy Industry Restructuring Act 2001
- Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012
- Films, Videos, and Publications Classification Act 1993
- Financial Advisers Act 2008
- Financial Markets Authority Act 2011
- Financial Markets Conduct Act 2013
- Gas Act 1992
- Hazardous Substances and New Organisms Act 1996
- Securities Act 1978
- Trade in Endangered Species Act 1989.

It is possible to draw some similarities between most of the regulatory regimes established by these statutes. Most of these regimes deal with complex decisions that are highly technical and highly dependent on facts. The first instance decisions are made by expert bodies with particular expertise and experience, such as the Commerce Commission, the Financial Markets Authority (FMA) or the Environmental Protection Authority (EPA). Courts may be institutionally less competent than such specialist bodies to deal with these types of decisions.

#### F11.5

In general, legislation establishing regulatory regimes does provide access to merits review of regulatory decisions.

A number of important regulatory regimes have a more limited access to merits review. The importance of these regimes in the New Zealand economy will have supported perceptions that there is limited access to merits review of regulatory decisions more generally. For example:

- small parts of the Commerce Act 1986 (that were the subject of significant comment from a number of submitters) – specifically, appeals are allowed on questions of law only against determinations under section 52P that set out how information disclosure regulation or negotiate/arbitrate regulation applies to regulated suppliers or the default price-quality path that applies to regulated suppliers (other appeals under the Commerce Act are by way of re-hearing);
- the Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012 provides for an appeal on a question of law only against the EPA's review of a decision on an application for consent;
- the Financial Markets Authority Act 2011, where the FMA may state a case for the opinion of the High Court on a question of law (s 48);

- some parts of the Gas Act – specifically there is an appeal on a question of law only against a decision under any gas governance regulations or rules (s 43ZC);
- most of the Insurance (Prudential Supervision) Act 2010, except for appeals allowed against powers to remove directors and officers of firms, ban certain persons from participating in the industry, and valuation of policies;
- the Overseas Investment Act 2005, with no right of appeal;
- the Reserve Bank of New Zealand Act 1989, with no right of appeal;
- the Telecommunications Act 2001, which provides for appeals on a question of law only, apart from appeals related to Commerce Commission directions about costs, against conditions imposed on the construction of networks, and against the Commerce Commission’s refusal of a person’s objection to a civil infringement notice.

**F11.6**

In areas of complex or highly technical regulation, access to merits review or the scope of appeal provided is often limited or non-existent.

Appeal rights are generally not provided to challenge the decisions of ministers. Providing for merits review of ministerial decisions would subject an elected representative’s evaluation of complex policy issues and community values to review by an unelected body. The appropriate recourse to exact accountability for these decisions is through the ballot box. Courts are generally quick to defer to the judgments of democratically accountable decision makers (*Wellington City Council v Woolworths (NZ) Ltd (No 2)*).

Seafood New Zealand had a “fundamental opposition” to not providing for appeals of ministerial decisions:

There is no reason why ministerial decisions should not be appealed and subject to open scrutiny. It is an essential tenet of a robust democracy that the actions of legislators should be open to review by the judiciary, irrespective of who the legislator is. Citing that the “appropriate recourse to exact accountability for these decisions is through the ballot box” is demeaning and dismissive and does not obviate the issue of flawed decision-making. Ministers and their advising officials are not infallible and there is no guarantee that the processes to inform the Minister as to the circumstances of the situation, the exercise of his discretion or the review of submissions are robust and reliable. (sub. DR 72, p. 4)

Judicial review is available to challenge ministerial decisions, including reviewing engagement and submission processes which led to the development of advice to the Minister. A recent example of this is *Board of Trustees of Phillipstown School v Minister of Education* (2013), where a failure to provide a sufficiently detailed breakdown of the cost involved in safely rebuilding an earthquake-damaged school was sufficient for the court to conclude meaningful consultation had not taken place, and so set aside the Minister’s decision to close a school.

Chapter 10 argues that allocating regulatory decisions to ministers should be rare, and is appropriate for decisions that involve value judgements that are not amenable to technical analysis, or that involve significant fiscal implications. For the same reasons that these decisions should be taken by elected government Ministers, they should generally not be subject to appeals.

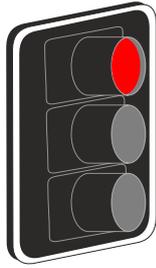
**F11.7**

It will generally be inappropriate to provide for appeals of ministerial decisions.

## 11.4 How to think about access to judicial review and merits review

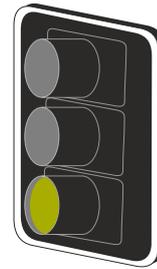
The red light theory and green light theory are the two main theories of the purpose of administrative law (Harlow & Rawlings, 2009). Figure 11.3 illustrates these two theories.

Figure 11.3 Two theories of administrative law



### Red light theory

- The purpose of administrative law is to curb state power, to protect the rights of the individual.
- Strong judicial control of executive power is desirable.
- Access to the courts is an end in itself.
- A **non-instrumentalist** approach.



### Green light theory

- The purpose of administrative law is to help the state meet its policy objectives.
- The judiciary is useful to the extent it serves these goals.
- Access to the courts is a means to an end.
- An **instrumentalist** approach.

The two theories can apply to review and appeal (Cane, 2004).

- Red light theorists would think about access to judicial oversight of regulators in a non-instrumental way. Such oversight is an essential part of the constitution that should be available to citizens as of right, except in the most extraordinary of circumstances. This is not to deny the likelihood of instrumental benefits from judicial oversight; only that access should not be contingent on such benefits.
- By contrast, green light theorists would think about access to judicial oversight in an instrumental way. What is the (expected) quality of outcomes from the review? Judicial oversight of regulators should be available where it is most likely to improve the quality of regulation.

It is essential to the rule of law that there are external checks to ensure Executive decision makers act lawfully. This is properly the role of the courts, and judicial review fulfils this function well. It follows that a non-instrumentalist approach should be taken to judicial review. It should be available as of right, and is an important component of New Zealand's constitutional arrangements.

Exceptions do exist. The courts have an inherent jurisdiction to rule on the legality of public acts and no public administration is immune *per se* from judicial review. Even so, while the courts will always have jurisdiction they may in a particular case find that the issues raised are "non-justiciable" and abstain from ruling on them. "Non-justiciable" means that the particular issue is not suitable for judicial adjudication because the court lacks institutional competence and/or legitimacy to determine the issue. Certain types of issues are often identified as non-justiciable. For example, the courts will be reluctant to review decision making if it involves public policies based on political judgements. They are reluctant to do so because the judicial decision-making method is ill-suited to dealing with complex policy issues and political judgements should be made by decision makers with a democratic mandate.

Judicial review will always be available where legislation establishes a regulatory regime and confers powers of decision on a regulator (including on a minister). Every legal power has limits; there is no such thing as unfettered discretion.<sup>74</sup> These limits constrain the design of decision review mechanisms in regulatory regimes: judicial review is a "given", and there is no way to restrict or amend its application. Although there are some constraints on judicial review which have been upheld, such as statutory time limits on the review of immigration decisions, in general attempts in legislation to exclude judicial review of regulatory decisions

<sup>74</sup> *Padfield v Minister of Agriculture, Fisheries and Food* (1968); and *Wellington City Council v Woolworths (NZ) Ltd (No 2)* (1996).

are wholly undesirable given the constitutional role of the courts in ensuring that executive power is exercised lawfully (LAC, 2012a).

By contrast, there is no general right to ensure that decision makers are **correct**, which is the general objective of merits review. “Natural justice does not require that there should be a right of appeal from every decision and there is no such thing as a common law right of appeal. However, in most circumstances it will be desirable for legislation to provide a right of appeal against an administrative decision” (LAC, 2012a).

It follows that designers of regulatory regimes should take an instrumentalist view about access to merits review. Taking into account the costs, risks and expected benefits, is it likely to improve the outcomes of the regulatory regime? This means that merits review should be thought of not as an external check on the regulatory regime, but as a part of the regime. For example, the test for whether a regime relating to the prudential regulation of insurers should provide for appeals of decisions should be whether the availability of the appeals would “promote the maintenance of a sound and efficient insurance sector” and “promote public confidence in the insurance sector” (which are among the stated purposes of the Insurance (Prudential Supervision) Act 2010, as set out in s 3).

**F11.8**

Access to judicial review should be approached in a non-instrumental way. Judicial review is an important constitutional check on the power of the Executive, and is available to citizens as of right.

**F11.9**

Designers of regulatory regimes should provide for access to appeal where it is likely to improve the quality of regulation, taking into account the costs of providing it.

LAC guidelines provide help on when to establish appeal rights (Box 11.3).

#### Box 11.3 **Legislation Advisory Committee guidelines on appeal and review**

The LAC guidelines state that: “Whether a right of appeal should be provided turns on the nature of the decision and the decision-maker at first instance, and the need to ensure subsequent oversight”. The guidelines advise that “it is generally desirable for legislation to provide a right of appeal against the decisions of officials, tribunals and other bodies that affect important rights, interests, or legitimate expectations of citizens”.

Appeals serve a private and public purpose. The private purpose is to scrutinise and correct individual decisions of decision makers with the aim of providing redress of the particular party involved. The public purpose is to maintain a high standard of public administration and public confidence in the legal system.

The value of having an appeal must be balanced against the following factors:

- cost;
- delay;
- significance of the subject matter;
- competence and expertise of the decision maker at first instance; and
- need for finality.

Appeals may be heard by a specialist tribunal or a court of general jurisdiction. The LAC guidelines identify the following factors as relevant to determining which type of body is best suited to hear and decide the appeal:

- the nature of the decision maker at first instance; in particular, the extent to which it performs a

specialist function concerned with fact-sensitive and complex technical determinations;

- the significance of the decision in question;
- the necessary balance between expeditious resolution of appeals and procedural rigour; and
- the extent to which the issues come within the ordinary scope of the court's work.

*Source:* LAC, 2012a, pp. 285-86.

Although brief, these guidelines appear to set out an approach that is suitably instrumentalist in nature. It invites those designing regulatory regimes to weigh the costs and benefits, and to consider the relative institutional capacity of the decision maker at first instance.

Despite the requirement for papers to the Cabinet Legislation Committee to assess proposals for compliance against the LAC guidelines, it is not clear how influential the guidelines are:

Officials and ministers are currently supposed to consider whether draft bills comply with the Legislation Advisory Committee's guidelines. But, as their name implies, these are merely guidelines; in practice they are often ignored, especially, where it matters most, by the Cabinet. (Caygill, 2010)

## 11.5 Calls for greater access to merits review

Most submitters wrote favourably about merits review, and told the Commission that there should be greater access to merits review where it is not currently available. A typical submission was that of Genesis Energy. They wrote that merits review mechanisms (beyond judicial review or appeal on questions of law) "correct errors and act as a discipline on the regulator (so drives better quality processes and decisions in the first instance)" (sub. 48, Appendix A, pp. 4-5). Carter Holt Harvey submitted that "[t]he right of those affected by regulation to appeal decisions to an independent authority should be identified by the Commission as a reasonable presumption" (sub. 8, p. 9). Wellington Electricity submitted that:

Merits appeal processes are essential for ensuring robust regulatory outcomes. Regulators should be accountable for the decisions that are made and should be subject to the potential for third party appeal. (sub. 17, p. 1)

Submitters made a number of arguments in support of merits review.

- The threshold for judicial review is high, and it does not provide an effective means of challenging decisions. (subs. 10, 29, 46, 48)
- Access to merits review reduces the incentives for firms to lobby politicians or officials for special treatment or legislative change. (sub. 46)
- Merits review would ensure regulators undertake a proper process (such as give sufficient consideration to consultation). (subs. 5, 31, 46, 48)
- Merits review would improve the upstream incentives on regulators to get the decision right, to a greater degree than judicial review. (subs. 5, 19, 24, 31, 46)
- Merits review provides for error correction, and better decisions. (subs. 19, 24, 29, 46, 51)
- Merits review would clarify the operation of new regimes, and its use would decline over time. (sub. 48)
- Merits review contributes to public and investor confidence in regulation. (sub. DR 79)

Even so, not all submitters thought that merits review served the interests of the general public. KLR Investments (sub. 18) and Internet New Zealand (sub. 45) said that merits review was used by large firms to undermine the objectives of regulation or the public interest: "From the perspective of end-users, merits review appears to be an additional expensive and lengthy process that operators use to avoid or delay regulation" (sub. 45, p. 10). 2degrees as a challenger firm echoed this perspective:

...there is a high risk that a merits review process could be used by incumbent operators to further delay or circumvent competitive regulation. Delay and gaming hurts challengers, creates further uncertainty, and requires significant resource commitments that are better spent on serving consumers and making competitive investments. In addition, incumbent operators tend to be better resourced and able to fund such appeal processes. (sub. DR 84, p. 3)

Cost, delay, and complexity are inherent in the appeal of decisions that require specialist expertise due to their highly technical nature. This is illustrated by a recent high-profile merits review of a determination by the Commerce Commission on the input methodologies (IMs) to be applied to the regulation of natural monopolies (Box 11.4).

**Box 11.4 Appeals from the Commerce Commission determinations of the input methodologies for regulation of natural monopolies under Part 4 of the Commerce Act 1986**

Changes to the Commerce Act in 2008 required the Commerce Commission to set IMs. IMs are the methodologies, rules, processes, requirements and evaluation criteria that underpin price control regulation and information disclosure regulation. IMs are intended to promote certainty for suppliers and consumers. Such regulation applies to markets where there is little or no competition and little or no likelihood of a substantial increase in competition. Such markets currently include electricity lines businesses, Transpower, gas pipeline businesses, and major airports.

The Commerce Commission set IMs in December 2010 following an extensive process, tightly prescribed by the Commerce Act.

Over a two year period the Commission produced over 800 separate substantive documents and based its consultation on a distribution list comprising more than 440 individual addressees representing more than 200 different organisations for the IM consultation alone. Consultation on the s 52P determinations was also occurring, often in parallel. It cannot be doubted, therefore, that the Commission's decision-making process was both careful and considered. (*Wellington International Airport Ltd & Ors v Commerce Commission*, 2013, at 173)

A number of regulated firms brought applications for judicial review that required the Commerce Commission to re-consult on some aspects of the IMs. The IMs were re-issued in June and September 2012.

In September 2012 the High Court began hearing a substantive appeal (merits review) of the IMs brought by 10 regulated firms and consumers. Parliament set different rules for appeals against IM determinations than apply to other appeals under the Commerce Act.

- Appeals against IM determinations will only succeed if the court is satisfied that a different IM would be "materially better" than that set by the Commerce Commission. The meaning of "materially better" was an issue of contention in the appeal.
- The High Court must sit with two "lay members". Lay members are economic or regulatory experts or academics who are appointed to help the court understand the subject matter of the appeals. In this appeal, both lay members were members of the Australian Competition Tribunal.
- The appeal takes place on the basis of a "frozen record". The court can only consider documentary information and views that were before the Commerce Commission when it made its determination. Although section 52Z of the Commerce Act describes these appeals as a "re-hearing", the ban on new evidence means it is more properly a pure appeal.

On 11 December 2013, the High Court released its decision in *Wellington International Airport Ltd and Others v Commerce Commission*. The judgment of the court was 636 pages long, reflecting the volume and complexity of material the court had to digest:

These appeals raise a large number of complex legal, economic and corporate finance issues. The hearings of these appeals occupied 39 days over the period September 2012 to February 2013. The documents before the Court, comprising 80 volumes containing 1,055 documents of over

40,000 pages in total, were the product of the extensive consultation undertaken by the Commission over a two year period concluding in December 2012. In addition to those documents, the Court was required to consider over 2,500 pages of written submissions and over 160 documents submitted in the course of the hearings to supplement, or expand on, the parties' oral submissions (as recorded in over 5,000 pages of transcript). (High Court media release, 2013)

The court found that 56 of the 58 challenges to the IMs were without merit or did not meet the test of providing materially better IMs. On two issues – relating to the date from which land assets are valued, and whether a catastrophic event would require the Commerce Commission to re-consider the default price path for regulated firms – the court found that the alternatives proposed on appeal would be materially better.

The hearings took 12 weeks in 2012 and 2013 and involved as many as 32 lawyers, including up to six Queen's Counsel. Press reports stated that one lawyer involved in the case claimed that Vector (one of the appellants) spent as much as \$17 million in a single year on litigation. Most of that money was spent on this appeal.

By contrast, the Commerce Commission says it spent more than \$5 million on the appeals (sub. 44, p. 4). The Commerce Commission is able to draw on dedicated money of about \$10 million each year to fund all of its litigation expenses, with an additional dedicated pool of \$2.5 million to cover adverse cost awards.

IMs are intended to apply for seven years. The IMs that were the subject of this appeal were set in December 2010. At almost halfway through the regulated period, only the first stage of possible legal challenges to the IMs have been determined. At the time of this report's printing, it appears that the High Court's decision will be the subject of further appeal.

However, as Minter Ellison Rudd Watts notes, "[i]t is too early to ascertain whether the appeal process will be a consistent feature of the regime or whether it is merely the bedding in of a new regulatory process" (sub. 28, p. 33).

*Source: Wellington International Airport Ltd & Ors v Commerce Commission, 2013; High Court of New Zealand, 2013; Smellie, 2013; and correspondence from MBIE to the Commission.*

As this case shows, providing access to merits review is not without cost. The financial costs will ultimately be borne by the customers of regulated industries, the shareholders of those firms, and the taxpayer. In many cases regulated firms will have greater financial resources to litigate than regulators. The more avenues that are provided to challenge decisions, the greater this imbalance becomes.

In the case of economic regulation, the costs arising from uncertainty and delay may also be significant. IMs are designed to promote certainty so that firms can invest in future infrastructure to serve the long-term interests of consumers.

There appears to be considerable value to finality in this situation, which the LAC guidelines indicate should be considered in deciding whether to provide an appeal. But this does not appear to have been substantively considered in the Cabinet paper or Regulatory Impact Statement (RIS) relating to 2008 decisions on amendments to the Commerce Act, with the RIS stating that "the associated risk of delay and gaming can be mitigated through careful design, for instance, by allowing the [Commerce] Commission's decision to stand while the courts are considering the case" (Office of the Minister of Commerce & Office of the Minister of Energy, 2008, p. 48).

Section 53 of the Commerce Act provides that, while appeals are underway, the Commerce Commission's determinations are in effect, to prevent regulated firms adversely affected by determinations using litigation as a delay tactic. Even so, while a successful appeal will allow firms to claw back revenue they have been denied, this cannot compensate for the uncertainty. This uncertainty may still discourage firms from planning and undertaking capital investment that might serve the long-term interests of consumers while awaiting judicial confirmation or amendment of the IMs.

## Is judicial review an effective means of challenging decisions?

A number of submissions argue that the threshold for judicial review in New Zealand is high (for example, sub. 46, p. 13) or that judicial review causes regulators to correct procedural deficiencies without leading to a better outcome for applicants.

It is possible for a regulator to be ordered by a court to correct a deficient process and yet still reach the same decision again. This can be appropriate. In *Fraser v State Services Commission* (1984) the Court of Appeal noted that the impugned decision may have been justified on the evidence. Even so, it set aside the decision for breach of natural justice.

During the Commission's inquiry it became clear that the pattern of use of judicial review varies widely across regulatory regimes. One financial institution told the Commission that seeking a review of a decision by the Reserve Bank of New Zealand (RBNZ) would be a "nuclear option". Vodafone's view was that "in practice, the existing threshold means that review proceedings are most unlikely to be brought" (sub. 46, p. 13).

Other firms that the Commerce Commission regulates have no such compunction. Since the Commerce Act was significantly amended in 2008, firms in the telecommunications, airport and electricity lines sectors have used judicial review to challenge the Commerce Commission's decisions. According to the Commerce Commission's annual reports, there have been no successful challenges of its processes in this time.

A claimed weakness of judicial review commonly identified is that "they go through the process again and you just get the same decision". That does not necessarily mean the decision is wrong, only that the regulated party is still displeased. The Commission has not been able to identify evidence on this question in New Zealand. The Court of Appeal has also noted the lack of evidence on the effectiveness of judicial review in promoting "good governance" more broadly:

Regrettably, there is little in the way of empirical evidence in the New Zealand context as to whether administrative law as a behaviour modification mechanism in government actually works. Such empirical evidence as there is in other jurisdictions tends to suggest that administrative law is likely to be able to make only a modest contribution to the promotion of external goals. (*Lab Tests Auckland Ltd v Auckland District Health Board*, 2009, at 398)

Yet an empirical study in Australia suggests regulators often change their decisions following a judicial review. The authors conclude:

Anecdotal belief had long held that a successful judicial review action would most likely be followed by an agency remaking the same decision, though taking care to avoid the earlier legal error. That belief has now been disproved, at least in Australian judicial review in the period covered by this research project. If theories are built upon facts, then the value of judicial review in producing a favourable outcome to an applicant has been demonstrated. (Creyke & McMillan, 2003, p. 186)

In New Zealand there is also a widespread belief that judicial review is futile. This belief was expressed to the Commission in the course of the inquiry engagement. Yet no evidence was presented to substantiate it.

### F11.10

The Commission has found no evidence to suggest that judicial review is an ineffective method of challenging the decisions of regulators, or that decision makers routinely reach the same decision after a successful judicial review.

Goddard argues that, in the area of economic regulation, judges may lack sufficient understanding of the complex issues to assess in a judicial review whether the decisions of a regulator are unlawful, or whether a regulator has taken the relevant material into account in forming a decision.

It is not easy to point to hard evidence of this, but my strong sense of appearing as a counsel in a range of judicial review cases (and a review of other recent decisions) is that this is an area where Judges are less confident than usual in identifying the outer bounds of statutory power and the purpose for which it was conferred, and as a result exercise less effective control over decisions by regulators than they do

in respect of other statutory decision-makers operating in more familiar, or less technical, fields.  
(Goddard, 2006, p. 6)

Merits review does not solve this problem and indeed exacerbates it. Even with the help of lay members or expert witnesses, it is judges alone who can rule definitively on questions of lawfulness. It is likely that only a greater degree of economic skills, or specialisation among the bench, will help to resolve this issue. On one hand, in the course of its engagement the Commission heard that New Zealand courts were reluctant to move towards judges becoming more specialised. On the other hand, the Ministry of Justice submitted that “among the judiciary there are judges who have considerable experience, arising from their previous experience as legal counsel, in regulatory proceedings” (sub. DR 87, p. 3). Specialist tribunals, lay members and specialisation are discussed in section 11.6.

## Does the absence of merits review encourage special pleading to politicians or officials?

A lack of access to merits review in the courts does not necessarily mean that aggrieved parties lack other means of recourse. Vodafone, considering the regulation of telecommunications markets notes that “current practice is for MBIE to act as a ‘final arbiter’ of regulatory decisions” (sub. 46, p. 13). For example, following the final decisions of the Commerce Commission’s benchmarking review of Unbundled Bitstream Access in 2013, Chorus Ltd had no recourse to merits review in the courts but was able to try to appeal to the Government directly and by motivating public opinion. MBIE brought forward by a number of years a scheduled review of the Telecommunications Act 2001 specifically to consider the Commerce Commission’s benchmarking decisions.

Appeal to ministers is more common and far more formal in Australia and some other countries than in New Zealand. In general, ministerial intervention in the decisions of independent regulators is undesirable. Where it does take place, it should occur through transparent channels.

In the situation described above, Chorus also has a contractual relationship with the Government to undertake the roll-out of ultra-fast broadband. This means that the Government has an additional interest in Chorus being able to fulfil its obligations.

Parties aggrieved by regulatory decisions are likely to pursue a range of strategies, including lobbying politicians and officials, regardless of the presence of merits review. Even so, the absence of merits review is likely to reduce the ability of politicians and officials to resist such pleading and direct them to the available formal appeal processes. A lack of merits review may provide politicians and officials with greater motive and opportunity to interfere in regulatory decisions than where there are formal processes to test the correctness of regulatory decisions.

### F11.11

An absence of merits review increases the likelihood that aggrieved parties will seek recourse outside the legal system. In particular, it will encourage special pleading to politicians.

A greater understanding of the ability of aggrieved parties to test the reasonableness of decisions through judicial review processes would improve the ability of politicians and officials to resist such special pleading. In late November 2013 a range of political parties made clear that there would be no parliamentary majority for legislating to overturn the Commerce Commission’s decision. Judicial review proceedings were filed in the High Court three days later.

## Would merits review get regulators to make lawful and reasonable decisions, or follow a better process?

A misunderstanding about the scope and focus of judicial review was evident in some submissions. Some submitters argued that merits review would cause regulators to improve their decision-making processes in the first instance. Some submitters also seemed to believe that judicial review is concerned exclusively with the process of making a decision and ignores the substantive aspects of the decision-making process and outcome. This is incorrect.

For example:

- the Insurance Council of New Zealand said that merits review would be “likely to induce a more considered and meaningful consultation process than occurs currently by the RBNZ, FMA and other regulators” (sub. 5, p. 5);
- Mortlock Consultants argued that merits review would allow a regulator’s decision to be challenged “on the grounds that it is unreasonable or inconsistent with the statutory objectives, or that the regulator did not pay adequate attention to the concerns raised in the consultation process in relation to the matter.” (sub. 31, p. 10); and
- Genesis Energy supported merits review because “reasonable submissions are dismissed without good reasons” by the Electricity Authority (sub. 48, pp. 4-5).

These matters are all within the scope of judicial review. Goddard notes that “[j]udicial review is well equipped to ... ensure that regulators follow a proper process consistent with the statutory framework under which they operate and the requirements of natural justice” (2006, p. 3). Often the courts set aside decisions of the Executive for procedural deficiencies, unlawfulness, or unreasonableness.

### F11.12

Merits review does not offer additional safeguards to ensure decision makers follow good processes, beyond those offered by judicial review.

## Would merits review sharpen the incentives on regulators to get it right?

Review of administrative decisions by courts appears to change the behaviour of regulators.<sup>75</sup> The widespread application of judicial review and the relatively broad scrutiny possible under a claim of unreasonableness provides a strong incentive for regulators to “get the decision right”. The reputational risk from having decisions set aside motivates decision makers, following a proper process, to make good decisions that will be defensible in the face of judicial review.

A number of submitters argued that the broader scope of merits review provided even stronger incentives than judicial review. No evidence was forthcoming in the submissions as to why this would happen. The Commission has considered what empirical evidence might be available to test the question. Examining the rates of decisions being overturned on judicial review or appeal would not seem to provide a sound basis to test this assertion. If merits review did provide stronger *ex ante* incentives to make a good decision, then it might be expected that the access to merits review would lead to fewer judicial challenges. Indeed it might also be expected to lead to fewer *successful* challenges than in regimes with no access to merits review. But any comparison would be largely meaningless because of differences in the underlying capability of regulators, and in the means and motivation of regulated parties to challenge decisions.

The starting point is that, to the extent good decisions flow from good processes, judicial review already provides all the incentives that merits review might provide. As the RBNZ argued, “a good process leads to good regulatory outcomes, and regulated entities already have a remedy against inadequate processes” (sub. 9, p. 6).

Earlier the Commission found significant overlap between the scope of judicial review and appeals in practice. The scope of judicial review that will be considered by a judge in any given case varies on the facts and circumstances (see the discussion in section 11.2). Applicants naturally seek a broad scope of judicial review, working merits arguments under the head of unreasonableness. Judges vary in their willingness to entertain these arguments, but scope exists for the substantive merits to be considered in the course of a judicial review.

<sup>75</sup> See for example the Judicial Review project in Australia discussed in Creyke & McMillan (2003).

Importantly, the scope of potential judicial review that a regulator might be subject to is uncertain at the point the decision is made. Applicants will understandably seek to bring a substantive examination of the merits within the scope of a judicial review. And at times judges can and do undertake such an examination.

The degree to which a court will defer to a decision maker is uncertain. In *Lab Tests Auckland Ltd. v Auckland District Health Board*, Justice Hammond noted the “lack of an agreed classification or taxonomy, accompanied by properly developed substantive principles as to when a court will intervene by way of judicial review” (2009, at 380). Joseph has described the variable thresholds of review as the “selective raising and lowering of the review threshold” (2001, at 936). As noted above, courts are likely to defer to specialist regulators in highly complex fields. Yet most regulators take decisions that are subject to an uncertain degree of potential judicial review, and with a realistic prospect of a substantive examination of the merits of a decision.

Clearly, the trend away from the strong *Wednesbury* deference is continuing. The threat of judicial review with a wide scope that scrutinises the merits of a decision is not qualitatively different from the threat of merits review itself. So the incentives provided on the decision maker *ex ante* are of similar strength.

The uncertainty about the scope of review that might be applied is unlikely to dull the incentive. Regulators are concerned with their reputation. They want to take decisions that will be upheld.

### F11.13

The broad scope of judicial review in New Zealand means that the availability of merits review would not provide significantly stronger incentives on regulators to make correct decisions than is provided by access to judicial review alone in most areas of administrative decision making.

Some submitters argued that the accountability for making good decisions would be lessened by the knowledge that a subsequent party would be the effective decision maker. The Electricity Authority noted, “the regulatory process risks becoming an entrée to the court process with parties restricting themselves to stating their points to get them on record as opposed to engaging fully and meaningfully to best meet the objectives of the regulator” (sub. 50, p. 5). Once a regulator knows that they are no longer actually the decision maker, then the regulator’s decision making could become only an information-gathering phase – the precursor to the real decision by the courts.

The Commission found no evidence to suggest that this was occurring in New Zealand. As noted above, judicial review is unlikely to involve scrutiny of the substantive merits of decisions in highly complex and technical fields, and is more likely to be limited to issues of lawfulness and process. In these situations, the additional scrutiny provided by merits review may strengthen the incentives on regulators to take good or “correct” decisions. Designers of regulatory regimes should weigh the expected strength of this incentive against any cost, delay or uncertainty that might result from providing access to appeals.

### F11.14

In highly complex or technical fields, where judicial review is less likely to scrutinise the substantive merits of decisions, merits review may strengthen the incentive on regulators to take good decisions.

## Are courts able to make “better” decisions than regulators?

Chorus submitted that “merits review recognises that regulatory decision makers will not always get it right” (sub. 51, p. 19). Regulators sometimes do make mistakes, as do courts.

Some submitters argued that merits review of complex, technical regulatory decisions is desirable because judicial review is not “an enquiry into the underlying evidence, or whether another substantive decision should be preferred based on this evidence” (sub. 46 p. 12).

Vector argued that “due to the often factual and merit-based elements of [decisions about economic regulation], judicial review can be an inadequate mechanism to ensure high quality regulatory decisions and

successful regulatory outcomes” (sub. 29, p. 14). However, in its 2008 review of the Commerce Act, the Ministry of Economic Development did not consider courts the appropriate body for appeals of economic regulation decisions: “There is a risk that the review of decisions about IMs are not suited for judicial decision-making since they relate to fact, rather than interpretation and application of the law” (Office of the Minister of Commerce & Office of the Minister of Energy, 2008, p. 49). For the Ministry, this led them to prefer using specialist tribunals rather than the courts to undertake merits review of these decisions. This option is discussed in more detail below.

New Zealand’s judiciary is widely regarded as independent, competent, and respected. A recent report by Transparency International New Zealand found the quality of the judiciary to be one of the strongest pillars in its framework of New Zealand’s “national integrity system” (2013).

Even so, in the course of its engagements, the Commission heard concerns expressed about the institutional capability of the courts to grapple with highly complex areas of regulation. In its submission, Powerco noted that “High Court judges can find [the specialist technical nature of many regulatory arrangements] difficult to comprehend fully, even with the assistance of specialist advisers” (sub. 14, p. 2).

Perhaps understandably, these sort of comments were expressed more strongly in the Commission’s engagement meetings than in the written submissions. These comments were not aimed at individual judges or the judiciary as a body, but the entirety of the court process. Comments included the degree of capability of senior barristers to accurately convey complex technical issues to the court, the lack of specialist technical support available to the court compared to the decision maker at first instance, and the procedural rules involved in appeals. The overwhelming sentiment expressed was one of sympathy towards the judges involved in hearing such appeals.

Even where it is likely that the court will correct an error, that may not lead inevitably to more preferable outcomes in terms of the objectives of regulation. As Yarrow, Egan & Tamblyn note:

Whilst this argument might have at least some force if errors to be corrected were selected at random, that does not correspond to the factual situation. Interested parties can choose their grounds of appeal, and this leads to bias in which particular errors are corrected. Thus, by way of illustration of the general point, if errors leading to a higher determination of revenue are approximately balanced by errors leading to a lower determination of revenue, then the correction of errors on only one side of the divide would actually create bias in what had previously been a near-unbiased assessment. (2012a, p. 31)

Where there is an imbalance between regulated firms and the consumers/beneficiaries of regulation in their ability to challenge decisions, this paradox may be magnified. The Major Electricity Users’ Group notes that “exposure to costs is a significant barrier in general to consumers in accessing, on an equal footing to the much better resourced monopolies, appeal processes.” (sub. DR 77, p. 2)

### F11.15

Providing access to merits review may not always promote the objectives of a regulatory regime.

Having merits review available where it is likely to support the objectives of the regulatory regime requires designers of those regimes to consider critically whether:

- the appellate body has sufficient institutional capability, compared with the decision maker at first instance, to improve the outcomes of decisions in terms of the objectives of the regulatory regime (including, but not limited to, whether correcting an error is more likely than creating one);
- the total costs in providing access to merits review, including monetary costs, delays and uncertainty, justify the expected outcomes in terms of the objectives of the regulatory regime; and
- mechanisms are available that might support or mitigate these two considerations.

These considerations are consistent with the pragmatic approach recommended by the LAC guidelines. Designers need to consider whether providing access to merits review will create incentives for market

participants to seek to improve regulatory outcomes through the courts, at disproportionate costs to the public.<sup>76</sup>

### F11.16

Designers of new regulatory regimes need to consider whether to provide access to merits review. In areas of highly complex, technical regulation, designers need to critically assess whether the appellate body has the institutional capability, compared to the decision maker at first instance, to improve the quality of decisions in terms of Parliament's objectives for the regulatory regime. Designers of regulatory regimes also need to take into account the costs, delay and uncertainty created by providing access to merits review.

## Will the incidence of appeals decline over time?

The Commission was told in engagement meetings that the number of appeals would decline over time as key areas of contention were clarified on appeal and precedents established to guide future resets. These arguments were made mainly in the context of the Commerce Commission's determination of IMs. For example, in correspondence to the Commission, MBIE said:

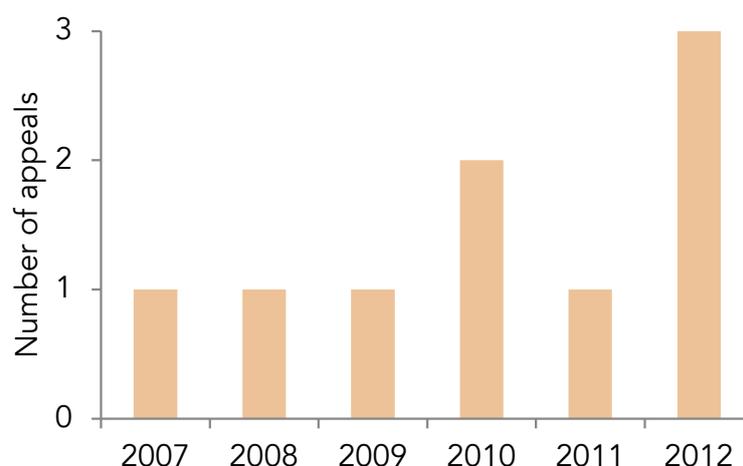
With the recent release of the High Court's merits review judgment, we are now well through this transitional bedding-in phase and anticipate a more settled period as we approach the end of the first complete regulatory cycle.

Chapman Tripp submitted, in the case of IM determinations in New Zealand:

The development of precedent in this area, combined with the fact that the re-determination of any input methodologies is unlikely (given the regime) to involve a completely new subject or approach to inputs, will also encourage a reduction in the scope and length of any future appeals. There has simply been insufficient time to draw the conclusion that there is no reason to believe that the incidence in such areas will decline over time. (sub. DR 68, p. 6)

Inherent in this argument is an assumption that the legislative framework will remain relatively stable over a significant period of time. Data and case summaries prepared in the course of the *Review of the Limited Merits Review* about appeals from decisions of the AER do not indicate that the frequency or complexity of appeals is declining (Figure 11.4).

**Figure 11.4** Number of appeals from the Australian Energy Regulator involving Weighted Average Cost of Capital



Source: Yarrow, Egan & Tamblin, 2012b.

<sup>76</sup> The RBNZ submitted that: "...due to the highly technical nature of many prudential requirements and New Zealand's relatively small pool of specialists experienced in prudential regulation, conducting a merits review of these decisions may be difficult. In addition, protracted court proceedings would have undesirable costs to efficiency and certainty for regulated entities, as observed in other areas" (sub. DR 99, pp. 3-4).

The Commission agrees that it is too early to state with certainty that appeals will or will not decline over time. However, in the Commission's view it would be wrong to assume that appeals will decline and that the costs of appeals need only be borne once. The complexity of economic regulation generally, and IM determinations in particular, makes it likely that there will always be scope for new challenges. There will always be a strong incentive on regulated firms to try to seek more favourable determinations through the appeals process when there are large amounts of money at stake, and to seek to distinguish previous appeal decisions from the facts that give rise to new appeals.

**F11.17**

Designers of regulatory regimes in highly complex or technical fields should not assume that the incidence or complexity of appeals will inevitably decline over time, particularly where the cost of regulated parties appealing is small compared to the potential gain.

## Provision of appeal rights can contribute to confidence in regulatory regimes

In its submission to the inquiry, Electricity Networks Association noted that access to appeal rights can contribute to investor confidence in a regulatory regime. It notes that “[i]n that context of economic regulation of the electricity sector the recent introduction of merits review provisions has been an important step to provide investors in the sector greater confidence of reasonable outcomes by being able to appeal a decision on method, if need be, to an independent party” (sub. DR 79, p. 2).

Ratings agencies also made this point to the Commission – access to appeals can be seen as an important safeguard, particularly by international investors unfamiliar with a regulatory regime or the quality of the regulator.

Access to appeals is one among many factors that international investors may look to when assessing the quality of the regulatory environment. Others factors include whether there is a record of political intervention in regulatory decisions or a history of dramatic lurches in regulatory approaches.

The benefits of being *seen* to provide appeals should not trump all other considerations. But it is a factor that designers of regulatory regimes should consider when assessing whether access to appeals is likely to support or undermine the objectives of regulation.

**F11.18**

Providing access to appeal rights can promote confidence in the quality of a regulatory regime, particularly for international investors.

## 11.6 Do alternatives exist that might improve the likelihood of good merits review decisions?

In its submission, Mighty River Power said that “the nature and form of merits review requires careful attention to avoid protracted and costly legal engagements” (sub. 30, p. 10). A number of mechanisms might improve the institutional capability of appellate bodies to hear appeals on areas of highly complex, technical regulation. There was broad support in submissions for these mechanisms.

### Different procedural rules

There were a number of suggestions of how different procedural rules could enhance the merits review of highly complex and technical regulatory regimes.

### A more inquisitorial approach

The first suggestion would be to allow a more inquisitorial approach. The New Zealand Airports Association noted:

It is also important to ensure that the appeal forum has the appropriate expertise and procedural flexibility to handle the challenges that come from a factual appeal against very technical and detailed

decisions. For example, it may be appropriate for a decision-maker on appeal (whether the Court or an expert panel) to be empowered to adopt an inquisitorial role where this will assist with the efficient and just determination of the issues on appeal. (sub. 33, pp. 15-16)

For example, where there are restrictions on the provision of new evidence, it still may be desirable to allow the court to examine the expert witnesses of parties to help the court gain a thorough understanding of the issues and arguments. This process should not extend to letting parties cross-examine each other's expert witnesses, to avoid undermining the inquisitorial approach.

In the course of the inquiry engagement the Commission was told about the benefits of "hot-tubbing" in relation to the Commerce Act. Hot-tubbing provides for different parties' experts (usually economists) to gather before or during a trial, with the aim of trying to reach agreement between the experts, or to better clarify areas of disagreement. Such processes would seem to help a court understand highly complex and technical issues.

### F11.19

In appeals of highly complex or technical regulation, providing the court with opportunities to directly question experts, in a non-adversarial setting, can assist in understanding the issues under appeal.

### Is a frozen record helpful?

As noted above, appeals against Commerce Commission determinations relating to IMs take place on the basis of the information that was before the Commerce Commission when it made its decisions: a closed or frozen record. In the recent IM appeal, the court noted that "as matters transpire, the [closed record] provision gives rise to little controversy in these appeals" (*Wellington International Airport Ltd & Ors v Commerce Commission*, 2013 at 176).

The stated justification for this restriction is to prevent gaming by parties. It would be undesirable for regulated firms (or the Commerce Commission) to withhold material from consideration only to deploy it later during an appeal.

In its inquiry into local government regulation, the Commission was sceptical about the widely held view that the availability of de novo appeals to the Environment Court encouraged participants in local authority processes under the Resource Management Act 1991 to "keep their powder dry" by holding back information until the appeal stage. The Commission noted that parties would not pay to create expert information until they knew it would be required, and that the success of mediation processes indicated that parties took a constructive approach (NZPC, 2013a, pp. 159-63).

In the case of economic regulation the stakes are higher. New Zealand Airports submitted that the frozen record means that at times the court is discussing what might happen in a hypothetical future, when there is existing information about what *did* happen not available to it (sub. 33). But the purpose of economic regulation is to regulate prices and quality over a defined period of time in markets where there is no realistic prospect of competition. This involves making predictions about the future based on imperfect information. It would be undesirable for emerging facts to influence a firm's incentives, when the objective of the regime is to promote certainty over the regulated period. This is particularly so where firms will only be incentivised to appeal when the emerging facts are favourable to their arguments.

On one hand, the Ministry of Justice noted that "in court proceedings involving appeals from other courts, it is a well-established principle that new evidence may only be admitted at the discretion of the appellate court and that court must be satisfied that the new evidence could not reasonably have been available in the first instance" (sub. DR 87, p. 4).

On the other hand, the frozen record may create a different set of problems. While it exists to prevent gaming, it may drive other perverse behaviour – an obsession with getting things on the record, not so they can be considered by the regulator, but so they are available to the court on appeal. In its submission the Commerce Commission noted that in the case of its 2010 decision on IMs, it received a submission a few days before the statutory deadline for its final determination (sub. 44). Such submissions are clearly

intended to be available on appeal rather than to influence the primary decision. Inevitably the Commerce Commission feels compelled to also get its response to such submissions on the frozen record. The substantial appeals about IMs were delayed by significant litigation about the composition of the frozen record. The frozen record appears to front-load the cost and effort involved in creating the material that will be considered on appeal, rather than substantially making the process simpler or cheaper for the Commission or other parties.

It may be that, in a more inquisitorial process, an appellate body could exercise more discretion over the admissibility of new evidence in a way that could reduce delay and costs involved in the merits review. In engagement meetings the Commission was told that the Australian Competition Tribunal would often discount newly introduced evidence if it thought that the evidence ought to have been provided to inform the initial decision. Broad discretion about cost awards could also discourage gaming.

### F11.20

Providing courts or tribunals discretion about the admissibility of new evidence may in some circumstances be more efficient than providing for appeals based on a frozen record.

## Different thresholds of appeal

Appeals against IM determinations must demonstrate that an alternative is “materially better”. Such thresholds may seek to deter marginal appeals, but they create additional scope for litigation.

While on balance it may be desirable to deter marginal appeals, such thresholds should not be intended to compensate for deficiencies in the institutional capability of the appellate body. If there is doubt about the ability of the body to correctly identify a *preferable* or *better* decision than the regulator, then there is no reason to suppose it is in a better position to correctly identify a *significantly preferable* or *materially better* decision.

## Alternative dispute resolution

In its report on housing affordability (2012b), the Commission noted that less formal alternative dispute resolution processes were likely to be less expensive, more accessible and faster than court processes. But the Commission cautioned that their outcomes may have less authority and so provide weaker incentives on decision makers (in that case, local government bodies).

Alternative dispute resolution mechanisms are a feature of a number of regulatory regimes, including:

- Animal Products Act 1999, s 118
- Education Act 1989, s 10
- Employment Relations Act 2000, ss 144-155
- Gas Act 1992, s 53D
- Health and Disability Commissioner Act 1994, s 61
- Human Rights Act 1993, s 77
- Privacy Act 1993, ss 74 and 76
- Residential Tenancies Act 1986, ss 86-90
- Retirement Villages Act 2003, Part 4
- Wine Act 2003, s 89.

Even so, most of these dispute resolution processes deal with disputes between the public and regulated parties (such as between consumers and retirement villages, or consumers and gas distributors), or to resolve disputes about levies on regulated firms (under the Animal Products Act and Wine Act).

Only the Education Act provides for a disputes resolution process to challenge the decision of a regulator: specifically, a determination by the Secretary of Education that a young person with special education needs should be required to attend a particular state school, special school, special class, or special clinic.

By their nature, regulators' decisions are unlikely to be suited to negotiated outcomes. This could compromise the independence of the regulator and encourage special pleading. Even so, the Commission has previously commented positively on the dispute resolution provisions available under the Resource Management Act 1991 (schedule 1, clause 8AA), and suggested similar procedures could be applied to the Local Government Act 2002 (in the context of disputes about developer charges) (NZPC, 2013a).

In its submission, ANZ says that alternative dispute resolution processes may be a less costly, more specialised, and more conciliatory way of resolving disputes than court processes, although it notes there are risks in the different evidential standards, and that the lack of precedent may lead to inconsistent outcomes over time (sub. DR 83).

## Lay members and specialisation

As the Commission noted in its issues paper, the Commerce Act 1986, Human Rights Act 1993, and Land Valuation Proceedings Act 1948 provide for lay members to be appointed as members of the High Court, which provide specialist expertise in cases relating to those Acts. High Court judges have the discretion to appoint lay members to particular cases. But once a lay member has been appointed to a case, that member becomes a member of the court for the purposes of that case.

In the course of the inquiry engagement, there was a uniformly positive view expressed about the role played by lay members in hearing Commerce Act cases. There are currently 15 lay members appointed by the Governor-General on the advice of ministers in recognition of their particular expertise in industry, commerce, economics, law or accountancy. Of the 15 lay members 8 are New Zealanders and 7 are Australians, including three members of the Australian Competition Tribunal.

Some guidance from the Treasury suggests the presumption in designing regulatory regimes should be that appeals are heard by relevant experts:

Appeal bodies should generally be comprised of experts in the relevant subject area. The more specialised or technical the subject area the more important it will be for the appeal body to include the relevant subject or technical experts. The more likely it is the appeal will involve legal issues the greater will be the need to have at least one person on the appeal body with some legal expertise. There are a range of choices as to the nature of the appeal and whether it is limited in some way, and the applicable appeal procedure (usually a choice of a re-hearing of some matters vs an entirely new hearing of the matter). (New Zealand Treasury, 2013a, p. 69)

Two recent studies in the United States provide conflicting evidence on the performance of generalist judges. Wright and Diveley (2012) find that the expert Federal Trade Commission does not perform as well as generalist judges in antitrust decision making. On the other hand, Baye and Wright (2011) find that judges trained in basic economics are significantly less likely to be appealed than are decisions by their untrained counterparts. The authors consider that their findings support the argument that some antitrust cases are too complicated for generalist judges.

The issue of judicial specialisation was discussed in a Law Commission report *Review of the Judicature Act 1908*, discussed in Box 11.5.

### Box 11.5 The Law Commission on the Commercial List and specialisation in the High Court

The 2012 Law Commission report on *Review of the Judicature Act 1908* discusses "what should be done about the existing Commercial List of the High Court" as well as asking "how far, if at all, should some form of judicial specialisation be effected in the High Court of New Zealand?" (pp. 99-116)

The report is careful to note the importance of the High Court's general jurisdiction, and particularly its constitutional role in exercising judicial review.

The Commercial List was established as a pilot in 1987, and formalised in 1991, to provide a list of judges to deal with pre-trial matters in commercial litigation, to assist in the timely and effective progress of commercial litigation.

Judges and lawyers were at odds over whether the judiciary needed greater specialisation. Judges were of the view that there was no need for an expert bench, if there was an expert bar: "It is said that judging *in itself* is a specialised form of legal practice in which the judge properly looks to counsel for the specialist subject-matter arguments" (p. 103).

After a survey of its members the New Zealand Bar Association took a different view. In the survey, 84% of members questioned indicated support for some form of judicial specialisation:

This shows overwhelming support for judicial specialisation from members of the Bar. ... Specialisation in one form or another is a reality in the modern practice of law and has been for some time now. It is an issue of relevance, not only for legal practitioners and their clients, but also to the judiciary. (p. 104)

The report provides a limited sample of the types of case on the civil list, and recommends that the Ministry of Justice ensures that further and better particulars of the classes of work being processed in the trial and appellate courts are made publicly available.

The Law Commission recommended a Commercial Panel to hear not only pre-trial applications relating to commercial litigation, but also the substantive hearings. It recommended that the Attorney-General work with the Chief High Court Judge to establish panels in other specialist areas of litigation.

These recommendations have been incorporated in the Judicature Modernisation Bill 2013. The Bill had its first reading on 5 December 2013 and was referred to the Justice and Electoral Select Committee for consideration.

*Source:* Law Commission, 2012a.

Trying to achieve consistent high performance is very hard when the pool of specialist people is small and the breadth of their work is large. There are advantages in having a pool of people doing particular types of review frequently so that they can develop expertise.

As at 25 March 2014, New Zealand had only 38 available High Court judges, and 8 associate judges. Given the small size of the judiciary, a significant degree of specialisation appears unfeasible. Without reliable data it is hard to assess whether sufficient work exists to justify an administrative panel to provide a degree of specialisation in administrative law cases in New Zealand. The Ministry of Justice noted that the Judicature Modernisation Bill, currently before select committee, would allow the establishment of specialist panels in the High Court, such as a commercial panel (sub. DR 87).

### **Specialist court/tribunal**

In its submission Vodafone argued in favour of a specialist tribunal to handle merits review of economic regulation. Recognising that a permanent standing tribunal would "involve significant costs, and may only rarely have a full workload ... it makes sense for it to be constituted when required using, as far as possible, resources that are already available within the New Zealand courts system" (sub. 46, p. 15). Such a model has also previously been advocated by Goddard:

We cannot justify a permanent specialist review body – but that is not what is required. We can in my view put together, on an ad hoc basis, a review body that would collectively bring to bear the relevant expertise, and would be well equipped to carry out merits reviews of decisions of the Commerce Commission, Electricity Commission, Securities Commission and possibly other bodies. The Commerce Act provides a model: a Judge, sitting with one or more lay members. (2006, p. 16)

Such a tribunal was considered following the 2008 review of the Commerce Act. Cabinet advice at the time noted that while such a tribunal or panel might allow for more tailored expertise and deliver faster decisions than the High Court, it also carries with it a high risk of further appeals, a heightened perception of political

involvement (particularly in selecting Tribunal members), and increased difficulty in managing conflicts of interest (Office of the Minister of Commerce & Office of the Minister of Energy, 2008, p. 8).

As the Ministry of Justice advised in the Cabinet paper following the 2008 review:

The Ministry considers that review decisions about input methodologies are not suited for judicial decision-making since they relate to fact, rather than interpretation and application of the law. There may also be difficulties in assigning judges with specialist knowledge in this area. (Office of the Minister of Commerce & Office of the Minister of Energy, 2008, p. 9)

The concerns about perceived political involvement in selecting panel members and conflicts of interest may be over-stated given the regard in which lay members appear to be held. Additional safeguards in appointing panel members could prevent political abuse. Such tribunals appear attractive given that they might more easily lend themselves to a more inquisitorial process, and the body could be provided with greater in-house specialist expertise to help it than is provided for in a traditional court structure. Care would need to be taken to protect the independence of such a tribunal, including ensuring it was resourced sufficiently to hear merits reviews.

But the regard in which lay members hearing cases under the Commerce Act are held may illustrate that these concerns are over-stated. Those involved in Commerce Act litigation place significant value on this specialist expertise.

Such a tribunal would be subject to judicial review in the discharge of its functions, but in so doing a court will generally only intervene for material errors of law, bad faith, breach of natural justice, or *Wednesbury* unreasonableness (*Unison Network Ltd v Commerce Commission*, 2007, at 55; and *Z v Dental Complaints Assessment Committee*, 2008, at 139).

### Foreign expertise in reviewing decisions

New Zealand's small size and associated difficulties in sourcing specialist expertise mean that foreign expertise can improve the capability of appellate bodies in areas of complex regulation. The Australian lay members are perceived as bringing valuable expertise in Commerce Act cases.

Recourse to Australian or joint trans-Tasman appellate tribunals may be desirable in some areas of regulation, given the desirability of harmonising regimes to promote trade and investment.

Many regulatory regimes will be unsuited to decision review by a foreign or international tribunal. The joint report between the Australian and New Zealand Productivity Commissions in 2012 noted the challenges with regulatory harmonisation generally:

Implementing agreements to reduce behind-the-border barriers – typically regulatory in nature – is more complicated than reducing tariffs. Work programs have taken many years in some cases. For example, the first consultation paper on establishing a joint therapeutic products agency was released in 2000, yet the new agency is not due to be operational until 2016. In other areas – such as a mooted merger of stock exchanges and the integration of banking supervision and competition policy regimes – deeper integration has not been achieved. (APC & NZPC, 2012, pp. 5-6)

Even so, New Zealand should continue to seek opportunities to provide for input from foreign experts in areas of complex and highly technical regulation (including in the evaluation and review of regulators and regimes – see Chapter 14).

#### F11.21

Foreign expertise can play a valuable role in bringing expertise to merits review of highly complex and technical regulatory regimes.

### Tribunal reform

Dr Graham Taylor, in a thoughtful submission, discusses the issue of tribunal reform and the possibility of an Australian-style general merits review tribunal (sub. DR 101). As he notes, these issues were considered at length by the Law Commission in its 2004 report *Delivering Justice For All: A Vision for New Zealand Courts and Tribunals*. Additionally, many specialist tribunals in New Zealand deal with matters that, while having

regulatory aspects, have been defined as out of scope for the purposes of managing the breadth of this inquiry. These specialist tribunals include, among others, those focused on ACC, immigration, social security, compulsory mental health assessment and treatment, and employment law.

In his submission, Taylor makes the case for a general review tribunal. Given the scope of this inquiry, and the previous work of the Law Commission on the subject, the Commission has not re-examined these arguments. Interested readers are invited to review Taylor's submission (sub. DR 101) and Law Commission, 2004 for more information on this subject.

## 11.7 What is the Commission's guidance on access to review and appeal of regulatory decisions?

Merits review should be available where it is likely to contribute positively to the objectives of regulation, taking into account the issues noted by the LAC:

- cost;
- delay;
- significance of the subject matter;
- competence and expertise of the decision maker at first instance; and
- need for finality.

If regulatory decisions are plotted along a scale of complexity, then trivial and mundane decisions are less likely to require access to merits review; and extremely complex decisions may be less likely to benefit from access to merits review. It is the vast bulk of decisions in the middle of that spectrum that are most likely to be improved by access to merits review (Figure 11.5).

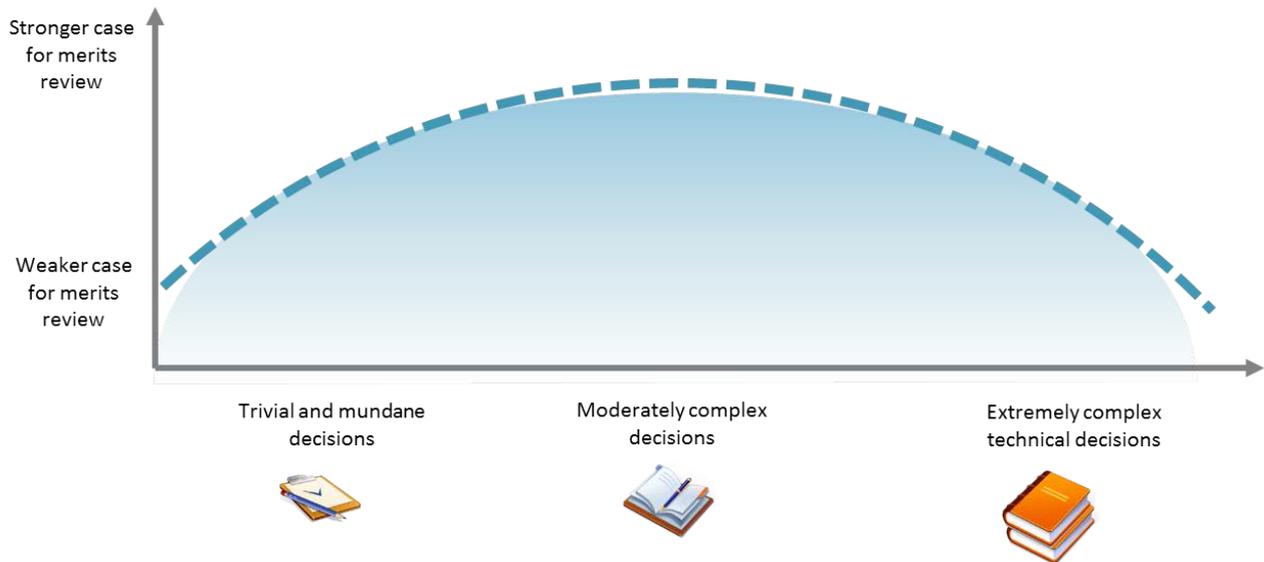
The RBNZ argued this point in its submission. It said that its proposed powers under the Non-bank Deposit Takers Bill to determine whether an individual is a fit and proper person to be a director or senior officer of a non-bank deposit taker are amenable to merits review. By contrast, prudential regulation is "inherently technical and judges do not usually have that technical or industry expertise" (sub. 9, pp. 5-6). The Electricity Authority also argued that "electricity industry disputes are often complex and technical, requiring specialised electrical engineering or economic knowledge or both" (sub. 50, p. 5).

The Commission has not formed a view on whether merits review should be provided in these or any other specific regulatory regimes, or what form and process any merits review should take. But in areas of highly complex and technical regulation, designers of regulatory regimes should critically assess whether courts have sufficient expertise or institutional capability, relative to the decision maker at first instance, to be confident that merits review would likely improve the desired regulatory outcomes.

This assessment should include considering what mechanisms could be used to support the capability of the appellate body. Minter Ellison Rudd Watts thought that

...there can be benefits in having an expert body developing expertise over a range of similar decisions, particularly in a highly technical field. There can also be benefits in a more streamlined process, for example, if the courts conducted a more inquisitorial process to speed up the production of evidence. These changes could be achieved within the existing court system or by creating a dedicated appeals body. (sub. 28, pp. 33-34)

Figure 11.5 When is merits review likely to be appropriate?



Determining whether appeals should be provided for is highly circumstantial. It will necessarily entail forming a robust view about the capability – or in the case of a new regulator, the likely capability – of the decision maker at first instance, and the capability and expertise of the appellate body.

Making such an assessment is fraught. Regulated firms often have a natural incentive to criticise a regulator. A firm faces minimal costs by advocating for the availability of merits review. Where large sums of money are at stake for firms, then choosing to appeal, even at great expense, may be a relatively small investment for the prospect (from their perspective) of a better result. Providing access to merits review will not always be appropriate.

Insurance Australia Group Limited (IAG)'s submission notes the danger in relying on court processes as the primary means of promoting regulator accountability: it is expensive, uncertain, potentially damaging to the relationship between regulator and regulated, and has a narrow focus on specific regulatory decisions. IAG also notes that:

...from an economic perspective, the rationale underlying regulation is dissatisfaction with the efficiency of court room disputes as a means of controlling business conduct. To rely on judicial review as the primary means of securing regulator accountability necessarily imports into the regulatory system many of the significant costs and inefficiencies that regulation is intended to avoid. (sub. DR 80, p. 10)

This highlights the importance of effective processes to review the performance of regulators and regulatory regimes, so that monitors can independently assess the quality of regulatory decisions regardless of whether appeal rights are provided in a given regime. This is discussed in greater detail in Chapter 13, which focuses on accountability and performance monitoring.

## 12 Approaches to funding regulators

### Key points

- The way that regulators are funded can affect the efficiency of resource use, equity and the achievement of policy outcomes.
- The Commission's survey of businesses, and submissions to the inquiry, reveal concern in the business community about:
  - the quality of the consultation before regulatory fees or levies are introduced;
  - weak constraints on the level of charges; and
  - the structure of charges.
- While there can be benefits from regulators recovering some costs through fees or levies, case-by-case assessment of proposals for funding regulators is required to secure these benefits. The framework for choosing between sources of funding needs to encourage this to happen.
- The funding frameworks in selected jurisdictions are similar to New Zealand in that they:
  - set out efficiency and sometimes equity as the main objectives of cost recovery;
  - require consent, usually of a minister or Parliament, before a fee or levy is introduced; and
  - are based on a distinction between cost recovery and taxation.
- There are, however, examples in other jurisdictions of:
  - more rigorous consultation and impact assessment before fees are introduced;
  - more detailed advice about how to implement cost recovery;
  - stricter requirements for performance standards and reporting against those standards; and
  - penalties for failing to achieve the standards.
- There is scope to improve New Zealand's approach to cost recovery through strengthening the governance and accountability framework, by:
  - publishing the Government's cost recovery policy;
  - requiring agencies proposing a new or amended fee or levy to publish a statement explaining, for example, why they are doing so and the expected effects;
  - strengthening performance reporting;
  - introducing regular reviews of regulators' cost recovery practices; and
  - improving the implementation of cost recovery by refreshing and rationalising the guidance material, and ensuring adequate departmental advice is available to regulatory agencies about how to approach cost recovery.

## 12.1 Introduction

The costs of administering regulation can be funded from various sources, including Crown contributions; levies on the regulated industry; or through fees imposed either on the beneficiaries of regulation or on those who cause the “problem” that needs to be regulated. The level of funding affects the capacity of regulators to perform their role. In addition, where the funds are sourced from can affect the outcomes of regulation and the efficiency with which these outcomes are achieved. The approach to funding regulators may also interact with other regulatory design features, such as independence, engagement, accountability, and transparency. And some ways of funding regulators are likely to be seen as fairer than others. Many countries, including New Zealand, have established frameworks whose purpose is to assist those designing and implementing regulation to select the appropriate sources of funds.

This chapter focuses on how regulators are funded rather than on the level of funding. It describes New Zealand’s approach to funding regulators (Section 12.2) and assesses it from three perspectives:

- insights from economic analysis (Section 12.3);
- issues raised by inquiry participants (Section 12.4); and
- lessons from other jurisdictions (Section 12.5).

This analysis suggests that New Zealand’s framework for funding regulators has many positive features, although the Commission has found little evidence about how well it is working. Economic analysis suggests that recovering some costs of regulation through fees is beneficial. But poor implementation can undermine the benefits. Some business participants consider that implementation risks are evident in New Zealand. Other jurisdictions use a variety of approaches to reduce these risks.

Overall, the chapter argues that while there is not a major problem with the approach to funding regulators in New Zealand, opportunities exist to improve it that would apply equally to new and existing regulators (Section 12.6).

## 12.2 The approach to funding regulators in New Zealand

### Sources of funding

The Commission has not found aggregated data to show how regulators in New Zealand are funded. However, the amounts involved appear significant. For example, the Board of Airline Representatives New Zealand pointed out that user charges and industry levies to fund the Civil Aviation Authority (CAA) are about \$35 million per year (sub. DR 89, p. 1). Table 12.1 shows that in the year to 30 June 2013 the Ministry of Business, Innovation and Employment (MBIE) collected \$156 million in fees and levies to recover costs largely incurred by regulators in its portfolio to administer regulation<sup>77</sup>.

**Table 12.1 Fees and levies administered by the Ministry of Business, Innovation and Employment**

Fee or levy	Regulatory activity funded by the fee or levy	Revenue for year ended 30 June 2013 (\$000)
Levy on Regulated Airports	Commerce Commission regulation of specified airport services	997
Control of Natural Gas Services	Commerce Commission regulation of gas pipeline services	2,111
Levy on Electricity Line Businesses	Commerce Commission regulation of electricity lines services	4,867

<sup>77</sup> In some cases, such as the levy on the electricity industry, a small proportion of the levy goes towards non-regulatory activities such as Energy Efficiency and Conservation Authority services.

Fee or levy	Regulatory activity funded by the fee or levy	Revenue for year ended 30 June 2013 (\$000)
Financial Service Providers Reserve Dispute Resolution Scheme	Dispute Resolution Services Ltd functions relating to the Financial Service Providers Reserve Dispute Resolution Scheme	651
Recovery of Fees and Levies for the Financial Markets Authority	Financial Markets Authority regulatory services	14,723
External Reporting Board Fees	External Reporting Board functions and duties under the Financial Reporting Act 1993	3,619
Telecommunications Levy	Commerce Commission functions, powers, and duties under the Telecommunications Act 2001	4,233
Levy on Electricity Industry	Electricity Authority functions, powers and duties under the Electricity Industry Act 2010	76,087
Health and Safety in Employment Levy	WorkSafe New Zealand administration of the Health and Safety in Employment Act 1992	47,404
Accounting Standards Review Board	Fees payable under section 5 of the Financial Reporting Order 1994	830
Health and Safety Fees and Licences	Revenue collected from fees and licences pertaining to amusement devices, explosives and dangerous goods; and from the issue of certificates of competency for safety supervision.	39
<b>Total</b>		<b>155,561</b>

Source: Treasury Budget 2014 Revenue Data (available at [www.treasury.govt.nz/budget/2014/data](http://www.treasury.govt.nz/budget/2014/data)) and MBIE.

*Notes:*

1. This table does not include levies administered by MBIE for activities outside the scope of the Commission's inquiry, such as immigration services and employment regulation.

Information that the Commission collected from 19 departments and other regulators indicates significant differences in practice between regulators.

- Six of the 19 are fully funded by Crown funding, while 13 receive funding from both Crown funding and fees, levies, and/or other sources of revenue.
- The numerous Acts under which the regulator is fully or nearly fully funded from fees or levies include the Building Act 2004, the Cadastral Survey Act 2002, the Health and Safety in Employment Act 1992, the Land Transfer Act 1952, the Radiocommunications Act 1989 and the Ratings Valuation Act 1998.
- The proportion of funding that major regulators receive from fees and/or levies varies considerably. The Civil Aviation Authority (95%), the Gas Industry Company Limited (100%), and the Electricity Authority (100%) are at the upper end, while the Office of Film and Literature Classification (36%), Environment Protection Authority (24%), Takeovers Panel (15% to 20% in most years), and Reserve Bank of New Zealand (close to 0%) are at the lower end, along with those agencies that the Crown funds entirely.

## Fees and levies

Regulators can recover costs through *fees* and *levies*. The Commission found no formal New Zealand definitions of these terms. The Australian Productivity Commission (APC, 2001b, p. xxxiii) defines a fee for service as a direct charge that reflects the costs of the service, and that the service must be rendered to, or at the request of, the party paying the account. The APC defines a levy as a form of tax that is imposed on a specific industry or class of persons. In New Zealand, it does not appear so clear-cut that a levy is regarded as a tax (Box 12.1). One distinction between fees and levies suggested to the Commission is that levies are

typically set through legislation, while fees may not be. However, there are examples of fees set through subordinate legislation. Fees are typically collected by regulators and retained by them.

### Box 12.1 Fees and levies

Neither term is defined in the guidelines for setting charges in the public sector issued by the Treasury. The guidelines of the Office of the Controller and Auditor-General (OAG) suggest that:

...a levy differs from a fee for a specific good or service; it is more akin to a tax, but one that is charged to a specific group. It is usually compulsory to pay a levy. Levies charged to a certain group are usually used for a particular purpose, rather than relating to specific goods or services provided to an individual. (OAG, 2008, p. 6)

The Legislation Advisory Committee (LAC) Guidelines imply that whether a levy – like a fee – is a tax depends on whether it is used to recover costs:

Although an Act may empower the making of fees regulations, this does not mean that the Act empowers the Crown to impose a tax. The cases establish that a fee, due, rate, levy, or toll may in fact be a tax by another name. *Re a By-law of the Auckland City Council* [1924] NZLR 907 at 911 (SC). In such cases the fee or charge is invalid. However, a fee, due, rate, levy, or toll will not be considered to be a tax if the amount charged is merely for recovering administrative costs reasonably incurred in regulating an activity. (LAC, 2012a, s 3.4.2)

The Concept Consulting Group suggests that a levy is paid by industry participants while a fee is paid by users/beneficiaries, and a levy is paid to the Government, while a fee is paid to the funded entity. However, it notes that there are exceptions to this definition (sub. 50, attachment one, p. 11).

Source: OAG, 2008; LAC, 2012a; and sub. 50, attachment one.

Levies for departmental regulators may be:

- received directly (and recognised as revenue), but with an appropriation still required to cover any related expenses, with any surpluses returned to the Crown unless permitted to do otherwise, or
- recorded as revenue by the Crown (but not the department), with any funding of the administering department provided separately as Crown funding (and the department's costs appropriated accordingly).

In the case of Crown entity regulators, the levies may be:

- received directly and recognised as revenue, without an appropriation process; or
- received on behalf of the Crown (that is, not as Crown entity revenue), with any Crown funding of the Crown entity's costs provided separately as Crown funding (and appropriated accordingly as a non-departmental expense).

Few submissions responded to the Commission's request in the draft report for advice about whether there is a clear distinction between fees and levies, and whether there are issues specific to fees and levies that it should consider. The Ministry for Primary Industries (MPI) commented that there is sufficient guidance in this area and that "in some instances, the terms are used interchangeably" (sub. DR 102, p. 17). MBIE considers that rules and processes relating to fees and levies are well understood (sub. DR 104, p. 16).

The view of the Parliamentary Counsel Office (PCO) is that clearer definitions of fees and levies are needed. However, the PCO suggested that the key issue is legislative authority and that, for any new legislation, policy terms should be clear on whether the intent is to impose charges to recover costs or to impose taxes and levies not directly linked to the costs of providing goods or services:

Legislative terminology may well vary unhelpfully (eg, what is called a "fee" may be in substance a tax, or what is called a levy may be in substance a charge for goods supplied) but the key question is what, in substance, does the legislation authorise? (sub. DR 88, p. 25)

The Board of Airline Representatives New Zealand argued that regulators do distinguish between fees and levies, and that this affects their approach to charging:

... regulators tend to draw a distinction between whether they consider the charge is a fee or levy, with the approach being that when the regulator feels it is able to characterise a charge as a levy rather than a fee, then it feels able to avoid the need to accurately match costs to the charges being set or the need to match the charges for a particular class of users with the costs caused by those users. There is a tendency for the regulator then to simply levy the lion's share of the revenue sought on the parties it believes have the ability to pay the cost, or the party less likely to vociferously object. This has been a key experience with respect to the setting of CAA levies on the aviation sector with commercial airlines being levied three quarters of all CAA costs despite only causing one quarter of CAA costs. (sub. DR 89, p. 1)

Overall, while the Commission agrees with the PCO that there would be benefits from more clarity about the definitions of fees and levies in the context of cost recovery by regulators, the inquiry has not identified major issues arising from the absence of clear definitions. Concerns about the level of levies should be lessened by proposals to improve scrutiny of new cost recovery proposals, suggested later in this chapter.

The rest of this section outlines the main features of the legal and institutional framework within which funding arrangements are determined.

## The legal and institutional framework for funding regulators

Important features of New Zealand's framework for guiding the choice of funding sources for regulators include:

- specified objectives of cost recovery;
- legal authorisation;
- governance and accountability arrangements;
- guidelines about how to choose between different funding sources; and
- processes for reviewing the effectiveness of funding arrangements.

### Specification of objectives

The Government, drawing on advice from departments, decides whether regulators should be funded from taxes or through cost recovery. The choice between funding sources will be guided by the objectives that the Government considers funding should achieve. The only general explanation of these objectives is in the Treasury Guidelines for setting charges<sup>78</sup> in the public sector, published in 2002. These guidelines indicate that options for user charges should be assessed against a combination of efficiency and equity objectives and ensure that the fees promote other government policy objectives (Box 12.2).

#### Box 12.2 Objectives of user charging listed in the Treasury Guidelines

These guidelines evaluate the options for user charges on the basis of the following objectives:

1. encouraging decisions on the volume and standard of services demanded and supplied that are consistent with:
  - the efficient allocation of resources generally, and also
  - the outcomes the government is seeking in providing the service;
2. minimising the cost of supply over the short term, and over the long term when capital costs

<sup>78</sup> The guidelines deal with charges for services for which the Government is a monopoly supplier. The services may be supplied by departments or other Crown entities and may be intended to provide benefits to individuals and groups and/or limit risks to public health or other negative effects. The guidelines also apply to charges for the supply of information. The guidelines do not deal with taxes to limit externalities, services produced in competitive or contestable markets, services in which income redistribution or social insurance are important, and charges for the use of resources such as minerals.

- are significant;
- 3 keeping transaction costs low and evasion at acceptable levels;
- 4 reducing reliance on funding from general taxation (with its associated costs);
- 5 dealing equitably with the taxpayer, those who benefit from the output, and/or those whose actions give rise to it; and
- 6 looking for new ways to lower costs and find appropriate providers.

*Source:* New Zealand Treasury, 2002, p. 3.

Two potential tensions between some of the objectives are:

- fees that improve efficiency could be passed on to less well-off consumers, which may be seen as inequitable; and
- imposing a charge to reduce reliance on general taxation may undermine the outcome the government is seeking in providing the service. For example, there have been concerns that the border-charging regime might discourage reporting of biosecurity risks: a person unloading a container at a transitional facility who finds a pest may be concerned about higher inspection charges if they notify the MPI. However, MPI pointed out that operators that report risk material may benefit in the long run through lower inspection frequency if MPI's assessment of their operation improves (MPI, sub. DR 102, p. 19).

### Legal authorisation

Most regulators derive their authority to charge fees from legislation. A public entity requires legal authority, through an Act of Parliament, to charge a fee for goods and services that it is legally obliged to provide. Regulations attached to the legislation, or sometimes the legislation itself, may set out the level and types of fees or levies that can be imposed:

The legislation will usually include an empowering provision that authorises the entity or the Governor-General to set the amount through regulation, rather than specify the amount in the primary legislation. (OAG, 2008, p. 9)

For example, the fees used to fund the Office of Film and Literature Classification are authorised by the Films, Videos and Publications Classification (Fees) Regulations 1994, and regulatory oversight of gambling is funded through fees set out in the Gambling (Fees) Regulations 2007.

The authorisations differ between regulators and can be complex.

- Although section 115 of the Electricity Industry Act 2010 authorises regulations to be made relating to fees, the requirement under section 128 of the Act that the Electricity Authority's costs are fully met from a levy means the fees cannot be used to recover costs in relation to the Authority's statutory functions. The practical effect of these arrangements is that all Authority funding is ultimately determined by Parliament through the annual appropriation process. The Authority is not able to charge and receive a fee direct from users for any statutory function carried out pursuant to the Act, but the levy can exhibit some characteristics of a fee (sub. 50, attachment one, p. 6).
- Unlike the Electricity Authority, the Financial Markets Authority (FMA) can raise some revenue from fees, which are not subject to the yearly appropriation and levy consultation process (since the revenue is received directly by the FMA).
- The Commerce Commission can recover some costs through fees, but not other costs.
- The Gas Industry Company, a co-regulatory company, is permitted to raise funds through levies, market fees and annual fees (sub. 50, attachment one, pp. 25-26).

For some regulators, legislation defines criteria for determining the most appropriate method of cost recovery. For example, under the Biosecurity Act 1993 (s 193 (a)), a levy recovering the costs of providing or performing a particular service or function must accord with the principles of equity and efficiency. The

Wine Act 2003 requires that justifiability and transparency are considered, as well as equity and efficiency (s 84 (2)).

Regulators are required to ensure that fees or levies are linked to providing a benefit and to avoiding charges that exceed costs, which could be interpreted as a tax. A tax that is not authorised by or under an Act of Parliament contravenes section 22(a) of the Constitution Act 1986 and could be declared ultra vires (beyond one's legal power and authority) and invalid by a court (New Zealand Treasury, 2002, p. 3).

### **Governance and accountability arrangements**

Organisations that determine, implement, monitor or review the approach to funding regulators include:

- the regulators and the ministers responsible for them, who may set fees acting on the advice of the departments responsible for administering appropriations;
- the Treasury and the OAG; and
- the Regulations Review Committee (RRC) of Parliament.

The process for reviewing the performance of funding after implementation is another important feature of the governance framework.

### **Ministers responsible for regulators**

Legislation that sets out the functions and powers of individual regulators may indicate that the minister responsible for the regulator recommends fees, or is responsible for the legislation that provides the power to impose fees or levies. This is the case, for example, in the Biosecurity Act, Electricity Industry Act 2010, and the Financial Markets Authority Act 2011. The legislation may, as in the Biosecurity Act, set out options for cost recovery (s 135) and provide the authority to impose levies (s 137). It may also set out how to approach the task.

### **Departments**

Departments administer parliamentary appropriations on behalf of ministers. As part of this role, departments advise ministers on funding and cost recovery and may, as described above, recover levies for Crown entities.

### **The Treasury**

The Treasury Guidelines (New Zealand Treasury, 2002) provide advice about when and how to set fees, although ministers are not obliged to use them. These Guidelines (which were issued in 2002 and reviewed, but not significantly altered, in 2008) are discussed below. Treasury officers provide advice on request about how to implement them. The Commission has found no evidence to suggest that the Treasury (or other departments) monitor whether regulators have complied with the Guidelines.

The Treasury has also issued guidance (New Zealand Treasury, 2011c) for the operation of departmental memorandum accounts. These guidelines record the accumulated surplus or deficit from providing services on a cost-recovery basis – accumulations that can be caused by temporary discrepancies between costs and revenues. The guidance states that memorandum account balances are expected to trend to zero “over a reasonable period of time”, with interim deficits being met either from the department's balance sheet or by a capital injection sought from the Crown. Agencies are required to have regular monitoring of memorandum account balances (at least quarterly) and these balances are audited. However, there is flexibility on the path that agencies can take to trend to zero balance over time. The treatment of memorandum accounts is asymmetric, as there are penalties for persistent deficits and persistent surpluses. Persistent deficits are added to the departmental net assets for the purposes of calculating the capital charge. Persistent surpluses are exempt from the capital charge, as they are user funds, not departmental capital.

**Box 12.3 Memorandum accounts**

Entities that provide services on a full cost-recovery basis, and for which the revenue and expenses will not necessarily agree in each financial year, must operate a memorandum account that records the accumulated surplus or deficit arising from providing the service. Memorandum accounts improve transparency and provide assurance that entities are not gaining from over-recovery. Requiring entities to prepare memorandum accounts increases their accountability to those purchasing the services and to other stakeholders.

Surpluses and deficits in memorandum accounts can be significant. For example, at 30 June 2012 the account for Occupational Licensing of Building Practitioners reported a deficit of \$15.3 million while the account for Civil Aviation Security Charges reported a surplus of \$23.1 million.

The Treasury's instructions state that departments must ensure all memorandum account balances are monitored regularly, at least quarterly (New Zealand Treasury, 2013d). The OAG (2013) has reinforced this, by pointing out that

- regular monitoring of account balances will allow management to put plans in place to reduce significant deficits and surpluses; and
- allocating costs accurately is important to ensure that costs are borne by the correct party.

For entities with memorandum account balances, having effective monitoring systems in place is important. Entities should ensure that there is regular monitoring of account balances on either a monthly or quarterly basis. (p. 97)

*Source:* Office of the Controller and Auditor-General, 2013; New Zealand Treasury, 2013d.

**The Office of the Controller and Auditor-General**

The Auditor-General has also issued guidelines for charging fees for public sector goods and services (OAG, 2008). The Auditor-General can examine the process that a public entity uses to set fees. This examination is part of the Auditor-General's role in assuring Parliament that public entities are operating in a manner consistent with Parliament's intentions (OAG, 2008, p. 17).

**The Regulations Review Committee**

The RRC is the parliamentary select committee that scrutinises regulations, including regulations that set fees, to ensure that delegated law-making powers are being used appropriately. The RRC examines regulations, investigates complaints about them, and assesses proposed regulation-making powers in bills for consistency with good legislative practice. Standing Order 378 (2) sets out nine grounds under which the RRC can draw a regulation to the attention of the House. These grounds focus on issues such as whether the regulation is consistent with the objectives of the relevant Act, whether the matter is suitable for inclusion in regulation, and whether it was introduced after a proper process. The grounds do not cover whether the fees are inefficient. Parliament can disallow a regulation that contravenes one of the nine grounds.

The RRC's reports on fees include proposed new fees for lodging a claim with the Disputes Tribunal (Box 12.4), civil aviation charges (RRC, 2014a), fees set by the Medical Radiation Technologists Board (2010, see RRC, 2011), and Unit Titles – Fees Regulations (RRC, 2011). The RRC typically asks the agencies concerned to demonstrate that the fee was calculated in line with the Treasury and OAG guidelines, and to address the constitutional principles for setting fees outlined in the RRC's previous reports. In its comments on the medical radiation technologists' fees, for example, the RRC criticised the Medical Radiation Technologists Board for not setting its fees in line with the Treasury and OAG guidelines.

#### Box 12.4 The Regulations Review Committee's consideration of fees for lodging a claim with the Disputes Tribunal

The Department for Courts justified two proposed increases in fees on the basis that they were consistent with the Government's user pays policy and would encourage more efficient use of the Tribunal system. The Committee found that the second increase breached standing order 378 (2) (a) because the fees were not in line with the general objectives and intentions of the Disputes Tribunal Act 1989, the purpose of which was to provide relatively low cost access to a small-claims court. The Committee recommended that the Government should review its fees policy. Ultimately the Government decided to reduce fees for smaller claims while retaining them for larger ones.

*Source:* Morris and Malone, 2004.

### Applying cost recovery: guidelines published by the Treasury and the Office of the Controller and Auditor-General

As indicated above, the Treasury and the OAG have both published guidelines to assist regulators contemplating recovering their costs through charges. Table 12.2 compares some of their key features, which indicate considerable differences between the two guidelines.

**Table 12.2 Key features of the Treasury guidelines and the Office of Auditor-General guidelines**

Feature	The Treasury Guidelines	OAG Guidelines
Legal status	Not legally binding Guidelines are "intended as a checklist"	Not legally binding Guidelines set out "matters that we expect public entities to consider"
Coverage of agencies	All public sector agencies	All public sector agencies
Coverage of charges	User charges, including fees and levies	Levies are not covered
Costs to be recovered	Charges should be at full cost, unless policy considerations justify less than this	Fee should be set at no more than is necessary to recover costs, unless there is specific authority to do so
Context	Agencies should describe characteristics of good or service (public, club, merit or private good), identify outcomes to which it contributes, and identify the beneficiaries	
Approach	Stepped approach that draws heavily on economic concepts	Focuses on requirement that public entities are guided by the principles of authority, efficiency and accountability
How fees should be set	Public entities should explain the context; identify who is to be charged; analyse the structure of costs; and identify ways to hold down costs	Public entities should consider: <ul style="list-style-type: none"> <li>• the legal authority it has to charge a fee</li> <li>• the justification</li> <li>• how fees should be calculated</li> <li>• whether its decisions, charging systems and revenue and costs are clearly documented and transparent</li> </ul>
Structure of charges	Consider whether to set charges at short-run marginal cost and, if so, how to recover the revenue shortfall  Consider whether to standardise costs	Fees may be set at average cost, unless the costs involved in producing individual goods or services vary significantly

Feature	The Treasury Guidelines	OAG Guidelines
	across locations or time, for reasons of administrative simplicity or equity	Goods and services should be grouped logically, and the resources used to produce them identified  Costs need to be divided into direct and indirect costs, and allocated against goods and services
Cost control	Identify ways to hold down costs and, where possible, provide evidence that these mechanisms will be effective	Fees should be reviewed regularly to ensure that they remain appropriate and based on valid assumptions
Role of consultation	Important. Requirements can be found in <i>Wellington International Airport v Air New Zealand</i> 1993 1NZLR 671	Important. Guidelines provide advice on requirements

Source: New Zealand Treasury, 2002; OAG, 2008.

## Processes for reviewing how well cost recovery is working

The RRC reviews cost recovery mechanisms *before* implementation, and when fees are set in regulations a regulatory impact statement (RIS) may need to be prepared. However, there appears to be no systematic approach to reviewing how well cost recovery performs *after* implementation, even though the Treasury and OAG guidelines both propose that regulators develop a process for undertaking regular charging reviews (New Zealand Treasury, 2002, p. 21; OAG, 2008, p. 12). The Commission asked 18 agencies with regulatory functions whether they have processes for periodically reviewing fees, levies or other cost-recovery mechanisms. Four agencies responded that there is no process for at least some of their charges and eight replied that the question did not apply to them. Six agencies identified review processes, which differ considerably:

- the Civil Aviation Authority (CAA) has triennial funding reviews, with the next one due in 2015;
- the Electricity Levy is reviewed each year;
- levies to fund the FMA are to be reviewed after two years;
- levies to fund the Gas Industry Company Limited are set each year;
- the New Zealand Qualifications Authority periodically reviews its fees and charges to ensure that it is achieving the estimated medium-term, full-cost recovery; and
- the Department of Conservation periodically reviews its fees, levies and other cost-recovery mechanisms, by direction from senior managers rather than by statute or regulation.

## Summary

The framework for funding regulators has significant positive features. Organisational responsibility for advising, implementing and scrutinising funding arrangements has been established, and guidelines offer regulators and advisors guidance on how to approach funding issues.

The Commission has found little evidence about how well the arrangements are working. There appear to be few studies of whether implementation of the Treasury and OAG guidelines is comprehensive or patchy, or of how funding arrangements have affected the performance of New Zealand regulators. The two sets of guidelines approach similar issues in different ways. There is no general requirement for ex post evaluation of regulations,<sup>79</sup> which might have generated evidence of the impacts of funding arrangements. This inquiry has therefore attempted to address this gap by surveying businesses about the fees that regulators charge,

<sup>79</sup> Some Acts may have requirements to review particular regulations.

and by seeking information from regulators, and comments through submissions to the inquiry (Section 12.4).

### F12.1

Organisational responsibility for advising on, implementing and scrutinising funding arrangements has been established, and guidelines offer regulators and advisors guidance on how to approach funding issues. However, the two sets of guidelines cover similar issues in different ways. There is no general requirement for ex post evaluation of the impact of cost recovery and little published evidence about how well funding arrangements are working.

## 12.3 Insights from economics

This section considers economic concepts that influence the choice between different approaches to funding regulators.

If regulation delivers significant positive spill-overs to the wider community as well as those in the market being regulated, it may be appropriate to fund part of the administration of the regulation from general taxation revenue (APC, 2012, p. 143). Where such spill-overs are small or absent, recovering the costs of administering regulation through fees or levies can improve efficiency, although factors that may affect the size of the efficiency gains need to be considered.

### Recovering the cost of regulatory services can improve efficiency

Recovering the administrative costs of regulatory services can improve the efficiency of resource use.

- Building the full costs of production (including the administrative costs of regulation) into products encourages users of regulatory services to adjust their use of those services in line with their willingness to pay for them. This discourages frivolous use of regulatory services and tells consumers choosing between products the full costs of their choices. The Independent Pricing and Regulatory Tribunal in New South Wales noted:
 

Cost-reflective pricing enables consumers and producers to make informed decisions on the services demanded and supplied. This further reduces the potential for government to provide services that cost more than the value consumers place on them (or more than the benefits they create). (IPART, 2013, p. 21)
- The responses of those who pay for regulatory services to “buy” more or less of these services signals to regulators which services are in demand. For example, fees for the urgent and after-hours services for issuing passports are about double and four and a half times the standard fee, respectively. Regulators that charge for their services and retain the revenue should be able to respond more flexibly and quickly to unexpected changes in demand than would be the case if they had to seek additional Crown funding.
- Appropriately structured charges can motivate regulators to look for better ways to provide services. The quality of consultation between regulators and those they are regulating is important in this context since consultation provides the opportunity for the shape of services to be altered in line with the requirements of both regulators and regulated parties (sub. 50, attachment one, p. 34).
- Those who have to pay for regulatory services may be motivated to monitor regulators’ performance, so as to constrain their costs to efficient levels.
- Cost recovery reduces the call on taxation revenue to fund regulators, and so decreases the costs of tax administration and compliance (APC, 2001b).

Recovering the costs of regulation may also appear more equitable, in the sense that less of the cost of regulation will be paid by those taxpayers who do not benefit from the regulations or use the regulated products.

## But there are other considerations

Some factors may constrain the size of these benefits, unless implementation is handled carefully. Cost recovery may:

- have little impact on the behaviour of users of regulated services if the fees are small and the firm or consumer that faces the charge has no alternative but to use the regulated service;
- conflict with a policy objective, as illustrated by the border-charging example provided earlier;
- facilitate gold plating – charges exceeding efficient costs or over-servicing by the regulator – if those who pay the fees or levies do not monitor regulators’ performance;
- distort competition, if registration and assessment charges discourage new firms from entering a market or bringing a new service to a market;
- discourage innovation, by penalising first movers (this could happen if a firm has to pay to secure a new standard for an unpatented product and the standard is available to competitors without charge);
- encourage regulators to focus on activities for which they can charge, even when another approach for which they cannot charge may be superior;
- disadvantage small firms. For example, all firms may benefit from or contribute to the need for a service, but a flat fee calculated by averaging across the number of businesses will impact disproportionately on small firms, especially if there is a large fixed cost component (New Zealand Food Safety Authority, 2006, p. 11); and
- weaken the independence of regulators. For example, the World Bank argues that levies based on profits would create a conflict of interest (Brown, Stern, & Tennenbaum, 2006, p. 223).

Equity and efficiency objectives may clash. Preferential treatment of particular classes of consumers may improve equity, but at the cost of reduced efficiency and higher administration costs. The OECD suggests that “measures through the tax and benefit system may be a more efficient way of ensuring equity than reduced charges” (1998, p. 6).

In general, there is a strong case for regulators to recover the administrative costs of regulation, so that an industry’s costs reflect the full costs of production. The case may, however, be weakened if there is a risk that cost recovery would be inconsistent with a policy objective, or would undermine competition (as in some of the examples above), and if fees or levies that are designed to avoid such problems become costly to administer. The level of regulators’ costs must be scrutinised to ensure that cost recovery does not lead to gold plating, although this is also a risk where regulators are funded from taxes.

Case-by-case assessment of proposals for funding regulators would make it more likely that costs are recovered in the best way possible. This highlights the importance of:

- having a guidance framework and process that encourages regulators to work through issues such as those identified above;
- processes to ensure that only efficient costs are recovered; and
- reviewing periodically how well cost-recovery arrangements are performing.

### F12.2

While there can be benefits from regulators being at least partially funded through cost recovery, case-by-case assessment of proposals for funding regulators is required to secure these benefits in practice.

## Who should pay?

When it is efficient to recover the costs of regulatory services through fees, the next question is who should pay: the beneficiary of regulation or the entity that is causing the problem that needs to be regulated (the exacerbator).

Charging the beneficiary can be justified on the basis that those who benefit from regulation should pay for it:

The 'beneficiary pays' principle has been widely cited as a major rationale for developing and implementing cost recovery. It is based on the notion that those that benefit from the provision of a particular activity or product should pay for it. This has both economic and equity dimensions. It encourages those who benefit from the activity or product to recognise that there are resource costs involved, and it decreases the taxation burden on those who do not benefit. (APC, 2001b, p. 15)

The APC explains further that:

The concept of beneficiary pays has its origins in the public finance concept of the benefit principle. This principle suggests that economic efficiency would be improved by requiring people to contribute (through taxation) according to the value they place on the public goods and services they consume. In practice, it is almost always impossible to estimate these values. (APC, 2001b, p. 16)

Finding a way to encourage the beneficiaries of regulation to reveal the values they each place on it is challenging.

When the benefits of regulation are captured by consumers within the regulated market, the exacerbator and beneficiary pays approaches to cost recovery lead to similar outcomes, because fees imposed on firms can often be substantially passed on to the consumers who benefit from the regulation. In such cases, when there is broad equivalence between the two approaches, the choice between them is likely to be determined by the relative costs of administering them. If there are many beneficiaries – which happens frequently – charging them directly can be costly to administer. For example, people who purchase food in retail outlets benefit from food safety regulation, but charging them directly for its costs would not be practical.

The equivalence between the exacerbator and beneficiary pays approaches breaks down when there is no commercial relationship between the regulated business and the beneficiary; for example, to the extent that building standards aimed at neighbourhood amenity are intended to protect people outside the housing construction market (VCEC, 2005b, p. 441). In such cases, cost recovery may be less feasible.

## 12.4 Issues raised by the survey of businesses and by inquiry participants

### Survey of businesses

The Commission's survey of businesses found that, of the businesses surveyed, just over a quarter (28%) agreed that it was clear what regulatory services the fees covered and just under a quarter (24%) disagreed. Only 9% agreed that the fees charged are fair and reasonable, while 48% disagreed (Colmar Brunton, 2013, p. 28). The survey also found that of the businesses that expect regulation to pose a significant barrier to expansion, 60% considered that a reason for this was the cost of obtaining a licence, permit or decision (Colmar Brunton, 2013, p. 22).

These results are broadly consistent with the finding in the Commission's inquiry into local government, that 70% of the businesses the Commission surveyed were dissatisfied with the regulatory fees that councils charged (NZPC, 2013a, p. 59). Fees for regulation are only part (and often a small part) of the costs that businesses face, but they sit within the context of general concern about the costs that regulation imposes.

### Submissions

Observations in submissions indicated that how regulators are funded is significant for some inquiry participants. They generally accepted that the efficient costs of regulatory activities need to be funded, and that under-funding can cause problems. For example, the Meat Industry Association considers that recent

failings by regulators, such as the recent interruption of meat exports to China “due to a mistake in the over-stretched market access team at Ministry for Primary Industries”, have been caused by under-resourcing of regulatory activities (sub. 40, p. 12). However, several participants have concerns about:

- the way charges are determined;
- weak constraints on the level of charges;
- the impact of charging on regulators’ independence; and
- poorly structured charges.

### **The way that charges are determined**

Several participants consider that processes for determining charges are deficient. For example, the New Zealand Bankers Association believes that the Ministry for Economic Development imposed fees to fund the FMA without considering concerns raised by the industry.

Another example of a lack of accountability and transparency in a regulators’ actions was the process taken by the then Ministry of Economic Development (MED) in deciding the levy structure to be placed on industry to fund the newly formed Financial Markets Authority (FMA) in 2011.

... With little warning MED issued a brief proposal which was heavily criticised by industry participants. Little rationale was provided by MED as to how they arrived at this model and the justification for imposing disproportionate costs on large banks, who were already prudentially regulated and least likely to require FMA attention. Despite extensive feedback from the many different industry participants on how the proposal could be made more equitable, the regulator did not accept or address any challenge to the principles upon which the levy allocation was based.

... The approach taken by the regulator had minimal transparency and accountability and this is unacceptable in the development of a policy that resulted in significant costs being imposed upon the regulated organisations. (sub. 43, p. 6)

The Insurance Council of New Zealand has similar reservations about these charges:

...there is serious concern about the way the insurance industry is currently funded. ... The focus in setting levies seems to have little correlation to how the FMA’s resources will likely be concentrated. (sub. 5, p. 8)

Application of the Treasury and OAG guidelines should reduce concerns such as these. However, Aviation New Zealand commented that “when government is cash strapped our experience is that these guidelines are not applied” (sub. 36, p. 25). Similarly, BusinessNZ suggested that user charges are sometimes applied simply to reduce the impact on the Government’s budget, rather than where cost recovery is justified:

...one area of Government practice where a number of industries have found unbalanced involves the funding methods of various authorities, for instance the Electricity Authority and the Energy Efficiency & Conservation Authority (EECA). This was instituted on the establishment of the Electricity Commission by the then Labour Govt, simply as a means to reduce the additional cost to taxpayers on their establishment as Crown agencies, but has survived with the establishment of the Electricity Authority.

...The move to have the Electricity Authority and a portion of EECA funded by industry has no basis in principle, but was purely a method to avoid taxpayers having to fund their establishment. (sub. 19, p. 13)

The Major Electricity Users Group (MEUG) raised similar concerns about the funding of the Energy Efficiency and Conservation Authority:

The initial decision to establish this levy was politically motivated rather than based on a robust analysis of possible market failures and consideration of possible solutions, including funding options, to overcome material proven failures. ...

An independent and comprehensive review of the rationale for and effectiveness of the EECA electricity levy is needed. The risk is that if this levy stays “on the books” then EECA or other parties will use this precedent for similar energy efficiency levies to apply to transport fuels, gas and other energy forms. (sub. DR 77, p. 3)

As noted earlier, the distinction between public and private goods is a central feature of the Treasury guidelines. Yet it can be difficult to make this distinction. Tasman District Council suggested that “improved disciplines around determining the public versus private benefit split in delivering regulation may have some merit” (sub. 1, p. 3).

A common theme between most of these concerns is that there was inadequate consultation before fees were introduced. The CAA, however, disagrees, suggesting that the processes required before fees are introduced may be too onerous:

All regulators whose funding is set by Regulation have funding transparency due to the process for making regulations, which includes the delivery of a Regulatory Impact Statement, and a mandatory consultation phase. ... However, the degree of this transparency is becoming increasingly onerous and expensive, particularly so because of the (apparent) expectation that the organisation will undergo a full business Value-for-Money review as a precursor to any fees charges and levies update. It may create the risk that the funding review process distracts the CAA from its primary role – aviation safety. (sub. 6, p. 37)

### **Weak constraints on the level of charges**

Several participants suggested that weak constraints on the level of charges imposed by regulators can lead to charges exceeding efficient costs (gold plating).

The Meat Industry Association considered that charges imposed on the industry are not transparent and may be for services that do not contribute directly to regulatory activity:

The costs of regulation are extremely heavy on business. A good example of the costs is from meat hygiene regulatory activity, for which industry is fully cost recovered. Industry pays around \$40 million each year to MPI (the regulator and who provides on-site veterinarians) and \$47 million to Asurequality (the provider of meat inspection services). ... A problem is that the costs charged to industry are not fully transparent. In particular, it is very unclear to industry what overheads industry is actually paying for – in the view of the MIA, it is inappropriate that industry pays for services that do not directly contribute to the regulatory activity being provided ... There has also been poor budgeting and reporting by government regarding cost recovery ... These are direct costs to industry. In reality, the indirect costs to industry in having to meet regulatory requirements are probably greater. (sub. 40, pp. 8-9)

Vector noted that if the Commerce Commission over-spends its budget, it can pass on the extra costs through its industry levy:

Most functions of the Commerce Commission under Part 4 are currently funded by an industry levy, which can be passed through to consumers by regulated suppliers. If the Commerce Commission over or under-spends, the amount that varies from budget is passed back to suppliers to pass on to consumers. This means the Commerce Commission is not necessarily constrained by the budgets that are set for it. (sub. 29, p. 23)

Aviation New Zealand similarly considered that there are weak constraints on regulators that are:

... state owned and operated monopolies but there is no redress to the Commerce Commission and the complaint to the Regulations Review Committee must be framed in the context of a breach of standing orders. Without full financial disclosure it is difficult to sustain a challenge and many of the agencies do not have systems which record hours spent on particular activities with any precision – to develop these financial management systems imposes a cost on the users so it’s a vicious cycle. (sub. 36, p. 25)

We are also aware that there is considerable variation in the charge-out rates of regulators. This presumably reflects funding allocation decisions to individual regulators, and a belief that industry in some sectors could or should pay more than others. The basis for such funding decisions is not clear and there needs to be greater transparency and consistency across regulators. (sub. DR 61, p. 3)

There are also concerns about possible over-servicing when fees can be charged. Aviation New Zealand noted that:

... it is not simply the charges but the lack of control over activities; ie the CAA is the final arbiter of when a “job” is finished. The industry is unable to get to any other provider to seek the service. There are no appeal rights and there are no controls on price, quality or service. ... Because of the mixed

funding model for CAA we are firmly of the view that it is nearly impossible for CAA to ensure Government contributes its fair share. (sub. 36, pp. 25-26)

Benchmarking charges imposed by similar regulators could constrain fee increases, but making comparisons may be difficult:

We think the Electricity Authority and Gas Industry Co provide good information about their future work programmes and associated costs. However, because this is provided in different forms it can be difficult to draw comparisons between both agencies which have similar functions. (Minter Ellison Rudd Watts, sub. 28, p. 38)

A small number of industry participants were less concerned about the constraints on regulators' charges. For example, Mighty River Power explained:

The Electricity Authority is funded under levy arrangements. Mighty River Power considers the benefit of levy funding is that it is generally transparent (requiring annual consultation with stakeholders) and the Authority has demonstrated a commitment to manage its operating costs. (sub. 30, p. 10)

## Impacts on independence

Participants noted that the way that funding is determined can affect a regulator's independence.

The New Zealand Council of Trade Unions considered that regulators need secure funding because regulators that are under-funded become reliant on the parties they are regulating and so less independent:

Where a regulator is carrying out a controversial or unpopular role (perhaps unpopular only with one interested party) there is pressure to reduce its activity by underfunding. Again, that was demonstrated in the occupational health and safety system. The Pike River Royal Commission inquiry documented the falling resources made available to the regulator with demonstrated but long term impacts on accidents, injuries and deaths. The regulator was unable to do its job properly as a result of the falling funding, which increased the attractiveness of taking short cuts including relying on employer processes or their word rather than carrying out proper inspections and investigations. This meant the regulator was highly reliant on employer goodwill, undermining its independence. (sub. 25, pp. 22-23)

The Reserve Bank suggested that having a 5-year funding agreement with the Government supports its independence:

Our primary source of funding is return on the investments we hold. The amount of this income is negotiated with the Minister of Finance in a funding agreement that has a five year term. These funding arrangements are consistent with enabling us to retain operational independence from government while not giving rise to any risk that an individual employee would obtain any benefit from taking imprudent risks with the Bank's funds. (sub. 9, p. 6)

On the other hand, Carter Holt Harvey was not convinced that providing regulators with access to an uncontested stream of income would encourage independence and accountability:

The Waste Minimisation Act mandates the imposition of a tax on solid waste disposed to landfill. ... It is not clear to us that an income guaranteed by regulation (the WMA) and expended on an uncontested basis gives rise to the level of objectivity and independence identified by Treasury as necessary to promote accountability. (sub. 8, p. 10)

## The structure of charges

Participants raised several issues about the structure of regulators' charges.

- Cross subsidisation can occur – for example, until recently between the costs of renewing a driver's licence and other licensing services (Ministry of Transport (sub. 39, p. 3).
- Charges not closely linked to changes in costs may reduce a regulator's capacity to fund their expenditure. For example:
  - levies that partially fund the CAA are based on passenger numbers, while the costs of regulation are driven by growth in hours flown. Fluctuations in passenger numbers can affect the CAA's cashflow and financial position (Aviation New Zealand, sub. 36, p. 22);

- the Gas Industry Co is partly funded by a wholesale levy based on purchased gas volumes, which can fluctuate with the weather even if the regulator's costs do not fluctuate (sub. 28, p. 36);
- the Insurance Council of New Zealand is concerned that levies to fund the FMA are not related to costs, as they have "little correlation to how the FMA's resources will likely be concentrated" (sub. 5, p. 8).
- The CAA argues that basing charges on costs can mean that maximum use is not being made of the capacity of charges to dissuade bad behaviour (sub. 36, p. 36). However, fees that exceed costs could be characterised as taxes. Requiring fees to be cost-related does not, in principle, prevent the Government from imposing a tax (in addition to this fee) to discourage such behaviour.

**F12.3**

The Commission's survey of businesses, and submissions to the inquiry, indicate concern in the business community about:

- the quality of the consultation that takes place before regulatory fees or levies are introduced;
- weak constraints on the level of charges, including limited transparency about how they are determined; and
- the structure of charges.

To address such concerns, the ANZ Bank proposed that:

the setting of fees and levies must be conducted according to an established and documented framework. This is particularly important where the regulator is empowered directly with the fee-setting ability in the absence of a third party reviewer. In particular, a fee/levy setting framework requires the following fundamental tenets:

- requirement to consult with entities subject to the fee/levy;
- determination of the upper limit of the fee/levy so that charges are not in excess of the estimated full costs;
- appropriate analysis of the basis for fee/levy setting and justification for the requirement to charge (eg Regulatory Impact Statement);
- embedded review mechanisms to ensure relevancy and necessity of fee/levy is checked in future.

The cost recovery basis for fee and levy setting should also take into account the size and number of participants that are affected to ensure that the application of fees is spread appropriately throughout the participants in the relevant industry. This includes an allocation that is not unduly weighted towards larger participants ... and also appropriately reflects the risks posed by the participants in terms of the requisite level of regulatory oversight. (sub. DR 83, p. 10)

Section 12.6 sets out a framework that addresses these issues.

## 12.5 Lessons from other OECD jurisdictions

Comparisons with other jurisdictions can provide insights into New Zealand's approach. This section describes the frameworks for funding regulators in Australia and two Australian states, Canada, and the United Kingdom. It also draws on the OECD's user-charging guidelines (OECD, 1998). The description focuses on the features used in Section 12.2 to describe the approach in New Zealand; that is:

- objectives of cost recovery;
- legal authorisation for different forms of funding;
- governance and accountability arrangements;

- application of cost recovery; and
- processes for reviewing the impacts of funding arrangements.

## The objectives of cost recovery

Like New Zealand, efficiency is the main objective in other jurisdictions (Box 12.5). Raising additional revenue is not an explicit rationale in any of them.

### Box 12.5 The objectives of cost recovery

- In the United Kingdom, HM Treasury suggests that cost recovery “can be a rational way to allocate resources because it signals to consumers that public services have real economic costs”.
- Australia’s guidelines note that “cost recovery can provide an important means of improving the efficiency with which Australian Government products and services are produced and consumed”.
- The guidelines in Victoria, Australia indicate that “appropriate cost recovery can improve the way that resources are allocated within the economy, thereby contributing to allocative efficiency”.
- The Treasury Board of Canada considers that user charges’ “main economic rationale is *not* to produce revenue. Rather it is to promote economic efficiency by providing information to public sector suppliers about how much clients are actually willing to pay for particular services and by ensuring that the public sector supply is valued at least at (marginal) cost by citizens...”.
- The OECD’s user charging guidelines specify that “the objective of user charging is not only to achieve cost recovery from users, but also to make government services more effective and efficient”.

Equity is sometimes mentioned. The Australian guidelines state that

... (cost recovery) may also improve equity by ensuring that those who use Australian Government products and services or who create the need for regulation bear the costs.

Similarly, Victoria’s guidelines note that “the establishment of a standard cost recovery framework improves equity by facilitating consistent treatment across regulated industries”.

Increasing accountability is seen as a rationale for user charges in Canada:

Proper user charges can significantly improve accountability by making clients aware of the costs of the services they receive and managers aware of the benefits and costs of the services they provide.

*Source:* Commonwealth of Australia, 2005; Department of Treasury and Finance Victoria, 2013; HM Treasury, 2013; Treasury Board of Canada Secretariat, 1997; and OECD, 1998.

## Legal authority for cost recovery

As in New Zealand, the requirement for legal authorisation in other jurisdictions invalidates using cost recovery as a form of taxation. The APC (2001b, p. G.6) points out that:

...many constitutions require that taxes be implemented through specific legislation, and this principle invalidates user charges that have the characteristics of a tax but are not supported by such specific legislation. This is the situation in Australia, Canada, New Zealand, and the UK and among other countries.

## Governance and accountability arrangements

Mechanisms to build accountability and transparency include requirements to:

- consult before a fee is imposed;
- justify fees in a RIS or equivalent processes;

- seek ministerial consent before imposing a fee; and
- disclose fees to Parliament.

The requirements that regulators must satisfy before imposing a fee seem more demanding in overseas jurisdictions.

### Consultation

Canada's framework, set out in the User Fees Act 2004, is particularly rigorous, imposing obligations on regulators to justify fees and to deliver "value for money" to those who pay them. The Act sets out:

- consultation requirements before a fee is fixed or changed, including how to manage complaints about proposed fees (Box 12.6);
- the role of parliamentary committees and of Parliament in approving, rejecting or amending proposals;
- scope for a fee to be reduced if established performance standards are not met; and
- a requirement that ministers report yearly to Parliament on all user fees in effect.

An important feature of Canada's approach is the "policy of the government that those who pay fees for government services are entitled to fundamental information on the services being provided and any associated service standards". To give effect to this policy, fees must be accompanied by measurable and relevant service standards, developed in consultation with paying and non-paying stakeholders and reported to Parliament each year, together with a summary of stakeholder feedback from consultation (Treasury Board of Canada Secretariat, 2004, p. 1). Regulators can draw on long-established guidance on how to establish service standards (Treasury Board of Canada Secretariat, 1996).

#### Box 12.6 The approach to consultation in Canada

A four-phase approval process involving extensive consultation precedes the imposition of fees.

- Phase 1: An iterative process under which the Department proposing a fee presents its rationale and analysis (covering elements referenced in the User Fees Act) to clients, who provide feedback, including in relation to recommendations for service improvement. Documentation should include pricing factor analysis and any methodologies that lead to the proposed fee level.
- Phase 2: The Department publicises the fee proposal in the light of the consultation proceedings from Phase 1. An independent panel review may be established to review any client complaints, and its recommendations are considered by the Department.
- Phase 3: The Minister tables the fee proposal in both Houses of Parliament, for approval or amendment. The proposal must be presented in line with a template that, among other aspects, requires:
  - explanation of the cost elements of the fee;
  - comparisons with other countries;
  - a summary of the findings of the impact analysis of the fee;
  - explanation of the communication strategy and how complaints have been addressed;
  - explanation of the performance standards against which performance of the regulating authority can be measured, and whether these standards are comparable with those in relevant countries; and
  - presentation of ideas or proposals received from clients about how to improve the service to which the fee relates and the departmental response to those ideas.

- Phase 4 is implementation.

If a regulator's performance does not meet the standards for that fiscal year by a percentage greater than 10%, the user fee shall be reduced by a percentage equivalent to the unachieved performance, to a maximum of 50% of the user fee, until the day on which the next yearly report is tabled in Parliament (User Fees Act 2004, s 5.1).

*Source:* User Fees Act 2004, Treasury Board of Canada Secretariat, 2004.

In Australia, the principles set out in the cost recovery guidelines specify that the portfolio minister is responsible for determining the most appropriate consultation arrangements for their agencies' cost recovery arrangements, where relevant (Commonwealth of Australia, 2005, p. 1).

## Impact assessment

The Canadian approach outlined in Box 12.6 is effectively an impact assessment specifically for fees. Australia also has a specific process for assessing the impact of fees. Regulators proposing significant cost recovery arrangements must document compliance with the Government's cost recovery policy in a cost recovery impact statement (CRIS). A 'significant' recovery arrangement is one where an agency's total cost recovery receipts equal \$5 million or more each year, where an agency's receipts are below this level but stakeholders are likely to be materially affected, or where ministers have determined the activity to be significant on a case-by-case basis. The CRIS should:

- demonstrate that charges reflect the costs of providing the good or service;
- identify the beneficiaries or the individuals/groups that have created the need for regulation; and
- identify the most appropriate means to impose the charge (as a fee for service or as a levy).

The preparation of a CRIS should involve "appropriate" consultation with stakeholders. Most cost recovered activities are regulatory, which means that regulatory impact analysis (RIA) requirements also apply. Hence, a regulation impact statement may be required to inform the decision by government to cost recovery of an activity. The CRIS is prepared after the Australian Government approves cost recovery for a specific activity to explain how cost recovery will be implemented, prior to cost recovery commencing.

## Seeking consent

It is common for regulators in other jurisdictions to be required to seek the consent of a Minister, Parliament or the Treasury before imposing a fee.

- In Victoria, any increase in fees above a specified rate set by the Treasurer that is expected to generate revenue of more than \$100,000 a year requires the approval of the Treasurer (Department of Treasury and Finance, Victoria, 2013, p. 34).
- In Australia, where agencies are proposing to introduce cost recovery arrangements, they should seek government policy approval, including through Budget processes (Commonwealth of Australia, 2005, p. 18). After government has agreed to recover the costs of an activity, portfolio ministers are responsible for ensuring that the cost recovery arrangements of agencies within their portfolios comply with the policy and report on implementation and compliance through a CRIS (Commonwealth of Australia, 2005, p. 3 and 2008). A CRIS must also be prepared when there is a material amendment to an existing cost recovery arrangement (ie, where price changes exceed CPI increases or there is likely to be an impact on stakeholders). All cost recovery charges (both fees and levies) should have appropriate legal authority and this can be in various forms including legislation that needs to be approved by Parliament or through Ministerial determinations. Ministers agree all CRISs and the Minister for Finance reviews the CRISs of all major cost recovery arrangements with receipts in excess of \$10 million. The Minister for Finance has the discretion to initiate a cost recovery review, regardless of the size of the receipts. Such a direction would be made to review activities which have not previously been subject to

government consideration; are inconsistent with the policy; or have not been considered recently. Entities must publish all CRISs (Commonwealth of Australia, 2008).

- In the United Kingdom, the Treasury's consent is required for all proposals to extend or vary charging regimes (HM Treasury, 2013, p. 46). Charges that exceed the cost of provision or are not clearly related to a service require an explicit ministerial decision and specific statutory authority. Further, the Treasury does not automatically allow departments to budget for net expenditures associated with charges above cost (HM Treasury, 2013, p. 44).
- In Canada, the responsible Minister must table fee proposals in Parliament, for approval, amendment or rejection.

## Disclosure to Parliament

In the United Kingdom, the annual report of the charging organisation should indicate:

- the amount charged;
- full costs and unit costs;
- total income received;
- the nature and extent of any subsidies and/or overcharging; and
- the financial objectives and how far they have been met (HM Treasury, 2013, p. 49).

In Canada, the User Fees Act 2004 (s 7) requires every Minister to table in Parliament each year a report that sets out all user fees in effect, including information on matters such as the performance standards and actual performance levels reached and revenue raised.

## Application of cost recovery

### When cost recovery is appropriate

All of the selected jurisdictions have guidelines for cost recovery. The guidelines differ in the amount of detail provided (with the United Kingdom the least detailed) and their approach, although they are generally underpinned by the private good/public good distinction that is at the centre of the New Zealand Treasury guidelines (Box 12.7).

#### Box 12.7 Determining whether cost recovery is appropriate

The Treasury Board of Canada (2009) sets out a three-step process:

- costing;
- estimating the full cost of the service, which represents the maximum allowable price; and
- considering pricing factors such as:
  - the mix of public and private benefit (taking into account rival consumption and excludability);
  - impact and contextual analysis;
  - stakeholder consultation;
  - additional fee structure features, such as adjustment formulas and differentiated pricing; and
  - fee level review.

The Australian guidelines identify four different types of regulatory activity:

- registration and approvals;
- issuing exclusive rights and privileges;
- monitoring ongoing compliance; and
- investigation and enforcement.

For each type of service, the guidelines suggest a sequence of questions that help to identify whether charging is efficient and, if so, whether a charge or levy is appropriate.

Victoria's guidelines advise regulators to analyse the economic characteristics of the regulatory service (where it sits on the private good/public good spectrum), the beneficiaries of the activity, the parties and circumstances that create the need for the government activity, and whether the activity contributes to other government objectives. A table summarises the different types of government activity and associated charging considerations. The guidelines note that the charging approach ultimately adopted will depend on a range of factors, including the relative weight given to equity and efficiency objectives, practical implementation and legal issues, and consistency with other government policy goals.

*Sources:* Treasury Board of Canada Secretariat, 2009; Commonwealth of Australia, 2005; and Department of Treasury and Finance Victoria, 2013, pp. 10-14.

### Which costs should be recovered

The Australian guidelines provide that the charge for each regulatory activity or product should incorporate the full cost of regulation, subject to the caveats of efficiency, cost effectiveness and consistency with policy objectives.

The Victorian guidelines stress that the costs of all outputs integral to the good, service, or activity subject to cost recovery are included in the full cost calculation. Costs that are not a fundamental part of, or directly related to, the output – such as the broad development of policy or regulation – should be excluded.

The UK guidelines provide a list of the cost elements (capital and operating) that need to be included and excluded when calculating the cost of providing a service. Among the excluded items are externalities imposed on society and the costs of policy work (HM Treasury, 2013, Annex A6.1).

### How capital costs should be calculated and allocated

The guidelines of other jurisdictions generally provide more advice about how to measure the cost of capital and how to allocate joint costs (Table 12.3).

**Table 12.3** Measuring and allocating capital costs

Jurisdiction	Measuring the cost of capital	Allocating joint costs
United Kingdom	Full cost recovery normally means recovering the standard cost of capital, currently 3.5% in real terms. A higher return is required for services that compete with private sector suppliers of similar services.	
Australia	Agencies should justify their approach to determining capital costs and depreciation.	The guidelines describe various approaches to allocating these costs to products.
Victoria	A real rate of return (currently 8% real) should be applied as a proxy for the cost of capital, and applied to capital that is integral to the delivery of the service.	Activity-based costing and the "pro rata" approach can be used to allocate indirect costs between outputs. An appendix explains how to do this.

Jurisdiction	Measuring the cost of capital	Allocating joint costs
Western Australia (WA)	The WA guidelines provide extensive advice on how to calculate and allocate costs, with more than one third of guidelines devoted to defining and estimating direct and indirect costs.	

*Source:* HM Treasury, 2013, Annex A1; Commonwealth of Australia, 2005, pp. 48-49; Department of Treasury and Finance, Victoria, 2013, pp. 26 and 42-45; and Department of Treasury and Finance, Western Australia, 2007, pp. 8-21.

### How efficient costs should be demonstrated

Guidelines in other jurisdictions focus more on this issue than is the case in New Zealand.

The Victorian guidelines point out that poorly designed cost-recovery arrangements can create incentives for inefficiency and cost padding. Techniques to keep costs at efficient levels include:

- benchmarking performance or costs;
- consulting with affected stakeholders;
- introducing competitive pressures; and
- audits by the Auditor-General (Department of Treasury and Finance, Victoria, 2013, pp. 29-30).

One purpose of the Australian Government's CRIS process is to ensure that costs are transparently documented and are at efficient levels at the time the new regulation is introduced; when major changes are made to the activity; and at periodic intervals of at most five years.

In Western Australia, each year agencies are required to review the fees and charges that they levy. Under some circumstances, a detailed submission to the Treasury is required before a proposed increase is submitted to the Expenditure Review Committee (Department of Treasury and Finance, Western Australia, 2007, p. 4).

In Canada, the Treasury Board (2009) recommends that reviews of the components of the pricing decision are undertaken every 3–5 years.

#### F12.4

The funding frameworks in other selected countries are similar to New Zealand in that they:

- set out efficiency and, to a lesser extent, equity as the main objectives of cost recovery;
- require consent, usually of a minister or Parliament, before a fee or levy is introduced;
- are based on a distinction between cost recovery and taxation; and
- provide guidance material.

However, other jurisdictions have examples of:

- more rigorous consultation and impact assessment requirements before fees are introduced;
- stricter requirements for performance standards and reporting against those standards when new fees are introduced;
- penalties for failing to achieve the standards; and
- more detailed advice about how to implement cost recovery.

## 12.6 Implications for funding regulators in New Zealand

The concerns that participants have raised about the current framework, combined with insights from economic analysis and international practice, suggest that options for improving the approach to cost recovery in New Zealand include:

- strengthening the governance and accountability framework, by:
  - publishing a clear statement of the Government’s cost recovery policy, including its objectives;
  - increasing the status of (refreshed) guidelines;
  - requiring more consultation before a levy or fee is introduced or amended;
  - strengthening performance reporting;
  - introducing regular reviews of the cost recovery practices of regulators;
- improving the implementation of cost recovery by:
  - refreshing the guidance material; and
  - providing more support to regulators.

### Strengthening the governance and accountability framework

#### Publishing a statement of the Government’s cost recovery policy

A short statement of the Government’s expectations would enhance the incentives and capability of those involved, to implement cost recovery in line with the Government’s expectations. For some agencies, this would inform them of Government objectives of which they are currently unaware. For others, as MPI suggests:

Development of an official policy in this area would essentially codify the existing practice of many departments and Crown agencies. (sub. DR 102, p. 18)

Australia’s cost recovery guidelines provide an example of a policy statement. These state that the Australian Government’s cost recovery policy is to improve the consistency, transparency and accountability of Commonwealth cost recovery arrangements and promote the efficient allocation of resources. This policy adopts 14 key principles, which cover issues such as:

- which costs should be recovered;
- when cost recovery should not be applied;
- legal authority;
- that costs should be recovered on an activity rather than agency basis;
- consultation requirements;
- obligations to review arrangements after implementation; and
- the responsibility of portfolio ministers to ensure that agencies within their portfolios comply with the policy (Commonwealth of Australia, 2005, pp. 2-3).

Such principles provide a broad statement of intent, without prescribing how cost recovery must be applied in each situation.

If the Government decided to prepare a policy statement, it could consider whether to re-focus cost recovery towards a single and well-specified efficiency objective. Kerr (2004) argued that

... there is too much focus on getting additional sources of revenue for the government and its agencies and not enough focus on economic efficiency – the best use of resources in the economy. Part

of the problem stems from the badly formulated Treasury Guidelines for cost recovery, which do not have a clear efficiency objective. (p. 8)

In addition to Kerr's concern about over-using cost recovery to raise revenue at the expense of efficiency, the reference to both equity and efficiency objectives in the Treasury Guidelines requires regulators to make trade-offs between them. This may reduce a regulator's accountability and lead to cost recovery arrangements being targeted at equity objectives that may be more effectively achieved using other policy instruments. On the other hand, equity objectives exist in other jurisdictions, perhaps because cost recovery is more politically acceptable when impacts on equity have to be considered. If the Government decides to retain both efficiency and equity objectives, it could consider providing guidance about how to make trade-offs when these objectives conflict.

The Commission recommends a government policy statement on cost recovery.

### R12.1

The Government should publish its cost recovery policy, outlining its policy objectives, and setting out guiding principles relating to:

- how to make trade-offs should objectives conflict;
- when cost recovery may be appropriate;
- consultation requirements before implementation;
- how and when arrangements are to be reviewed and by whom; and
- responsibility for ensuring compliance with the policy.

### Enhancing the status of (revised) advisory guidelines

The status of the Treasury guidelines is ambiguous. Some text implies that the guidelines are advisory only: they "do not set out to be definitive" (New Zealand Treasury, 2002, p. 2) and "use of the guidelines is not obligatory" (p. 5). However, the guidelines also use firmer language: ministers are "likely to seek assurances that the guidelines have been applied" (p. 5), and the guidelines "are primarily intended to *ensure* services are charged at full cost to the appropriate parties" (p. 2; emphasis added). In addition, as noted earlier, when the RRC examines whether a fee should be disallowed, it investigates whether the guidelines have been consulted.

Stronger incentives to apply the Treasury guidelines (particularly if the guidelines are improved) could increase the transparency and quality of cost recovery arrangements. In the draft report, the Commission proposed that either the Treasury or the chief executive of the agency proposing a fee or levy should be required to certify that the guidelines have been applied adequately. Imposing this obligation on the chief executive has the advantage that it focuses responsibility on the agency that introduces the fees.

Some government departments disagreed with this view. The Treasury and State Services Commission noted that:

While we would certainly agree on the desirability of agencies following good practice in the matter of cost recovery policy development, it may seem disproportionate to require portfolio ministers and chief executives to prioritise this among all the other agency activities that they are responsible for. (sub. DR 97, p. 17)

MPI:

... does not consider such certification is necessary. There are already checks and balances in place through financial audits, select committee financial reviews of each department/agency, and Chief Executive performance assessment by Ministers. (sub. DR 102, p. 18)

And MBIE argued that:

It is not clear why this particular matter would be signalled out for Chief Executive certification, as opposed to other elements of regulation making or policy advice. (sub. DR 104, p. 16)

The Commission accepts that requiring certification that the cost recovery guidelines have been used is not the best way to encourage improved practice. A better approach would be to require agencies introducing or amending a fee or levy to publish, possibly in their annual reports, a statement outlining, for example:

- the reasons why they are introducing/amending a fee or levy;
- their legal authorisation for doing so;
- the consultation undertaken;
- the expected effects of the fee or levy; and
- the process for monitoring these effects and reviewing the arrangements.

Publication would encourage agencies to apply the Guidelines and generate a “library” of good practices that other agencies could draw on.

### R12.2

Agencies proposing a new or amended fee or levy for regulatory services should publish a statement outlining, for example:

- the reasons why they are introducing/amending a fee or levy;
- their legal authorisation for doing so;
- the consultation undertaken;
- the expected effects of the fee or levy; and
- the process for monitoring these effects and reviewing the policy.

The next two sections consider how agencies can demonstrate an effective approach in two of these areas: consultation, and monitoring and review.

### More effective consultation before fees or levies are introduced or amended

The amount of consultation before fees are amended or introduced seems patchy. Some agencies already run thorough consultation processes before introducing or amending fees. Fees that are given effect in regulations will normally require a RIS, which will involve some consultation. However, as noted earlier, some submissions pointed to inadequate consultation.

Additional consultation could lead to better-designed fees with more support from those who pay them. For example, while the Meat Industry Association is currently concerned that regulatory transparency is often poor, earlier experience in this industry highlights the benefits of consultation (Box 12.8).

#### Box 12.8 Consultation about cost recovery in the meat industry

Cost recovery for the meat inspection service was introduced in the mid-1980s. This covers the direct and indirect costs of about 1,600 meat inspectors, veterinarians and others involved in regulatory work focused on market access. The costs were considered to be high and there was pressure from industry to be more transparent and to cut costs. During the early 1990s, the costs of inspection and regulatory work focused on market access were itemised and recovered separately. From 1998 onwards separate organisations carried out these functions. AsureQuality, a State-Owned Enterprise (SOE), carried out the inspection function, and the Ministry of Agriculture and Fisheries (MAF) managed the regulatory work focused on market access.

To facilitate cost recovery and better underpin the meat sector, MAF management changed the way it worked. Its old process was to hold a meeting with the industry about cost recovery. Its new process was to seek industry input into, and ultimately agreement with, the strategy for regulatory market

access. The industry was involved in determining the format of yearly plans. MAF met with the industry every 3 to 4 months, to report back on spending and progress against the plan.

Three examples indicate that this approach created a level of comfort in the industry about cost recovery.

- When the MAF's planning process revealed a shortage of (market access) staff experienced in the international environment, the industry agreed to pay about \$200,000 to fund a post in Washington, DC.
- The industry agreed to boost funding to improve recruitment and retention of veterinarians when the strategy indicated risk exposure from insufficient veterinarians.
- One year when cost recovery generated a surplus, rather than reduce costs the industry stipulated that MAF use the surpluses to fund operational research aimed at reducing the risks/costs associated with market access.

*Source:* Information provided by the Meat Industry Association, 18 February 2013.

Consultation could be improved by requiring preparation of a CRIS, as in Australia, or the phased consultation process that is required in Canada. Either approach would, however, add cost and time, which might discourage small regulators in particular from pursuing cost recovery.

MPI agreed that consultation brings benefits "in terms of clarity and transparency, and confidence of users in the robustness of charging mechanisms". However, it considered that an additional general obligation to consult (which the Commission considered in the draft report) is not needed:

We note that the majority of MPI's primary legislation requires consultation before regulations can be made. We would expect this pattern to be common across other legislation that contains regulation making provisions. (sub. DR 102, p. 17)

The PCO similarly favoured a tailored approach rather than a general obligation:

A general obligation to consult before imposing fees or charges is likely to be overbroad and unhelpfully rigid – but tailored requirements are likely to add value – consultation is likely as a matter of practice anyway (sub. DR 88, p. 25)

Meaningful consultation before a fee or levy is implemented increases the effectiveness and acceptability of cost recovery. However, imposing a general obligation to consult could lead to a "one-size-fits-all" approach that is unnecessarily costly. A better approach would be for the proposed cost recovery policy statement (recommendation 12.1) to clarify that portfolio Ministers are responsible for determining broad consultation policies for their agencies. This, combined with the proposed obligation on agencies to publish their approach to cost recovery, including the consultation they have undertaken, would strengthen incentives for agencies to consult effectively.

## Monitoring and review

### Linking fees to performance reporting

Performance reporting would encourage agencies to improve their monitoring of the effects of cost recovery. As discussed above, Canada's regulators must report to Parliament whether their services are achieving service standards, with the possibility that the fees they receive can be temporarily reduced when they do not achieve such standards.

The Commission is not convinced that this approach is necessary in New Zealand. First, performance reporting requirements do not yet set out standards that could be used for this purpose. Second, penalising regulators for poor performance by reducing their revenue could reduce their capacity to deliver government policy objectives.

That said, as performance reporting by regulators improves, it would become more feasible for them to report publicly whether they are achieving performance standards and the cost of doing so, in order to strengthen the incentives for efficient service delivery.

### F12.5

It is desirable that regulators, as they develop improved performance reporting frameworks, use these frameworks to measure the cost of delivering regulatory services and report this information publicly.

#### Memorandum accounts

Memorandum accounts monitor whether fees are over- or under-recovering costs. The Commission received few responses to its request in the draft report for views about whether surpluses and deficits on memorandum accounts signify a problem. The PCO submitted that:

Asymmetric memorandum accounts are evidence fee-setting has misfired and should be reassessed (with refunding or credits so far as fees have over-recovered). (sub. DR 88, p. 26)

The Treasury and the State Services Commission commented that:

Memorandum accounts exist precisely in order to record surpluses or deficits. The focus should be on how these balances are managed so that they trend to zero over time (consistent with policy objectives of the regulatory regime). These accounts are already reported ex ante (Estimates) and ex post (Annual reports) so any concerns should be about how this information is used rather than whether we have sufficient information. (sub. DR 97, p. 17)

As noted earlier, these accounts are intended to be in balance over a “reasonable” period, but there is asymmetric treatment of surpluses and deficits during the period that accounts are not balanced. Options for reducing this asymmetry could be for some form of charge to be imposed on surpluses, or for surpluses that persisted beyond, say, two years, to trigger a review of fees.

Both options might, however, weaken regulators’ incentives to constrain their costs. Further, the second option might trigger unnecessary reviews in cases where, for example, the factors causing the surplus were temporary. The Commission therefore does not support these options. Rather, the Commission agrees with the advice of the OAG, noted previously, that entities should ensure that there is regular monthly or quarterly monitoring of account balances.

#### External reviews

The Regulations Review Committee, as noted above, can scrutinise regulations that set fees. In the draft report, the Commission proposed that the grounds on which the RRC can draw a regulation to the attention of the House should be expanded, to include situations where the regulator has had inadequate regard for the economic framework set out in the Government’s guidelines for setting charges in the public sector. The purpose of this proposal was to strengthen regulators’ incentives to apply the guidelines. However, the PCO disagreed with this proposal, arguing that:

since fees appear to have been able to have been scrutinised adequately under the existing grounds specified in SO 315(2) (2011), non-compliance with fees guidance or fees frameworks may anyway be clear evidence of infringing existing grounds, and so may not justify being a new ground in its own right. (sub. DR 88, p. 26)

The Commission agrees and has therefore withdrawn this recommendation.

The Performance Improvement Framework (PIF) could provide another mechanism for reviewing cost recovery arrangements. Requiring that these reviews consider the approaches to cost recovery of regulators within each portfolio would highlight good practices, identify cases of over-charging and, conversely, may suggest areas where cost recovery could be introduced. Alternatively, agencies could be required to report on their approach to cost recovery in their Regulatory Systems Report, which is required as part of their obligations under the regulatory stewardship programme (Chapter 14).

MPI suggested that the reports on regulatory stewardship will lead to additional review of cost recovery, but suggested that these reports could be supplemented by targeted, 'deep dive' reviews.

Cost recovery regimes are an important aspect of regulatory stewardship and we would expect the ways in which agencies operate and review these schemes to be captured in assessment of regulatory stewardship. ... cost recovery regimes could be one of the topics for 'deep dive' review. Existing financial reporting and audit requirements and select committee reviews can also provide information on the operation of cost recovery regimes. (sub. DR 102, p. 18)

Criteria for selecting cost recovery arrangements for "deep dive" reviews could build on the arrangements used in Australia where, as noted above, the Minister can require the preparation of a CRIS to review activities that:

- have not previously been subject to government consideration;
- are inconsistent with the cost recovery policy; or
- have not been considered recently.

This raises the question of which agency might undertake such reviews. In the draft report, the Commission suggested that the Auditor-General set out a programme of audits of cost recovery arrangements. However, it has been pointed out to the Commission that this could divert resources from more urgent audit topics. MPI suggested that:

Should a Government policy on cost recovery provisions be promulgated, the costs and benefits of the Auditor-General auditing compliance with this would need to be further considered. In practice, the OAG audits for 'hot-topic policy', and it is not anticipated this would change if a government cost recovery policy document existed. (sub. DR 102, p. 18)

The Commission considers that it is more useful to focus on the desired outcome – that cost recovery arrangements remain effective and efficient – than to specify the precise review instrument that will deliver this outcome. However, agencies should be required to ensure that significant cost recovery arrangements are reviewed periodically.

### R12.3

Agencies responsible for cost recovery arrangements should make sure that the arrangements are reviewed periodically to ensure that they remain justifiable in principle, efficient and effective.

## Improving the implementation of cost recovery

### Refreshing the guidance material

The recommendations outlined above would lead to increased use of the Treasury guidelines to enable and encourage efficient funding arrangements for regulators. Yet, as described earlier, the Treasury and the OAG have both published guidelines, there are overlaps between them, and they take seemingly different approaches to similar issues (Table 12.2). These weaknesses could undermine the benefits from giving the guidance material a more important role in the policy framework.

Despite these apparent problems, only three departments or regulators that the Commission contacted through its information request considered that the existing guidelines needed to be improved. The Treasury's view is that it is not "clear that an update of the Treasury's and the Auditor-General's guidelines in this matter is the most urgent use of central agency resources" (sub. DR 97, p. 18).

MPI, on the other hand, suggested that consolidation of the guidelines would be useful, although it does not agree that the guidelines are in conflict. MPI considers that a single agency should be responsible for developing and maintaining the guidelines, and promoting a coherent cost recovery policy framework across government (sub. DR 102, p. 18). The PCO also considered that:

Updating and combining Treasury and OAG guidance would help, and it is vital every fee setting process involves accessing, fairly easily, adequate advice and experience. (sub. DR 88, p. 26)

It appears to the Commission that regulators are not helped by having to consult two sets of guidelines which, while intended to complement each other, cover the same issues in slightly different ways. To avoid confusion, these matters should be explained once only, either in one unified set of guidelines or in two separate guidelines that have clearly different yet complementary, non-overlapping, roles.

It is possible that the different responsibilities of the Treasury and the OAG justify having two sets of guidelines. If so, each set should indicate clearly:

- their respective roles;
- which entities and types of funding arrangements each covers;
- how the two sets of guidelines complement each other; and
- in the event that a regulator considers that the two sets of guidelines provide conflicting advice, how that regulator can seek resolution of the conflict.

#### R12.4

The Government and the Auditor-General should review the Treasury's *Guidelines for setting charges in the public sector* (2002) and the Auditor-General's *Charging fees for public sector goods and services* (2008), to ensure that the guidelines reflect current knowledge about when and how to implement cost recovery.

Users of the guidelines (whether the two sets of guidelines continue or are combined) should:

- only have to go to one place for advice on any issue;
- not receive conflicting advice from the guidelines; and
- be clearly informed about the scope of the entities and charges that the guidelines cover.

This review would also present opportunities to use the guidelines to provide more practical advice.

Australia's Department of Finance is currently redrafting the Australian Government's Cost Recovery Guidelines. One aim is to make the guidelines more useful to regulators as they implement the Government's cost recovery policy. This review has been informed by extensive consultations with government and non-government stakeholders. Given this effort, and that both cost recovery frameworks have similar rationales, any review of the New Zealand guidelines would benefit from being informed by the experience in Australia.

Any review of New Zealand's guidelines should also be informed by considering the advantages and disadvantages of adopting common features of these frameworks across the two countries. One advantage of a common approach is that it could be helpful whenever amalgamation of national regulators into a single trans-Tasman regulator is considered. Drawing on the revised Australian approach would also reduce the cost of developing new guidelines for New Zealand.

#### R12.5

The Government, when it reviews New Zealand's cost recovery guidelines, should seek to collaborate with the review of the cost recovery guidelines currently being undertaken in Australia.

### Providing more support to regulators that implement cost recovery

While guidance material can help, even if improved it will not address all the case-by-case issues that will arise. Further, most regulators rarely establish or review fees and levies. Smaller regulators in particular are unlikely to have the expertise to do this in-house, although they may be able to contract that expertise.

Options for improving the capability of regulators include:

- using established or new forums of regulators to exchange lessons learnt in introducing and administering fees and levies; and
- ensuring that departments have adequate capability to help regulators.

Professional networks of regulators (chapter 5) could spread good practices in relation to cost recovery. Even so, particularly if new guidelines are developed, it is likely that advice from the Treasury and/or portfolio departments would be needed in addition to these forums. Such advice is already available, as MPI pointed out:

There is already an excellent level of cross-communication on issues between agencies, particularly on what are essentially financial policy issues. The public sector CFO (Chief Financial Officer) forum is very active, meets regularly and is led by the CFO from Treasury. There does not appear to MPI to be an issue in ensuring public sector agencies can access advice, support and experiential information from other agencies – whether those agencies be core departments (such as MPI), Crown agencies/entities, or territorial authorities (sub. DR 102, p. 19)

However, if the Government decides to refresh its approach to cost recovery, as this chapter suggests, it would be timely to confirm that the support for regulators remains adequate. For example, as MBIE suggested:

The modelling and forecasting required to make recommendations about setting fees and levies, and to manage memorandum accounts, is complicated and requires specific capabilities. Policy and regulatory agencies that have well-developed regulatory impact analysis and consultation processes should be able to retain the expertise needed, but where an agency does not have that expertise then further guidelines are unlikely to be sufficient to support that agency. Rather than further guidelines, greater central agency support could be required for agencies that do not have this expertise.

One area where guidance or central agency support could be particularly valuable is in relation to new fees or levies associated with new policy areas where there is significant uncertainty about assumptions used in modelling eg volumes of applications. (sub. DR 104, p. 16)

#### R12.6

The Government should consider whether those agencies that set or amend fees or levies can access adequate advice and experience from other agencies and departments.

# 13 Monitoring and oversight

## Key points

- Ministers are accountable for the performance of regulatory regimes, but decisions about the implementation of regimes are generally delegated to departments or Crown entities. Monitoring helps ministers assess whether the objectives of the regimes are being achieved, and whether changes should be made to legislation or the regulator’s behaviour.
- Assessing the performance of regulators can be a challenging task. Regulatory practice can be opaque and involve highly specialised knowledge, and attribution of success to a regulator’s actions can be difficult.
- The effectiveness of current monitoring practice varies. Interviews conducted for the Commission with regulator board members and their departmental monitors highlighted issues around:
  - insufficient support from departments for regulator Crown entities, especially around progressing legislative amendments;
  - role confusion, where some departments attempted to influence how a Crown entity was run or “second guess” the regulator’s actions;
  - inadequate capability and high turnover in departmental monitoring staff; and
  - too much reporting sought from departments, and insufficient focus in reporting on the regulator’s performance and strategy.
- Current monitoring practices can be improved by providing greater stability in monitoring staff; making stronger links between monitoring staff and policy staff who provide advice on the relevant regime; adopting a more risk-based monitoring approach; and re-focusing departmental and ministerial engagement on the boards of regulatory Crown entities.
- Current monitoring practices do not pay enough attention to the detail and effectiveness of a regulator’s strategies and practices. The best judges of regulatory practices are other practitioners. The Commission therefore recommends establishing a peer review process, through which panels of senior regulatory leaders would review the practices and performance of individual agencies.
- The logical home for this new peer review function is the Performance Improvement Framework (PIF) process, which is run by the State Services Commission (SSC) for central agencies. The SSC should identify current and former regulatory leaders to join PIF review teams, and to assist in developing regulator-specific questions for the reviews.
- The priority for the PIF peer reviews should be the larger regulatory Crown entities, those entities that implement regimes managing significant potential harms, and departments that implement regulatory regimes. Small regulatory Crown entities should be able to volunteer for a peer review, but not obliged to undertake one.

## 13.1 Introduction

Monitoring of regulators plays an important part in ensuring that regulatory agencies are effective, efficient and accountable and that regimes are working as intended. Although ministers are accountable for the performance of regimes, decisions about the implementation of regimes are generally delegated to departments or arm’s length bodies, such as Crown entities. Monitoring helps provide ministers with the

“business intelligence” necessary to judge whether the objectives of the regime are being achieved, and whether changes need to be made, either to legislation or the regulator’s behaviour. This chapter:

- defines monitoring and discusses why it is important (section 13.2);
- discusses the challenges of monitoring regulators (section 13.3);
- outlines issues with current monitoring practice (section 13.4); and
- examines how monitoring performance could be improved (sections 13.5 to 13.7).

## 13.2 What is monitoring and why is it important?

### The monitoring function

Monitoring refers to the processes by which a minister oversees a regulatory agency and ensures it is fulfilling its legislative duties, using taxpayer funds appropriately, and acting in line with agreed strategic directions. Where regulatory functions are performed by a Crown entity, monitoring is generally carried out by the relevant policy department. Of the 34 regulatory agencies within the scope of this inquiry, 20 were Crown entities.

Section 27A of the Crown Entities Act spells out the role of a monitor:

The role of the monitor is, in relation to the monitored statutory entity,—

- (a) to assist the responsible Minister to carry out his or her role; and
- (b) to perform or exercise any or all of the following functions, duties, or powers:
  - (i) administering appropriations;
  - (ii) administering legislation;
  - (iii) tendering advice to Ministers;
  - (iv) any other functions, duties, or powers in this Act or another Act that may, or must, be performed or exercised by the monitor.

State Services Commission (SSC) guidance provides a more detailed description of the sorts of activities carried out by a monitoring department (Box 13.1).

#### Box 13.1 SSC guidance on monitoring

A department’s role derives from its status as an agent of the Minister... Ministers usually expect, and will normally receive, the following support services:

- an initial briefing on each entity on becoming Responsible Minister that, among other things, gives the Minister a “heads up” about how to work with the type of entity (Crown agent, Autonomous Crown Entity or Independent Crown Entity, and provisions in the entity’s empowering legislation or other legislation that materially modify core governance provisions in the Act)
- briefings to support Ministers’ engagement with entities on strategic matters
- ongoing briefings on each entity that identify emerging governance or performance issues that require the Minister’s attention
- management of all processes relating to board membership, including appointments, re-appointments, setting members’ fees, helping the board induct and train new members, and ensuring compliance with Cabinet expectations and processes in respect of these matters
- transmittal of information to each entity about relevant decisions and/or changes in policy by the Government, relevant government processes, especially the Budget, and the Government’s

expectations of the entity

- negotiation of an annual output agreement and any protocols (e.g. relationship protocols) as required by the Minister
- critical review of the entity's draft Statement of Intent (SOI)
- monitoring of each entity
- advice on the compliance of Crown entities with their legislation, and
- where appropriate, leadership and/or coordination of departments and entities working within a sector, or working in pursuit of interdependent results.

*Source:* SSC and New Zealand Treasury, 2006, pp. 8-9

A number of policy departments implement regulation. The monitoring processes around departmental monitors are not as clearly delineated in legislation. This may reflect the fact that departments are unequivocally agents of their ministers, while Crown entities are distinct agencies that are not part of the core public service. Ministers typically have more control over departments than Crown entities, and "decide both the direction and the priorities for their departments" (Cabinet Office, 2008, p. 37). Ministers can change these directions and priorities as required and the opportunities to do so are greater than with Crown entities, given the frequent ministerial interaction with their departments.

Central agencies and Parliamentary offices play a range of monitoring roles over departments, including:

- checking and controlling their expenditure (the Treasury);
- reviewing the adequacy of their plans to maintain and grow capability (SSC);
- reviewing the performance of chief executives (SSC);
- auditing the accounts and performance of departments (Office of the Controller and Auditor-General); and
- reviewing the adequacy of departmental regulatory stewardship processes (the Treasury).

## The importance of monitoring

Under New Zealand's political system, ministers are accountable to Parliament and the public for the performance of regulatory regimes. However, many strategic and operational decisions about the implementation of a regime are generally made by others. Where a regulatory regime is implemented by a Crown entity, the entity's board is responsible for setting operational policy, overseeing the performance of management, ensuring the entity acts efficiently and effectively, in line with its legal powers and duties and strategic agreements reached with the ministers. In some cases, Crown entity boards make regulatory decisions (eg, the Commerce Commission). Where a regime is implemented by a department, the chief executive is generally responsible.<sup>80</sup>

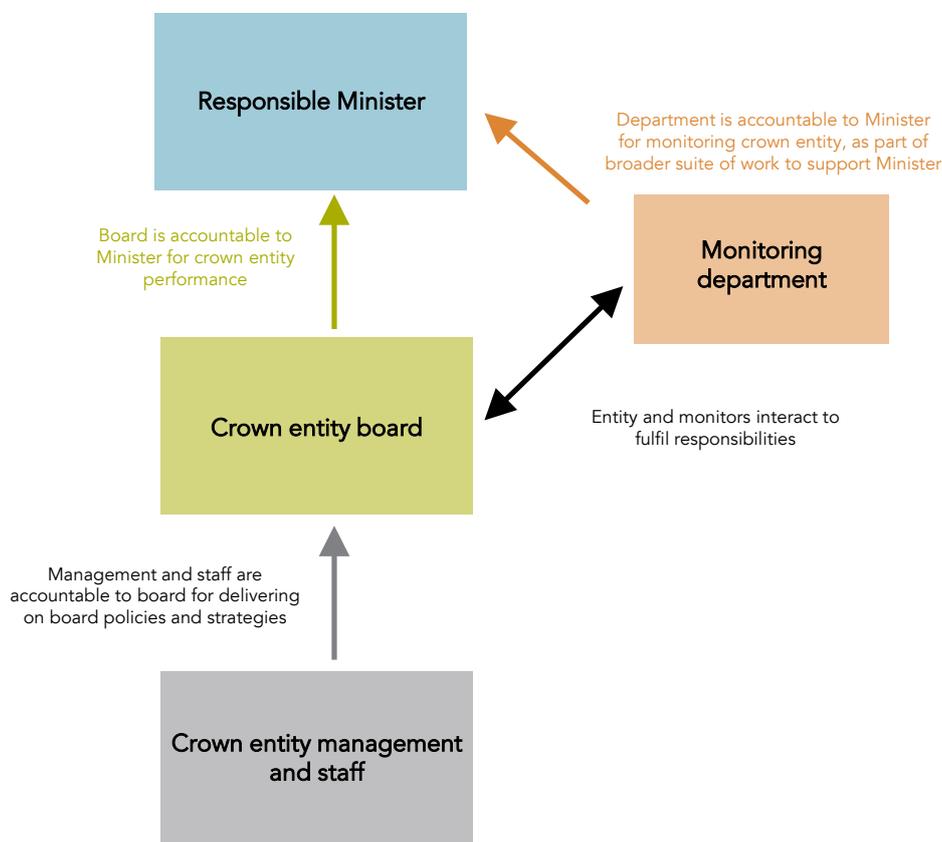
This separation of functions creates the risk that the agents (regulators) may act in a way that is contrary to the interests of the principals (ministers and, through them, the public). Monitoring helps ministers ensure that agents are performing as expected, and allows ministers to intervene, if necessary, to correct undesirable behaviour (eg, through revisions to the SOI or output plan) or seek Parliamentary agreement to address weaknesses in the legislative framework. Ministerial interventions need to acknowledge and respect the institutional form of the Crown entity and its degree of statutory independence (see Chapter 9 for

<sup>80</sup> Some regulatory regimes delegate specific roles or responsibilities to specific officers within a department (eg, Medical Officers of Health).

further discussion). Monitors play an important role in ensuring that ministers respond appropriately to issues with an entity's performance.

As discussed in Chapter 10, monitoring supports a wider set of accountability relationships with and within Crown entities, and should reinforce the responsibilities of boards to oversee the management of the entity and ensure that the entity is effectively and efficiently run (Figure 13.1).<sup>81</sup>

**Figure 13.1** Crown entity accountability relationships



Source: Adapted from OAG, 2009a.

### 13.3 The challenges of monitoring regulators

Much monitoring activity is common across regulatory and non-regulatory bodies. However, monitoring of regulators can differ from monitoring of other public bodies due to the difficulties in assessing the performance of regulators. As Black (2012b) notes, a number of factors can confound this assessment:

- **“Multiple hands”**: Often more than one regulator is involved in regulating a sector or pursuing specific objectives. This can make it hard to determine which particular agency has made the greatest contribution to the achievement of regulatory objectives.
- **Unclear roles or objectives**: A regulator's objectives may be expressed in vague or general terms, or may involve competing goals without guidance on how trade-offs should be made. There are “considerable difficulties in measuring performance against generally framed outcomes” (p. 9). The Commission discusses options for improving role clarity and reducing overlaps in Chapter 8.
- **Highly specialised knowledge**: Regulators are “often tasked with roles which require a high degree of technical and specialised knowledge, but which are often highly contestable” (p. 10). Where experts disagree about approaches, non-experts can face serious challenges assessing whether regulators have made the right judgements.

<sup>81</sup> The wider public sector accountability and control framework is described in Appendix G.

- **The opacity of regulatory process:** Regulation is “a continuous process of negotiation, compromise and challenge – on both sides of the regulator–regulatee relationship. It is very hard for outsiders to penetrate or have visibility of that process” (p. 11). This opacity is enhanced by the move to principle-based or process-based regulatory standards that both “rely more on the professional judgement of regulators”.
- **Attribution:** How confident can monitors be that the absence of regulatory failures is due to the actions of the regulator? As Black (2012b) observes:

...assessing performance can require judgements to be made on counter-factuals: if there is no environmental degradation, is that because the environmental regulator has done a good job in preventing it and thus is a success, or does that show that it has not been sufficiently active as environmental indicators, though remaining stable, have not improved? Or is it because there has been an economic downturn and so industries are producing less pollution? (p. 9)

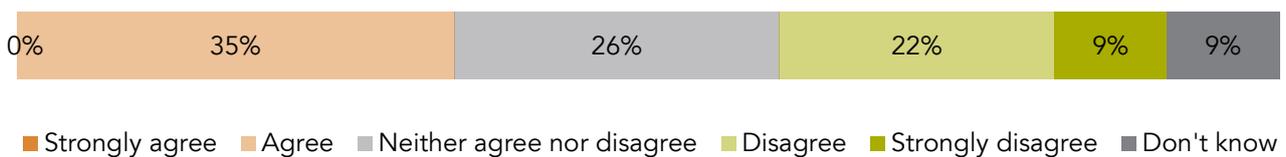
### F13.1

Assessing the performance of regulators can be a challenging task. Regulatory practice can often be opaque or involve highly specialised knowledge, and attribution of success to a regulator’s actions can be difficult.

## 13.4 Current monitoring practice

The Commission sought evidence from a number of sources on the effectiveness of monitoring practice, including commissioning interviews with regulator Crown entity board chairs and members and their monitor counterparts in departments, and surveying chief executives of regulatory agencies. Not surprisingly, the research indicated that monitoring effectiveness varied. This can be seen in the response of regulatory chief executives about the effectiveness of monitoring. Opinions were split over the degree to which monitoring contributed to better regulatory outcomes (Figure 13.2).

**Figure 13.2** Regulatory chief executive agreement with the statement “formal monitoring of regulatory functions by other agencies improves the quality of regulation”



Source: NZPC, 2014b.

Notes:

1. Rounding means that the figure does not add up to 100%

In general, board members were less satisfied with monitoring arrangements than their departmental counterparts (Spencer, 2014, pp. 17 and 20). A number (primarily board chairs) pointed to issues with the current arrangements, including:

- insufficient support from departments;
- role confusion;
- insufficient capability; and
- too much reporting, and not enough focus on performance and strategy.

## Insufficient support from departments, especially about legislation

Several board chairs expressed frustration about the lack of support they received from monitors around issues such as appointing new board members, policy advice, resourcing of the regulator, and interaction with select committees. A common complaint was the lack of priority that some monitors placed on progressing legislative change that would help keep regimes up to date. This sentiment was typified in a comment from one board member, who said that “it never seems to be a priority for them” (Spencer, 2014, p. 16). Several monitors interviewed for the Commission noted that disagreements between regulators and portfolio departments about the need, urgency or content of legislative change could be a source of tension.

## Role confusion

As discussed in Chapter 8, role clarity is an important determinant of regulatory performance. Board chairs argued that some departments appeared not to understand their roles in the monitoring relationship, with some monitors attempting to influence how the entity was run, second guessing the regulator, or trying to “catch the entity out” (Spencer, 2014, pp. 16-17). Without a clear sense of relative roles between the monitor and regulator, accountabilities may be confused, issues may fall between the cracks, or agencies may seek to shift blame for errors. Monitors interviewed for the Commission agreed this could be a problem.

For some regulators covered by the interviews, the line between the regulator and monitor was particularly unclear. In the case of one Crown agent, “contact...was almost daily, augmented by monthly ‘team to team’ meetings between itself and the entity, and a boundary between the two that was fuzzy” (Spencer, 2014, p. 21). With another Crown agent, the monitor “spoke of continuous dialogue, receiving monthly board papers, joint ownership of outcomes, secondment of staff, and collaboration on policy” (ibid). Such close relationships are likely to raise issues of respective accountability, and make it difficult for the monitor to independently assess the regulator.

Issues of role clarity also emerged in the Office of the Controller and Auditor-General (OAG)’s 2009 audit of the Crown entity monitoring practices of three departments.<sup>82</sup>

Representatives from Crown entities we spoke with had different views about whether roles and responsibilities of the departments and Crown entities were clear. Representatives from three entities thought that they were. Representatives from four entities told us that a lack of clarity about the monitoring department’s role created difficulties for them.

For example, a representative from one Crown entity said that lack of clarity in the monitoring arrangements meant that board members were unsure about whether they were there to make decisions or to follow the monitoring department’s lead.

A representative from another Crown entity told us that they had several different relationships with the monitoring department. For example, the department purchased services from the entity as well as having responsibility for monitoring it. The representative told us that the department could adversely affect the entity’s performance through some of these relationships, but that the department did not take account of this in carrying out its monitoring work. (OAG, 2009a, p. 19)

The Ministry of Business, Innovation and Employment (MBIE) identified a lack of clarity over “the mandate and ownership for regulatory systems” as one cause of past regulatory failures (sub. 52, p. 4).

## Inadequate capability

In some cases, board members interviewed for the Commission complained about monitoring staff lacking the capability, knowledge and seniority to engage.

A number of boards complained there was a lack of capability in the monitoring departments and that the staff involved needed to be more senior and knowledgeable than the ‘third-level bureaucrats’ currently in the role. One chair commented that it was inappropriate to send staff from this level to

<sup>82</sup> The Ministry of Culture and Heritage, Department of Internal Affairs and Ministry of Economic Development.

meet a chair, believing that they were too inexperienced and lacking in expertise to be able to add any value. (Spencer, 2014, p. 16)

This finding was echoed in the OAG's audit.

A representative from one Crown entity expressed concern to us about the monitoring department's level of understanding. These concerns included the department's lack of understanding of the entity's critical issues and capability. (OAG, 2009a, p. 25)

Frequent staff turnover in the monitoring department was another irritant, requiring regulators to devote time and resource to building new relationships and bringing the new staff up to speed (Spencer, 2014, p. 16).

### **Too much reporting, and not enough focus on performance and strategy**

Most board members felt that monitors focused "on the entity's financial performance rather than assessing performance on its substantive role" (Spencer, 2014, p. 17). In the view of some, this meant that attention was drawn away from important issues.

A similar theme emerged in the Performance Improvement Framework (PIF) review of a monitoring department.

Monitoring is an important means for the Ministry [of Education] to exercise leadership within the sector; however, current arrangements with regard to Crown entity monitoring are narrowly focused on financial performance, with insufficient attention given to the extent to which the entity contributes to critical elements of the overall education sector performance. (SSC, New Zealand Treasury & DPMC, 2011c, p. 34)

A number of other PIF reviews highlighted a gap around strategic engagement between monitors and Crown entities.

There is significant lack of clarity between the roles of the Crown entity Boards and MED [the Ministry of Economic Development] regarding monitoring, resulting in most Crown entities reporting that the relationship is positive (nice people at MED) but adds limited value or challenge. Engagement between MED and Crown entity personnel is generally collegial and positive but there is some frustration for Crown entities' chief executive officers and chairs where they find they are interacting on critical strategic issues with Tier 3 and 4 personnel within MED. (SSC, New Zealand Treasury & DPMC, 2012b, p. 32)

We received a number of comments about the Ministry [of Transport]'s role in monitoring the various Crown entities it has accountability for. Some of these comments were positive, particularly as to the role the Chief Executive plays in ensuring there is good ongoing contact with the chief executives of the Crown entities. Other comments questioned whether the Ministry was aware of some of the key challenges facing these Crown entities and suggested therefore that the Ministry was not well placed to add value. The focus was often on more operational issues rather than those of a more strategic nature about goals, performance requirements and how to meet them. (SSC, New Zealand Treasury & DPMC, 2013a, pp. 24 & 27)

Board members also expressed unhappiness about the usefulness and level of reporting (especially quarterly reporting), which some board chairs characterised as "over-reporting", including "'waste of time' measures" and disproportionate to private sector reporting requirements (Spencer, 2014, pp. 8 & 17). An example of the volume of reports that regulators produce is noted in Box 13.2. Some monitors reported relying heavily on the quarterly reports, while others obtained information from other sources (Spencer, 2014, p. 11).

#### **Box 13.2 Civil Aviation Authority (CAA) reporting**

CAA's "monitoring and reporting requirements include, but are not limited to:

- Weekly reports to the Minister (cc to the Ministry of Transport);
- Regular briefings of the Minister and the Ministry of Transport on issues of importance;

- Monthly Governance and Regulatory Decisions reporting to the Board;
- Quarterly governance reporting to the Minister (cc to the Ministry of Transport);
- An Aviation Safety Summary Report is published on a quarterly basis;
- A Strategic Directions document is published periodically;
- A Statement of Intent is published annually;
- An Annual Report is published annually;
- Ad-hoc Reports by the Auditor-General and others on aspects of the CAA's operations; and
- Monitoring by the ICAO of the CAA's performance in defined areas."

Source: CAA, sub. 6, p. 65.

### F13.2

Members of regulatory boards interviewed for the Commission were less satisfied with monitoring arrangements than their departmental monitors. Key problems identified with current monitoring practices were:

- insufficient support from departments;
- departments who did not understand their roles;
- inadequate capability and high turnover in monitoring staff; and
- too much reporting, and not enough focus on the regulator's performance and strategy.

## 13.5 Improvements to existing practice

As is evident from the commentary in section 13.4, there is room to improve the effectiveness of monitoring. Some of these improvements can be achieved by changes to existing practice, while others require additional processes. This section discusses the recommended changes to existing practice, namely:

- providing greater stability in monitoring staff;
- making closer links between policy and monitoring staff;
- more risk-based monitoring and reporting; and
- refocusing engagement back onto the board.

### Greater stability in monitoring staff

Like other important relationships, effective interactions between regulators and departments require considerable investment of valuable time and resource from both parties. Board members are often drawn from senior ranks of industry and the community, and can bring considerable expertise and experience to their roles. The frustrations expressed by a number of board members about the high turnover in departmental monitoring staff, and the tendency of departments to allocate monitoring tasks to junior staff are therefore understandable. Greater stability in monitoring staff is clearly preferable, and departments should pay more attention to this.

**F13.3**

High levels of turnover in departmental monitoring staff are not conducive to effective relationships with regulatory Crown entities.

**R13.1**

Departments should appoint staff into monitoring roles for terms that support good working relationships with regulatory Crown entities.

However, while the desire of board members and chairs to deal with more senior departmental staff is understandable, higher seniority does not always equate to greater knowledge of a particular regulatory regime or environment. Senior executives in many departments have a wide span of control and must cover a range of issues. Particularly in large departments, the detailed knowledge is more likely to lie elsewhere (eg, at the level of the relevant policy team). A more efficient use of departmental resources could be to appoint a dedicated relationship manager for each regulator.

### Closer links between policy and monitoring staff

The ability to assess a regulator's performance will depend, in part, on detailed knowledge of the regulatory regime and the environment within which the entity operates. This point was noted by the OAG and in a number of submissions to the inquiry.

Good overall sector knowledge [is important], so that the department can alert the entity to more general issues that may affect the entity, connect the entity with other parts of the sector when necessary, and can be independently aware of emerging issues and risks. This aspect overlaps with the department's policy responsibilities. (OAG, 2009a, p. 6)

...the CAA also believes that the monitoring agency needs to demonstrate a deep understanding of the regulatory regime the Crown agency is responsible for, as much as deep sectoral knowledge in order to understand the regulators operating environment. (CAA, sub. DR 64, p. 9)

In our experience the monitoring relationship works well when [m]onitoring agencies demonstrate strong policy leadership and credibility in the areas that the regulator is responsible. (Commerce Commission, sub. DR 93, p. 8)

...an appropriate level of understanding of the regulatory role is necessary to undertake effective monitoring of regulatory outcomes. (Maritime New Zealand, sub. DR 95, p. 7)

it is the 'policy hat' rather than the 'monitoring hat'...that allows the richer performance conversation. We tend to view the monitoring hat as representing a narrower performance perspective – basically just a subset of the matters of interest from a policy point of view – rather than an alternative or conflicting performance perspective to that provided by the policy hat. (New Zealand Treasury and SSC, sub. DR 97, p. 7)

Sector and regime knowledge is most likely to reside in the relevant policy teams of a department. Yet, in a number of departments, monitoring functions are conducted separately from policy teams. Arguments can be made for concentrating monitoring functions in separate units, such as promoting specialisation, economies of scale or the sharing of experience across entities. But these outcomes may only be achieved in departments that have responsibility for a large number of entities, and any benefits would need to be weighed against a more limited ability of monitors to engage in substantive dialogue with regulator boards.

The Commission notes that in some departments (eg, some units within MBIE), monitoring responsibilities are embedded within policy teams. This arrangement can help to:

- ensure that monitors are aware of policy developments;
- promote rich, informed discussion between monitors and regulators;
- provide feedback to policy staff about the effectiveness of past policy decisions; and
- ensure that advice on appointments to boards – one of the key ministerial intervention tools – is placed in the context of the regulatory regime and environment.

**F13.4**

Strong links between monitoring and policy functions within departments are important for effective engagement with regulators and quality advice to ministers. Formally allocating monitoring responsibilities to relevant policy teams within departments may help provide these strong links.

## More risk-based monitoring and reporting

Obligations on regulators to report create costs and draw resources away from other tasks. It is important, therefore, that the reporting processes seek the right information at the lowest necessary cost. One approach is risk-based reporting, which is applied in a number of individual regulatory regimes.

An example of risk-based reporting is that operated by the Education Review Office (ERO), which sets the length of an audit cycle for a school based on its previous performance and the strength of the school's self-review and assessment practices. Schools with a stable reporting history, robust self-review and effective use of assessment information are reviewed less frequently (eg, every 3 years or more). Where a school's performance is weak or there are risks to education or students' safety, ERO will review more frequently (eg, every year or every 2 years). This approach ensures that limited review resources are directed towards the highest needs, and provides incentives and rewards for high performance.

There would be merit in departments taking a similar approach to monitoring. For example, as a monitoring department developed confidence in the regulator board's risk management and self-review processes, it could adjust the:

- frequency of reporting (eg, from quarterly to half-year or yearly);
- amount of contact between the monitor and regulator;
- frequency of meetings between the regulator and the minister; and
- level of scrutiny applied to the regulator's draft SOI or performance reporting.

Some departments already appear to take a risk-based approach to monitoring Crown entities. The OAG's audit noted:

Representatives from three Crown entities told us that the monitoring department left them to carry out their business when things were going well and got involved only when they needed to. They told us that this approach worked well for them. (OAG, 2009a, p. 21)

Similarly, one of the monitors interviewed for the Commission commented that they were paying close attention to a particular regulator's performance because the legislation and entity were new, and there was a need to ensure that the regime was working as intended (Spencer, 2014, p. 11). Under a more risk-based approach, the monitor would progressively step back, as confidence in the new regime and its implementation grew.

**R13.2**

Departments should move towards risk-based monitoring and reporting, with higher-performing regulatory Crown entities subject to less frequent reporting obligations.

## Re-focus engagement on the Board

The "fuzzy boundaries" between some monitors, board members and regulator staff is a potential source of confusion and blurred accountabilities. Monitoring practices should more squarely focus on assessing how well the board is carrying out its legislative responsibilities to effectively and efficiently govern and oversee the entity.

The interviews with regulator board members and their monitors revealed a few departmental-regulator relationships that involved very regular and close contact (eg, co-production of policy or programmes and staff secondments). As discussed in Chapter 10, relationships of this nature can be a signal that the

governance or the form of the entity needs to be reviewed. These relationships should be revisited, with a view to moving to more formal interactions, based on clearly-defined roles and responsibilities. This is particularly important where the Crown entity has a higher degree of statutory independence (eg, autonomous or independent Crown entities).

### R13.3

Department–regulator relationships that involve very regular and close contact should be revisited, with a view to moving to more formal interactions, based on clearly-defined roles and responsibilities.

Monitoring relationships that focus on the role of boards imply a more evaluative approach by departments. Rather than attempting to “second guess” specific actions of boards, monitors should look to assess:

- how appropriate and robust the board’s strategies are;
- how well the board is functioning as a coherent unit; and
- how well the board is holding management to account.

This would reinforce the expectation expressed by the Ministers of Finance and State Services in their 2012 enduring letter of expectations that the board of a Crown entity “is the most important monitor of entity performance” (Minister of Finance & Minister of State Services, 2012).

Placing the onus of monitoring more squarely on boards is not just a question of changing departmental practice; it will also require higher performance by a number of boards. As noted in Chapter 10, while some board chairs believed they had the right performance measures in place to assess the performance of their entities, others said they were still working on getting a meaningful set of indicators for their organisation’s substantive functions.

A stronger focus on boards as the primary point of accountability also has implications for ministerial engagement with regulators. Ministerial meetings between entity chief executives or senior management without the presence of board members can send confusing signals about accountability. Regulator chief executives and senior managers are agents of the board, not the minister.

## 13.6 Is there a need for new institutions?

One issue that emerged from the evidence collected by the Commission is whether policy departments are actually the right organisations to understand and assess regulatory practice or identify risks of significant regulatory failure. As a response, a number of submitters proposed alternative monitoring arrangements. This section reviews the arguments made for change, examines the proposed alternatives, and outlines the Commission’s view on what additional tools might be needed to provide effective oversight of regulators.

### Arguments made for change

There was a strong sense in a number of submissions, engagement meetings and other evidence that current monitoring frameworks do not provide much assurance of effective regulatory practice or risk management. For example, the Treasury and the SSC commented that:

...we think the regulatory strategy should be an important part of the performance conversation between a regulator and the regulatory policy agency and relevant portfolio Minister. At present we worry that many Ministers and regulatory policy agencies are not sufficiently aware of the potential implications of the regulatory strategy adopted by the regulator, and may have different perceptions or expectations of, for example, funding adequacy, regulator capacity, the prioritisation of different risks, what constitutes regulatory success and failure etc. A misalignment of perceptions or expectations potentially leaves all parties exposed. (sub. DR 97, p. 7)

Questions about the ability of departments to assess risk and performance came from several corners. As noted earlier, several board members expressed concerns about the depth of understanding within departments. Individual regulators also raised issues in their submissions. The Environmental Protection Authority (EPA) said that the ability of:

...central Government agencies to undertake an auditing or monitoring role of the performance of regulators may be questionable. Central Government agencies may not necessarily have the experience or expertise in regulation. Our experience is that these agencies lack 'practical' experience. (sub. DR 103, p. 4)

Maritime New Zealand (MNZ) argued that, in some cases, tension between the roles of a policy department as both a monitor and partner in the administration of the regime could compromise the department's ability to independently assess the performance of a Crown entity:

...it is our experience that the performance of a crown entity, such as Maritime New Zealand, cannot be entirely separated from the performance of the monitoring department. By way of example, Maritime New Zealand is responsible for the delivery of maritime and marine protection rules for the Minister of Transport. While the majority of the actions associated with the delivery of the programme certainly rest with Maritime New Zealand, the Ministry of Transport also has a key role as the Minister's advisor. The delivery of the programme therefore relies on both agencies in terms of process and policy and legal input. In monitoring Maritime New Zealand's performance against the annual Rules programme it would be difficult to have a performance measure that isolates the Maritime New Zealand contribution or that can reasonably be construed as reflecting only on Maritime New Zealand performance...

In a general sense, the relationship between the two agencies suggests that the monitoring hat cannot effectively be worn independent of the policy hat at the same time. This is not to suggest that the majority of the elements of the performance monitoring framework raise similar issues of conflicting objectives, but it does illustrate that on a day to day basis there is a partnership in various areas that significantly diminishes the prospect of independent monitoring involving tough questions and free and frank reporting on monitoring results. (sub. DR 95, p. 7)

MNZ also argued that:

...effective and proportionate monitoring requires the monitoring agency to have a well-developed understanding of regulatory practice, as this enables it to meaningfully assess the performance of a regulator. (ibid)

A number of departmental monitors interviewed for the Commission also expressed doubts about their ability to prevent or provide warning of impending failures.

Our monitoring of the entity has limited ability to prevent failures or provide warnings.

We are largely reliant on the entity but we do look for patterns and pressure points.

Our oversight doesn't really provide warning. The entity is responsible for alerting the minister and ourselves to any problems. (Spencer, 2014, pp. 13-14)

In addition, several monitors commented that existing reporting processes were not useful for revealing problems.

## Proposed alternative approaches

Submitters suggested a number of additional or alternative approaches for monitoring that would help ministers, central agencies and monitoring departments to assess the effectiveness of regulator practice.

Insurance Australia Group Limited (IAG) and the Department of Internal Affairs (DIA) recommended the establishment of a PIF-type framework for regulators (IAG, sub. DR 80, p. 6; DIA, sub. DR 63, p. 4). In IAG's view, the benefits from such an arrangement "...would include:

- measurable standards to increase accountability for the development of an appropriate internal culture;
- mitigating the effects of path dependency by encouraging flexibility and responsiveness in regulatory implementation;
- a drive towards internalising monitoring, evaluation and self-improvement processes; and
- real incentives to focus on long-term direction and achievement, rather than sacrificing overall quality of address immediate concerns". (ibid)

DIA proposed that the PIF-style process should be “run by an expert group of regulators across government (potentially assisted by external expertise)” and “undertake a deep analysis of a small selection of regulatory systems every year to suggest improvements” (sub. DR 63, p. 4). The PIF-type evaluation “...could focus on indicators of good regulation, for example whether:

- there is regular evidence-based evaluation of the regulatory framework;
- how the regulator is considering risks, including those that might be ‘just around the corner’;
- there is a framework in place to evaluate outcomes; and
- the regulator has sufficient capacity and capability to effectively deliver its functions”. (ibid)

The EPA similarly argued for a “peer review system between regulators”(sub. DR 103, p. 4).

MNZ proposed establishing a:

...dedicated regulatory monitor (or ‘super’ monitor) encompassing system wide monitoring of the effectiveness of regulatory outcomes. This option would enable a clearer monitoring framework for all agencies (whether Departments or Crown Entities) with regulatory functions, which will provide a much clearer layer of support to the minister with responsibility for regulatory management and the existing PIF system. It will also enable a much clearer delineation of respective accountability mechanisms under the Crown Entities Act, reducing the burden on smaller agencies, yet ensuring that monitoring by the super monitor focuses on the achievement of regulatory outcomes. Such an Agency could also facilitate functional leadership and coordination of regulatory practice and workforce capability development – ensuring a clear link between the ‘findings’ of system monitoring activity and the ongoing development of regulatory practice and workforce capability development. (sub. DR 95, p. 2)

## Should monitoring functions be centralised?

There is a genuine question as to whether monitoring functions should remain dispersed across the system, or be concentrated in one organisation. A number of arguments can be made for concentration:

- it could help encourage the development of specialised expertise around regulatory practice and capability;
- it could simplify the reporting and accountability lines across the system and create savings or efficiencies for departments;
- it could promote greater consistency in monitoring approaches;
- it could allow more independent assessments of performance; and
- as noted by MNZ, if combined with capability development and good practice promotion roles, it could create a feedback loop between evaluation and action.

However, arguments can also be made against centralising monitoring functions. First, it potentially makes it more difficult for departments (who are responsible for ensuring that regulatory regimes are functioning well and up to date) to gather “business intelligence” about the performance of regimes. This could make it even harder for regulators to have their concerns about obsolete legislation responded to in a prompt manner.

Second, judgements about the performance of a regulator need to be made, at least in part, in the context of their regime. As noted earlier, detailed knowledge of regimes is most likely to lie in the relevant policy department.

Finally, depending on how it was operationalised, a centralised monitoring agency may add to the accountability and monitoring burden, rather than reduce it. Most or all savings in individual departments may be offset by the expense of establishing and running a central monitoring agency.

## The Commission's view

Justifying the removal of monitoring functions from policy departments would require a clear case that departments were inherently unable to perform a meaningful monitoring role and that the benefits of change would outweigh the costs or disadvantages outlined above. The Commission was not convinced that there was sufficient evidence to draw that conclusion. In particular, the Commission considered that retaining links between regulators and departments was necessary to support effective monitoring and reform of regimes.

**F13.5**

The Commission is not convinced that the potential merits of moving monitoring functions from policy departments to a central organisation outweighed the likely costs.

Nor was it clear that departments were necessarily unable to identify risks or potential failure, or whether this was simply a reflection of current monitoring practices. Although a number of monitors and board members questioned the reach of departmental monitoring, some were not as sceptical. Two monitors did believe there was scope for departments to identify issues, in particular by regularly talking to members of the regulated sectors. Regulated parties were a good source of business intelligence and were "very quick to let [the department] know if the regulator was overstepping their mandate" (Spencer, 2014, p. 14). This suggests that a monitoring approach that draws off a wider range of evidence may be more effective than one that relies solely on entity reporting.

Even so, there was a clear sense from submissions and other evidence that departments lack the experience or capability to understand and assess a regulator's practices, and that this limits the ability of monitors to form accurate views about the performance of a regulator. The Commission has already noted that regulatory practice is the "sharp end" of regulation and so deserves more focus (Chapter 3). As noted by Black (2012b) and submitters above, regulation can be a technical and specialised field. The best judges of the effectiveness of regulatory practice are likely to be other practitioners. The Commission therefore saw merit in the proposals from DIA, IAG and EPA for some form of peer review, with panels of senior regulatory leaders convened to review the strategies, practices and capability of individual entities on a semi-regular basis.

**F13.6**

Current monitoring processes do not pay enough attention to the detail or effectiveness of a regulator's strategies and practices. This limits the ability of policy departments or ministers to form accurate views about the performance of a regulator.

**R13.4**

Some form of peer review, drawing on the expertise of other regulatory leaders, should be established to help fill the gap in current monitoring processes.

## 13.7 Implementing the regulator peer reviews

The operational details of how the peer review panels should operate will need to be worked out by officials. However, the Commission has considered a number of implementation matters, including:

- responsibility for managing the reviews;
- focus of the reviews;
- membership of the review teams; and
- coverage and frequency of the reviews.

## Who should be responsible for running the peer reviews?

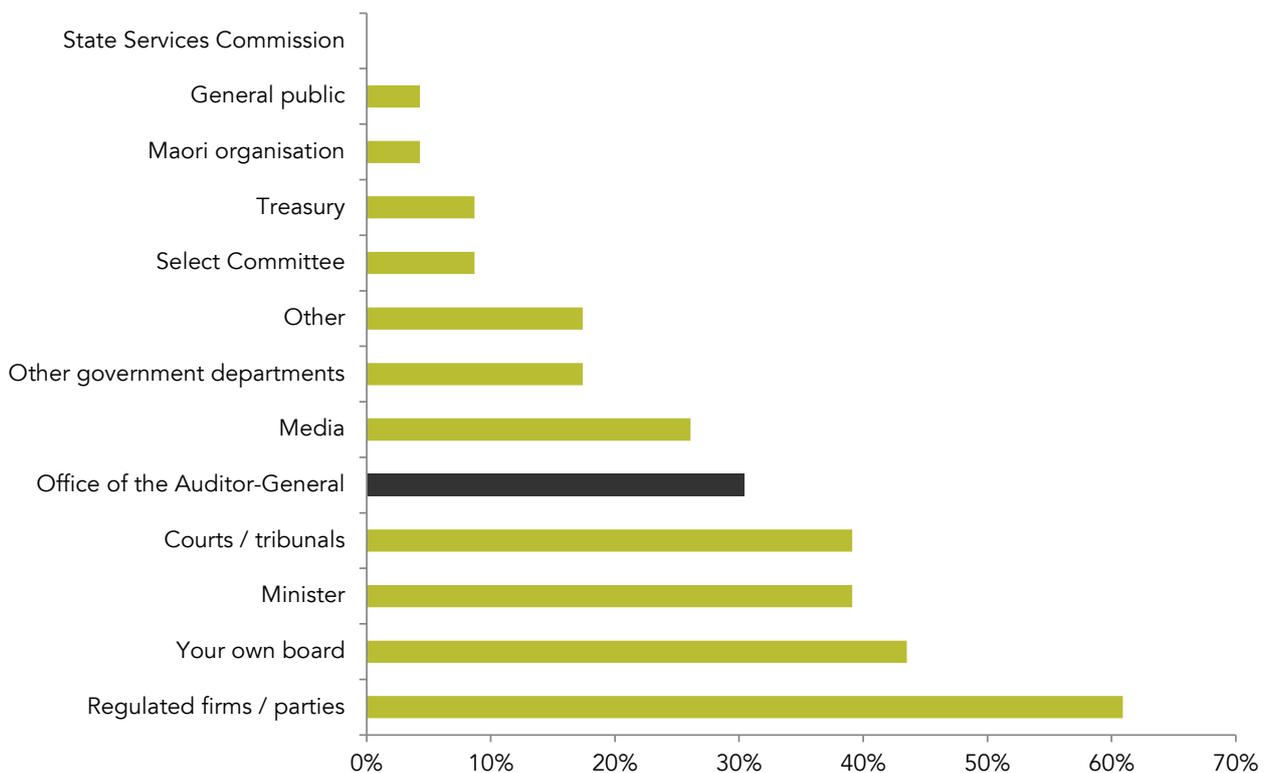
Given that policy departments will retain the primary responsibility for monitoring regulators, one option would be for the relevant department to convene a peer review for each entity they oversee. However, this could be burdensome on some departments, requiring them to establish new systems to support the reviews.

Allocating responsibility for organising the peer reviews to a single organisation would be the more efficient response, as it would allow for expertise to be built up in one organisation and avoid unnecessary duplicative costs elsewhere. To further minimise the costs, the peer reviews could form part of existing audit processes. Two options are available. The first is the OAG, and the second would be a modified form of the PIF audits managed by the SSC.

### The Office of the Controller and Auditor-General

There could be a number of benefits to giving the OAG responsibility for running the peer reviews of regulators. The OAG is an independent agency with considerable mana. Regulatory chief executives surveyed by the Commission about the organisations that played the greatest role in holding their agency to account rated the OAG ahead of central agencies and other government departments (Figure 13.3).

**Figure 13.3** Which three organisations/stakeholders play the greatest role in holding your agency's regulatory functions to account?



Source: NZPC, 2014b.

#### Notes:

- Only 19 of the 33 (58%) regulators who received the survey had boards in place. 23 responses were received. Responses were confidential, so the Commission cannot identify what proportion of respondents had boards. As a result, the results in Figure 13.3 may underplay the significance of boards as sources of accountability.

The OAG already conducts performance audits of a wide range of agencies and issues, including regulators and regulatory regimes (see, for example, OAG, 2005, 2009b, 2010, 2012), and has established processes that could be built off. A more prominent role by OAG in regulatory matters would also reflect practice in Australia and the United Kingdom.

However, the breadth of the OAG's responsibilities means that the Office is unlikely to be the best host for the regulator peer reviews. The Auditor-General must look across the range of entities it oversees and

decide where its discretionary resources would be put to best effect. While the British National Audit Office covers only central government,<sup>83</sup> the OAG is responsible for auditing over 3,000 public entities, across central and local government. In an engagement meeting with the leadership of the OAG, the Commission heard that the Auditor-General has coverage of over \$240 billion of public assets. In such a context, regular reviews of regulators may not be the highest priority or best use of the OAG's resources. Building up a larger regulatory review capability could draw resources away from other, more pressing, needs.

### Performance Improvement Framework reviews

As suggested by IAG and DIA, the second option would be to conduct the regulator peer reviews through a modified form of the PIF reviews. A PIF review is:

...a review of an agency's fitness-for-purpose today and for the future ... a PIF review looks at the current state of an agency and how well placed it is to deal with the issues that confront it in the medium-term future. It then proposes areas where the agency needs to do the most work to make itself fit-for-purpose and fit-for-the future. (SSC, New Zealand Treasury & Department of the Prime Minister and Cabinet (DPMC), 2013b, p. 5)

PIF reviews were introduced by central agencies (the DPMC, the SSC and the Treasury) in 2009 and are conducted by independent reviewers, many of whom are former senior public service leaders. The reviews explore agency performance against six main areas:

- delivery of government priorities;
- delivery of core business;
- leadership, direction and delivery;
- external relationships;
- people development; and
- financial and resource management.

The reviewers make recommendations to agency boards (for Crown entities) or chief executives (for departments), which they then accept or reject.<sup>84</sup> For departments, the agreed outcome of the review is reflected in the chief executive's performance agreement. Reviews are repeated every 2-3 years. Thirty-one agencies have had a PIF review since 2009, including three Crown entities, and a number have had more than one review.

There are a number of reasons why embedding regulator peer reviews within the PIF process would make sense. First, PIF has already established itself as a valuable and well-respected mechanism. The 2013 PIF review of the SSC noted that, while there were questions about the intensive nature of the process, feedback from ministers, chief executives and central agencies about the PIF reviews was "uniformly positive" (SSC, New Zealand Treasury & DPMC, 2013c, pp. 37 & 53). All of the Ministers interviewed for the SSC review "expressed strong satisfaction with the PIF process. It is trusted and is seen to help change culture within agencies" (ibid, p. 53).

Second, embedding the peer reviews within PIF would avoid creating an additional or duplicative accountability process onto regulators. There is already an intention to roll the PIF reviews out beyond the core public service (especially into other Crown entities). Most regulatory agencies are therefore likely to have a PIF review in the future.

Third, the PIF process is increasingly attuned to regulatory issues. A number of reviews of regulatory agencies have already been conducted, and the PIF model was updated in January 2014 to focus more clearly on regulatory stewardship activities (one of the new questions is outlined in Table 13.1). The upgrade was trialled with MBIE in January and is intended to be used with agencies that have a "significant

<sup>83</sup> In 2012/13, the National Audit Office audited the accounts of 355 organisations (NAO, 2013, p. 13).

<sup>84</sup> The SSC also has the right to comment on the lead reviewers' recommendations, but the reviewers are not obliged to accept these comments.

regulatory footprint” (SSC, New Zealand Treasury & DPMC, 2014b, p. 12). Work is also underway at the moment to “unbundle” PIF and develop bespoke PIF approaches, for specific sectors (New Zealand Treasury and SSC, sub. DR 97, p. 8).

**Table 13.1** New PIF question on regulatory stewardship

Lead question	Lines of inquiry	Signposts
How well does the agency exercise its stewardship role over regulation?	<p><b>Understanding of regulatory span.</b> How does the agency understand the scope of the regulation for which it has a stewardship responsibility?</p> <p><b>Understanding of regulatory impact and risk.</b> How does the agency know about the impacts (positive and negative) of the different areas of regulation for which it is responsible? Has the agency clearly identified the key areas of risk to the effectiveness of that regulation?</p> <p><b>Approach to regulatory improvement.</b> How proactive is the agency in identifying and flagging the need or opportunity for regulatory changes? Does the agency consider all avenues for potential regulatory improvement? How does the agency prioritise its identified opportunities for regulatory improvement?</p> <p><b>Quality of regulatory analysis and advice.</b> How does the agency use evidence and operational intelligence to inform its analysis of the underlying problem and available policy options? How complete and coherent is the agency’s analysis of potential impacts? To what extent does the agency offer free and frank advice to Ministers on the relative merits and risks of the regulatory options?</p> <p><b>Robustness of regulatory design.</b> Are affected parties, subject experts and other stakeholders appropriately consulted on the regulatory design choices? What other testing processes and techniques are used by the agency to ensure the regulatory design is workable and covers all necessary matters?</p> <p><b>Capacity and capability to manage.</b> How well does the agency understand the regulated community and how it operates? How effectively does the agency communicate with the regulatory community, other agencies with related regulatory roles and other interested stakeholders? Does the agency have the technical skills, capacity and sources of evidence of intelligence to appropriately discharge its regulatory duties? What strategies does the agency employ for mitigating the key risks to the effectiveness of its regulation?</p>	<p>The agency manages key legislative interventions to deliver benefits that exceed total costs.</p> <p>Analysis demonstrates current interventions deliver higher net benefits than alternatives.</p>

Source: SSC, New Zealand Treasury & DPMC, 2014b.

Fourth, PIF is a relatively low-cost exercise, with the average direct cost for a review estimated in 2010 to be less than \$80,000 (Office of the Minister of State Services, 2010, p. 3). Finally, PIF is an exercise conducted by and for the Executive. As such, it may be better-placed to provide ‘safe challenge’ and the sorts of “frank, meaningful dialogue about regulatory performance” (New Zealand Treasury & SSC, sub. DR 97, p. 7) that was identified through submissions and engagement meetings as critical for regulatory improvement, and largely absent from the current monitoring and accountability arrangements.

### R13.5

The regulator peer reviews should be conducted as part of the Performance Improvement Framework process.

## Focus and structure of the peer reviews

The existing PIF model will need some modification to incorporate the regulator peer reviews.

The key change is the development of a module or set of questions devoted to regulatory practice. Although some of the new questions on regulatory stewardship (Table 13.1) and most of the other PIF questions will be of relevance to implementers of regulation, other issues (such as the matters raised earlier in this report) should be explored in more detail. Examples of the types of questions that could be asked include those noted below.

### Regulatory practice

- Does the organisation have a coherent view of the regulatory regime(s) it enforces, including its purpose, performance, effectiveness, risks and weaknesses?
- How appropriate is the organisation's compliance and enforcement strategy to the attitudes of regulated parties?
- How effectively does the organisation identify and target risk or compliance by regulated parties?
- Does the organisation's use of interventions and other compliance tools comprise a consistent and coherent strategy? How do regulated parties view the organisation's practice?
- How does the organisation adapt and adjust its compliance and enforcement strategy in light of changes in markets, technologies, and institutional strategies?
- How does the organisation ensure that its choice of intervention tools is proportionate to the risk posed and/or size of the regulated party?
- How does the organisation make use of business intelligence and feedback loops to inform regulatory decisions?

### Engagement with stakeholders and regulated parties

- How fair, efficient and well-targeted are the organisation's consultation processes with stakeholders?
- Do regulated parties perceive the organisation's consultation processes as open, clear and reasonable?
- How well does the organisation communicate its decision-making frameworks and decisions to regulated parties?

### Culture (see Appendix C for more detail on these questions)

- How does the organisation's culture support the entity's role as an educator and facilitator of compliance?
- How does the organisational culture encourage internal debate and empower staff to raise risks to suggest improvements to regulatory practice?
- How does the organisational culture support robust, evidence-based decision making?
- How does the organisational culture promote operational flexibility and adaptation to changes in the regulatory environment?
- How does the organisational culture encourage continuous learning at all levels?
- Does the regulator have an open, transparent and accountable culture?
- How does the regulator value organisational independence and impartiality?
- Do regulatory staff have a deep understanding and respect for the responsibilities that come with developing, monitoring and enforcing regulation?
- How well aligned are organisational subcultures with the regulator's overarching objectives and values?

The final set of PIF regulatory practice questions should be developed with senior regulatory leaders.

### R13.6

The State Services Commission should convene a panel of current and former senior regulatory leaders to develop a set of regulator-specific questions for the Performance Improvement Framework reviews.

The second possible area of modification could be to develop a streamlined form of the PIF, focusing solely on the regulatory practice questions. As noted by the Treasury and the State Services Commission, under current plans, “only the large footprint Crown entities have either completed or will complete a PIF review in the next year” (sub. DR 97, p. 8). A streamlined PIF would allow a faster roll-out to regulatory Crown entities and more quickly fill the gap in knowledge about regulator practice. It could also allow for assessments of regulatory departments, without requiring them to go through a full PIF review again.

Ideally, regulatory Crown entities should be given the opportunity to go through the full PIF review (suitably adjusted for Crown entities and regulators), as answers to the full set of PIF questions are likely to be beneficial for their boards and managers. However, if resource constraints mean that progress on rolling PIF out to the wider set of Crown entities will be slow, then central agencies should explore the feasibility of a streamlined regulatory PIF process, focusing on regulatory practice, engagement and culture.

### R13.7

If resource constraints mean that progress on rolling PIF out to the wider set of Crown entities will be slow, central agencies should explore the feasibility of introducing a streamlined PIF process for regulators, focusing on regulatory practice, engagement and culture.

## Membership

Current PIF review panels draw from a cadre of respected senior and former public service leaders. While some of these individuals have regulatory expertise, to provide a full assessment of an agency’s regulatory practice this group of reviewers should be expanded by drawing from current and former regulatory leaders. For example, where a full PIF is being conducted on a regulator, the review team could be made up of one regulatory leader and one of the existing experienced lead assessors. If the streamlined PIF process outlined above is preferred, the full review team could be made up of regulatory leaders.

Over the course of this inquiry, the Commission has met with a number of current Tier 1 and Tier 2 regulatory leaders who have demonstrated a deep knowledge of the art of regulatory practice, and understanding of the challenges that regulators face. These individuals would have a great deal to offer the PIF process, and to other regulators. Drawing peer reviewers from existing regulatory leaders could also help promote the sharing of experience and the building of communities of practice discussed in Chapter 5.

### R13.8

The State Services Commission should identify current and former regulatory leaders to join PIF review teams.

Some regulators have argued to the Commission that their particular role or function is not replicated elsewhere in the New Zealand system, and they therefore see more value in benchmarking themselves against comparative organisations overseas. The Commission accepts that there may be particular circumstances where the most appropriate knowledge and expertise lies overseas. Where this is the case, the State Services Commission could look to source suitable individuals from Australia or another suitable jurisdiction to join a review team.

## Coverage and frequency

Although PIF reviews cost comparatively little, the expense may be substantial for some smaller regulators (eg, the Privacy Commissioner, Takeovers Panel, and Broadcasting Standards Authority). While these

organisations should be free to volunteer for a PIF review, smaller organisations (eg, with a total budget of less than \$5 million a year) should not be obliged to participate.

The priority should be the larger regulatory Crown entities and those that implement regimes managing significant potential harms. In addition, the next rounds of follow-up reviews for departments that implement regimes should include the regulatory practice questions. Although departments are subject to greater control by ministers, this does not necessarily reduce the risk of regulatory failure. Two of the more prominent regulatory failures to have occurred over the past 20 years – the Pike River mine tragedy and leaky buildings – were in regimes implemented by departments.

**R13.9**

The priority for the PIF peer reviews should be the larger regulatory Crown entities, those entities that implement regimes managing significant potential harms, and departments that implement regulatory regimes. Smaller Crown entities (eg, with a total budget of less than \$5 million) should be able to volunteer for a peer review, but not be required to undertake one.

**Making use of the reviews**

The regulator reviews would be useful not only for the agencies themselves (eg, in terms of setting out areas for improvement), but also as a key input to the monitoring department. In particular, the findings will assist departments in reviewing proposed new SOIs, assessing the need for changes to legislation or the board’s membership, and deciding the intensity and frequency of monitoring to apply to the regulator (as discussed in section 13.5).

The reviews will also help the centre judge how well regulators are functioning, and how well they (and their monitors) are responding to identified problems. The reviews may also reveal system-wide problems. Where identified problems are not acted on appropriately, the centre may need to take further action. The role of the centre in overseeing and managing the regulatory system is discussed in more detail in Chapter 16.



**13.8 Conclusion**

Monitoring plays an important part in New Zealand’s accountability framework for regulators. However, current practice and gaps in capability are limiting the potential of monitoring to assure ministers, Parliament and the public that regulators are effectively and efficiently pursuing their regime’s objectives, or that risks of failure are being appropriately managed. Changes to monitoring practices should help provide more proportionate and informed oversight, and the new peer review function will bring greater focus to the adequacy and effectiveness of regulatory practices in New Zealand.

# **Part 2: Better regulatory management**

# 14 System-wide regulatory review

## Key points

- New Zealand's stock of legislation is large, growing rapidly and complex. Parliament has enacted between 100 and 150 Acts and about 350 Legislative Instruments each year since the mid-1990s, although the net increase after repeals and revocations is less than this.
- Keeping it up to date – ensuring that outcomes are still being achieved and unnecessary or inefficient rules are removed – is an important task for the Government.
- In-depth reviews of regulatory regimes have often followed a crisis, rather than being part of a systematic and strategic approach to review.
- The Government does not use many of the approaches to system-wide evaluation of regulatory regimes that are used in other countries, and which may not be suited to New Zealand's circumstances. It is, however, implementing a suite of initiatives to improve how the stock of regulation is managed. Cabinet has articulated a set of expectations of what departments need to do to keep the regulatory systems they are responsible for up to date.
- To improve the effectiveness of these initiatives, the Government should:
  - publish the regulatory system reports prepared by departments;
  - require departments to articulate in their Statements of Intent their strategies for keeping their regulatory regimes up to date;
  - within three years, commission a review of departments' progress and seek advice from that review about whether it is necessary to create a legislative framework or other obligations for managing the stock of regulation;
  - articulate a set of principles to encourage departments to focus effort on reviews of regulatory regimes that have the largest anticipated benefits. These could be supported by capping yearly expenditure or by setting a target number of reviews, to force identification of the reviews with the largest potential benefits;
  - direct the Treasury to articulate in more detail its overall strategy for improving how the stock of regulation is managed, indicating how the initiatives it is implementing fit within the strategy and how success will be measured.

## 14.1 Introduction

New Zealand has a large stock of legislation and regulation (Table 14.1). Currently 1,077 Acts and 2,496 Legislative Instruments (including regulations) are in force. If amendment Acts and Legislative Instruments are included, the numbers increase to 2,871 Acts and 4,950 Legislative Instruments

Table 14.1 New Zealand regulatory stock

Acts <sup>1</sup> or Legislative Instruments	Number <sup>2</sup>
Number of Acts currently in force (excluding amendment Acts)	1,077
Number of Acts currently in force (including amendment Acts)	2,871
Number of Legislative Instruments <sup>3</sup> currently in force (excluding amendment Instruments)	2,496
Number of Legislative Instruments <sup>3</sup> currently in force (including amendment Instruments)	4,950

Source: New Zealand Legal Information Institute and Parliamentary Counsel Office databases (see Note 1 below).

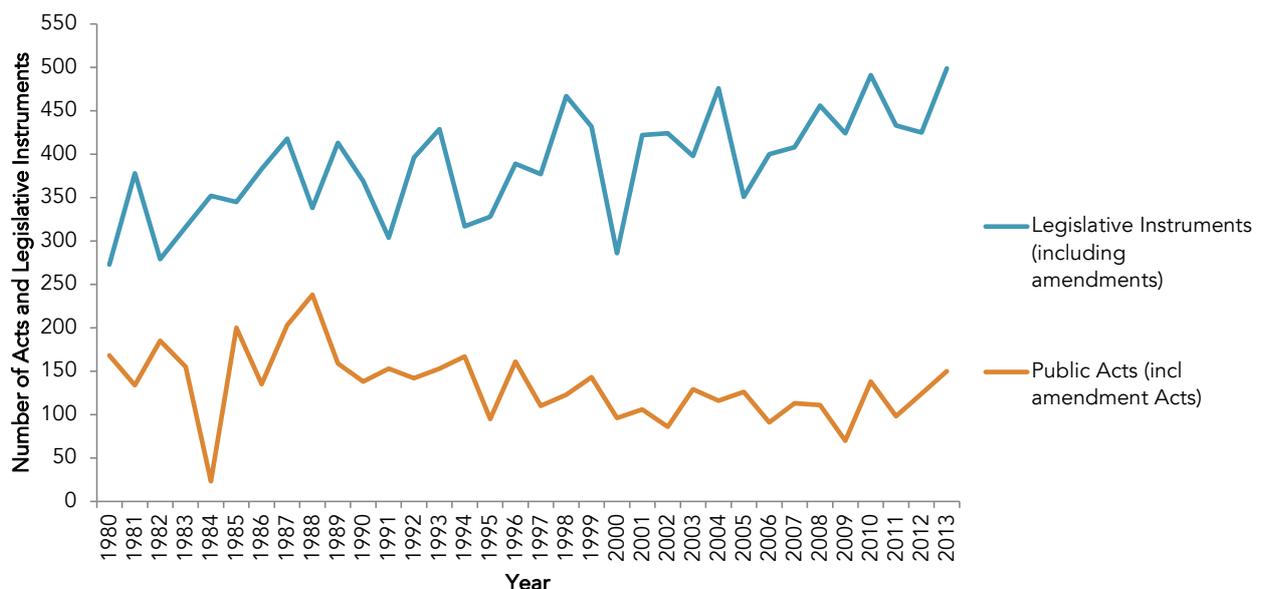
Notes:

1. This table is limited in focus to “public” Acts, and excludes local, private, provincial, and imperial acts. The Parliamentary Counsel Office defines a “public Act” in the glossary to its Legislation New Zealand website: “A public Act is an Act that affects the public at large. It deals with matters of public policy and is promoted by the Government or a member of Parliament who is not a Minister”.
2. Numbers are taken from a search on 4 March 2014 of the databases of Acts and Legislative Instruments on the Parliamentary Counsel Office’s “Legislation New Zealand” website ([www.legislation.co.nz](http://www.legislation.co.nz)).
3. The Parliamentary Counsel Office defines a “legislative instrument” in the glossary to its *Legislation New Zealand* website: “Legislative instrument” is defined in section 4 of the Legislation Act 2012. They can include Orders in Council, regulations, rules, notices, determinations, proclamations, or warrants. Legislative Instruments are laws made by the Governor-General, Ministers of the Crown, and certain other bodies under powers conferred by an Act of Parliament. Certain resolutions of the House of Representatives are also classed as Legislative Instruments. Legislative Instruments generally deal with technical details that may be subject to frequent change. Before 5 August 2013, legislation of this type was in general known as “Regulations”, or “Statutory Regulations”. On this website, these documents are now found under “Legislative Instruments”.

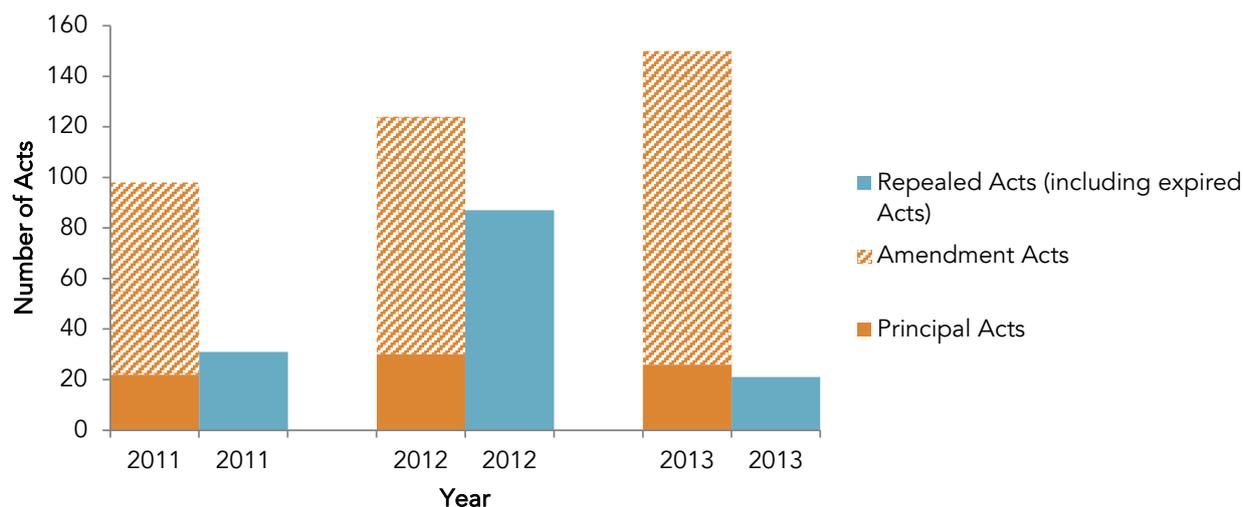
The stock is growing rapidly. Parliament has enacted between 100 and 150 Acts and about 350 Legislative Instruments each year since the mid-1990s (Figure 14.1). In each of the last three years, more than 75% of the new Acts were amendment Acts, while Legislative Instruments are more evenly split between principal and amendment instruments.

The growth in the stock is considerably less than the number of new Acts and Instruments, as some Acts and a significant number of regulations are revoked each year, consistent with the more straightforward process to make and revoke regulations (Figures 14.2 and 14.3).

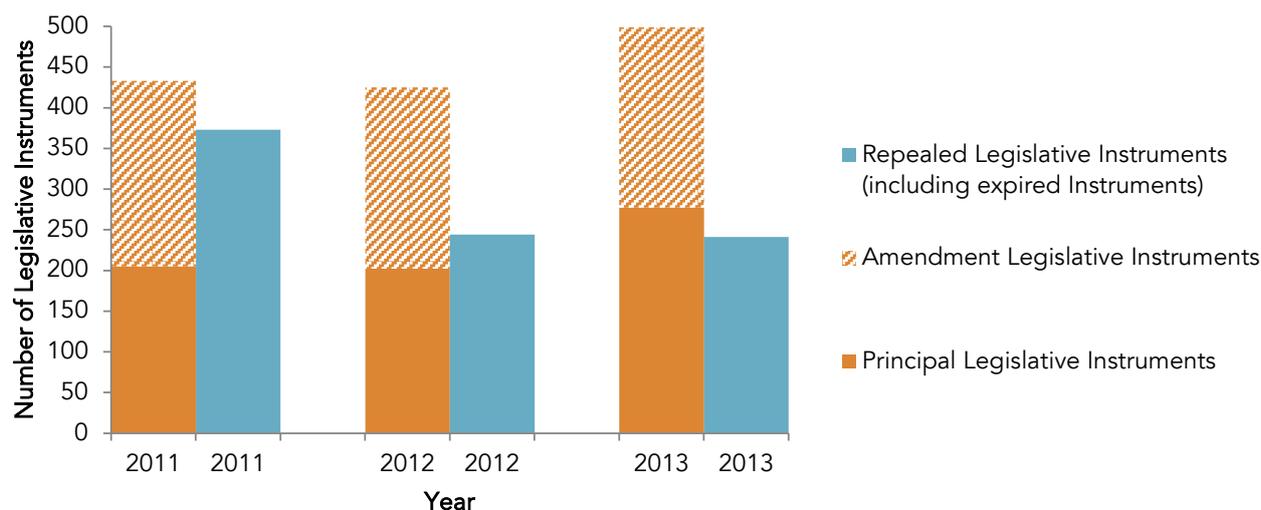
Figure 14.1 The number of Acts enacted and Legislative Instruments (Statutory Regulations) made 1980-2013



Source: Treasury and State Services Commission sub. DR 97, p. 22, drawing on data compiled by the Parliamentary Library and the Parliamentary Counsel Office.

**Figure 14.2** Number of Public acts enacted and repealed 2011-2013

Source: The New Zealand Legislation website, compiled by the Treasury on 18 March 2014 and reported in sub. DR 97, p. 23.

**Figure 14.3** Number of Legislative Instruments (Statutory Regulations) made and repealed 2011-2013

Source: The New Zealand Legislation website, compiled by the Treasury on 18 March 2014 and reported in sub. DR 97, p. 23.

Much of this legislation establishes regulatory regimes. The Treasury recently estimated that New Zealand "might have perhaps 200 core regulatory regimes" (New Zealand Treasury, 2013e, p. 16). Many regimes are very complex, as the recent inquiry into the dairy sector found:

The recent inquiry into dairy food safety regulation found that the "tertiary layer includes numerous instruments of different types and runs to about 12,000 pages, taking up more than three metres of shelf space. Submitters noted this layer as 'difficult to navigate', 'inaccessible', and a 'bit of a nightmare'." (Government Inquiry into the Whey Protein Concentrate Contamination Incident, 2013, p. 31)

Seafood New Zealand presented a similar picture of regulation in the seafood sector:

The Ministry for Primary Industries estimated that they administer over 9,000 regulatory provisions applicable to the seafood sector, many dating back to former regulatory environments and some with a lost lineage. Regulation of the seafood sector changed markedly with the introduction of the 1986 Fisheries Act and the Quota Management System. The Act was further amended in 1996 to reinforce an output based management control regime. However many of the provisions contained in secondary regulation are still based on the input control regime prior to 1986 rather than the output measures of

the current regime. Even within the current regime, input measures are used to protect environmental concerns.

To these 9,000 provisions must be added the provisions applying to the preparation of food resources, the control and regulation of the maritime environment, health and safety and environmental protection...

As a sector with a substantial number of regulations from a wide number of regulators, the sector faces a somewhat confusing array of regulations, some overlapping, from a variety of regulatory forms and environments covering all aspects of the operations within the sector. (sub. DR 72, pp. 1-2)

Chapter 2 pointed out that regulatory regimes in New Zealand can become rigid and obsolete, as well as complex. This reflects the strongly statute-driven system in New Zealand and the weakness of review and evaluation systems. As a result, New Zealand regulation can struggle to keep up with changes in technology or public expectations. One consequence is that regulators often have to work with legislation that is outdated or not fit for purpose.

There have been many initiatives aimed at improving the management of the stock of regulation. The Parliamentary Counsel Office (PCO) attached to its submission a 13-page chronology of initiatives to scrutinise regulation. These initiatives fall into two categories: enhancing the accessibility of the law; or reducing or simplifying the rules governing economic activity specifically (sub. DR 88). Yet in spite of these initiatives, inquiry participants see ongoing problems. The PCO's submission put forward proposals to improve scrutiny. And the Treasury recently suggested that there needs to be

**more systematic identification and prioritisation of problems or potential improvements in the existing stock of legislation** (because we know legislative mistakes can be made; that legislation can become less effective or redundant over time as the policy environment changes; and assessing the cost and performance is a neglected and under-resourced task compared with assessing government spending). (New Zealand Treasury, 2013e, p. 7)

The Law Commission has also observed that:

In New Zealand, we do few evaluations of whether legislation has met its policy objectives or has had unexpected consequences or costs. We cannot continue to pass Bills and never consider their effects again. There needs to be a systematic mechanism to assess and test the effects of Bills after they have been passed. (2008, p. 64)

Submissions from industry also raised concerns about the cumulative costs of the large stock of regulation; that parts of it may be out of date; and that there is insufficient attention to system-wide issues (Box 14.1).

#### Box 14.1 Industry views about the stock of legislation and regulation

A major problem in New Zealand is that there is no process that enables or ensures regulatory regimes are subject to ongoing and regular review (referred to in the draft report as the "set and forget" tendency). We consider this is one of the most important and concerning issues identified in the draft report. Without change, there is a real risk that regimes will be left to operate in sub-optimal or unintended ways, possibly for considerable periods of time (Vector, sub. DR 98, p. 4).

In particular, New Zealand needs a regulatory process/framework that takes a system-wide aggregated view of legislation and regulation and its associated cost rather than just assessing the impact of each individual piece of legislation and regulation. The cumulative cost of compliance is an area of real concern for our members.

There is also a need for in-built periodic reviews of existing legislation to ensure that it remains current and continues to reflect the intended outcomes that it was designed to deliver and/or if those objectives remain appropriate, eg, The Friendly Societies and Credit Unions Act 1982 is in great need of an overhaul to reflect the 21st Century environment that our members operate in (New Zealand Association of Credit Unions, sub. DR 73, p. 2).

We share the Commission's concern that regulatory regimes have been allowed to go stale, and struggle to keep pace with industry changes. We have seen this with financial markets regulation in the past (Financial Markets Authority, sub. DR 90, p. 3).

Insurance Australian Group (IAG) has a number of concerns with the overall management of regulatory quality in New Zealand, which extends beyond the remit of individual regulators. These issues include: ... [a] focus on the review and accountability in respect of specific outcomes, rather than regulatory processes and regimes generally. Further, regulator independence may afford an opportunity for those with political responsibility for regulation to attribute responsibility to the regulator for a particular outcome, rather than accepting responsibility on a system-wide basis.

In our view, these issues largely stem from a lack of accountability within New Zealand's wider regulatory management system. Only initiatives that address the capability of the regulatory management system as a whole will be able to promote meaningful change (IAG, sub. DR 80, pp. 12–13).

Other countries face similar challenges in keeping their regulation up to date:

One of the most important tasks facing governments today is updating of the accumulated regulations and formalities that have gone unexamined over years or decades. National regulatory systems require periodic maintenance. Periodic and systematic review of existing regulations is needed to ensure that outcomes are assessed, unneeded or inefficient rules are weeded out, and needed rules are adapted to new economic and social conditions. (Organisation for Economic Co-operation and Development [OECD], 1997, p. 224)

Most approaches to managing the stock of regulation involve some form of evaluation. This chapter explains what evaluation is (section 14.2) and shows that New Zealand has not picked up approaches to managing the stock of regulation (applying some form of evaluation) that are used internationally (section 14.3). It argues that the Government's evolving approach to managing this stock contains many initiatives, but still has gaps. Implementation of the policy initiatives will need to be managed carefully (section 14.4).

## 14.2 Evaluation

### What is evaluation?

The OECD defines evaluation as

... systematic and analytical assessments of important aspects of a government activity (here: regulatory tools and institutions) and its value, with a view to creating or enhancing regulatory policy feedback – that is, enhancing the future performance of the activity being evaluated. (2004b, p. 11)

Coglianesse (2012, p. 14) suggests that evaluation “answers the question of whether a treatment (i.e., a regulation or regulatory policy) works in terms of reducing a problem”. To a considerable extent, this depends on how well a regulation or regulatory policy was implemented. This chapter considers the second set of questions that evaluations can consider: whether a regulation is still needed, and whether it remains effective in achieving its objectives and does so at lower cost than feasible alternatives. Regulations are typically long-lived, and the original problem that justified intervention, as well as the options for addressing it, may well change over the life of a regulation.

The key stages of evaluation usually include:

- determining the purpose of the evaluation, and the criteria or objectives against which to conduct it;
- collecting data, which needs to begin before a policy is implemented, so that a “baseline” against which to compare outcomes can be developed;
- analysing and synthesising data against the evaluative criteria, to reach judgements about, for example, efficiency, effectiveness, meeting of stakeholder expectations, value for money, and setting information requirements and formulating research.

### What are its benefits?

Good practice evaluation begins before a policy is implemented, by developing clear, measurable objectives for the regulation and a “baseline” measure of the situation prior to implementation. The

objectives, baseline and ongoing monitoring then provide a consistent framework against which to evaluate progress against the objectives.

Evaluation of regulations and of broader regulatory regimes can have considerable benefits. International experts such as the OECD and the National Audit Office in the United Kingdom consider that ex post evaluation is an integral part of good policy making:

Management is often described as a cycle of planning/preparation, budgeting, implementation and evaluation. Evaluation is the link which closes the circle and completes the feedback loop. The evaluated policy or programme is improved, expanded or replaced. (OECD, 1999b, p. 13)

Regulators should constantly review the efficiency and effectiveness of their regulations, in order to determine whether the desired improvements in regulatory outcomes are being realised and if these benefits still justify the costs of intervention. (NAO, 2007, p. 4)

MPI points out that evaluation can

provide positive assurance about regulations' effectiveness, improve communication and understanding across government and key stakeholders/users, inform decision-making and prioritising of resources, identify unintended downstream impacts that are diluting or even contradicting the purpose of regulation, and identify areas for improvement or additional value-add enhancements. Evaluation can also positively build awareness and capability for those engaged with regulatory design and enforcement, to focus monitoring efforts on 'what really matters' in terms of actual results for the end users, not just measuring outputs. (sub. DR 102, p. 24)

Focused evaluation can:

- reduce the risk of major regulatory failures, by identifying possible precursors of such failures and suggesting ways to address them;
- increase the scope for regulation to achieve policy outcomes;
- identify opportunities to achieve policy outcomes at lower cost;
- identify opportunities to re-focus regulatory effort on areas where it can add more value; and
- identify areas of redundant regulation and legislation that can be repealed.

Evaluation is an emerging process in New Zealand. MPI pointed out that the regulatory impact analysis (RIA) process can provide a framework for evaluation. It

is an important tool used in New Zealand to set out the intended outcomes of regulation. Ideally this developmental policy phase includes an explicit analysis of the expected steps from problem/s to solution/s at different phases against which evaluation can assess progress, eg, using intervention logic for the causal effects in the short medium and long term; investing in stakeholder research that identifies key drivers and barriers to address in the regulatory design; or system mapping of the wider 'field' of the regulatory topic. This developmental work provides dividends for then providing a framework against which to later evaluate how effectively the regulations have delivered against the policy design and expectations. (sub. DR 102, p. 24)

MPI also provided other examples of evaluation:

- the Performance Improvement Framework (PIF);
- the Social Policy and Evaluation Research Unit;
- the support for evaluation given by the Government's chief science advisor, Sir Peter Gluckman;
- the review of expenditure on policy advice, chaired by Dr Graham Scott; and
- building requirements into legislation to undertake evaluations of the effectiveness of a policy (eg, the Emissions Trading Scheme, and Waste Minimisation Act's waste levy review) (sub. DR 102, p. 24).

The Education Review Office (ERO), which reviews early childhood services and schools, is another example of evaluation, albeit not of policy (Box 14.2).

#### Box 14.2 Evaluation by the Education Review Office

The evaluation of education providers is based on supporting effective self-review processes, supplemented with differentiated external review.

Schools are required to undertake self-review, and the ERO provides support tools and training to build self-review capability and use self-review for school improvement.

ERO is legally responsible for the external evaluation of school quality. It can initiate a review on its own initiative, at the request of the Minister, or as part of a regular review cycle. ERO has legal powers of entry and inspection.

The purpose of a review is to support a school to strengthen its capacity to promote student learning and achievement. Schools undertake their self-review in preparation for the external review, and the review coordinator and their team work with the school's board and leadership team to establish a shared commitment to the review process.

- For schools experiencing difficulty, ERO institutes a longitudinal review methodology for 1-2 years. These schools receive extra support and professional development from the Ministry of Education.
- Schools performing well are reviewed on average every 3 years, with a focus on identifying areas to improve and on ways to strengthen self-review.
- Schools with the strongest performance and self-review capacity are reviewed every 4-5 years, because it is expected they can understand their own performance and respond appropriately.

Broader lessons from ERO's approach include that reviews are intended to help schools strengthen their capacity, and that to achieve this it is useful to:

- combine internal and external reviews;
- base reviews on a clearly articulated process, with ERO support for schools in their use of that process; and
- vary the frequency of review according to ERO's assessment of the educational health of the school, which signals a risk-based approach to review.

*Source:* Education Review Office 2014; OECD, 2012b.

## Barriers to evaluation

The barriers to evaluation are considerable.

- Evaluation is difficult, even when data is available. For example, evaluation requires attributing how much regulation has contributed to outcomes that may also be influenced by other factors. If key performance indicators, baseline estimation and a process for collecting data were not developed when a regulation was implemented, evaluating its impacts years later might not be possible (VCEC, 2011, p. 140).
- Imprecise regulatory objectives (discussed in Chapter 8) make it difficult to evaluate what a regulation has achieved.
- Conducting evaluations involves costs, which vary in size. For example, evaluation may range from a low-scale internal process evaluation of administrative efficiency or customer satisfaction, through to a substantial and independent ex post evaluation of the cost-effectiveness and outcomes achieved after a

number of years. Evaluation (and collection of monitoring data) needs to be embedded in budgets and business planning, for evaluation to be most effective.

- Evaluation results that reveal weaknesses in a policy or process may provoke resistance to change. However, when evaluation is well supported by leaders, such results can provide an opportunity to identify areas for improvement (or re-prioritisation of effort).
- Evaluation may be also resisted by people who benefit from a regulation, and are concerned that evaluation may erode this benefit.

Given such barriers, evaluation may not be the norm (or even an occasional activity) unless it has a “champion”. Yet ministerial responsibility for managing the stock of regulation is not clear, as has been observed by others:

In principle the doctrine of Ministerial responsibility applies – Ministers are responsible for regulatory policy, and are answerable to the [H]ouse on policy and administrative and operational matters while public agencies are responsible for the actual administration of regulation. In practice the mechanisms to make Ministers answerable for the management of the stock of regulations are highly attenuated. ... there is no standard process to make the executive answerable for the administration and maintenance of legislation as a matter of course. (Gill & Frankel, 2013, p. 9)

And there is little support for evaluation in official handbooks:

The Treasury’s (2009) Regulatory Impact Handbook provides guidance to staff developing new regulatory proposals. The handbook contains a half page of aspirational material on the need for monitoring, feedback and review. There is no formal expectation that the introduction of regulations will be accompanied by programmed review, nor requirements to undertake formative or summative evaluations, nor monitoring and reporting requirements beyond that required for compliance with the Public Finance Act as discussed above. There is no discussion in the handbook of how and when to develop evaluation plans, monitoring and measurement plans, embedded review clauses, sunset clauses or even links to examples of review provisions. (Gill & Frankel, 2013, p. 10)

### 14.3 Systemic approaches to reviewing the stock of regulation used internationally

#### A suite of approaches

There are many different approaches to reviewing the stock of regulation, with differing degrees of rigour and varying breadth of coverage, and some approaches involve arbitrary rules rather than evaluation. Table 14.2 sets out nine approaches commonly used in other countries and reports on their use in New Zealand.

**Table 14.2 Use of system-wide approaches to evaluation in New Zealand**

Approach	Description	Comment	Is it used in New Zealand?
Regulator-based reviews	Regulators evaluate own performance	Limited to aspects of administration and enforcement over which regulators have discretion	Yes
Stock-flow linkage rules	Introduction of new regulation conditional on an assessment of, and changes to, the stock (examples are regulatory budgets, and the “one-in, one-out” rule)	Can force prioritisation and prompt government to be more pro-active in seeking out regulation for simplification and elimination. Risks are that it may encourage hoarding of regulations as “bargaining coin” and focus attention on removing rather than improving regulation	No

Approach	Description	Comment	Is it used in New Zealand?
Red tape reduction targets	Targets that focus on reducing paperwork or administrative compliance costs	Need independent quantification of the savings achieved. Require implementation of a framework (such as the Standard Cost Model) and can be costly to implement. Tends to ignore benefits of regulation	No general target
Sunsetting	A process in which new regulations are given automatic expiration dates, unless re-made through normal rule-making processes. This ensures continuing review and updating of stock of regulations	Can help with removing redundant regulation, but will not achieve more broad-based improvement unless related regulations sunset at the same time. Is not discerning, as it can require review of regulations that are working well	No general requirement
Embedded review requirements in new legislation	Australia, Canada and the United States have recently established requirements in their regulatory systems to undertake ex post evaluations of significant regulations	Need a process for focusing reviews on priority areas and monitoring that required reviews have been carried out, with adequate quality	No general requirement
Public stocktakes	Used as a discovery mechanism for unnecessary regulatory burdens	Most effective when there is wide engagement. Should not be undertaken too frequently	No
Principle-based reviews	Involves assessing regulation and legislation against a principle (eg, that anti-competitive restrictions should only be retained when they demonstrate a net benefit)	More resource-intensive than general stocktakes, but can be influential	No
Benchmarking	Provides information on comparative performance and leading practices (eg, the World Bank's <i>Doing Business</i> reports, the OECD's indexes of regulatory restrictions on trade and investment, and Australian Productivity Commission benchmarking studies)	Can identify leading practices, although the complex nature of the regulations means that comparisons are often qualitative	Not extensively
Formal large-scale reviews	Generally commissioned when a case for reforming a major area has been identified, and options need to be explored	Most important requirement is transparency, through publication of submissions, public hearings and publication of a draft report with preliminary findings and recommendations	Yes

Source: Draws on data from Australian Productivity Commission, 2011.

Three of these approaches have been used recently in New Zealand.

- Some regulators review their own performance. For example, the Commerce Commission compares its performance to that of similar regulators in other countries (sub. DR 93, p. 1).

- One of the targets of Result 9 of the Government's Better Public Services programme is to reduce the business costs from dealing with Government by 25% by 2017. While this result covers all government services, regulation is one of these services and so there is some overlap with the red tape reduction targets used in other countries.
- In-depth reviews are also used, sometimes prompted by a major event or perceived regulatory failure. The Ministry of Business, Innovation and Employment (MBIE) submitted that three regulatory systems for which it is responsible have suffered systemic failures in recent years: financial market regulation, health and safety regulation, and building standards regulation. These have triggered in-depth reviews:
  - the Commerce Committee inquiry into finance company failures;
  - the Royal Commission on the Pike River Coal Mine Tragedy;
  - the independent taskforce on workplace health and safety; and
  - reports on building standards that include the Report of the Overview Group on the Weathertightness of Buildings and a review of the Building Act (sub. 52).

Regulatory reforms that end up on the legislative agenda tend to be driven by departmental policy reviews that may or may not involve public consultation (Table 14.3).

**Table 14.3 Regulatory changes driven by departmental reviews on the legislative agenda in early 2014**

Regulatory change on the legislative agenda in early 2014
Fair Trading Amendment Bill; Consumer Guarantees Amendment Bill ( <i>amends the Fair Trading Act 1986 and Credit Contracts and Consumer Finance Act 2003, enforced by the Commerce Commission</i> )
Credit Contracts and Financial Services Law Reform Bill ( <i>amends the Credit Contracts and Consumer Finance Act 2002, enforced by the Commerce Commission</i> )
Building (Earthquake-prone Buildings) Amendment Bill ( <i>amends the Building Act 2004, enforced by MBIE</i> )
Building Amendment Bill (No 4) ( <i>amends the Building Act 2005, enforced by MBIE</i> )
Smoke-free Environments (Tobacco Plain Packaging) Amendment Bill ( <i>amends the Smoke-free Environments Act 1990, enforced by the Ministry of Health</i> )
Maritime Transport Amendment Bill ( <i>amends the Maritime Transport Act 1994, enforced by Maritime New Zealand</i> )
Financial Markets Conduct Bill ( <i>amends the Securities Act 1977, enforced by the FMA</i> )
Financial Reporting Bill ( <i>establishes the Financial Reporting Act 1993, enforced by the FMA</i> )
Reserve Bank of New Zealand (Covered Bonds) Amendment Bill ( <i>amends the Reserve Bank of New Zealand Act 1989 (Part 5C), enforced by Reserve Bank of New Zealand</i> )
Non-bank Deposit Takers Bill ( <i>establishes the Non-bank Deposit Takers Act, enforced by the Reserve Bank of New Zealand</i> )

New Zealand has not adopted regulatory budgets, or "one-in, one-out" rules, and has made little use of embedded reviews, or of sunseting, principle-based reviews, and stocktakes. There are, however, examples of some of these approaches being used in specific cases.

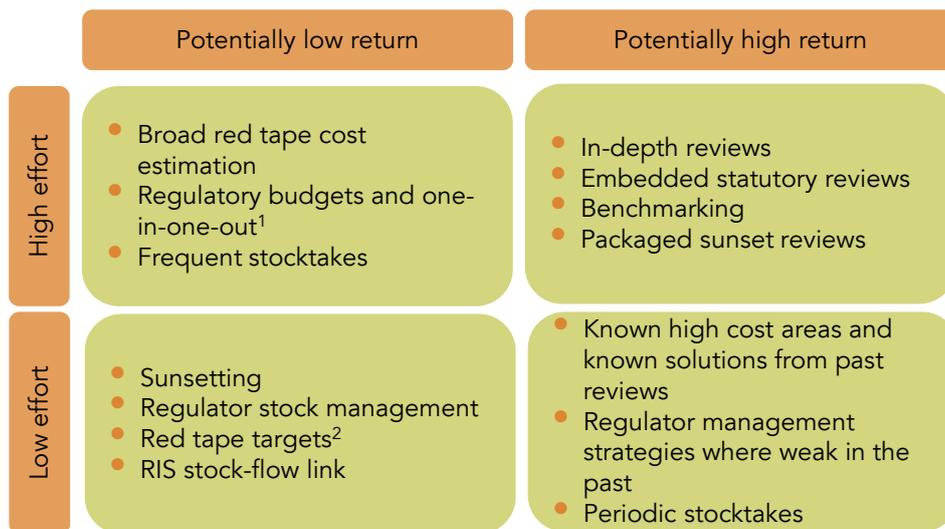
- While there is no general sunseting requirement, it is occasionally required in individual Acts (for example, the Mental Health Commission Act 1996).
- Some legislation has embedded review provisions. For example, section 157AA of the Telecommunications Act 2001 requires the Minister to commence a review of the policy framework for regulating telecommunications services in New Zealand by 30 September 2016.
- A report by the Ministry of Economic Development, while stating clearly that it is not a comprehensive stocktake, surveyed a large number of initiatives to reduce the compliance costs of regulation in

response to a Government commitment “to review existing regulation in order to remove requirements that are unnecessary, ineffective or excessively costly” (2011, p. 6).

## Cost effectiveness of the different approaches

Figure 14.4 reports an assessment by the Australian Productivity Commission (APC) of the cost-effectiveness of the different approaches (considered from the perspective of the Australian Government). The high-effort, low-return quadrant (major red tape costing exercises, regulatory budgets and stocktakes that are too frequent) should normally be avoided. The approaches in the low-effort, low-return quadrant may be warranted (and indeed “business as usual”), but the effort should be proportionate to the return. The low-effort, high-return quadrant is most attractive. This leaves the high-effort, high-return quadrant, which is where prioritisation of activities is most important.

**Figure 14.4** Approaches to managing and reviewing the stock of regulation: an effort-impact matrix (for individual areas of regulation)



Source: APC, 2011, p. 90.

Notes:

1. High effort to do well and potential for perverse impacts.
2. Where the awareness of compliance burdens is still lacking can be high return.

## 14.4 Approaches to evaluating regulation in New Zealand

### The approach to a “stock management system” is evolving

The Government recognises that the processes for evaluating the performance of existing regulations need to be improved:

We have begun to put in place systems which require departments to better plan for proposals for regulatory change and to scan their regulatory stock for areas that require review, or are redundant; but we still do not have strong management expectations and systems to support and give us assurance about the ongoing operation of existing regulation. We tend to have a “set and forget” mindset to regulation...

We have begun to make improvements in our regulatory management systems, but our departments still do not, in general, systematically apply basic good management principles and practices to the regulatory regimes that they administer. This is a clear and longstanding gap in our state sector arrangements. (Offices of the Ministers of Finance & Regulatory Reform, 2013b, pp. 3-5)

Since the New Zealand Treasury took over responsibility for regulatory management oversight in 2008, it has begun to build a stock management system, made up of initiatives including:

- best practice regulation assessments of key regulatory regimes: the Treasury has developed best practice regulation principles and its assessment of 56 regimes (New Zealand Treasury, 2012a, p. 1)

against them has suggested that growth impact and regulator capability are the aspects of regimes requiring most focus (Offices of the Ministers of Finance & Regulatory Reform, 2013a, annexure);

- ongoing regulatory scanning of existing Legislative Instruments, to identify where there are performance issues in the regulatory stock (Offices of the Ministers of Finance & Regulatory Reform, 2013b, p. 2): the initial scan undertaken in 2010 revealed that a number of departments were not aware of the regulations for which they were responsible and few had actively monitored the operation of the legislation (Gill & Frankel, 2013, p. 19);
- yearly regulatory plans of expected new regulation, or reviews of existing regulation; and
- a Regulatory Review Programme, being driven by eight agencies (Department of Internal Affairs, Inland Revenue Department, MBIE, Ministries for the Environment and Primary Industries, and Ministries of Health, Justice, and Transport (17 reviews have been completed).

In a related policy development, Cabinet has also placed the burden on departments to keep up to date the regulatory regimes for which they are responsible. Departments are expected, for example, to:

- monitor, and thoroughly assess at appropriate intervals, the performance and condition of their regulatory regimes to ensure they are, and will remain, fit for purpose;
- be able to clearly articulate what those regimes are trying to achieve, what types of costs and other impacts they may impose, and what factors pose the greatest risks to good regulatory performance;
- have processes to use this information to identify and evaluate, and where appropriate report or act on, problems, vulnerabilities and opportunities for improvement in the design and operation of those regimes; and
- maintain an up-to-date database of the Legislative Instruments they have policy responsibility for, with oversight roles clearly assigned within the department (New Zealand Treasury, 2013f, p. 6).

Treasury guidance advises departments about the information they will be required to provide in their yearly regulatory system report, about how they are meeting these expectations. The Government intends to develop more specific expectations over time. However, it recognises that it will take some time for departments to develop the revised capabilities, frameworks and information systems needed to develop a “more systematic, comprehensive life-cycle approach to the management of existing regulation” (Offices of the Ministers of Finance & Regulatory Reform, 2013b, para 15).

The Government is implementing other initiatives to lift performance, which may encourage more focus on evaluation, including:

- upgrading and expanding the regulatory component of the PIF;
- the Better Public Services reform agenda, mentioned above, which opens up an opportunity to integrate regulatory management frameworks and processes within wider state sector management thinking and practice; and
- changes to the State Sector Act 1988 to recognise that chief executives have explicit stewardship responsibilities that include the legislation that their departments administer.

## Departments are testing interesting initiatives

Individual departments are undertaking initiatives to manage their existing regulations more effectively.

MBIE, for example, is trialling:

the use of a form of ‘Statements of Intent’ for regulatory systems, which formally sets out the expected outcomes or objectives of the system and the contributions that different parties are expected to make to those objectives, and monitoring of the performance of regulatory systems against those Statements of Intent and key indicators. This would include using this tool to work with Crown Entities to monitor performance of regulatory outcomes. (sub. 52, p. 6)

Some benefits are noted below.

- Better coordination between the components of a regime (such as policy departments and crown entities). This is likely to be of particular benefit in distributed regimes (ie, where implementation roles are allocated across a number of agencies), in regimes where agencies have overlapping roles, and in regimes where local authorities play a significant role in implementation.<sup>85</sup>
- Identification of areas where regulatory maintenance may be needed (MBIE, sub. DR 104, p. 9).
- As suggested by the Treasury and State Services Commission, regime-level reporting may prompt a different type of discussion about regulatory performance than would occur with reporting on an entity basis. Entity reporting is less likely to prompt a “look at the costs imposed on those being regulated, the nature of the regulated population and its capability and willingness to comply, the nature of the regulatory strategy being pursued, the regulatory outcomes achieved or experienced (including unintended effects); or the potential need to revise the regulatory approach” (sub. DR 97, p. 6).

MBIE is currently trialling the “SOI /charter” concept in the workplace health and safety and employment relations and standards regimes, following reviews of both systems. It intends to roll out the approach more widely, once individual regimes have been assessed (MBIE, 2014). Box 14.3 describes MBIE’s proposed approach.

#### Box 14.3 MBIE’s regulatory statements of intent (SOIs)/charters

Each regulatory system SOI /charter will:

- reinforce shared ownership for the regulatory systems between policy setters and the deliverers of regulatory systems; and
- treat each regulatory system as a living system, where there is good knowledge of how the system is performing, based on good information flows, and the system is able to respond to issues quickly.

This approach will involve:

- setting out a vision for a system’s objectives and the outcomes that the system aims to achieve;
- providing role clarity for regulatory actors, which will involve:
  - describing how different parts of the system are expected to contribute and how success will be measured;
  - describing the relationships or dependencies between the parts of the regulatory system, from policy through operational policy and other elements of the system responsible for a comprehensive compliance strategy;
- placing expectations for the system within a broader environmental context;
- describing the trade-offs or risks that are part of the system, and the plan for monitoring and responding to them;
- describing how we will know if and when the system’s outcomes are being achieved, including efficiency and effectiveness measures; and
- describing choices made in relation to the funding of the system and the rationale for choices to invest in one part of the system over another; and

<sup>85</sup> The Commission concluded in its inquiry into local government regulation that the level of engagement between central and local government over regulatory matters was poor (NZPC, 2013a).

- identifying risk factors that need to be monitored to ensure that the system is not prevented from achieving its objectives.

Source: MBIE, 2014.

## Other options have been considered as well

Other initiatives have been considered or are still being considered.

- MBIE has developed a process for Regulatory System Bills, which will “provide a regular vehicle for the maintenance and continuous improvement of regulatory systems administered by MBIE” (sub. DR 104, p. 2).
- The Treasury, in a RIS prepared in 2011, outlined a package of proposals, including investigating a substantive new review role for an Officer of Parliament, which would “provide the House with the sort of expert, independent oversight on legislation that the Auditor-General provides on government spending” (New Zealand Treasury, 2011a, p. 26). Alternatively, rather than setting up a new Officer of Parliament, the mandates of existing Officers of Parliament, such as the Auditor-General, could be revised to include more regular investigation and reporting to Parliament on the regulatory questions (Gill & Frankel, 2013, p. 33).
- Cabinet has agreed to legislative disclosure requirements, which will place additional obligations on departments proposing new legislation. An early discussion paper suggested that the disclosure statement for *delegated* legislation should disclose when this legislation will be formally reviewed, or is expected to warrant review, to ensure it is still needed and remains fit for purpose (New Zealand Treasury, 2012b, p. 31). It also proposed that the minister responsible for the enacted bill should commission an independent review of the performance of existing executive government processes and requirements intended to support the development and maintenance of high-quality, fit-for-purpose legislation (New Zealand Treasury, 2012b, p. 32). These proposals were, however, omitted from the subsequently released technical guide for departments (New Zealand Treasury, 2013a).

## And there are many other possible options

Figure 14.4 suggests that New Zealand has been wise to avoid broad-brush options such as red tape targets, regulatory budgets and “one-in-one-out”. However, other options that might be worth exploring include:

- a stocktake of existing regulation;
- embedding ex post review requirements in new legislation;
- requiring any RIS to consider related regulations; and
- requiring any RIS to set out an evaluation strategy.

## Overall

While many initiatives are being used to improve the management of the stock of regulation, there appears to be no framework that requires systematic review of regulatory regimes. A survey published in 2013 (although the research was undertaken earlier) concluded that New Zealand had no systematic and well-defined process to learn about regulation through monitoring, review and evaluation, and describes the approach as “at best a patchwork” (Gill & Frankel, 2013, p. 1). The survey also concluded that, while there are a plethora of potential reviewers in New Zealand, some significant gaps remained:

Other than ad hoc reviews, and the role of researchers in analysing reviews and writing articles, there are few mechanisms to learn about the effectiveness of regulations in contributing to achieving near term impacts and final goals. Unlike comparable Westminster jurisdictions, there is no requirement for programmed reviews of existing regulations nor has there been a concerted effort to increase the supply of evaluative evidence to enable more evidence based policy decisions. ... the formal

requirements for review of existing regulations are limited relative to other comparable jurisdictions and underdeveloped relative to the provisions applying to new regulations. (Gill & Frankel, 2013, pp. 24-25)

Vector considers that the current approach involves considerable risks:

A key problem in New Zealand at present is that there is no process that enables or ensures regulatory regimes are subject to ongoing and regular review of the extent to which they are meeting their policy objectives. Accordingly, under the status quo, there is a real risk that regimes can continue to operate in a suboptimal way for considerable periods. While the importance of review of the effectiveness of regimes is set out in a recent Cabinet paper, this in itself does not appear to have addressed the issue. Rather, the question of whether or not there is a follow-up of regimes turns on political will and / or officials' work load. We consider this is one of the most important and concerning issues identified in the draft report.

The challenge is to find an effective mechanism for ensuring that regular review becomes an inbuilt part of New Zealand's regulatory environment. (sub. DR 98, pp. 5-6)

The Government is in the early stages of implementing a diverse agenda for keeping regulatory regimes up to date. Cabinet's expectations require departments to devote more attention to this issue, and the Treasury is performing a key role by developing initiatives in a stock management system. However, while the increased policy effort is welcome, the Commission considers that options for building up and focusing this effort should be carefully considered.

#### F14.1

The New Zealand Government is implementing a suite of initiatives to improve the management of the stock of legislation and regulation. It does not use many of the approaches to system-wide evaluation of regulatory regimes that are used in other countries, some of which have been identified as involving low effort and potentially low/high return in those countries.

## 14.5 Improving how the stock of regulation is managed

Better management of the stock of regulation can be achieved by:

- coordinating complementary approaches;
- strengthening incentives for departments to improve their management of the stock;
- improving evaluation capability;
- building on new initiatives that are being trialled; and
- articulating more clearly the overall stock management strategy.

### Coordinate complementary approaches

As noted above, the PCO's submission provided a 13-page chronology of initiatives that have been used to improve the scrutiny of regulation. For the future, the PCO suggested that three different approaches could be used to review the stock of legislation, each of which has advantages and disadvantages.

- *Option 1: Increase the role of Parliament.* Parliament could give select committees the authority to review legislation in their areas or assign a general responsibility for review to a new select committee.
- *Option 2: Build on existing initiatives.* This option provides time for existing initiatives to take root. This includes a revision programme required under the Legislation Act 2012, which is aimed at eliminating obsolete, redundant, and inconsistent laws but has a restricted scope in terms of re-stating laws and not reforming badly designed underlying legislative and regulatory regimes. The Legislation Act will be reviewed, allowing an evidence-based assessment of the programme, which can be used to adjust its requirements and supporting powers.

- *Option 3: Implement a new initiatives system.* Each administering agency could regularly review those enactments with a view toward improving the stock of regulation. They could use this work to inform ministerial decisions and drafting instructions. Consideration could also be given to requiring agencies to report regularly on their reviews to Parliament. (sub. DR 88, pp. 26-30)

The PCO notes that even Option 1 would “rely heavily on the executive”. So this chapter focuses on how the role of the executive in managing the stock of regulation might be enhanced. The role of Parliament is discussed in Chapter 16. The initiatives to improve the stock of regulation that are being led by the Treasury need to build on and work with others already under way, such as under the Legislation Act 2012, or with new initiatives that might be implemented should Parliament decide to implement options such as those in the PCO’s first option.

## **Strengthen incentives for departments to perform in line with Cabinet expectations**

The Treasury (2013e) has “speculated” that 100 of New Zealand’s 200 core regulatory regimes “warrant regular monitoring/reporting and better periodic review/maintenance” (p. 16). With so many possible candidates for review, a process is required that sets out accountabilities for ensuring that any regime is reviewed, is cost effective, and focuses effort where it can add most value. The current approach does not appear to do this effectively.

A theme throughout the report has been that having clearly defined roles and responsibilities is a prerequisite for getting things done. This is no less important in relation to managing the stock of regulation:

The first and crucial step to improving the contribution of monitoring, evaluation and review to regulatory effectiveness is to establish a much clearer statement of the roles and responsibilities of departments administering legislation and regulation. This would be analogous to [the] role [of departments] in the maintenance and care of physical assets on the agency’s balance sheet or the assets that they are administering on behalf of the Crown. ... Without this role clarity other areas, where standards and expectations are clearer, will continue to gain resources and attention. (Gill & Frankel, 2013, p. 30)

To this point, Cabinet has set out broad expectations of what departments will do, while indicating that these expectations will become more precise over time. Cabinet has placed the burden on departments to keep up to date the regulatory regimes for which they are responsible, and anticipates providing more specific expectations about how to do this over time. The approach relies on persuasion rather than obligation, except for a requirement that departments report yearly on how they are meeting these expectations.

An advantage of this approach is that departments that willingly become involved in managing the stock of regulation, because they consider this is important, will do so more effectively than if they are motivated purely by obligation. The downside of relying on persuasion is that some departments that have many competing responsibilities may pay only “lip service” to the expectations of Cabinet.

The Commission was concerned to learn that not all departments responded to the Treasury’s request for information for the Regulatory Systems Report or consistently prepared regulatory scans and plans. This constrains the ability of the centre to prioritise efforts and identify risk. If the Government’s regulatory stewardship expectations are to have their full effect, non-compliance needs to carry consequences.

The Treasury commented that its

... approach to the development and extension of the regulatory management system has been one of cautious experimentation and learning – trying new tools and then seeking to adjust or adapt them as we go. With the recent introduction of the government expectations for regulatory stewardship, our aim is to increase our engagement with departments on discharging their role as stewards of regulatory regimes, and work more closely with them to further develop our current regulatory management tools in ways that are better tailored to departmental circumstances. (sub. DR 97, p. 1)

An analogy can be drawn with other forms of regulatory practice. In a transition or “bedding in” phase, some degree of flexibility and experimentation can be helpful, as both the regulator and regulated parties try to understand their respective roles and responsibilities. At some point, however, a firmer stance has to be taken. Like other forms of regulation, the regulatory management system cannot rely on goodwill and good relations alone; if it does, it is unlikely to achieve the objectives expected from it. Expectations on departments, and penalties for non-participation, need to be strengthened.

The challenge is to design a framework that has sufficient force to bring in those who otherwise may not become involved, while not becoming so coercive that it undermines genuine commitment from those who would otherwise participate willingly. There are a series of options that involve progressively more specific obligations. It is a matter of judgement as to which of these options will be most effective.

A first option is to strengthen reporting obligations. Treasury is already attempting to collect information about the performance of departments in meeting Cabinet’s expectations, in the Regulatory Systems Reports. While the quality of this information will improve as Cabinet’s expectations become more precise, even now the Reports’ impact on strengthening the motivation of departments would increase if they were published. MPI supported publication (sub. DR 102, p. 22). Depending on the amount and quality of information in these reports, publishing them within the public sector would enable departments to learn how others are meeting Cabinet’s expectations, while also providing incentives for lagging departments not to fall further behind the leaders. If the reports were more widely available to the general public, this would enable stakeholders affected by regulatory regimes to assess the actions being undertaken to modernise these regimes and to apply pressure if the actions appear deficient.

A second option is to link evidence on performance revealed in the Regulatory Systems Reports to chief executive performance agreements. How effectively this would increase the priority that departments attach to managing the stock of regulation would depend on factors such as the quality of the information in the reports; the extent to which that information can be meaningfully linked to the agency’s performance; and the weighting given to this issue compared to others for which the chief executive is responsible.

A third option is to require departments to explain their strategy for achieving Cabinet’s expectations in their SOIs. This could add an additional incentive to that provided by the publication of the stewardship reports in so far as the SOIs are subject to audit by the Office of the Controller and Auditor-General (OAG).

A fourth, and more far-reaching, option involves creating a legislative requirement to review regularly the performance of regulatory regimes, supported by a new dedicated unit to ensure that reviews of regulatory regimes are undertaken effectively. This option could be implemented in different ways. In its submission, Vector outlined in detail one way this might be achieved (Box 14.4).

A legislative framework of the type suggested by Vector would institutionalise Cabinet’s request to departments to review and keep up to date the regulatory regimes for which they are responsible. The objectives of the legislation could be modelled on the Cabinet’s expectations, as set out above, to:

- achieve regulatory regimes that are, and will remain, fit for purpose; and
- provide information about the types of costs and other impacts they may impose, and about the greatest risks to good regulatory performance.

To achieve these outcomes, departments could be required to have processes that reflect Cabinet’s expectation to identify and evaluate, and where appropriate report or act on, problems, vulnerabilities and opportunities for improving the design and operation of those regimes; and to maintain an up-to-date database of the Legislative Instruments they have policy responsibility for, with oversight roles clearly assigned within the department.

#### Box 14.4 A legislative framework

Vector proposes a staged approach, beginning with a preliminary high-level assessment, to identify areas requiring deeper analysis. There should also be scope for these regular reviews to be brought

forward for particular regimes if evidence is presented of problems with them.

To give effect to this review process, Vector recommends:

- enacting a legislative framework setting out high-level principles; and
- establishing a dedicated unit, which would be responsible for:
  - developing guidance and processes for effective review, evaluation and monitoring of regimes (possibly mandated as a requirement under legislation);
  - ongoing oversight of reviews of regimes and monitoring of regulatory performance;
  - undertaking reviews and monitoring the performance of regulatory regimes (or, at least, of those regulators or regimes identified as the most critical in terms of economic growth, public safety, etc); and
  - considering and investigating serious issues raised in connection with the operation of regulatory regimes (independent of the regulator or the regulator’s policy agency) – in particular it could consider whether decisions are being made consistently with the policy underlying the regime.

*Source:* Vector, sub. DR 98.

Table 14.4 summarises the advantages and disadvantages of the four options against the current situation. The Commission’s judgement is that the advantages of publishing regulatory system reports outweigh the disadvantages. It also considers that departments should outline their strategies for managing the stock of regulation in their SOI, and indeed expects that they would do this anyway given the importance that Cabinet has attached to this issue. At this stage, it is less clear that there would be net benefits from linking departmental performance in this area to chief executive performance agreements, or that legislation is needed. However, given the importance of better management of the stock of regulation, these options could be considered should there be evidence that the other options are not being effective after a reasonable period, say three years, as indicated by a review of progress that the Government should commission.

**Table 14.4 Use of system-wide approaches to evaluation in New Zealand**

Approach	Advantages	Disadvantages
Status quo	Encourages dialogue with departments Encourages long-term commitment from some agencies	Weak incentives for engagement by reluctant agencies
Publication of regulatory system reports	Encourages spreading of good practice and competition between departments	
Link departmental performance to chief executive performance agreements	Additional incentive to improve management of stock of regulation	Depends on capacity to link progress to agency performance and on weighting of this issue in the chief executive’s contract
Statement of intent	Additional incentive to improve management of stock of regulation, because of scope for audit by OAG	
Legislative framework	Clarifies and strengthens obligations	Compulsion may undermine ownership Would take time to develop Legislation can build in inflexibility

**R14.1**

The Government should:

- publish the regulatory system reports prepared by departments;
- require departments to articulate in their Statements of Intent their strategies for keeping their regulatory regimes up to date;
- within three years, commission a review of each department's progress and seek advice from that review about whether it is necessary to create a legislative framework or new mechanisms for managing the stock of regulation.

## Focusing review effort

Satisfying Cabinet's expectations will require reviews of regulatory regimes. There are so many of them, however, that it will not be feasible to review them all. Vector suggested that the process for regular review of regulatory regimes could include:

- reviews occurring either as part of a regular review cycle, or where a review is brought forward as a result of credible indications that a regulatory regime is not achieving or is not likely to achieve its underlying policy objectives;
- as a first step, the agency/unit considering the policy underlying the legislation and undertaking a preliminary assessment of
  - whether the regime is meeting those objectives; and
  - whether decisions are being made that are consistent with the policy intent underlying the regime (if no issues are identified, the review process would cease at this point, until the next regular review);
- if the preliminary assessment identifies issues, then the agency seeking to identify their cause and identify potential solutions; and
- depending on the issues identified, the agency then issuing a review paper and seek input from stakeholders, or in some cases considering whether to escalate the review further; for example, to a dedicated taskforce (sub. DR 98, pp. 7-8).

Vector also suggested a set of principles that could be developed for determining when regulatory arrangements or regimes should be reviewed, including:

- their impact on New Zealand's productivity;
- the length of time that they have been in place;
- design elements that were novel or untested;
- where there is a reason to be concerned that the policy objectives are not being implemented as intended;
- where the institutional design has not been reviewed over the last 10 years (despite new functions); and
- where there are existing issues with the institutional design in terms of potential conflicting roles (Vector, sub. DR 98 pp. 8-9).

These principles are similar to ones that the Commission set out in the draft report:

- width of reach (number of entities and/or value of activity affected);
- depth of reach (the extent to which entities are affected);
- information that the issue is critical for stakeholders; and

- any other information that a regulation is imposing large costs.

MBIE noted in its submission that that reviews of regulatory systems can become too wide-ranging. MBIE is therefore

exploring the idea of an “80/20” rule of thumb over what proportion of regulatory systems are stable and enduring, compared to being regularly updated to allow the flexibility at the margin to respond to issues and pressures that emerge over time. We expect that providing for a core of systems that are stable and enduring would provide significant benefits to government, business and other stakeholders, by providing greater certainty about core obligations while maintaining systems to avoid the costs of regulatory failures. (sub. DR 104, p. 10)

The Commission’s view is that there is a strong case for a clearly articulated review process that combines both breadth and depth to keep regulatory regimes up to date. Breadth could be provided through broad scans of regulatory regimes to identify potential problem areas. Depth could be provided through detailed exploration of these identified areas.

The costs of undertaking reviews of regulatory regimes could be large. Reviewing a large and complicated regime could be equivalent to one of the larger inquiries undertaken by the Commission. A Commission review typically involves salary and overhead costs exceeding \$1 million, as well as the costs faced by stakeholders who engage with the inquiry process. Smaller reviews of simple regulatory regimes may have significantly lower costs.

The Government can constrain the costs of this process in several ways, including those noted below.

- The Government could apply principles, such as those identified above, to encourage departments to focus effort on reviews that have the largest anticipated benefits.
- The Government could set up an ongoing preliminary assessment process to identify areas requiring attention. These assessments could be undertaken by the responsible departments, or by a central department or even by a new agency. The reviews of regulators (discussed in Chapter 13) may suggest potential problem areas that preliminary assessments might consider.
- The Government could cap overall yearly expenditure on reviews, or set a target number. These measures are blunt, but would help to force identification of the reviews with the largest potential benefits.

The review process could be managed entirely by the portfolio departments; could be coordinated by a central agency and delivered by departments; or delivered by a central agency. The advantages and disadvantages of these options are discussed in Chapter 16.

## R14.2

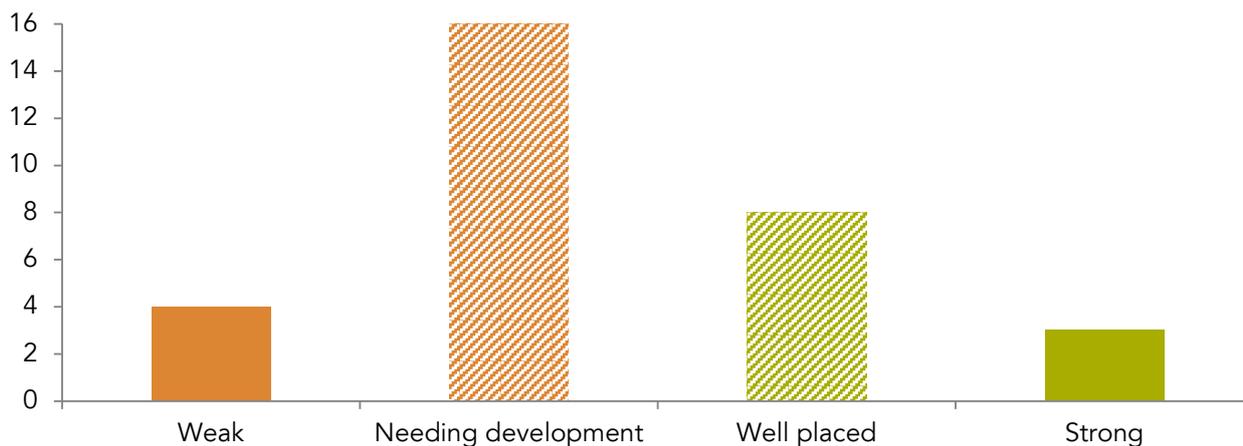
The Treasury should:

- articulate a set of principles to encourage departments to focus effort on reviews that have the largest anticipated benefits;
- set up an ongoing preliminary assessment process to identify areas requiring attention (these assessments could be undertaken by the responsible departments, or by a central department or even by a new agency); and
- specify targets such as overall yearly expenditure, or a target number of reviews, to force identification of the reviews with the largest potential benefits.

## Improve evaluation capability

If the Government chooses to expand the evaluation of regulatory regimes, it will need to build up the capability to undertake such evaluations. PIF reviews of departments in New Zealand indicate that most agencies are weak or need development in this area (Figure 14.5).

**Figure 14.5** How well do 31 government agencies monitor, measure, and review their policies, programmes and services to make sure that they are delivering their intended results?



*Source:* Analysis of 31 Performance Improvement Framework reviews of government agencies. Reviews are available at [www.ssc.govt.nz/pif-reports-announcements](http://www.ssc.govt.nz/pif-reports-announcements)

Some departments already have evaluation units, and others may need to develop them. MPI pointed out that sharing experience and expertise can also be useful:

It would be useful to have forums where experience can be shared so that each agency does not need to reinvent the wheel, eg, it would be useful for us to know how MBIE has worked through the issues raised by the outcomes-based regimes in building and workplace health and safety so that other regulators have the benefit of these lessons.

We note that there are already some forums for discussion of approaches to evaluation. Government evaluators participate in two-way dialogue about good-practice evaluation of regulation through various international evaluation associations, conferences etc; and in some areas New Zealand is considered a leader. In addition, informal evaluation-related coordination and information-sharing already occurs across government. For instance, the Natural Resources Sector, MBIE and SuPERu have regular network forums or projects that share best-practice information, experiences, and resources around evaluating government activities. (MPI, sub. DR 102, p. 23)

### Build on new approaches

MBIE's trialling of SOI /charters of regulatory regimes is described above. While there will be scope to learn from these trials (for example, it is not clear how the proposed approach gathers the perspectives of regulated parties, and it could duplicate existing accountability documents, such as annual reports), the approach could increase knowledge of how well regimes are performing. There could also be benefits to the centre from:

- a more complete picture of performance that can feed into system-level monitoring, and
- better sources of information to identify regimes requiring review.

The question of where and whether SOIs /charters should be applied is best left to ministries and implementing agencies. The largest benefits from this approach are likely to lie in regimes that are very complex and/or that involve a number of actors (eg, distributed regimes). These could be the priority for the roll-out of SOIs /charters beyond the first two trials or outside MBIE.

MBIE's trial of SOIs provides an opportunity to test the concept and iron out issues. Once the first two statements have been completed, MBIE and the Treasury should evaluate the process, with a view to providing guidance to other policy ministries.

**F14.2**

Developing charters or Statements of Intent for individual regulatory regimes could be beneficial, especially if the process:

- actively involves all the agencies involved in the administration and implementation of the regime;
- clearly outlines the relative roles and responsibilities of each agency;
- identifies measures of success and risk factors to be monitored; and
- considers the environment within which regulation takes place, especially the regulated community and the costs imposed on them.

**R14.3**

Once the Ministry of Business, Innovation and Employment (MBIE) has completed the development of Statements of Intent/charters for the workplace health and safety and employment relations regimes, the Treasury and MBIE should evaluate the process, with a view to:

- identifying any areas for improvement; and
- providing guidance about the model to other policy ministries.

## Improve the articulation of the overarching stock management strategy

The large number of initiatives for improving how the stock of regulation is managed has been set out in a series of information releases. For example, recent Cabinet papers provide an update on the current state of knowledge of regulatory design and implementation in New Zealand and proposed new initiatives to continue to improve New Zealand's regulatory environment and performance (Offices of the Ministers of Finance & Regulatory Reform, 2013a; 2013b). These papers, and a series of other Cabinet papers and minutes available on the Treasury's website, are informative and useful, but are not pitched at the general reader.

There are many initiatives, and the Commission's recommendations in this chapter would add to them. The Government could usefully provide a more accessible overarching paper that articulates the overall objective of the strategy that the Government is implementing, explains how the initiatives work together to achieve this objective, identifies the resources that will be deployed to implement the strategy, and explains how its success will be measured and will benefit the community. MPI suggested that the Government's 2013 *Initial Expectations for Regulatory Stewardship* is the starting point for such a framework and that these were further elaborated in the Regulatory Systems Report and the Treasury assessment of the responses to that report.

There would be value in Treasury bringing these together into clear statements of what is expected at each stage of the regulatory cycle, so that there is clarity about what quality regulatory stewardship looks like and what departments should aim for. This would ideally be done in consultation with regulatory departments. (sub. DR 102, p. 22)

The main audience for this strategy paper may well be within the public sector, as it could provide a useful way of articulating the "big picture" within which the Government is expecting the public sector to implement the various initiatives. It would also, however, be of use to sections of the business and wider community and would help to build their support for the policy.

Chapter 16 recommends that the minister responsible for the regulatory management system overall should publish a strategy report that sets out Government's medium-term objectives for the system, its strategic prioritisation of effort for achieving these objectives, and its work programme. The minister should report regularly on progress towards delivering this work programme, and update the statement as necessary. The

proposed strategy on how to manage the stock of regulation could be published as part of the broader strategy report for the overall system.

**R14.4**

The Government should publish an overarching strategy that sets out how it will improve the management of the stock of regulation. The strategy should explain how specific initiatives fit within it, and should describe how successful implementation of the strategy will be measured and how it will benefit the community.

## 14.6 Conclusion

New Zealand has a large and rapidly growing stock of legislation. Keeping it up to date is an important task for the Government. There is a history of initiatives intended to achieve this, but evidence also that more needs to be done. The current approach is light-handed and broad, and could be enhanced through more focus and stronger drive from the centre. Chapter 16 discusses how this might be achieved.

# 15 Information to understand and manage the system

## Key points

- The volume and complexity of the stock of regulation in New Zealand poses challenges to people wanting to understand what their regulatory obligations are, and for the centre (ministers and central agencies) to manage the system. Tools are needed to help people navigate the stock and for the centre to effectively govern the system.
- The absence of a central electronic repository of Other Instruments (also known as “tertiary” or “deemed” regulations) constrains the ability of firms and individuals to understand their regulatory rights and obligations. Parliamentary Counsel Office should expand their New Zealand Legislation website to provide a single, comprehensive source of these regulations.
- Tools to assist the centre to better manage the regulatory system need to:
  - be set at the right level to most effectively identify areas of risk or weakness and enable appropriate interventions; and
  - acknowledge that regulatory agencies already produce significant amounts of information, and either fill gaps in existing provision or make better use of current data.
- Central agencies do not need to develop or maintain a deep understanding of the institutional arrangements and regulatory environment for 200 different regimes to govern the system. They should instead look to identify areas where they have a comparative advantage (eg, provision of public goods, coordination and facilitation between agencies) and ensure that the key actors in the regulatory system – especially policy departments and the boards of Crown entities – properly carry out their duties and obligations.
- The Commission considered creating maps or typologies of regulators and regimes, standardised reporting obligations and a framework for assessing the health of the system overall. Of these options, the last appeared to have the greatest potential, in that it would allow central agencies to assess how well the regulatory system is delivering proportionate and necessary regulation, prioritised regulatory effort, adequate resourcing of implementation, fair and effective implementation and self-aware and adaptive regulatory organisations.
- The Treasury has already begun collecting information from departments on the performance of the system. This work would be strengthened by making greater use of information from external and independent sources, and by focusing more on the outputs and outcomes of departmental processes.

## 15.1 Introduction

As discussed in Chapter 14, New Zealand has a large and complex regulatory stock. This has implications for the effectiveness of regulatory regimes, the ease with which regulated parties can understand their obligations, and the ability of overseers to assess the performance of regimes and regulators. This chapter considers options to improve the comprehension and management of the regulatory system.

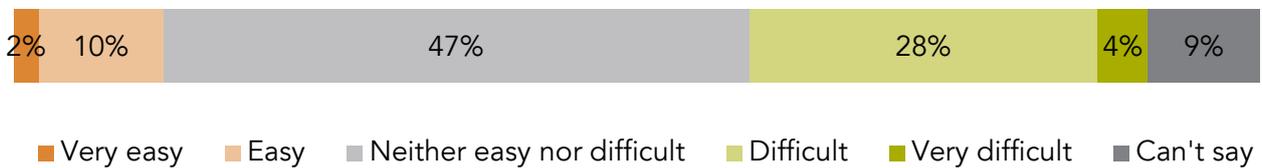
## 15.2 Better information for regulated parties

A core principle of the rule of law is that the law must be accessible. If regulation is to impose penalties, rights or obligations, it is important that affected individuals and firms are able to find out and understand what they are. Accessibility also matters for commerce, as Bingham (2010) observed:

The successful conduct of trade, investment and business generally is promoted by a body of accessible legal rules governing commercial rights and obligations. No one would choose to do business, perhaps involving large sums of money, in a country where the parties' rights and obligations were vague or undecided. (p. 38)

Responses to a survey of businesses suggested that understanding regulatory requirements in New Zealand can be challenging and time-consuming for some firms. Of the businesses surveyed, 32% said that keeping up to date with regulation was either "difficult" or "very difficult", while 12% believed it was "easy" or "very easy" (Figure 15.1).

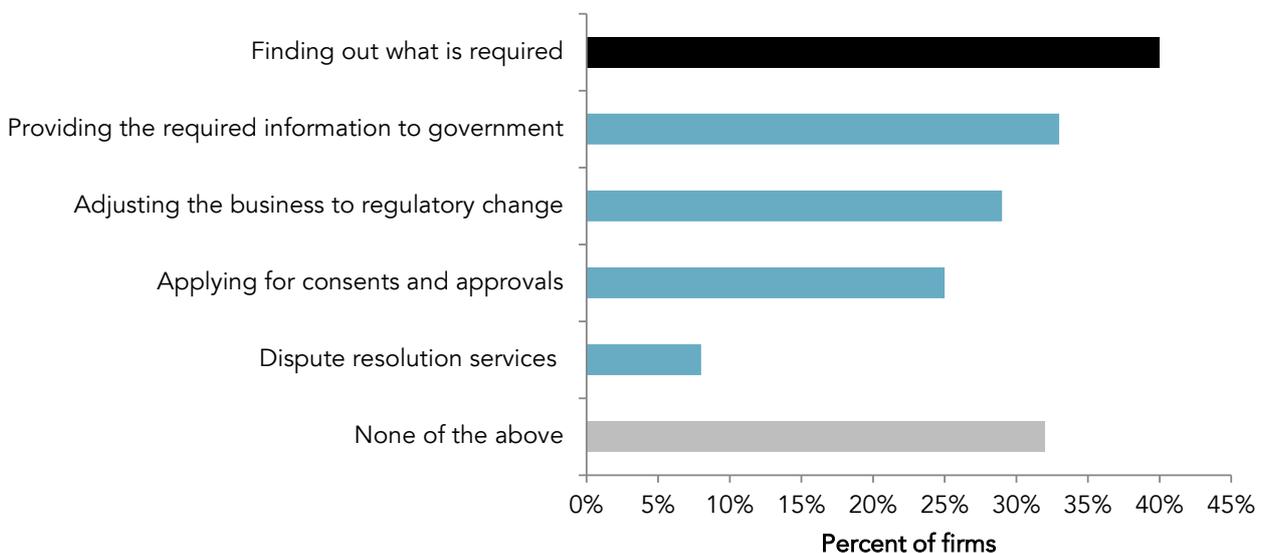
**Figure 15.1 Perceived difficulty keeping up to date with regulation**



Source: Statistics New Zealand, 2013.

A large and complex network of regulation also adds costs to firms and the economy. Of the 1,526 firms surveyed for the Commission, 40% reported that they had spent "significant time and resources" finding out what their regulatory requirements were (Figure 15.2). The proportion rose to 53% for firms in the financial and insurance services sector, and firms with yearly turnovers above \$100,000 were more likely to report spending time discovering their regulatory obligations.

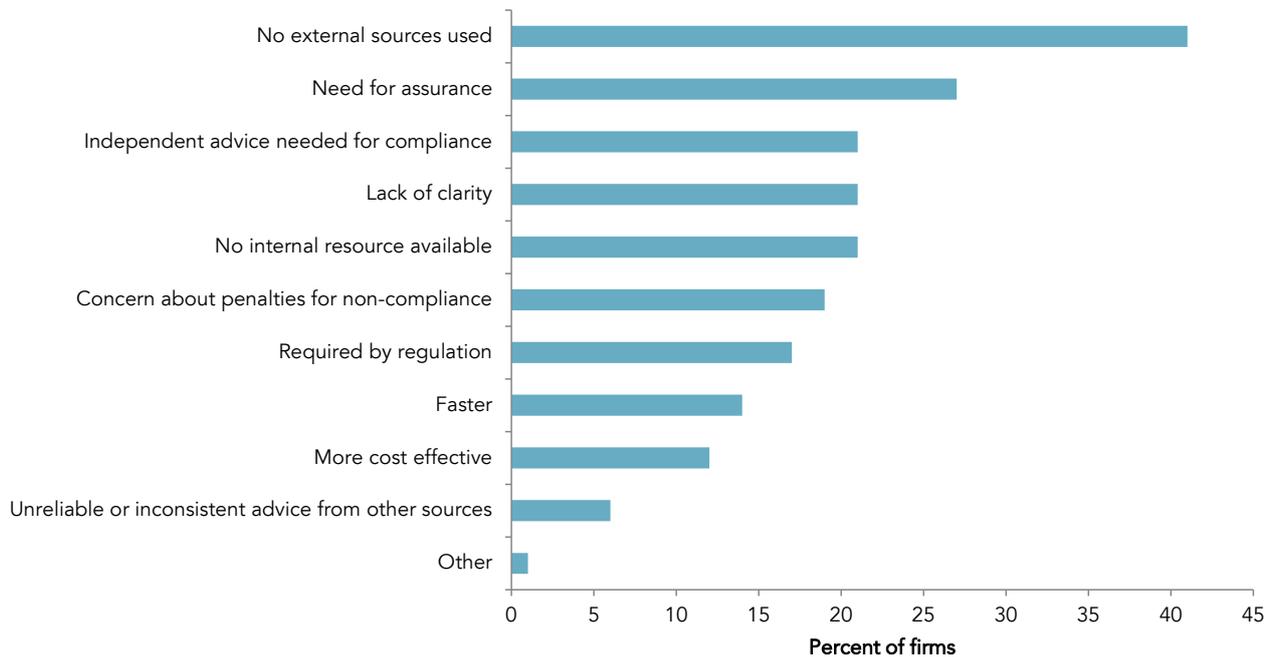
**Figure 15.2 Regulatory requirements that businesses spent significant time and resources on in past two financial years**



Source: Productivity Commission; Colmar Brunton.

In some cases, firms may need to pay others to understand their obligations. Of firms surveyed for Statistics New Zealand's 2012 Business Operations Survey, 59% reported using some form of external advice to understand how to comply with regulation (Figure 15.3).

**Figure 15.3** Reasons for using external sources of advice on compliance with regulation



Source: Statistics New Zealand, 2013.

### Better access to tertiary regulation is needed

Changes at the level of both regulatory practice and design would help improve the ability of regulated parties to more easily navigate the regulatory stock and to comply. Much of the responsibility for taking action on these fronts lies with policy departments and other regulatory agencies. A number of findings and recommendations in this report will lead to longer-term improvements in performance, such as better communication with those affected by regulation, greater transparency about regulatory policies and processes, clearer and more coherent legislative frameworks, and more regular updating of regulatory regimes.

But there are short-term steps that could be taken to improve accessibility. One key contribution would be to improve the collation and presentation of tertiary regulation (ie, regulations made by agencies under delegated authority).

Since 2008, the Parliamentary Counsel Office (PCO) has published statutes on its New Zealand Legislation website ([www.legislation.govt.nz](http://www.legislation.govt.nz)). The website currently includes all:

- public, private, local, imperial and provincial Acts in force;
- all amendment Acts passed from 2008 onwards; and
- all legislative instruments passed from 2008 onwards.

As the Law Commission commented in 2008, the advent of the New Zealand Legislation website "is a great advance for accessibility of legislation" (Law Commission/PCO, 2008, p. 24). It significantly reduces search costs for firms or individuals wishing to understand their regulatory rights and obligations.

However, the New Zealand Legislation website does not currently include "Other Instruments". These were formerly known as "deemed" or "tertiary" regulations, and include rules and orders made by regulatory agencies. As noted in Chapter 14, the scale of such instruments can be significant; the Whey Protein Contamination inquiry found some 12,000 pages of tertiary instruments for the dairy sector alone (Government Inquiry into the Whey Protein Concentrate Contamination Incident, 2013, p. 31). "Other

Instruments” are also not covered by key regulatory management processes, such as the regulatory plans and scans discussed in Chapter 2.

Information about Other Instruments is distributed across a number of sources, such as regulator websites, making it harder for citizens and firms to locate and comprehend their requirements. This is particularly the case where firms are subject to multiple regimes.

The absence of a central repository for Other Instruments is a major gap that should be addressed. When the Law Commission considered the New Zealand Legislation website in 2008, it observed that the website could be built on in a number of ways, including the addition of “a register of legislative instruments (including deemed regulations)” along the lines of those run by Australian state, territory and the federal governments (Law Commission/PCO, 2008, p. 30). The Commission agrees, and considers that establishing a central electronic repository of Other Instruments should be a priority.

**F15.1**

The absence of a central electronic repository of Other Instruments constrains the ability of firms and individuals to access and understand their regulatory rights and obligations.

**R15.1**

The Parliamentary Counsel Office should expand the New Zealand Legislation website ([www.legislation.govt.nz](http://www.legislation.govt.nz)) to provide a central and comprehensive source of Other Instruments.

Expanding the New Zealand Legislation website so that it includes the full range of regulation would also open up “a range of new possibilities for utilising technology to improve access to that data. Electronic data can be searched and ordered by powerful search engines, and manipulated in ways that print information cannot” (Law Commission/PCO, 2008, p. 24). This may help not just with accessibility, but also with managing the regulatory system. An example of what can be achieved with electronic regulatory data is outlined in Box 15.1.

**Box 15.1 Measuring the stock of regulation – the Industry-specific Regulatory Constraint Database (IRCD)**

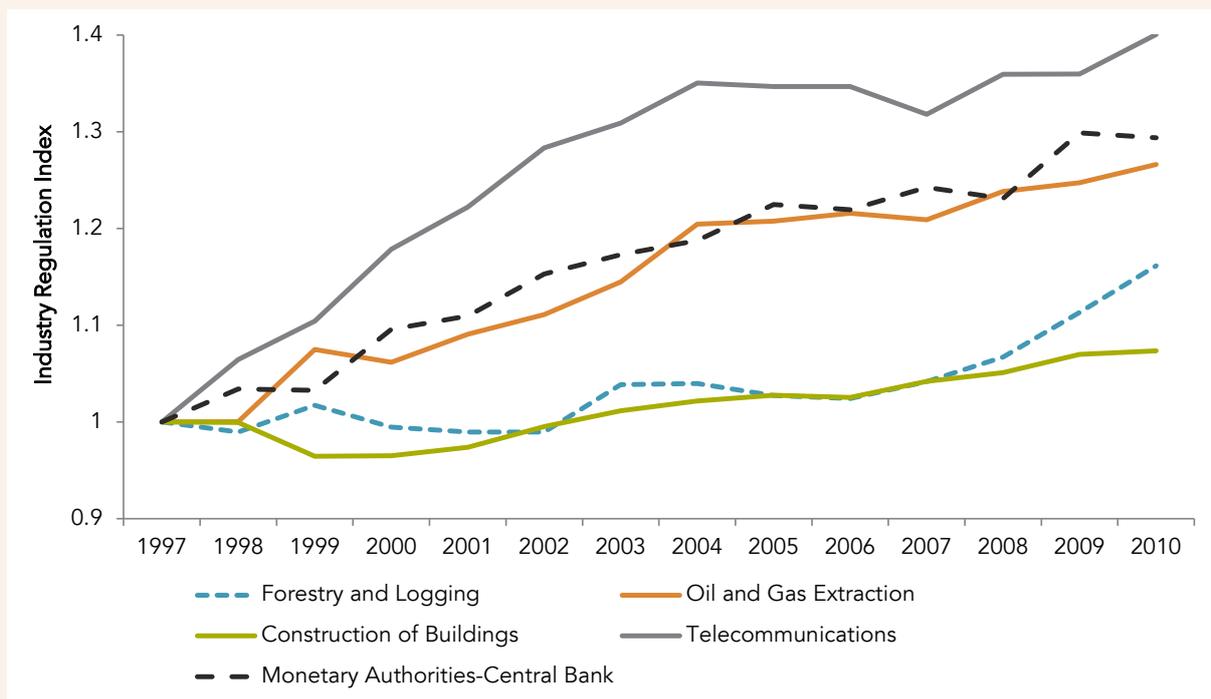
The IRCD has been developed by George Mason University (located in Virginia) to assist with assessing the stock of regulation in the United States. The database is constructed through text analysis of the US *Code of Federal Regulations* (CFR). The CFR is published by the US Government Printing Office each year and contains all regulations issued at the federal level in the United States.

The IRCD is based on the observation that regulatory texts typically use a relatively standard suite of verbs and adjectives to bind the legal choices of regulated parties (Al-Ubaydli and McLaughlin, 2013). For example, verbs such as “shall” and “must” and adjectives such as “prohibited” and “required” are commonly used to specify regulatory obligations.

George Mason University developed a computer program that counts the occurrences of these terms in the CFR published from 1997 to 2010. This count is used to measure the number of restrictions within the CFR. In addition, the program uses a text analysis to assess which industry is affected by the regulation. Industries are specified according to the North American Industry Classification System (either at the two-digit or three-digit level).

This data is then used to create the Industry Regulation Index (IRI), which provides information on how regulated an industry is at a given time compared to how regulated it was in 1997. The IRI is constructed so that it equals 1 in 1997. In subsequent years a number above than 1 would indicate that regulation has grown; a number below 1 would indicate that regulation has shrunk. An example of how the IRI can be used is below.

Figure 15.4 Regulatory restrictiveness trends in selected US sectors



The IRI can be accessed at <http://regdata.mercatus.org>

Source: Al-Ubaydli and McLaughlin, 2013.

### 15.3 Information for the centre

A large and complex network of regulation makes it difficult for ministers and central agencies to assess the overall performance of the regulatory system, identify areas where improvements are needed, or prioritise their efforts.

The Treasury and the State Services Commission (SSC) noted that, without additional tools to better understand the stock of regimes, there are likely to be:

...significant limits on the range of roles the centre can sensibly play in the development of better regulatory institutions and practices. Even if there was a lift in resourcing for regulatory management at the centre, we cannot hope to develop or maintain a deep understanding of the institutional arrangements and regulatory environment for 200 different regimes. (sub. DR 97, p. 5)

#### The need for an active centre

Monitoring and management of regulation is largely devolved in New Zealand. Under the “regulatory stewardship” expectations and recent changes to the State Sector Act 1988 and Crown Entities Act 2004, most of the responsibilities for overseeing regimes and regulators lies with policy departments and their chief executives.

In many respects, this approach makes sense. It reflects long-established constitutional arrangements for the state sector, under which ministers are responsible to Parliament for the performance of regimes, and there are strong vertical lines of accountability running from ministers, through departments and down to Crown entities and other arm’s length bodies. Portfolio departments are also best-placed to have detailed information about the environments within which individual regulators operate.

For the model to work at its best, however, there needs to be some central coordination and management. The vertical lines of accountability mean that individual policy departments have strong incentives to pursue the interests of their ministers and portfolios. With limited Cabinet and Parliamentary time available, some filtering or directing of effort is necessary, to ensure that the most pressing regulatory issues are dealt with first.

The effective and efficient operation of New Zealand's regulatory system depends on individual policy departments: fulfilling their responsibilities to conduct thorough policy analysis on new regulatory proposals; keeping a watching eye on their stock of regulation and reviewing regimes in need of repair; and monitoring the performance of regulatory Crown entity boards. The assessments earlier in this report (especially in Chapters 2, 13 and 14) suggest that some of these responsibilities are not being carried out well. Central agencies can and should look across the performance of individual departments in carrying out these responsibilities, and hold poor performers to account.

The devolved nature of the model also means that 'public good' activities and other opportunities to achieve benefits by cooperating may not be fully picked up. An active centre can help identify, coordinate and support activities that would be beneficial to multiple agencies. Similarly, individual departments are often not well placed to identify and resolve problems that stretch across multiple portfolios. Individual agencies may not be aware of what is occurring in other portfolios, and they may face considerable difficulties coordinating to convince their respective ministers to agree to necessary legislative or policy changes. Action by central agencies may be the most efficient response.

Finally, as will be discussed in Chapter 16, if the performance of the overall regulatory system is to be improved, one party – and, in particular, one minister – needs to have clear accountability for the system and the responsibility for setting the rules, priorities and strategies that guide and govern its efforts. Strong support from central agencies will be needed to help that minister carry out this responsibility.

For the purposes of this chapter, the issue is what sort of information would best help an active centre carry out the roles outlined above. Possible criteria include:

- **Targeting:** Central agencies have limited time and resources available to commit to system monitoring and maintenance, as can be seen in the Treasury/SSC comment above. Any additional information or tools need to be set at the right level, to most effectively identify areas of risk or weakness and enable appropriate interventions.
- **Efficiency:** Current accountability mechanisms – such as statements of intent, annual reports and estimates questionnaires for select committees – already require regulators to produce significant amounts of information. The challenge is therefore to either make better use of existing information or fill gaps in the existing information stock.

The following sections discuss three possible options:

- maps or typologies of regulators or regulatory regimes;
- standardised reporting of common regulatory indicators; and
- system-level indicators.

## Maps or typologies

As part of the Terms of Reference for this inquiry, the Commission was tasked with developing:

- "a high-level map of regulatory regimes and regulators across central government, including their organisational form"; and
- "a set of thematic groupings which can be used to broadly categorise regulatory regimes by their objectives, roles or functions" (paragraphs 6 and 7 in the Terms of Reference).

The Commission outlined two indicative groupings of regulators in its Issues Paper. The first group was based on the type of organisation carrying out regulatory functions (such as public service departments,

Crown agents, independent and autonomous Crown entities), and the other group was based on the broad subject area (such as economic, environmental, or social) that the regulatory regime covered (NZPC, 2013b, pp. 16-17). In the draft report, the Commission then laid out commentary from submitters on the maps and typologies, and described some alternative groupings prepared by submitters.

A number of submissions questioned the value of maps and typologies, noting that apparent high-level similarities did not always translate to the “coalface” and that, as a result, such groupings may lead to oversimplification or inaccurate conclusions.

The transport sector (e.g. rail, land, air, maritime) regulations are not homogenous to the extent that might be imagined. Civil aviation and maritime have broad similarities (e.g. similar international regulatory frameworks, broadly similar domestic regulatory frameworks, etc) but have quite different characteristics in a technical sense (aviation and maritime engineering, navigation etc, whilst conceptually similar in some ways, are very different). In reality, the transport sector is a set of systems that have elements/degrees of overlap and congruence – it is not all that obvious that categorization by theme (e.g. transport) would add much in the way of value or insight. (Civil Aviation Authority, sub. 6, p. 11)

There will inevitably be differences in the nature and scope, structure and focus of regulations between and within the areas identified that would mean that it is going to be difficult to come up with a typology for which uniform design and operation principles could be established. (Tasman District Council. sub. 1, p. 2)

We note...the great variety of regulators and the very different contexts in which they work. It is likely to be futile to attempt to categorise them too tightly, let alone try to do so in a legal or institutional sense which is likely in fact to be counterproductive and damaging. (New Zealand Council of Trade Unions, sub. 25, pp. 10-11)

Maritime New Zealand observed that some regimes occupy more than one thematic grouping, leading to questions about “what purpose such a grouping would serve” (sub. 15, p. 4).

The Commission also drew on analysis by academics, who had developed their own typologies and concluded that:

How we use the idea of regime anatomy as a method of comparing types of regulation depends on what we are applying it to and what we are using it for. The more similar the systems being compared, the further down the scale of disaggregation the comparison will need to go if their distinctive fingerprints are to be identified... How far we need to disaggregate regimes to greater levels of complexity also depends on how many ‘degrees of freedom’ there are in regulatory regimes – that is, how far variation in one element of a regime is linked to variation in another, or how far we can predict what one dimension of a regulatory regime will be like from knowledge about another dimension. If there are infinite degrees of freedom in regulatory regimes, we need very complex ways of describing and comparing them; if there are only a few degrees of freedom, a parsimonious characterization will suffice. (Hood, Rothstein & Baldwin 2001, p. 35)

As a result, the Commission made these conclusions:

- Maps and groupings can be valuable as a way to understand regulatory regimes and agencies, but mainly as a first step in a more detailed analysis. For most regimes, further disaggregation is likely to be needed to gain a full understanding of their dynamics, relationships and differences.
- No single set of categories will support all avenues of analysis into how regulatory regimes perform. A range of frameworks can be applied that answer different questions and lead to different combinations of agencies and regimes.
- Maps and groupings are perhaps best thought of as initial hypotheses for research and analysis. To properly test a hypothesis, the analysis would need to proceed below the level of regime or agency.

The Treasury and the SSC responded in their submission to the draft report that the absence of a set of maps or thematic groupings had:

...some wider implications. If it is important to have a good understanding of the dynamics, relationships and differences between regulatory regimes, then this implies some significant limits on

the range of roles the centre can sensibly play in the development of better regulatory institutions and practices...More generally, it leads us to ask when it will be appropriate to pursue improvements at a whole-of-system level, and to question the extent to which system-wide improvement can be effectively led, prioritised and driven by a single Minister and central supporting agency. (sub. DR 97, p. 5)

The Commission does not agree that maps and typologies are essential, or even very helpful, for gaining “a good understanding of the dynamics, relationships and differences between regulatory regimes.” Indeed, if they are not used with care, maps and typologies can oversimplify regimes and lead to inaccurate or inappropriate policy conclusions.

### F15.2

Maps and typologies of regulatory regimes and agencies may not be of much use in assisting central agencies to understand the relationships and differences between regulatory regimes. In some circumstances, they may oversimplify regimes or lead to inaccurate or inappropriate conclusions.

Nor does the absence of maps and typologies represent a binding constraint on the ability of the centre to pursue “system-wide improvements.” As outlined throughout this report, the Commission sees a number of areas where greater action or effort by central organisations could help improve the effectiveness and efficiency of many regimes and regulators, including:

- assistance with the development and promotion of public goods, such as updated guidance for regulatory agencies (Chapter 5);
- more support for cross-agency networks and forums for sharing knowledge and experience (Chapter 5);
- a stronger role in assisting portfolio departments to identify appropriately-skilled governors for regulatory Crown entities (Chapter 10); and
- development and management of regulator peer reviews, through the current Performance Improvement Framework process (Chapter 13).

Chapter 16 will discuss other enhancements to the role of central institutions.

Achieving greater performance by the regulatory system does not require central organisations to “develop or maintain a deep understanding of the institutional arrangements and regulatory environment for 200 different regimes” (New Zealand Treasury / SSC, sub. DR 97, p. 5). The knowledge surrounding each regime lies in portfolio departments and Crown entities, and it would be inefficient and impractical to attempt to replicate that in the centre. In the Commission’s view, a better approach is:

- to identify areas where central organisations have a clear comparative advantage; and
- for central agencies (especially the Treasury and SSC) to ensure that the key actors in the regulatory system – especially policy departments and the boards of Crown entities – properly carry out their duties and obligations.

## Standardised reporting

A second option is to require all regulators to report against some common indicators of performance. The Commission proposed this option in the draft report, based in part on a reporting system run in Victoria (a regular survey of regulators run by the Victorian Competition and Efficiency Commission (VCEC<sup>86</sup>)), and sought feedback.

The aim of standardised reporting would be to help policymakers to:

- better understand and assess the scale of regulatory activity in New Zealand;

<sup>86</sup> See, for example, VCEC, 2005a; 2013.

- compare and contrast regulatory approaches and features;
- identify trends in implementing regulation or performance of regulators, or identify areas for improvement;
- help regulators to identify practice among their peers that might be adopted in their own operations; and
- provide more informed debate on regulatory matters.

The appeal of a standardised reporting framework lay in the dearth of comparative information on New Zealand regulators, and the lost opportunities for understanding and action that this created. An attempt by the Commission to gather information from New Zealand regulatory agencies about aspects of their practices, capability and resources revealed differing definitions of some core regulatory inputs and information gaps elsewhere. For example, one agency did not know much it was spending on its regulatory activities, and another did not know how many staff worked on these activities. These gaps raise questions about how well some agencies can assess the efficiency and cost-effectiveness of their regulatory strategies.

The Victorian system has allowed analysis to be conducted of trends in particular regulatory practices, and provided a critical information base for a state-wide review of the governance of regulatory bodies (VSSA, 2009). In addition, the costs of running such a framework could be kept low. Although there were some set-up costs associated with developing the Victorian reporting system, the Commission was advised by VCEC officials that the average yearly time commitment for each regulator was about 4 hours (information provided by VCEC, 2014).

The possible set of standardised indicators outlined in the draft report is noted in Table 15.1.

**Table 15.1 Possible scope of comparable information that could be collected from regulators**

<b>Regulator structure</b>	
<ul style="list-style-type: none"> <li>• Organisational form (eg, department, Crown entity, other body)</li> <li>• Method of appointment for governing body (if appropriate)</li> </ul>	<ul style="list-style-type: none"> <li>• Size of governing body (if appropriate)</li> <li>• Composition of governing body</li> <li>• Who has decision-making responsibility</li> </ul>
<b>Efficiency</b>	
<ul style="list-style-type: none"> <li>• Total expenditure and revenue</li> <li>• Total staff</li> </ul>	<ul style="list-style-type: none"> <li>• Total or proportion of revenue recovered by fees, levies or other charges</li> <li>• Unit costs of key regulatory processes</li> </ul>
<b>Effectiveness</b>	
<ul style="list-style-type: none"> <li>• Number of licences/approvals issued</li> <li>• Number of investigations undertaken</li> <li>• Number of regulatory actions reviewed or appealed</li> <li>• Type of enforcement strategy (eg, risk-based)</li> </ul>	<ul style="list-style-type: none"> <li>• Number of complaints received about regulated parties</li> <li>• Number/type of enforcement actions taken</li> <li>• Outcome of reviews and appeals</li> </ul>
<b>Responsiveness</b>	
<ul style="list-style-type: none"> <li>• Whether licences/approvals can be applied for (and/or renewed) online</li> <li>• Average time taken to process a licence/approval or other regulatory activity</li> <li>• Whether the regulator's enforcement strategy is published</li> </ul>	<ul style="list-style-type: none"> <li>• Whether the regulator has statutory obligations to consult, and, if so, with whom</li> <li>• Whether the regulator publishes online guidance on how to comply</li> </ul>

Scope of activity	
<ul style="list-style-type: none"> <li>Regulatory objectives</li> <li>Number of other instruments (eg, guidance)</li> </ul>	<ul style="list-style-type: none"> <li>Number of Acts and Regulations enforced</li> <li>Presence of overlapping responsibilities with other agencies, and, if so, measures taken to manage overlaps (eg, formal agreements).</li> </ul>
Burden of activity on regulated parties	
<ul style="list-style-type: none"> <li>Number of pages of Acts or statutory regulations enforced</li> <li>Period of licences/approvals issued</li> </ul>	<ul style="list-style-type: none"> <li>Level of user charges</li> </ul>
Transparency and accountability	
<ul style="list-style-type: none"> <li>Whether public reporting includes outcome measures</li> </ul>	<ul style="list-style-type: none"> <li>Whether client satisfaction is regularly surveyed</li> </ul>

A few submitters supported the proposal (Insurance Council of New Zealand, sub. DR 67, p. 4; ANZ, sub. DR 83, p. 5). But a larger number raised concerns or questions, including:

- the potential for some indicators to provide a misleading picture of performance – for example, a measure of the volume of licensing may not be appropriate for regimes where the refusal of licences by an agency (eg, to an individual or firm that is judged unsafe) helps protect the public (Civil Aviation Authority, sub. DR 64, p. 3; Department of Internal Affairs, sub. DR 63, p. 4); and
- the sheer diversity of regulatory regimes and functions, and the difficulty of reflecting this in one set of indicators (Commerce Commission, sub. DR 93, p. 2; New Zealand Transport Agency, sub. DR 85, p. 3; Ministry for Primary Industries, sub. DR 102, p. 2; Department of Internal Affairs, sub. DR 63, p. 4; Financial Markets Authority, sub. DR 90, p. 2).

The Commission accepts the critiques made by submitters. While some form of comparative analysis of regulator practices and behaviour could help improve understanding of performance, system-wide standardised reporting is probably not the most effective risk identification tool for the centre.

### F15.3

There is a need for greater comparative analysis of regulator practices and behaviour. However, system-wide standardised reporting is unlikely to be the most effective tool for identifying risks or performance issues across the system, as it would be very difficult to fairly reflect the diversity of regimes and regulators in a single set of indicators.

## System-level indicators

The final option would be for the centre to collect information on the performance of the system as a whole; for example, in line with the sorts of criteria laid out in Chapter 2:

- proportionate and necessary regulation;
- prioritised regulatory effort;
- adequate resourcing of implementation;
- fair and effective implementation; and
- self-aware and adaptive regulatory organisations.

Such an approach would build off existing processes, avoiding significant new costs. The Treasury is already collecting information to assess the performance of the system. Over 2013, the Treasury sought information from policy departments for a Regulatory Systems Report. That Report focused on such topics as how policy oversight is allocated, how policy is developed and implemented, how outcomes are monitored, and

include aspects of evaluation and review (see Box 15.2). The information collected through that Report was used by the Treasury to advise the Minister for Regulatory Reform on their forward work programme.

#### F15.4

Central agencies should monitor the performance of the regulatory system as a whole; in particular, its ability to provide proportionate and necessary regulation; prioritised regulatory effort; adequate resourcing of implementation; fair and effective implementation; and self-aware and adaptive regulatory organisations. The Commission notes that the Treasury has already begun this process.

#### Box 15.2 The Regulatory Systems Report

During 2013 the Treasury collected the following information from departments about their regulatory management systems.

##### Allocating policy oversight

1. Does your department use the regulatory scanning database set up by the Treasury and hosted in CFISnet for keeping track of the legislation that it administers?
2. Does your department maintain a comprehensive database for keeping track of the legislation it administers, other than the database hosted in CFISnet? If so, please provide a copy or sample from that database.
3. Has your department clearly assigned policy oversight roles and responsibilities for each of the regulatory regimes it administers? (Clear assignment means an individual or team is fully aware of their responsibility for the regulatory regime.) In answering this question, for each regulatory regime please provide details on:
  - a) Is the oversight assignment visible within the organisation (eg, to senior management, or reception/telephonist staff) and outside the organisation?
  - b) Has the department clearly described the nature of, or set out minimum expectations for, this policy oversight role? If so, how?
4. Does the policy oversight role drive cross-agency collaboration or encourage feedback loops between departments? If so, how?

##### Policy development

5. Does your department's regulatory impact analysis (RIA) quality assurance (QA) process involve:
  - a) an independent QA panel;
  - b) a designated independent person or persons; or
  - c) other (please explain)?
6. Does your department's quality assurance review cover:
  - a) final assessment of preliminary impact and risk assessments (PIRAs) and regulatory impact statements (RISs) only;
  - b) comments on drafts, and final assessment, of PIRAs and RISs;
  - c) comments on drafts, and final assessment, of PIRAs, RISs, and discussion documents; or
  - d) other (please explain)?

### Implementation

7. For each of the regulatory regimes administered by your department that impose obligations on members of the public or businesses, does your department, or any other agency with responsibilities under that regime, have a documented compliance strategy?

If so, please provide a copy or sample from each documented compliance strategy.

8. For each of the regulatory regimes administered by your department but implemented (in full or part) by another entity, does your department maintain any specific systems for monitoring the approach taken to implementation, monitoring, and enforcement by that entity? If so, what are those systems?

### Monitoring outcomes

9. Does your department have any systems or processes for encouraging feedback from the regulated community on the impact of regulation?
10. Does your department maintain any systems for collecting and recording information on:
- difficulties or problems in implementing legislation administered by the department (whether they are problems for the implementing agency or the regulated community), and
  - errors or potential problems identified during implementation in the way legislation administered by the department has been drafted.
11. For each of the regulatory regimes administered by your department, does your department maintain any systems or processes for collecting and recording information on its regulatory impacts (positive and negative, intended or otherwise)? If so, what are those systems or processes?
12. For each of the regulatory regimes administered by your department that impose obligations on members of the public or businesses, does your department maintain any systems or processes for collecting and recording information on:
- levels of compliance by the regulated community;
  - the drivers or determinants of compliance levels; and
  - the costs incurred by the implementing/administering agency to encourage or ensure compliance, including information provision and enforcement activity?

If so, please provide information about those systems or processes.

13. Do those responsible for policy oversight have ready access to the information provided by the systems and processes discussed in questions 10 to 12 above? How is this access facilitated?

### Evaluation and review

14. What, if any, requirements does your department have for periodically formally reviewing and reporting on the performance of each of the regulatory regimes it administers?

Please provide information on both external and internal requirements (eg, What are those regimes and requirements? What is the trigger point? What happens to the resulting report? Do certain regulatory regimes have no requirements for review, and why?)

15. Does your department, or any other agency, maintain any policies or processes (not already covered) for identifying, assessing, or testing possible vulnerabilities or performance risks for any of the regulatory regimes it administers? Please provide details.

Three observations can be made about the existing information. First, as noted in Chapter 14, all departments need to take their obligations to report on regulatory performance seriously. The fact that some departments did not respond to the Treasury's request for information for the Regulatory Systems Report or have not consistently prepared regulatory scans and plans constrains the ability of the centre to prioritise efforts and govern the system.

**F15.5**

The fact that some departments are not fully participating in the Treasury's regulatory management and oversight processes limits the ability of ministers to make informed judgements about priorities and the performance of the system.

Chapter 14 recommended that reporting obligations on departments should be strengthened, including by publishing the reports provided to the Treasury for the Regulatory Systems Report. Publication could help promote higher participation, by making the absences transparent. However, if this does not prove sufficient, Cabinet should look to strengthen expectations on departmental chief executives, including the other options considered in Table 14.4 (eg, in chief executive performance agreements).

Second, the information currently sought through the Regulatory Systems Report focuses on inputs – for example, the presence of systems and processes for collecting feedback from regulated communities, reviewing regimes and so on. Given that the regulatory stewardship expectations are still new, this is a reasonable place to start. As departmental management systems bed in and mature, the Treasury should look to seek information about outputs and outcomes, so that the impacts of departmental systems can be assessed.

**R15.2**

As the Regulatory Systems Report (or equivalent monitoring processes) evolves, the Treasury should collect more information about the outputs and outcomes from departmental regulatory management systems.

Third, much of the current information relies on self-reporting by departments and other regulatory agencies. This possibly reflects the fact that the regulatory stewardship project is still in an early phase. However, if the centre is to form robust judgements about the performance of the system, it will need to draw on a wider range of data, including external and independent sources. These could include:

- Regulatory Impact Analysis Team quality assurance statements for RIAs and external reviews of RISs (for 'proportionate and necessary regulation');
- Office of the Controller and Auditor-General audits into regulators, court judgments on regulator decisions, and complaints to the Regulations Review Committee on particular agencies or regimes ("fair and effective implementation");
- Statistics New Zealand's annual Business Operations Survey (BOS), which has a component ("contracted module") that changes topic every year. In 2012, the module was devoted to regulation, and collected a range of information about the costs and impacts of regulation in general and from specific regimes. Regular inclusion of a regulation module in BOS could provide a valuable input to system-level monitoring; and
- the regulator peer reviews recommended in Chapter 13.

**F15.6**

Central monitoring of the regulatory system's performance should be based on both a mix of information generated by departments and regulatory agencies, and data from external or independent sources.

## 15.4 Conclusion

The scale and complexity of the regulatory system presents considerable challenges to both those subject to regulation, and those who are responsible for the system's performance. Some of these challenges can be mitigated through greater accessibility to the regulatory stock (especially tertiary regulation), and through enhanced monitoring of the regulatory system's performance.

This chapter outlined the need for a more active and energetic role by the centre in promoting the performance of the regulatory system. This reflects the Commission's view that there are some important roles in the system where the centre has a comparative advantage and which either are not currently being played, or not being played well enough. Chapter 16 discusses these roles, and broader opportunities to strengthen the institutions that contribute to good regulatory outcomes.

# 16 Strengthening institutions

## Key points

- This report has reviewed the components of the regulatory system and found system-wide deficiencies. There is also a surprising complacency about how the system as a whole is performing as revealed in part by the insufficient, and in some cases declining, resources committed to matters of regulatory design and review.
- The designers and implementers of regulation face escalating expectations, complexity and challenge. In many areas, the capability and performance of the regulatory system in designing and regularly upgrading regulatory regimes falls well short of what it should and can be. There has been some progress through recent initiatives to improve the management of regulation, but these are fragmented and follow-through has been inadequate in some cases.
- Focus, continuity and a system-wide view of performance weaknesses and potential improvements are required. There is considerable scope to get much better performance out of the system, to support the greater wellbeing of New Zealanders, and reduce the risk of regulatory failure.
- Fit for purpose legislative provisions provide the foundation for high-quality regulatory institutions and practices. However, there are long-standing concerns about the quality of some policy and legislative processes, and about the ability of Parliament to ensure legislative regimes remain current. While some improvements have been made in recent years, other quality checks have eroded. The government should commission a review of the processes and institutions for maintaining and improving the quality of legislation.
- Moving the regulatory system to the next level of performance requires:
  - energetic and focused leadership from within the Cabinet, as the “owners” of the system;
  - paying more attention to organisational design, implementation, monitoring and review;
  - stronger encouragement and support for regulators to fulfil their stewardship obligations; and
  - monitoring of regulators that pays more attention to regulatory practices and strategies.
- Having a senior minister responsible for regulatory management is essential. The minister’s responsibilities should include:
  - defining the overall objective of the system and bringing focus and attention to it;
  - strategic prioritisation of effort across the system;
  - specifying and allocating tasks for improving the system; and
  - promoting continuous improvement in regulatory design and practice.
- Effective institutional support for the minister is needed, through an expanded team within the Treasury that has a published charter setting out its objectives and functions, its own website, and the authority to identify itself as a separate unit within the Treasury. The proposed position for providing intellectual leadership on regulatory issues should be located in this team.
- Stronger and more focused mechanisms to encourage continuous improvement, not just a one-off lift in performance, should become permanent features of the regulatory system.

## 16.1 Introduction

This report has demonstrated that New Zealand has a large and complex regulatory sector, comprising, according to the Treasury, possibly as many as 200 regulatory regimes (New Zealand Treasury, 2013e, p. 16). Regulation touches the lives of New Zealanders in many ways, even though most people would rarely give them a passing thought. Regulation also affects the costs and competitiveness of businesses and sometimes even their right to operate. As such, it goes to the core of personal rights and freedoms, social cohesion, and business dynamics and efficiency. While there is surprisingly little information about the overall regulatory system and its effects, the processes for introducing, implementing, enforcing and reviewing regulation are profoundly significant for the wellbeing of New Zealanders.

When people think about regulation, they tend to think about their interactions with a particular regulator or regulation. Yet, these are only components of a much larger system. An analogy may help to make this clearer. Most people would understand that there is an education “system”, even though they will only deal with a particular school. Yet behind that school is a system that determines or influences the national curriculum, school funding, qualifications and training requirements for teachers, and so on.

The same applies to regulation. While most people interact with specific regulators or regulations, behind them sits a “regulatory system” that includes processes that must be followed before a new regulation is introduced, the scope of regulators’ powers, requirements for consultation, whether and how regulations need reviewing to ensure that they remain fit for purpose, and so on. This system was described in Chapter 2.

The regulatory system is an important part of New Zealand’s policy infrastructure and should be seen, for example, as no less significant than the systems behind taxation and government spending. Regulation is one of the main instruments through which governments achieve social, environmental and economic objectives. However, regulation also imposes burdens that need to be controlled, and poor implementation can undermine its effectiveness in achieving outcomes and expose the community to risks. This means that having a regulatory system that encourages up-to-date focused regulation, is directed at genuine problems that only regulation can solve, is implemented well, and does not impose any unnecessary burdens, is one significant way that governments can meet the aspirations of New Zealanders. Other countries have long recognised the importance of their regulatory systems. Since the 1990s the Organisation for Economic Co-operation and Development (OECD) has been developing policy tools to capture the notion of quality in regulatory management (Jacobzone, Chou & Miguet, 2007).

New Zealand has introduced improvements to the regulatory system. The introduction of the Regulatory Impact Analysis (RIA) process in the late 1990s is an important example. This work is, however, incomplete. Every chapter in this report has identified weaknesses in particular parts of the regulatory system and has suggested ways to fix them.

To move the regulatory system to the next level of performance:

- the Cabinet needs to show energetic and focused leadership, based on the premise that the regulatory system is a strategic part of New Zealand’s policy infrastructure, combined with more transparent processes from both ministers and agencies;
- more attention should be paid to organisational design, implementation, monitoring and review;
- regulators need stronger encouragement and support to fulfil their stewardship obligations – the system should rely less on goodwill and the commitment and interest of those who work in regulators, and more on exposing boards and chief executives to performance expectations and incentives commensurate with the Government’s stated objectives;
- departmental monitors of regulators need a better understanding of their role, and monitoring should focus more on regulator practices and strategies; and
- agencies with important roles in ensuring the system functions well must be funded adequately.

This report is largely pitched at the level of the regulatory system, rather than at individual regulators or regulations. It looks at broader system-wide issues rather than seeing how they play out for individual regulators, and provides guidance that will help in designing new regulatory regimes and in improving the operation of existing regulatory regimes.

The Commission is proposing 44 recommendations. Implementing them would require a strategic and focused approach. This chapter provides suggestions about how these recommendations could be embedded in New Zealand's regulatory system by strengthening existing institutions and creating an environment in which the recommendations will have most effect.

The following features would facilitate the implementation of recommendations and encourage continuous improvement:

- enhancing the role of Parliament in generating high-quality regulation and legislation and scrutinising the existing stock (section 16.2);
- clear definition of roles and responsibilities, particularly of the minister responsible for stewardship of the regulatory system (16.3);
- effective institutions to support the minister (section 16.4); and
- strengthened and more focused incentives to encourage the completion of tasks (section 16.5).

## 16.2 Enhancing the role of Parliament

### Concerns about legislative quality

A good legislative framework is a fundamental component of good regulation. But over the course of this inquiry the Commission was told that policy development and legislative processes were not consistently delivering high-quality legislative frameworks, and that systems did not allow for necessary improvements to those frameworks:

Ongoing maintenance of regulation ensures that it remains appropriate to the purpose for which it was intended. Problems arise if only parts of the regulatory regime are able to be maintained efficiently, or if changes to the whole regime are overly time consuming and complex. (EPA, sub. DR 103, p. 2)

The consequences of this are significant.

- Regulation may be imposed where other non-regulatory solutions are preferable.
- Unnecessary costs are imposed on businesses or the community. For example, in its submission the Reserve Bank of New Zealand noted that the Insurance (Prudential Supervision) Act 2010 "placed significant compliance costs on a particular class of insurers, but in many cases the reporting provided almost no value to the Reserve Bank. As the requirement was set out in primary legislation, it took 3 years before this requirement could be altered" (sub. DR 99, p. 5).
- Requirements fail to keep pace with technological changes or societal expectations (for example, transport legislative frameworks – see Chapter 9).
- Regulators ignore unworkable requirements in legislation (for example, handling of complaints under the Real Estate Agents Act 2008 as described in Chapter 9).
- Technical amendments to legislative regimes that should be relatively non-controversial are unable to be progressed. One example is the Gambling Amendment Bill No. 2, which was introduced in 2007 and had its second reading in 2009, but has still not been passed.
- There are design differences between regulatory regimes which add complexity and cost. This is not to say that the design of regulators or regimes should be uniform and that all differences are unjustified. But, for example, it is difficult for all parties if the Crown, in engaging with an iwi on a range of issues, is obliged to "take account of", "take appropriate account of", or ensure a "full and balanced account is

taken of" either the Treaty of Waitangi or the principles of the Treaty of Waitangi depending on the regulatory issue at hand (see Chapter 7).

Concerns about legislative quality are not new. In 1999 the Ministry of Justice told its incoming minister that

...dissatisfaction with the legislative process has increased over the years. The volume of legislation is greater than Parliament can manage. There is frustration that routine technical Bills cannot be passed. ...The legislative programme is a choke point on government initiatives. By contrast with the modern budgetary process, very little resource is attached to prioritising and quality control of law making. The quality of law-related policy decisions and prioritisation is the underlying issue. (Ministry of Justice, 1999, p. 49)

In its 2008 Briefing to the Incoming Minister of Justice, the Law Commission said that the problem might have become worse. It diagnosed a number of problems.

- Legislative proposals receive inadequate scrutiny before they are introduced into Parliament. Such mechanisms as do exist (such as the Legislation Design Committee (LDC), RIA and Bill of Rights vetting) are fragmented: "As a result, there is no consideration of all the dimensions of the costs and benefits of legislative proposals, whether their objectives are being pursued through the right vehicle, and whether they conform with fundamental legislative principles" (Law Commission, 2008, p. 64).
- Extensive amendment Acts strain and distort the principal Act's architecture, features and scheme, rather than redrafting the whole Act in a coherent way.
- There is a lack of evaluation of whether legislation is meeting its objectives or creating unexpected costs or consequences: "We cannot continue to pass Bills and not ever consider their effects again. There needs to be a systematic mechanism to assess and test the effects of Bills after they are passed" (Law Commission, 2008, p. 64). Further discussion on regime evaluation and review can be found in Chapter 14.
- There are no adequate mechanisms for removing unnecessary laws, including statutes that have fallen into total disuse.

In the course of this inquiry the Regulations Review Committee (RRC) expressed concerns about the quality of some bills it reviewed, identifying basic deficiencies such as the absence of commencement dates or inappropriate empowering provisions.

In its 2012 Annual Report, the Legislation Advisory Committee (LAC) noted that of the 42 bills it reviewed in 2012:

- 20 bills did not comply with the LAC guidelines, and resulted in a submission to select committee;
- 3 bills had minor non-compliance and the LAC engaged with the department or Parliamentary Counsel Office (PCO) on the issue; and
- 19 bills complied with the guidelines. (LAC, 2012b)

During a meeting with the Law Commission, the inquiry was told that there was a similar pattern in 2013: approximately half of the 46 bills they reviewed in 2013 were "materially deficient". The Law Commission noted that the number of bills it scrutinised was reducing due to resource constraints.

One cause of poor legislation is poor policy. In *Towards Better Local Regulation*, the Commission expressed concerns about the effectiveness of the RIA process, noting that "some 15 years after RIS [regulatory impact statement] requirements were introduced, about two-thirds of RISs still fail to fully meet the Treasury's quality assurance requirements" (NZPC, 2013a, p. 74). This indicates weaknesses in the underlying policy processes, and a failure of RIA to incentivise better quality policy. Those concerns have been reaffirmed in the course of the current inquiry. A significant number of submitters to this inquiry highlighted deficiencies in the RIA process as a contributor to poor quality regulation. For example:

In our experience more often than not current regulatory guidelines, such as the Government's 2009 statement on "Better Regulation, Less Regulation" and the Treasury's Regulatory Impact Analysis

Handbook are not followed or attract only cursory attention. It appears that these guidelines, although well intentioned, are treated as political 'window dressing' rather than practical advice for officials to follow when developing policy. This has meant the quality of regulatory process documents such as Regulatory Impact Statements (RIS) vary considerably, often resulting in poor quality regulation. (New Zealand Bankers Association, sub. 43, p. 3)

The structure of a legislative framework can differ significantly depending on the instructing policy department (eg, whether a regime to regulate psychoactive substances is led from the Ministry of Health or Ministry of Justice; whether the regulation of real estate agents is designed by the Ministry of Justice or the Ministry of Economic Development), and, the Commission was told, on the individual parliamentary drafter allocated to a bill.

In addition to improving checks on the quality of policy, there is likely to be scope for the PCO to take a more coordinated approach that would improve legislative quality. In practice, drafters exercise great power in determining what is and is not possible with legislation, designing the structure of legislative frameworks, and providing advice. The Law Commission has said "PCO plays a crucial role not just in the drafting of bills and regulations but in their form and content as well" (2009, p. 5). While drafters will always take instructions from departments, a Parliamentary Counsel Office with a collective vision of what legislative quality means could make a powerful contribution to improving the issues identified. PCO expresses the view that "[t]he mechanisms by which PCO can influence outcomes have become increasingly limited" (sub. DR 88, p. 2). However, it is also eager to contribute to improvements:

The PCO would welcome the opportunity to have greater input into the legislative design process to try to ensure there is greater thought about the overall structure of each legislative proposal, at a primary, secondary and tertiary level. However, empowering the PCO in this way will not work unless we can provide our input at the beginning of the legislation design phase, and there is understanding and agreement by Ministers, government agencies, the RRC, the LAC and other stakeholders to the approach that is to be taken to the divide between primary secondary and tertiary legislation. We would not want our involvement in this area to be an adversarial one, but rather, a truly collaborative one. (sub. DR 88, p. 10)

As discussed in Chapter 2, the chief executives of regulatory agencies reported that they often have to work with legislative frameworks that are outdated or not fit for purpose. A lack of parliamentary time is consistently identified as an important reason for this. The PCO submitted to the 2011 review of standing orders that:

Parliament continues to be unable to process Bills introduced by the Government in a sufficiently efficient, effective and timely way, as shown clearly by the Order Paper which, at any time, generally includes 40-55 Bills, many of which have been waiting several months to progress, and a large number of which make largely technical uncontroversial amendments to remedy existing problems, or to otherwise maintain and enhance our legislative infrastructure. (PCO, 2011, p. 4).

Similarly, in the course of its 2012/13 financial review by the Justice and Electoral Committee, the Law Commission noted that "[t]he biggest constraint on the Law Commission's work at this time, and perhaps for the foreseeable future, is the availability of parliamentary time to advance legislation" (Law Commission, 2014, p. 1).

## **There have been improvements**

### **Streamlined parliamentary processes**

Changes to parliamentary proceedings over recent years have attempted to address the difficulties in progressing legislation. They include:

- the move away from clause by clause debates in the committee of the whole House to Part by Part debates;
- the move to party voting rather than divisions;
- limits on the number and length of speeches;
- the use of closure motions; and

- empowering the Business Committee to decide that a Bill does not require consideration in committee of the whole House.

Following the 2011 review of standing orders, a number of additional reforms to parliamentary procedures were introduced:

- the ability to consider two or more bills together as “cognate bills”;
- greater powers for the Business Committee to expedite select committee or committee of the whole House consideration of certain bills;
- the introduction in this Parliament of extended sitting hours for non-controversial bills (typically settlement bills); and
- the introduction of a streamlined process for considering Revision Bills and a legislative requirement for the Attorney-General to prepare a draft 3-yearly revision programme for each new Parliament (Geiringer, Higbee & McLeay, 2011b).

This last development, in particular, is promising in terms of its ability to make the law more accessible and intelligible. But it does not help update or change the effect of the law, where this may be necessary.

### **Disclosure statements for government bills**

Additionally, the introduction of disclosure statements requires agencies to publish essential information about government bills (except Imprest Supply and Appropriation Bills, Statutes Amendment Bills, Regulatory Reform (Repeal) Bills, Subordinate Legislation (Confirmation and Validation) Bills, and Revision Bills). The information to be disclosed is discussed in Chapter 2.

If effective, the disclosure statements will significantly improve the availability of information about the objectives, quality, and design of new legislation. But the Commission is concerned that other quality assurance mechanisms reliant on disclosure (such as the Attorney-General’s vetting of bills for consistency with the New Zealand Bill of Rights Act 1990 or the Regulatory Impact Analysis process) have not been shown to incentivise quality improvements.

A Legislation Amendment Bill recently introduced would make the disclosure statements a legal requirement. An independent review of the disclosure requirements is to be carried out within five years.

## **But other quality checks have eroded**

### **Regulations Review Committee (RRC)**

The RRC is an essential parliamentary check on the exercise of delegated law-making. However it appears to be viewed as a poor relation to other select committees, with much less meeting time (only about an hour a week when Parliament is in session) and other committees taking priority. Its membership has been on a steady decline, with around eight members in the 45<sup>th</sup> to 47<sup>th</sup> Parliaments, seven members in the 48<sup>th</sup> and 49<sup>th</sup> Parliament, and only five members currently.

Currently the RRC’s core functions are supported by the equivalent of one full-time legal advisor. In 2012 the RRC reviewed every bill creating regulation-making powers, 557 statutory regulations, and more than 200 deemed regulations (RRC, 2014b). The current level of expert support for the RRC’s functions seems inadequate for the volume of work if Parliament is to properly scrutinise the creation and exercise of regulation-making powers.

Chapter 9 argues that there is scope to increase the use of delegated legislation. This would increase the workload of the RRC. Chapter 12 supports an ongoing role for the RRC in scrutinising the setting of regulatory fees and charges. This requires specialist skills among officials who support the committee or the increased use of the Office of the Controller and Auditor-General (OAG)’s advice.

The Commission heard that in recent times the RRC had become more politically partisan. This is concerning. To the extent the RRC is considered to be effective by commentators, that success is universally attributed to its non-partisan operation. The work of the RRC may be assuredly dull (and this is indeed a

prerequisite for its effectiveness), but it deserves greater support and attention from members of Parliament than it appears to currently receive if it is to be effective, or if it is to assume an increased role.

### **The Law Commission**

The Law Commission is an independent Crown entity. It was established in 1985. Its functions are to review the law and make recommendations for improvement.

The 2012/13 financial review report of the Justice and Electoral Committee on the Law Commission notes that the Law Commission's capacity to deliver law reform services is dependent on its staff numbers, and that those staff members had declined. Legal and policy advisors had declined over the previous five years from 24 to 15. The number of Commissioners had declined from 5 to 3.5 FTE (Justice and Electoral Committee, 2014). Funding constraints are also evident. From a peak in 2006/7, the Law Commission's nominal funding from the government has declined by 25%.

The result is that the Law Commission has been reducing its review of bills introduced to the House, and will continue to reduce this activity. This is regrettable, because Law Commission scrutiny of bills represents a rare independent source of advice on legislative quality. Cabinet papers introducing bills are required to discuss the degree of compliance with LAC guidelines. The Commission has seen no evidence that this is taken seriously by departments, and the number of bills the Law Commission submits on supports that conclusion.

### **Legislation Design Committee (LDC)**

The LDC was established in 2006 to provide advice on the drafting of significant legislative proposals at an early stage. It comprised the President of the Law Commission, the chief executive of the Department of the Prime Minister and Cabinet, the Secretary for Justice, the Secretary to the Treasury, the Solicitor-General, and the Chief Parliamentary Counsel (or their nominees).

The 2011 LAC Annual Report helpfully indicates which of its submissions were incorporated in the final versions of bills passed. In every case, some LAC submissions were not accepted. This indicates the importance of early engagement in designing legislation. Sir Geoffrey Palmer has said that "the experience of the [Legislation Advisory] Committee over 20 years has led to the conclusion that most of the problems with legislation occur early in its design phase. It is often too late to perform major surgery on a Bill after it has been introduced" (Palmer, 2007, p. 16).

The objective in establishing the LDC was to provide for expert advice in the initial stages of developing legislation before final policy and design issues are set in concrete and a bill finalised. It was to focus in particular on significant or complicated legislative proposals, basic design issues, instrument choice, and impact on the coherence of the statute book.

The Law Commission reported that an evaluation of the LDC indicated that departments thought it had worked well and that there was demand for its services (Law Commission, 2011). Even so, the LDC appears to have gone into total abeyance. This is unfortunate, because it was one of the few mechanisms with the potential to improve the quality of legislation at an early stage in its development.

### **There are options to improve the situation**

There is a clear and long-standing issue with the quality of legislation, the mechanisms available to maintain that legislation, and to repeal unnecessary legislation.

Options to improve the quality of legislation in New Zealand include:

- improving the quality of policy development, and the RIA process;
- amending the Cabinet Manual to encourage more use of disclosure drafts of legislation, as recommended in Chapter 8;
- process improvements within the PCO to provide extra checks for quality or consistency;

- reconsidering whether the LAC, LDC and Law Commission need to be organised or supported differently to ensure that they can undertake the following functions:
  - providing advice on proposals for legislation at an early stage in the policy development process (as the LDC was intended to), including input from PCO;
  - maintaining guidelines about good legislative design;
  - reviewing all bills against those guidelines and making submissions to select committee as appropriate;
  - the other general law reform activity of the Law Commission; and
- increasing the membership, sitting time and legal support to the RRC to improve its ability to scrutinise regulations and the creation of regulation-making powers (although the PCO submitted that the RRC may be in need of more fundamental reform).

The Commission does not support suggestions to expand the role of the RRC to consider the merits and policy of regulations. As noted by the Ministry for Primary Industries (MPI), “expansion of the committee’s grounds for scrutinising regulations into questions of merit and/or policy could politicise the role of committee members and undermine the committee’s non-partisan approach” (sub. DR 102, p. 5).

There are also measures that might improve the maintenance of the existing stock of legislation and regulation. Responsibility for overseeing this stock is vested in the chief executives of the departments that administer the legislation by the State Sector Act 1988. The Regulatory System Reports to the Treasury aim to uncover information about the nature and quality of processes within departments. These processes, and the obligations in the State Sector Act, should ensure chief executives have a view about the quality and weaknesses in the legislation and regulation their agency administers, and an obligation to report this to ministers. Chapter 15 recommended enhancements to the Regulatory Systems Report process.

Existing mechanisms to monitor the stock of legislation are located within the Executive. However, more could be done to empower Parliament to understand the quality of the stock of legislation that it has created or authorised. For example, the stewardship obligations should allow departments to report regularly to Parliament about their assessment of the state of each piece of legislation or regulation they administer. PCO submitted that “Parliament could give responsibility to each select committee to carry out regular reviews of the stock of regulation relevant to its area, which would draw on each committee’s particular expertise” (sub. DR 88, p. 28). It notes that “increasing the role of Parliament in this area is attractive in terms of parliamentary sovereignty and democratic control”, but that in practice Parliament will still be reliant on the Executive (p. 28).

None of these options addresses the bottleneck of parliamentary time. In its submission to the Standing Orders Committee, the Urgency Project<sup>87</sup> noted that further changes to parliamentary processes to streamline the legislative process could risk weakening the legislative process too much, and that “[i]f that is so, then the answer, if one is needed, must lie in the House sitting for more hours” (Geiringer, Higbee & McLeay, 2011b, p. 10). Two possible options are noted below.

- More sitting hours could be made available. There is some evidence that the New Zealand Parliament sits for fewer hours in a year than comparable legislatures (Geiringer, Higbee & McLeay, 2011a and 2011b). This inevitably comes at the expense of the non-legislative activity of Members of Parliament or of the personal lives of members and their families.
- A chamber like the Australian “Main Committee” could be established. This possibility was also proposed by the then Clerk of the House, David McGee, to the 2003 Review of Standing Orders (along with increased sitting hours). The Main Committee would be a second chamber to progress legislation

<sup>87</sup> The Urgency Project was a joint project of the New Zealand Centre for Public Law and the Rule of Law Committee of the New Zealand Law Society, funded by the Law Foundation, which reviewed the use of urgency in Parliament. Its findings contributed significantly to Parliament introducing extended sitting hours following the 2011 Review of Standing Orders.

concurrently with the main House of Representatives, but both are components of a single system, rather than separate entities. It would progress some legislation through the “Committee of the Whole” stage (ie, between the second and third readings). Any Member of Parliament could speak about the bill being considered in the main chamber. In Australia it is often used for dealing with non-controversial legislation, but it also deals with some legislation where there is not unanimity. It would be expensive to establish a parallel infrastructure for a Main Committee, and could be difficult for small parties to maintain a presence in both chambers.

These options are not exhaustive.

#### F16.1

Quality checks on legislation and regulation appear to be reducing. They are fragmented, of varying effectiveness, and in some cases under strain.

#### F16.2

The availability of parliamentary time remains a significant bottleneck to the maintenance, repair and, where appropriate, repeal of the stock of regulatory legislation.

#### F16.3

A range of options exist to improve the quality of legislation, and to enable Parliament to better understand the quality of the legislation it has created or authorised.

The Commission is cautious about making recommendations with implications for Parliament and its processes. Even so, if the design and operation of regulation in New Zealand is to improve, the starting point is with these policy and parliamentary processes. There is more that can be done to improve the quality of regulatory legislation that regulators are tasked with implementing. The Commission considers that a wide-ranging review about improving the quality of new and existing legislation is necessary.

The Law Commission could be an obvious candidate to undertake such a review. Section 5(1) of the Law Commission Act 1985 says that the principal functions of the Law Commission are:

1. to take and keep under review in a systematic way the law of New Zealand; and
2. to make recommendations for the reform and development of the law of New Zealand;
3. to advise on the review of any aspect of the law of New Zealand conducted by any government department or organisation (as defined in section 3A) and on proposals made as a result of the review;
4. to advise the Minister of Justice and the responsible Minister on ways in which the law of New Zealand can be made as understandable and accessible as is practicable.

However, it would be undesirable for the Law Commission to undertake a review of its own activities (including its support of LAC and, in theory, LDC).

Ministers, departments, PCO, the Law Commission, LAC, Members of Parliament, and the Office of the Clerk all have a stake in, and a contribution to make to, better processes for producing and maintaining the stock of high quality legislation. Because all these groups have a role to play, a standalone inquiry may be preferable to asking any one of them to review these issues, or asking several to review the issues piecemeal.

**R16.1**

Government should commission a review into improving and maintaining the quality of new and existing legislation, including:

- processes for producing and vetting the quality of legislative proposals and draft legislation;
- the respective roles of the Parliamentary Counsel Office, the Law Commission, Legislation Advisory Committee, and Legislation Design Committee; and
- relevant parliamentary processes.

### 16.3 Clear roles and responsibilities within the regulatory system

A theme of the report has been that roles and responsibilities must be clearly defined. This applies equally to responsibility for the regulatory system. Virtually every minister interacts with this system and most are responsible for some part of it. This begs the question of who is responsible for the overall system.

Table 16.1 illustrates why this is an important issue. It provides examples of tasks proposed in this report that, if undertaken, would strengthen the regulatory system as a whole. Unless there is a single point of accountability with a system-wide perspective, improvements that are designed to affect the system overall are unlikely to be implemented in a timely and co-ordinated manner. A portfolio minister who is responsible for a particular regulatory regime would not have the responsibility, authority, or system-wide perspective to ensure that all these tasks are carried out. As the OECD suggests:

...governments should consider assigning a specific Minister with political responsibility for maintaining and improving the operation of the whole-of-government policy on regulatory quality and to provide leadership and oversight of the regulatory governance process. (OECD, 2012a, rec. 1.6)

In 2008, 24 OECD jurisdictions reported that their governments had assigned responsibility for promoting government-wide progress on regulatory reform to a specific minister (OECD, 2012a, p. 23). A single point of accountability – a minister for regulatory management – has significant advantages. This minister would be required to take a whole-of-government approach to regulatory policy, rather than one that comes from a portfolio perspective, and a whole-of-system view of how to improve the system, rather than ad hoc improvements to current initiatives in part of the system.

**Table 16.1** Examples of system-wide tasks arising from the report

Chapter title	Task
Regulator culture and leadership	Develop guidelines to assist regulatory bodies to manage cultural changes.
Workforce capability	Create a position to provide intellectual leadership in regulatory practice.
Role clarity	Ensure the Cabinet Manual is updated to reflect expectations for greater use of exposure drafts.
Regulatory independence and institutional form	A principle-based review of the allocation of provisions between primary legislation and other secondary legislation in regulatory regimes.
Governance, decision rights and discretion	More central support processes to appointment of board members to regulatory Crown entities, and induction material for new board members.
Decision review	Review the adequacy of funding for the Office of the Ombudsman to undertake its statutory functions to a high standard.
Funding regulators	Prepare a statement outlining the Government's cost recovery policy.

Chapter title	Task
Monitoring and oversight	Develop and introduce new regulator peer reviews.
Regulator and regime evaluation and review	Ensure that departments publish their strategies for keeping their regulatory regimes up to date.
System information	Expansion of the New Zealand Legislation website to include 'tertiary regulations'.

## Responsibilities of the minister

The Minister of Finance took over the regulatory reform portfolio in 2013 (discussed in Chapter 2). It is common internationally for this responsibility to be assigned to a senior minister.

Previously, the regulatory reform portfolio was held by ministers outside Cabinet. However, assigning the responsibility to a senior Cabinet minister has significant advantages, as seniority provides:

- the ability to take a whole-of-government perspective;
- the capacity to maintain the Government's focus on improving the system;
- the authority to ensure that initiatives are implemented; and
- access to the information required to develop and implement policy.

The specific responsibilities of the current regulatory reform ministerial portfolio have not been published. The Commission (drawing on Victorian Competition and Efficiency Commission (VCEC) 2011, and OECD, 2012a) considers that there are four main responsibilities that a regulatory minister needs to carry out:

- identifying an integrated policy for regulatory management;
- strategic prioritisation of effort across the regulatory system;
- specifying and allocating tasks for improving the system; and
- promoting continuous improvement in regulatory design and practice.

This set of responsibilities would see the minister undertaking a different set of activities, focused more on the management of the regulatory system, than have been carried out in the past. The Commission has therefore referred to this position as the 'minister for regulatory management', to highlight that the role and responsibilities would change.

### Identifying an integrated policy for regulatory management

Chapter 8 pointed out that regulatory regimes with clear objectives are more likely to enjoy high levels of compliance and credibility, although achieving clarity is not straightforward. This also applies to the regulatory system overall. This is illustrated by the APEC-OECD integrated checklist on regulatory reform, which states that

... the point of departure is to ask whether a regulatory reform policy exists. Such a policy often takes the form of a statement setting out principles to govern regulatory reform which provides strong guidance and benchmarks for action by officials, and also sets out what the public can expect from government regarding regulation. (OECD, 2005, p. 5)

The regulatory system, as an overarching set of governance and institutional arrangements, does not, by itself, achieve the Government's regulatory objectives. Rather, its role is to be an enabler of good performance by the regulatory regimes that operate within the system. The overall policy objective for the system could be expressed in different ways. Box 16.1 sets out one possible approach.

**Box 16.1 Possible high-level regulatory management policy**

The Government seeks a regulatory system that enables and encourages the effective and efficient operation of the regulatory regimes that operate within that system. The Government is seeking a system that is at all times fit for purpose for achieving the Government's regulatory objectives without imposing an undue regulatory burden. The system should be focused on continuous improvement and consistency with best practice principles of regulation.

**Strategic prioritisation of effort across the regulatory system**

With the primary objective of the regulatory system defined, the minister's second responsibility is to lead a process for establishing the strategic priorities for improving – when necessary – different components of the system. There needs to be periodic diagnosis of performance at the system level, followed by the development of strategy and the allocation of effort to achieve these priorities.

For example, it is common overseas for ex ante evaluation of regulations through a Regulatory Impact Statement (RIS) to be given more attention than ex post evaluation. This seems also to be the case in New Zealand. A major strategic choice for the Government is whether to allocate more resources to improving ex post evaluation, and indeed the Government is moving in this direction (Chapter 14). Examples of other broad priorities are focusing on reducing the compliance costs of regulation, or on developing the organisational capability of regulators.

Once major priorities have been determined, a detailed programme for implementing specific initiatives to deliver them should be developed and kept current. This is likely to be an iterative process that involves collecting extra evidence, monitoring the outcomes of initiatives, identifying barriers to progress and considering how to overcome them and, where necessary, finding a place for initiatives in the Government's legislative programme. This will require a strong ongoing commitment from the minister for regulatory management, with appropriate departmental support (see below).

**Specifying and allocating tasks for improving the system**

Many different institutions could be involved in delivering this large number of tasks, including portfolio ministers, the Treasury, the State Services Commission (SSC), the Auditor-General, departments responsible for monitoring regulators or establishing regulatory regimes, regulators, and the Compliance Common Capability Programme (CCCP).

An important role for the minister for regulatory management would be to ensure that tasks the Government accepts are specified precisely and accountabilities for delivering them are allocated appropriately:

The assignment of specific responsibilities for aspects of reform and the creation of a framework for accountability are essential for the success of the programme. (OECD, 2005, p. 6)

A particularly important feature of assigning responsibilities is that there is clarity about the respective responsibilities of the minister for regulatory management and the portfolio ministers who are responsible for specific regulatory regimes. Often, portfolio ministers are responsible for implementing initiatives that are driven from the centre. Part of the role of the minister for regulatory management is following up to ensure that allocated tasks have been completed. This task will only be feasible if the respective responsibilities of different ministers are clear, and if the minister for regulatory management holds a senior position in Cabinet.

Assigning responsibilities will likely be influenced by factors such as existing strengths, capabilities and resources; fit with existing functions; and ensuring that the independence of independent regulators is not compromised (VCEC, 2011, p. 22).

**Promoting continuous improvement in regulatory design and practice**

Ensuring the quality of the regulatory structure is a "dynamic and permanent role of governments and Parliaments" (OECD, 2012a). Maintaining support for improving systems, however, requires sustained

effort. The recommendations in this report, if accepted, would take some years to implement. Indeed, system improvement is a continuous process that never ends. Some changes may be opposed by those who feel they might be adversely affected. Other changes involve “machinery-of-government” issues, which usually have a low public profile. These issues can easily slip down the Government’s agenda, particularly when they are crowded out by episodes of perceived regulatory failure that create pressure for an immediate response, even if this is not consistent with the long-term direction of regulatory policy.

In this inhospitable environment, a central function of the minister for regulatory management would be to identify opportunities for system-wide improvements and to be a champion for implementing them, while preventing this process of continuous improvement from being derailed by short-term responses to regulatory failures. The minister will need to make this case to different audiences, including:

- Parliament;
- ministerial colleagues, who have their own priorities that may seem more pressing;
- departments responsible for overseeing regulators;
- regulators;
- other institutions that can support continuous improvement of the system, such as the Auditor-General and the RRC; and
- those affected by regulation, who in practice are represented by industry associations or community groups.

The most effective approach to communication will vary between these audiences. However, a useful foundation document would be a statement that sets out the Government’s medium-term objective for the regulatory management system, its strategic priorities, and work programme. The Government’s 2009 Statement on Regulation: *Better Regulation, Less Regulation* (Minister of Finance & Minister of Regulatory Reform, 2009), which has now been replaced, was an early example. It set out the Government’s two main commitments at a high level and set out how the Government intended to deliver on these commitments. This could provide a framework to build on when crafting a future statement on regulation. The approach in fiscal policy, where the Government is required to publish a strategy report that sets out long-term objectives, short-term intentions towards meeting these objectives, and then reports regularly on its progress, provides another example.

An equivalent statement for regulation would promote continuous improvement by:

- becoming a vehicle for the Government to report on progress and issues not yet covered;
- motivating stakeholders to monitor progress and lobby the Government to complete the issues that remain;
- providing strategic direction for those who have been allocated tasks to improve the regulatory system; and
- becoming the basis for a living document that could be refreshed as circumstances change.

## R16.2

The Government should publish the responsibilities of the minister for regulatory management. These responsibilities could include:

- defining the overall objective of the regulatory system;
- prioritising effort across the system;
- specifying and allocating tasks for improving the system; and
- promoting regulatory policy and the case for continuous improvement in regulatory design and practice.

**R16.3**

The minister for regulatory management should publish a strategy report that sets out the medium-term objectives that the Government is seeking to achieve through the regulatory system, its strategic prioritisation of effort for achieving these objectives, and its work programme. The minister should report regularly on progress towards delivering this work programme, and update the statement as necessary.

## 16.4 Effective institutions to support the minister and the functioning of the system

Two features are particularly important in designing the institutional support for the minister for regulatory management:

- specifying the functions that the agency needs to perform to give adequate support to the minister; and
- specifying the form of the agency (independent, a branch within a department, or something else) and the department in which it should be located.

### Functions

Table 16.2 identifies 15 functions that could be involved in providing this support for the minister's four roles identified in recommendation 16.1.

**Table 16.2** Functions to support the minister for regulatory management

Functions	Who currently does this?
1. Provide advice on medium-term strategic objectives for the regulatory system.	Treasury
2. Undertake regular stocktakes and evaluations of the state of the regulatory system and priorities for reform, as the basis for advice to the minister and for a report that the minister would table.	Treasury
3. Provide advice on new mechanisms (eg, on design of a new system for monitoring regulators and for evaluating regulatory regimes).	Treasury; MBIE
4. Promote better regulation throughout the public sector, including by providing support and expertise to other agencies on regulatory design and on implementation of regulatory instruments, when required.	-
5. Manage the RIS process.	Treasury
6. Manage the proposed new process for monitoring regulators.	-
7. Manage the proposed new process for evaluating regulatory regimes.	-
8. Train departments/agencies/reviewers in how to prepare RISs; undertake reviews of regulators etc.	Treasury does this for the RIS process
9. Report periodically on compliance with the Government's requirements in respect of RISs, reviews of regulators, etc.	-
10. Maintain an online register of all RISs, and of reviews of regulators and regimes.	Treasury does this for RISs
11. Monitor practices in other jurisdictions.	Treasury
12. Provide advice/thought leadership on regulatory practice.	CCCCP (informally)
13. Provide advice on the current state and needs of the regulatory workforce.	CCCCP (informally)

Functions	Who currently does this?
14. Assess the adequacy of the monitoring of departmental regulators.	PIF reviews are beginning to do this
15. Assist departments to undertake effective appointment processes for regulatory Crown entities.	-

These functions can be categorised into five groups; those that:

- report on the overall state of the regulatory system, identify areas needing improvement and a strategy for delivering improvement (Functions 1 and 2 in Table 16.2);
- design mechanisms and approaches to improve the operation of the regulatory system (Functions 3 and 11);
- manage implementation of the mechanisms (Functions 5, 6, 7, 8, 9, and 10);
- use system-wide information from implementation of these mechanisms to inform development of strategies for improving the regulatory system (Functions 1 and 2); and
- improve regulators' organisational and workforce capability (Functions 4, 12, 13 14 and 15).

Table 16.2 highlights that if the Government accepts the recommendations in this report and, for example, decides to introduce new mechanisms for monitoring the effectiveness of regulators and for evaluating the stock of regulation, there will be a consequent requirement to design and manage the implementation of these mechanisms. This will lead to new functional requirements that currently do not have a departmental "home".

The last five functions in Table 16.2 relate to aspects of capability, which the report has identified as being particularly important to achieving regulatory outcomes. The CCCP is currently, in effect, performing two of these functions. As noted in Chapter 5, a more active role by central agencies appears warranted, such as strengthening the responsibility on agencies to focus on workforce capability and increasing the emphasis on workforce capability through performance reviews. Other system-wide responses are also needed to professionalise and lift the capability of the regulatory workforce. Examples are:

- developing and promoting system-wide guidance material (cost recovery guidelines that apply to all regulators are an example);
- encouraging knowledge sharing across the system; and
- tapping into international regulatory expertise that is relevant to the regulatory system as a whole.

## The form and location of the agency

In 2008 almost all OECD countries had a dedicated regulatory oversight body, responsible for promoting regulatory policy and monitoring on regulatory reform, and undertaking at least some of the functions identified in Table 16.2. However, there are different views about where these functions should be located within government (Box 16.2).

### Box 16.2 OECD insights about the location of regulatory management functions

#### OECD 2010

Many countries have difficulty determining the best location for a central unit, if they are trying to establish one. Possible locations which have been tested include the centre of government (prime minister's office or equivalent), enterprise ministry, finance ministry, justice ministry, and home affairs ministry. This is very country specific, reflecting traditions and the relative weight given, for

example, to the economic or legal context for regulatory policy. In countries with a long regulatory management tradition, location may vary over time (for example between the centre of government and the enterprise ministry).

The differences also reveal a more fundamental issue: regulatory management affects a wide range of ministries and does not have an automatic “home” (as does, for example, fiscal policy). One or two countries have set up units made up of secondees from key ministries. This appears to be a very promising approach. There are advantages and disadvantages to a single location. For example, centres of government are often reluctant to take on substantive tasks that may compromise their key function of arbitration and strategic management; finance ministries may be too engaged in other parts of their portfolio to pay enough attention to regulatory management (although they are important because of their power); and enterprise ministries are closer to their clients than to centres of government, but may lack authority over other ministries. (pp. 70-71)

## OECD 2011

The OECD cite Cordova-Novion and Jacobzone (2011), who analyse the central factors contributing to success of regulatory oversight, including the mandate, powers, structure, location, resources and coordination mechanisms. The findings are set out below.

- Oversight bodies are generally located close to core executive functions: either at the centre of government itself, or as part of central ministries. Despite significant institutional heterogeneity, a key issue for success is the existence of a structured unit or dedicated secretariat. It can be set up within the executive, or as a council/committee as part of an arm’s length arrangement.
- The credibility of the core unit builds on technical expertise and political support, and is important to ensure coherence, leadership and efficiency. In some countries the core functions of oversight remain divided among different institutions. Such division has implications for coordination.
- The system of regulatory oversight involves checks and balances, and often includes opt-out exemptions and time limits. A constant concern is to minimise infringements to ministerial responsibilities, while ensuring commitment at the political level. A balanced approach is necessary, so that no significant loopholes can undermine regulatory quality oversight, such as omitting tax issues, or checking only part of the new regulations. Transparency and accountability mechanisms are required.
- Countries increasingly tend to adopt networked approaches for regulatory oversight. A core body, enjoying direct explicit or indirect implicit powers, coordinates a network of units in the various ministries. This contributes to policy coherence, while ensuring the interface with policy making in sectoral areas. The units collaborate and complement each other in a dynamic way when fulfilling the core functions. While decentralising the substantive work helps to foster change in the sectoral areas, this also entails issues in terms of balancing powers and priorities. (2011, p. 80)

*Source:* OECD, 2010; OECD, 2011.

Maritime New Zealand (MNZ) submitted that the current ministerial support arrangements are not working. MNZ proposed a “super monitor” that would:

...provide a much clearer layer of support to the minister with responsibility for regulatory management and the existing PIF system. It will also enable a much clearer delineation of respective accountability mechanisms under the Crown Entities Act, reducing the burden on smaller agencies, yet ensuring that the super monitor focuses on the achievement of regulatory outcomes... departments and ministries with policy and regulatory monitoring functions would no longer have those regulatory monitoring functions ... the monitoring agency could also monitor regulatory activity in departments and ministries. This would achieve a more comprehensive and consistent “whole of government” approach to monitoring of regulatory activity. (sub. DR 95, p. 2)

Departments with regulatory monitoring functions would no longer have these functions under this model. In MNZ’s view, the only disadvantage of this option, apart from its additional establishment cost, is its lack

of clarity in terms of its capacity to advise the minister. However, MNZ considers that it is clearly the best approach

... given the stated advantages in terms of sharper focus and more openness to innovation, and other advantages such as dedicated expertise in regulatory issues, no competing priorities, potential for centralisation of regulatory agency monitoring by a specialist monitoring body, and a community wide perspective. (sub. DR 95, p. 2)

The Commission agrees with MNZ that it is important that the entity advising the minister is focused on regulatory management, has dedicated regulatory expertise, no competing priorities within the organisation, and takes a community-wide perspective. It also agrees that a small team in a branch within the Treasury, where there are many competing priorities, will always have difficulty attracting the attention of decision makers.

However, as discussed in Chapter 13, the super agency model proposed by MNZ could, unless very carefully designed, infringe on the accountabilities of portfolios for delivering regulatory outcomes. Portfolio ministers appear, under this model, to no longer to have a role in monitoring the performance of the regulators within their portfolios. The Commission concluded in Chapter 13 that retaining close links between regulators and policy departments was necessary to support effective reform of regimes, and that responsibility for monitoring regulators should therefore remain with departments, supported by the new peer reviews. The Commission is also not aware of “super agencies” that perform all of these functions in other jurisdictions.

A possible option that could provide many of the focus and specialisation benefits envisaged by MNZ would be to create a separate division within a government department, which has some independence from the department when undertaking its roles. One example is the New Zealand Debt Management Office, which is an operating unit of the Treasury responsible for managing the Crown’s debt, overall cash flows and interest bearing deposits. The Office was established to improve the management of the risks associated with the Government’s debt portfolio. It has its own website, to provide access to information about its activities and about debt management more generally ([www.nzdmo.govt.nz](http://www.nzdmo.govt.nz)). Previously, its separation from the department was enhanced by, for example, having an advisory board.

The Office of Best Practice Regulation (OBPR) in Australia provides another example. Its roles (which include administering RIS requirements; training departments and agencies about how to prepare RISs; and monitoring and reporting on the Government’s Regulatory Impact Analysis requirements) are formally set out in a charter that is published on the OBPR’s website ([www.dpmc.gov.au/deregulation/obpr](http://www.dpmc.gov.au/deregulation/obpr)). This is an example of a separately “badged” unit that is located within a government department but nevertheless has an identifiable profile. This structure could provide a model for raising the profile of regulatory management in New Zealand, by permitting more focus on this issue but not taking over responsibilities that should sit with the portfolio departments.

A further issue is the department in which to locate the support agency. Table 16.3 presents four possible options (the Treasury; the Ministry of Business, Innovation and Employment (MBIE); the SSC; and a networked approach), and summarises their advantages and disadvantages. Under a networked approach the Treasury, for example, would have the main oversight role, but with the SSC being assigned responsibility for parts of it. The participation of the SSC would reflect its statutory role to “promote strategies and practices concerning government workforce capacity and capability” (s 6 (f) of the State Sector Act 1988, relevant to Function 13 and Function 14 in Table 16.2) and to provide advice about “the allocation and transfer of functions and powers ... and the establishment, amalgamation, and disestablishment of agencies” (s 6(b)(i) & (iii) of the State Sector Act 1988). The State Services Commissioner also has a number of wider roles, which suggests it should be an active participant in the regulatory management system. However, it is clear from material collected from both inquiry participants and external parties that the SSC is not currently playing a major role in regulatory management affairs.

**Table 16.3 Possible locations of a support agency for the minister for regulatory management**

Possible location	Advantages	Disadvantages
The Treasury	<ul style="list-style-type: none"> <li>• Has authority within the government sector.</li> <li>• Already plays a role in regulatory management.</li> <li>• Can take an economy-wide perspective.</li> </ul>	<ul style="list-style-type: none"> <li>• Many competing priorities could mean that regulation struggles for attention.</li> <li>• Does not have expertise in some regulatory hot spots (such as workforce capability).</li> </ul>
MBIE	<ul style="list-style-type: none"> <li>• Oversees many regulators.</li> <li>• Is well placed to understand industry's needs.</li> <li>• Is closer to regulators and to those who are regulated.</li> </ul>	<ul style="list-style-type: none"> <li>• May not take a community-wide perspective.</li> <li>• Is not well placed to address issues facing regulators outside the portfolio.</li> <li>• Has less authority than central agencies within the government sector.</li> </ul>
SSC	<ul style="list-style-type: none"> <li>• Has current functions in relation to governance and capability.</li> </ul>	<ul style="list-style-type: none"> <li>• Does not have expertise in other regulatory issues.</li> <li>• Is not seen by chief executives as playing a role in holding them to account for regulatory functions.</li> </ul>
Networked approach	<ul style="list-style-type: none"> <li>• Combines the knowledge and skills of different agencies.</li> </ul>	<ul style="list-style-type: none"> <li>• Can lead to accountability problems unless roles and responsibilities are specified precisely.</li> </ul>

The Commission considers that the Treasury remains the appropriate location for the agency to support the minister for regulatory management, but that the resourcing and status of the group responsible for supporting the minister needs to be enhanced to reflect the minister's increased responsibilities. To achieve this, the group should have a charter that sets out its objectives and functions based on functions identified in Table 16.2, and the capacity to identify itself separately with its own website. It would need additional resources.

An issue that would need to be resolved is whether the new group within the Treasury should be responsible for both designing and managing the implementation of instruments to evaluate regulations, regulators and the stock of regulation. Combining the design and implementation of instruments within one group would capture synergies between these functions. However, the authority of those responsible for implementation may be greater if they cannot be held accountable for the design of the instruments they are implementing. On balance, the Commission does not have a strong view about whether combining or separating these two functions is superior.

**R16.4**

The Treasury should provide support for the minister for regulatory management, through an expanded team, with a published charter setting out its objectives and functions, its own website, and the authority to identify itself as a separate unit within the Treasury.

### Location of the new position to provide intellectual leadership in regulatory practice

In relation to capability, the Commission proposed in Chapter 5 that a position should be created to provide intellectual leadership in regulatory practice. The position would be responsible for activities designed to have system-wide impacts, including:

- coordinating the development of professional development pathways and accredited qualifications;
- working with chief executives of regulatory bodies to identify common capability gaps and strategies for filling these gaps across the system;

- working with research organisations to investigate regulatory issues of importance to New Zealand agencies;
- developing and maintaining good practice guidance; and
- leading and managing professional forums of regulators.

The effectiveness of this new position will be affected by its location. Options include locating it in:

- the proposed new team within the Treasury;
- a portfolio department with regulatory responsibilities, such as MBIE;
- the SSC;
- a new “Office of the Head of Profession”; or
- a university or other educational institution.

Table 16.4 sets out the advantages and disadvantages of these options.

**Table 16.4 Possible locations of intellectual leadership position**

Possible location	Advantages	Disadvantages
The new team in the Treasury	<ul style="list-style-type: none"> <li>• Would set up clear line of accountability to the minister for regulatory management.</li> <li>• Would have authority within the government sector.</li> <li>• Likely to have synergies (both in respect of issues covered and personnel) with the rest of the team.</li> <li>• Can take economy-wide perspective.</li> </ul>	<ul style="list-style-type: none"> <li>• Is remote from regulators, which may reduce understanding of the issues facing the sector and create communication problems.</li> <li>• May be a risk that thought leadership issues will be crowded out by other issues facing the team.</li> <li>• May not be seen as credible, as regulation is not the core business.</li> </ul>
Major regulatory agency (eg, MBIE, MPI, DIA)	<ul style="list-style-type: none"> <li>• Is well placed to understand industry’s needs.</li> <li>• Is closer to regulators and to those who are regulated.</li> <li>• May have internal systems for identifying regulatory developments</li> </ul>	<ul style="list-style-type: none"> <li>• Does not have a clear line of accountability to the minister for regulatory management.</li> <li>• May not take a community-wide perspective.</li> <li>• Has an incentive to focus on issues facing regulators within the portfolio.</li> <li>• Has less authority within the government sector.</li> </ul>
SSC	<ul style="list-style-type: none"> <li>• Has expertise in relation to governance and capability.</li> <li>• Is close to performance review frameworks.</li> <li>• Has high visibility across government.</li> </ul>	<ul style="list-style-type: none"> <li>• Does not have a clear line of accountability to the minister for regulatory management.</li> <li>• Is remote from regulators, which may reduce understanding of the issues facing the sector and create communication problems.</li> <li>• Does not have expertise in some regulatory issues.</li> </ul>
A new, specially created, “Office”	<ul style="list-style-type: none"> <li>• Would provide a strong focus on thought leadership, as this is its only responsibility.</li> </ul>	<ul style="list-style-type: none"> <li>• Would face the additional costs of setting up a new entity.</li> <li>• Lacks authority across the government</li> </ul>

Possible location	Advantages	Disadvantages
	<ul style="list-style-type: none"> <li>• Could be set up to have clear line of accountability to the minister responsible for the regulatory system.</li> </ul>	<ul style="list-style-type: none"> <li>• Is remote from regulators.</li> <li>• Is remote from policy advisors, including the proposed new team in the Treasury.</li> </ul>
University or educational institution	<ul style="list-style-type: none"> <li>• Is well placed to tap into international academic thinking.</li> <li>• Has an existing infrastructure and networks to support research.</li> <li>• Would bring an element of academic rigor and scrutiny to published guidance</li> </ul>	<ul style="list-style-type: none"> <li>• Is not part of government, so lacks authority across government.</li> <li>• Is remote from regulators.</li> <li>• Is remote from policy advisors.</li> <li>• May be seen as too academic and not grounded in regulatory practice.</li> </ul>

None of these options stands out as clearly the best. However, the advantages of locating the position within the new unit in the Treasury are important and its disadvantages could be addressed by setting out clearly the role and responsibilities of the new role. Any concerns that this might not provide sufficient autonomy for the new role could be addressed by a hybrid of the first and fourth options in Table 16.4. This hybrid would involve creating an office of the head of the regulatory profession within the new team in the Treasury.

Whichever option is chosen, the person selected to fill the new position would need to have credibility with regulators. The person would also need to work closely with people in portfolio departments who are responsible for monitoring regulators and providing policy advice; with regulators; and with others involved in developing capabilities for those in the regulatory sector. This would include in particular the SSC, the CCCP, the Skills Organisation, and universities.

The Government could of course review the effectiveness of any new arrangements at any time, but should do so no later than three years after they are established.

### R16.5

The Government should locate the proposed role for providing intellectual leadership on regulatory issues within the Treasury team that provides advice to the minister for regulatory management. It should review the effectiveness of the new arrangements no later than three years after they are established.

## 16.5 Strengthening and aligning incentives with regulatory objectives

How well initiatives are implemented will be influenced by the strength of the motivations of those who are accountable for implementing them. The possibility that a change will lead to better outcomes provides some motivation for implementation. However, the report has identified other ways to motivate those operating within the regulatory system. Table 16.5 groups them into five broad categories and lists the recommendations that fit within each category.

Importantly, the Commission is proposing that these mechanisms would become permanent features of the regulatory management system. This means that they would encourage continuous improvement, not just a one-off lift in the system's performance.

The Commission's proposals would place some extra burdens on external reviewers (such as the RRC of Parliament), and on the SSC. However, the Commission considers that these organisations will be an important part of any plan to improve how the regulatory system operates.

**Table 16.5** Mechanisms for motivating change

Type of incentive	Examples	Comment	Relevant recommendations
Expectations	Expectations that departments will review the stock of legislation or comply with cost recovery guidelines.  Clearer expectations that regulators will promote capability.	Can be a powerful incentive if expectations come from an authoritative source (such as the Cabinet.) But may be weakened if there is no follow up for non-performance.	5.1, 14.1
Legislative requirement	Legal requirement to review the operation of legislation/regulation.	Non-compliance can have serious consequences. May not be appropriate when flexibility is needed.	14.1
Professional	Development of a professional regulatory workforce, with shared training, qualification and standards.	Effectiveness depends on being able to specify clear enough standards and develop enforcement mechanisms.	5.3, 5,4
Transparency	Reporting by regulators on their capability development strategies.  Regular presentation of a progress report by the minister responsible for regulatory management.	Can be very powerful, when people can be held accountable for achieving clearly-defined performance measures.	5.1, 14.1, 16.3
External review	Increased use of Performance Improvement Framework audits and peer reviews	Provides an independent perspective, but can create additional costs for reviewed agencies.	13.4, 13.5

## 16.6 How the Commission's proposals will improve the performance of the system

At the beginning of this report (Chapter 2), the Commission laid out an assessment of how well the regulatory system is currently performing, against five main criteria:

- only necessary and proportionate new rules are introduced;
- prioritisation of effort towards the most significant issues or risks;
- adequate resourcing of the implementation of new rules;
- fair and effective implementation of new rules; and
- a self-aware and learning system.

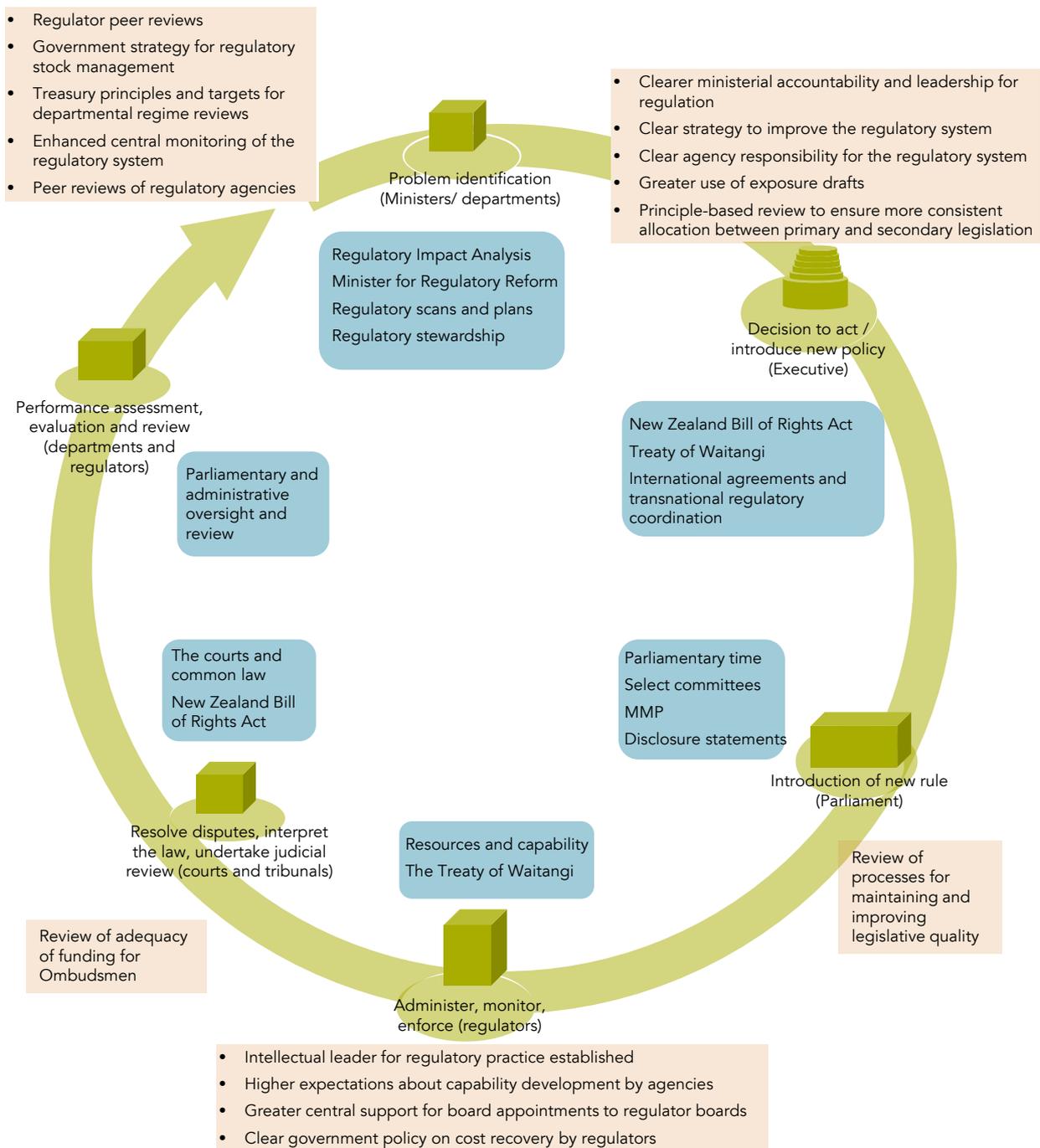
The assessment led to four conclusions.

- The regulatory system struggles to deliver proportionate and necessary rules because of weaknesses in the policy and RIA processes (which were not adequately testing proposals for new regulation), heavy reliance on statute and limited Parliamentary time.

- The system does not seem to effectively prioritise its efforts, due to the patchy implementation of some regulatory management tools (eg, regulatory scans and plans) and weak central leadership.
- Resourcing of implementation is a concern, with inadequate capability of regulatory agencies a contributor to regulatory failures.
- Weak review and evaluation cultures and monitoring practices, and the culture of some regulators, inhibit the ability of the system to identify issues and learn from experience.

In this report, the Commission is recommending changes to regulatory practice and design and the management of the overall system, to resolve or mitigate many of these problems. Figure 16.1 summarises the major changes the Commission is recommending, and their location in the regulatory system.

**Figure 16.1 The Commission's proposed changes to the regulatory system**



The impacts of these recommended changes on the performance of the system can be seen in Table 16.6. Some changes affect more than one performance criterion.

**Table 16.6** Impacts of the Commission's recommended changes on the performance of the regulatory system

System criteria	Relevant recommendations
Necessary and proportionate rules	<ul style="list-style-type: none"> <li>• Greater use of exposure drafts for legislation proposing significant changes to regulatory regimes.</li> <li>• Expanded LAC guidelines on when to use the different types of delegated legislation.</li> <li>• Review of the processes for maintaining and improving legislative quality.</li> </ul>
Prioritisation of effort	<ul style="list-style-type: none"> <li>• Senior Cabinet minister given clear responsibility for the regulatory system, with strengthened central agency support.</li> <li>• Publication of a government strategy for the regulatory system, with regular reporting on progress.</li> <li>• Policy departments to move to risk-based monitoring of regulatory Crown entities.</li> <li>• Focus new regulator peer reviews on the larger Crown entities and on departments that implement regulation.</li> <li>• Development and publication of government strategy for improving the management of the regulatory stock.</li> <li>• Development by the Treasury of principles and targets to focus departmental regime review efforts on those that have the highest anticipated benefits.</li> </ul>
Adequate resourcing of implementation	<ul style="list-style-type: none"> <li>• Introduction of regulator peer reviews through the PIF process.</li> <li>• Higher minimum expectations about the promotion of regulatory capability in agencies.</li> <li>• Establishment of an intellectual leader for regulatory practice.</li> <li>• Greater central support for policy departments managing appointments and reappointments in regulatory Crown entities.</li> </ul>
Fair and effective implementation	<ul style="list-style-type: none"> <li>• Publication of government policy on cost recovery, and stronger incentives on regulators to adhere to that policy.</li> <li>• Introduction of regulator peer reviews through the PIF process.</li> <li>• Better guidance on risk targeting, the appropriate use of compliance strategies and the use of feedback loops/business intelligence.</li> <li>• Principle-based review of regulatory legislation to ensure consistent allocation of material between primary and secondary legislation.</li> <li>• More transparency about regulator decision-making processes, decisions and conflict of interest policies.</li> <li>• Review of the adequacy of funding for the Ombudsmen by the Officers of Parliamentary Select Committee.</li> <li>• Publication of a government cost recovery policy, and greater transparency from agencies about their fees, policies and processes.</li> </ul>
A self-aware and learning system	<ul style="list-style-type: none"> <li>• Publication of a government strategy for the regulatory system, with regular reporting on progress.</li> <li>• Introduction of regulator peer reviews through the PIF process.</li> <li>• Development and publication of a government strategy for improving the management of the regulatory stock.</li> <li>• Establishment of an intellectual leader for regulatory practice.</li> <li>• Enhanced system monitoring.</li> </ul>

## 16.7 What the proposals would cost

Implementation of most recommendations in this report would be undertaken by the proposed new Treasury unit, the SSC, departments with responsibility for regulators, regulators, and other agencies such as the Parliamentary Counsel Office. The SSC, with responsibility for eight recommendations, would perform an important role. However, most recommendations affecting the Commission involve refining or re-directing its existing roles, and so should not require a significant increase in resources.

The proposed new Treasury team would also implement many recommendations. Some involve re-directing existing effort. However, the team would also take on additional responsibilities, including the new position for providing professional leadership. While the requirement for additional staff would need to be assessed carefully, the Commission's expectation is that up to 10 additional full-time equivalent staff might be required – a significant increase on the six or so people in the team at the moment.

Some recommendations, such as regular peer reviews through the PIF process and reviews of regulatory regimes, would impose costs on other parties. However, in these cases as well there is scope to re-direct existing effort. In other cases, such as the proposed reviews of regulatory regimes (Chapter 14), the Government can cap expenditure. The crucial requirement is that the Government has a logical approach for selecting high-priority reviews within a budget constraint.

Given that some recommendations involve re-prioritising current expenditure while in other cases the Government has discretion about the pace and extent of action, the Commission has not quantified the cost of its recommendations. However, some indication is given by two RISs prepared by the Treasury's Regulatory Quality Team (New Zealand Treasury, 2011a; 2013e), which assessed packages of options for encouraging better-quality regulation. These packages included options such as increased disclosure, guidance and support to departments from the Parliamentary Counsel Office and the Treasury, tighter RIA requirements, enhanced roles for select committees, and enhanced reporting requirements. As there is considerable difference between the scope of the packages, their estimated costs vary widely – between \$0.85 million and \$10 million a year.<sup>88</sup>

The Commission's view is that the costs of its recommendations are low in relation to the benefits from reduced compliance costs and improved regulatory outcomes, which could be achieved from addressing the significant deficiencies of the regulatory management system identified in this report.

## 16.8 Next steps

Given that the report suggests 44 recommendations for improving the regulatory system, careful implementation will be needed. The first step should be to clarify the roles of the senior Cabinet Minister who is responsible for regulatory management and to provide the minister with strengthened central agency support (Recommendations 16.3 and 16.4). This will enable the minister to publish a strategy report outlining the medium-term objectives to be achieved through the regulatory system; and the strategic prioritisation of effort for achieving these objectives; and the work programme (Recommendation 16.2).

## 16.9 Conclusion

The regulatory system is a large and important part of New Zealand's policy infrastructure. This report has reviewed the components of the system and found deficiencies in each of them alongside a surprising complacency about how the system as a whole is performing, as revealed in part by the insufficient, and in some cases declining, resources committed to matters of regulatory design and review.

The designers and implementers of regulation face escalating expectations, complexity and challenge. This report shows many areas where the capability and performance of the regulatory system in designing and regularly upgrading regulatory regimes falls well short of what it should and can be. There has been some progress through recent initiatives including the creation of a ministerial portfolio for regulation, the "Better

<sup>88</sup> This excludes about \$5 million which was the estimated cost of creating a new Office of Parliament, which is not recommended in this report.

Regulation, Less Regulation” package, the Regulatory Standards Bill, and the regulatory stewardship requirements. But while efforts to improve the regulatory system can be identified, these are fragmented and follow-through has been inadequate in some initiatives. Focus, continuity and a system-wide view of performance weaknesses and potential improvements are required. There is considerable scope to get much better performance out of the system, with a real imperative to do so in support of the greater wellbeing of New Zealanders, and reduced risk of regulatory failure.

The approach suggested in this chapter would concentrate attention on the role and contribution of the system to the wellbeing of New Zealanders and encourage a more strategic approach to initiatives aimed at improving it. It would:

- sharpen the accountabilities of those who have important roles to perform in improving the system;
- redirect effort to improve the system to where it can yield the highest dividends;
- increase the attention devoted to improving organisational and workforce capability; and
- build in mechanisms to encourage continuous improvement of the system, to keep it current.

New Zealand is not so well off that it can afford to settle for second best in its foundational systems. Indeed, given the disadvantages of small scale and isolation, New Zealand needs to excel in such matters if it is to meet its aspiration to deliver first-class living standards to all New Zealanders. Achieving this will require focus, enthusiasm, professional capability and active political support.

# Findings and recommendations

The full set of findings and recommendations from the report are below.

## Chapter 2 – New Zealand’s regulatory system

### Findings

**F2.1**

Frequent changes to the underlying regulatory frameworks have contributed to New Zealand utilities being assessed as having a higher risk profile than equivalent sectors overseas.

**F2.2**

The balance of pressures from industry and the community, and New Zealand’s very centralised constitutional system, create a bias in favour of more regulation.

**F2.3**

New Zealand appears to make more use of primary legislation in its regulatory regimes than other jurisdictions, and statutes often address matters in considerable detail.

**F2.4**

It can be difficult to find time on the Parliamentary calendar for “repairs and maintenance” of existing legislation. As a result, regulatory agencies often have to work with legislation that is out of date or not fit for purpose. This creates unnecessary costs for regulators and regulated parties, and means that regimes may not keep up with public or political expectations.

**F2.5**

The ability of the courts to review the behaviour of regulators and, in many cases, the merits of their decisions, is one of the most significant constraints on the exercise of regulatory power in the system.

**F2.6**

New Zealand does not have strong processes for reviewing regulatory regimes, leading frequently to a “set and forget” mindset to regulation.

## Chapter 3 – Regulatory practice

### Findings

**F3.1**

Responsive regulation has been an important influence in the thinking about effective regulatory compliance worldwide over the last two decades and is widely used as a compliance strategy by New Zealand regulators.

**F3.2**

The literature points to a number of impediments to successfully implementing responsive regulation. There may be instances where implementing a graduated compliance approach is not in the interest of the overall objectives of the regulatory regime and there can be significant constraints on the regulator in being able to use the responsive/enforcement pyramid as intended.

**F3.3**

Risk-based regulation has become increasingly influential and Cabinet expects that “departments, in exercising their stewardship role over government regulation, will maintain a transparent, risk-based compliance and enforcement strategy” (Offices of the Ministers of Finance and Regulatory Reform, 2013b, p. 15).

**F3.4**

There has been widespread endorsement of risk-based approaches to regulation because risk-based approaches directly relate the activities of the regulator – targeting risk – to the objectives of the regulatory regime – reducing the risk of harm. But risk-based approaches pose a number of challenges in implementation. There can be a lot of uncertainty about the nature of the risk and at what point the regulator should intervene.

**F3.5**

Regulators adopt a range of responses to reconciling responsive and risk-based approaches to regulation.

**F3.6**

An integrated approach to risk-based and responsive regulation can help the regulator choose the best intervention to meet the objectives of the regulation, based on both the nature of the risk and the nature of the regulated party.

**F3.7**

There is no single, superior regulatory strategy. The key lies in understanding and adapting regulatory strategies to take account of the influences and dynamics of the many different contexts in which they are deployed.

## Chapter 4 – Regulator culture and leadership

### Findings

**F4.1**

The espoused values of new regulators may be “aspirational” rather than deeply ingrained and widely accepted. This means such values may not actually reflect the beliefs of those working within the organisation or be reflected in their actions.

**F4.2**

The culture that emerges within a new regulatory agency will be influenced by:

- the beliefs, values, assumptions and behaviour of its founding leaders;
- the experiences of members of the organisation as it matures; and
- the injection of new beliefs, values and assumptions through new members.

**F4.3**

Good internal communication is a catalyst for developing a culture of organisational learning. Yet central government regulatory workers are significantly less likely than non-regulatory workers to believe that there is good communication within their organisation.

**F4.4**

With some exceptions, New Zealand regulators do not appear to have a strong culture of learning from experience.

**F4.5**

The culture of some New Zealand regulatory bodies appear to place significant weight on managing risks to the organisation, at the expense of the efficient management of social harm. Such cultures can resist innovation in regulatory practices.

**F4.6**

Clarifying how regulators are expected to perform and reshaping their views of success are important steps to addressing institutional risk-aversion within regulatory bodies.

F4.7

Adopting new approaches to monitoring and enforcement can result in tension between the cultures of “traditional” enforcement staff and organisational leaders. This tension can act as a barrier to regulators improving how they operate.

F4.8

When implementing new regulatory practices, leaders within regulatory agencies should assess the extent to which advocates of existing practices will resist any new practices. Strategies to manage cultural changes should be factored into the broader change management process.

F4.9

The likelihood that systemic failures in regulatory regimes will go unchecked is higher when regulators have poor internal communication, lack the ability to learn from experience and have professional subcultures that resist change.

F4.10

It is important for regulatory bodies, as far as possible, to gain an understanding of the culture and motivations of regulated parties, and for regulated parties to gain an understanding of the culture and motivations of the regulatory body.

F4.11

Evidence suggests that previous changes to the functions and structure of regulatory agencies have been made without a sophisticated understanding of the cultural implication of change.

F4.12

Prior to contemplating changes to the structure and functions of regulatory bodies, the Government should undertake a substantive assessment of the cultural issues associated with change. Strategies for managing potential cultural issues should be explicitly included in change management plans.

F4.13

The way in which a regulator engages with stakeholders is often perceived as a “window” to the organisation’s culture. It is important to assess whether the quality of engagement is driven by the regulator’s deeply held values and beliefs, or whether it is driven by some other factor – such as the legislative framework or available resources.

F4.14

Regulatory workers who perceive their managers clearly communicated the organisational mission are more likely to feel emotionally attached to the organisation, be more loyal to the organisation, and be more committed to the organisation. However, generally central government regulatory workers do not perceive that senior managers communicate a clear organisational mission.

F4.15

When looking to improve the performance of a regulator, it is vital to understand whether what is required is a *change in regulatory practice within a given culture*, or a change in culture. This requires specific assessment of the culture within a regulatory agency and the institutional factors that impact the way it operates.

F4.16

Government can “seed” the culture of a new regulatory agency by appointing founding leaders who have values, beliefs and experiences that are consistent with its vision of the “ideal” culture. However, selecting the “right people” does not guarantee that the “right” culture will emerge – the actions of founding leaders are the key embedding mechanism.

**F4.17**

When establishing a new regulator, it is important to have founding leaders in place from the start of the organisation. This will provide the leader with the opportunity to influence the cultural foundations of the organisation. The use of “interim leaders” should be avoided where possible.

**F4.18**

While legislative provision can codify required actions, they do not guarantee that a regulator will develop deeply held values around the importance of those actions.

**F4.19**

Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.

**F4.20**

There is disagreement in the academic literature around the extent and pace at which embedded cultures can actually change. This debate reaffirms the importance of promoting an “appropriate” culture from the inception of a regulatory body.

## Recommendations

**R4.1**

The State Services Commission should develop guidelines to assist regulatory bodies to manage cultural changes associated with restructures and changes in functions. Monitoring agencies should use this guidance as the basis for assessing whether cultural issues are adequately reflected in broader change management strategies.

## Chapter 5 – Workforce capability

### Findings

**F5.1**

The regulated environment is constantly changing, requiring regulators to be flexible and able to adapt. New technologies, new risks and new risk creators may require new skills and upskilling of regulatory staff.

**F5.2**

Most regulators share a set of core functions, and these functions create demand for a set of foundational capabilities. However, specialist knowledge of the subject matter is often required to perform these core functions in a manner that is appropriate to the regulatory task at hand.

**F5.3**

Regulatory agencies face challenges in training people with specialist industry knowledge and technical skills (and who may bring with them their own professional cultures and attitudes) to become regulatory professionals with a core set of generic skills and competencies required of the role.

**F5.4**

Only 5 of the 23 regulator chief executives surveyed agreed there are significant skill gaps among regulatory staff. This is in contrast to the results of a PSA survey and the Productivity Commission’s business survey which both indicated considerable concern around the level of skill, knowledge and training of central government regulatory workers. These results may indicate that some regulator chief executives do not fully appreciate the skill gaps within their organisation.

**F5.5**

Compared to the size of the regulatory workforce, the number of people completing qualifications within the compliance sector (excluding Police trainees) is very low.

**F5.6**

A range of training opportunities seem to be available but some evidence indicates that those opportunities do not meet the needs of regulatory agencies or their staff. This could be because the training is insufficiently tailored to the specific needs of regulatory agencies or that generic training in core competencies is not required of staff working in regulatory roles. In any event, the completion rates for compliance and regulatory control qualifications appear to be low.

**Recommendations****R5.1**

The State Services Commission should develop a set of minimum expectations around the promotion of regulatory capability, and require Crown entity statements of intent to demonstrate how the Crown entity will meet those expectations.

**R5.2**

Guidance on regulatory practice should be updated to provide additional information on:

- how to define and target risks;
- how to select compliance tools that reflect both the risk and compliance attitudes of regulated parties;
- how to establish strong internal feedback loops for gathering and assessment of how well enforcement strategies are working; and
- tools and strategies to enable the regulator to understand the wider influences that shape the response of regulated parties to the regulatory regime.

**R5.3**

The government should provide partial direct funding of regulator communities of practice (subject to a suitable business case and performance measures) and strengthen its expectations about regulatory agencies participating in these networks (for example through revising Cabinet's *Expectations for Regulatory Stewardship*).

**R5.4**

A position should be created to provide intellectual leadership in the area of regulatory practice. The position would be responsible for:

- disseminating information on the latest developments in regulatory theory and practice;
- coordinating the development of professional development pathways and accredited qualifications;
- working with chief executives of regulatory bodies to identify common capability gaps and strategies for filling these gaps across the system;
- working with research organisations to investigate regulatory issues of importance to New Zealand agencies;
- developing and maintaining good practice guidance;
- promoting a common "professional language" throughout New Zealand regulatory agencies;
- coordinate study tours and visits by international experts and leading academics in the field of regulatory studies; and
- leading and managing professional forums of regulators.

## Chapter 6 – Consultation and engagement

### Findings

**F6.1**

The “regulatory relationship” is influenced by both the nature of the regulation and the characteristics of regulated parties and beneficiaries. When designing new regulatory regimes, careful thought must be given to the relationships that should exist between the regulator, regulated parties and those who are the beneficiaries of regulation.

**F6.2**

In general, the greater the level of public participation, the more critical it becomes that there is a common understanding of the scope for stakeholders to influence regulatory decisions. Failure to do so can undermine public confidence in engagement processes and in the competence of the regulator.

**F6.3**

When developing engagement strategies, regulators need to examine both the fairness and proficiency of alternative mechanisms. Both proficiency and fairness are influenced by the manner in which mechanisms are implemented.

**F6.4**

New Zealand common law, such as case law, contains a number of important principles that affect how and when regulators have an obligation to consult and what constitutes proper consultation.

**F6.5**

Inquiry participants have raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement with predetermined views and concerns that some regulators lack the capacity to engage effectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably NZTA and the EPA.

**F6.6**

Statutory consultation requirements are potentially most useful:

- when there is a likelihood that failure to consult would breach natural justice principles – for example regulation that involves a significant use of the state’s coercive powers that could impact the civil liberty, livelihood or property rights of individuals;
- when regulators have wide, discretionary rule-making powers that involve making judgements about what is in the public interest;
- when there are social equity reasons for specifying the consultation processes that should be followed for a specific group – for example where the affected group may not have the resources or capacity to effectively participate in a conventional consultation process; and
- where the affected community holds information on trade-offs and technical issues necessary for the regulator to make sound decisions.

**F6.7**

The structure of statutory consultation requirements can have a significant impact on the cost and speed of regulatory decisions, the weight a regulator gives to the views of specific stakeholders and how the regulator allocates its budget (and the budget flexibility the regulator has). As such, it is important that officials give considerable thought to the likely trade-offs associated with an alternative wording of the provision.

**F6.8**

Collaborative approaches have the potential to improve the decisions of regulators. Factors central to the success of any collaborative process include:

- a shared understanding of the boundaries of influence of the group;
- commitment to implementing the outcomes of the collaborative process;
- understanding the information needs of all parties and reducing information imbalance;
- selecting participants that represent the wider interests of the community; and
- establishing clear and transparent processes.

**F6.9**

Failure to adequately explain the rationale behind regulator decisions can create the impression that consultation processes are insincere and that regulators are simply “going through the motions”. It is important that regulators make every effort practicable to clearly explain the logic of their decisions.

## Chapter 7 – The Treaty of Waitangi in regulatory design and practice

### Findings

**F7.1**

While a precise definition of the Crown is lacking, it is generally accepted as encapsulating the key machinery of executive government.

**F7.2**

Statutes with references to the Treaty of Waitangi or to Treaty principles often contain regulatory provisions and create obligations on a range of parties that are not the Crown.

**F7.3**

When drafting legislation, greater care to ensure that differences in wording are both intended and justified, with respect to Treaty principles, would reduce the complexity and cost of regulatory processes.

**F7.4**

Overall the quality of guidance to help apply Treaty principles could be improved. Some guidance was misleading or inaccurate.

**F7.5**

The framework for assessing guidance material proposed by the Commission could be used as a tool to help regulatory agencies develop guidance about applying Treaty principles in their area of regulation.

**F7.6**

The EPA does not limit its role to ensuring that applicants comply with regulatory standards before an application is approved. Applicants are helped in preparing their applications and the EPA also helps those affected by applications. Conflicts of interest are minimised because the application process is open, transparent and public.

**F7.7**

Māori have additional steps and costs to incur when developing submissions, but care is needed when considering funding, having regard to the capability of respective stakeholders and the importance of their perspectives, and ensuring funding is directly related to gaining those perspectives. Regulators need to monitor these expenses carefully.

**F7.8**

Providing guidance for applicants and other stakeholders about navigating the process is considered a core part of the EPA's role as a regulator.

**F7.9**

Open and timely communication, accessibility, a balanced approach, pro-activity and a culture of respect and understanding, comes from the leadership of the organisation, through to its staff, and is demonstrated in the behaviour and actions of the EPA.

**F7.10**

In designing institutional arrangements, processes and practices to incorporate Treaty principles into their work, regulators should focus on their own regulatory responsibilities and functions, and the capabilities, capacity and incentives of their stakeholders.

**F7.11**

An important lesson from the EPA's experience for other regulators is that the investment in developing good relationships pays off in the form of reduced cost on all parties involved in the application process, while improving the quality of engagement and the resulting decisions. Such investment has achieved buy-in to the success of the EPA approach and a shared commitment to making it work. When decisions go against stakeholders, those decisions are now more readily accepted and are less likely to be contested.

## Chapter 8 – Role clarity

### Findings

**F8.1**

Many firms that the Commission surveyed saw contradictory or incompatible regimes, and regulators poorly managing duplicated compliance requirements, as issues in New Zealand.

**F8.2**

"Deemed-to-comply" systems can let regulatory regimes adapt to changes in technology or shocks. They also permit different firms to find the compliance approach that best suits them. This lets regimes more effectively cover industries where the capability among regulated firms varies.

**F8.3**

Legislative frameworks that keep the number of objectives and conflicts to the lowest possible number, and provide a clear hierarchy of objectives, help to support regulators in making consistent and predictable decisions.

**F8.4**

New regulators, and regulators implementing new regimes, should publish statements outlining how they will interpret and give effect to the regime's objectives, and engage with regulated parties on these statements.

**F8.5**

Before new regulatory functions are allocated to an existing agency, policymakers should assess that the mission of the agency is compatible with the objectives of the new regime, and whether the new functions will get sufficient resource and attention.

**F8.6**

Regulator involvement in providing strategic policy advice is important for effective regulatory outcomes. Strategic policy should be developed so that it taps the experience of regulators and provides a dispassionate assessment of the issue. To ensure this balanced assessment, regulators should not have the sole or main responsibility for reviewing underpinning frameworks.

**F8.7**

Creating separate bodies so that one body is responsible for making rules and the other for enforcing them can have benefits, such as greater transparency, probity and good decisions. Even so, whether structural separation creates net benefits will depend very much on the details of the regulatory regime. Combinations of other regulatory design options (such as clearer regulatory objectives, stronger reporting and consultation obligations) may provide equivalent benefits, with lower costs and less disruption.

**F8.8**

Cooperative arrangements like Memoranda of Understanding play an important role in managing regulatory overlaps. To be most effective, they should be reviewed regularly, be publicly available, provide clear guidance to regulated firms and individuals, and be empowered by legislation.

**F8.9**

Exemptions can help a regulatory regime adapt to changing circumstances and manage overlaps. They may be appropriate where:

- unforeseeable circumstances may undermine the effectiveness of primary legislation;
- there is a need for urgent action;
- regulated activities change frequently;
- regulated parties are subject to overlapping or inconsistent requirements; or
- there is a need for technical or trivial changes to the law.

**F8.10**

Exemption powers in new regimes should be specified in primary legislation, including purposes for the granting of exemptions, criteria for their issue, requirements for regulators to give reasons for an exemption, and sunset clauses. Where exemptions are granted by regulators, they (and the reasons for the decision) should generally be published.

## Recommendations

**R8.1**

The Cabinet Manual should be amended to set a general expectation that exposure drafts will be published and consulted on before introducing into Parliament legislation that creates a new regulatory regime or significantly amends existing regimes.

## Chapter 9 – Regulatory independence and institutional form

### Findings

**F9.1**

Designers of regulatory regimes must carefully assess the arguments for and against regulator independence. Arguments for political control must be weighed against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.

**F9.2**

There are a number of situations when it is likely to be appropriate for regulatory regimes to be established independently of political control, including:

- where the costs are long term, and likely to be undervalued due to a focus on electoral cycles;
- where powerful private interests are weighed against a dispersed public interest;
- where a substantial degree of technical expertise, or expert judgement of complex analysis is required; or
- where the causal relationship between the policy instrument and the desired outcome is complex or uncertain.

**F9.3**

To be effective, an expert regulator must operate within institutional arrangements that let it assess risks objectively and manage risks.

**F9.4**

“Independence” is multi-faceted and covers significantly more than formal legal designation, including:

- the ability to adjust the regulatory settings and rules (regulation independence);
- the ability to undertake functions without interference (operational independence);
- funding arrangements that protect the regulator from external pressure (budgetary independence); and
- formal distance from the Executive and security of tenure for governors and senior management (institutional independence).

**F9.5**

The independence of regulators needs to be balanced with commensurate obligations to consult and operate transparently. Independent regulators require strong governance, and should be subject to robust and proportionate performance monitoring and accountability arrangements.

**F9.6**

As regulatory legislation is reviewed, designers should consider how the regime can be flexible enough to take account of ongoing technological developments.

**F9.7**

There is inconsistent allocation of legislative provisions between primary legislation and types of secondary legislation in regulatory regimes. There is evidence that existing mechanisms to promote greater consistency are ineffective.

**F9.8**

Overseas guidance acknowledges that a need to regularly adjust legislative provisions can support placing those provisions in secondary legislation.

**F9.9**

There is scope for the greater use of delegated legislation, subject to stronger controls discussed in this report, to ensure regulation can keep pace with technological and other developments. Designers of regulatory regimes need to consider whether delegation could help future-proof the regime, particularly in areas subject to technological or other changes.

**F9.10**

Political pressures to intervene in the decisions of independent regulators are inevitable from time to time. Providing transparent mechanisms for political intervention in the decisions of independent regulators is preferable to wholesale regulatory reform designed to resolve short term political frustrations. It can also strengthen a regulator's ability to withstand informal political pressure.

**F9.11**

Designers need to plan for how to manage the political imperatives to intervene in regulatory decisions. Where direct powers of intervention are provided, they should be infrequent and there should be transparency obligations around their use. The design and exercise of any powers of intervention should seek to mitigate the risks that:

- precedent is set for future intervention;
- the regulator's authority is undermined;
- regulated parties are encouraged to work around the regulator.

**F9.12**

Designers of regulatory regimes to assure quality in public services need to consider how they expect the funding and regulatory levers will be exercised to manage performance issues across the whole system. They also need to ensure that regulatory requirements are appropriate for publicly-funded and privately-funded services.

**F9.13**

The expectation that departmental agencies will operate with a high degree of autonomy is dependent on agreements between ministers and between chief executives and any provisions for statutory independence, rather than any legal protections associated with this institutional form.

**F9.14**

Government has indicated that departmental agencies offer a means to incorporate regulatory functions currently carried out in Crown entities into the legal Crown. By itself, this would serve to reduce the formal operational independence with which those functions are undertaken. As a result, Government will need to review any functions that are transferred to consider whether they should be undertaken in a statutorily independent way.

**F9.15**

There is the potential for confusion about the accountability arrangements of departmental agencies, and the respective roles and responsibilities of:

- the minister responsible for the departmental agency;
- the minister responsible for the host department;
- the chief executive of the departmental agency; and
- the chief executive of the host department.

**F9.16**

The three types of statutory Crown entity are distinguished by the ease with which board members can be appointed and removed, and whether the entity is obliged to "have regard to" or "give effect to" ministerial policy directions made under the Crown Entities Act 2004. However, it is very rare for ministers to issue policy directions or remove members of regulatory Crown entities.

**F9.17**

The choice of institutional form will be important as much in terms of what it signals around expected levels of agency independence, as for the legal protections associated with particular agency forms.

**F9.18**

Ministers and the founding governors and leaders of new agencies need to pay particular attention to the norms and cultures established around independence, in terms of the relationships between them, and the agency's operations.

**F9.19**

Regulation designed to prevent low-frequency, high-consequence (catastrophic) events is less likely to suffer from loss of focus or institutional support over time if located in stand-alone agencies.

**F9.20**

Coherence problems between executive functions cannot be resolved by co-locating those functions alone. Designers of regulatory regimes need to identify what functional, personal and professional relationships are key to the effective operation of a regulatory regime, and assess which of those relationships are best managed within an organisation and which are amenable to management between separate organisations. This should inform decisions around the location of regulatory functions.

**F9.21**

While structural changes in regulatory agencies can be necessary from time to time, the benefits of change can take time to emerge, and the operation of regulatory regimes may be disrupted in the interim.

**F9.22**

Chief executives of regulatory agencies undergoing structural change should ensure that change management strategies discuss how the effective operation of regulatory functions will be maintained during the change.

## Recommendations

**R9.1**

The minister with responsibility for regulatory management should coordinate a principle-based review of regulatory legislation to ensure greater consistency in allocation of legislation material between primary legislation and types of secondary legislation.

**R9.2**

The Legislation Advisory Committee should expand its guidelines to describe the situations where different types of delegated legislation are appropriate, including delegating authority to the Governor-General in Council and to regulators.

**R9.3**

The Minister of State Services should review agreements between ministers to establish and allocate functions to departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear and, where appropriate, in statute.

**R9.4**

The State Services Commissioner should approve agreements between the chief executives of host departments and departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear, and that there are appropriate formalities in place to preserve the independent exercise of statutorily independent powers.

**R9.5**

Updated State Services Commission guidance on machinery of government choices should discuss the practical benefits, costs and risks associated with allocating functions to a department or stand-alone agency, as well as the accountability and governance considerations.

## Chapter 10 – Governance, decision rights and discretion

### Findings

**F10.1**

Boards of Crown entities, not departmental monitors, are accountable to ministers for the performance and effectiveness of the organisation.

**F10.2**

A high degree of interaction between a minister and the chief executive of a regulatory Crown entity, without the participation of the board chair, can be a signal that the governance, oversight or form of the entity may need to be reviewed.

**F10.3**

The quality of strategic leadership from the board of a regulatory Crown entity strongly influences the effectiveness of the organisation.

**F10.4**

Boards of regulatory Crown entities report difficulties in developing and gaining agreement on meaningful performance indicators. Activity measures by themselves are not effective indicators of regulatory performance.

**F10.5**

There is a wide degree of unjustified variation in the processes used to appoint, re-appoint, induct and support the development of board members of regulatory Crown entities.

**F10.6**

Opportunities exist to enhance the capability of boards overseeing regulatory Crown entities by leveraging the regulatory expertise developed by board members in other fields of regulation. This could be done by cross-appointing members of regulatory Crown entities, and by exploring further opportunities for international cross-appointments.

**F10.7**

There is evidence of confusion around the role that some members of Crown entity boards with industry backgrounds are expected to play.

**F10.8**

There is good SSC guidance on managing conflicts of interest for members of Crown entity boards.

**F10.9**

No board member of a Crown entity should be appointed to act as a representative of any external group. Regardless of their background, experience and prior or ongoing association that make them valuable as a board member, their duty should always be to ensure the entity acts in a manner consistent with its statutory objectives and functions, and not as the representative or agent of any external group. The exception is where co-management arrangements are expressly intended.

**F10.10**

The variety of internal governance arrangements and allocation of decision-making rights in regulators appears to be ad hoc rather than based on sound governance principles.

**F10.11**

Ministerial decision making is likely to be appropriate where decisions involve:

- significant value judgements, where trade-offs are not readily amenable to analysis; or
- significant fiscal implications, or which are integral to a government's economic strategy.

**F10.12**

In practice, the distinction between single-member and multi-member decision making is not always sharp. Overarching policies can control, and colleagues/staff are likely to inform, the actions of individual decision makers.

**F10.13**

Multi-member bodies offer the potential to produce higher-quality decisions than individuals because of the wider range of skills and perspectives. Whether they do deliver better decisions depends on the quality of members and the quality of the body's decision-making processes.

**F10.14**

There is extensive delegation of regulatory decisions within New Zealand regulatory regimes. In practice, decisions are taken by a range of compliance staff, managers, chief executives, boards and ministers.

**F10.15**

Internal governance manuals should describe how a board will recognise the distinction between the exercise of regulatory functions (including taking regulatory decisions) and internal governance (including oversight and assurance) functions in its operation.

**F10.16**

Administrative discretion is a feature of many regulatory regimes. Principle-based or outcome-based regulatory regimes inherently involve the exercise of discretion, as do risk-based approaches to implementing regulation.

**F10.17**

There is a range of legal constraints on the exercise of discretionary decisions. Decisions must be taken in accordance with principles derived from the common law, and not unjustifiably infringe the civil and political rights enshrined in the New Zealand Bill of Rights Act 1990. The courts can enforce these constraints.

**F10.18**

Institutional and cultural constraints on the exercise of discretionary power support legal constraints by promoting ethical decision making.

## Recommendations

**R10.1**

The centre supporting the minister for regulatory management should actively support departments in managing appointments and reappointments to regulatory Crown entities. It should particularly assist departments in analysing the knowledge, skills and experiences required on the board of each regulatory Crown entity, and work with the department and the board chair to analyse the current skills on the board.

**R10.2**

The Cabinet Office should require that agencies consult with the centre supporting the minister with responsibility for regulatory management, before submitting papers proposing the appointment of members to regulatory Crown entities. The centre should be able to insert a comment in appointment papers about the quality of appointment processes undertaken.

**R10.3**

The State Services Commission and the Treasury should evaluate the effectiveness of more active support of regulator board appointments, and advise the Government on whether a similar process should apply to non-regulatory board appointments.

**R10.4**

Regulators should make their conflict of interest policies available on their website.

**R10.5**

The State Services Commission's guidance about appointing board members to Crown entities and its induction material for new board members provide good information on the duties of members. But it should update these documents to emphasise that a member is neither appointed nor should act as the representative or agent of any external group.

**R10.6**

All regulators should publish and maintain up-to-date information about their regulatory decision-making processes, including timelines and the information or principles that inform their regulatory decisions.

## Chapter 11 – Decision review

### Findings

**F11.1**

In New Zealand there is significant overlap between the scope of judicial review and appeal in practice.

**F11.2**

Judicial review in New Zealand is much wider in scope than in Australia, and can include greater scrutiny of the merits of decisions.

**F11.3**

Courts will generally defer to the decisions of expert regulators of highly complex or technical areas. In these areas of regulation, there is still a clear distinction between judicial review and appeals, and judicial review is less likely to scrutinise the substantive merits of decisions.

**F11.4**

Designers of new regulatory regimes should consider providing for the internal review of day-to-day administrative decisions taken by individuals.

**F11.5**

In general, legislation establishing regulatory regimes does provide access to merits review of regulatory decisions.

**F11.6**

In areas of complex or highly technical regulation, access to merits review or the scope of appeal provided is often limited or non-existent.

**F11.7**

It will generally be inappropriate to provide for appeals of ministerial decisions.

**F11.8**

Access to judicial review should be approached in a non-instrumental way. Judicial review is an important constitutional check on the power of the Executive, and is available to citizens as of right.

**F11.9**

Designers of regulatory regimes should provide for access to appeal where it is likely to improve the quality of regulation, taking into account the costs of providing it.

**F11.10**

The Commission has found no evidence to suggest that judicial review is an ineffective method of challenging the decisions of regulators, or that decision makers routinely reach the same decision after a successful judicial review.

**F11.11**

An absence of merits review increases the likelihood that aggrieved parties will seek recourse outside the legal system. In particular, it will encourage special pleading to politicians.

**F11.12**

Merits review does not offer additional safeguards to ensure decision makers follow good processes, beyond those offered by judicial review.

**F11.13**

The broad scope of judicial review in New Zealand means that the availability of merits review would not provide significantly stronger incentives on regulators to make correct decisions than is provided by access to judicial review alone in most areas of administrative decision making.

**F11.14**

In highly complex or technical fields, where judicial review is less likely to scrutinise the substantive merits of decisions, merits review may strengthen the incentive on regulators to take good decisions.

**F11.15**

Providing access to merits review may not always promote the objectives of a regulatory regime.

**F11.16**

Designers of new regulatory regimes need to consider whether to provide access to merits review. In areas of highly complex, technical regulation, designers need to critically assess whether the appellate body has the institutional capability, compared to the decision maker at first instance, to improve the quality of decisions in terms of Parliament's objectives for the regulatory regime. Designers of regulatory regimes also need to take into account the costs, delay and uncertainty created by providing access to merits review.

**F11.17**

Designers of regulatory regimes in highly complex or technical fields should not assume that the incidence or complexity of appeals will inevitably decline over time, particularly where the cost of regulated parties appealing is small compared to the potential gain.

**F11.18**

Providing access to appeal rights can promote confidence in the quality of a regulatory regime, particularly for international investors.

**F11.19**

In appeals of highly complex or technical regulation, providing the court with opportunities to directly question experts, in a non-adversarial setting, can assist in understanding the issues under appeal.

**F11.20**

Providing courts or tribunals discretion about the admissibility of new evidence may in some circumstances be more efficient than providing for appeals based on a frozen record.

**F11.21**

Foreign expertise can play a valuable role in bringing expertise to merits review of highly complex and technical regulatory regimes.

## Recommendations

**R11.1**

The Officers of Parliament Committee should review the adequacy of funding for the Office of the Ombudsman to undertake its statutory functions to a high standard.

## Chapter 12 – Approaches to funding regulators

### Findings

**F12.1**

Organisational responsibility for advising on, implementing and scrutinising funding arrangements has been established, and guidelines offer regulators and advisors guidance on how to approach funding issues. However, the two sets of guidelines cover similar issues in different ways. There is no general requirement for ex post evaluation of the impact of cost recovery and little published evidence about how well funding arrangements are working.

**F12.2**

While there can be benefits from regulators being at least partially funded through cost recovery, case-by-case assessment of proposals for funding regulators is required to secure these benefits in practice.

**F12.3**

The Commission's survey of businesses, and submissions to the inquiry, indicate concern in the business community about:

- the quality of the consultation that takes place before regulatory fees or levies are introduced;
- weak constraints on the level of charges, including limited transparency about how they are determined; and
- the structure of charges.

**F12.4**

The funding frameworks in other selected countries are similar to New Zealand in that they:

- set out efficiency and, to a lesser extent, equity as the main objectives of cost recovery;
- require consent, usually of a minister or Parliament, before a fee or levy is introduced;
- are based on a distinction between cost recovery and taxation; and
- provide guidance material.

However, other jurisdictions have examples of:

- more rigorous consultation and impact assessment requirements before fees are introduced;
- stricter requirements for performance standards and reporting against those standards when new fees are introduced;
- penalties for failing to achieve the standards; and
- more detailed advice about how to implement cost recovery.

**F12.5**

It is desirable that regulators, as they develop improved performance reporting frameworks, use these frameworks to measure the cost of delivering regulatory services and report this information publicly.

**Recommendations****R12.1**

The Government should publish its cost recovery policy, outlining its policy objectives, and setting out guiding principles relating to:

- how to make trade-offs should objectives conflict;
- when cost recovery may be appropriate;
- consultation requirements before implementation;
- how and when arrangements are to be reviewed and by whom; and
- responsibility for ensuring compliance with the policy.

**R12.2**

Agencies proposing a new or amended fee or levy for regulatory services should publish a statement outlining, for example:

- the reasons why they are introducing/amending a fee or levy;
- their legal authorisation for doing so;
- the consultation undertaken;
- the expected effects of the fee or levy; and
- the process for monitoring these effects and reviewing the policy.

**R12.3**

Agencies responsible for cost recovery arrangements should make sure that the arrangements are reviewed periodically to ensure that they remain justifiable in principle, efficient and effective.

**R12.4**

The Government and the Auditor-General should review the Treasury's *Guidelines for setting charges in the public sector* (2002) and the Auditor-General's *Charging fees for public sector goods and services* (2008), to ensure that the guidelines reflect current knowledge about when and how to implement cost recovery.

Users of the guidelines (whether the two sets of guidelines continue or are combined) should:

- only have to go to one place for advice on any issue;
- not receive conflicting advice from the guidelines; and
- be clearly informed about the scope of the entities and charges that the guidelines cover.

**R12.5**

The Government, when it reviews New Zealand's cost recovery guidelines, should seek to collaborate with the review of the cost recovery guidelines currently being undertaken in Australia.

**R12.6**

The Government should consider whether those agencies that set or amend fees or levies can access adequate advice and experience from other agencies and departments.

## Chapter 13 – Monitoring and oversight

### Findings

**F13.1**

Assessing the performance of regulators can be a challenging task. Regulatory practice can often be opaque or involve highly specialised knowledge, and attribution of success to a regulator's actions can be difficult.

**F13.2**

Members of regulatory boards interviewed for the Commission were less satisfied with monitoring arrangements than their departmental monitors. Key problems identified with current monitoring practices were:

- insufficient support from departments;
- departments who did not understand their roles;
- inadequate capability and high turnover in monitoring staff; and
- too much reporting, and not enough focus on the regulator's performance and strategy.

**F13.3**

High levels of turnover in departmental monitoring staff are not conducive to effective relationships with regulatory Crown entities.

**F13.4**

Strong links between monitoring and policy functions within departments are important for effective engagement with regulators and quality advice to ministers. Formally allocating monitoring responsibilities to relevant policy teams within departments may help provide these strong links.

**F13.5**

The Commission is not convinced that the potential merits of moving monitoring functions from policy departments to a central organisation outweighed the likely costs.

**F13.6**

Current monitoring processes do not pay enough attention to the detail or effectiveness of a regulator's strategies and practices. This limits the ability of policy departments or ministers to form accurate views about the performance of a regulator.

### Recommendations

**R13.1**

Departments should appoint staff into monitoring roles for terms that support good working relationships with regulatory Crown entities.

**R13.2**

Departments should move towards risk-based monitoring and reporting, with higher-performing regulatory Crown entities subject to less frequent reporting obligations.

**R13.3**

Department–regulator relationships that involve very regular and close contact should be revisited, with a view to moving to more formal interactions, based on clearly-defined roles and responsibilities.

**R13.4** Some form of peer review, drawing on the expertise of other regulatory leaders, should be established to help fill the gap in current monitoring processes.

**R13.5** The regulator peer reviews should be conducted as part of the Performance Improvement Framework process.

**R13.6** The State Services Commission should convene a panel of current and former senior regulatory leaders to develop a set of regulator-specific questions for the Performance Improvement Framework reviews.

**R13.7** If resource constraints mean that progress on rolling PIF out to the wider set of Crown entities will be slow, central agencies should explore the feasibility of introducing a streamlined PIF process for regulators, focusing on regulatory practice, engagement and culture.

**R13.8** The State Services Commission should identify current and former regulatory leaders to join PIF review teams.

**R13.9** The priority for the PIF peer reviews should be the larger regulatory Crown entities, those entities that implement regimes managing significant potential harms, and departments that implement regulatory regimes. Smaller Crown entities (eg, with a total budget of less than \$5 million) should be able to volunteer for a peer review, but not be required to undertake one.

## Chapter 14 – System-wide regulatory review

### Findings

**F14.1** The New Zealand Government is implementing a suite of initiatives to improve the management of the stock of legislation and regulation. It does not use many of the approaches to system-wide evaluation of regulatory regimes that are used in other countries, some of which have been identified as involving low effort and potentially low/high return in those countries.

**F14.2** Developing charters or Statements of Intent for individual regulatory regimes could be beneficial, especially if the process:

- actively involves all the agencies involved in the administration and implementation of the regime;
- clearly outlines the relative roles and responsibilities of each agency;
- identifies measures of success and risk factors to be monitored; and
- considers the environment within which regulation takes place, especially the regulated community and the costs imposed on them.

## Recommendations

### R14.1

The Government should:

- publish the regulatory system reports prepared by departments;
- require departments to articulate in their Statements of Intent their strategies for keeping their regulatory regimes up to date;
- within three years, commission a review of each department's progress and seek advice from that review about whether it is necessary to create a legislative framework or new mechanisms for managing the stock of regulation.

### R14.2

The Treasury should:

- articulate a set of principles to encourage departments to focus effort on reviews that have the largest anticipated benefits;
- set up an ongoing preliminary assessment process to identify areas requiring attention (these assessments could be undertaken by the responsible departments, or by a central department or even by a new agency); and
- specify targets such as overall yearly expenditure, or a target number of reviews, to force identification of the reviews with the largest potential benefits.

### R14.3

Once the Ministry of Business, Innovation and Employment (MBIE) has completed the development of Statements of Intent/charters for the workplace health and safety and employment relations regimes, the Treasury and MBIE should evaluate the process, with a view to:

- identifying any areas for improvement; and
- providing guidance about the model to other policy ministries.

### R14.4

The Government should publish an overarching strategy that sets out how it will improve the management of the stock of regulation. The strategy should explain how specific initiatives fit within it, and should describe how successful implementation of the strategy will be measured and how it will benefit the community.

## Chapter 15 – Information to understand and manage the system

### Findings

#### F15.1

The absence of a central electronic repository of Other Instruments constrains the ability of firms and individuals to access and understand their regulatory rights and obligations.

#### F15.2

Maps and typologies of regulatory regimes and agencies may not be of much use in assisting central agencies to understand the relationships and differences between regulatory regimes. In some circumstances, they may oversimplify regimes or lead to inaccurate or inappropriate conclusions.

**F15.3**

There is a need for greater comparative analysis of regulator practices and behaviour. However, system-wide standardised reporting is unlikely to be the most effective tool for identifying risks or performance issues across the system, as it would be very difficult to fairly reflect the diversity of regimes and regulators in a single set of indicators.

**F15.4**

Central agencies should monitor the performance of the regulatory system as a whole; in particular, its ability to provide proportionate and necessary regulation; prioritised regulatory effort; adequate resourcing of implementation; fair and effective implementation; and self-aware and adaptive regulatory organisations. The Commission notes that the Treasury has already begun this process.

**F15.5**

The fact that some departments are not fully participating in the Treasury's regulatory management and oversight processes limits the ability of ministers to make informed judgements about priorities and the performance of the system.

**F15.6**

Central monitoring of the regulatory system's performance should be based on both a mix of information generated by departments and regulatory agencies, and data from external or independent sources.

## Recommendations

**R15.1**

The Parliamentary Counsel Office should expand the New Zealand Legislation website ([www.legislation.govt.nz](http://www.legislation.govt.nz)) to provide a central and comprehensive source of Other Instruments.

**R15.2**

As the Regulatory Systems Report (or equivalent monitoring processes) evolves, the Treasury should collect more information about the outputs and outcomes from departmental regulatory management systems.

## Chapter 16 – Strengthening institutions

### Findings

**F16.1**

Quality checks on legislation and regulation appear to be reducing. They are fragmented, of varying effectiveness, and in some cases under strain.

**F16.2**

The availability of parliamentary time remains a significant bottleneck to the maintenance, repair and, where appropriate, repeal of the stock of regulatory legislation.

**F16.3**

A range of options exist to improve the quality of legislation, and to enable Parliament to better understand the quality of the legislation it has created or authorised.

## Recommendations

### R16.1

Government should commission a review into improving and maintaining the quality of new and existing legislation, including:

- processes for producing and vetting the quality of legislative proposals and draft legislation;
- the respective roles of the Parliamentary Counsel Office, the Law Commission, Legislation Advisory Committee, and Legislation Design Committee; and
- relevant parliamentary processes.

### R16.2

The Government should publish the responsibilities of the minister for regulatory management. These responsibilities could include:

- defining the overall objective of the regulatory system;
- prioritising effort across the system;
- specifying and allocating tasks for improving the system; and
- promoting regulatory policy and the case for continuous improvement in regulatory design and practice.

### R16.3

The minister for regulatory management should publish a strategy report that sets out the medium-term objectives that the Government is seeking to achieve through the regulatory system, its strategic prioritisation of effort for achieving these objectives, and its work programme. The minister should report regularly on progress towards delivering this work programme, and update the statement as necessary.

### R16.4

The Treasury should provide support for the minister for regulatory management, through an expanded team, with a published charter setting out its objectives and functions, its own website, and the authority to identify itself as a separate unit within the Treasury.

### R16.5

The Government should locate the proposed role for providing intellectual leadership on regulatory issues within the Treasury team that provides advice to the minister for regulatory management. It should review the effectiveness of the new arrangements no later than three years after they are established.

# Appendix A Public consultation

## Submissions

<b>INDIVIDUAL OR ORGANISATION</b>	<b>SUBMISSION NUMBER</b>
Air New Zealand	047
Alan Marshall	002
ANZ Bank New Zealand Limited	024, DR 083
Association of Financial Sector Organisations	DR 092
Auckland Energy Consumer Trust	022
Aviation New Zealand	036, DR 061
Bell Gully	038
Board of Airline Representatives New Zealand Inc	016, DR 089
Brent Sheather – Private Asset Management Limited	DR 058
BusinessNZ	019, DR 066
CarterHoltHarvey	008
Chapman Tripp	DR 068
Chorus	051, DR 091
Civil Aviation Authority of New Zealand	006, DR 064
Commerce Commission	044, DR 093
Compliance Common Capability Programme	012, DR 062
Cwmglyn Farmhouse Cheese	DR 059
Department of Internal Affairs	DR 063
Electricity Authority	050, DR 070
Electricity Networks Association	027, DR 079
Energy Trusts of New Zealand Inc	023
Environment Canterbury Regional Council	004
Environmental Protection Authority	020, DR 103
Federated Farmers of New Zealand	011, DR 065
Financial Markets Authority	053, DR 090
Foodstuffs (NZ) Ltd	049
Genesis Energy	048
Graeme Aitken	DR 060
Graham Taylor	DR 101
Grey District Council	DR 056
Health and Disability Commissioner	DR 081
Human Rights Commission	DR 096
IAG New Zealand Limited	010, DR 080
Insurance Council of New Zealand	005, DR 067
InternetNZ	045
Investors Mutual Limited	DR 082
IPENZ Engineers New Zealand	021
KLR Investments	018
Land Information New Zealand	037
Legislation Advisory Committee	DR 100
Major Electricity Users' Group	DR 077
Maritime New Zealand	015, DR 095
Meat Industry Association of New Zealand (Inc)	040
Mighty River Power Limited	030, DR 069

Ministry for Primary Industries	DR 102
Ministry of Business, Innovation and Employment	052, DR 104
Ministry of Justice	DR 087
Ministry of Transport	039, DR 094
Minter Ellison Rudd Watts	028
Molly Melhuish	042
Mortlock Consultants Limited	031
New Zealand Airports Association	033
New Zealand Association of Credit Unions	DR 073
New Zealand Bankers' Association	043, DR 086
New Zealand Council for Infrastructure Development	034
New Zealand Council of Trade Unions	025
New Zealand Customs Service	013
New Zealand Food and Grocery Council	035
New Zealand Maritime Forum	DR 057
New Zealand Public Service Association	026
New Zealand Transport Agency	DR 085
New Zealand Treasury/State Services Commission	DR 097
Paradox Consulting Ltd	DR 074
Parliamentary Counsel Office	DR 088
Physicians and Scientists for Global Responsibility	003
PowerCo	014
Reserve Bank of New Zealand	009, DR 099
Seafood New Zealand	DR 072
Securities Industry Association	054
Tasman District Council	001
Telecom New Zealand Limited	041
The Skills Organisation	DR 071
Transpower New Zealand Ltd	032, DR 076
TrustPower	007
Two Degrees Mobile Limited	DR 084
Vector	029, DR 098
Veda	DR 078
Vodafone New Zealand Limited	046, DR 075
Wayne Wright	DR 055
Wellington Electricity Lines Limited	017

## Engagement meetings

Age Concern New Zealand  
 Air New Zealand  
 AMI Insurance  
 ANZ Banking Group (NZ)  
 Bank of New Zealand  
 Brent Layton  
 Buddle Findlay  
 Buddy Mikaere  
 BusinessNZ

CarterHoltHarvey  
CERT Systems  
Chorus  
Civil Aviation Authority of New Zealand  
Claire Matthews  
Commerce Commission  
Compliance Common Capability Programme – Steering Group  
Consumer New Zealand  
Crown Law Office  
David Caygill  
David Goddard QC  
Department of Internal Affairs  
Department of Internal Affairs – Forum  
Derek Gill  
Education Review Office  
Electricity Authority  
Electricity Networks Association  
Energy Efficiency and Conservation Authority  
Environmental Protection Authority  
Federated Farmers of New Zealand  
Financial Markets Authority  
Financial Services Council of New Zealand  
Financial Services Federation  
Fitch (Hong Kong) Ltd  
Hon Maryan Street, MP  
Human Rights Commission  
IAG New Zealand Limited  
Inland Revenue  
Insurance Council of New Zealand  
James Ataria  
Law Commission  
Leadership Development Centre  
Maersk New Zealand  
Major Electricity Users' Group  
Malibu Hamilton  
Māori Party  
Maree Pene  
Maria Bartlett  
Maritime New Zealand  
Medsafe  
Michael Webb  
Mighty River Power  
Ministry for Primary Industries  
Ministry for the Environment  
Ministry of Business, Innovation and Employment  
Ministry of Business, Innovation and Employment – Small Business Development  
Ministry of Education – Taskforce on Regulations Affecting School Performance  
Ministry of Health  
Ministry of Justice

Ministry of Transport  
Molly Melhuish  
Mortlock Consultants Limited  
New Zealand Association of Credit Unions  
New Zealand Automobile Association  
New Zealand Banker's Association  
New Zealand Council of Trade Unions  
New Zealand Fire Service  
New Zealand Law Foundation  
New Zealand Public Service Association  
New Zealand Qualifications Authority  
New Zealand Transport Agency  
New Zealand Treasury  
NZI  
Office of Film & Literature Classification  
Office of the Controller and Auditor-General New Zealand  
Office of the Clerk of Representatives  
Parliamentary Counsel Office  
Payments NZ  
Progressive Enterprises  
Public Law Committee of the Wellington District Law Society  
Public Service Association  
Reserve Bank of New Zealand  
Richard Hill  
Russell McVeagh  
Simon Power  
Sir Michael Cullen  
Standard & Poor's Rating Services  
State Insurance  
State Services Commission  
Te Puni Kōkiri  
Television New Zealand  
The Skills Organisation  
Tim Hale  
Tipene Wilson  
Tower Insurance  
Transpower  
Tuatara Breweries  
Vector  
Victoria University of Wellington – School of Management  
Vodafone New Zealand Limited  
Waikato Regional Council  
Webb Henderson  
Westpac  
Worksafe New Zealand

#### **ACADEMICS**

Dean Knight, Faculty of Law, Victoria University of Wellington  
Professor Edgar Schein, *Society of Sloan Fellows Professor of Management Emeritus*  
and Professor Emeritus, MIT Sloan School of Management

Professor (Associate) David Round, Massey University of New Zealand

Professor (Associate) David Tripe, Centre for Banking Studies, Massey University

Professor Julia Black, Pro Director for Research, London School of Economics and Political Science

Professor Lew Evans, Victoria University of New Zealand

Professor Martin Lodge, London School of Economics and Political Science

Professor Philip A Joseph, University of Canterbury

## Appendix B Disaster reports

**Table B.1** Reports examining disasters from New Zealand and other countries

Report name	Country	Citation
Inquiry into the Explosion and Fire at Icepak Coolstores, Tamahere, on 5 April 2008	New Zealand	Beever et al., 2008
Offshore Petroleum Safety Regulation Varanus Island Incident Investigation	Australia	Bills and Agostini 2009
The Buncefield Incident	United Kingdom	Buncefield Major Incident Investigation Board, 2008
Inquiry into finance company failures	New Zealand	Commerce Committee, 2011
Commission of Inquiry into the Collapse of a Viewing Platform at Cave Creek near Punakaiki on the West Coast	New Zealand	Commission of Inquiry, 1995
Report of the ministerial inquiry into the under-reporting of cervical smear abnormalities in the Gisborne region	New Zealand	Duffy et al., 2001
Report on price manipulation in Western markets	United States	Federal Energy Regulatory Commission, 2003
Report on New Zealand's Dairy Food Safety Regulatory System Government Inquiry Into the Whey Protein Concentrate Contamination Incident	New Zealand	Government Inquiry into the Whey Protein Concentrate Contamination Incident, 2013
Deep Water The Gulf Oil Disaster and the Future of Offshore Drilling (p. 398). New Orleans: National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling	United States	Graham et al., 2011
The run on the Rock	United Kingdom	House of Commons Treasury Committee, 2008
Report of the overview group on the weathertightness of buildings to the Building Industry Authority	New Zealand	Hunn et al., 2002
The Public Inquiry into the September 2005 Outbreak of E.coli O157 in South Wales	United Kingdom	Pennington, 2009
Upper Big Branch	United States	McAteer et al., 2011
Inquiry into financial products and services in Australia	Australia	Parliamentary Joint Committee on Corporations and Financial Services, 2009
Report of the Mid Staffordshire NHS Foundation Trust Public Inquiry	United Kingdom	House of Commons, 2013
Royal Commission on the Pike River Coal Mine Tragedy	New Zealand	Royal Commission, 2012
Review of risk management and safety in the adventure and outdoor commercial sectors in New Zealand 2009/10	New Zealand	Department of Labour, 2010
The ICL Inquiry: Explosion at Grovepark Mills, Maryhill, Glasgow, 11 May 2004	United Kingdom	House of Commons, 2005

## Appendix C External review of regulator culture

Table C.1 provides a list of questions aimed at gaining insights into whether a regulatory body is actively promoting the cultural attributes listed in Chapter 4. The questions are aimed at identifying “clues” to the underlying assumptions and beliefs that influence the behaviour of staff, and the steps that leaders are taking to promote functional cultures.

**Table C.1 Questions to guide assessment of culture**

Questions to help determine if an attribute is present
<p><b>Does the regulator have a culture that values its role as an educator and facilitator of compliance?</b></p> <ul style="list-style-type: none"> <li>• What evidence is there that the regulator is actively seeking to educate and facilitate compliance? How well resourced are these functions? Has expenditure been increased or is it decreasing over time?</li> <li>• Is there evidence of a structured and strategic approach to education and facilitation? Does this approach appear to match the needs of regulated parties? What efforts have been made to ensure that they do?</li> <li>• How do regulated parties perceive the regulator’s approach to education and compliance facilitation? How often is information accessed by regulated parties (eg, web hits or attendance at public seminars)?</li> <li>• What messages do corporate communications and organisational documents send about the importance of education and facilitation of compliance?</li> <li>• Does anyone in the organisation have specific accountability for the quality of educational material and the development of programmes to facilitate compliance? How well supported is this individual/group?</li> <li>• How do front-line staff interpret their roles – as primarily enforcers of the law, or as the preventers of social harm?</li> </ul>
<p><b>Does the regulator have a culture that encourages internal debate? Do staff feel comfortable raising risks and suggesting improvements to regulatory practice?</b></p> <ul style="list-style-type: none"> <li>• Are there formal channels for staff to raise concerns about emerging risks or gaps in current regulatory practices? Are these channels accessible to all staff? How often are these channel used? Do all areas of the organisation use these channels or only specific groups or pockets of staff?</li> <li>• How comfortable do staff feel about raising issues? Do they have a good understanding of how to raise issues? How do they perceive the effectiveness of the channels through which issues can be raised? How do they perceive the willingness of their line managers to act on issues?</li> <li>• What measures do senior leaders take to promote the importance of raising concerns and issues? Are there visible reminders of the importance of raising issues and concerns (eg, posters, notices on bulletin boards or the organisation’s intranet)? Are stories frequently told about improvements that were made as a result of an issue being raised? Are successes celebrated and acknowledged?</li> <li>• How are decisions made within the organisation? Are alternative views expressed in an open and collegial manner? Are staff provided with the opportunity to speak and be heard? How do managers respond to dissenting opinions around decisions – are they defensive or do they see diverse opinions as an avenue for strengthening regulatory practices?</li> <li>• Does the chief executive encourage debate within the senior leadership team?</li> </ul>

### Questions to help determine if an attribute is present

#### Does the regulator have a culture that places a high value on robust, evidence-based decision making?

- What processes exist within the organisation to review the quality and robustness of analysis? If internal reviews are used, do those conducting the reviews have the necessary skills, experience and moral authority to influence the attitudes of those whose work they are reviewing?
- Do stakeholders view the organisation as having a reputation for rigorous analysis? If not, why not? Are these reasons valid? How do leaders respond to reasons given by stakeholders? Are they defensive? Do they seek to clarify misinformation, or do they take criticism on board?
- Do leaders propagate a sense of professional pride in the standard of the work being produced? What are the avenues through which this occurs? Are successes celebrated through “corporate rituals”? Are there formal awards and recognition processes outside yearly performance reviews?
- Are external reviews or quality assurance processes seen as opportunities to learn and grow, or “hoops that must be jumped through to get the job done”?

#### Does the regulator have a culture that promotes operational flexibility and adaption to changes in the regulatory environment?

- Does the regulator use a process of flexible or “zero-base” budgeting? Is there evidence that funds have been reallocated from “traditional” areas of expenditure to the management of emerging risk? Are the stated priorities of the organisation reflected in the allocation of new resources?
- Have the mandates/functions of groups within the regulator changed through time? What was the rationale behind changing those mandates/functions? How was the need to change the mandates/functions identified?
- Does the regulator have a strategic intelligence capability (eg, is there a dedicated unit or group within the organisation)? How well are these capabilities resourced? Are there channels for staff from outside the “intelligence unit” to feed information into the pool of intelligence?
- Is there a strong emphasis on agility and flexibility in the recruitment, training and engagement strategies? Are staff encouraged to rotate roles within the organisation? Are systems in place to track an employee’s skills, experience and capabilities (ie, to allow the matching of skills with the emerging needs of the organisation)? Is the value of agility clearly and repeatedly communicated to staff? Are staff rewarded for demonstrating flexibility?
- Are there institutional barriers to operational flexibility that hinder the ability of the regulator to adapt to changing circumstances (eg, rigidity in budgeting processes, employee contracts, etc)? How well are these barriers understood by the chief executive and senior leadership within the organisation? What steps have been taken to overcome them?
- Are staff encouraged to be flexible and use their judgement and experience when new or unforeseen situations arise? Do staff trust that management will support them when they use their judgement? Or are they wary of being made the scapegoat if something goes wrong?

#### Does the regulator have a culture that values continuous learning (ie, does it have a “learning culture”)?

- Are all staff encouraged to pro-actively solve problems? Do managers (particularly front-line managers) actively communicate and emphasise the role of staff in identifying problems, solving them and sharing their experiences? How is this message communicated? How genuine do staff perceive this message to be (ie, do they perceive it as “all talk” or is it accepted as “the way things are done”)?

### Questions to help determine if an attribute is present

- Are formal and informal channels available for staff to share their learning and experiences? Does the physical work environment facilitate informal communication within and across teams? If not, what efforts have been made to facilitate such communication?
- Is the importance of training and learning emphasised in corporate documents and values and procedures?
- Do leaders create time and space for staff to undertake formal training? How effective do staff see current training measures?
- How does the organisation act in times of high stress workloads? Does the emphasis on training dissipate in favour of meeting short-term objectives? Does the emphasis on problem solving dwindle?
- Does the training budget seem appropriate for the size of the organisation and the composition of its staff? Has the budget been increasing or decreasing through time? What reasons explain budget declines? If the organisation's **overall** funding has been declining, what proportion of organisational cuts have come from the training budget? Are there signs that the training budget is often under-spent? Is the under-spending in specific areas of the organisation or across the organisation?

### Does the regulator have an open, transparent and accountable culture?

- Does the organisation voluntarily share information with the public? Or is disclosure confined to information that is required by law? For example, are organisational processes and procedures publicly available? Does the organisation publish the rationale behind its decisions? Does the organisation provide interested parties with regular updates on its activities (eg, through newsletters, blogs or social media)?
- Is publicly available information expressed in clear and accessible language? Or is it laden with technical jargon and unnecessary complexity? Is information provided through easily accessible channels? Or is information only available via complex bureaucratic processes? Are these areas adequately funded?
- Is there a position within the organisation that has accountability for the transparency of organisational information? How senior is this position? What is the visibility of the position within the organisation? When was the last time this information was reviewed and updated?
- Does the organisation publish drafts of documents for comment and feedback? If not, what is the rationale behind not doing so? Is there a mindset that disclosure creates risks (eg, delay or public criticism) for the organisation?
- Does the organisation host or attend events that encourage an open dialogue with stakeholders? How well attended are these events by the chief executive and senior leadership team?
- Is the organisation perceived as open, transparent and accountable by stakeholders? Do stakeholders tell similar "war stories" about their interactions with the organisation? What are the common themes in these stories? Are these themes consistent with other observations of the organisation (such as those above)?
- How clear are the lines of accountability throughout the organisation? How aware are staff and managers of the areas for which they are personally accountable? Are systems and processes in place to hold managers accountable for the quality of their decisions? How well have these systems performed during periods of organisational stress (eg, during a high-profile incident or failure of the regulation)?

## Questions to help determine if an attribute is present

### Does the regulator place a high value on organisational independence and impartiality?

- Who do staff see as their “customers”? Regulated parties or society in general? Does induction material stress the importance of independence and impartiality? Is this message emphasised by mentors?
- When staff talk about their role, do they emphasise their *own* independence and impartiality? Do staff tell stories about occasions when they were put under pressure to compromise their impartiality (but ultimately prevailed)? Do staff talk with pride about how the organisation “stood up to” political pressure or pressure from industry? Conversely, do staff recall stories of occasions when “management buckled under the pressure”?
- Are systems in place to detect patterns of decision making that are less than impartial (eg, benchmarking the number of infringement notices typically given out in a given period)?

### Do staff have a deep understanding and respect for the responsibilities that come with developing, monitoring and enforcing regulation?

- Do leaders use formal and informal channels to stress the responsibility that comes with regulatory activities? Is this message repeatedly and consistently communicated to all staff from the highest levels of the organisation?
- Do induction materials highlight the civic responsibility of the organisation and its staff? Do junior staff consider that they have been mentored on these responsibilities? Or is the topic rarely mentioned outside the initial induction material?
- Is there a strong “code of ethics” operating within the organisation? Are staff aware of the code of ethics? Is it well communicated by management? Is the code taken seriously or is it largely ignored? Do staff believe that their leaders act with honesty and integrity?
- Is there a history of public complaints against regulatory staff? What has been the internal response to these complaints? For example, were complaints met with clear messages from “the top” reinforcing the need for appropriate behaviour, or were the complaints dismissed by management as “sour grapes”? When discussing these incidents with other staff, is the “tone” of their response dismissive or do they appear disappointed in the behaviour of their fellow staff?

### Are subcultures aligned with the organisation’s overarching objectives and values?

- Is there evidence that different regional offices are implementing the same regulations in different ways? For example, do seemingly similar regions have vastly different numbers of warning letters or infringement notices? Are systems in place to identify such differences? What is the impact of these differences on organisational performance/public perceptions? What steps have been taken to reduce any inconsistencies?
- Do staff in different functional units mix formally and informally? For instance, do they share common office facilities, or does the office layout mean they rarely interact? How do leaders encourage interaction and mutual understanding between groups? Can staff describe the responsibilities of other areas of the organisation?
- Do staff move between regions or parts of the organisation? Do staff who move notice significant differences between groups? What is the impact of these differences on organisational performance?
- Are there avenues for staff who undertake similar roles in different regions to communicate and learn from each other? How often does this occur? Do they share a professional language? Do they perceive seemingly similar compliance risks in a comparable way?
- Is there evidence of tension between parts of the organisation? For example, do some groups talk disparagingly about others (eg, “The economists just don’t get it!” or “Head office hasn’t got a clue what happens on the ground”)?

## Appendix D The regulatory workforce

Estimates of the size of the regulatory work force differ, but indicate that it is large.

- The National Compliance Qualifications Project (NCQP) estimated, drawing on Census data, that there were about 14,000 workers in the compliance sector in 2006. This includes large agencies, such as the police and the Inland Revenue Department. The NCQP suggested that with turnover of about 11%, 1,320 jobs are taken up by new position holders per year (2009, p. 19). It also found that the overwhelming majority (about 87%) of employees were practitioners or senior practitioners, whose tasks might include conducting compliance activities, ensuring agencies are meeting required legislative standards, and investigating and preparing prosecutions (NCQP, 2009, p. 31).
- The State Services Commission's human resource capability survey reports that in 2012 there were 2,350 information professionals and 8,698 inspectors and regulatory officers – which are the two survey categories that relate directly to compliance work (Kimberley, 2012, p. 8).
- The 27 agencies that responded to the Commission's request for information have a total of 4,630 full-time equivalent staff "directly involved in the implementation of regulation". About half of these people work in the Ministry of Business, Innovation and Employment (MBIE), which includes immigration staff and, at the time the information was gathered, included people who have now moved to Worksafe.

### Where do regulatory staff work?

Table D.1 illustrates the distribution of the workforce between regulators. MBIE dominates the staff count, because it has primary responsibility for overseeing 16 regulatory regimes. Most regulators have more than 50 staff, although there are 10 regulators in the "other" category that have 70 full-time equivalent staff in total. Maintaining a combination of specific and generic skills is likely to be a challenge for small regulators.

**Table D.1 Regulatory staff numbers by agency**

Number of staff directly involved in the implementation of regulation (full-time equivalents)	Agencies
0-4	New Zealand Walking Access Commission Commission for Financial Literacy and Retirement Income Ministry of Transport Broadcasting Standards Authority
5-9	Energy Efficiency and Conservation Authority Takeovers Panel Gas Industry Company Limited
10-19	New Zealand Historic Places Trust Office of the Privacy Commissioner Office of Film & Literature Classification
20-49	Reserve Bank of New Zealand Electricity Authority
50-99	Health and Disability Commissioner Maritime New Zealand Environmental Protection Authority

Number of staff directly involved in the implementation of regulation (full-time equivalents)	Agencies
100 or more	Financial Markets Authority New Zealand Qualifications Authority Department of Internal Affairs New Zealand Commerce Commission Civil Aviation Authority Statistics New Zealand Land Information New Zealand Ministry of Business, Innovation and Employment

*Source:* Productivity Commission information request to New Zealand regulators.

*Notes:*

1. Two agencies were unable to provide numbers of staff in regulatory roles: Department of Conservation and Ministry of Education.

# Appendix E Applying the Treaty principles guidance framework

Table E.1 Assessment of 10 documents against the Treaty principles guidance framework

Document	Assessment
<p>Best practice guidelines: Tangata whenua effects assessment – a roadmap for undertaking a Cultural Impact Assessment (CIA) under HSNO 1996<sup>1</sup></p> <p><i>Consultants prepared this guidance for the Environmental Risk Management Authority (ERMA). The guidance was to help applicants prepare a CIA under the Hazardous Substances &amp; New Organism Act (HSNO).</i></p>	<p><b>The good</b></p> <p>It is very positive that the ERMA (now part of the Environmental Protection Authority) commissioned guidance to help applicants (under the HSNO) collect the information needed for ERMA to be able to assess the applicant’s proposal. Organisations don’t always place a high priority on helping regulated entities to navigate the process, instead viewing their role as simply enforcing compliance.</p> <p>The guidance appears comprehensive. It covers the purpose of the relevant legislation and related guidance, the key Māori interests and how they are to be identified. Contemporary thinking is identified, but the guidance lets itself down a little by dwelling too long on how undeveloped it is, at the risk of users losing confidence in the approach outlined.</p> <p>While identifying the legal basis for the guidance, best practice beyond the legal standards is promoted.</p> <p>Excessive prescription is avoided.</p> <p><b>The not so good</b></p> <p>The guidance could easily have been made more accessible. In particular, Māori terms should have been defined, and the reference to “various pieces of legislation” appears lazy.</p> <p>There could have been more guidance on how best to engage with Māori, how best to prevent/resolve differences of view between the applicant and Māori, and the implications and options for the claimant if differences are not resolved.</p> <p>Curiously, the document appears written for the benefit of Māori with an interest in the application, rather than the applicants themselves, which is confusing in places (such as the 2nd half of page 3). It may have been better to provide separate guidance for applicants and for Māori with an interest in applications.</p> <p>The guidance is confusing in places (the discussion of economic values, Treaty principles, and the way the material is structured appears to allow for double counting of impacts). Also, it isn’t always clear about the different categories of impacts. The guidance would have benefited from a worked example.</p> <p>In places the document is internally inconsistent. For example, it is described as a cultural impact assessment, yet culture is only one of four categories of impacts covered. It discusses quadruple bottom line reporting, and in places is consistent with this approach, but then provides a table with two additional categories (relationships and the Treaty). In the introduction it is described as being for applicants, yet the footnote on the same page says the guidelines are to assist applicants, tangata whenua and advisors.</p> <p>Discussion of Treaty principles appears incorrect. Applicants are expected to consider whether Treaty principles are “impacted by the proposed application, and if so how?” This is unreasonable. The principles apply to Māori and the Crown – the applicant will usually be neither. It is ERMA and affected Māori, not the applicant that should judge whether the application, if approved, would impact Treaty principles. Rather, the guidance should have tried to more precisely articulate the nature of Treaty principles from the regulator’s point of view. The applicant and Māori would have found this more useful.</p>

Document	Assessment
	<p>There are few links to additional information and no link/contact for applicants or Māori if they are finding it hard to apply the guidance.</p> <p><b>The unsure</b></p> <p>It is unclear:</p> <ul style="list-style-type: none"> <li>- whether there is a review process for the guidance and, if so, whether stakeholders are able to input to that process; and</li> <li>- how well the guidance is promoted.</li> </ul> <p><b>Summary and assessment</b></p> <p>The guidance is a positive initiative and will provide some help to applicants and Māori potentially affected by an application. It is pleasing that its focus is mostly “best practice” rather than legal compliance. It is reasonably comprehensive, although there are likely gaps for the average applicant.</p> <p>The guidance could easily have been improved at little cost. Perhaps ERMA should have done this, with the resulting document then being more closely associated with ERMA rather than the consultants (Repo Consultancy Ltd). In particular; a worked example, a glossary of Māori terms, a guide to effective engagement with Māori and links to assistance in applying the guidance would have added to its value. The requirement imposed on applicants by the guidelines with respect to Treaty principles appears a significant and inappropriate burden.</p> <p>Assessment: “Passable”</p>
<p>He Tirohanga o Kawa ki te Tiriti o Waitangi<sup>2</sup></p> <p><i>Te Puni Kōkiri prepared this document, in the first instance to help its policy analysts provide advice about incorporating Treaty principles into government policy. It is also available to other government analysts to help them understand Treaty principles.</i></p>	<p><b>The good</b></p> <p>The guidance document is impressive. The breadth and depth of coverage, primarily of Court, Waitangi Tribunal and the Executive’s pronouncements on Treaty principles is informative and illuminating. The information appears authoritative, credible and current.</p> <p>The document is very easy to read and is accessible to stakeholders other than policy analysts.</p> <p>There is a comprehensive range of links to other material, including administrative and legal standards and agencies with responsibilities for providing advice on Māori/Treaty issues.</p> <p><b>The not so good</b></p> <p>The guidance document is curious in that its purpose is generic (government wide), yet it is almost completely made up of discrete pronouncements (albeit within themes). What is lacking is a formal framework to tie it all together and make it easier and more relevant for policy advisors (rather than lawyers and people studying the Treaty, for example). For policy analysts it would have been useful to take it to the next stage – building the themes into the policy development framework, for example by explaining what the principles mean at the problem definition, options identification, option selection and review stages of policy development.</p> <p>The material is very much presented from a legalistic “what is” rather than the more appropriate normative “what should be” approach that policy advisors use. An alternative to presenting a normative framework would have been to apply the principles to a policy development example.</p> <p>The document was printed in 2001 and has not been updated. This is a particular problem as case law can age quickly.</p> <p>The guidance was difficult to find.</p> <p><b>Summary and assessment</b></p> <p>For what it is, a descriptive outline of decisions and perspectives (mainly legal) on</p>

Document	Assessment
	<p>the Treaty, the guidance is very good. However, given its stated purpose “This guide has been prepared as a resource for policy analysts who are called upon to formulate policy advice on the application of the Treaty Principles”, it falls short. In getting to the end of the document, one is left feeling a significant opportunity has been missed – for the Executive to define in broad terms what it believes the relationship between Māori and the Crown should be, and the impact this should have on the policy development process.</p> <p>Assessment: “Good”</p>
<p>Guidelines for Cultural Safety, the Treaty of Waitangi and Māori Health in Nursing Education and Practice<sup>3</sup></p> <p><i>The Nursing Council of New Zealand prepared this guidance.</i></p> <p><i>The purpose of the guidelines is to provide a framework for training providers to follow when training nurses on cultural safety, Treaty principles and Māori health. The guidance must be viewed in the context of the process surrounding its use. For example, entities are audited against the guidance.</i></p> <p><i>It is interesting to note that the guidance pre-dates the New Zealand Public Health and Disability Act 2000, which introduced Treaty principles into the health sector.</i></p>	<p><b>The good</b></p> <p>The guidance appears to be comprehensive in the breadth of material covered, at least in part because it is strongly principle based. It is also strongly focused on best practice (and focused on outcomes), with no reference to managing legal risk.</p> <p>The material covered in the guidance is clearly linked to the relevant statutes.</p> <p>The guidance has been updated several times, and appears well publicised and accessible.</p> <p>Appropriately, the relevance of the Treaty approach is extended to the treatment of non-Māori cultures by nurses.</p> <p><b>The not so good</b></p> <p>The interface between Treaty principles and cultural sensitivity is unclear. For example, what does the Treaty require in the treatment of patients that isn’t provided for by appropriately applying cultural sensitivity? In this sense, the model appears a little “forced”, inconsistent and unnecessarily repetitive in places.</p> <p>Also, some of the Treaty messages appear more suited for health providers than for nursing students, for example, “enabling Māori autonomy and authority over health”.</p> <p>In spite of numerous reviews, there are some inaccuracies. For example, the guidance incorrectly claims the Court of Appeal decided in “1975 that both versions of the Treaty were legal.” And “As Crown agents, nurses have an obligation to honour the principles of the Treaty...” also appears suspect.</p> <p>In places the guidance appears to border on opinion. For example, no evidence is cited to support the statement that poor relative Māori health status is the result of the loss of cultural beliefs and practices and the Māori language.</p> <p><b>The unsure</b></p> <p>The guidance is very high level and abstract. Because education providers implement the guidance, it is unclear how well the principles are being explained, illustrated with best practice examples, and generally being made relevant to nursing students.</p> <p>Similarly, how the audits are performed ultimately determines whether the principles are able to operate as they should (enabling different approaches to achieving the learning objectives).</p> <p><b>Summary and assessment</b></p> <p>It is pleasing that the guidance takes a strongly “best practice approach” in preference to legalistic. Also, the spill-over relevance of a Treaty-oriented approach to other cultures is outlined (cultural sensitivity), although the relationship between the two concepts is not always clear. This detracts from the quality of the guidance. The impact of the guidance depends greatly on how well education providers apply it, which is uncertain, although some confidence can be had in that the function is audited.</p> <p>Assessment: “Good”</p>

Document	Assessment
<p>New Zealand Coastal Policy Statement 2010 Guidance note Policy 2: The Treaty of Waitangi, tangata whenua and Māori heritage<sup>4</sup></p> <p><i>The Department of Conservation prepared this guidance to help local government develop their Coastal Policy Statements.</i></p>	<p><b>The good</b></p> <p>The guidance is comprehensive, working systematically through the stages needed for local government to appropriately implement the policy, summarising and linking to the main legislative provisions. Many other links to additional information and guidance are also provided.</p> <p>No errors were picked up, and the document appeared logically consistent and relevant to planners and others, including Māori with an interest in ensuring their interests and rights are taken into account in the planning process.</p> <p>Although prescriptive legal standards were appropriately highlighted, the guidance itself appeared to avoid excessive prescription, and focuses nicely on encouraging best practice beyond the legal requirements.</p> <p>The guidance made very good use of examples, including links to real life practices.</p> <p>The document appeared reasonably well promoted and accessible. Past reviews and their findings were evidenced, suggesting the guidance is a living document.</p> <p><b>Summary and assessment</b></p> <p>The guidance appears an excellent aid for helping local government meet and exceed their legal obligations with respect to Māori interests, without being excessively prescriptive (an important feature in this case because of the differing capabilities and interest of the stakeholders). Māori, too, should benefit from having their legal rights so clearly laid out, and in certain cases should be able to use the guidance to help drive better performance across local government.</p> <p>Assessment: "Excellent"</p>
<p>Guidelines for Consulting with Tangata Whenua on the RMA: An Update on Case Law<sup>5</sup></p> <p><i>The Ministry for the Environment (MFE) prepared this guidance to help local authorities, resource consent applicants and tangata whenua groups.</i></p>	<p><b>The good</b></p> <p>The guidance appears comprehensive, logically consistent, is well laid out and appears professional. No errors were detected. It is relatively current (2010), and is an update of earlier documents.</p> <p>While the focus was clearly legal, being a review of the relevant case law, in places it also encouraged best practice.</p> <p>There was also a good balance of core principles, illustrated with real examples. Both good and bad practices were illustrated.</p> <p>The document flowed well (logically) and good summaries were provided at the start of each section, helping to make it more accessible.</p> <p>The guidance was easy to find.</p> <p><b>The not so good</b></p> <p>It would have been even more useful had there been more links/references to related material/topics across government – not just to court cases and MFE material.</p> <p>More discussion of best practice would have been good, that is, as a strategy for managing legal risk and to achieve better outcomes, and perhaps within the wider context of the purpose of the RMA and impacts assessments.</p> <p><b>Summary and assessment</b></p> <p>The guidance material is very good and would be a useful aid to the range of stakeholders involved in the Resource Management consents process. More links to and discussion of a wider context may have improved usefulness at minimal cost.</p> <p>Assessment: "Very good"</p>

Document	Assessment
<p>Guidelines for Cultural Assessment – Māori Under the Intellectual Disability (Compulsory Care and Rehabilitation) Act 2003<sup>6</sup></p> <p><i>The 2004 guidelines update earlier guidelines promulgated in 1995. Interestingly, the earlier guidelines pre-date the 2003 Act, which incorporated Treaty principles into legislation for the mental health sector. The purpose of the guidelines is to facilitate a cultural experience for Māori under the Act consistent with supporting their recovery.</i></p>	<p><b>The good</b></p> <p>The guidelines seek to encourage best practice, while appropriately evidencing the legal basis for the guidelines.</p> <p>The guidelines appear appropriately principle based.</p> <p>The flow of the document appears logical.</p> <p><b>The not so good</b></p> <p>There are no links to other material or a contact person in the event further advice is needed. For example, the commentary on confidentiality appears inadequate and should perhaps link to more comprehensive advice. Further, “resolving issues in the final report” perhaps warrants more discussion.</p> <p>The guidance doesn’t have the professional polish of some of the other guidance material reviewed. In particular, the second part of Appendix 2 is bordering on incomprehensible, and reads in places as an incomplete policy proposal.</p> <p>A good edit would have made the document more accessible and credible.</p> <p><b>The unsure</b></p> <p>At face value it is not clear the guidance would be of tremendous value to the range of stakeholders identified (a number of mental health professionals, a specialist in tikanga, and whānau). It is possible their needs would have been better met by providing a range of guidance products (for example, a pamphlet for the patient/whānau, a formal document for the health professionals, and another for the specialist in tikanga focusing on expectations and boundaries). It is possible other, more targeted material is available.</p> <p><b>Summary and assessment</b></p> <p>The guidance material appears broadly appropriate for its purpose, but lets itself down in places through unprofessional drafting and little coverage of some topics. Links to other material would have made the document more useful.</p> <p>Assessment: “Good”</p>
<p>Good practice guidelines for working with tangata whenua and Māori organisations: Consolidating our learnings<sup>7</sup></p> <p><i>Garth Harmsworth (an employee of Landcare Research) prepared this document for Landcare Research. The document is “...intended to improve race relations in New Zealand ...”, and to improve Māori participation in resource management planning and policy.</i></p>	<p><b>The good</b></p> <p>The document provides a very strong foundation to the guidelines, in particular the need for greater Māori involvement in resource management, the legal context, international developments, and the current direction of travel. The document also has a very useful section that outlines differences in perspectives between local government and Māori.</p> <p>The guidance is strongly orientated towards best practice (consistent with meeting the purposes of the relevant legislation) in preference to simply meeting legal obligations. It is appropriately principle based, and well illustrated with good and bad real-life examples.</p> <p>Extensive referencing gives the document a strong sense of credibility.</p> <p>The explicit acknowledgement of the importance of other stakeholders, and the targeting of their interests and perceptions was a welcome addition to this form of guidance.</p> <p>For the most part, the document is well crafted, although at times it appeared to stray into an academic piece rather than guidance.</p> <p><b>The not so good</b></p> <p>The structure/organisation of the document is not always clear, for example, the inclusion of an interesting but perhaps out-of-context section on Local Government New Zealand views within the legislative framework section.</p>

Document	Assessment
	<p>After an impressive build-up with numerous strong insights, the guidance falls a little flat. The one page of dot points in particular is repetitive and not well organised. In contrast, the consultation guideline from the Auckland Regional Council (Appendix 2) is very good. Also, the guidance would have benefited from links to other key documents/guidance.</p> <p>The recommendations and conclusion at the end of the document appear to be directed to at least two different audiences – the government and local authorities. This is confusing. In reality, the key themes appeared appropriate also for Māori and other stakeholders. With little effort, useful recommendations could have been distilled from the document for these groups too.</p> <p>The Treaty was discussed, but not in a way that would provide strong direction to decision makers.</p> <p><b>Summary and assessment</b></p> <p>The document at times appeared to be an academic piece, advocacy, and guidance. This was confusing. Regrettably, the guidance aspect appeared to be the weakest part. That said, excellent insights and perspectives were woven through the document that would be of great value to a wide range of stakeholder interests. Clearly the author has extensive practical experience working with Māori and other groups.</p> <p>Assessment: “Good”</p>
<p>Guidance on the Marine and Coastal (Takutai Moana) Act 2011<sup>8</sup></p> <p><i>The Ministry of Justice has prepared this guidance to facilitate and clarify the status and impact of claims under the Marine and Coastal (Takutai Moana) Act 2011.</i></p>	<p><b>The good</b></p> <p>This guidance material is excellent. It is the only guidance reviewed that has sections specifically targeted to different stakeholder groups (Māori claimants, local authorities and business). This, together with intelligent use of links, a logical flow, a flow chart to bring all the material together, a frequently asked questions section, and the omission of any advocacy sections has made the document very easy to navigate and assimilate.</p> <p>The document has been professionally prepared and presented, appears comprehensive and free of errors. Links to other material and a named contact for enquiries adds to the likely value of the document.</p> <p>The guidance is current. Applications under the Act are possible only up to 2017, so it is unlikely to need further review/updating.</p> <p>For what the guidance is – an aid to understanding of the Marine and Coastal (Takutai Moana) Act 2011, it appears to strike an appropriate balance between prescription and principle-based standards. Similarly, the guidance itself appears “best practice” rather than the behaviours being encouraged. Within this context, it would have been interesting to review the related guidance for officials in implementing the Act against the best practice criteria.</p> <p><b>The unsure</b></p> <p>There is likely to be guidance for officials on their discharging their responsibilities under the Act. It is not known what the quality of this guidance might be.</p> <p>Although the Act has a Treaty clause, there is no mention of it in the guidance. It would be interesting to know the reason for this – this is a notable contrast with other guidance documents reviewed.</p> <p><b>Summary and assessment</b></p> <p>The guidance is excellent and would be likely to add significant value to applicants under the Act while also being useful to other stakeholders with an interest in claims.</p> <p>Assessment: “Excellent”</p>

Document	Assessment
<p>Ngā Ara Tohutohu Rangahau Māori Guidelines for Research and Evaluation with Māori 2004<sup>9</sup></p> <p><i>The purpose of these guidelines is to improve research by the Ministry of Social Development (MSD) and its contractors where that research requires input from Māori.</i></p> <p><i>The origins of the guidelines include problems with past research involving Māori and the importance of good research on Māori to meet MSD's objectives. There is no explicit reference to the statutes under which MSD operates (that is, the guidelines are not legalistic).</i></p>	<p><b>The good</b></p> <p>The guidelines are clearly focused on promoting best practice, which is described as including government and Māori objectives. Interestingly, while the Treaty is mentioned only once in passing, an objective consistent with tino rangatiratanga is described – “enables Māori to advance their own social and economic development programmes and agendas.”</p> <p>The framework used appears logical, robust and complete, principles are used in preference to prescriptive standards, and no errors were identified.</p> <p>There are good links to additional information and resources across the government and non-government sector. Ministry contacts are identified for further information.</p> <p><b>The not so good</b></p> <p>The guidance could have been shortened considerably by cutting back on the repetition, and by using the services of a good editor.</p> <p>The document would have benefited from the use of more examples to illustrate the principles.</p> <p>In places the guidance appeared excessively aspirational. For example, in most cases it will not be possible (or even sensible) for contractors to have secured the support of Māori before being awarded a research contract by MSD.</p> <p>The guidelines do not appear complete, despite them being nearly 10 years old. For example, the ethics guidelines intended to guide engagement with Māori are “forthcoming”.</p> <p>The guidance does not appear to be current, one example being the contacts identified.</p> <p><b>Summary and assessment</b></p> <p>The guidance material appears fit for purpose and has comprehensive links to other material. But it lets itself down by being repetitive and not including real-life examples to bring the theory to life.</p> <p>Assessment: “Good”</p>
<p>Consistency with the government's Treaty of Waitangi obligations (in Treasury's Technical Guide for Departments, “Disclosure statements for government legislation”, June 2013)<sup>10</sup></p> <p><i>The Treaty guidance is a subset of the wider disclosure statement guidance for officials. The existing administrative disclosure statements are intended to become legislative requirements after a trial period and review. The Treaty guidance is an aid to officials answering the question “What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?”</i></p>	<p><b>The good</b></p> <p>The rationale for the guidance is clearly articulated.</p> <p>The guidance is professional, clear and succinct. It covers what needs to be covered for a high-level document (key principles, and a link to further reading).</p> <p>While the disclosure requirements are prescriptive, the guidance is principles based.</p> <p>The new disclosure requirements are being trialled before they become legislative requirements. Within this context, it is appropriate to see Treasury contacts identified for clarification, and to see feedback on how the guidance works.</p> <p><b>The not so good</b></p> <p>The references are almost exclusively legal. It would have been useful to reference some of the normative guidance available to encourage best practice.</p> <p><b>The unsure</b></p> <p>The required disclosure is new. It is not clear how effective the guidance will be; for example, whether officials will resort to a pro forma response along the lines of legal advice was sought. Success will depend on the attitude of officials and the extent of effective monitoring and comment by interested stakeholders. For example, it was found that stakeholder monitoring and review of Regulatory Impact Statements was by itself insufficient to generate the quality improvements sought</p>

Document	Assessment
<p><i>Answering this question promotes accountability of officials to ministers and other stakeholders. It is also an opportunity for officials to share information on their approach to promoting compliance with Treaty principles.</i></p>	<p>by government.</p> <p>Also, the guidance invites officials to identify impacts of the respective bill on the rights and interests of Māori, and the steps taken to determine if those effects are consistent with the principles of the Treaty. What appears to have been omitted is whether the bill is actually deemed to be consistent with Treaty principles, and, if not, where it is not and what has been done as a consequence. After review, this may be a logical next step for the requirements and guidance.</p> <p><b>Summary and assessment</b></p> <p>The guidance appears broadly appropriate for helping officials think about whether a bill is consistent with Treaty principles, although it is perhaps a little legalistic in its focus, at the expense of a wider and more aspirational approach.</p> <p>Assessment: "Good"</p>

*Notes:*

1. [www.epa.govt.nz/publications/erma-cia%20guidelines-250510.pdf](http://www.epa.govt.nz/publications/erma-cia%20guidelines-250510.pdf)
2. [www.tpk.govt.nz/en/in-print/our-publications/publications/he-tirohanga-o-kawa-ki-te-tiriti-o-waitangi/](http://www.tpk.govt.nz/en/in-print/our-publications/publications/he-tirohanga-o-kawa-ki-te-tiriti-o-waitangi/)
3. <http://nursingcouncil.org.nz/content/download/721/2871/file/Guidelines-for-cultural-safety-the-Treaty-of-Waitangi-and-Maori-health-in-nursing-education-and-practice.pdf>
4. [www.doc.govt.nz/Documents/conservation/marine-and-coastal/coastal-management/guidance/policy-2.pdf](http://www.doc.govt.nz/Documents/conservation/marine-and-coastal/coastal-management/guidance/policy-2.pdf)
5. [www.mfe.govt.nz/publications/rma/guidelines-tangata-whenua-dec03/](http://www.mfe.govt.nz/publications/rma/guidelines-tangata-whenua-dec03/)
6. [www.health.govt.nz/system/files/documents/publications/idccrguidelines-culturalassessment.pdf](http://www.health.govt.nz/system/files/documents/publications/idccrguidelines-culturalassessment.pdf)
7. [www.landcareresearch.co.nz/\\_data/assets/pdf\\_file/0007/39967/Good\\_practice\\_guidelines\\_tanata\\_whenua-4.pdf](http://www.landcareresearch.co.nz/_data/assets/pdf_file/0007/39967/Good_practice_guidelines_tanata_whenua-4.pdf)
8. [www.justice.govt.nz/treaty-settlements/office-of-treaty-settlements/marine-and-coastal-area-takutai-moana](http://www.justice.govt.nz/treaty-settlements/office-of-treaty-settlements/marine-and-coastal-area-takutai-moana)
9. [www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/planning-strategy/guidelines-research-evaluation-Māori/guidelines-research-evaluation-Māori.pdf](http://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/planning-strategy/guidelines-research-evaluation-Māori/guidelines-research-evaluation-Māori.pdf)
10. [www.treasury.govt.nz/publications/guidance/regulatory/disclosurestatements](http://www.treasury.govt.nz/publications/guidance/regulatory/disclosurestatements)

## Appendix F Stocktake of appeals provided for in regulatory legislation

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Animal Products Act 1999	Section 154: appeal against making of or refusal to make compliance order	District Court	Re-hearing	High Court
Animal Welfare Act 1999	Section 143: appeal against decision on enforcement order	District Court	Re-hearing	High Court
	Appeal against criminal convictions (pursuant to Crimes Act)	District Court	Re-hearing	High Court
Anti-Money Laundering and Countering Financing of Terrorism Act 2009	No appeal rights			
Atomic Energy Act 1945	No appeal rights			
Auditor Regulation Act 2011	Section 24: appeal against decision about licensing and related matters	Accredited body or FMA	Re-hearing	District Court
	Section 31: appeal against decision concerning registration of a firm	Accredited body or FMA	Re-hearing	District Court
	Section 63: appeal against decision concerning accreditation of a person	FMA	Re-hearing	High Court
Biosecurity Act 1993	Section 154EL: appeal against compliance order		Re-hearing	District Court
Broadcasting Act 1989	Section 8: review of broadcaster's decision on a complaint	Broadcaster		Broadcasting Authority
	Section 18: appeal against decisions relating to complaints	Broadcasting Authority	Re-hearing	High Court
Building Act 2004	Section 208: appeal against specified decisions	Chief Executive	Re-hearing	District Court
	Section 330(1): appeal against decision relating to licence as a building practitioner	Registrar of Licensed Building Practitioners		Building Practitioners Board
	Section 330(2): appeal from decision of Building Practitioners Board under s 330(1)	Building Practitioners Board	Re-hearing	District Court
Building Societies Act 1965	Section 16: appeal against refusal to register the rules	Registrar	Re-hearing	High Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 122C: appeal against refusal to disclose information under s 122B	Any person	Re-hearing	High Court
	Section 124: appeal against suspension or cancellation of registration	Registrar	Re-hearing	High Court
Burial and Cremation Act 1964	Appeal against decision regarding denomination's use of cemetery	Local authority	Re-hearing	District Court
Charities Act 2005	Section 59: appeal against decision of the Board	Board	Re-hearing	High Court
Civil Aviation Act 1990	Section 27P: appeal against decision concerning medical certificates	Director of Civil Aviation	Re-hearing	District Court
	Section 66: appeal against specified decisions concerning licensing, registration, medical certificates, etc	Director of Civil Aviation	Re-hearing	District Court
	Section 64(2): appeal against disqualification from holding or obtaining an aviation document	District Court	Re-hearing	High Court (under Criminal Procedure Act 2011)
Climate Change Response Act 2002	No appeal rights			
Commerce Act 1993	Section 91(1): general right of appeal against Commission determinations (except s 52P determinations and input methodology determinations under s 52Z)		Appeal on the merits by way of re-hearing	High Court, with two lay expert members
	Section 91(1B): right of appeal on a question of law against any Commission determination		Question of law	
	Section 52Z: right of appeal against Commission input methodology determinations		"Qualified" appeal on the merits by way of re-hearing	High Court, with two lay expert members
Conservation Act 1987 (Freshwater Fisheries Regulations 1983)	Clause 51(7) of the Regulations: appeal against decision relating to authority for use of electric fishing machines	Fish and Game Council or Director-General	Re-hearing	Minister
	Clause 67A: appeal against revocation of licence	Director-General	Re-hearing	Minister
Co-operative Companies Act 1996	Section 47: appeal against any decision or act under this Act		Re-hearing	High Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Corporations (Investigation and Management) Act 1989	No appeal rights			
Credit Contracts and Consumer Finance Act 2003	Section 85: appeal against any proceedings in District Court under the Act	District Court	Re-hearing	High Court
Crown Pastoral Land Act 1998	Section 23J: appeal against determination of base or current carrying capacity of pastoral leases	Expert determiner	Question of law	High Court
Customs and Excise Act 1996	Provision for appeal against specified decisions of the Chief Executive	Chief Executive	De novo	Customs Appeal Authority
Dairy Restructuring Act 2001	Section 132: appeal against Commission determination on a dispute between Fonterra and another	Commerce Commission	Question of law	High Court
Education Act 1989	Section 21: appeal against refusal to grant exemption from enrolment	Designated officer in Ministry of Education		Secretary
	Section 26: appeal against refusal to grant exemption from school enrolment	Designated officer in Ministry of Education		Secretary
	Section 126: appeal against specified decisions of Teachers Council	Teachers Council	Re-hearing	District Court
	Section 129AZB: appeal against disciplinary decision under certain sections	Teachers Council or Disciplinary Tribunal	Re-hearing	District Court
	Section 247: appeal against refusal of entrance to university on certain grounds			Qualifications Authority
	Section 305: appeal against specified decisions concerned with student allowances	Employee of Ministry		Review by Secretary; appeal to Student Allowance Authority
	Electricity Industry Act 2010	Section 49: appeal against order of suspension of trade	Electricity Authority	Re-hearing
	Section 50: appeal against certain decisions made under the Code		Re-hearing	Rulings Panel
	Section 64: appeal against any decision of Authority or Rulings Panel	Authority or Rulings Panel	Question of law	High Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 65: appeal against specified decisions of Rulings Panel	Rulings Panel	Re-hearing	High Court
Energy Efficiency and Conservation Act 2000	No appeal rights			
Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012	Section 104: appeal against Environmental Protection Authority's review of decision on application for consent	Environmental Protection Authority	Question of law	High Court
	Section 105: appeal against whole or part of EPA's decision regarding application for consent	Environmental Protection Authority	Re-hearing	High Court
Fair Trading Act 1986	Section 37: appeal against criminal offences against ss 40 and 47J and orders under s 40A	District Court		High Court
Films, Videos, and Publications Classification Act 1993	Section 58: appeal against decision under s 41(3) or s 47	Board	Question of law	High Court
Financial Advisors Act 2008	Section 137R: appeal against temporary banning order	FMA	Question of law	High Court
	Section 138: appeal against specified decisions of FMA	FMA	Re-hearing	District Court
Financial Markets Authority 2011	Section 48: FMA may state a case for the opinion of the High Court on a question of law arising before it	FMA	By case stated	High Court
Financial Reporting Act 1993	No appeal or review rights			
Financial Services Providers (Registration and Dispute Resolution) Act 2008	Section 20: objection to proposed de-registration of financial service provider			Registrar
	Section 42: appeal against specified decisions regarding registration and inspection powers	Registrar of Financial Service Providers	Re-hearing	High Court
Fisheries Act 1996	Section 51: appeal against Chief Executive's review of determination as to quantum and allocation	Chief Executive	Re-hearing	Catch History Review Committee or High Court
	Section 180: objection to proposal to establish taiapure – local fishery			Tribunal (Māori Land Court judge)

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 186Z: appeal against revocation of registration under s 186Y			District Court
Flags, Emblems, and Names Protection Act 1981	No appeal			
Food Act 1981	Section 8V: appeal against refusal to grant exemption from provisions of Food Hygiene Regulations	Territorial authority		Director-General
Forest and Rural Fires Act 1977	Section 28: landholder/owner can request review of notice to make a firebreak or escape route or remove combustible material			Rural Fire Mediator
	Section 49: any person upon whom a levy is imposed under specified sections can request the National Rural Fire Officer to appoint a Rural Fire Mediator to review the levy imposed			Rural Fire Mediator
	Section 52: a Fire Authority may lodge an appeal against the apportionment by the National Rural Fire Officer of firefighting costs in a regional fire emergency	National Rural Fire Officer		The Minister must appoint a person to conduct and determine the review
	Section 65: appeal in relation to a dispute about a levy or determination in ss 45 or 46	Rural Fire Mediator	Re-hearing	District Court
Freedom Camping Act 2011	Section 39: objection against refusal to return property	Local authority	Re-hearing	District Court
Friendly Societies and Credit Unions Act 1982	Section 79: certain disputes may be referred to the Registrar to hear and determine			Registrar
	Section 85: any member of a society or any person may object to the proposed amalgamation or transfer of the engagements of a society on certain specified grounds			Registrar

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 91: appeal against Registrar's direction forbidding new business or members	Registrar		High Court
	Section 92: appeal against cancellation or suspension of registration			High Court
	Section 139: appeal against suspension of business of credit union			High Court
	Section 151: general right of appeal against any decision	Registrar		High Court
Gambling Act 2003	Section 46: appeal against Secretary's decision regarding class 3 operator's licence	Secretary		Gambling Commission
	Section 61: appeal against Secretary's decision regarding class 4 operator's licence	Secretary		Gambling Commission
	Section 77: appeal against Secretary's decision regarding class 4 venue licence	Secretary		Gambling Commission
	Section 143: appeal against Secretary's decision regarding minimum operating standards of casino licence	Secretary		Gambling Commission
	Section 148: appeal against decision of Gambling Commission to cancel or suspend casino licence	Gambling Commission	Re-hearing	High Court
	Section 171: appeal against decision to refuse or cancel certificate of approval	Secretary		Gambling Commission
	Section 235: appeal against decisions of Gambling Commission	Gambling Commission	Re-hearing	High Court
Gas Act 1992	Section 10: objection to notice of inspection		Re-hearing	District Court
	Section 28: appeal against conditions imposed on construction or maintenance of fitting on roads	Local authority	Re-hearing	District Court
	Section 43ZA: appeal against decision of Rulings Panel	Rulings Panel	On ground of lack of jurisdiction	High Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 43ZC: appeal against decision of industry body, Energy Commission, or Rulings Panel under any gas governance regulations or rules	Industry body, Energy Commission, or Rulings Panel	Question of law	High Court
	Section 43ZD: appeal against suspension or termination order			High Court
Hazardous Substances and New Organisms Act 1996	Section 125: appeal against specified decisions	Environmental Protection Authority	Re-hearing	District Court
	Section 126: appeal against decision on application for determination of new organism or hazardous substance	Environmental Protection Authority	Question of law	High Court
Health Act 1956	Section 28: appeal against appointment of environmental health officers	Director-General		Minister
	Section 43: appeal against closing order		Re-hearing	District Court
	Section 45: appeal against refusal or failure to cancel closing order		Re-hearing	District Court
	Section 54: appeal against decision regarding carrying on of offensive trade within 8 km of local authority boundary	Local authority	Re-hearing	District Court
	Section 55: appeal against establishment of offensive trade	Local authority or medical officer of health	Re-hearing	Board of appeal, constituted by Minister
	Section 59: appeal against refusal to consent to establishment or extension of stock saleyard	Local authority or medical officer of health	Re-hearing	Board of appeal, constituted by Minister
	Section 69ZZK: appeal against water supply compliance order	Local authority or medical officer of health	Re-hearing	District Court
Health and Disability Commissioner Act 1994	No appeal			
Health and Disability Services (Safety) Act 2001	Section 51: appeal against certain orders			District Court
Health and Safety in Employment Act 1992	Section 46: appeal against improvement or prohibition notice	Inspector	On reasonableness grounds	District Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Historic Places Act 2003	Section 20: appeal against decisions under specified sections	Historic Places Trust	Re-hearing	Environment Court
Human Assisted Reproductive Technology Act 2004	No appeal			
Human Tissue Act 2008	No appeal			
Imports and Exports (Restrictions) Act 1998	No appeal			
Intellectual Disability (Compulsory Care and Rehabilitation) Act 2003	Section 133: appeal against proceedings in Family Court under this Act	Family Court	Re-hearing	High Court
Insurance (Prudential Supervision) Act 2010	Section 42: appeal against power to remove directors and officers	Reserve Bank	Re-hearing	High Court
	Section 169(4): appeal against valuation of policies	Liquidator or deed administrator	Re-hearing	High Court
	Section 224: appeal against order to ban certain persons from participating in insurance business	District Court	Re-hearing	High Court
Kiwisaver Act 2006	No appeal			
Land Act 1948	Section 18: appeal against decision affecting lease or licence	Board	Case agreed on by Board and appellant	High Court
	Section 87A: appeal against conditions of repayment and interest	Board		Land Valuation Tribunal
	Section 123: appeal against values ascertained by Board in s 22(5) or s 22(7A)	Board		Land Valuation Tribunal
	Section 156: appeal against determination of 1942 basic value of land	Board		Land Valuation Tribunal
Land Transfer Act 1952	Section 216: review of decision of Registrar	Registrar		Registrar
	Section 218: appeal against Registrar's review	Registrar		High Court
Land Transfer (Computer Registers and Electronic Lodgement) Amendment Act 2002	No appeal			

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Land Transport Act 1998	Section 29B: appeal against denial of application for reinstatement of passenger endorsement			High Court
	Section 95A: appeal against extension of driver licence suspension			High Court
	Section 98B: appeal against order prohibiting sale or disposal of vehicle (where person charged with an offence and confiscation of the vehicle is a mandatory sentence)		Re-hearing	District Court
	Section 101: appeal against suspension of driver licence		On grounds that the person was not the driver of the vehicle at the relevant time; or the enforcement officer did not have reasonable grounds of belief as required	Land Transport Agency
	Section 102: appeal against seizure and impoundment of vehicle		Appeal on specified grounds	Enforcement officer, authorised by Commissioner
	Section 106: general right of appeal against any decision made under the Act by the Agency in respect of the grant, issue, revocation or suspension of a land transport document sought or held	Agency	Re-hearing	District Court
	Section 107: appeal against disqualification from holding or obtaining a driver licence	District Court	Re-hearing	High Court (Criminal Procedure Act applies)
	Section 108: appeal against refusal to remove disqualification	Agency	Re-hearing	District Court
	Section 109: appeal against refusal to remove suspension of licence	Agency	Re-hearing	District Court
	Section 110: appeal against refusal to direct release of impounded vehicle	Police	Re-hearing	District Court

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 267: appeal against specified decisions of Registrar or enforcement officer	Registrar or enforcement officer	Re-hearing	District Court
Land Transport Management Act 2003	Section 140: appeal against arrangement of public transport services into units and the allocation of those units in a regional public transport plan	Regional council	Re-hearing, merits	Environment Court
	Section 141: appeal against an "adverse decision"		Re-hearing	District Court
	Section 144: appeal against decision		On question of law	High Court
Marine Mammals Protection Act 1978	No appeal			
Marine Reserves Act 1971	No appeal (except general rights of appeal against criminal offences)			
Maritime Security Act 2004	Section 25: review of Chief Executive's decision to not approve ship security plan	Chief Executive		Chief Executive
	Section 43: review of Chief Executive's decision not to approve port facility security plan	Chief Executive		Chief Executive
	Section 64: appeal against specified decisions of Chief Executive	Chief Executive	Re-hearing	District Court
Maritime Transport Act 1994	Section 79: appeal against order disqualifying person from holding or obtaining a maritime document	District Court	Re-hearing	High Court (in accordance with Criminal Procedure Act)
	Section 52: appeals from persons who do not require a maritime document that are suspended from work on a New Zealand ship by the Director	Director		Maritime Appeal Authority
	Section 424: appeal against specified decisions		Re-hearing	District Court
Medicines Act 1981	Section 49: appeal against a notice restricting supply of medicine to a particular person			Minister

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
	Section 88: appeal against certain decisions of the Director-General or licensing authority under certain sections: s 30 (clinical trials); s 38 (sale of medical devices); or s 51 (grant of licences)	Director-General, licensing authority	Re-hearing	Medicines Review Committee
	Section 89: appeal against certain decisions (Minister's decision to refuse, revoke, or suspend a consent or approval or add conditions under ss 20, 23, 24, or 35; a decision to issue a notice under ss 36(3) or 37(1) or imposition or variation of conditions; a decision of the Medical Review Committee under s 88)	Minister, Medical Review Committee	Can appeal if a relevant requirement of the Act or regulations has not been complied with, or the decision that is the subject of the appeal is unreasonable	High Court
Mental Health (Compulsory Assessment and Treatment) Act 1992	Section 16: review of patient's condition			Family Court judge if possible; if not, a District Court judge plus medical professionals
	Sections 76 and 79: review of compulsory treatment order			Review Tribunal
	Section 83: review of Review Tribunal's decision	Review Tribunal		Family Court
Misuse of Drugs Act 1975	Section 13L: appeal against grant of detention warrant under s 13E	District Court		High Court
	Section 25: appeal against notice restricting certain individuals from being supplied with controlled drugs	Medical officers of health		Minister
National Animal Identification and Tracing Act 2012	No appeal			
National Parks Act 1980	No appeal			
Native Plants Protection Act 1934	No appeal			
Overseas Investment Act 2005	No appeal			
Ozone Layer Protection Act 1996	No appeal			

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Primary Products Marketing Act 1953	No appeal			
Protected Objects Act 1975	Section 9: appeal against refusal to grant permission to remove protected New Zealand object	Chief Executive		Minister
	Section 12: appeals relating to taonga tūturu			Māori Land Court
Psychoactive Substances Act 2013	Section 45: appeal against decision to refuse to grant a licence, impose a condition on a licence, or suspend or cancel a licence to import, manufacture, research, or sell a psychoactive substance	Psychoactive Substances Regulatory Authority	Re-hearing	Psychoactive Substances Appeal Committee
	Section 33: appeal against refusal to approve a product, impose a condition on approval, revoke approval, or issue a recall order for a product	Psychoactive Substances Regulatory Authority	Re-hearing	Psychoactive Substances Appeal Committee
Public Works Act 1981	Section 23: objection to taking of land	Government or local authority		Environment Court
Racing Act 2003	Clause 20 of Schedule 3 to the Act: appeal under the Racing Rules			Appeals Tribunal
Radiation Protection Act 1965	Section 23: appeal against decisions of Director-General under specified sections			Board of Appeal (District Court judge and two assessors), appointed by Minister
Radiocommunications Act 1989	Section 67: appeal against decisions under specified sections	Registrar	Re-hearing	High Court
Railways Act 2005	Section 68: appeal against decision of the Agency	Agency	Re-hearing	District Court
	Section 89: appeal against conditions imposed under s 87(2)		Re-hearing	District Court
Rating Valuations Act 1998	Section 34: review of information contained in notice of valuation			Valuer
	Section 34: appeal against valuer's review	Valuer		Land Valuation Tribunal
Reserve Bank of New Zealand Act 1989	No appeal or review rights			

Legislation	Specific legislative provision	Initial decision maker	Type of appeal	Appeal body
Reserves Act 1977	No appeal rights			
Resource Management Act 1991	(See note on Environment Court, written for Local Government inquiry)			
Retirement Villages Act 2003	Section 52: resolution of dispute according to statutory dispute process for certain types of dispute			Disputes Panel
	Section 75: appeal against decision of Disputes Panel	Disputes Panel	Re-hearing	District Court
Securities Act 1978	Section 65G: appeal against decisions of FMA	FMA	Question of law	High Court
Securities Transfer Act 1991	No appeal or review rights			
Shipping Act 1987	No appeal or review rights			
Statistics Act 1975	No appeal or review rights			
Superannuation Schemes Act 1989	Section 23: appeal against specified decisions of FMA	FMA		High Court
Takeovers Act 1993	Section 31G: appeal against decisions under ss 31A-31C	Panel or Registrar		High Court
Trade in Endangered Species Act 1989	Section 12: appeal against decision under s 11 (relating to grant of various permits and certificates)	Director-General	Question of law	District Court
Tuberculosis Act 1948	Section 17: appeal against order of isolation			High Court
Unit Trusts Act 1960	No appeal or review rights			
Walking Access Act 2008	No appeal or review rights			
Wild Animal Control Act 1977	Review of authorisation of entry			Minister
Wine Act 2003	Section 114: review of certain decisions	Official acting under delegated authority		Director-General or person appointed by Director-General

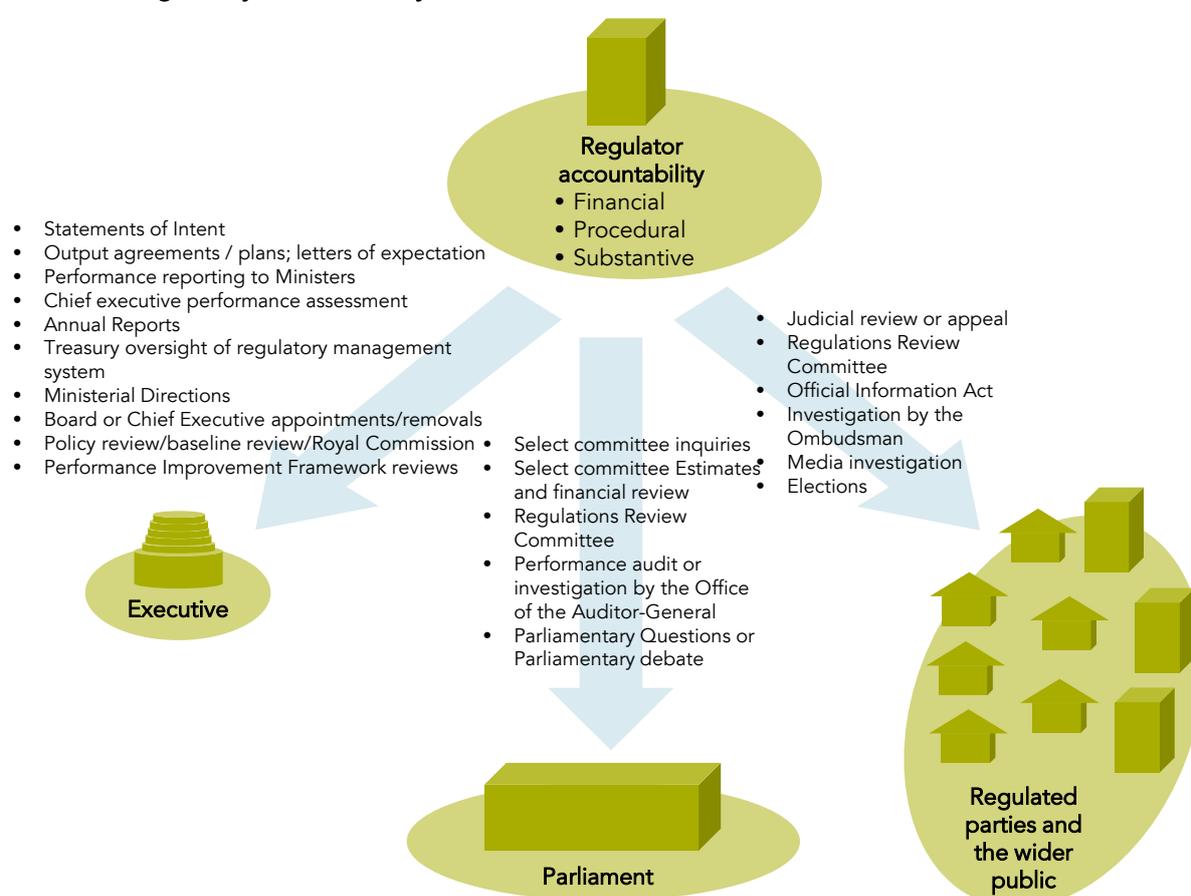
# Appendix G Regulator accountability mechanisms in New Zealand

## Introduction

Four main groups can call regulators to account in New Zealand: the Executive, Parliament, regulated parties and the wider public. This appendix lays out the mechanisms through which these four groups hold regulators to account and which accountability criteria (such as financial, procedural or substantive) each mechanism meets.

Although this appendix explores each accountability mechanism individually, it is worth recalling that a number of these mechanisms inter-relate (for example, Statements of Intent, Annual Reports and financial reviews are part of the annual performance cycle). As a result, the weakness of one individual mechanism may be offset by strength in another mechanism.

Figure G.1 Regulatory accountability mechanisms in New Zealand



## Accountability to the Executive

Under New Zealand constitutional conventions, ministers have direct and indirect responsibility for the performance of regulators, depending on their form and degree of statutory independence (such as a department, Crown agent, autonomous Crown entity or independent Crown entity). Ministers “are individually responsible to the House for their official actions and for the general conduct of their departments and officials. This is a political accountability. It is not limited to matters over which the Minister has legal control” (McGee, 2005, p. 92). Where regulators are Crown entities, ministers “are responsible to Parliament for overseeing and managing the Crown’s interest in, and relationships with, the Crown entities in their portfolios” (Cabinet Office, 2006). The different nature of the accountability for Crown entities reflects the fact that they are legal bodies in their own right, outside of the Crown, and governed by boards, whose members are responsible for the performance of their organisation.

## Regular mechanisms

Virtually all regulators are subject to the state sector financial and performance management processes laid out in the Public Finance Act 1989, State Sector Act 1988 and Crown Entities Act 2004. Regulators that are not subject to those processes (mainly occupational regulators that are not part of the State sector) have similar obligations to report their performance to ministers and Parliament.<sup>89</sup>

Financial and performance management processes in the state sector operate on a yearly cycle, starting with specifying departmental or Crown future operating intentions through the Strategic Intention or Statement of Intent (SOI) and the Supporting Information in the Budget Estimates.

SOIs and Strategic Intentions are strategic documents that set out the agency's direction and objectives, over at least the next four financial years. Crown entities must also outline how they propose to assess their performance. Minimum content requirements for each are outlined in Table G.1.

**Table G.1 Minimum content requirements for Strategic Intentions and Statements of Intent**

Departmental Strategic Intentions	Crown Entity Statement of Intent
<ul style="list-style-type: none"> <li>• Period of the document.</li> <li>• Whether the department hosts a departmental agency.</li> <li>• The department's strategic objectives.</li> <li>• The nature and scope of the department's functions and operations.</li> <li>• How the department will manage its functions and operations to achieve its strategic objectives.</li> <li>• Pay and employment equity strategies.</li> <li>• Any other information "reasonably necessary" to understand the department's strategic intentions.</li> <li>• Any other requirements of the responsible minister or Minister of Finance.</li> </ul>	<ul style="list-style-type: none"> <li>• Period of the document.</li> <li>• The Crown entity's strategic objectives.</li> <li>• The nature and scope of the entity's functions and operations.</li> <li>• How the entity will manage its functions and operations to achieve its strategic objectives.</li> <li>• How the entity will manage its organisational health and capability, including equal employment opportunities, capital investment and asset management.</li> <li>• How the entity proposes to assess its "strategic performance".</li> <li>• Any process to be followed in the proposed acquisition of shares or interests in companies, trusts or partnerships.</li> <li>• Any other information "reasonably necessary" to understand the entity's strategic intentions.</li> </ul>

Source: New Zealand Treasury, 2013g, 2014b.

Departmental Strategic Intentions must be agreed with the relevant minister. Ministers responsible for Crown entities may direct that information in an SOI be presented in a specific format, make comments on a draft SOI, and direct amendments to an SOI. The minister may also ask for a new SOI at any time. Even so, Ministerial Directions may not affect statutorily independent functions of a Crown entity.

Ministers may also seek an output plan (with their department) or output agreement (with a Crown entity).<sup>90</sup> Output plans or agreements are yearly agreements between the minister and chief executive (for departments) or board (for Crown entity). These plans or agreements:

- describe the full range of outputs to be delivered, including the associated performance measures and standards;
- set out the amount and basis on which the agency will be paid, or expects to earn revenue for delivering the outputs. This includes Crown funding, fees and levies or trading revenue (Steering Group Managing for Outcomes Roll-out, 2002).

<sup>89</sup> For example, the health sector occupational regulatory bodies recognised through the Health Practitioner Competence Assurance Act 2003 must report yearly to the Minister of Health (s. 134). Similarly, the Plumbers, Gasfitters and Drainlayers Board must provide a yearly report to the Minister for Building and Construction, who in turn must present it to the House (ss. 152-154 of the Plumbers, Gasfitters and Drainlayers Act 2006). These bodies tend not to receive any funding from the Crown.

<sup>90</sup> Output agreements will be replaced with 'statements of performance expectations' from 1 July 2014.

Output plans are cross-referenced in the job descriptions of departmental chief executives, to reinforce incentives for performance. The State Services Commission (SSC) conducts yearly reviews of each chief executive's performance against their job description and other government or ministerial expectations. Part of a chief executive's salary is "at risk", and paid out depending on levels of performance.

Another mechanism for signalling ministerial expectations to Crown entities is the Letter of Expectations. Letters of Expectations set out a minister's specific priorities for the planning period or for the entity's strategic direction. They are generally issued yearly or after the appointment of a new Chair, after legislative changes that affect the entity's environment, or when a new minister takes up responsibility for the entity (SSC, 2006).

The Information Supporting the Estimates are part of the Budget documents. These documents describe how different areas of spending (appropriations) contribute to the Government's goals (including priorities, outcomes and impacts). They also outline trends in expenditure and the performance measures and delivery standards that will be applied to each appropriation.

Throughout the financial year, departments and Crown entities must report to ministers on their progress in delivering on their outputs and strategic objectives. Departments are also responsible for monitoring the performance, financial viability and capability of Crown entities and providing "Ministers with an independent view of the financial performance and cost-effectiveness of the entity" (SSC, 2006). Alongside this, the Treasury monitors the regulatory quality management system and periodically advises ministers on options to improve its performance.

At the end of the financial year, departments and Crown entities must report to ministers on their achievements, and ministers are required to present these annual reports to Parliament. The reports form the basis for any future financial review by a select committee (see below). Departmental annual reports must include audited financial statements; a statement of service performance spelling out the levels of performance, the revenue and expenses achieved for each class of outputs supplied, as well as

the information that is necessary to enable an informed assessment to be made of the department's performance during the financial year (including an assessment against the intentions, measures, and standards set out at the start of the financial year in the information on the department's future operating intentions. (s. 45(2), Public Finance Act 1989)

Crown entity reports have similar content requirements, but must (among other aspects) also include commentary on their performance as good employers, payments made to board members, and any Ministerial Directions issued during the year (s.151, Crown Entities Act 2004).

A recent innovation in the New Zealand accountability and performance assessment cycle is the Performance Improvement Framework (PIF) review. A PIF review is

a review of an agency's fitness-for-purpose today and for the future ... a PIF review looks at the current state of an agency and how well placed it is to deal with the issues that confront it in the medium-term future. It then proposes areas where the agency needs to do the most work to make itself fit-for-purpose and fit-for-the future. (SSC, New Zealand Treasury & Department of the Prime Minister and Cabinet (DPMC), 2013b, p. 5)

PIF reviews were introduced in 2009 and are conducted by independent reviewers. The reviewers make recommendations to agency Boards (for Crown entities) or chief executives (for departments), which they then accept or reject.<sup>91</sup> For departments, the agreed outcome of the review is reflected in the chief executive's performance agreement.

The final regular accountability mechanism on ministers responsible for regulators is the electoral cycle. Although the performance of regulatory agencies seldom features prominently in election campaigns, ministers may be called on to justify their own performance on regulatory matters.

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<sup>91</sup> The SSC also has the right to comment on the lead reviewers' recommendations, but the reviewers are not obliged to accept these comments.

## Irregular mechanisms

Ministers have a number of other accountability levers they can pull, which can be of particular use where ministers are dissatisfied with aspects of a regulator's performance.

Where the regulator in question is a Crown entity, ministers can, in some circumstances, issue directions and appoint or remove board members. These powers, and the constraints placed on ministers by the degree of Crown entity independence, are discussed in Chapter 9 of this report. The State Services Commissioner, with the agreement of the Governor-General in Council can remove departmental chief executives from office for "just cause or excuse" (s. 39, State Sector Act 1988).

Ministers may commission fundamental reviews of the performance of a regulator or regulatory regime.<sup>92</sup> Options include an expenditure review, a policy review, a performance audit by the Office of the Controller and Auditor-General (see below), or Commissions of Inquiry. The options vary in terms of their intrusiveness and public profile, and focus on different issues.

Expenditure (or "baseline") reviews test the value for money obtained from spending in a particular sector or organisation, especially the efficiency of agency management and the effectiveness of interventions (New Zealand Treasury, 2008). Policy reviews assess the fitness-for-purpose of underlying frameworks or legislation. They can be conducted internally by officials (for example, the current review of the Telecommunications Act 2001) or by external parties appointed by ministers (for example, the Capital Markets Taskforce).

Commissions of Inquiry "exist as distinct entities as they do not technically belong to the Legislature, the Executive, or the Judiciary. They do not decide questions put before them as a court does; rather they are set up by government to inquire into and report on all kinds of matters" (Palmer & Palmer, 2004). As Sir Ivor Richardson, former president of the Court of Appeal, notes, Commissions of Inquiry are often established to conduct "a searching inquiry ... into events or rumours which have given rise to public concern with the object of ascertaining the truth and attributing blame if blame is due" (Richardson, 1989, p. 4). They tend to fall into one of two categories – investigation of "behaviour or conduct and the propriety of it" (such as the Cave Creek Commission and Pike River Commission); and investigation of policy issues (such as the Royal Commission into electoral law and Royal Commission into genetic modification) (Palmer & Palmer, 2004, p. 309).

## Accountability to Parliament

Parliament is, in many respects, the central accountability mechanism of New Zealand's political system. The Executive and its agents may not tax, borrow, levy or spend money without parliamentary authority,<sup>93</sup> and ministers and their agents exercise powers granted through parliamentary means.

The main way that Parliament can call regulators or their responsible ministers to account is through Select Committees. As noted in Chapter 2 of the report, select committees play a prominent role in the New Zealand political system, scrutinising almost all draft legislation. Under Standing Orders (Parliament's rules of operation), select committees have a wide scope of activity and considerable independence and influence. Palmer and Palmer (2004) comment:

Select committees are empowered to initiate their own inquiries. They are not dependent on receiving a direction from the House of Representatives ... Select committees can inquire into virtually any subject of government policy, expenditure, and administration, and the decision whether to conduct such an inquiry will depend upon how important and politically significant the committee members consider the topic to be. Whether the recommendations made are taken up will be a question for the government, although it is obliged by Standing Orders to make a formal response to such select committee reports and the recommendations not more than ninety days after the report has been presented to the House. (p. 170)

<sup>92</sup> For Crown entities, the responsible minister "may review the operations and performance of a Crown entity at any time" (s. 132, Crown Entities Act 2004).

<sup>93</sup> Section 22, Constitution Act 1986.

Depending on the question and Select Committee in question, a committee may summon witnesses or documents as evidence or ask the Speaker of the House to issue a summons. However, this power is not used lightly and, as McGee (2005) notes, it is “used only as a last resort in a case where the evidence is vitally necessary to the inquiry that is being carried out” (p. 429).

Reflecting the constitutional principle that public money may only be spent with parliamentary authority, select committees play a central role in scrutinising how agencies use the funds allocated to them. Outside of inquiries, this scrutiny takes place through two main mechanisms: the annual review of the Estimates, and financial reviews.

- **Yearly review of the Estimates:** After the Budget has been presented to Parliament, select committees have two months to examine the Government’s proposed spending plans for the coming financial year. The Finance and Expenditure Committee may carry out this examination, or it may refer specific areas of spending (Votes) to the relevant subject select committee. Committees call for evidence from the responsible minister to justify the proposed spending and, under Standing Order 333, may recommend changes to the Vote. Any recommended changes must be confirmed by a parliamentary vote. Although the review of Estimates looks at all spending within a ministerial portfolio, it does provide an opportunity for Parliament to focus on particular areas, including the performance and value for money from regulators.<sup>94</sup>
- **Financial reviews:** Each year, select committees review the performance of a selection of departments, Crown entities, officers of Parliament, state-owned enterprises or any other public organisation the House wishes to investigate. The purpose of the reviews “is to determine whether the entity concerned has performed as promised – whether its actual performance, both in supplying services and in managing its balance sheet and other assets, is consistent with forecast performance. It also involves considering how the entity is currently performing” (McGee, 2005, p. 510). The Finance and Expenditure Committee decides which agencies will be reviewed, and whether it will conduct the review or refer the topic on to the relevant subject committee. While select committees do not have the power to require an agency to act on the findings of a review, a poor financial review report can be embarrassing. In addition, where a review reveals matters of concern, a select committee can conduct an inquiry into the agency or invite the Auditor-General to investigate (McGee, 2005, p. 513).

The Regulations Review Committee (RRC) is a specialised select committee that focuses “on the appropriateness of the use of regulations” (RRC, cited in Malone & Miller, 2012, p. 10). Chapter 2 in this report described the role of the RRC in more detail.

A fourth accountability lever available to Parliament is the Office of the Controller and Auditor-General (OAG). The OAG is an Office of Parliament that “provides Parliament with independent assurance that state sector agencies are operating and accounting for their performance in line with Parliament’s intentions” (New Zealand Treasury, 2011d, p. 6). This includes auditing the financial statements of the Government and of all public entities, as well as conducting performance audits or inquiries into “any matter concerning a public entity’s use of its resources” (s. 18(1), Public Audit Act 2001).

Performance audits can examine a public entity’s efficiency and effectiveness, compliance with statutory obligations, probity and financial prudence and use of public resources. Performance audits or inquiries can be conducted at the request of Parliament, a minister or agency or be initiated by the Auditor-General. In all cases, however, the decision on whether to carry out an audit or inquiry rests with the Auditor-General.

The OAG has considerable investigatory powers, including the power to enter premises and inspect bank accounts, and the power to require the giving of evidence under oath or the presentation of documents. People or organisations who do not comply with a lawful request from the OAG may be fined. In addition, the Auditor-General also has a number of powers to ensure financial accountability, including the power to direct a minister to report to Parliament for unappropriated or otherwise unlawful spending and the ability to stop payments from Crown or departmental accounts that may be applied for unlawful or

<sup>94</sup> Select Committees also review the Supplementary Estimates (which outline any additional expenses and capital spending required for the fiscal year that is about to end). While this presents an opportunity to explore specific areas of spending or agencies, in practice this seldom happens.

unappropriated purposes. Recommendations from an OAG performance audit or inquiry are not mandatory, but carry significant moral authority.

Finally, Members of Parliament can:

- put written or oral questions to the minister responsible for a specific regulatory regime or agency, seeking information on its performance; or
- raise the performance of a specific agency in the House during the general debate or the debate on the Estimates, or seek the agreement of the Speaker and the House to have an urgent debate on the agency.

In the case of oral or written questions, Standing Orders require that an “answer that seeks to address the question asked must be given if it can be given consistently with the public interest” (Standing Order 383(1)). Parliamentary questions or debate do not oblige the minister or regulator to change behaviour, but can serve to highlight performance issues and create pressure for change.

## Accountability to regulated parties and the wider public

### The courts are more than just an accountability mechanism

As discussed in Chapter 10, the courts are more than just an accountability mechanism. They are “one of the arms of government,...exert an important checking function on the executive and legislative branches” and “go a considerable distance towards checking government excesses and preventing arbitrary and unfair decisions” (Palmer & Palmer, 2004, pp. 285-86).

In the context of regulation, the courts exercise this power when regulated parties seek to challenge a regulator’s decision or processes. Regulated parties can seek to call regulators to account for their actions through judicial review or an appeal. As noted earlier, the High Court has an important role supervising the Executive through its inherent powers of judicial review, which can test the legality, procedural fairness and reasonableness of a regulator’s action. At times, this can involve reviewing the substantive merit of a decision. Where Parliament provides for them, appeals deal directly with the substantive merits and correctness of a decision. In this way the Executive is not only accountable to regulated parties through the courts, but is accountable to the courts themselves.

Regulated parties (and the wider public) can also make use of the RRC, where the actions of a regulator fall within the grounds for drawing a regulation to the attention of the House.

Finally, as described in Chapter 8, statutory and common law obligations on regulators to consult with regulated parties also create accountability relationships. While these are generally weak accountability mechanisms, failure to properly fulfil the obligations may prompt a judicial review.

The main accountability mechanism open to the wider public is the Official Information Act 1982. The Act establishes the principle that official information “shall be made available unless there is good reason for withholding it” (s. 5). The burden is on the minister or agency receiving the official information request to demonstrate that there are grounds for withholding the information, in line with the criteria laid out in the Act. Ministers or agencies receiving a request must also process it within a statutorily specified period of time.

“Official information” is defined broadly as:

...all information held by a Department, a Minister of the Crown in his or her official capacity, or an organisation subject to the OIA [Official Information Act] or Local Government Official Information and Meetings Act (LGOIMA) is official information. This includes information held by an independent contractor engaged by an agency, and information held by any advisory council or committee established for the purpose of assisting or advising a department, Minister or organisation.

The Ombudsmen consider that the definition of official information also includes knowledge of a particular fact or state of affairs held by officers in such organisations or Departments in their official capacity. The fact that such information has not yet been reduced to writing does not mean that it does not exist and is not “held” for the purposes of the Act. (Office of the Ombudsman, 2012b, p. 7)

Official information may be requested by New Zealand citizens, permanent residents, a person who is in New Zealand, a body corporate incorporated in New Zealand, or a body corporate incorporated elsewhere but which "has a place of business in New Zealand" (s. 12, Official Information Act 1982).

Most, but not all, regulators are subject to the Official Information Act. All departments of state are subject to the Act, as are virtually all Crown entities. However, the Law Commission's 2012 review of official information legislation found that:

- the grounds for which agencies were included or not within the scope of the legislation were unclear;
- the public found it hard to find out whether or not a specific organisation was covered; and
- there were a number of anomalous exclusions from the scope of the Act (Law Commission, 2012b).

For example, the Law Commission found that

The Plumbers, Gasfitters and Drainlayers Board and the Building Practitioners Board are included, but not the Electrical Workers Registration Board. ... The Accounting Standards Review Board is included, but not the Council of Legal Education. (p. 336)

Public interest criteria for withholding information are specified in legislation. A request may be declined without further inquiry where it is judged to meet the "conclusive" grounds for withholding information in section 6. These grounds cover such matters as the impact of release on the defence, security and international relations of New Zealand, or where release would "prejudice the maintenance of the law". Where a request is judged to meet the "other" grounds for withholding information (s. 9), "a further inquiry is necessary as to whether other considerations make it desirable in the public interest to make the information available" (Law Commission, 2012b, p. 124).

Where a request for official information is declined, the requestor may appeal to the Ombudsman, an Officer of Parliament. If the Ombudsman concludes after an investigation that a declined request should be released, they can report to the minister or agency in question, recommending release. This recommendation imposes "a public duty" on the minister or agency to release the information within 21 working days (s. 32, Official Information Act). The Governor-General, through an Order in Council (also known as the "veto"), can override the public duty to release. But the veto has never been used (Law Commission, 2012b, p. 240). The Ombudsman is also restricted from recommending the release of information where the Prime Minister certifies that the release would prejudice defence, security of international relations, or where the Attorney-General certifies that it would "be likely to prejudice the prevention, investigation, or detection of offences" (s. 31b).

Official information investigations are only one part of the Ombudsmen's functions. The Ombudsmen have a wide range of investigatory powers, covering more than 4,000 organisations in the state sector and including:

- investigating state sector administration and decision making;
- dealing with requests for advice and guidance about alleged serious wrongdoing;
- monitoring and inspecting places of detention for cruel and inhuman treatment; and
- providing comment to the Ministry of Transport on applications for authorised access to personal information on the Motor Vehicle Register (Office of the Ombudsman, 2013).

Finally, investigation and campaigns by the media can create pressure on regulators or ministers to change behaviour. As Black (2012b) observes:

...a highly critical media campaign can be more effective in causing the resignation of a chief executive of a regulatory body than any legal power to sack him. (p. 5)

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