

The role of principles in a rules-based regime: the decision-making process at the Brazilian
Regulatory Agency of Electricity

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Abstract

This study explores the limits of standards-setting based primarily on prescriptive detailed rules, having as a background the Brazilian electricity sector (BES). It also attempts to understand why it has adopted this approach while scholars have extensively described its limitation. Starting from a classification of 1,618 appeals and requests lodged against the formal regulatory body (ANEEL), this paper proceeds towards an in-depth qualitative analysis of ANEEL's decisions in order to identify the reasons rule-makers and enforcers diverge, if at all, when applying the rules. This paper explores some hypotheses that question if a rules-based regime tends to trigger an adversarial regulatory scene, one where regulators and regulatees engage in a fierce game characterised by highly risk-averse behaviour on both sides. In fact, 40% of ANEEL's board of directors' efforts to regulate the sector is spent ruling on appeals and requests filed by companies. Another hypothesis says that the regulatory process matters, which means that a participative, high-budget, transparent decision-making process endowed with powerful tools—such as Regulatory Impact Assessment—tends to consolidate understandings to allow rules to later be applied harmoniously, at least by those engaged in the process of crafting new rules. However, signs of misalignment between enforcers and rule-makers are still considerable and interpretations diverge because of the highly legalistic discourse associated with establishing precise rules. Finally, this study concludes that although the literature regards a principles-based approach as being more appropriate to complex sectors, a rules-based regime is not clearly a mere strategic option but rather a “dependent path” derived from a legalistic and formalistic culture that prevents regulators from opting for another approach. In such contexts, “normative rules” and “regulation” are interpreted as having the same meaning.

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Introduction

Rules are about standard-setting, and by themselves do not guarantee achievement of any regulatory goals, despite being essential to the development of any regulatory strategy. To clarify, an opposition between rules and principles is as elucidative as tricky. In this debate, rules are generally understood as prescriptive detailed written rules, whereas principles convey a broad idea or goal to be pursued. However, it is misleading to think of rules and principles as two atomised concepts, as if they seldom interfere with each other. That does not correspond to reality. Instead, they look like two extremes of a continuum (Ford, 2010, p. 266).

This study will attempt to understand why BES has been adopting a rules-based approach and what the consequences of it are. It focuses on the analysis of decisions made by the Brazilian Regulatory Agency of Electricity (ANEEL), an agency embedded in a rules-based regulatory regime, as the “context” section will discuss. Rules have their limitations, and a belief that they can deliver all regulatory goals through their precision seem to be based more on optimism than facts, in a “triumph of hope over experience” (Hood and Peters, 2004, p.272). Although rules tend to be appealing because they are expected to bring certainty, transparency, and equality, some scholars have exposed the limitations of such an approach (Braithwaite, 2002; Baldwin, 1990; Black, 1997; Ford, 2010).

Hot debate surrounds standard-setting. First, it has directly impact on enforcement strategies. Clear rules tend to lead to “check-box” behaviour that, without a deep understanding of their goals, moves enforcers away from objectives, as Braithwaite (2001) showed through his analysis of USA nursing home regulation. Baldwin (1990) also demonstrates that there is a gap between rule-makers and enforcers. The former tends to adopt a policy-centred, top-

down approach that does not consider the intrinsic characteristics of enforcement strategies, ignoring most implementation problems. Rule-makers are prone to believe in a sort of *erga omnes* effect of rules that does not take into account the diversity of regulatees.

Second, advocates of more precise and prescriptive rules argue that they give less discretion to regulators, boost transparency, and are helpful to fight regulatory capture (World Bank 2006: 96). However, any rule requires interpretation (Lodge and Wegrich, 2012, p.51), even one that applies to an apparently simple and stable event, such as one prescribing a speed limit on a road: What if it rains? What if the road is foggy? Thus, some degree of flexibility and space to develop informal understandings are essential, even in a rules-based approach.

Third, a principles-based approach potentially can tackle the shortcomings found in a rules-based system. However, principles-based regulation poses challenges created by the deep structure of some regulatory regimes. It requires an enormous shift in the mindset of regulators, accompanied by different skills and attitudes (Black, Hopper and Band, 2007). Only through an enhanced relationship based on trust can regulators and regulatees build up a stream of shared understandings whereby they engage in a constructive regulatory conversation (Black, 2002). Hence, enforcement strategies would also have to change from *ex-post* enforcement strategy—strongly based on supervising with a threat of sanctions—to an *ex-ante* enforcement—based on identifying the needs and failures of an industry in order to reach a degree of compliance that would balance the system (Ford, 2010, p.262). This shift would require trust, but trust, as Black (2008a, pp.35-36) stated, is the “ultimate paradox” because a development of a principles-based approach, for example, needs trust as prerequisite to succeed.

This study seeks to contribute to the literature by addressing this discussion mentioned above. In addition, if rules and principles are extremes of a same continuum, what is the role of principles in a formal rules-based approach? Using empirical evidence, I will test whether the conclusions of previous scholars who explored the limits of a rules-based approach could possibly apply to the reality of an electricity regulatory sector.

Some consequences have already been described as side-effects of the adoption of a rules-based standard-setting, such as the correlation between a rules-based approach and an adversarial regulatory environment. For this, I will proceed to a quantification of decisions regarding appeals ruled by ANEEL during 2014, 2015, and 2016 and estimate their representativeness in the decisions made by the board of directors. Then, I will classify these decisions to verify how susceptible are they to change and how consistent the application and interpretation of rules are in real cases, according to the role of regulators (rule-makers and enforcers). Finally, I will draw an analysis of a possible gap between discourse and practice through qualitative research based on ANEEL's board of directors' decisions in a search for possible explanations.

Several reasons underpin this study case choice. Firstly, Brazil is acknowledged as one of the most bureaucratic countries in the world, because of "over-regulation" and a legalistic, formalistic approach, which may be reflected in the "ease of doing business" in that country: Brazil ranks 123rd out of 190 countries in ease of doing business, according to World Bank (2016, p.195). Secondly, the electricity market is a cornerstone of any country's development. Brazil has the largest electricity market in Latin America, comprised of over 150 gigawatts of installed electrical generating capacity (ANEEL, 2017), with more than 6,000 regulatees, including generation, transmission and distributions companies, traders, and

big consumers, taking part in the sector. Thirdly, ANEEL is regarded as one of the top regulatory agencies in terms of governance (Correa, 2007) due to its transparency, providing virtually full access to documents,¹ agendas, decisions, and its reasoning, and its weekly board of directors meeting is public and broadcasted via the internet,² resulting in a robust decision-making process.

Literature review

In 1990, Baldwin wrote “Why rules don’t work,” describing side effects of an over-reliance on the regulatory powers of rules without proper attention to enforcement strategies, which he understands not as simple as formal prosecutions or sanctions but as any form of compliance-seeking (Baldwin, 1990, p.321). Two central arguments may be extracted from his article: (1) regulatees are not homogeneous; and (2) rules by themselves do not shape the world.

According to Baldwin, there can be no “good” rule that is good for all purposes, since rules can only be effective if a proper enforcement strategy is adopted. Baldwin lists four categories of regulatees and categorises them according to how informed and well-intentioned they are. For each, a bespoke approach to standard-setting would better achieve compliance. After all, there is no point in spending time to strategically craft precise rules aimed at facilitating prosecution of those who are well-intentioned. That might be counterproductive, demotivating them by making them face unnecessary coercion by the State. Equally, a search for precision and certainty that generates a great number of rules may be innocuous for those who are well-intentioned but also ill-informed, as it may create an

¹ See <http://www.aneel.gov.br/consulta-processual>.

² See <https://www.youtube.com/user/aneel/featured>.

inegalitarian form of uncertainty in that only well-resourced companies will be able to comply with intricate rules and “play the regulatory game” (Lodge and Wegrich, 2012, p.61).

A rules-based approach generally fails because problems are often underestimated. Rule-makers tend not to look to the means of achieving compliance and disregard the fact that there are different types of regulatees, as if an *erga omnes* rule could be applied to an entire sector. There is a gap between rule-makers and enforcers because the former traditionally adopt a policy-centred, top-down approach (Baldwin, 1990, p.332), where Weberian rational bureaucracy and a hierarchical mentality are commonly deployed by public organisations that consider implementation a secondary concern. Although standard-setting and enforcement are two essential parts of regulation, the two subgroups, rule-makers and enforcers, construct reality differently and often focus on different goals (Baldwin, 1990, p.335). This gap between rule-makers and enforcers may come from the notion that rules are endowed with some sort of automaticity.

Rules are prone to express certainty when they stand alone, but uncertainty is created by juxtaposition with other rules (Braithwaite, 2002). Even though they found some balance between transparency, accessibility and congruence (Diver, 1983), they require sensitivity and some degree of flexibility. Otherwise, they will tend to lead to ossified standards that do not accommodate innovation and technological change (Lodge and Wegrich, 2012, p.50), and also create loopholes for regulatees that are not willing to comply.

The main argument developed by Braithwaite is that rules are effective only when the object to be regulated is “simple, stable and does not involve huge economic interests” (Braithwaite, 2002, p.7). The BES, analysed in the present study, is far from being simple and stable and

does involve huge economic interests. In these circumstances, principles would perform better than precise rules with regard to consistency, as attempts at precision through written-down rules increase the imprecision of complex regulatory systems as a whole.

In his analyses, Braithwaite assesses two different approaches regarding nursing homes in Australia and the USA. He argues that principles-based regulation in Australia delivers better outcomes than rules-based regulation in the USA. For instance, both countries set standards to create a “homelike environment.” In Australia, residents were encouraged to put family pictures or works of art that were important to them on their walls, or were even helped to bring in furniture from their former home. Quite often, residents wanted to have something not in a list of items that were thought to characterise a “homelike environment,” e.g. a pet. Inspectors were then challenged to interpret the standard and the reasonableness of having a pet was discussed.

The rules-oriented US system contrasted greatly with the Australian outcome-oriented nursing home regulation. In some US states, such as Illinois, precise rules required counting the number of pictures on nursing home walls, which resulted in a common practice of nursing homes gluing pictures of magazines above the beds of residents, hours before an inspection (Braithwaite, 2002, p.19).

Moreover, the number of nursing home standards in Australia and the US differed considerably. In Australia, only 31 outcome-oriented standards were negotiated among federal and state governments, industry, professional, union, and consumer groups, whereas the US system was comprised of over a thousand rules. One problem with the latter is that the

necessity of writing more detailed rules as time passes to eliminate loopholes and inconsistencies makes the entire framework less consistent.

Braithwaite, like Baldwin, also concludes (citing Black, 2001b, p. 9) by stating that one size cannot possibly fit all and thus compliance failures vary according to regulatees' own features. Regulatory approaches would then require profiling types of non-compliers to properly address the needs of a system; for instance, providing user-friendly guidance manuals for organizationally incompetent companies in order to translate standards into practice (Black, 2001b, p.24). An *erga omnes* regulation would fail if it treated unequal regulatees equally.

Black (2002) asserts that application of any standard becomes more certain as there is agreement about its terms through an "interpretive community." Shared understandings, then, would be the key to more certainty and more chance of compliance, as no matter how precisely rules are written, interpretation is still necessary (pp.179-180). Nonetheless, Black et al. (2007) eventually recognise that ultimate certainty is an impossible goal (p.198).

Flexibility when interpreting written rules to promote the purpose of law may reduce "creative compliance" (McBanet and Whealen, 1991, p.850) by closing loopholes created by an attempt to achieve high precision and allow less discretion. To some extent, when rules are applied to complex circumstances, loopholes tend to leave room for creative compliance due to both under- and over-inclusion of norms: The former does not cover all possible circumstances, whereas the latter creates alternative paths for complying with the letter of the rule. Moreover, over-inclusion traditionally imposes burdensome regulation on markets by ossifying the rules, while under-inclusion may generate risks to the system because certain

situations cannot be foreseen (Lodge and Wegrich, 2012, p. 53). Braithwaite (2002) states that a rules-based approach tends to lead to box-ticking behaviour—concern about completing checklists that do not capture real problems involved in regulatory decisions.

Seeking an alternative to these problems generated by rules-based standard-setting would lead to a principles-based approach, which also poses several challenges in its implementation. Black et al. (2007) identify several critical points that may demotivate adoption of a principles-based regime. Firstly, a regime with broad scope and high complexity would require a balance between principles and rules to provide “safe harbours” to deal with frequent non-compliers. Secondly, as firms need different stimuli, a regime concerned with maximising compliance must pay close attention both to the needs of small firms—which are prone to requiring more guidance—and well-resourced firms—which should not be managerially limited by overzealous standard-setting. Thirdly, there is a risk of rules being replaced by highly complex and inaccessible “case law,” which would equally contribute to uncertainty and instability. Fourthly, one of the greatest obstacles to implementing a more principles-based regime is a necessary change in the mindset of both regulators and regulatees. The BES’s mindset tends to be considered rule-oriented, as inferred from statements in an institutional leaflet, in which regulation is defined as being merely “comprised of issuing rules (resolutions) and decisions needed to implement Federal Government policies.”³

Furthermore, starting from Lodge and Wegrich (2012, p.16), who assert that regulation resembles what economists call an “incomplete contract,” this study will take some insights from this field of knowledge related to contracts. Interestingly, ANEEL carries out its

³ Retrieved from http://www.aneel.gov.br/arquivos/PDF/folder_intitucional_ANEEL_2012.pdf

regulation not only through rules and their enforcement, but also through contracts signed by the State and companies. The so-called “incomplete contracting theory”⁴ may add insightful arguments to the subject of this study, where a principal (state), which retains the ownership of potential electricity as well as the responsibility for public service related to the deliverance of electricity, does not have control of the regulatee, which actually performs the duty of delivering a public good or service. Hart and Moore (1999) explain that a precise specification of goods in contracts is just an ideal goal; besides being prohibitively expensive, it makes the majority of contracts incomplete insofar as it depends on the ex-ante indescribability of a future state of nature (p.115).

Incomplete contracting theory, although most of the time assuming rational players, self-interested in maximising their payoffs, is somehow related to the discussion about standard-setting in the sense that parties cannot describe all future events or contingencies (The Royal Swedish Academy of Sciences, 2016, p.25), such as new laws, market conditions, and states of nature. Maskin and Tirole (1999) claim that indescribability of future events may not be that relevant, as long as parties can perform “dynamic programming” in such a way that parties establish a contract with only describable possible payoff contingencies (the core of any contract) and only later on add details to the contract as the state of the world is realised (p.84).

CONTEXT

ANEEL is the formal regulatory body for the electricity sector in Brazil. It was created in late 1996 in the wake of increased privatisation prompted by the de-statisation law.⁵ The first

⁴ Retrieved from https://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2016/hart-lecture-slides.pdf

⁵ Law n. 8,031/1990, replaced by Law n. 9,491/1997

utility privatized in the electricity sector was Escelsa in 1995, followed by Light in 1996 (Baer and McDonald, 1998, pp.512-515). Then, as part of the trend toward delegation to regulatory agencies resulting from recently opened markets in a search to create an investor-friendly environment where credible commitments would be attainable (Gilardi, 2002, p.877), several regulatory agencies were created, including ANEEL. This can be seen as a measure to demonstrating governmental engagement in tackling problems related to the time-inconsistency of policies, which is particularly relevant when it comes to privatising utilities (Spiller, 1993, pp.398-399; 1996, p.84).

Despite being administratively linked to the Ministry of Mines and Energy (MME), ANEEL is considered to be formally independent, based on Gilardi's (2006) five dimensions (agency head status, management board members' status, relationship with government and parliament, financial and organizational autonomy, and regulatory competencies), where ANEEL scores 0,765 according to Tiryaki (2011, p.700).

ANEEL replaced the National Department of Water and Electricity (DNAEE), inheriting its responsibilities and taking on new duties. There are significant differences between these two entities, although DNAEE also had regulatory powers in the electricity sector to establish, for instance, general conditions of provision of electricity to the public (Portarias n. 222/1987 and 466/1997), and regarding free access to the transmission and distribution network (Portaria n. 459/1997). ANEEL re-regulated these topics years later through identical regulatory tool, that is, detailed prescriptive rules.

It is interesting to notice that there has been a great deal of discussion in Brazil about an allegedly innovative rule-making power delegated to new regulatory agencies (Guerra, 2015,

p.15), but a few observers have noted that former “autarchies” (a designation used in Brazilian administrative law), such as DNAEE, had the power to make rules to regulate markets.

There seems to be a “path dependence” in the approach adopted for the regulatory system applied to the electricity sector in Brazil. “Path dependence” refers to the likelihood of continuing on the same route—in this case continuing to regulate by issuing rules—increasing as steps are taken down a path. This idea can be expressed as a sequence of “increasing returns” understood as “a self-reinforcing or positive feedback process” (Pierson, 2000, p.252). In part, it may also be a heritage from a French civil law tradition that tends to develop centralised state institutions, as – to some extent – opposed to a common law tradition that limits the power of state (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1999, pp.231-232). However, legal system is just one more variable in analysis of regulatory regimes for the following reasons: to see civil law and common law as opposites is too generalist. Social and regulatory needs, similar economic questions tend to smoothen differences, leading to a sort of *rapprochement* of the two systems (Dainow, 1966, p.434). Secondly, diffusion of non-majoritarian entities such as regulatory agencies is widespread, even more than privatisation (Levy-Faur, 2006, p.506). Such entities were aliens to some civil law countries, which did not avoid their adoption. Moreover, it barely explains the regulatory differences between countries that share same legal system such as the USA and the UK, being the former more litigious and adversarial, whereas the latter develops a culture that drives to informal resolutions and consensus (Vogel, 1986).

Distribution of regulatory power

Rules in the electricity sector are numerous, and are produced by entities that formally and informally hold regulatory power in the electricity sector in Brazil. These rules derive from ordinary and complementary laws, presidential decrees, acts from the ministry (*portarias*), DNAEE, ANEEL, and National Council of Energy Policy (CNPE)⁶ resolutions. There is, to use Braithwaite's words (2001, p.14), a smorgasbord of rules.

MME is a governmental entity in charge of formulating and carrying out energy policies, representing the "conceding power" that originally belongs to the State. MME undeniably holds regulatory power, in that it issues *Portarias* to define rules to be applied to the energy sector. As an example, Portaria n. 544/2015 started a technical discussion about "revising methodology to define the amount of tradable electricity of hydropower plants," which also included a period of public comment.

The executive branch is responsible for great regulatory changes in the last decades in the BES. As an example, Provisional Measure n. 466/2009 reformulated policies regarding the isolated system in northern Brazil, which is not fully connected to the rest of the transmission network, causing the region to be dependent on more expensive thermoelectric generation of electricity based on fossil fuels. To deal with this issue, there is a cost-sharing policy levied on all consumers' tariffs, resulting in a fund managed by CCEE. As prescribed by Brazilian constitutional law, Congress converted the provisional measure into Law n. 12.111/2009, and has altered the law four times since then. Moreover, the presidency and ANEEL have both regulated the topic by issuing new rules:

⁶ CNPE is an inter-ministerial body formally created to advise the presidency regarding establishing principles for the development of policies related to energy sectors. Regulatory power embodied through, for example, Resolutions n. 2/2015 and 12/2017.

| Entity | Type of rule | Number/Year |
|------------------------|---------------------|-------------|
| Presidency of Republic | Provisional Measure | 466/2009 |
| Congress | Law | 12.111/2009 |
| Presidency of Republic | Decree | 7.093/2010 |
| Presidency of Republic | Decree | 7.246/2010 |
| Presidency of Republic | Decree | 7.355/2010 |
| ANEEL | Resolution | 427/2011 |
| ANEEL | Resolution | 493/2012 |
| ANEEL | Resolution | 494/2012 |
| Congress | Law | 12.783/2013 |
| ANEEL | Resolution | 535/2013 |
| ANEEL | Resolution | 597/2013 |
| ANEEL | Resolution | 630/2014 |
| ANEEL | Resolution | 645/2014 |
| ANEEL | Resolution | 662/2015 |
| Congress | Law | 13.182/2015 |
| ANEEL | Resolution | 679/2015 |
| Congress | Law | 13.299/2015 |
| ANEEL | Decision | 465/2016 |
| Congress | Law | 13.360/2016 |
| ANEEL | Resolution | 743/2016 |
| ANEEL | Resolution | 748/2016 |
| Presidency of Republic | Decree | 9.047/2017 |

Table 1. Compiled from data available at <http://biblioteca.aneel.gov.br/> and <http://www2.planalto.gov.br/acervo/legislacao>.

Analysis of such cases shows the predominance of a rules-based approach in the BES, where prescriptive norms seem to be the major strategy. As can be seen, regulatory standards are

also found in primary legislation establishing the regime and the agency as observed by Scott (2010, p.106) and noted by Dias (2014, p.88) and Regis (2016) more recently in Brazilian regulatory environment.

In its narrowest meaning, regulatory power is thus decentred, in the sense that there is fragmentation of responsibilities for forming and implementing regulation (Black, 2001a, p.14). However, regulation is not just about standard-setting, despite being an essential part of it (Lodge and Wegrich, 2012, p.47). Also important are information-gathering and behaviour modification (Black, 2002; Baldwin, Cave, Lodge 2012, chapter 1). Although regulatory power is decentralised when it comes to standard-setting, the other two components of regulation are highly concentrated in ANEEL functions (enforcement, sanctioning, and public participation in its decision-making process), complemented by regional regulatory agencies and CCEE.

As we have seen, since the days of the former regulatory body (DNAEE), the BES has been relying on the viability of a rules-based approach to achieve its regulatory goals, which implies that the adoption of typical features of regulatory states (such as new regulatory agencies) is always mediated by national factors, including institutional tradition, preferences, and culture (Thatcher, 2002, pp.865-866; Gilbert, Khan and Newbery, 1996, p.5).

Regulation has also inherited particularities of the Brazilian legal culture, which is also highly characterised by legalism and formalism. As described by Rosenn (1984), there is high hope that all possible social relations could be somehow regulated by laws and any “legal vacuum” is seen as an element that can possibly paralyse action. He also observes that “the country has

reams of laws and decrees regulating with great specificity every aspect of Brazilian life” (p. 19). Rosenn also refers to a harmful mentality that pays no attention, when enacting laws, to their enforceability, and then tries to remedy problems with new laws and regulations, which sometimes are fraught with the same weaknesses. This mindset clearly drives regulators into a hopeless attempt to anticipate and regulate “all possible future occurrences with detailed [...] legislation” (p.20). Finally, Rosenn regards this mindset as a heritage of Portuguese institutions as well as a consequence of a legal education that is too focused on understanding the rule of law but fails to pay attention to non-legal disciplines such as political science and economics and to non-legal facts.

Methodology

This study is based on an analysis of ANEEL’s board of directors’ decisions in 2014 to 2016. It will focus on the board’s decisions on regulatees’ appeals of previous decisions of either enforcers or the board itself. The objectives of this analysis are to identify the representativeness of appeals regarding the regulatory agency, considering the board’s effort, and to assess how enforcers and rule-makers (the board of directors) interpret the rules when they apply them in real cases, in an attempt to clarify the reasons that lead to either disagreement or convergence.

At ANEEL, a rule is promulgated after a process that involves superintendencies (technical internal department), the internal department of legal affairs, and the board of directors, which approves the rule through an administrative act (resolution) during a public meeting preceded by a regulatory impact assessment and a public comment period. Rules are applied to every company involved in the topic regulated. Any change to the rule, which is almost

inevitably necessary, requires repeating the whole process, which usually takes several months and sometimes over a year.

Rules approved by the board of director are enforced by superintendencies, which decide on each case according to what has been established in the written norms. Regulatees may appeal that decision to the same authority, which agrees or refuses (partially or completely) to what the regulatee has requested. If there is not complete agreement as to the arguments on appeal, the decision will then be reviewed by the board of directors, which issues a final decision. There are cases, however, in which the board is in charge of issuing a first decision. In such circumstances, whenever a company files an appeal, the board itself reviews the decision, with a different director in charge.

The first objective of this study is to test the hypothesis that a rules-based approach is to some extent related to a command-and-control regime (Black, 1997, p.6), which leads to a more adversarial relationship between regulators and regulatees focusing on appeals and formal requests. How much effort the board of directors puts forth in reviewing topics due to regulatees' appeals will be quantified.

The first step was to separate board of directors' decisions related to appeals from those concerning other subjects. That makes it possible to measure how significant they are with respect to the total number of decisions made by the board of directors. The objective of this assessment is to determine how adversarial the regulatory environment is in a typical rules-based regime such as the BES.

After that, I classified the board of directors' decisions related to previous decision made by superintendents into three categories: (1) unchanged; (2) partially changed; and (3) wholly changed. The main aim of this categorisation is to assess how significant the gap, if any, is between rule-makers and enforcers and whether applying the rules to different cases is automatic to any extent. The next step was to analyse decisions that are categorised as “partially changed” and “wholly changed” to look for reasons rule-makers and enforcers interpret rules differently and determine if any patterns can be identified. This step is intended to shed some light on the hypothesis that a rules-based approach reduces discretion and thus leads to a more certain regulatory process. A hypothesis regarding the robustness of a decision-making process that could possibly tackle the shortcomings of standard-setting strategy will be drawn, considering that ANEEL has participative, high-budget, transparent decision-making, which in theory can result in shared understandings among stakeholders, aiding in rules later being applied harmoniously by those who contributed to establishing the rules.

I also subcategorised appeals according to the origin of first decision and subsequent decisions throughout the regulatory decision process in the BES.

The first category contains typical appeals of decisions made by either ANEEL's superintendencies or decentralised regulatory agencies that are located in different Brazilian states. ANEEL establishes agreements with these agencies to be its arm's-length agent in enforcement and sanctioning.

The second category contains appeals requesting revision of a decision made originally by the board itself. As there is no higher level in the ANEEL hierarchy, the appeal is analysed by

a different director than the one who was in charge when the board made its initial decision. I also included in this category appeals of decisions that denied a request because formal requirements were not met (a petition that was filed late, for instance).

The third category contains appeals consisting of formal requests on behalf of regulatees for a ruling either to prevent some alleged risk or to interpret a rule differently (typically more flexibly). The former refers to a precautionary measure prescribed in Brazilian administrative procedure law, whereas the latter is an ordinary petition asking for a flexible interpretation of a certain rule—for the purposes of this study this was called an “exemption request”.

Finally, since 2013, ANEEL has been regulating the processes of the Chamber of Electricity Trade (CCEE). CCEE is a private legal entity whose main responsibilities are related to electricity trading, as well as verifying the measurement of energy generated and consumed, proceeding to auctions when delegated by ANEEL, and operationalising the Brazilian electricity spot market. CCEE clearly has regulatory power insofar as it has adjudicatory functions as well as the power to sanction regulatees in the energy market in Brazil. Against these sanctions, companies may lodge appeals to be later reviewed by ANEEL.

Findings

A QUANTITATIVE STARTING POINT: APPEALS FIGURES

I chose to focus on appeals and requests because they expose differences in understandings of rules, not only between regulators and regulatees but also between rule-makers and enforcers. ANEEL’s structured decision-making process makes the reasons for its rulings accessible, providing possibility to identify the motives behind different interpretations in a rules-based regime like the BES.

Long complex rules are identified as being suitable for regulatory regimes that primarily use prosecution to theoretically find innocence and guilt easily (Baldwin, Cave and Lodge 2012, p.230). In such a regime, an adversarial regulatory environment is expected, which seems to be the case in the BES, as evidenced by a large number of appeals and formal requests, as shown in table 2.

| Category | 2014 | 2015 | 2016 | Total |
|---------------------------------------|-------------|-------------|-------------|--------------|
| Appeals: superintendencies | 194 | 215 | 261 | 670 |
| Appeals: decentralised agencies | 115 | 115 | 75 | 305 |
| Appeals: chamber of trade (CCEE) | 18 | 11 | 34 | 63 |
| Revision requests: board of directors | 143 | 107 | 142 | 392 |
| Precautionary measure requests | 28 | 32 | 71 | 131 |
| Exemption requests | 10 | 14 | 33 | 57 |
| | 508 | 494 | 616 | 1,618 |

Table 2. Compiled from data available at www.aneel.gov.br/memorias.

I primarily focused on the board of directors' decisions that significantly changed previous decisions. These provided useful elements to aid in understanding how precise rules work in a regulatory agency and their possible strengths and shortcomings when they are applied.

Through the analysis of decisions on appeals filed by regulatees, outcomes of a rules-based approach become more visible, where different interpretations stand out in the regulatory process. These findings suggest that trying to control discretion or “complete contracts” tends not to be entirely successful for the reasons I explore below.

DRAWBACKS OF A RULES-BASED APPROACH

The regulatory system in the BES as a whole seems to prioritise the same conduct, that is, to rely on a belief that a top-down rules-based approach is the best strategy to effectively regulate the sector (Baldwin, 1991, pp.332-333). Furthermore, as already mentioned, standard-setting is directly correlated with enforcement strategies and, hence, a rules-based approach that produces incentives for players to game seems to be contrary to the agency's aspirations to make regulatees more responsive,⁷ as a big gun seems to be lurking in every detailed rule that is issued by the board of directors. The challenge is how to develop a strategy based on rules and, at the same time, use enforcement strategies (Braithwaite and Ayres, 1992, pp.38-39) like self-regulation or enforced self-regulation when rules prescribe in detail how to behave (which is more related to the two top levels of the enforcement pyramid of responsive regulation).

This strategy can also be related to two main deficits in regulation identified by Lodge (2015): the incentive deficit and the adaptability deficit. The incentive deficit refers to over-prescription that results in a lack of responsiveness by regulatees due to their high degree of loss aversion and tick-the-box compliance, which prevent the actors from searching for the true causes of and solutions to regulatory challenges (p.14). The adaptability deficit refers to lack of diversity in regulatory strategy that recurrently leads to unintended side effects caused by gaming between regulators and regulatees.

⁷ New ANEEL sanctioning process proposal. Retrieved from <http://www2.aneel.gov.br> – Audiências Públicas - 077/2011 – reabertura REN 063: paragraph 8.

Nonetheless, in the past few years, ANEEL clearly has been searching for a more diversified strategy to reach compliance and better outcomes. A significant shift of enforcement strategies is currently taking place at the agency's oversight superintendencies (for this, see Hirata, França, Fernandes and Cantarino, 2016), taking into account different regulatees' profiles identified through a risk-based analysis, towards a more conciliatory approach (Kagan, 1984, pp.92-93). Besides, ANEEL has been developing non-normative measures, such as publication of rankings according to concessionaires' performance⁸ and according to consumers' perception of quality of services⁹. New spaces of dialogue of such as "Meeting with investors"¹⁰ as well as outcome-oriented initiatives such as Plan of Results¹¹ for concessionaires of distribution. However, attempts to innovate in standard-setting – such as deployment of rules without the traditional legal format – such as procedures (PRORET¹², PRODIST¹³ for example) were later assimilated to a traditional normative status when ANEEL revised its own charter¹⁴.

Table 3 depicts the figures about disagreement between the board of directors and enforcers when applying rules after regulatees challenge them via appeals.

⁸ <http://www.aneel.gov.br/ranking-2016>.

⁹ <http://www.aneel.gov.br/iasc>.

¹⁰ [http://www.aneel.gov.br/sala-de-imprensa -> reuniao-debate-temas-regulatorios-com-analistas-de-investimentos](http://www.aneel.gov.br/sala-de-imprensa->reuniao-debate-temas-regulatorios-com-analistas-de-investimentos) (11.08.2017).

¹¹ <http://jc.ne10.uol.com.br/blogs/jcnegocios/2016/09/21/aneel-diz-que-distribuidoras-terao-que-melhorar-servicos-oferecido-ao-consumidor-final/>

¹² <http://www.aneel.gov.br/procedimentos-de-regulacao-tarifaria-proret>.

¹³ <http://www.aneel.gov.br/prodist>.

¹⁴ Article 25, Resolution n. 503/2012 - <http://www2.aneel.gov.br/cedoc/ren2012503.pdf>.

| 2014-2016 | Quantit. | Wholly changed | Partially changed | Unchanged | Not acceptable for review | Ex officio changes | *Net changes |
|---------------------------------------|--------------|----------------|-------------------|------------|---------------------------|--------------------|--------------|
| Precautionary measure requests | 131 | 20 | 23 | 69 | 19 | 0 | 38% |
| Exemption requests | 57 | 19 | 12 | 24 | 2 | 0 | 56% |
| Revision requests: board of directors | 392 | 53 | 126 | 157 | 45 | 11 | 55% |
| Appeals: chamber of trade (CCEE) | 63 | 5 | 4 | 47 | 7 | 0 | 16% |
| Appeals: superintendencies | 670 | 68 | 196 | 318 | 79 | 9 | 46% |
| Appeals: decentralised agencies | 305 | 31 | 107 | 144 | 20 | 3 | 49% |
| Total | 1,618 | 196 | 468 | 759 | 172 | 23 | 47,5% |

$$* \text{NetC} = (\text{WC} + \text{PC} + \text{ExC}) / (\text{Q} - \text{NAcR})$$

Table 3. Compiled from data available at www.aneel.gov.br/memorias.

Table 3 shows interesting facts. Around half of decisions change when they are reviewed by the board of directors or by enforcers themselves. There are several reasons for that, and the standard-setting strategy adopted probably contributes to some outcomes; e.g., enforcers are expected to follow written rules as they supposedly express regulatory intent. Furthermore, since decisions change considerably when they are challenged, these figures support rejecting the hypothesis that a rules-based approach brings more certainty to a regulatory system.

Additionally, high-quality procedures in the decision-making process do not guarantee that understandings are shared among stakeholders. These figures also indicate that nearness to rule-makers does not lead to harmonious interpretation of written rules. For instance, decisions made by either superintendents or regional regulatory agencies are similarly likely to be later changed by ANEEL's board of directors.

The reasons underlying these facts—to be explored in the following sections of this paper—may include (i) discourse and practice are misaligned when precision of rules is pursued but in the end the board resorts to applying principles instead of approved written rules; (ii) the goal of “regulating by rules not by humans” may lead to risk-averse decision-making by some enforcers that tends to apply the letter of law instead of its spirit; (iii) the attempt to eliminate every “legal gap” leads to difficulties in deciding what to pick from the smorgasbord of rules and invites regulatee-gamers to find loopholes; (iv) ossified rules are not able to keep up with a changing regulatory system that involves technology, political interests, and a decentralised distribution of regulatory power; (v) the bounds of regulators’ rationality cannot deal with the complexity of the system, nor can it foresee future contingencies.

Finally, appeals of CCEE’s decisions stand out as resulting in the lowest rate of change, suggesting a higher degree of alignment between ANEEL and the co-regulatory body responsible for energy trade. CCEE recently (since May 2017) gained ground as it became also responsible for managing the Energy Development Fund (CDE), which was previously administrated by Eletrobras, the major Brazilian electric utility, the majority owner of which (52% of shares) is the state. Although it may be indicative of the good reputation and legitimacy of the CCEE, further research is needed to understand these reasons.

A BOOST FOR AN ADVERSARIAL RELATIONSHIP

A rules-based regime that favours prescriptive detailed standards tends to be highly adversarial. Overinclusiveness combined with a legalist culture may lead to unreasonable application of regulation that tend to boost resentment and resistance that undermines cooperation and compliance (Bardach and Kagan, 1982, Chapter 4). This is shown by figures

concerning appeals and formal requests through ANEEL’s adjudicatory process where, in the absence of a regulatory approach driven by a cooperative environment of shared understandings, the path often taken is that of administrative prosecution. In the year 2016 alone, appeals and its varieties accounted for 618 requests decided by the board of directors. This represents 41,5% of all decisions made by the board in that year—616 out of 1,489. If we consider appeals as one subject only, it outnumbers by far other topics, such as rule-making or tariff-setting, which indicates that prosecution is an expensive and time-consuming task for the agency. By contrast, in 2016 the board issued only 46 decisions about rule-making (3%) and 113 decisions related to tariff-setting (7,5%), involving all companies in charge of electricity distribution. Table 4 below summarises the proportions of work demanded by the analysis of appeals and requests challenging ANEEL’s interpretation of its own rules:

| Year | Appeals and Requests | Rule-making | Tariff-setting |
|-------------|-----------------------------|--------------------|-----------------------|
| 2014 | 508 (38%) | 34 (2.5%) | 125 (9%) |
| 2015 | 494 (39%) | 37 (3%) | 109 (8.5%) |
| 2016 | 616 (41%) | 46 (3%) | 113 (7.5%) |

Table 4. Compiled from data available at www.aneel.gov.br/memorias.

It is hard to claim that standard-setting carried out by ANEEL is the sole cause of a high level of litigation, as other factors may contribute to that. As mentioned before, regulatory power is decentralised in Brazil, where Congress, the presidency, and the ministry regulate the electricity sector through their laws, decrees, and *portarias*. Thus, interestingly, regulation of Brazil’s electricity sector resembles Majone’s Positive State (1994), characterised by majoritarian institutions such as parliament, the ministry, and state owned firms—all of them acting under the legitimacy provided by voters in a democracy—in which political

accountability is direct. However, this model shares the same regulatory environment with the new entity that virtually introduced the term “regulation”¹⁵ during the 1990s in Brazil: the quasi-independent regulatory agencies.

In this sense, the “disappointment” mentioned as one of the conditions of a regulatory state in Europe (Lodge, 2008)—which in Brazil may still be acute due to highly regulatory power concentrated on elected official regulators—might be to some extent manifested in a distrustful relationship between the official regulatory body and regulatees. While ANEEL engages in a never-ending search for “completing the contracts” and eliminating discretion, regulatees attempt to challenge regulators’ decisions through a myriad of appeals and requests. Trust, after all, “is of crucial importance for the functioning of many economic and non-economic relationships” (p.180).

A search for minimising discretion of both regulatees and regulators through issuing new detailed rules may signal distrust, as observed by Herold (2009) when analysing the choice of principles, one of which is to leave incompleteness in contracts to signal trust to better cope with non-contractible duties that cannot be precisely defined. In this sense, ANEEL signals distrust when it attempts to fill every rule gap in the regulatory framework, which, besides not guaranteeing system improvement because of the intrinsic shortcomings of rules, may also backfire by causing more appeals, which account for 40% of board of directors’ efforts to regulate the sector.

¹⁵ For a summary of discussion between “regulação” and “regulamentação”, see Gonçalves: 2015: 249. To a certain degree, this study adopts a more skeptical view regarding the use of both terms in Brazilian official documents, where the change from “regulamentação” to “regulação” “may serve to exaggerate the amount and significance of underlying change” (Hood and Lodge 2010: 591).

INCREMENTALISM AND A SMORGASBORD OF RULES

One of the most recurring drawbacks is that enforcers may be not be totally aware of all the rules that should be applied to specific cases (in accord with what Braithwaite verified when researching nursing home regulation in the US—rules are abundant, so enforcers focus on just some of them when they do their jobs).

Decision n. 1359/2016 is an elucidating example. In this case, a decentralised agency in a state member of Ceará (ARCE) ruled on a request from a recycling association that asked the local electricity distribution company for a new power connection to install a hydraulic pressing machine. The local company charged R\$ 158,00 (£38 on 12.8.2017), which according to ARCE was not due. The local distributor then appealed to ANEEL. The key point of the arguments was related to the phase of circuits: roughly, a power circuit is only free of charge when a request is for a single phase, and the association had asked for three-phase power.

These rules regarding this case are prescribed in Resolution n. 414/2010, one of the cornerstones of electricity regulation in Brazil as it addresses general conditions of electricity provision. The board ruled in favour of the local distributor on appeal, holding that the enforcer had misinterpreted the rules. Similar situations occurred with Decision n. 118/2016, 524/2016 and 1405/2016.

Interestingly, Resolution n. 414/2010 has 229 articles plus eight appendixes, covering energy supplying itself, measurement, types of tariffs, how to proceed to charge and pay, and so forth. Not surprisingly, through seven years the rule has changed quite often, reaching a total of 38 amendments by June 2017 (an average of over five changes per year). Nothing

indicates that the rule has finally reached the state of the art. The attempt to “complete the contract” seems like a utopian project for the human mind when it comes to regulation of future events in complex sectors. Rules, after all, are to a great extent a product of observation and experience (Black, 1997, p.8).

Moreover, this idea of fine-tuning standard-setting displays a belief in an “unbounded rational human.” However, the product of human minds when designing policies or regulatory strategies can only be a simplification of the real complexity of event that are not yet realized (Simon, 1955, p.101). Despite the fact that human capacity has been constantly evolving (e.g., improvement of the analytical process due to the development of information technology (Bendor, 2015), public entities move incrementally (Lindblom, 1959), as shown in the Resolution n. 414/2010 example. That said, regardless of the enthusiasm of some literature and “best practices” spreading the idea that a highly rational-comprehensive method is feasible for complex social endeavors, where “means” and “ends” could always be detached from each other, regulatory agencies tend to deploy incremental changes to tackle unintended outcomes that could not be detected *ex ante*, when standards are being set.

A CHANGING REGULATORY SYSTEM

Another reason for changes in decisions is somewhat related to the previous one, in that some decisions are overturned due to constant changes in the rules. For this category, Decision 539/2016 provides a clear example. The board of directors changed a past understanding of a superintendency that revoked an authorisation of a company to trade energy. According to a previous rule, a company should not be inactive in energy trade market for 24 months in a row, and if that occurred, the firm would be subject to prosecution for violating the rule. These were exactly the circumstances featured in Decision n. 539/2016. Since appeals

challenge ANEEL's interpretation and sometimes demand a new understanding of the subject, analysing them takes time. More specifically, the board's analysis that resulted in the aforementioned decision required seven months to be issued. In the meantime, Resolution n. 63/2004, the basis upon which the sanction was applied, had been changed and so had the very article proscribing 24-month inactivity.

The shortcoming of a rules-based regime shown in these cases is that particular cases tend to generate an amendment of the rule, requiring time and resources from regulators. As an example, in Decision n. 198/2016, paragraph 15, the board asserted that there was not a rule covering a specific topic, resulting in a "regulatory gap," which, through the eyes of the board, added doubt and ambiguity to the case. In short, this idea of filling regulatory gaps summarises an inclination to "complete the contract" in which hard rules are understood as a proxy for regulation and it is thought that more rules would necessarily bring more certainty, contrary to Braithwaite's conclusion (2002) drawn in the nursing home research. Moreover, although our optimism may deny it, in the long term, rules are intrinsically indeterminate (Schauer, 1993, pp.35-37), not only due to the nature of language itself but also from generalizations that characterise rules, which becomes clear when they are applied to an unforeseen situation (Black, 1997, p.11). However, the regulatory regime in which ANEEL participates still pursues minimal discretion and high precision, which contributes to frequent changes in regulatory framework.

As said before, ANEEL is affected by decisions made by other regulatory entities, which cause the agency to be responsive to decisions in which it does not take part in formulating. In this sense, one may say that ANEEL's deck is not only stacked by mandatory administrative procedures (McCubbins, Noll and Weingast, 1987), such as reason-giving,

public meetings, and regulatory impact assessments, but also by laws, decrees, and portarias that limit the choices and discretion of the regulatory agency. A small change in a law that contains a regulatory command triggers a new cycle of adaptations in ANEEL's rules to harmonise them with newly enacted laws.

NON-BINDING RULES IN A RULES-BASED REGIME

The most relevant reason for different interpretations by rule-makers and enforcers is related to non-binding rules that are backed by principles. There are different interpretations of the same rule when the board tends to apply more flexibility, whereas the enforcer tends to follow the letter of the law, generating an incongruence in the understanding of regulation. In several occasions, the board let the principles prevail (Decisions 290/2016, 783/2016, 887/2016, 1503/2016, 2827/2016). On the other hand, as observed previously in Decision n. 198/2016, the board believed that a reliance on detailed rules is the best choice. The board displays the same thinking in Decision n. 1,958/2016.

An analysis of these decisions shows that despite regulation of the electricity sector being largely based on rules, which becomes clear by reading the decisions, in many circumstances the rules are set aside to give way to principles. In Decision n. 783/20116, ANEEL's superintendencies denied a request related to hydrologic risks shared among companies to ensure an optimum generation of electricity. According to the board of directors, the two superintendencies that took part in the first decision applied the rule by the letter of law, not taking into account all the circumstances and the reasons and principles that underlie the development of that particular topic. Moreover, according to the board, every decision should pay careful attention to legal assumptions and observe public goals (paragraphs 25 - 26). Although the company that appealed had not been successful in meeting the formal

requirements of the rule, the board understood that the circumstances allowed them to agree with the initial request. The board then followed principles instead of rules, translated in the paragraph 33 where the “commitment to maintain the conditions originally agreed on the contract should prevail as a principle,” preventing consumers being required to pay the bill for a later change in the details of the contract.

As this case shows, rules by themselves can never suffice, as they are not clear enough and cannot cover future events precisely (Black, 1997, p.12). In this sense, there will nearly always be room for interpretation. One of the main challenges of a regulator, then, is to create an environment suitable to the development of an awareness of the underlying purposes of the rules. A literal interpretation not rarely, as it has been shown in this study, leads to outcomes distinct from those intended by the rule-makers.

Another decision (n. 2928/2016) also exemplifies a trail to reach an understanding and exposes the inevitability of resorting to some degree of discretion. In the end, the board’s thinking was different than that found in the literalness of rules in effect at the time. The subject was universalisation goals applicable to a concessionaire (Vale Paranapanema), which did not meet the goals during the years 2004 and 2005, resulted in a reduction of its tariff as a penalty in the subsequent process of tariff-setting. The concessionaire had a target of 3,542 electricity connections to be made in the area for which it was responsible. The regulatory agency of São Paulo state penalised the company by leaving 565 requests for electricity provision unsatisfied. Public policy regarding universalisation in Brazil requires expenditure of public resources by both federal and regional governments, which in this specific case was not accomplished because the São Paulo government state did not allocate resources for the cause. Additionally, and atypically, there were not enough requests for

electricity connections for rural houses, so the concessionaire could not meet the 97 connections target that was set for this category of consumers. In the following year (2006), after the period established to accomplish the goal, the company reached its full target, a year-and-a-half before ARSESP (São Paulo regulatory agency) supervision took place (March 2008).

Additionally, Resolution n. 238/2006, the rule on which the discussion was developed, was going through a revision process by that time. In its proposal of improvement designed by the Superintendence of Distribution Regulation (SRD), a waiver of 95% has been suggested on the penalty of tariff reduction if the company meets the target in the year following the period set to universalise electricity provision. In the Vale Paranapanema case, this logic was applied despite the fact that the process of revising the rule (Resolution n. 238/2006) was still going on.

Interestingly, regulators involved in this discussion interpreted rules quite different. ARSESP agreed that the penalty should consider the mitigating factors, such as the lack of a subsidy by the São Paulo government and the non-existence of requests from rural houses, an opinion followed by the SRD. The oversight superintendency (SFE) concluded, however, that no waiver should be granted and applied the full penalty. In its turn, the board decided to cancel the penalty entirely, as the target was met eventually, based on the logic that had been contained in the revision process of Resolution n. 238/2006.

Finally, in November 2016, during the discussion of Resolution n. 238/2006, the board decided to postpone the revision of the universalisation regulatory process due to the disagreement on the 95% waiver to be granted to a belated accomplishment of a

universalisation target. Interestingly, the members agreed entirely with the logic and the principle that a belated complier is more beneficial than a non-complier, and so an incentive should be designed for concessionaires. The key point is how to shape this incentive. Would a 95% waiver fit all circumstances? Or 50% or 25%? The board did not come to an agreement. The board ended up approving, two weeks later, an escalating waiver of 50% for those who later comply within a year's time after the deadline and a 25% waiver for those who comply a year after the deadline but still before the supervision takes place.

The universalisation regulatory process illustrates a rich example of the challenges in setting regulatory standards. First, it shows how difficult it is to precisely set a standard to both create incentives and at the same time leave room for a "benign gun" on those who unjustifiably fail to comply. However, the reasons underlying non-compliance have not been stressed in the discussions.

To some extent, it embodies a preference for resorting to discretionary power *ex ante*, when standard-setting is being designed. One may argue that it is even more discretionary insofar as the rule will not cover all future circumstances and, depending on upcoming changes that are likely to happen in a decentralised regulatory system, it may not guarantee the achievement of future goals. Conversely, allocating a higher degree of *ex post* discretion to enforcers, a bespoke waiver could be calibrated as the facts would have been established and more information would be accessible.

This case depicts two tendencies. Firstly, it seems to be easier to agree on principles than on a precise standard that should cover all future circumstances (Braithwaite, 2002, pp.2-3). A 50% waiver might be suitable for one set of circumstances, whereas a 70% waiver might be

preferable for another. Secondly, it is easier to agree on real cases than on hypothetical ones because more elements to make a decision are available, as happened in the Vale Paranapanema case (Decision n. 2,928/2016).

LEGALISTIC OBSTACLES

Black et al. (2007) points out “legal obstacles” as one of the main challenges to shift or even to improve a rules-based regime towards an approach more based on broad assumptions that would better accommodate unforeseen situations. Not only can legal obstacles prevent development of an approach that copes with the shortcomings of a rules-based regulatory system but also the culture of administrative law can play a leading role. In Brazil, for instance, the culture surrounding public administration conceives the idea that there is no room for freedom or for individual will when an administrator performs her task—in public law, only legal instruments can bindingly dictate whether an action is allowed or not (Meirelles, 1995, pp.82-83). This very rationale is expressed in Decision n. 2,516/2016, where the legal department asserted that it is a basic premise of public law that a regulator can only do what is legally prescribed, and in the event the laws are not exhaustive, then she would need to issue a new norm to fill the alleged vacuum (paragraph 26). This refuse of accepting discretion seems to be an incentive to make enforcers “go by the book” (Bardach and Kagan, 1982), where imposition of uniform regulatory requirements are applied generally, even when they do not fit circumstances and do not necessarily yield intended benefits.

This formalistic approach could only be workable if regulation were “dis-embedded” from the complexity of society, culture, and politics (McBanet and Whealan, 1991, p.849). This is analogous to the classic economists’ attempt to make the economy work based on perfect

competition, which faced an inevitable counter-movement to protect “fictitious commodities” such as humanity and nature (Block, 2001, p.25). Any monodisciplinary approach regarding regulation, either based solely on law or on economics, tends to severely limit the attainment of regulatory goals.

Moreover, interpretation, even from different lawyers within the same law department, is not homogeneous. Through Decision n. 1,960/2016, the board of directors followed the law department’s opinion that “undoubtedly, rules cannot foresee nor regulate every situation that may occur, no matter how complete they are. It is the decision-maker’s responsibility to apply an adequate solution in the absence of legal prescription.” Interpretation then varies. On one hand, there are high hopes for hardwiring rules and creating complete contracts that would require no effort to implement because they would be endowed with automaticity—that seems to be the major belief in the regulatory system under analysis. However, on the other hand, real cases lead decision-makers to revert to principles and to underlying purposes to make the regulatory process feasible, which in fact takes part in the lengthy road to find a balance among competing interests. To this extent, new ideas that consider the inevitability of resorting to discretion have been challenging traditional administrative law in Brazil. A move towards principles promulgated by the Constitution seems to be gaining favour, where administrators would decide proportionally, taking into account circumstances and strategy in order to formulate standards decisions that consider the peculiarities of each case as well as avoiding generating legal uncertainty (Binenbojm, 2007, p.11).

CHAMBER OF ELECTRICITY TRADE (CCEE)

The appeals of CCEE decisions stand out insofar as they show a high degree of agreement between ANEEL and the chamber responsible for operating electricity trade in Brazil (an

average of 16% of disagreement, much lower than the average in the other categories of appeals). CCEE works as a co-regulatory body that performs highly technical duties related to electricity trading as well as the price of this good in the spot market. As CCEE may sanction companies engaged in trading energy - e.g., due to defaulting on generating electricity required by a contract - regulatees may appeal these decisions to ANEEL.

However, as a co-regulator, a discourse of limiting CCEE's discretion seems to be even stricter. In Decision n. 3395/2015, paragraph 39, ANEEL's board declares that CCEE is not allowed to resort to any discretion as its activities are established by rules approved by ANEEL, which leaves no room for subjectivity.

Nonetheless, as this study has already shown, the real world is far more complex than the human mind could ever reproduce in written rules. Sometimes, following the rules lead to a different path that does not necessarily move the agency towards achievement of its goals. Decision n. 1292/2016 offers an illustration of how misguided loyalty to a rule can be when it is deprived of awareness of the purposes that initially underlay the rules. CCEE sanctioned the company Parnaíba I for violating a rule that obliged it to sell electrical energy either until a deadline (1st April 2012) or until the thermal power plant was ready to trade electricity, which was comprised of two generating units (169mW + 169mW) that could work independently. In the Parnaíba I case, the first unit started functioning on 1st February 2012, whereas the second one started up and was ready to sell electricity on 20th February 2012. Thus, both of the units were fully operational before the deadline (1st April 2012). However, the contract signed by Parnaíba I and a command of Resolution 583/2013 considered that the plant had to honour the contract (which means selling 338mW) since the first unit was able to sell electrical energy. Therefore, the company was sanctioned by only selling half of the

energy (169mW) prescribed on the rules and contract during the period between 1st February (first unit) and 20th February (second unit), even though it was at an earlier date than the deadline. According to CCEE, ANEEL had not established a rule that could consider partial functioning. This is a good example how rules may suffer from under-inclusion.

In paragraph 18, the board supported its arguments by focusing on the underlying principles, translated as “the early the plant starts trading electricity, even if it is partially, the better.” In paragraph 26, the ANEEL legal department supported the board interpretation by stating that regulation should not sanction conduct that is, after all, favourable to the whole system, which is being able to sell energy on a date earlier than that established as a deadline.

As has been shown, there is a discourse that conveys the idea that rules translate precisely the goals of an agency that would eventually contribute to a balanced regulatory system.

However, it does not happen all the time. It may also create an environment of high risk aversion by enforcers that lead them to apply rules without taking into account all elements of the context because they are not allowed to use any discretion. Misleadingly, they tend to believe that rules are the expression of the board’s will, balanced by a participative process of standard-setting, and it is deprived of discretion and attuned to the agency’s objectives. In this sense, a rules-based approach tend to be process-oriented, which, instead of measuring regulatees’ performance according to established goals, seeks compliance with detailed and procedural rules (Ford, 2009, pp.273-275).

The point is that, as observed by Majone (1997, p.160), regulators tend to have more discretion power in the rule-making process due to their legitimacy derived from expertise and standardised procedures, with access to judicial review and public participation often required. Too, the choice of words, the length of the rule, and the way it is shaped are all

discretionary, although this is an *ex ante* discretion that can hardly capture the complexity and all combinations of upcoming events.

Legitimacy is then a key question for any regulator in a way it means credibility and acceptability by those she seeks to regulate (Black, 2008b, p.144). In this study case, there seems to be an idea that legitimacy finds its source in the authority of those officially in charge to issue rules (legal validity), which is why discretion is more tolerable at the standard-setting stage, compared to *ex post* discretion of enforcers. However, in a regulatory state, using law as a measure of “first resort” based on authority, conversely to what Hawkins (2002) criticises, may decrease the legitimacy of courses of action carried out by agencies. Legitimatising procedures, such as public participation, cooperation and dialogue, a fair use of coercion, transparency of decisions that hold regulators accountable, reasoning technically founded, and a clear credible commitment to underlying regulatory goals (not to state bureaucracies), seems to be alternative strategies to gain legitimacy through non-authoritative means, which may deal better with a more cooperative regulatory system that avoid litigation and foster responsiveness by regulatees.

Conclusions

As put by Ford (2010, p.265), “no workable system consists entirely of rules or of principles, but different systems can be comparatively more rules- or principles-based”. In the case study, there is a prevalence of a rules-based approach. This top-down approach based on rules to be strictly followed tends to signal an adversarial strategy, which reminds us that detailed rules are suitable standard-setting for strategies such as command-and-control.

Despite the latest efforts of the regulatory agency to improve enforcement performance of oversight superintendencies, it still seems to exist a gap in enforcement strategy due to the belief that regulatees themselves can cope better with precise rules. Besides, an over-emphasis on rules may not be seen as just one more regulatory strategy but rather a consequence of a deep-rooted mindset that confuses “rules” with the very concept of regulation. A rules-based approach then seems not to be just a strategy to follow, but rather regulating *per se*, as if “rules and regulations” were synonyms. It may particularly present an obstacle to enhancement of regulatory performance as some strategies may not be considered since they may be regarded as “non-regulatory” options, preventing different approaches from thriving, as it hides underlying problems and possible solutions from regulators.

Here, the challenge is not only to decide how detailed should be a standard-setting but also how regulatory rules embody the idea of a Rousseauian sovereignty of the rule of law that would be essentially legitimate because it would translate an alleged general will. Problems arise when regulatory rules attempt to mimic these features.

A rules-based regime may also cause a misalignment between discourse and practice that may decrease the credibility and consistency of the regulatory decision-making process. The source of this misalignment can be found in the flawed belief that a state-of-the-art of precise rules is achievable by unbounded rational regulators. As shown in this study case, regulators move incrementally and have to constantly resort to some degree of discretion to steer the regulatory process towards its objectives.

Moreover, a rules-based approach tends to lead to a process-oriented regulatory regime, instead of focusing on the true purposes and outcomes of regulation. An assessment of

degrees of compliance and regulatees' performance tends not to be as clear or stressed as apparently it should be. Thus, oversight that seeks compliance to ossified rules that sometimes do not express true regulatory intent is of little avail and sometimes it contributes to an "unreasonable regulation".

ANEEL seems to have a potential that is yet to be unleashed. Despite new attempts to develop a different enforcement approach, such as launching "plans of results" for distributors and a shift towards a more conciliatory risk-based enforcement approach focused on responsiveness and on outcomes, the agency is still embedded in a hierarchical Weberian state, where classic bureaucratic tools can hardly deal with the challenges of a decentralised regulatory state. From an optimistic point of view, however, these changes may be a first stage to solve Black's ultimate paradox of trust.

These enhancements aid in tackling considerable drawbacks of a rules-based regime that ideally applies automatically to any situation. More attention needs to be paid to the means to reach regulatory goals, which different strategies of standard-setting need to be taken into account. Moreover, the discourse of precision of rules tend to lead to high risk-averse behaviour by enforcers as they are only allowed to follow strictly the rules established. To some extent, they perform accordingly to the culture spread by the organisation and to what is expected of them.

Although utopian, the idea of separating regulatory endeavors between means and ends in order to elevate standard-setting to a state-of-the-art level brings psychological comfort, besides functioning as a sign of prestige to those concerned about formalities. This behaviour, however, does not contribute to the crafting of new solutions, mainly because it turns a blind

eye to real underlying problems. A legalistic culture combined with a rules-based standard-setting strategy threatens the achievement of most basic goals that represent regulatory agencies' *raison d'être*, which includes making credible commitments in order to create a balanced investor-friendly environment and a subsequent development of the sector, as it avoids several regulatory strategies to flourish and does not necessarily deliver certainty to the system.

Even when rules are developed carefully, enriched with public participation and a transparent decision-making process, they are intrinsically flawed. Any attempt to reach high precision and avoid discretion entirely is prone to face the shortcomings described in this paper. Resorting to principles, even in a rules-based regime, is thus unavoidable in several circumstances.

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