

ASIC AND THE SECONDARY ELECTRICITY MARKET

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ABSTRACT

The deregulation of Australia's electricity grid led to the development and growth of derivative financial products used to offset risk. These derivatives have formed a market of their own: the secondary electricity market. To date, there has been no investigation of the regulation of the secondary electricity market.

This paper presents an empirical investigation of the Australian Securities and Investment Commission's ('ASIC') regulation of the secondary electricity market. Using a modified version of the regulatory conversations model, regulatory effectiveness is examined from the perspective of the subjects of regulation. The findings reveal dissatisfaction with ASIC's regulatory approach. Viewing the results through the lens of historical institutionalism further reveals that the cause of this dissatisfaction has become ingrained in ASIC as a result of ASIC's historical development.

From the perspective of the subjects of regulation in the secondary electricity market, three critical junctures in ASIC's historical development prevent ASIC from properly regulating these derivatives:

1. The formation of ASIC as a 'pro-industry' body.
2. The switch from ASC to ASIC, which promoted an anti-regulatory ideology.
3. The growth in derivatives in the 90's, which forced ASIC to adopt ineffective, pragmatic regulation.

Both the existence and justifiability of these perceptions pose challenges for ASIC. This paper suggests that ASIC's historical development has left it unable to achieve its own measures of effectiveness in regulating electricity related derivatives. It further suggests that, given ASIC's funding and regulatory load, that it would be undesirable for ASIC to attempt to address the specific needs of the secondary electricity market.

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AUTHOR'S DECLARATION

I declare that, except where explicit reference is made to the contribution of others, that this thesis is the result of my own work and has not been submitted for any other degree at Macquarie University or any other institution.

I further declare that all empirical research was undertaken in accordance with ethics approval reference number 5201200182.

David Mullan

ACKNOWLEDGEMENTS

I thank the energy traders, lawyers and business consultants who gave their time to make this thesis possible. Confidentiality prevents me from providing personal thanks here, but I hope they will know who they are and how important they were to this process.

I thank my supervisor, Dr Vijaya Nagarajan, who has read this thesis more times than any person should ever have to. Her time and comments were invaluable. Without her guidance and patience, this thesis would not be.

I thank the staff at Macquarie University and the faculty of law for their generosity, warmth and support. In particular I would like to thank Dr Frank Carrigan for his ongoing intellectual guidance, debate and challenge on the state of derivatives, corporate law and the world electricity market.

I thank my wife, for enduring with me the emotional and financial strain of completing a PhD.

Most importantly, I thank God, for bringing all the wonderful people mentioned above into my life.

CHAPTER ONE: INTRODUCTION

I BACKGROUND AND OVERVIEW

In 1998 Australia followed the Chilean model of electricity deregulation in launching a wholesale electricity market.¹ While offering the potential of lowered prices through increased competition, the existence of a wholesale electricity market introduced concerns about the stability of electricity prices and electricity supply.² Both the government and the electricity market participants attempted to maintain stability of electricity prices and electricity supply through their own means. The government introduced comprehensive legislation,³ including price caps and a dedicated regulator.⁴ Electricity market participants attempted to reduce volatility through the use of complex financial instruments which would cancel or counteract market fluctuations. The use of these complex financial instruments created a ‘secondary electricity market’ which fell outside the jurisdiction of the newly created legislation and regulator.⁵

The secondary electricity market is a loosely structured market which involves a number of private agreements, options, swaps, over the counter derivatives and other financial instruments. These instruments are designed to reduce volumetric and commodity risk in the wholesale electricity market.⁶ This stability comes at a cost. The creation of the secondary electricity market creates the risk of price fluctuations within the secondary electricity market. This concern is negligible if viewed through a purely theoretical lens, as a price crash in the secondary electricity market should not in any way impact on the price or volume of electricity traded in the

¹ Navroz Dubash and James Williams ‘The political economy of electricity liberalisation’ in John Byrne, Noah Toly and Leigh Glover (eds) *Transforming Power* (Transaction Publishers, 2006) 155; Australian Energy Regulator, *State of the Energy Market 2013*, 20 December 2013, 120 - 140.

² Lynne Chester ‘The conundrums facing Australia’s National Electricity Market’ (2006) 25 *Economic Papers: A Journal of Applied Economics and Policy* 362; and Xinmin Hu, George Grozev and David Batton ‘Empirical observations of bidding patterns in Australia’s National Electricity Market’ (2005) 33 *Energy Policy* 2075.

³ *Competition and Consumer Act 2010* (Cth), Part IIIA.

⁴ *National Energy Market Rules 2014* (Cth), Chapter 3.

⁵ Australian Energy Regulator, above n 1, 60 - 83.

⁶ Shijie Deng and Schmuël Oren ‘Electricity derivatives and risk management’ (2006) 31 *Energy, The International Journal* 940.

wholesale electricity market. However, when such concerns are viewed in light of the possibility of human error and the historical effects of price fluctuations in overseas secondary electricity markets, the consequences are significant and troubling. If a price fluctuation in the secondary electricity market were to lead to changed behaviour in the wholesale electricity market, both the cost and the supply of Australian electricity would be jeopardized. Mechanisms in place to protect the wholesale electricity market could only protect the stability of price at the cost of stability of supply or vice versa.

The risks introduced by the creation of the secondary electricity market necessitate regulatory oversight. This regulatory oversight has not been provided in the same manner as the regulation of the wholesale electricity market. Whereas the wholesale electricity market was provided with targeted laws and a dedicated regulator, the secondary electricity market naturally fell under the jurisdiction of the Australian Securities and Investments Commission ('ASIC').⁷ The *Corporations Act* provided a wide definition of 'financial products' which covered the creation of most of the instruments used in the secondary electricity market.⁸ No consideration was given to the potentially unique needs of the secondary electricity market and no additional training, funding or resources were provided to ASIC to deal with this new regulatory jurisdiction.

The problems currently facing ASIC and the secondary electricity market are complex. The complex nature of the product traded in the secondary electricity market, the relationship between the wholesale electricity market and the secondary electricity market, and the resource limitations of ASIC create a regulatory challenge which is difficult to understand and even more difficult to resolve. What is presently known is that ASIC's jurisdiction has expanded to cover the secondary electricity market. This expansion in jurisdiction has not been met by any comprehensive reconsideration of ASIC's regulatory approach. Rather, ASIC has continued to use the regulatory methods that it applies to other financial product markets in relation to the

⁷ *Corporations Act 2001* (Cth), Chapter 7 ('*Corporations Act*').

⁸ *Ibid*, Chapter 7, Division 3.

secondary electricity market. Given that the majority of participants in the secondary electricity market do not have a history in financial product markets but are rather wholesale electricity market participants, these approaches are potentially inappropriate.

Being a relatively new market, there have been few studies which have aimed to understand and interrogate the operation of the secondary electricity market. More troublingly, no notable studies to date have attempted to examine the relationship between ASIC and the secondary electricity market. The result is that, at present, the stability and price of Australian electricity is potentially dependent on a regulatory relationship which is completely unknown and which has been subject to little investigation.

II RESEARCH QUESTIONS

This thesis empirically examines the effectiveness of ASIC's regulation of the secondary electricity market. In order to achieve this research objective, this thesis investigates the following questions:

1. How do the subjects of ASIC's regulation in the secondary electricity market view the effectiveness of ASIC?
2. To what extent was ASIC's predecessor, the Australian Securities Commission ('ASC') formed as a 'pro-industry' institution, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?
3. To what extent did the shift from the ASC to ASIC result in ASIC adopting an anti-regulatory ideology, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?
4. To what extent did the boom in derivatives trade following the repeal of the Glass-Steagall Legislation⁹ result in ASIC refocusing its resource allocation away from the financial

⁹ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

markets, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?

In answering these research questions this thesis will also address two other important issues.

First, it will explore 'to what extent do the operations of ASIC fall within the responsive regulation framework (an influential regulatory framework used by comparable regulators)?'

Second, it will consider 'to what extent do the unique characteristics of the secondary electricity market impact on the ability of ASIC to be an effective regulator?' The discussion on these issues and the research questions are guided by theoretical scholarship, published literature and empirical findings.

III RESEARCH SCOPE AND METHODOLOGY

The scope of the thesis is to obtain and analyse first-hand information from secondary electricity market participants on the effectiveness of ASIC's regulation of the secondary electricity market.

For the sake of consistency and in order to be both objective and relevant to ASIC, regulatory 'effectiveness' will be measured against the measures adopted and used by ASIC in its annual report.¹⁰ This examination will be strictly limited to the secondary electricity market and will consider the wholesale electricity market and the wider energy market only where such markets are absolutely essential to understanding the function of and impact on the secondary electricity market.

This thesis adopts the ontology of historical institutionalism and pairs it with a positivist empirical epistemology. Historical institutionalism examines the behaviour of institutions through an investigation of their historical development.¹¹ Key moments of rapid change and

¹⁰ See Australian Securities and Investments Commission 2012-2013, 5-6.

¹¹ Paul Dimaggio and Walter Powell 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields; (1983) 48 *American Sociological Review* 147.

flux at various points in an institution's development can shape the trajectory of an institution.¹²

This thesis therefore seeks to understand ASIC (including its formative period as ASC) as an institution through an investigation of key moments in ASIC's historical development.

Empiricism is used to investigate these key moments in ASC and ASIC's historical development. Empiricism aims to obtain knowledge through sensory experience.¹³ Positivist empiricism aims to adopt a logical framework through which to interpret and understand sensory experience.¹⁴ For the purposes of this thesis, a positivist empirical method is used in the form of semi-structured interviews and thematic analysis. These methodological tools provide the means of examining ASC and ASIC's historical development while minimising any researcher input or bias.¹⁵

The choice of an empirical methodology has been guided by the present lack of information on which to base a hypothesis about the relationship between ASIC and the secondary electricity market. Accordingly, qualitative research is undertaken by way of semi-structured interviews with 16 secondary electricity market participants. In keeping with the interdisciplinary methodology, the results of these semi-structured interviews are subjected to positivist thematic analysis, the methodological suggestions of Black,¹⁶ and the conventions of legal research methods. Black suggests the use of interviews and discourse analysis to understand the perspective of the subjects of regulation.¹⁷ As the experience of the subjects of regulation and the discourse between regulator and its subjects is unknown, Black posits that it is not possible to formulate a meaningful hypothesis to test.¹⁸ Regulation, as a social construct, is better

¹² Christopher Carrigan and Cary Coglianese 'The Politics of Regulation: From New Institutionalism to New Governance' (2011) 14 *Annual Review of Political Science* 107.

¹³ Stephen Priest, *The British Empiricists* (Routledge, 2nd Edition, 2007).

¹⁴ Andrew Wicks and Edward Freeman 'Organizational Studies and the New Pragmatism: Positivism, Anti-positivism, and the Search for Ethics' (1998) 9 *Organisational Science* 123.

¹⁵ Greg Guest, Kathleen MacQueen and Emily Namey, *Applied Thematic Analysis* (Sage Publications, 2011).

¹⁶ Julia Black 'Regulatory Conversations' (2002) 29 *Journal of Law and Society* 163.

¹⁷ *Ibid.*

¹⁸ Black, above n 16, 171.

understood through open communication and interaction.¹⁹ Black's research method adopts traditional post-positivist discourse analysis and utilises it in the regulatory sphere. This offers a useful starting point for this thesis, which faces the problem of revealing and understanding the experience of the subjects of regulation. For the reasons set out in Chapter 3, Black's methodology has been altered slightly for this thesis.

This thesis utilises semi-structured interviews and positivist thematic analysis (the difference between this and post-positivist discourse analysis is explored more fully in chapter 3). That is, interviews are conducted with 16 subjects of ASIC's regulation, including electricity traders, their legal advisers and their business consultants (further details are provided in chapters 2 and 3). The results of those interviews are subject to a scientific analytical process. This shares similarities with the interviews conducted by Neilsen and Parker in examining the subjects of regulation of the Australian Competition and Consumer Commission ('ACCC').²⁰ The analysis process also shares similarities with the studies conducted by Jonnergard and Larsson,²¹ and Picciotto,²² which also borrow from Black's methodology, albeit using primary rather than secondary data.

The thematic analysis reveals three themes which have guided the adoption of historical institutionalism as the thesis' ontology. All three themes identify periods in ASIC's historical development where ASIC was in a state of rapid change. First, interviewees identified problems resulting from the formation of ASC. Second, interviewees identified problems resulting from the switch from ASC to ASIC. Finally, interviewees identified problems resulting from the rapid increase in derivatives following the repeal of the Glass-Steagall Legislation.²³ These three

¹⁹ Ibid 165.

²⁰ Vibeke Nielsen and Christine Parker 'Testing Responsive Regulation in Regulatory Enforcement' (2009) 3 *Regulation and Governance* 376; Vibeke Nielsen and Christine Parker 'To what extent do third parties influence business compliance?' (2008) 35 *Journal of Law and Society* 309.

²¹ Karin Jonnergard and Ulf Larsson 'Developing Codes of Conduct: Regulatory Conversations as Means for Detecting Institutional Change' (2007) 29 *Law and Policy* 4.

²² Sol Picciotto 'Constructing Compliance: Game Playing, Tax Law and the Regulatory State' (2007) 29 *Law and Policy* 11.

²³ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

themes ostensibly relate to three critical junctures in the historical development of ASIC, something that is confirmed through further investigation and analysis throughout this thesis. In this way this thesis will follow historical institutional analyses such as Bakir's investigation of the banking industry,²⁴ Pierson's analysis of nation states and institutions in European Union Integration,²⁵ and Sell's analysis of historical institutionalism's effect on intellectual property law.²⁶

These central themes / critical junctures also form the basis for the research questions which guide the discussion of ASIC's effectiveness in regulating the secondary electricity market. As a result, the analysis of qualitative data drives an evaluation of ASIC's effectiveness as a regulator through the lens of historical institutionalism, particularly focusing on three critical junctures revealed through the interviews.

IV RESEARCH CONTRIBUTION TO KNOWLEDGE

A A Unique Area of Study

This thesis is ostensibly the first to undertake an empirical investigation of the relationship between ASIC and the secondary electricity market in Australia. In fact, there have been no notable published studies examining the secondary electricity market from a regulatory perspective. To date, a majority of the studies on the secondary electricity market have focused on issues of financial product pricing.²⁷ Studies conducted outside of pricing have focused on

²⁴ Caner Bakir, *Bank Behaviour and Resilience: The Effect of Structures, Institutions and Agents* (Palgrave MacMillan, 2003).

²⁵ Paul Pierson 'The Path to European Integration: A Historical Institutional Analysis' (1996) 29 *Comparative Political Studies* 123.

²⁶ Susan Sell 'The Rise and Rule of a Trade-Based Strategy: Historical Institutionalism and the International Regulation of Intellectual Property' (2010) 17 *Review of International Political Economy* 762.

²⁷ See Claudio Albanese, Harry Lo and Stathos Tompaidis 'A numerical algorithm for pricing electricity derivatives for jump-diffusion processes based on continuous time lattices' (2012) 222 *European Journal of Operational Research* 361; Nikos Nomikos and Orestes Soldatos 'Modelling short and long-term risks in power markets: Empirical evidence from Nord Pool' (2010) 38 *Energy Policy* 5671; Iivo Vehvilainen 'Basics of electricity derivative pricing in competitive markets' (2002) 9 *Applied Mathematical Finance* 45; and Craig Pirrong and Martin Jermakyan 'The price of power: The valuation of power and weather derivatives' (2008) 32 *Journal of Banking and Finance* 2520.

risk, volatility and financial accounting practices.²⁸ As a result, there has been significant progress in determining the financial environment in which secondary electricity market products operate, but there has been no real focus on the structure and regulation of the market itself.

This thesis aims to close this gap by providing insight into the regulatory structure and environment present in the secondary electricity market. Doing so not only provides an initial understanding of the regulation of the secondary electricity market, but should provide insight into market specific factors which may inform future scholarship on the pricing and volatility of secondary electricity market products. By examining the regulatory environment of a relatively newly created market this thesis produces results which will inform the regulation of new and complex markets. Likewise, the study design may be utilised as a framework for examining new markets where there is insufficient evidence to generate a hypothesis about the effectiveness of a regulatory environment. Specifically, the results may prove useful in other markets without a clear underlying asset, such as the primary electricity market, emissions markets or other industry specific derivatives markets.

B *A Contribution to Regulatory Theory*

Responsive regulation is a well-established regulatory theory. Resting on sociological theory,²⁹ responsive regulation posits that regulators should move beyond rules and legislation in order to control behaviour.³⁰ Instead, regulation involves influencing social and business norms through education and co-operation, while maintaining formal legislation and penalties where necessary.³¹ Responsive regulation and other regulatory theories will be set out in full in Chapter

²⁸ See Deng and Oren, above n 6; Pavel Pavlatka 'Option Derivatives in Electricity Hedging' (2010) 50 *Acta Polytechnica* 1; and Patricia Teixeira Lopes 'Accounting for electricity derivatives under IAS 39' (2007) 13 *Journal of Derivatives and Hedge Funds* 233.

²⁹ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

³⁰ Vijaya Nagarajan 'From command and control to open method communication: Theorising the practice of regulatory agencies' (2008) 8 *Macquarie Law Journal* 5.

³¹ Julia Black 'Critical reflections on regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1.

2. This thesis will work within the wider regulatory framework on which the responsive regulation model is founded. An empirically based and focused discussion of responsive regulation and its effectiveness in the secondary electricity market is set out in chapter 7.

Braithwaite continues to be one of the chief proponents of responsive regulation, and he has found support from a number of prominent theorists such as Parker, Nielsen and Baldwin. Their most recent contributions to responsive regulation are examined in chapters 2 and 7 of this thesis. Responsive regulation has also recently been challenged by a number of theorists. Foremost among the critics is Ford who has suggested that the responsive regulation model is unworkable in complex regulatory environments.³² While Ford examines wider financial markets in her assessment, they may also be relevant to the secondary electricity market. This thesis provides an empirical test of Ford's claim. The secondary electricity market is complex both in its structure and in the nature of the product traded. By exploring changing complex commercial activity through an empirical examination of the effectiveness of ASIC's use of responsive regulation, this thesis provides data to strengthen or rebut the critique of responsive regulation offered by Ford. In doing so this thesis applies empirical data to widely accepted regulatory theory and investigates responsive regulation's effectiveness in a complex commercial environment.

Other theorists have offered advances on responsive regulation. Really responsive regulation,³³ risk-based regulation,³⁴ holistic regulation,³⁵ regulatory craftsmanship³⁶ and meta-regulation theory³⁷ have all developed existing responsive regulation theory. While studies exist examining

³² Cristie Ford 'Macro- and micro-level effects on responsive financial regulation' (2011) 44 *University of British Columbia Law Review* 589.

³³ Robert Baldwin and Julia Black 'Really responsive regulation' (2008) 71 *The Modern Law Review* 59.

³⁴ Julia Black 'The emergence of risk-based regulation and the new public risk management in the UK' (2005) *Public Law* 512.

³⁵ Malcolm Sparrow, *The Regulatory Craft: Controlling Risk, Solving Problems and Managing Compliance* (Brookings Institution Press, 2000), 108.

³⁶ *Ibid.*

³⁷ Christine Parker 'Meta-regulation: Legal accountability for corporate social responsibility' in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds) *The New Corporate Accountability* (Cambridge University Press, 2009).

the effectiveness of many of these approaches,³⁸ this thesis offers insight into the views of subjects of regulation and whether these advances address the perceived weaknesses of responsive regulation. Being both a complex and new regulatory environment, the secondary electricity market offers a unique opportunity to gain insight into responsive regulation, its flaws and the action needed to rectify such possible flaws.

There has been a trend in recent regulatory theory studies toward a greater focus on the experience of the subjects of regulation. Black has gone as far as suggesting a model of investigation that would ascertain the views of the subjects of regulation.³⁹ As previously discussed, this ‘regulatory conversations’ model provides a means of analysing the interactions and opinions of the regulator and its regulatory subjects.⁴⁰ It does this through direct conversation with the subjects of regulation, creating an open dialogue which explores unknown possibilities, rather than attempting to verify a more limited hypothesis. Nielsen and Parker have undertaken similar investigations,⁴¹ but with a much wider agenda than this thesis. This thesis undertakes a regulatory subject-focused examination of the effectiveness of regulation in a specific market. As such, this thesis provides results which will challenge or confirm the applicability to individual regulatory markets of the results of generalised subject-focused studies. This thesis also helps develop a body of scholarship examining and considering regulation from the perspective of the subjects of regulation. It gathers and analysis the experience and opinions of the secondary electricity market. In doing so it creates a more complete picture not only of the regulatory environment in the secondary electricity market, but

³⁸ See Dimitri Kingsford Smith ‘A harder nut to crack? Responsive regulation in the financial services sector’ (2011) 44 *University of British Columbia Law Review* 695; Vibeke Nielsen and Christine Parker ‘Testing responsive regulation in regulatory enforcement’ (2009) 3 *Regulation and Governance* 376; and Vibeke Nielsen and Christine Parker ‘To what extent do third parties influence business compliance?’ (2008) 35 *Journal of Law and Society* 309.

³⁹ Black, above n 16.

⁴⁰ Ibid.

⁴¹ Nielsen and Parker, above n 20.

also provides a basis for drawing distinctions between the subjects of regulation in specific markets and the experiences revealed by the wider analyses conducted by Neilsen and Parker.⁴²

C *Responsive Regulation and Historical Institutionalism*

There have been significant studies examining regulation through the lens of historical institutionalism.⁴³ Sell suggests that the historical development of regulatory agencies and regulatory subjects has led to an intellectual property regime which favours market based regulatory approaches.⁴⁴ Likewise, Bakir uses historical institutionalism to reveal the cause of regulatory oversights which have led to historical bank collapses.⁴⁵ Both Sell and Bakir identify dependent paths resulting from key historical moments in the developments of institutions.

There has also been limited but meaningful examination of the relationship between historical institutionalism and responsive regulation.⁴⁶ One such study is identified by Nagarajan, who explores the historical institutionalism underpinning Wilks and Bartle's analysis of independent regulatory agencies.⁴⁷ The data obtained in this thesis has led to the adoption of historical institutionalism as the thesis' ontology. As a result this thesis provides empirical support for the use of historical institutionalism as a means of examining the effectiveness of regulatory theory. It also offers an empirical methodology which harmonises the interdisciplinary challenges of qualitative research, historical institutionalism and traditional legal research methods. The result is both a means of study and a theoretical framework of study which may be applied to future regulatory scholarship.

D *Advances to Empirical Method*

⁴² Nielsen and Parker, above n 20.

⁴³ See Henry Farrell and Abraham Newman 'Making global markets: Historical Institutionalism in international political economy' (2010) 17 *Review of International Political Economy* 609; Ranjit Lall 'From failure to failure: The politics of international banking regulation' (2012) 19 *Review of International Political Economy* 609; and Sell, above n 26.

⁴⁴ Sell, above n 26.

⁴⁵ Caner Bakir, *Bank Behaviour and Resilience: The Effect of Structures, Institutions and Agents* (Palgrave MacMillan, 2003).

⁴⁶ Baldwin and Black, above n 33.

⁴⁷ Vijaya Nagarajan, *Discretion and Public Benefit in a Regulatory Agency* (ANU E Press, 2013) 7.

Legal research has traditionally adopted a doctrinal research methodology.⁴⁸ This examination of law and legal concepts has been, and continues to be, the dominant method of legal research design.⁴⁹ Doctrinal research also remains the dominant form of research in the field of regulation and regulatory theory. While recent trends have seen a greater adoption of empirical methods in legal research, empirically based papers remain a minority.⁵⁰ This trend is discussed further in chapter 3. Stott notes that where such research has been undertaken, it has traditionally been quantitative empirical research.⁵¹ This trend does not appear to have changed in recent times.⁵² This thesis contributes to the body of legal research which has adopted a qualitative empirical methodology.

The underlying premise for this qualitative empirical thesis has been informed by existing regulatory scholarship. Black has suggested that a clear understanding is needed of the opinions of the subjects of regulation.⁵³ As previously discussed, the ‘regulatory conversations model’ proposed by Black offers a qualitative research method based on interviews and discourse analysis.⁵⁴ A similar model of investigation was utilised by Nielsen and Parker in their wider study of the effectiveness of the Australian Competition and Consumer Commission.⁵⁵ This thesis furthers this research method in analysing a new a complex market. As is explained in chapter 3, the regulatory conversations model has been altered from a post-positivist discourse

⁴⁸ Terry Hutchinson and Nigel Duncan ‘Defining and describing what we do: Doctrinal legal research’ (2012) 17 *Deakin Law Review* 83.

⁴⁹ Desmond Manderson and Richard Mohr ‘From oxymoron to intersection: An epidemiology of legal research’ (2002) 6 *Law Text Culture* 159.

⁵⁰ Gregory Shaffer and Tom Ginsburg ‘The empirical turn in international legal scholarship’ (2012) 106 *American Journal of International Law* 1.

⁵¹ See Kathleen Segerson and Miceli Thomas ‘Voluntary approaches to environmental protection: the role of legislative threats’ in Carlo Carraro and Francois Levenque (eds) *Voluntary Approaches in Environmental Policy* (Springer, 1999); Abdoul Sam and Robert Innes ‘Voluntary reductions and the enforcement of environmental law: an empirical study of the 33/50 program’ (2008) 51 *Journal of Law and Economics* 271; Joseph Rees, *Reforming the workplace: A study of self-regulation in occupational safety* (University of Pennsylvania Press, 1988); and Richard Morgenstern and William Pizer, *Reality check: the nature and performance of voluntary environmental programs in the United States, Europe and Japan* (Routledge, 2007).

⁵² See Robert Lawless, Jennifer Robbennolt and Thomas Ulen, *Empirical Methods in Law* (Aspen Publishers, 2010); Shaffer and Ginsburg, above n 50; Mike McConville and Wing Hong Chui ‘Introduction and Overview’ in Mike McConville and Wing Hong Chui (eds) *Research Methods for Law* (Edinburgh University Press, 2007).

⁵³ Black, above n 16.

⁵⁴ *Ibid.*

⁵⁵ Nielsen and Parker, above n 20.

analysis to a positivist thematic analysis, in order to better fit with the existing rigors of legal and sociological research.

This thesis will use semi-structured interviews and positivist thematic analysis to analyse the effectiveness of a regulatory institution from the perspective of the subjects of regulation. The adoption of sociological rigors in semi-structured interviews should assist in harmonizing qualitative research with the expectations of traditional legal research. Likewise, the use of positivist thematic analysis rather than post-positivist discourse analysis offers a greater harmony with traditional legal research. As Black notes, the use of post-positivist discourse analysis is a ‘hard sell’⁵⁶ within traditional legal research frameworks. The developments made in this thesis will help integrate this research method while maintaining its overall goal of subject-focused analysis. These developments are needed in regulatory scholarship, a field that straddles both legal and sociological concepts.

V STRUCTURE OF THESIS

This thesis is structured around the results of its empirical research and is presented in eight chapters. The general structure of this thesis is set out below. The structure will set out the general contents of each chapter.

A *Chapter 1*

Chapter 1 is an introductory chapter that provides the background of this thesis and an overview of its aims. It sets out the background for this thesis and proposes a number of research questions. It establishes the theoretical and research methodologies of the paper along with the scope and limitations of the thesis. Chapter 1 also identifies the importance of the research by providing an overview of its importance as an area of study and its contribution to regulatory theory, historical institutionalism and legal research design.

⁵⁶ Black, above n 16, 196.

B *Chapter 2*

Chapter 2 provides a review of the relevant literature. It provides the framework by which the first research question will be answered. While the material contained in chapter 2 will feed into all research questions, it provides the material necessary to identify ASIC's measure of effectiveness and to analyse ASIC against this measure. Chapter 2 commences with the identification and consideration of ASIC's current regulatory approach, stated regulatory theory and measure of effectiveness. It then considers the scope, nature and limitations of the secondary electricity market. It considers the law applicable to the secondary electricity market as well as its ambit, purpose and history. In doing so, this chapter defines the wholesale electricity market and distinguishes it from the secondary electricity market. Chapter 2 then provides an overview of the regulatory theories that will be applied in examining ASIC's regulatory effectiveness. The chapter concludes with an overview and discussion of historical institutionalism, the key theory which will be used to examine the data generated by this thesis.

C *Chapter 3*

Chapter 3 provides a framework of the empirical method and methodology adopted by this paper.⁵⁷ It considers the problems associated with examining a new market in a wider regulatory theoretical framework. It outlines recent literature offering a means of examining regulatory effectiveness where insufficient data is available to form a hypothesis and where the investigation focuses on a sociologically based regulatory theory. It then considers the challenges presented to conventional legal research by the model of research offered by recent literature. Chapter 3 discusses the necessity for a number of alterations to existing regulatory research models to create a qualitative research model which can be harmonised with existing legal research methods. Finally, it sets out a clear qualitative research method which incorporates semi-structured interviews and positivist discourse analysis. In doing so, this chapter sets out the

⁵⁷ Further information on the empirical process can be found in Appendix 1 and Appendix 2.

appropriateness of this model for an examination of regulatory theory through the lens of historical institutionalism.

D *Chapter 4*

Chapter 4 focuses on the first of three critical junctures identified by analysis of the empirical data: the formation of ASC as a pro-industry body. In doing so, it answers the second research question of this paper. A thematic analysis is presented which identifies a theme that the ASC was formed as a body which was, from its inception, subject to regulatory capture. Chapter 4 then establishes that this theme represents more than an historical issue, but is rather a critical juncture which continues to affect ASIC's ability to effectively regulate the secondary electricity market. In doing so, chapter 4 probes the validity of the views of the secondary electricity market and considers the regulatory theories and inconsistencies that led to the first critical juncture.

E *Chapter 5*

Chapter 5 sets out the second critical junctures identified by analysis of the empirical data: namely that the switch from ASC to ASIC led to ASIC adopting an anti-regulatory ideology. In doing so, it answers the third research question. Thematic analysis of empirical data suggests that the interviewees believe that the shift from ASC to ASIC has resulted in ASIC either preferring an anti-regulatory approach. Chapter 5 probes the validity of these views and suggests that the shift from ASC to ASIC is in fact a critical juncture, but one which did not involve the ideological shift suggested by the interviewees. Rather, the critical juncture represents ASIC exercising risk-based regulation strategies to cope with an increased regulatory load.

F *Chapter 6*

Chapter 6 sets out the final of three critical junctures identified by analysis of the empirical data: that the growth in derivatives resulted in ASIC refocusing its resources away from financial markets. In doing so, it answers the fourth research question. A thematic analysis of the interviewee's responses is presented, which identifies a theme that the growth in derivative financial products following the repeal of the Glass-Steagall legislation⁵⁸ led to an unmanageable work load for ASIC, causing ASIC to respond by losing focus of certain markets and industries. An historical review of literature suggests that the interviewee's are justified in holding this belief, suggesting the existence of a critical juncture in ASIC's historical development. In order to establish this critical juncture, chapter 6 charts ASIC's funding against the growth of global derivatives trade.

G *Chapter 7*

Chapter 7 considers the effect of the three critical junctures identified in chapters 4, 5 and 6. These critical junctures form the basis for an analysis of ASIC and its regulatory effectiveness through the lens of historical institutionalism. An examination is conducted of the interplay between the critical junctures and regulatory theory before suggesting that ASIC is on a dependent path which is detrimental to its relationship with the secondary electricity market. Chapter 7 concludes by proposing and examining alternate means of regulating the secondary electricity market which may better serve the secondary electricity market while saving ASIC from the real costs associated with diverting from its dependent path.

H *Chapter 8*

⁵⁸ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

Chapter 8 suggests that it is inappropriate and undesirable for ASIC to respond to the needs of the secondary electricity market. It is suggested that the breadth of ASIC's regulatory scope, coupled with its limited funding, implores ASIC to focus resources on larger segments of its regulation. It is suggested that the Australian Energy Regulator may be an appropriate institution to take charge of the secondary electricity market, as it has already proven responsive to the closely related primary electricity market.

Chapter 8 then concludes the thesis by considering the contributions made by this thesis. It considers the methodological contributions, contributions to knowledge and contributions to regulatory theory. It then considers the consequences of the contributions made by this thesis. It concludes with an identification of the limitations of this thesis and makes recommendations for future study.

CHAPTER TWO: THEORETICAL FRAMEWORK APPLICABLE TO ASIC AND THE SECONDARY ELECTRICITY MARKET

I OVERVIEW

This chapter examines ASIC's attempt to regulate the Australian secondary electricity market through the use of regulatory scholarship. In doing so, it will provide the foundation for answering the first research question: How do the subjects of ASIC's regulation in the secondary electricity market view the effectiveness of ASIC? It sets out the measures of effectiveness adopted by ASIC, as well as providing the foundational theories that will be used to assess all of the research questions.

The chapter commences with an investigation of ASIC's regulatory approach, which is stated to be a 'responsive regulatory' approach. An examination of ASIC annual reports and regulatory scholarship reveals that ASIC has developed a regulatory strategy which may be suitable for generic market regulation or financial sector regulation, but which may not be sufficiently responsive to the needs of the secondary electricity market. Second, this chapter determines the distinct characteristics of the secondary electricity market through an examination of its boundaries, history, product and legislative framework. Third, this chapter considers the manner in which ASIC's regulation of the secondary electricity market could be viewed through current regulatory scholarship. It is argued that while ASIC's regulatory approach is an easy fit with concepts such as decentred regulation, its lack of responsiveness to the secondary electricity market casts doubt on whether ASIC can be said to be engaging in 'responsive regulation'. Finally, this chapter will consider historical institutionalism and how it applies to ASIC and its regulation of the secondary electricity market. Historical institutionalism will be used throughout the thesis to analyse the empirical data and demonstrate the problems faced by ASIC in being responsive to the secondary electricity market.

II ASIC'S APPROACH

As with most of Australia's corporate regulators, ASIC has abandoned traditional command and control regulatory approaches in favour of a decentred regulatory model.¹ In particular, ASIC has explicitly committed to using the responsive regulation model formulated by Ayres and Braithwaite, with Jeffery Lucy describing ASIC's regulatory task in terms of 'a pyramid with three layers',² referencing the compliance pyramid proposed by Ayres and Braithwaite. As a result, ASIC has moved its regulatory aims beyond the enforcement of regulation. A review of ASIC annual reports conducted throughout this chapter reveals that ASIC has adopted a series of performance measures which reflect the compliance pyramid in the responsive regulation model.³ The performance measures which ASIC has adopted are well aligned to a compliance pyramid, indicating a present and ongoing commitment by ASIC to the responsive regulation model.

This responsive regulatory approach was adopted by ASIC while it was still operating as ASC.⁴ Hartnell, the former chairman of ASC was committed to a responsive regulatory approach that fostered relationships with the industry which ASC hoped to regulate.⁵ It will be argued throughout this thesis that the early choices made by ASC have had a profound and lasting effect on the regulatory models adopted by ASIC.

Despite ASIC's commitment to responsive regulation, the secondary electricity market reports a lack of responsiveness from ASIC. This section of the thesis examines the theories relevant to ASIC's regulatory approach. It then identifies and discusses the performance measures adopted

¹ Vijaya Nagarajan 'From command and control to open method communication: Theorising the practice of regulatory agencies' (2008) 8 *Macquarie Law Journal* 5, 9; Australian Law Reform Commission, *Australian Privacy Law and Practice* (ALRC Report 108) August 2008, Chapter 4.

² Department of Parliamentary Services, Parliament of Australia 'Australia's Corporate Regulators – the ACCC, ASIC and APRA' 14 June 2005, Research Brief no 16, 2004-2005, 22; and Nagarajan, above n 1.

³ See Australian Securities and Investments Commission 2012-2013, 5-6.

⁴ Nagarajan, above n 1, 9.

⁵ Tony Hartnell 'Regulatory Enforcement by the Australian Securities Commission' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology 1993) 25.

by ASIC. In doing so this chapter sets out ASIC's performance measures and adopts them as the means of measuring ASIC's regulatory effectiveness throughout the thesis.

A *ASIC's adoption of Responsive Regulation*

Responsive regulation is a decentred regulatory⁶ theory which moves beyond traditional command and control regulation. ASIC's adoption of this regulatory method (and subsequently ASIC's adoption of this regulatory method) may be best understood in light of both responsive regulation theory and the general concept of decentred regulation. In order to properly illuminate the application of these theories to ASIC's regulatory approach, this thesis begins by considering ASIC's interaction with and abandonment of traditional forms of command and control regulation.

1 *ASIC's rejection of Command and Control Regulation*

There has traditionally been a dichotomy between command and control regulation and decentred regulation. While the theoretical underpinnings of the two concepts are opposed, the responsive regulatory approach may not be a wholesale rejection of command and control regulatory methods. A consideration of the traditionally viewed dichotomy and ASIC's approach reveals an ongoing relevance of command and control regulatory approaches to ASIC.

The view of regulation which has been referred to as 'command and control' regulation in this thesis goes by many names. In addition to 'command and control regulation',⁷ it has also been labelled 'centralised regulation'⁸ and the 'regulatory state'.⁹ At its most basic, the concept covered by these names is a view that regulation is an activity that involves the state enacting

⁶ The term 'decentred regulation' is used to capture a body of regulatory theory that posits that regulation exists beyond state-based control. The definition adopted for this paper is taken from Julia Black 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1. This definition encompasses the responsive regulation approach adopted by ASIC, as well as many subsequent theories which consider a range of regulatory bodies and influences beyond legislation.

⁷ Darren Sinclair 'Self-Regulation Versus Command and Control? Beyond False Dichotomies' (2002) 19 *Law and Policy* 529.

⁸ Julia Black 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1.

⁹ Giandomenico Majone 'The Regulatory State and its Legitimacy Problems' (1999) 22 *West European Politics* 1.

and enforcing legal sanctions.¹⁰ It is commonly viewed as expensive¹¹ and unresponsive.¹² The view that command and control regulation is expensive and unresponsive is well supported by studies by Sunstein and Ackerman and Stewart.¹³ This expense and unresponsiveness arises as a result of the regulator's lack of discretion and creativity in implementing legislative standards.¹⁴ Regulators can either enforce legislative penalties through a costly court process, or overlook infractions.¹⁵

The expense and lack of responsiveness of command and control regulation is a partly the explanation for its rejection by many of Australia's regulators.¹⁶ The time and cost of implementing and altering legislation to respond to the dynamism of commercial innovation is logically unappealing. The concept of enforcing strict rules on the market has drawn comparison, in more extreme scholarship, to 'socialist central planning'.¹⁷

Despite these problems, legislative control and penalties remain an integral part of ASIC's regulatory approach. Rather than being an adoption of an inefficient regulatory approach, responsive regulation leaves open the possibility of using traditional command and control methods where necessity or reason dictates. In fact, many empirical investigations provide a different perspective on the cost effectiveness of command and control regulation. Studies such as those conducted by Cole and Grossman and Harrington and Morgenstern have revealed that command and control regulation may be more cost effective in environments with high levels of uniformity and non-compliance.¹⁸ The existence of these environments which favour command

¹⁰ Giandomenico Majone 'The Rise of the Regulatory State in Europe' (1994) 17 *West European Politics* 77.

¹¹ Stephen Wilks and Ian Bartle, 'The Unanticipated Consequences of Creating Independent Competition Agencies (2002) 25 *West European Politics* 148.

¹² Nagarajan, above n 1.

¹³ See Bruce Ackerman and Richard Stewart 'Reforming Environmental Law' (1985) 37 *Stanford Law Review* 1333; Cass Sunstein, *Free Markets and Social Justice* (Oxford University Press, 1997).

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Department of Parliamentary Services, above n 2.

¹⁷ Richard Stewart 'Environmental Regulation and International Competitiveness' (1993) 102 *Yale Law Journal* 2039, 2087.

¹⁸ Daniel Cole and Peter Grossman 'When is Command and Control Efficient? Institutions, Technology, and the Comparative Efficiency of Alternative Regulatory Regimes for Environmental Protection' (1999) 1999 *Wisconsin Law Review* 887; Winston Harrington and Richard Morgenstern 'Economic Incentives Versus Command and

and control approaches is not a reason to reject decentred regulation, but rather to see command and control methods as having ongoing relevance to effective regulation. It calls for the rejection of mutual exclusivity between command and control and decentred regulation, rather than the rejection of any particular theory. This is something that ASIC appears to have accepted in its adoption of responsive regulation.

Yet, ASIC's decision to move beyond total command and control regulatory methods represents a rejection of the theories underpinning command and control regulation. This is perhaps a necessity. A number of studies have suggested that pure command and control regulation simply does not exist. Empirical studies of the cost effectiveness of command and control regulation have suggested that comparing the efficiency of command and control regulation with other forms of behavioural control is a case of 'comparing apples and oranges'.¹⁹ This argument is made primarily because there can be no clear dichotomy between command and control regulation and other forms of regulation.²⁰

This is a view supported by a number of regulatory theorists.²¹ Sunstein suggests that even strict command and control regulation is not a purely positivistic measure.²² Rather, it is subject to the interpretation of the courts, which is based on societal values.²³ While this argument may be faulted for rejecting Keslen's pure theory of law in favour of legal realism, such a fault is well covered and supported by positivist and empirical research. Sunstein does not attempt to disprove the possibility of a pure positivistic regulatory environment but instead offers evidence of a series of regulatory approaches that utilise both state based regulation and other forms of behavioural modification.²⁴ A regulator's discretion, the regulatory subject's reputation, market

Control: What's the Best Approach for Solving Environmental Problems' in Gerald Visquilio and Diana Whitelaw (eds) *Acid in the Environment* (2006), 233.

¹⁹ Harrington and Morgenstern, above n 18, 233.

²⁰ Ibid.

²¹ See Sinclair, above n 7; Cass Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (Harvard University Press, 1990).

²² Sunstein, above n 21.

²³ Ibid.

²⁴ Ibid.

competition and a range of other factors mean that any regulatory approach will necessarily involve more than state based directives.²⁵

The empirical evidence of the existence of such regulatory approaches in Australia's major regulators²⁶ provides a basis for dispensing with the notion of a pure command and control regulatory environment for the purposes of this thesis. The ACCC and the Australian Prudential Regulatory Authority both explicitly adopt responsive regulation – a decentred regulatory system which maintains elements of command and control regulation.²⁷ Accordingly, ASIC is in good company in adopting responsive regulation. In doing so, it rejects the underlying theory of command and control regulation, namely, that regulation must come from state based legislation and penalties, in favour of an approach that adopts a sociological view of regulation while maintaining elements of command and control regulation.

2 *ASIC's Adoption of Decentred Regulation*

The alternate view of regulation presented in the traditional dichotomy of regulatory theory is that of 'decentred regulation'. The ASC, and subsequently ASIC, has adopted the theoretical foundations of decentred regulation. While it in part maintains the methods of command and control regulation, it is possible for ASIC to maintain a decentred regulatory approach while imposing and enforcing regulatory penalties.

As with command and control regulation, decentred regulation takes many forms and names. 'Responsive regulation',²⁸ 'environmental initiative regulation',²⁹ and 'non-state' regulation³⁰ are all forms of decentred regulation. The term 'decentred regulation' was developed by Black and

²⁵ Sunstein, above n 21.

²⁶ Vibeke Nielsen and Christine Parker 'Testing Responsive Regulation in Regulatory Enforcement' (2009) 3 *Regulation and Governance* 376.

²⁷ Department of Parliamentary Services, above n 2; Nagarajan, above n 1; and Nielsen and Parker, above n 26.

²⁸ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

²⁹ Sonia Labatt and Virginia Maclaren 'Voluntary Corporate Environmental Initiatives: a Typology and Preliminary Investigation' 16 *Environmental and Planning: Government and Policy* 209.

³⁰ Benjamin Cashore 'Legitimacy and Privatisation of Environmental Governance: How Non-State Market Driven (NSMD) Governance Systems Gain Rule-Making Authority' (2003) 15 *Governance* 503.

provides a useful umbrella term for many of the types of regulation within this regulatory theory.³¹ Decentred regulation refers to a series of regulatory approaches that move away from traditional command and control regulation towards a sociological view of regulation that accounts for non-legal regulatory agents.³²

As an explicit adherent to responsive regulation,³³ ASIC has identified its commitment to decentred regulation and accordingly its theoretical origins. Decentred regulation theories find their origins in sociology. Ayres and Braithwaite clearly acknowledge the sociological basis of their theory of responsive regulation.³⁴ Baldwin and Black's really responsive regulation,³⁵ prominent meta-regulatory scholars³⁶ and even Black's decentred regulation³⁷ all in turn acknowledge responsive regulation as a foundational work for their theories.

Decentred regulatory theories share the basic premise that regulation can be drawn from non-legislative and non-state actors. For example, regulation may come from market forces,³⁸ social norms³⁹ or industry groups.⁴⁰ Decentred regulation attempts to utilise these non-legislative regulatory mechanisms to create cheaper and more effective regulatory frameworks. In doing so it draws on social rather than legislative regulatory power. This again supports the notion of decentred regulation's sociological origins.⁴¹

³¹ Black, above n 8.

³² Nagarajan, above n 1.

³³ Department of Parliamentary Services, above n 2; Nagarajan, above n 1.

³⁴ Ayres and Braithwaite, above n 28.

³⁵ Robert Baldwin and Julia Black 'Really Responsive Regulation' (2008) 71 *Modern Law Review* 59, 63.

³⁶ Sharon Gilad 'It runs in the family: Meta-regulation and its siblings' (2010) 4 *Regulation and Governance* 485; Colin Scott 'Regulation in the age of governance: the rise of the post-regulatory state' in Jacinta Jordana and David Levi-Faur (eds) *The Politics of Regulation: Institutions and Regulatory Reforms in the Age of Governance* (Edward Elgar Publishing, 2004), 145.

³⁷ Black, above n 8.

³⁸ Peter Grabosky 'Green Markets: Environmental Regulation by the Private Sector' (1994) 16 *Law and Policy* 419.

³⁹ Richard Posner 'Social Norms and the Law: An Economic Approach' (1997) 87 *The American Economic Review* 365.

⁴⁰ Neil Gunningham and Joseph Rees 'Industry Self-Regulation: An Institutional Perspective' (1997) 19 *Law and Policy* 363.

⁴¹ See Emile Durkheim *The Rules of Sociological Method* (Sarah Solovay and John Mueller trans, 1895 8th ed) 14 [trans of: *Les Règles de la Méthode Sociologique*] in which it is argued that social regulation rather than legal regulation is the most effective means of influencing behaviour.

In adopting a decentred regulatory approach, ASIC may be able to overcome the unresponsiveness of command and control regulation. While this has generally been accepted as a positive trait of decentred regulation,⁴² it is necessary to consider the wider jurisprudential context that this responsiveness operates within. Theorists who support flexible regulation generally do so as it minimises bureaucratic delays and cost which in turn increases business efficacy and economic development.⁴³ The unstated cost of this flexibility is uncertainty.⁴⁴ A flexible regulatory system based on shifting social norms, industry pressures and non-codified government discretions reflects less Weber's model of rational justice, and more the irrational and spontaneous model of law he labels 'Khadi Justice'.⁴⁵

While there is scholarship which supports a legal system which favours flexibility over certainty,⁴⁶ the rationale for ASIC adopting decentred regulation may be more easily found in the fact that it is not necessarily creating extra-legal regulatory systems, but rather recognising them. It has already been noted that pure command and control regulation remains subject to societal standards and flexible non-legal factors.⁴⁷ Recognising and directing these factors may create a greater level of predictability and order than would otherwise be achieved by simply ignoring their existence.

Regardless of the reason for its adoption, ASIC appears committed to responsive regulation, a decentred model which adopts command and control methods where necessary.⁴⁸ While Welsh has questioned whether this approach has actually been adopted by ASIC,⁴⁹ it is sufficient for

⁴² Sunstein, above n 21.

⁴³ See Ackerman and Stewart, above n 13; and Sunstein, above n 21.

⁴⁴ Omri Ben-Shahar 'The Tentative Case Against Flexibility in Commercial Law' (1999) 66 *University of Chicago Law Review* 781.

⁴⁵ Max Weber *Max Weber on Law in Economy and Society* (Max Rheinstein and Edward Shils, trans, 1954 1st ed) 137, 138.

⁴⁶ See David Charny 'The New Formalism in Contract' (1999) 66 *Chicago Law Review* 842; and Lisa Bernstein 'The Questionable Empirical Basis of Article 2's Incorporation Strategy: A preliminary Study' (1999) 66 *Chicago Law Review* 710.

⁴⁷ Sinclair, above n 7.

⁴⁸ Jeffrey Lucy 'Significant Regulatory Issues Facing ASIC and Australian Business' (Speech delivered at the Australia-Israel Chamber of Commerce, Sydney, 4 August 2004).

⁴⁹ Michelle Welsh 'Civil Penalties and Responsive Regulation: The Gap Between Theory and Practice' (2009) 33 *Melbourne University Law Review* 908.

this thesis that ASIC is committed to a decentred approach. This thesis makes its own evaluation of whether responsive regulation is being effectively applied in the secondary electricity market. Accordingly, this thesis will accept ASIC's view of regulation and measure its effectiveness against that view.

3 *Responsive Regulation*

The specific method of decentred regulation adopted by ASIC is that of responsive regulation.⁵⁰ Responsive regulation finds its roots in the work of Scholz.⁵¹ Scholz proposed a regulatory mechanism which incorporated 'a combination of cooperative and deterrence routines... that is at once vengeful and forgiving'.⁵² Based on game theory, his regulatory concept acknowledged the power of cooperative regulation when applied to cooperative long-term regulatory subjects,⁵³ whilst maintaining the need for sanctions and penalties for the uncooperative and those whose relationship with the regulator was coming to an end.⁵⁴ This early compliance model was fairly binary in its approach, dealing with the concept of a cooperative regulatory subject and a non-cooperative regulatory subject.⁵⁵

ASIC's responsive regulation model adopts the more recent proposal of responsive regulation offered by Ayres and Braithwaite.⁵⁶ Responsive regulation maintains the basic concept developed by Scholz; namely, that different regulatory approaches can and should be applied to different regulatory subjects at different times.⁵⁷ Rather than maintain the categorisation of cooperative and uncooperative regulatory subjects, the responsive regulatory model develops a spectrum of regulatory behaviour. Between the extremes of completely compliant and

⁵⁰ Department of Parliamentary Services, above n 2; Australian Law Reform Commission, above n 1; Nagarajan, above n 1.

⁵¹ John Scholz 'Voluntary Compliance and Regulatory Enforcement' (1984) 6 *Law and Policy* 385; and John Scholz 'Cooperation, Deterrence, and the Ecology of Regulatory Enforcement' (1984) 18 *Law and Society Review* 179.

⁵² John Scholz 'Cooperation, Deterrence, and the Ecology of Regulatory Enforcement' (1984) 18 *Law and Society Review* 179, 179.

⁵³ John Scholz 'Voluntary Compliance and Regulatory Enforcement' (1984) 6 *Law and Policy* 385.

⁵⁴ *Ibid* 388.

⁵⁵ *Ibid*.

⁵⁶ Ian Ayres 'Responsive Regulation: A co-authors Appreciation' (2013) 7 *Regulation and Governance* 145.

⁵⁷ *Ibid*.

completely non-compliant lie, among others, those regulatory subjects who may wish to be compliant but lack the knowledge and resources, those who are compliant only where they may get caught and those who are non-compliant because of a careless error or accident.⁵⁸

The reasons for compliance and non-compliance have been greatly expanded upon since the development of responsive regulation. Black suggests that finding the motivations for non-compliance can improve the effectiveness of regulatory response.⁵⁹ This is a concept that has been explicitly adopted by the Australian Taxation Office ('ATO').⁶⁰ The ATO identifies the motivations for noncompliance as industry factors, psychological factors, sociological factors, economic factors and business profile.⁶¹ This is linked to motivational postures including managerial accommodation, capture, resistance and non-engagement.⁶² Identifying these motivations and motivational postures theoretically improves the ability of a regulator to provide the appropriate regulatory response.⁶³ ASIC has not explicitly adopted these motivations or motivational postures as part of its regulatory model, but the measures of effectiveness set out in ASIC's most recent annual report suggest that it may have done so.⁶⁴

Regardless of whether the motivations of non-compliance are taken into account, responsive regulation offers a graduated response to non-compliant behaviour.⁶⁵ It also suggests the proper attention and funding that should be allocated to each of these responses.⁶⁶ This is a concept which is well illustrated by the 'compliance pyramid' reproduced in figure 2.1.

⁵⁸ Ayres, above n 56.

⁵⁹ Julia Black 'Chancer, Failure or Trier? Regulatory Conversations and the Construction of Identities' (2008) (Paper presented at Crime Narratives in Context seminar, Cardiff University).

⁶⁰ Neal Shover, Jenny Job and Anne Carroll 'the ATO compliance model in action' in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate, 2003).

⁶¹ Valerie Braithwaite and John Braithwaite 'An Evolving Model for Tax Enforcement' in Neal Shover and John Wright (eds) *Crimes of Privilege* (1st ed, 2001).

⁶² Ibid.

⁶³ Ibid.

⁶⁴ Australian Securities & Investments Commission, *Annual Report 2012 – 2013*, 10 October 2013.

⁶⁵ John Braithwaite 'Responsive Regulation: Fasken Lecture: The Essence of Responsive Regulation' (2011) 44 *University of British Columbia Law Review* 475.

⁶⁶ Ibid.

Figure 2.1
Compliance Pyramid⁶⁷

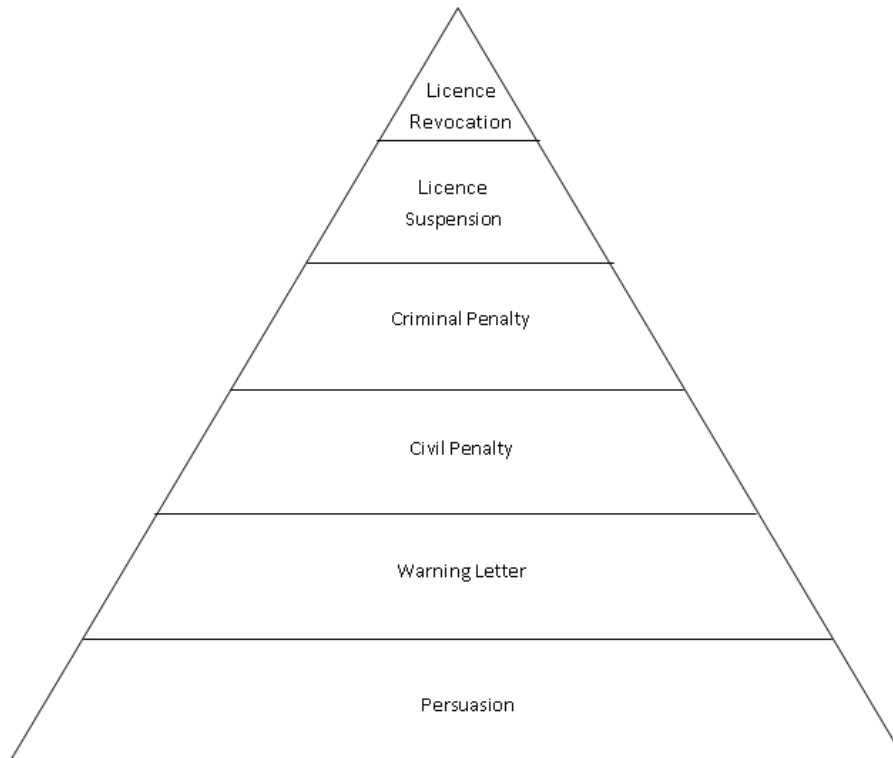


Figure 2.1 represents the regulatory deterrents that are to be used by a regulator, in this case ASIC, in ensuring compliance. The majority of funding and attention should be allocated to the widest and most effective regulatory approach: education and persuasion.⁶⁸ This is in keeping with the sociological origins of decentred regulation. Non-legal regulatory measures guide conduct.⁶⁹ By harnessing the power of social structures, educational institutions, peers and industry, more costly and confrontational regulatory action can be avoided.⁷⁰ It is based on the assumption that most regulatory subjects are not intending to behave in a manner which would

⁶⁷ Ayres and Braithwaite, above n 28.

⁶⁸ Ian Ayres 'Responsive Regulation: A co-authors Appreciation' (2013) 7 *Regulation and Governance* 145.

⁶⁹ Durkheim, above n 37.

⁷⁰ Christie Ford 'Responsive Regulation in Context' (2011) 44 *University of British Columbia Law Review* 463.

require the intervention of a regulator.⁷¹ By focusing on educating regulatory subjects on the regulator's expectations the regulator empowers the regulatory subject to ensure its own compliance.⁷² This is something that is both absent from the secondary electricity market and undesired by the secondary electricity market.

Working through the compliance pyramid, the second level recognises the possibility of accidental non-compliance and opportunistic non-compliance.⁷³ There is little value in ASIC exploring costly litigation against market participants who have made an accidental transgression (either through lack of knowledge or lack of attention). Likewise, a regulatory subject may simply be testing the boundaries of regulatory coverage.⁷⁴ In these instances, a warning letter from the regulator will likely be sufficient to deter any future breaches and to remedy any ongoing breach.⁷⁵ As with education, warning letters were reported to be largely absent from the secondary electricity market.

More costly and confrontational regulatory action is retained, but the aim of the regulator is to prevent non-compliance, rather than penalise it.⁷⁶ This is perhaps reflected as ASIC has, at least in its annual report, lumped the next two levels of the pyramid together.⁷⁷ The distinction between civil and criminal penalties in a corporate context is vexed by the concept of separate legal personality. If ASIC is to take action against a director, financial advisor or other human person then the distinction is of utmost importance. Civil penalties are far less extreme and do not attract the possibility of deprivation of liberty or the stain of a criminal record. The distinction is far less clear in a corporate context, where the majority of the secondary electricity market operates. The *Salomon* principle⁷⁸ means that any action taken against a corporation is generally taken against the corporation in its own right. As the oft misquoted expression from

⁷¹ Ayres and Braithwaite, above n 28.

⁷² Ibid.

⁷³ Julia Black, above n 59.

⁷⁴ Ibid.

⁷⁵ Ayres and Braithwaite, above n 28.

⁷⁶ Ibid.

⁷⁷ Australian Securities and Investments Commission, above n 64.

⁷⁸ *Salomon v Salomon & Co Ltd* [1897] AC 22.

Edward Thurlow states ‘did you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?’⁷⁹ Without the threat of penal sanction, the distinction between civil and criminal penalties may appear to be far less important.

There is nonetheless a clear distinction between the two. A civil penalty will generally be subject to the principle of *restitutio ad integrum*.⁸⁰ While the possibility of punitive or aggravated damages is possible, it is unlikely. Australia’s rejection of *Rookes v Barnard*⁸¹ has limited the possibility of punitive damages and the corporation’s lack of ethical accountability would render findings of aggravated damages difficult. Criminal penalties then, appear to be the appropriate mechanism for imposing a penalty on a corporation that is greater than the cost of the damage caused by the corporation. The ability to penalise beyond the cost of damage caused may be of utmost importance when dealing with a company basing decisions purely on cost-benefit analysis, as was seen in *Grimshaw v Ford Motor Company*.⁸² This may have special significance in the secondary electricity market, where the results of a breach of legislation may be severe but impossible to quantify.

The imposition of a criminal penalty may also be of reputational importance. Criminal penalties may cause consumers to avoid products or favour competitors.⁸³ The potential loss of valuable goodwill may itself be a significant enough deterrent to maintain the civil / criminal distinction when dealing with a corporate person.

While ASIC does not maintain this distinction, it is nonetheless clear that a distinction can be made between civil and criminal penalties in its responsive regulatory approach. Civil penalties, while significant, do not carry the stigma or increased penalties that may flow from criminal penalties. There is a logical break in the pyramid. Some behaviour has caused damage and that

⁷⁹ Edward Thurlow quoted in John Poynder *Literary Extracts from English and Other Works: Collected During Half a Century, Together with Some Other Matter* (University of Toronto Libraries 2012 edition, 1844).

⁸⁰ *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25.

⁸¹ (1964) 1 All ER 367.

⁸² (1981) 119 Cal App 3d 757.

⁸³ Stephen Greyser ‘Corporate brand reputation and brand crisis management’ (2009) 47 *Management Decision* 590.

damage must be remedied. This is the purpose of the civil penalty level of the pyramid.⁸⁴ Other behaviour is more abhorrent and deserves remedy at a greater level than correcting the wrongdoing. This is the purposes of the criminal penalty.⁸⁵ ASIC has not used civil or criminal penalties extensively in the secondary electricity market.

The final levels of the pyramid are concerned with removing the disengaged regulatory subject from the market.⁸⁶ If civil and criminal penalties are not deterring errant behaviour, then the regulator has the power to remove the rogue regulatory subject from the market either temporarily or permanently.⁸⁷ This is frequently used by ASIC in the financial services market,⁸⁸ where a licensing system fits well within the compliance pyramid. As with civil and criminal penalties, the increasing level of severity of suspension and revocation provide the regulator with discretion in the severity of response. Despite being the smallest part of the compliance pyramid, this is the only area that the secondary electricity market reported any real interaction with ASIC.

B *ASIC's Performance measures*

The secondary electricity market's perception of a lack of adherence to the compliance pyramid by ASIC has a profound effect on ASIC's ability to regulate the secondary electricity market. In determining the extent of this effect, this thesis measures ASIC's regulatory effectiveness against ASIC's own performance measures. A thorough examination of ASIC's annual reports reveals a clear set of performance measures structured around the compliance pyramid.

In its annual report, ASIC enumerates its top three regulatory priorities. In order, these are:

- 'Confident and informed investors and financial consumers'⁸⁹
- 'Fair and efficient financial markets'⁹⁰

⁸⁴ Ayres and Braithwaite, above n 28.

⁸⁵ Ibid.

⁸⁶ Braithwaite and Braithwaite, above n 61.

⁸⁷ Ayres and Braithwaite, above n 28.

⁸⁸ Australian Securities and Investments Commission, above n 64.

⁸⁹ Ibid 22.

⁹⁰ Australian Securities and Investments Commission, above n 64, 36.

- ‘Efficient registration and licensing’⁹¹

Each of these priorities has a series of measurable performance measures by which ASIC measures its effectiveness. These performance measures are identified in sub-headings below each of the priorities below. An analysis of these performance measures reveals a clear correlation between ASIC’s performance measures and the compliance pyramid.

1 *Confident and Informed Investors and Financial Consumers*

ASIC’s primary goal is to ensure that investors and financial customers are ‘confident and informed’. In pursuit of this goal it has dedicated 42% of its revenue.⁹² To measure its effectiveness in this area ASIC has developed performance measures of ‘engagement with stakeholders’,⁹³ ‘setting rules, standards and expectations’,⁹⁴ ‘education’,⁹⁵ ‘enforcement’,⁹⁶ and ‘policy advice and implementation’.⁹⁷ ASIC does not state that any of these priorities are more important than the others. They have been reproduced in the order that they appear in ASIC’s most recent annual report. While these categories reflect the enforcement pyramid presented by Ayres and Braithwaite,⁹⁸ they do not reflect the order in which they appear. It is possible that ASIC has deliberately ordered these measures to reflect their importance. As ASIC staff could not be interviewed on this point, it will be assumed that each of these categories is of equal importance.

Given that ASIC has explicitly adopted responsive regulation as its guiding regulatory theory,⁹⁹ it may be assumed that the fulfilment of these measures is in line with the concepts of responsive

⁹¹ Ibid 46.

⁹² Ibid 6.

⁹³ Ibid 22.

⁹⁴ Ibid 27.

⁹⁵ Ibid 28.

⁹⁶ Ibid 32.

⁹⁷ Ibid 35.

⁹⁸ Ayres and Braithwaite, above n 28.

⁹⁹ Department of Parliamentary Services, above n 2; Nagarajan, above n 1.

regulation. The investigation of these measures will be structured around the compliance pyramid.

(a) *Education*

The compliance pyramid presents a graphic representation of ASIC's goals with regard to consumer confidence. The largest impact it can make is at the bottom of the pyramid. A majority of market participants will presumably not be engaged in surreptitious and immoral behaviour. In order to ensure its goals are met by the majority of honest market participants, ASIC needs only to educate and direct behaviour towards transparency and fairness. This is covered by ASIC's 'education' and 'engagement with stakeholders' measures. ASIC is attempting to train financial advisors,¹⁰⁰ 'collaborate' with investment managers,¹⁰¹ and provide community education.¹⁰² If firms can be persuaded through this education and consultation process, the need for more formal enforcement mechanisms should be greatly reduced.¹⁰³

The effectiveness of these processes can therefore be understood as being reflected in two ways. First, a lack of need for enforcement further up the pyramid reflects effective persuasion. To verify effectiveness in this way would require a well-constructed quantitative investigation, factoring in the number of market participants in need of persuasion, benchmarking against previous performance and a consideration of moral sentiments which may compel some to disregard all forms of regulation that do not impose an immediate penalty. These figures are simply not available for the secondary electricity market.

The second way effectiveness of persuasion can be measured is to ask regulatory subjects about ASIC's persuasive techniques.¹⁰⁴ This evaluation falls within the empirical study done as part of this thesis. It is discussed further in Chapter 3 and the resulting analysis reveals that ASIC, while

¹⁰⁰ Australian Securities and Investments Commission, above n 64, 22.

¹⁰¹ Ibid 23.

¹⁰² Ibid 28.

¹⁰³ Welsh, above n 49.

¹⁰⁴ Julia Black 'Regulatory Conversations' (2002) 29 *Journal of Law and Society* 163.

potentially highly effective when educating the financial services market generally, is not engaged in educating the secondary electricity market.

(b) *Warning Letters*

Within the compliance pyramid there is a recognition that both well-meaning and deviant businesses may engage in behaviour which is in a legal grey area or simply outside the law.¹⁰⁵ A demonstration of this legal grey area in the secondary electricity market is provided in Case Study 2.1.

Case Study 2.1

Operating in the legal grey area in the secondary electricity market¹⁰⁶

Roy was preparing a disclosure statement for a weather future which was to be sold on the secondary electricity market. ASIC requires that the product disclosure statement contains ‘sufficient information so that a retail client may make an informed decision about whether to purchase a financial product’.¹⁰⁷ Roy believes that the fees and charges applicable to the weather future are a key piece of information that must be included in the product disclosure statement.

With only a few hours remaining on his deadline to submit the product disclosure statement to his supervisor, Roy realises that he has left out one of the fees applicable to the weather future. Including the fee in the section discussing fees will require a thorough re-writing of the product disclosure statement together with a recalculation of the example

¹⁰⁵ Adrian Cherney ‘Trust as a Regulatory Strategy: A Theoretical Review’ (1997) 9 *Current Issues in Criminal Justice* 71, 73.

¹⁰⁶ The case study is derived from an anecdote related in interview 13. Names have been changed for the sake of anonymity.

¹⁰⁷ Australian Securities & Investments Commission, *Regulatory Guide 168 – Disclosure: Product Disclosure Statements (and other disclosure obligations)*, 6 September 2010.

figures in the product disclosure statement. He also realises that ASIC has not been prescriptive as to where the information is to appear – as long as it appears somewhere.

Roy realises that he could insert the fee into the sample calculations. The fee, being only 1.1% per annum, amounts to a reasonable fee on the sample calculation of \$5,000. If however, he were to run the sample calculation on \$50, a 1.1% fee would simply round out of existence. He includes the 1.1% fee in the formula and divides all of the sample figures by 100, completing the product disclosure statement by the deadline. He has technically complied with the disclosure requirements, while providing information that may potentially mislead anyone reading the document with anything less than absolute attention.

The deliberate and legally questionable actions taken in case study 2.1 may be difficult to prosecute. Given that the fee has been technically included and is unlikely to result in any damage worth taking legal action for, even on a \$5,000 future, ASIC may be unwise to attempt to bring civil or criminal action. It is for this type of behaviour that a warning letter may be issued requiring rectification. This may cause inconvenience and embarrassment which would deter further attempts of this nature.

Not all behaviour which attracts a warning letter from ASIC needs to be deliberate type of behaviour set out in Case Study 2.1. The behaviour may be wholly accidental, result from a lack of understanding and education.¹⁰⁸ Where such behaviour occurs the regulator issues a warning rather than resorting to penalties. As was seen in case study 2.1, the misinformed and foolish can correct their behaviour without the need for ASIC to incur enforcement costs. ASIC reflects this

¹⁰⁸ Cherney, above n 105.

in the ‘enforcement’ section of its annual report, noting the issuance of warning letters to 4% of the total misconduct reports filed with ASIC.¹⁰⁹

As with ‘persuasion’, the effectiveness of warning letters lies both in a reduction in higher level enforcement mechanisms and in the response to these letters by regulatory subjects. The use of warning letters in the secondary electricity market is examined as part of the empirical study in this thesis. The secondary electricity market reports that little has been done by ASIC to issue any warnings to secondary electricity market participants.

(c) *Penalties, License Suspensions and License Revocations*

The remainder of the pyramid also falls within the ‘enforcement’ section of ASIC’s annual report. ASIC notes 149 litigations commenced with a 95% success rate.¹¹⁰ Of these, 25 were criminal proceedings, 72 involved the disqualification of people from directing companies and 88 were people banned from providing financial services or consumer credit.¹¹¹ This reflects the increasing severity of the compliance pyramid. ASIC’s measure of effectiveness here appears to be the number of cases resulting in a successful prosecution or resulting in the banning of individuals from working in certain industries. This is quite a different measure to the lower levels of the pyramid, which sought to deter rather than penalise errant behaviour. If ASIC measures the effectiveness of civil penalties by their ability to prevent criminal actions, it is not reflected in their annual report. ASIC’s ‘litigation successfully completed’ performance measure lumps together ‘criminal and civil litigation and administrative actions’.¹¹² It appears, at this level, that ASIC is more concerned with penalising rogue behaviour. Having been warned, the companies that find themselves subject to prosecution are presumably intentionally dishonest – the only remedy is a penalty. Effectiveness can thus be quantitatively measured, and has been so measured by ASIC in its annual report.

¹⁰⁹ Australian Securities and Investments Commission, above n 64, 56.

¹¹⁰ Ibid 18.

¹¹¹ Ibid.

¹¹² Ibid 18.

The shape of the pyramid is well reflected in these performance measures. The pyramid is broadest at its base, suggesting that a majority of time and effort should be dedicated to persuading the majority of market participants, the generally well-meaning.¹¹³ This is reflected in ASIC's annual report. Of the 14 pages dedicated to reporting on ASIC's effectiveness in achieving 'confident and informed investors and financial consumers', only 3 are dedicated to the top 5 layers of the pyramid.¹¹⁴ This weighting of information within the annual report suggests that ASIC is, as responsive regulation suggests it ought to be,¹¹⁵ primarily focused on its persuasive role.

2 *Fair and Efficient Financial Markets*

ASIC's secondary goal is to ensure the existence of 'fair and efficient financial markets'. In pursuit of this goal it has dedicated 32% of its revenue.¹¹⁶ ASIC measures its effectiveness in providing fair and efficient financial markets in much the same way it measures its effectiveness in providing confident and informed investors and financial consumers. ASIC measures 'engagement with industry and stakeholders',¹¹⁷ 'surveillance',¹¹⁸ 'guidance – setting rules, standards and expectations',¹¹⁹ 'enforcement' and 'policy advice and implementation'.¹²⁰

(a) *Industry as a stakeholder*

The first is the inclusion of the word 'industry' in the 'engagement with stakeholders' measure. This is an unusual inclusion as 'industry' is necessarily a 'stakeholder'. There are two possible explanations for this anomaly. Either ASIC is seeking to exclude industry from their goal-setting

¹¹³ Nagarajan, above n 1, 7.

¹¹⁴ Australian Securities and Investments Commission, above n 64, 22 – 35.

¹¹⁵ Ayres and Braithwaite, above n 28, 37.

¹¹⁶ Ibid.

¹¹⁷ Australian Securities and Investments Commission, above n 64, 22 – 35, 36.

¹¹⁸ Ibid 37.

¹¹⁹ Ibid 40.

¹²⁰ Ibid 45.

in relation to fully informed markets and consumer confidence or ASIC is noting a greater level of industry inclusiveness in its attempt to achieve fair and efficient financial markets.

The former explanation is unlikely. If ASIC is attempting to persuade and educate its way to confident and informed investors and financial consumers then, as a matter of common sense, it must necessarily attempt to persuade the keepers of financial information, corporations and the industries in which they operate. Secondly, ASIC's annual report identifies its effectiveness in working collaboratively with superannuation advisers¹²¹ and providing guidance to investment managers,¹²² hedge funds,¹²³ deposit takers¹²⁴ and credit and insurance providers.¹²⁵ This clearly shows that ASIC does not intend to exclude success in persuading industry from its measure of effectiveness.

The latter explanation is far more likely. While confident and informed investors and financial consumers can, in part, be achieved by educating investors and consumers, fair and efficient markets is only achievable through engagement with the corporations that form those markets. This greater inclusion of industry is reinforced throughout the report. Page 36 of the report dedicates half a page to discussion of consultation with 'corporations' but only a paragraph to 'financial market infrastructure' and 'other engagement'.¹²⁶ ASIC reports that it held 'corporate finance liaison meetings in five states'¹²⁷ and 'also held a series of industry meetings... on takeovers law reform'.¹²⁸ Likewise, the report dedicates half a page to discussion of supervision of corporations.¹²⁹ The discussion of 'guidance' on page 41 includes another half page discussion of guidance of corporations.¹³⁰ In total, 2 pages of the 10 pages dedicated to fair and

¹²¹ Australian Securities and Investments Commission, above n 64, 23.

¹²² Ibid 27.

¹²³ Ibid 28.

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ Ibid 36.

¹²⁷ Ibid.

¹²⁸ Australian Securities and Investments Commission, above n 64.

¹²⁹ Ibid 38.

¹³⁰ Ibid 41.

efficient markets fall under the heading ‘corporations’.¹³¹ Much of the remainder involves discussion related to corporations, such as financial licensing and cases concerning directors’ duties.¹³²

In light of this dedication to corporations in its annual report, it is difficult to conclude other than that ASIC intended to include corporate and industry persuasion as one of its goals. The greater focus on industry provides a meaningful insight into what is likely one of ASIC’s performance measures in achieving fair and efficient markets: ASIC’s working relationship with industry. This measure of effectiveness is in line with the responsive regulatory model, which requires open communication and trust between the regulator and the subjects of regulation.¹³³

(b) *Surveillance*

The second difference between ASIC’s measures of effectiveness in achieving ‘confident and informed investors and financial consumers’ and ‘fair and efficient financial markets’ is the inclusion of ‘surveillance’ in the latter. This inclusion is in part explained by ASIC’s statutory duty to review market licensees in accordance with Part 7.2 of the *Corporations Act*.¹³⁴ This is explicitly recognised in the report where ASIC identifies ‘under the Corporations Act, ASIC must assess, at least once a year, whether a market licensee has adequate arrangements to operate its market and/or clearing facility’.¹³⁵

A deeper consideration of the report suggests that ‘surveillance’ may also reflect ASIC’s regulatory approach and measures of effectiveness. If ASIC were solely concerned with discharging a statutory duty, then its surveillance would likely be reported in a quantitative manner, with the inclusion of a table which reported the number of reviews conducted and the total time and cost of conducting those reviews. Instead, ASIC has reported on industry

¹³¹ Ibid 36 – 45.

¹³² Ibid.

¹³³ Ayres and Braithwaite, above n 28.

¹³⁴ 2001 (Cth), Part 7.2.

¹³⁵ Australian Securities and Investments Commission, above n 64, 37.

consultation, activities in the takeovers market and efforts to improve prospectuses.¹³⁶ As a result, the annual report indicates that ASIC is taking its surveillance duties as more than a mere statutory obligation. Instead, surveillance is used to develop the persuasion and warning levels of the compliance pyramid. This can be seen in ASIC's discussion of its surveillance of Chi-X Australia. ASIC found that Chi-X Australia had met statutory requirements, but nonetheless agreed to a number of changes in its operations including 'publishing its arrangements for managing conflicts on its website and improving its participant admission process'.¹³⁷

The inclusion of surveillance may then be seen as ASIC taking a more 'hands-off' approach to regulating fair and efficient markets. More so than in its consumer protection role, ASIC appears to be regulating in a non-interventionist manner, rather than imposing itself on the market. This ties in to a regulatory approach which has a greater level of inclusion of industry. If ASIC is to build a strong working relationship with its regulatory subjects, common sense would dictate that a consultative, non-interventionist approach will best achieve that relationship. While the results of the empirical study in this thesis contradict this common sense claim, ASIC's approach is in line with scholarship on responsive regulation which advocates for intervention only when less costly and direct regulatory measures have failed.¹³⁸

3 *Efficient Registration and Licensing*

ASIC's tertiary goal is to ensure 'efficient registration and licensing'. In pursuit of this goal it has dedicated 26% of its revenue.¹³⁹ In measuring performance under this goal ASIC has adopted a completely different set of measures. This is perhaps unavoidable. Whereas the other two goals aim for effectiveness, this goal aims only for efficiency. As indicated by Galbraith, effectiveness

¹³⁶ Australian Securities and Investments Commission, above n 64, 38.

¹³⁷ Ibid 37.

¹³⁸ Ayres and Braithwaite, above n 28; Nagarajan, above n 1; Cherney, above n 105.

¹³⁹ Australian Securities and Investments Commission, above n 64, 6.

and efficiency are often confused, but far from interchangeable.¹⁴⁰ Efficiency measures are reflected in ASIC's report: applications processed per hour,¹⁴¹ faster websites,¹⁴² speed and percentage of debts collected.¹⁴³ The aim is to increase the output of an activity, rather than to question whether that activity is desirable.¹⁴⁴

This section of the report thus provides only one real insight into ASIC's measures of effectiveness. That insight is provided by the inclusion of 'efficiency' as a goal. Faster registrations lead to a faster and more responsive regulator, but may work against ASIC providing a proper assessment of registration applications.¹⁴⁵ As previously discussed, the choice to be responsive may be at the cost of more complete regulation.¹⁴⁶ This choice not only reflects the ideology of ASIC, but also supports the conclusion that ASIC largely measures effectiveness based on its relationship with industry. By this measure, ASIC is most effective where it is able to stand back and assume the best of industry, surveying for the worst and only intervening when its surveillance reveals a problem.

4 *ASIC's evaluation of its own performance*

ASIC's annual report provides an answer to the question 'is ASIC effective?' ASIC's success in enforcement is clear from the data contained in figure 2.2, extracted from ASIC's annual report.

¹⁴⁰ John Galbraith, *The Economic of Innocent Fraud: Truth for Our Time*, (Houghton Mifflin Company, 2004), 26.

¹⁴¹ Australian Securities and Investments Commission, above n 64, 49.

¹⁴² Ibid 51.

¹⁴³ Australian Securities and Investments Commission, above n 64, 52.

¹⁴⁴ Galbraith, above n 140.

¹⁴⁵ Edward Luttwak, *Turbo Capitalism: The Hidden Effects of Free Market Capitalism – Winners and Losers in the Global Economy* (Harper Perennial, 1998).

¹⁴⁶ Sunstein, above n 21.

Figure 2.2
ASIC's Enforcement Outcomes¹⁴⁷

Major enforcement outcomes

Major enforcement outcomes, 2012–13

Type of action	2012–13	2011–12
Litigation completed (total) ¹	144	179
Litigation completed successfully ²	95%	92%
New litigation commenced ¹	149	134
Investigations commenced	193	173
Investigations completed	187	183
Criminal proceedings completed	25	28
No. of people convicted	22	27
No. of people jailed	9	20
Non-custodial sentences/fines	13	8
Civil proceedings completed	15	24
Illegal schemes shut down or other action taken	39	1
People disqualified or removed from directing companies	72	84
People/companies banned from financial services or consumer credit	50 (financial services) 38 (credit)	54
Action against auditors/liquidators	7	7
No. of enforceable undertakings	20	22
Negotiated outcomes	17	17

1. Includes criminal and civil litigation and administrative actions. Excludes summary prosecutions, conducted by ASIC, for less serious criminal offences.

2. Includes criminal and civil litigation. Excludes administrative actions and summary prosecutions, conducted by ASIC, for less serious criminal offences.

¹⁴⁷ Australian Securities and Investments Commission, above n 64, 18.

As can be seen from figure 2.2, ASIC has experienced significant success over the 2012 to 2013 period. It has had an increased success rate for litigation, increased rate of shutting down illegal schemes and has commenced more litigation against more companies.¹⁴⁸ ASIC has also provided qualitative reports on stakeholder engagement¹⁴⁹ and quantitative data on faster enquiry response and licence issuing times¹⁵⁰ are all used as evidence of ASIC's effectiveness. Taken at face value, there is little reason to conduct any further investigation into ASIC's effectiveness as a regulator, especially if ASIC's own measures are to be used.

The most immediate justification for an independent evaluation of ASIC's effectiveness is the possibility of bias in ASIC's evaluation. ASIC's self-evaluation does not reach the same conclusion as the studies conducted by Welsh and Ford.¹⁵¹ Welsh and Ford have both questioned ASIC's adherence to responsive regulation and the effectiveness of ASIC's responsive regulation approach as a whole.¹⁵² ASIC clearly has an interest in presenting itself as being a highly effective regulator, a move that may be essential in ensuring ASIC's survival in an increasingly complex resource allocation environment.¹⁵³ The qualitative sections of the annual report would prima facie support this view: there is not one report which is not entirely positive about ASIC's performance.¹⁵⁴ The quantitative data is primarily positive, but suggests ASIC has declined in effectiveness in certain areas. ASIC has been slower to answer general phone enquiries,¹⁵⁵ engaged in lengthier litigation processes¹⁵⁶ and incurred \$27 million more in operating costs than it did in the previous year (an increase of 7%).¹⁵⁷

¹⁴⁸ Australian Securities and Investments Commission, above n 64.

¹⁴⁹ Ibid 22.

¹⁵⁰ Ibid 60.

¹⁵¹ Welsh, above n 47; Cristie Ford 'Macro- and micro-level effects on responsive financial regulation' (2011) 44 *University of British Columbia Law Review* 589.

¹⁵² Ibid.

¹⁵³ Vicky Comino 'Effective Regulation by the Australian Securities & Investments Commission: the Civil Penalty Problem' (2009) 33 *Melbourne University Law Review* 802, 815; Robert Baldwin and Martin Cave *Understanding Regulation: Theory, Strategy and Practice* (Oxford University Press, 1999); and Devon Garvie and Andrew Keeler 'Incomplete Enforcement with Endogenous Regulatory Choice' (1994) 55 *Journal of Public Economics* 141.

¹⁵⁴ Australian Securities and Investments Commission, above n 64.

¹⁵⁵ Ibid.

¹⁵⁶ Ibid 18.

¹⁵⁷ Ibid 19.

Such negative data may easily be explained as quantitative data may be more difficult to misrepresent than qualitative data. This is an unlikely explanation. ASIC has discretion as to what measures it includes in its annual reports and could easily leave out many of these measures. ASIC may likewise be seen to include some trivial negative outcomes to support the legitimacy of its otherwise positive data. Such suggestions are not without merit. Studies by Laufner, Magat and Viscusi and Neu, Warsame and Pedwell have questioned the possibility of annual reports (both public and private) being used as a promotional tool.¹⁵⁸ An evaluation of ASIC which aims to correct any such bias would require a great deal of non-public information from ASIC, as well as ASIC's co-operation. In order to ensure that ASIC is fairly represented, it has been assumed that ASIC has been fair and honest in its official releases, including in reporting its own effectiveness.

This thesis measures the effectiveness of ASIC in the secondary electricity market. In doing so, it evaluates whether ASIC is meeting the performance measures set out in the annual reports specifically in relation to the secondary electricity market. This process does not call for an evaluation of the figures in the annual report, which demonstrate success within their general regulatory jurisdiction. Rather, a regulatory subject-focused evaluation of ASIC's practises will reveal whether the success ASIC reports generally is applicable to the small, complex and important secondary electricity market. ASIC's performance measures are thus adopted, but for measurement of a different sample population.

¹⁵⁸ See William Laufer 'Social Accountability and Social Greenwashing' (2003) 43 *Journal of Business Ethics* 253; Wesley Magat and Kip Viscusi 'Effectiveness of the EPA's Regulatory Enforcement: The Case of Industrial Effluent Standards' (1990) 33 *Journal of Law and Economics* 331; and Dean Neu, Hussein Warsame and Kathryn Pedwell 'Managing Public Impressions: Environmental Disclosures in Annual Reports' (1998) 23 *Accounting, Organisations and Society* 265.

III THE SECONDARY ELECTRICITY MARKET

This thesis examines the effectiveness of ASIC's approach in the secondary electricity market. This section of the thesis first considers the development of the wholesale electricity market, an important aspect of the development of the secondary electricity market. It then defines the secondary electricity market and distinguishes it from the wholesale electricity market. Once the secondary electricity market has been defined, the unique characteristics of electricity as a product are considered. An argument is then made for considering the secondary electricity market a unique market, separate from the general financial products market. Finally, the legislative framework governing the secondary electricity market is set out.

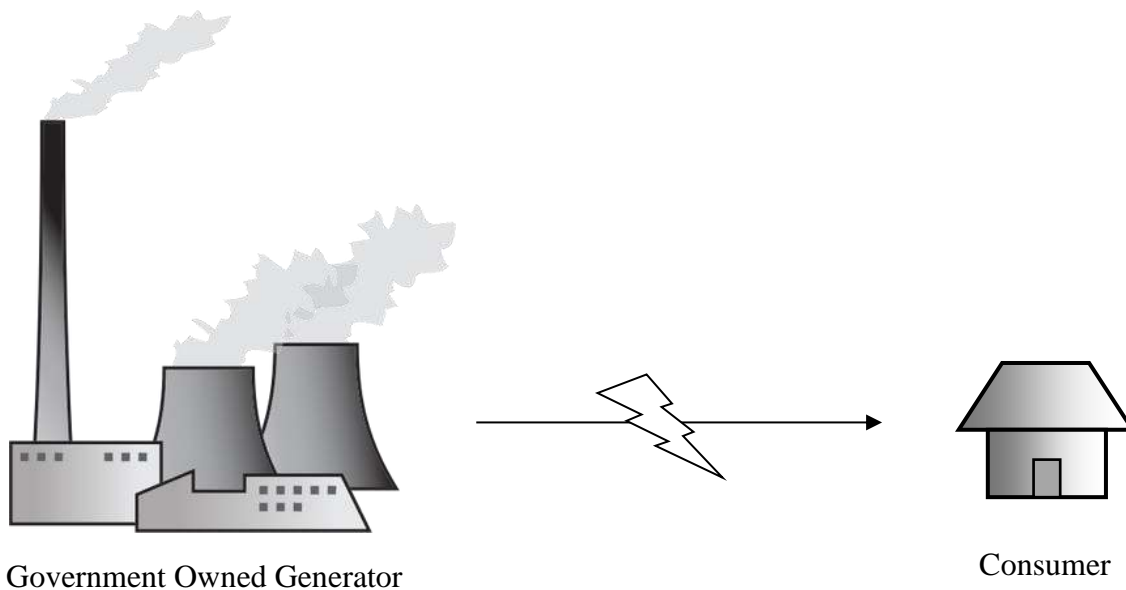
A *Development of the Wholesale Electricity Market*

Prior to 1994, the national and state governments held a monopoly on the production and sale of electricity in Australia.¹⁵⁹ Both the production and supply of power were fairly easily understood. Figure 2.3 sets out the traditional government monopoly power supply chain.

¹⁵⁹ Damien Cahill and Sharon Beder 'Regulating the Power Shift: The State, Capital and Electricity Privatisation in Australia' (2005) 55 *Journal of Political Economy* 5.

Figure 2.3

Government Monopoly Power Supply Chain



* Generator image by Catherine Collier, used with permission from the Integration and Communication Network.

As shown in figure 2.3, power is produced in a government owned power generator. It is then transmitted via government owned power lines directly to the consumer's house or business.¹⁶⁰ The kilowatt hours consumed by each house and business is monitored.¹⁶¹ Each house and business is then billed for the energy it has consumed.¹⁶² The price of electricity is set by public policy and not by market forces (as there is no real market).¹⁶³

From 1994 onward, the electricity market in Australia became more complex. From 1994, Victoria began to privatise the supply and sale of power.¹⁶⁴ The privatisation process involved the creation of a privatised electricity infrastructure, based largely on a larger number of government entities which were corporatised before being privatised.¹⁶⁵ The complexity of this

¹⁶⁰ Australian Energy Market Commission, *The Australian National Electricity Market: Choosing a New Future* (Presented at World Energy Forum, Quebec on 13 May 2012).

¹⁶¹ Information Exchange Committee and Retail Market Executive Committee, *IEC and RMEC Annual Report Period Ending 31 December 2012*, 26 June 2013, 14.

¹⁶² Ibid.

¹⁶³ VENcorp, *Vision for Victoria's Energy Transmission Networks 2009* (Report produced for Australian Energy Market Operator) November 2009, Appendix 2.

¹⁶⁴ Damien Cahill and Sharon Beder, above n 159, 15.

¹⁶⁵ Ibid.

process is possibly a driving force behind the greater success of electricity privatisation in Australia than was seen in the United Kingdom.¹⁶⁶ Unfortunately, the complexity also makes it possible for some abstract conceptual difficulties in the privatised electricity market to go unnoticed.

The first and easiest phase of privatising electricity was to privatise the retail sale of electricity.¹⁶⁷ By providing consumers with a choice of electricity suppliers, suppliers would be forced to compete on price or differentiate their products.¹⁶⁸ The conceptual difficulty of this becomes evident when one considers the realities of electrical infrastructure. As was seen in figure 2.3, electricity flows from a power station through a network of wires to a house. It is easy to imagine that a retailer purchases large amounts of power from the power plant, stores it in a battery and then passes it on to the consumer.

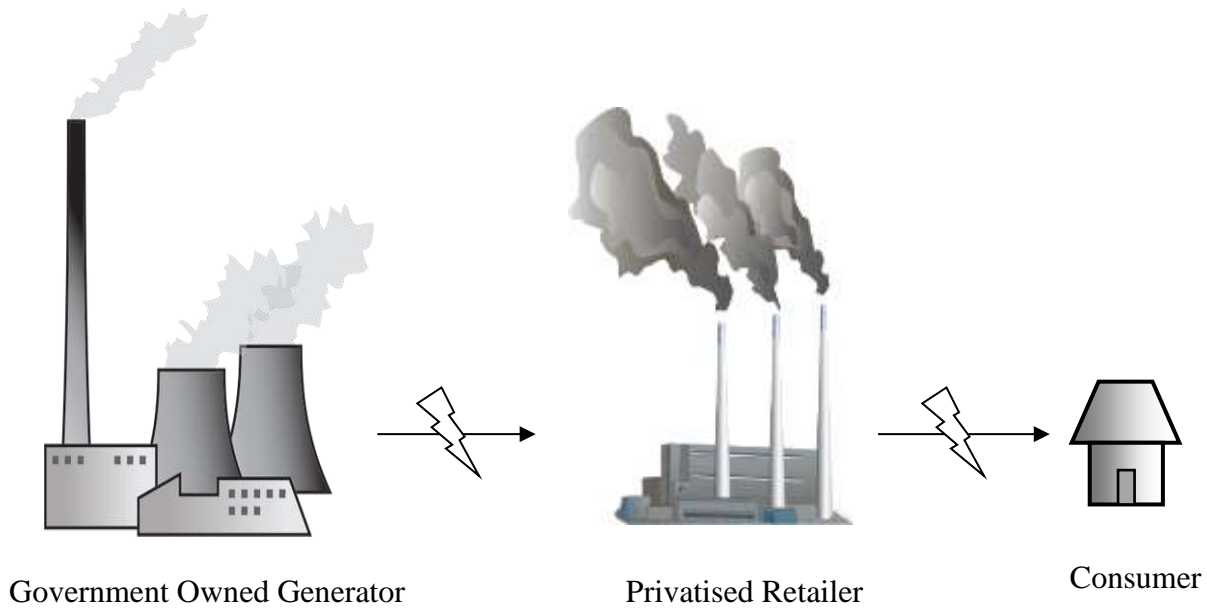
¹⁶⁶ Geoff Kelly 'Renewable Energy Strategies in England, Australia and New Zealand' (2007) 38 *Geoforum* 326.

¹⁶⁷ Australian Energy Market Commission, *The Australian National Electricity Market: Choosing a New Future* (Presented at World Energy Forum, Quebec on 13 May 2012).

¹⁶⁸ Michael Pollitt 'The arguments for and against ownership unbundling of energy transmission networks' 36 *Energy Policy* 704.

Figure 2.4

Common View of Privatised Electricity Retailing



* Generator image by Catherine Collier, used with permission from the Integration and Communication Network.

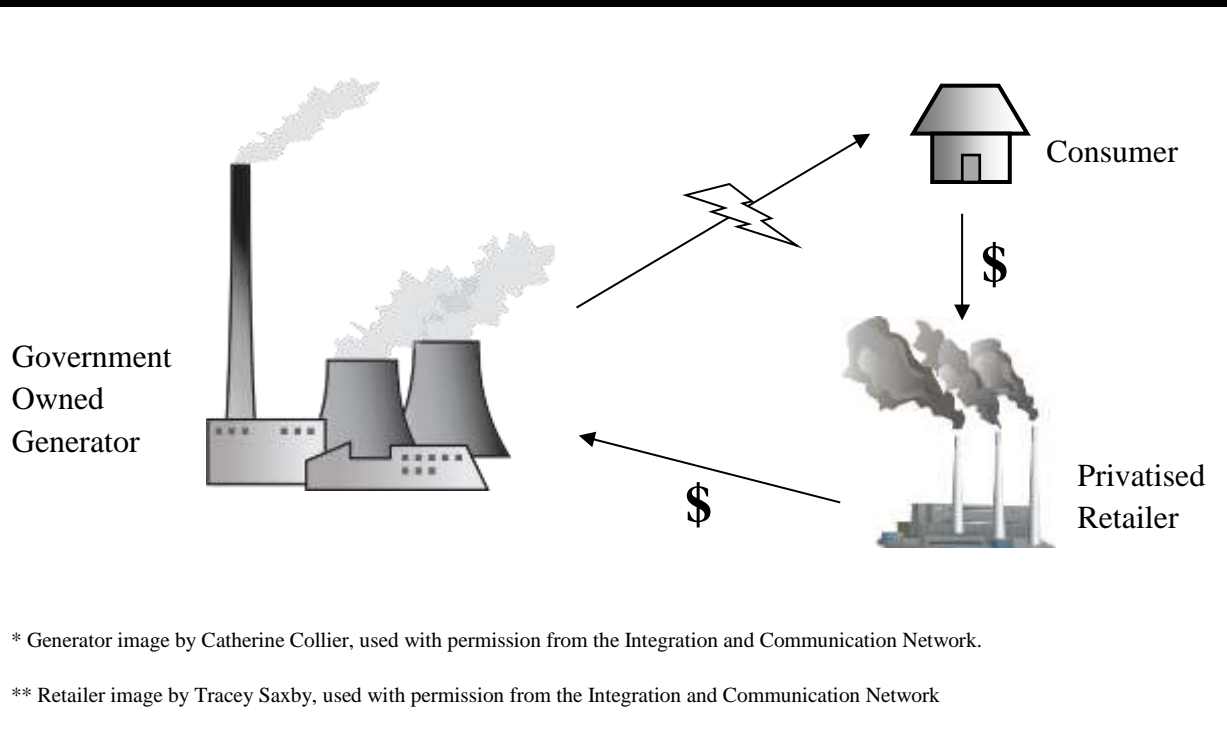
** Retailer image by Tracey Saxby, used with permission from the Integration and Communication Network

Figure 2.4, while easy to envisage, is an impractical and inefficient means of producing electricity. If the retailer is buying electricity from the power plant in the same manner as consumers, then it is unable to provide electricity at a lower price than the power plant itself. This inefficiency is greatly expanded when the cost of producing and maintaining large batteries is considered.

Figure 2.5 provides a more conceptually difficult but accurate depiction of privatised electricity retailing.

Figure 2.5

Accurate View of Privatised Electricity Retailing



The conceptual difficulty in figure 2.5 is that the electricity retailer is never in possession of the electricity. The electricity still flows from the power plant to the consumer's house. Any purchase of power by the electricity retailer is a legal construct with no physical asset base. The purchase and sale of electricity becomes a conceptual market, with retailers purchasing electricity from the power plant, and selling it to consumers without ever taking ownership of the electricity. The retailer can 'own' power, but it cannot possess it. For the retailer, ownership of power is essentially a call option on the power plant to produce a certain quantity of power and deliver it to a particular place at a particular point in time. Multiple retailers can compete by negotiating competitive prices on bulk power and marketing these reduced prices to consumers.

This process is made more conceptually difficult as the electricity retailer may or may not be the electricity supplier. While electrical retailing was the first area to be privatised, it was not the last.¹⁶⁹ The electrical grid and power plants have both been privatised.¹⁷⁰ As power plants and the

¹⁶⁹ Australian Energy Regulator, *State of the Energy Market 2013*, 20 December 2013, Chapter 5.

¹⁷⁰ Ibid.

electrical grid are static assets, they may not be able to be used to supply power directly to their own customers.¹⁷¹ The electricity company (now potentially a retailer, producer and asset owner) may still have to purchase power from a geographically appropriate power plant, even if it has an excess of electrical productive capacity at its own power plant.

In 1998 the ‘National Electricity Market’ was created to simplify the buying and selling of power in Australia.¹⁷² Essential infrastructure links were created to ensure that electricity could be transferred over greater geographic distances, avoiding geography dependent pricing problems.¹⁷³ The buying and selling could then be centralised to create an open and transparent environment for electricity trading.¹⁷⁴ Figure 2.5 depicts the National Electricity Market. As the National Electricity Market is a wholesale electricity market, the term ‘wholesale electricity market’ is used throughout this thesis, except where specific reference is made to the mechanisms specifically present in the National Electricity Market.

¹⁷¹ Australian Energy Regulator, above n 169, Chapter 1.

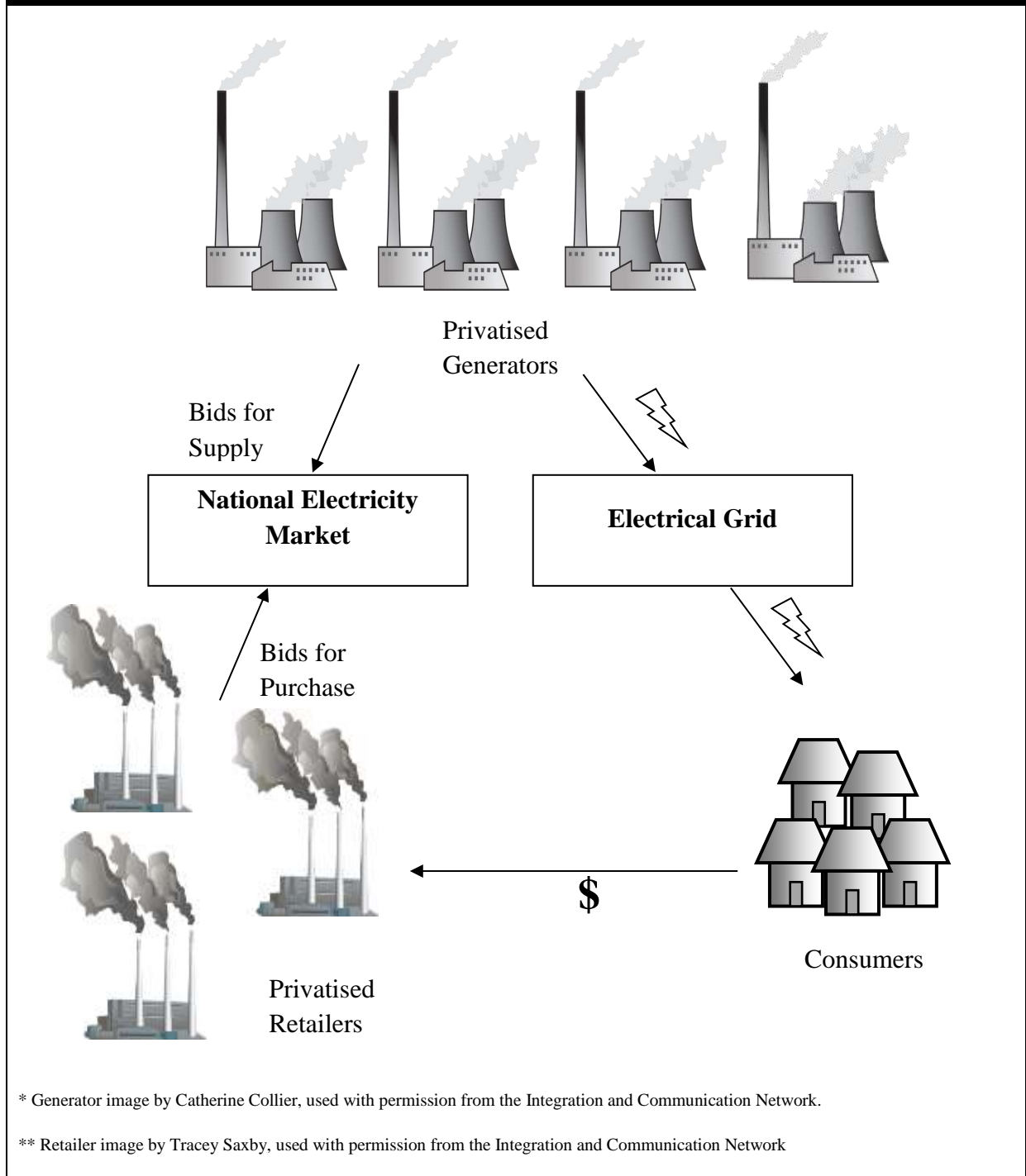
¹⁷² Ibid.

¹⁷³ Ibid Chapter 3.

¹⁷⁴ Subhes Bhattacharyya ‘Economics of Electricity Supply’ (2011) *Energy Economics* 227.

Figure 2.6

National Electricity Market



As can be seen in Figure 2.6, electricity orders are placed with the Australian Energy Market Operator ('AEMO'), which co-ordinates the ordering and transmission of electricity. Suppliers offer to supply electricity at a cost ideally determined by market forces and the derived labour

cost curve.¹⁷⁵ Retailers and large consumers offer to purchase electricity at a cost determined by the market and supply is secured.¹⁷⁶ To ensure that sufficient electricity is produced to meet supply, orders for electricity are placed one month in advance.¹⁷⁷ These supply orders can then be altered one week in before transmission and then again 24 hours before transmission.¹⁷⁸

B *Development of the Secondary Electricity Market*

The secondary electricity market was created in response to the needs of the wholesale electricity market. Electricity retailers often commit to supplying electricity to consumers at a fixed price for a predetermined period.¹⁷⁹ The market based nature of the wholesale electricity market means that the electricity retailer cannot be certain of a stable supply price for electricity over the same predetermined period. As electricity is only received in its consumption, excess electricity cannot be stored without incurring both cost and a loss of quantity.¹⁸⁰ This problem is exacerbated by the fact that the purchaser is often an electrical retailer, who does not at any time receive the electricity which they have purchased. The retailer is subject to short-term pricing fluctuations, as it must constantly place short term orders on the wholesale electricity market.

The secondary electricity market arose to offset these price fluctuations. Options, futures and contracts for difference were made available.¹⁸¹ Initially, these were contractual arrangements between the retailer and generator, subject only to the laws of contract.¹⁸² Later, they would become products available in their own right.¹⁸³ It is the trading of these items that form the secondary electricity market.

¹⁷⁵ Bhattacharyya, above n 174.

¹⁷⁶ Ibid.

¹⁷⁷ Australian Energy Regulator, above n 169.

¹⁷⁸ Ibid.

¹⁷⁹ Chris Strickland and Les Clewlow, *Energy Derivatives: Pricing and Risk Management* (Lacima, 2000).

¹⁸⁰ Australian Energy Regulator, above n 169.

¹⁸¹ Strickland and Clewlow, above n 179.

¹⁸² Australian Energy Regulator, above n 169.

¹⁸³ Ibid.

The secondary electricity market is thus a market comprised of financial products used to offset or reduce risk in the wholesale electricity market. Its only major difference to other financial product markets is the fact its price is ultimately linked to the generation and sale of electricity. From a regulatory perspective, these products are no different from any other financial product and accordingly fall under the jurisdiction of chapter 7 of the Corporations Act.¹⁸⁴ Despite these similarities, the nature of electricity creates a unique complexity and importance which justifies the secondary electricity market as a unique market separate from the general financial products market.

C *Unique Characteristics of Electricity as a Product*

As all electrical particles are the same, it is not necessary that any purchaser in the wholesale electricity market specify which electricity generator it intends to purchase from. It is sufficient that one producer is willing to place power into a grid and that the power can be transmitted to the consumer. In many ways, the wholesale electricity market works in a similar manner to a pure financial market. There is little product differentiation, and the purchaser is frequently purchasing something with no real underlying asset. Despite this, the electricity market differs from a pure financial market in two key ways.

1 *Supply Level Product Differentiation*

Many electricity retailers have attempted to differentiate their product. Some have attempted to do this based on complex pricing and loyalty schemes,¹⁸⁵ while others have opted to differentiate based on environmental sustainability.¹⁸⁶ While the wholesale electricity market operates in a way which prevents any guarantee to the consumer that their electricity was generated by an environmentally responsible power generator (the AEMO may reallocate the production to avoid congestion in the electrical transmission grid), these retailers can deliberately order electricity

¹⁸⁴ *Corporations Act 2001* (Cth), Chapter 7.

¹⁸⁵ See Energex's 'Pool Rewards' and Red Energy's 'Rewards Program'.

¹⁸⁶ See green energy retailer 3Green and Energy Australia's 'Green Energy' option.

from a specific supplier. This will ensure a proportion of that generator's power is in the power grid, even if that generator is not the most price effective option.

This form of differentiation is not possible in a pure financial market. While fund managers may offer similar differentiated products such as 'corporate social responsibility' investment packages,¹⁸⁷ the differentiation exists only at the funds management services level. The purchase of shares, debentures, futures or other financial products is genuinely homogenous. The products are not generated (they are 'second-hand' so to speak), have no underlying asset and are thus not able to be differentiated in any way.

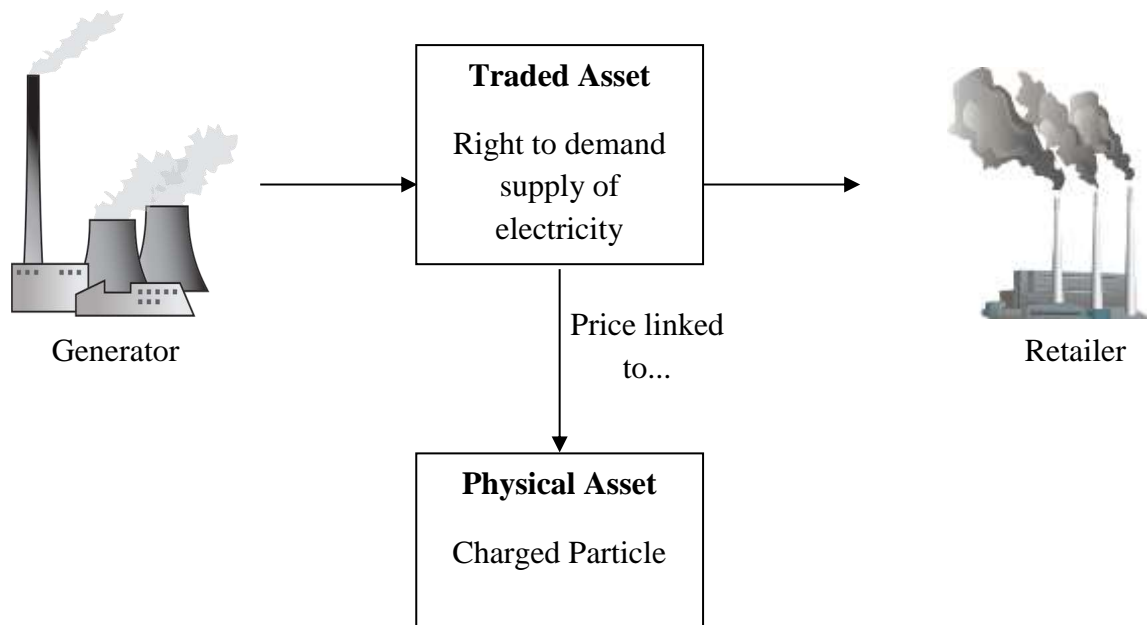
2 *Abstraction from Physical Asset*

The wholesale electricity market differs from a pure financial market as it has an underlying physical asset. This is a distinction which is fundamental to the separation of the wholesale and secondary electricity markets. Ultimately, the Wholesale electricity market is dealing with the transmission of electrically charged particles. While the retailer will never own this asset and is thus simply trading in the arbitrage opportunity of economies of scale, the retailer is ultimately only one abstract concept from a real physical asset. Figure 2.7 depicts the abstraction present in the wholesale electricity market.

¹⁸⁷ See UCA Funds Managements 'Corporate Social Responsibility Fund' and Australian Superannuation's 'Socially Responsible Investment' option.

Figure 2.7

Abstraction in the wholesale electricity market



* Generator image by Catherine Collier, used with permission from the Integration and Communication Network.

** Retailer image by Tracey Saxby, used with permission from the Integration and Communication Network

The abstraction in Figure 2.7 mirrors the Australian Securities Exchange ('ASX'). Company shares represent voting rights, certain rights to dividends and a proportionate right to the company's assets upon winding up, but offer no real physical ownership of the company.¹⁸⁸ As with the purchaser of electricity from the wholesale electricity market, the purchaser of shares is buying something which derives its value from a physical asset (or, in the case of the ASX, a series of physical assets owned by a corporation).

A distinction can be drawn between the wholesale electricity market and ASX style markets and more complex financial markets. This distinction can be found in the Corporations Act itself,

¹⁸⁸ *Salomon v Salomon & Co Ltd* [1897] AC 22.

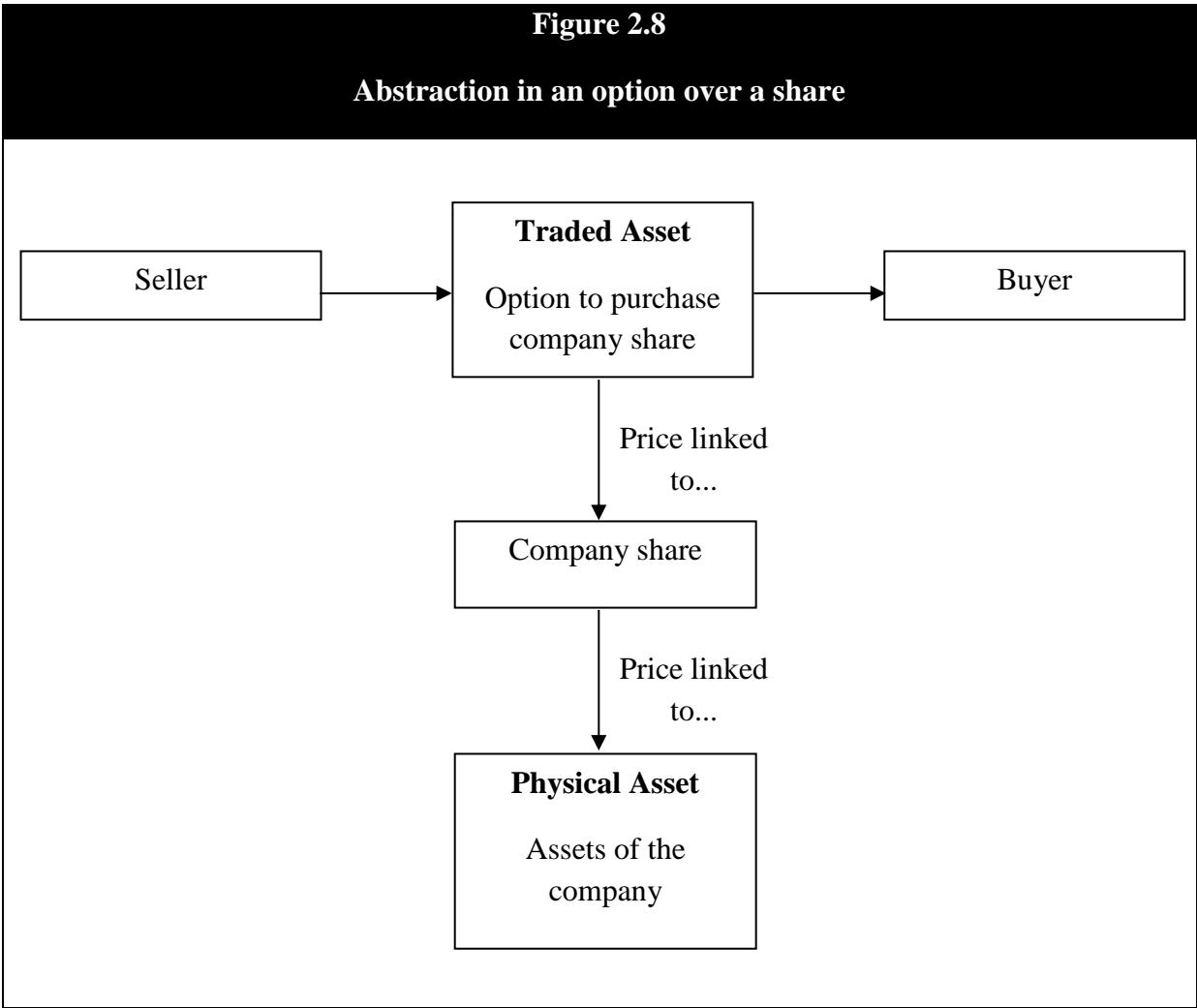
where separate chapters¹⁸⁹ and different rules¹⁹⁰ are devoted to company shares and more complex financial products. This is in keeping with the fact that company shares and more complex financial products are generally traded on separate markets.¹⁹¹

One clear explanation for this differentiation lies in the level of abstraction that exists in the product being purchased. While the Wholesale electricity market and ASX facilitate the trade of products that are one level of abstraction from a physical asset, many financial markets exist in the realm of far greater abstraction. Figure 2.8 illustrates this using an option over a share.

¹⁸⁹ *Corporations Act 2001* (Cth) Chapter 6 primarily deals with the buying and selling of shares while chapter 7 deals with other types of financial markets.

¹⁹⁰ The ASX provides separate rules for the listing of company shares (the *ASX Listing Rules*) and the trading of more complex financial products (see the *ASX Clear (Futures) Operating Rules*).

¹⁹¹ The ASX provides a separate market for shares (the Australian Stock Exchange) and futures (The Australian Futures Exchange).



As seen in Figure 2.8, the option has a price based on the perceived value of the share at a set time in the future. The option's price is thus dependent on the share's price which is in turn dependent on the price of a physical asset. The option's price may be determined by applying the Black-Scholes Option Pricing Model,¹⁹² but the impossibility of determining a risk free rate means that any such pricing will remain inaccurate.¹⁹³ More importantly, the impossibility of predicting human irrationality cannot be predicted, a factor which led to Black and Scholes' financial undoing.¹⁹⁴ This irrationality factor will be explored in relation to the secondary electricity market in Chapter 5.

¹⁹² $aV/at + 1/2\sigma^2 S^2(a^2V/aS^2) + rS(aV/aS) - rV = 0$

¹⁹³ Michael Jensen, Fischer Black and Myron Scholes 'The Capital Asset Pricing Model: Some Empirical Tests' in Michael Jensen *Studies in the Theory of Capital Markets* (Praeger Publishing Co, 1972).

¹⁹⁴ Niall Ferguson, *The Ascent of Money: A Financial History of the World* (Penguin Group, 2008).

The second layer of abstraction makes pricing an asset increasingly difficult. It also makes the asset less 'real' in the sense that it is increasingly removed from a physical item. While it is no less a chose in action from a property perspective,¹⁹⁵ the ability to theoretically link the chose to a real world asset becomes difficult. This can be illustrated by using a real financial product recently offered for public sale.

The complexity and abstraction of financial products can be seen in the product disclosure statement of JB Global Pty Limited's 'JB Global Berkshire Hathaway Income and Equity Accelerator 4' units.¹⁹⁶ As with many complex financial products, this was advertised with a fairly straightforward explanation that it was a 'fund to invest in Berkshire Hathaway B shares on Wall Street'.¹⁹⁷ This was an explanation repeated by financial reporters.¹⁹⁸ Closer examination of the PDS reveals that what is actually being purchased is a right to take a loan in order to purchase a bundle of ASX listed shares, the size of which will be calculated by reference to class B Berkshire Hathaway shares multiplied by a currency hedging instrument and a volatility hedging instrument. Figure 2.9 depicts the product's abstraction from a physical good.

¹⁹⁵ Kevin Gray 'Property in Thin Air' (1991) 50 *Cambridge Law Journal* 252.

¹⁹⁶ This example has been selected because ASIC recently took action against JB Global Pty Limited over a more complex financial product offering. Details of the historical operation of the units could thus be confirmed through an independent source.

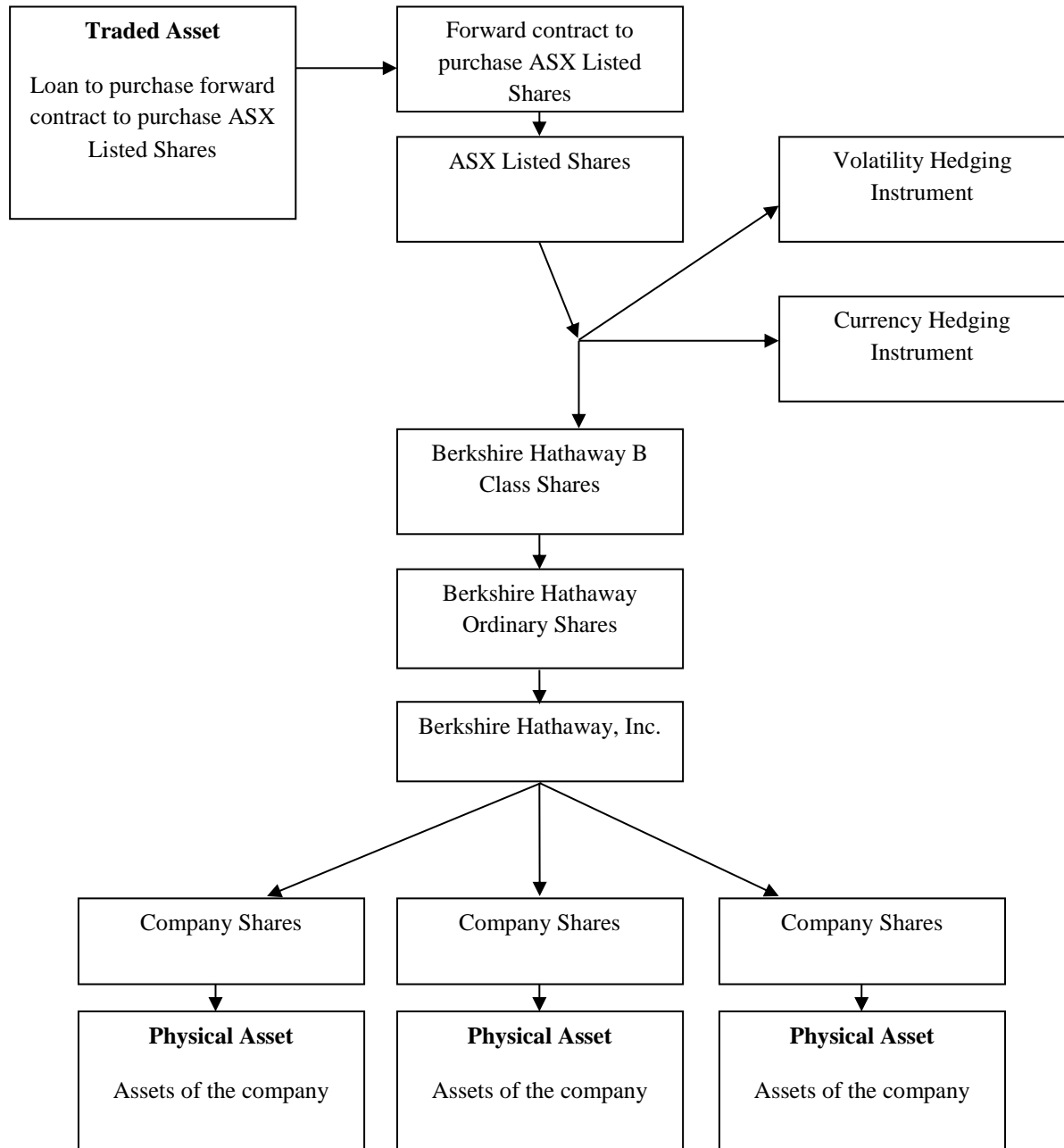
¹⁹⁷ JB Global, *JB Global Berkshire Hathaway Income and Equity Accelerator Units Series 4 Product Disclosure Statement*, June 2009, 7.

¹⁹⁸ *The Australian*, Product Watch 26 February 2011 (accessed on 31 January 2013)

<<http://www.theaustralian.com.au/business/wealth/the-jb-global-berkshire-hathaway-income-and-equity-accelerator/story-e6frgac6-1226012198277>>.

Figure 2.9

**Abstraction in a complex financial product – the ‘JB Global Berkshire Hathaway
Income and Equity Accelerator 4 Units’**



As seen in Figure 2.9, calculating the rational price of these units is near impossible. The multitude of factors that must be considered is prohibitive. For example, if political turmoil were to break out in Madagascar, the vanilla supply to The Coca Cola Company would be disrupted. This would in turn affect the price of shares in The Coca Cola Company which would in turn

affect the value of A class Berkshire Hathaway shares. As B class Berkshire Hathaway shares derive their value from A class Berkshire Hathaway shares, the B class Berkshire Hathaway shares would be effected. This would in turn affect both the value of the shares and possibly the volatility of price which forms components of determining the value of the bundle of ASX listed shares that the loan may purchase. Theoretically then, the rational purchaser of JB Global Berkshire Hathaway Income and Equity Accelerator Units should keep a keen eye on the political situation in Madagascar, along with an impossibly large number of other complex political, environmental and human systems. It is perhaps for this reason that the investment manager of Berkshire Hathaway, Warren Buffet, has described these types of products as ‘financial time bombs’.¹⁹⁹

Regardless of the necessity or wisdom of these types of products, their abstraction results in a different set of regulatory concerns. The wholesale electricity market and ASX are relatively easy to understand. Pricing is based on supply and demand of a physical good. The price of that good is dependent on supply, which is dependent on a number of identifiable inputs of production. The highly abstract financial product on the other hand has such a variety of supply variables and is so far removed from a real product that pricing is likely to be purely based on supply and demand (which is unlikely to be fully linked to the factors which affect the value of the underlying physical asset). The fact that the underlying return or asset exists is likely to be of little or no relevance to the price paid. The market exists, for the most part, in the realm of pure supply and demand.

The possibility of a purely abstract product is not new. There have been several historical attempts to take the notion further and to buy and sell things which do not exist.²⁰⁰ Perhaps the most famous of these is Enron’s ill-fated attempt to buy and sell ‘international bandwidth’.²⁰¹

Working off the very basic principle that all that is needed for a market to exist is buyers, sellers

¹⁹⁹ Warren Buffet, *Chairman’s Letter to the shareholders of Berkshire Hathaway, Inc.* 2008, 17.

²⁰⁰ See the recent ‘Bitcoin’ phenomenon and the largely failed ‘second life’ phenomenon.

²⁰¹ Loren Fox, *Enron: The Rise and Fall* (John Wiley & Sons, 2004), chapter 11.

and a place to trade, Enron was able to offer unused bandwidth for sale. The concept was simple; half of the world is sleeping at any one time.²⁰² During this period, their internet bandwidth (that is, the electrical cable that carries internet signal) is unused.²⁰³ This could be sold to those who were awake. This concept was purely theoretical, as bandwidth is geographically static. While Enron was working toward completing a physical network, the trading platform was to precede the physical possibility.²⁰⁴ The purchased bandwidth was of no value whatsoever, except that it could be sold.

While there is thus a clear distinction between the wholesale electricity market and ASX traded products on the one hand and complex financial products on the other hand, there is a less obvious distinction between the wholesale electricity market and ASX traded products. Nonetheless, there remains a lesser level of abstraction in the wholesale electricity market. While electrical particles may appear less tangible, the wholesale electricity market is closer to a tangible good than a company share. A company share may, at any point in time, offer no part of any physical asset. If its value reaches zero, there is a high likelihood of the owner receiving no compensation. The wholesale electricity market purchaser is always assured of a physical product, albeit one that must be spontaneously delivered and consumed. While only a small difference, the relationship to a tangible good offers some justification for viewing the wholesale electricity market as separate from company securities and other financial product markets.

3 *Consequences of Market Failure*

Perhaps the most significant difference between electricity and other abstract product markets is the result of a market failure. If the wholesale electricity market experiences an immediate increase in retail demand that cannot be met by supply, the result is not an adjustment to price, but rather wide scale black-outs. A significant power shortage could easily halt the productive

²⁰² Fox, above n 201.

²⁰³ Ibid.

²⁰⁴ Mary Swatz and Sherron Watkins, *Power Failure: The Inside Story of the Collapse of Enron* (Broadway Business, 2004).

capacity of entire cities, leading to great economic loss. Perhaps more importantly, the loss of heating, cooling and alarms may lead to great social discomfort or strife.

These consequences were seen in Los Angeles in 2000 and 2001, where the privatised electricity trading grid experienced a supply shortage.²⁰⁵ Wholesale electricity market manipulation resulted in a significant undersupply of electricity.²⁰⁶ This undersupply of electricity was caused not by a lack of productive capacity, but by a lack of supply.²⁰⁷ Economic production was significantly halted, with businesses having to either operate without electricity or simply shut down.²⁰⁸ During this same period crime escalated and police resources were put under stress.²⁰⁹ This was a relatively long term problem as electricity generation cannot be done instantaneously; there is a significant lag between identifying a power shortage and producing the power needed to meet demand.²¹⁰

If the loss of power cannot be said to be a greater problem than the loss of capital investment, it can at least be said to be a different problem. The immediate social impact of power shortages suggest that the wholesale electricity market should be considered as existing separate from other abstract product markets. This appears to have followed in Australia, where the wholesale electricity market is both separate from other markets and regulated by a unique regulator.

D *How the Unique Features of Electricity Justify a Separate Secondary Electricity Market*

The Australian Energy Regulator (‘AER’) has drawn a distinction between the secondary electricity market and other financial markets,²¹¹ but offers no real justification for doing so. A consideration of the application of the unique characteristics of electricity as a product to the secondary electricity market reveals a sensible reason for distinguishing the secondary electricity

²⁰⁵ Swatz and Watkins, above n 204.

²⁰⁶ Fox, above n 201.

²⁰⁷ Ibid.

²⁰⁸ Swatz and Sherron Watkins, above n 204.

²⁰⁹ Fox, above n 201.

²¹⁰ Bhattacharyya, above n 174.

²¹¹ Australian Energy Regulator, above n 169.

market from other financial markets. Further, the nature of the participants in the secondary electricity market creates a set of circumstances unique to the secondary electricity market. Taken together, these factors justify the consideration of the secondary electricity market as a separate market to other financial product markets.

1 *Electricity as a Product and the Secondary Electricity Market*

The fact that electricity may be differentiated and the fact that electricity is less abstract than traditional financial market products separates electricity from products traded on the ASX. These unique characteristics offer less differentiation when considered in the secondary electricity market. As the secondary electricity market is primarily a series of hedging instruments, both the complexity and abstraction of secondary electricity market products are brought closer in line with general financial products. Despite this, a small differentiation remains in the differentiated nature of the underlying asset.

A more clear differentiation is seen in the consequences of secondary electricity market failure. The cost of rogue financial products is well known. The recent Global Financial Crisis has often been attributed to the failure of complex derivative debt products tied to unsupportable loans.²¹² Bad derivatives, like many other bad financial products, can cause companies and even economies to collapse.²¹³

The cost of rogue secondary electricity market products is not as well known, but can be easily foreseen. The consequence of a failure in the wholesale electricity market was seen in the collapse of the Los Angeles power supply in 2000 and 2001.²¹⁴ This consequence will be the same in the secondary electricity market if a collapse in the secondary electricity market prompts a decrease in demand in the Wholesale electricity market. A case study depicting how this

²¹² James Crotty 'Structural Causes of the global financial crisis: a critical assessment of the 'new financial architecture' (2009) 33 Cambridge Journal of Economics 563; and John Foster and Fred Magdoff, *The Great Financial Crisis: Causes and Consequences* (Monthly Review Press, 2009).

²¹³ Ibid.

²¹⁴ Swatz and Sherron Watkins, above n 204.

collapse may operate is set out in case study 2.2. This case study is set some time in the near future but assumes that the secondary electricity market has followed the course of other financial products, insofar as speculative traders have entered the market.

Case Study 2.2

A Failure of the Secondary Electricity Market

Speculative traders have purchased large volumes of electricity contracts for difference under the assumption that the price of electricity will rise considerably in the next 5 years. New government legislation is passed not long after allowing for the cheaper exploitation of coal. Those who are involved in the wholesale electricity market will be relatively unconcerned; the purpose of purchasing the contract for difference was to smooth out price fluctuations. The contract for difference may no longer be useful, but it continues to serve its purpose of ensuring a maximum price for electricity in the future. For the speculative trader, the contract for difference is now likely to be worthless.

Speculative traders begin selling their contracts for difference for whatever price they can get. A large glut of electricity contracts for difference hits the market, resulting in rapidly dropping prices. The price of other secondary electricity market derivatives begins to suffer a similar fate as speculators attempt to cut their losses. Rational investors realise that they can sell their electricity derivatives now and buy them back cheaper in a couple of days' time. The secondary electricity market begins to collapse, just as a normal financial product market may.

The key difference between an ordinary financial market and the consequences of case study 2.2 is the impact on the wholesale electricity market. A fully informed and rational wholesale electricity market participant would not alter their wholesale electricity market purchases. Rather, they would realise that the price fluctuations in the secondary electricity market do not

reflect the value of the underlying asset, but rather reflect a speculative supply and demand system which has either not understood or not had regard to the value of the underlying asset. Such a cause of action requires information that is likely to be unavailable to the rational wholesale electricity market participant. The only information available to the rational wholesale electricity market participant is that the secondary electricity market is collapsing. There are three possible causes of action:

- a) Assume irrationality on behalf of the secondary electricity market. This will cause the trader to keep steady on both the primary and secondary electricity markets, greatly limiting any damage caused.
- b) Assume rationality on behalf of the secondary electricity market. Traders who have been educated in classical economic theory rather than behavioural economic theory are likely to adopt this approach.²¹⁵ If demand for the contract for difference is falling, then it must be because of a decrease in demand for the underlying asset. The rational trader should decrease their orders in the wholesale electricity market.
- c) Assume nothing about the secondary electricity market, but wait for further information to emerge. In waiting for further information, a safe investor would minimise orders in the wholesale electricity market.

Both b) and c) have significant consequences for the wholesale electricity market and consequently society. The change in legislation should, if anything, increase demand for electricity (as it is now likely to be cheaper). Electricity retailers have decreased their order for electricity, resulting in all of the problems that flow from a lack of supply in the wholesale electricity market.

These potential consequences call for a careful consideration of the secondary electricity market in its own right. The existence of subtle but real differences in the underlying product also

²¹⁵ Herbert Simon 'A Behavioural Model of Rational Choice' (1955) 69 *The Quarterly Journal of Economics* 99.

suggests that there is value in identifying a separate secondary electricity market. This justification is amplified when the participants in the secondary electricity market are taken into account.

2 *Secondary Electricity Market Participants*

The secondary electricity market is unlike a standard futures market or options market in that it has a relatively closed group of buyers and sellers.²¹⁶ A vast majority of people purchasing products on the secondary electricity market are involved in the production or sale of power.²¹⁷ The only significant purchaser who is not involved in the electricity supply chain is Westpac Banking Corporation, an active participant in the wholesale electricity market.²¹⁸

There appears to be no evidence of consumer-facing secondary electricity market products. While retailers offer to ‘lock in prices’ and buy options and futures to meet their customer contracts,²¹⁹ the electrical consumer is at best an indirect secondary electricity market participant. This is unlike many commodity financial products or share-based derivatives, which have a large number of purchasers with no interest in the underlying asset. There is no electricity market equivalent to Commodity Warrants Australia (a consumer-facing contract for difference marketer), Optionetics (a consumer-facing options marketer) or ForexCT (a consumer-facing foreign exchange trading marketer). According to interview data, there is also little speculative trading on the secondary electricity market.²²⁰ While there is some contention as to whether Westpac Banking Corporation is a market speculator (it does not consume the electricity it trades),²²¹ it was generally accepted that its participation in the secondary electricity market is used to offset risk in the wholesale electricity market, not for speculative gain.²²²

²¹⁶ Interviews 2-9 and 13.

²¹⁷ Interviews 2-5, 7-12 and 14.

²¹⁸ Interviews 2, 6 and 12.

²¹⁹ See Energy Australia’s ‘rate fix electricity plan’.

²²⁰ Interviews 1-12, 14.

²²¹ Interviews 6 and 11.

²²² Interviews 1-12, 14.

Ultimately then, the secondary electricity market can be expected to retain a stronger link to its underlying assets than many other financial markets. Trading is primarily being undertaken by sophisticated investors who have an interest in the wholesale electricity market. This link should theoretically reduce regulatory risk, but may result in a market that requires a different regulatory approach to a market which is rich in speculative traders. This is a theme that will be developed in chapter 6.

E *Legislation governing the Secondary Electricity Market*

The primary and secondary electricity markets are subject to separate regulatory bodies and legislation. The wholesale electricity market is regulated by the AER.²²³ The AER works in conjunction with the AEMO²²⁴ and in certain areas the ACCC.²²⁵ A specific regulatory regime was created to oversee the establishment and ongoing operation of the wholesale electricity market.²²⁶

The secondary electricity market falls outside the jurisdiction of the AER.²²⁷ Many of the secondary electricity market trades are governed by contract law and exist outside the control of a regulatory body. Other secondary electricity market products are offered for sale on market. These products are subject to regulation by ASIC. As this thesis focuses on ASIC's regulation of the secondary electricity market, it is only this regulatory regime that will be examined in detail.

1 *Financial Product Regulation*

²²³ Australian Energy Regulator, above n 169.

²²⁴ Ibid.

²²⁵ Ibid.

²²⁶ Ibid.

²²⁷ Ibid.

While this thesis maintains a distinction between the secondary electricity market and general financial products markets, legislation does not.²²⁸ The command and control regulatory mechanism, Chapter 7 of the Corporations Act, covers the regulation of ‘financial products’.²²⁹ Financial products are defined as:

‘a facility through which, or through the acquisition of which, a person does one or more of the following:

- a) makes a financial investment;*
- b) manages a financial risk;*
- c) makes non-cash payments.’²³⁰*

This is a broad definition, likely to catch any product within the secondary electricity market. The inclusion of secondary electricity market products can be further identified in section 746A(c) of the Corporations Act, which specifies that ‘a derivative’ is specifically included in the definition of ‘financial product’.²³¹ A ‘derivative’ is defined as:

‘an arrangement in relation to which the following conditions are satisfied:

- a) under the arrangement, a party to the arrangement must, or may be required to, provide at some future time consideration of a particular kind or kinds to someone;*
- b) that future time is not less than the number of days, prescribed by regulations made for the purposes of this paragraph, after the day on which the arrangement is entered into; and*
- c) the amount of the consideration, or the value of the arrangement, is ultimately determined, derived from or varies by reference to (wholly or in part) the value or*

²²⁸ Corporations Act 2001 (Cth) s760A.

²²⁹ Ibid.

²³⁰ Ibid s763A.

²³¹ Ibid s746A(c).

amount of something else (of any nature whatsoever and whether or not deliverable), including, for example, one or more of the following:

- i) an asset;*
- ii) a rate (including an interest rate or exchange rate);*
- iii) an index;*
- iv) a commodity.*²³²

As the secondary electricity market has been defined as the sale and purchase of products which derive their value from the wholesale electricity market (the wholesale of electricity, a commodity) then the secondary electricity market fits within the scope of Chapter 7 of the Corporations Act.

Chapter 7 of the Corporations Act sets out a legislative framework for the regulation of financial products. As has been noted, this is not the entirety of ASIC's regulatory approach to financial products, but it does provide a legislative framework in which ASIC must operate. Chapter 7 of the Corporations Act sets out the following: which financial markets must be licensed;²³³ financial markets must establish operating rules and procedures;²³⁴ how licenses are to be granted;²³⁵ what conditions are to be placed on the licenses;²³⁶ how licences are to be varied, suspended or cancelled;²³⁷ disclosure requirements for financial services licensees (and for those who are not required to be licensed);²³⁸ product disclosure requirements;²³⁹ and the consequences of market misconduct.²⁴⁰

²³² *Corporations Act 2001* (Cth), s761D.

²³³ *Ibid* s791A.

²³⁴ *Ibid* s793A.

²³⁵ *Ibid* s795A.

²³⁶ *Ibid* s796A.

²³⁷ *Ibid* s797A.

²³⁸ *Corporations Act 2001* (Cth), ss940A – 953C.

²³⁹ *Ibid* ss1010A – 1022C.

²⁴⁰ *Ibid* ss1040A – 1045A.

While there are various nuances and technicalities in this legislation, the main points that apply to the secondary electricity market can be summed up fairly easily:

- If a person is to commence operations marketing and selling secondary electricity market products, then they must obtain a license from ASIC and must comply with the terms and conditions of that license.²⁴¹
- In some circumstances, a financial product may be sold to certain types of consumers by someone without a license.²⁴²
- ASIC will still monitor these sales.²⁴³
- When offering a secondary electricity market product for sale, disclosure about the product and the risks associated with it must be provided.²⁴⁴
- The level of disclosure varies depending on the people to whom the product is offered, but always includes a full and fair explanation of the product and the risks associated with it.²⁴⁵

While the legislation is primarily a piece of command and control regulation, it does provide for a decentred regulatory approach. The ability of ASIC to work with industry to formulate rules²⁴⁶ allows for a co-regulatory approach.²⁴⁷ Likewise, the licensing system²⁴⁸ fits within the responsive regulatory pyramid.²⁴⁹ This may suggest legislation supports a decentred regulatory strategy, an issue which is explored throughout this thesis.

Finally, it is worth noting that there is no restriction on the creation of products. Provided that proper licensing requirements have been met and that proper disclosure has been made, any

²⁴¹ Ibid parts 7.2 – 7.7.

²⁴² Ibid part 7.7.

²⁴³ Ibid.

²⁴⁴ Ibid part 7.9.

²⁴⁵ Ibid.

²⁴⁶ Ibid s793A.

²⁴⁷ Luara Albareda 'Corporate responsibility, governance and accountability: from self-regulation to co-regulation' (2008) 8 *Corporate Governance* 430.

²⁴⁸ *Corporations Act 2001* (Cth) ss791A, 795A.

²⁴⁹ Ayres and Braithwaite, above n 28.

financial product can be legally marketed and sold, regardless of its preposterousness. The disclosure requirements presumably discourage investment in preposterous products. Those who purchase them anyway may take themselves as fairly warned. The liberal and permissive nature of this legislation will be revisited throughout the thesis.

2 *OTC Derivatives Legislation*

On 1 January 2013 new over-the-counter ('*OTC*') derivatives legislation was passed.²⁵⁰ Part 7.5A of the Corporations Act provides that the Minister may declare certain classes of derivatives subject to ASIC rule-making power.²⁵¹ ASIC is currently working in conjunction with the Australian Prudential Regulatory Authority and the Reserve Bank of Australia to produce guidelines and reports which will guide the minister's decision. ASIC has released 5 major reports: the first 'report on the Australian OTC derivatives market',²⁵² the second 'report on the Australian OTC derivatives market',²⁵³ 'response to submissions on CP 156 Retail OTC derivative issuers: financial requirements',²⁵⁴ 'review of client money handling practices in the retail OTC derivatives sector',²⁵⁵ and 'response to submission on CP 205 derivative transaction reporting'.²⁵⁶ ASIC has made clear progress on the development of a central clearing system.²⁵⁷ As yet, neither ASIC nor the minister has declared any rules in force under part 7.5C of the Corporations Act.

²⁵⁰ *Corporations Act 2001* (Cth) part 7.5A.

²⁵¹ *Ibid.*

²⁵² Australian Securities & Investments Commission, Australian Prudential Regulatory Authority and Reserve Bank of Australia, *Report on the Australian OTC derivatives market*, October 2012.

²⁵³ Australian Securities & Investments Commission, Australian Prudential Regulatory Authority and Reserve Bank of Australia, *Report on the Australian OTC derivatives market*, July 2013.

²⁵⁴ Australian Securities & Investments Commission, *Response to submission on CP 156 retail OTC derivative issuers: financial requirements*, July 2012.

²⁵⁵ Australian Securities & Investments Commission, *Review of client money handling practices in the retail OTC derivatives sector*, December 2012.

²⁵⁶ Australian Securities & Investments Commission, *Response to submissions on CP 205 derivative transaction reporting*, July 2013.

²⁵⁷ Australian Securities & Investments Commission, Australian Prudential Regulatory Authority and Reserve Bank of Australia, *Council of Financial Regulators* (Media Release, 8 May 2013).

This legislation has the potential to fundamentally alter the secondary electricity market. ASIC's reports suggest that ASIC is adopting a fairly standard definition of OTC derivatives.²⁵⁸ That is, OTC derivatives are those derivatives that are not traded on a formal stock exchange.²⁵⁹ Given that most secondary electricity market derivatives are not publicly traded, the rules that eventuate from part 7.5C of the Corporations Act are likely to have a significant effect.

The empirical data for this thesis was collected prior to the passage of part 7.5C of the Corporations act. Participants were contacted again in December 2013 and asked to provide a brief response to questions about part 7.5C. One participant declined to provide comment. Of the remainder who responded, none were involved in discussions with ASIC regarding part 7.5C and none knew anything about the legislation other than the material that has been made publicly available.

IV REGULATORY THEORIES USED TO EXAMINE ASIC

In addition to responsive regulation and command and control regulation, a number of other regulatory theories are used in this thesis to examine the effectiveness of ASIC in regulating the secondary electricity market. Most of these theories have their origins in responsive regulation, but offer further advances and developments. While not a complete list of the developments that have been made on responsive regulation theory, this section of the thesis sets out the key ideas which will be used to examine and critique ASIC throughout the thesis.

A *Really Responsive Regulation*

²⁵⁸ Australian Securities & Investments Commission, Australian Prudential Regulatory Authority and Reserve Bank of Australia above n 252; Australian Securities & Investments Commission, Australian Prudential Regulatory Authority and Reserve Bank of Australia above n 253; Australian Securities & Investments Commission, above n 255; Australian Securities & Investments Commission, above n 256.

²⁵⁹ Lynn Stout 'Why the law hates speculators: Regulation and private ordering in the market for OTC derivatives' (1998) 48 *Duke Law Journal* 701.

Really responsive regulation was a theory introduced by Baldwin and Black in direct response to responsive regulation.²⁶⁰ Really responsive regulatory theory aims to develop a means by which regulators can focus limited resources.²⁶¹ Responsive regulation is concerned with the interaction between the regulator and the subject of regulation. It does not address the issue of how a regulator is to detect regulatory subjects whose activities or existence is beyond the knowledge of the regulator. In a way, really responsive regulatory theory widens the scope of responsive regulation to answer not only the question of how a regulator is to deal with its regulatory subjects, but how it is to find them and relate to them given the realities of time and budget constraints.²⁶²

Really responsive regulation calls upon regulators to be responsive not only to regulatory subjects but to ‘the operating and cognitive framework of firms, the institutional environment and performance of the regulatory regime, the different logics of regulatory tools and strategies and to changes in each of these elements’.²⁶³ Essentially, regulators should be ‘detecting undesirable or non-compliant behaviour, developing tools and strategies for responding to that behaviour, enforcing those tools and strategies, assessing their success or failure and modifying them accordingly’.²⁶⁴ This provides a framework for regulation within the boundaries of the regulator’s knowledge and budget. It recognises that the best regulatory tool to use may not theoretically be the most effective, but rather the most effective when taking into consideration the knowledge and resources currently available to the regulator.²⁶⁵

While ASIC has not explicitly adopted really responsive regulation, it may assist in explaining many of ASIC’s regulatory approaches. As is seen throughout the thesis, ASIC is operating in an environment of tight resources and wide regulatory duties. The use of seemingly sub-optimal

²⁶⁰ Baldwin and Black, above n 35.

²⁶¹ Ibid.

²⁶² Dimity Kingsford Smith ‘A harder nut to crack? Responsive regulation in the financial services sector’ (2011) 44 *University of British Columbia Law Review* 695, 708.

²⁶³ Baldwin and Black, above n 35, 64.

²⁶⁴ Ibid 65.

²⁶⁵ Kingsford Smith, above n 262.

regulatory strategies may be well explained by the adoption of really responsive regulation, which may be slowly improving ASIC through a review and feedback mechanism, without the risk and cost associated with developing new and costly regulatory tools for surveillance and enforcement.

B *Risk-based Regulation*

Risk-based regulation²⁶⁶ and the closely related ‘really responsive risk-based regulation’,²⁶⁷ like really responsive regulation, draw from and expand upon responsive regulatory theory. At their most basic, risk-based regulation argues that regulatory resources should be allocated based on the risk of potential wrongdoing and its impact on society.²⁶⁸ Critics have noted that this is easier in theory than in practice,²⁶⁹ but this is not a reason to abandon the theory. Really responsive risk-based regulation adopts the resource allocation and feedback system designed in really responsive regulation and applies it in a risk-based regulatory framework.²⁷⁰ In this way a framework is developed by which risks can be discovered and assessed with the highest possible resource allocation efficiency.

Shapiro and Glicksman note a dissenting opinion which identifies risk-based regulation as an inefficient means of resource allocation.²⁷¹ Traditional economic logic suggests that cost-benefit analysis, rather than risk-based regulation, is the most efficient means of regulating business conduct.²⁷² This criticism, while logical from a classical economic viewpoint, discounts the non-monetary goals of regulation. As Shapiro and Glicksman note, there is value in adopting a

²⁶⁶ Julia Black ‘The emergence of risk-based regulation and the new public risk management in the UK’ (2005) *Public Law* 512.

²⁶⁷ Julia Black and Robert Baldwin ‘Really Responsive Risk-Based Regulation’ (2010) 32 *Law and Policy* 181.

²⁶⁸ Henry Rothstein, Phil Irving, Terry Walden and Roger Yearsley ‘The risk of risk-based regulation: insights from the environmental policy domain’ (2006) 32 *Environmental International* 1056.

²⁶⁹ *Ibid*; Sidney Shapiro and Robert Glicksman, *Risk regulation at risk: restoring a pragmatic approach* (Stanford Law and Politics, 2003).

²⁷⁰ Black and Baldwin, above n 35.

²⁷¹ Shapiro and Glicksman, above n 269.

²⁷² *Ibid* 47.

regulatory system which adopts societal values.²⁷³ As this thesis has adopted a decentred view of regulation, it is consistent to favour a regulatory system which is able to account for sociological influences.

The key criticism of risk-based regulation is not focused on its resource allocation wisdom, but rather on the practicalities of its implementation. Black and Baldwin note in a much later article that problems may emerge where regulators cease to focus on high-volume, low-risk issues.²⁷⁴ This is not so much an issue with the regulatory theory as it is an issue with the ability of regulators to implement it. Baldwin and Black answer this concern by developing a comprehensive system for identifying and intervening in high-volume low-risk activities.²⁷⁵

Rothstein et al note a similar issue with the practicality of risk-based regulation.²⁷⁶ The regulator must assess both risk to society and risk to the regulator itself.²⁷⁷ The balance between these two objectives poses a considerable problem for regulatory agencies attempting to implement a risk based regulatory strategy. Despite these difficulties, Rothstein et al note that risk-based regulation remains a beneficial regulatory strategy, provided it is properly managed.²⁷⁸ The framework developed by Baldwin and Black may provide the management system called for by Rothstein et al.

ASIC has made an explicit commitment to risk-based regulation.²⁷⁹ Moreover, their risk-based regulatory approach appears to adopt the framework of really responsive risk based regulation. ASIC states that its compliance approach involves ‘identifying problems, needs and risks’,²⁸⁰

²⁷³ Ibid 49.

²⁷⁴ Julia Black and Robert Baldwin ‘When risk-based regulation aims low: Approaches and Challenges’ (2012) 6 *Regulation and Governance* 2.

²⁷⁵ Ibid.

²⁷⁶ Rothstein et al, above n 268.

²⁷⁷ Ibid.

²⁷⁸ Ibid.

²⁷⁹ Australian Securities & Investments Commission, *ASIC’s Submission to the Senate Select Committee on Superannuation and Financial Services*, January 2000, 14.

²⁸⁰ Ibid 15.

‘surveying consumer issues’,²⁸¹ ‘taking a consumer education stock-take’,²⁸² ‘studying financial products and remuneration’²⁸³ and ‘understanding the needs of vulnerable consumers’.²⁸⁴ While no feedback loop is identified in ASIC’s submission, it is otherwise closely aligned with the really responsive risk-based regulation approach to risk identification.

This commitment to a risk-based regulatory approach is supported by ASIC’s actions. ASIC has made no commitment to fighting the company stationery requirements of the Corporations Act²⁸⁵ (something that a cursory glance at a good number of company documents reveals to be a problem), nor has it made any effort to enforce the proper form of annexing documents to ASIC forms²⁸⁶ (something that the author can say from experience with lodging non-compliant attachments). Instead, ASIC has made efforts to crack down on corporate restructuring and disclosure,²⁸⁷ bankruptcy involving suspected directorial fraud,²⁸⁸ and devising rules to monitor potentially dangerous OTC derivatives.²⁸⁹

C *Meta-Regulation*

Meta-regulation expands on the non-legal regulatory aspects of responsive regulation. Meta-regulation recognises the many non-legal sources of regulatory influence and attempts to regulate these regulatory forces.²⁹⁰ Gilad has classed meta-regulation together with other regulatory theories such as enforced self-regulation and principles-based regulation under the

²⁸¹ Ibid.

²⁸² Ibid 16.

²⁸³ Ibid 17.

²⁸⁴ Ibid 18.

²⁸⁵ *Corporations Act 2001* (Cth) s153.

²⁸⁶ *Corporations Regulations 2001* (Cth) reg 1.0.06.

²⁸⁷ See *ASIC v Hellicar* [2012] HCA 17.

²⁸⁸ See *ASIC v Groves: in the matter of ABC Learning Centres Limited (Administrators Appointed) (Receivers and Managers Appointed)* [2009] FCA 915.

²⁸⁹ *Corporations Act 2001* (Cth), Part 7.5A.

²⁹⁰ Christine Parker ‘Meta-Regulation: Legal Accountability for Corporate Social Responsibility’ in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds), *The New Corporate Accountability* (Cambridge University Press, 2009).

umbrella ‘process-oriented regulation’.²⁹¹ Regardless of its title, the aim of this form of regulation is to organise industries, non-governmental organisations and other non-legal sources of regulation toward a consistent and desirable regulatory outcome.²⁹²

This concept may be considered a recognition of, and response to, the fact that the non-legal aspects of regulation are much wider than theories such as responsive regulation gave credit.²⁹³ The focus of the meta-regulator is not so much on the relationship between the regulator and the regulator subject, but between the regulator and the pre-existing regulatory forces acting upon the regulatory subject.²⁹⁴ The adoption of meta-regulation may not only be seen as an acceptance of a wider regulatory environment,²⁹⁵ but also as a cost and staff effective means of regulating complex environments.²⁹⁶

Listokin-Smith clearly demonstrates that the regulation of OTC derivatives incorporates sufficient regulatory influences for meta-regulation to be work.²⁹⁷ Further, the use of meta-regulation may be an effective means of combating both the prolific nature and complexity of OTC derivatives.²⁹⁸ Despite this, ASIC has provided no indication that it is adopting a meta-regulatory approach to OTC derivatives or any other area of regulation. It is possible that ASIC is taking a conservative approach to engaging with new regulatory theories. It is also possible that ASIC has acted as a direct regulator for such a period that the step to meta-regulator may prove too great an ideological leap. As a result, meta-regulation will be used throughout this argument not to explain ASIC’s conduct but to offer a point of comparison or an alternate course of action where necessary.

²⁹¹ Sharon Gilad ‘It runs in the family: Meta-regulation and its siblings’ (2010) 4 *Regulation and Governance* 485, 485.

²⁹² Siona Listokin-Smith ‘Meta-regulation of OTC derivatives contracts post-reform’ (2013) 21 *Journal of financial regulation and compliance* 188.

²⁹³ Bronwen Morgan ‘The economization of politics: Meta-regulation as a form of nonjudicial legality’ (2003) 12 *Social Legal Studies* 489.

²⁹⁴ Parker, above n 290.

²⁹⁵ Ibid.

²⁹⁶ Listokin-Smith, above n 292.

²⁹⁷ Ibid.

²⁹⁸ Listokin-Smith, above n 292.

D *Holistic Regulation*

The concept of holistic regulation is not so much a regulatory theory as it is a way of thinking about the application of any regulatory theory.²⁹⁹ It involves abandoning the traditional constraints of goal-oriented regulatory problem solving and instead focusing on the entirety of the issue at hand.³⁰⁰ This may require inter-agency co-operation and the input of fresh perspectives on what may appear to be a localised problem.³⁰¹ While this may lend itself much more easily to a meta-regulatory approach, it is applicable to all regulatory approaches.

The holistic assessment of problems appears to have been adopted by ASIC. Comino notes that ASIC has both stated and demonstrated a commitment to an holistic regulatory approach.³⁰² This suggests that ASIC is engaged in responsive regulation, but aims to foster inter-agency communication and seeks to address the wider cause of problems, rather than merely achieve direct regulatory goals within its mandate. This can be seen in ASIC's annual report, which devotes many pages to discussing its relationship with other regulators in Australia and abroad.³⁰³

E *Regulatory Craftsmanship*

Like holistic regulation, regulatory craftsmanship is an approach to regulation, rather than a regulatory theory. Regulatory craftsmanship is a concept which aims to utilise a series of problem solving methods from outside regulatory theory in order to achieve positive regulatory outcomes.³⁰⁴ Regulatory craftsmanship incorporates many problem solving techniques, including

²⁹⁹ Malcolm Sparrow, *The Regulatory Craft. Controlling Risk, Solving Problems and Managing Compliance* (Brookings Institution Press, 2000), 108.

³⁰⁰ Ibid.

³⁰¹ Sparrow, above n 299.

³⁰² Vicky Comino 'Towards Better Corporate Regulation in Australia' (2011) 26 *Australian Journal of Corporate Law* 6.

³⁰³ Australian Securities and Investments Commission, above n 64.

³⁰⁴ Sparrow, above n 299.

holistic regulation.³⁰⁵ As with holistic regulation, Comino has noted that ASIC appears to have adopted regulatory craftsmanship in its releases and in its conduct.³⁰⁶

V HISTORICAL INSTITUTIONALISM

In accordance with standard qualitative research design,³⁰⁷ the results of the research have driven the selection of the theoretical methodology of this thesis. The empirical study produced results which have lent themselves to an examination of ASIC's effectiveness through the lens of historical institutionalism. While responsive regulation and its related developments will form the basis by which ASIC's effectiveness is measured, historical institutionalism offers insight into the cause of ASIC's effectiveness (or otherwise), as well as the consequences of any regulatory failure. This section of the thesis examines historical institutionalism, defining and refining the central theoretical framework that will be used throughout this thesis.

A *Historical Institutionalism as it applies to ASIC and the Secondary Electricity Market*

While traditionally bound to economics and social science, historical institutionalism is increasingly being adopted as a theoretical methodology for regulatory theorists and legal academics.³⁰⁸ Historical institutionalism provides a mechanism for examining the development and behaviour of institutions beyond Weber's Iron Cage.³⁰⁹ It offers a view of institutions which may be formed and guided by events, people and ideologies, as well as its formal bureaucratic structure,³¹⁰ making it ideal for an examination of ASIC's effectiveness in the secondary

³⁰⁵ Ibid 245.

³⁰⁶ Comino, above n 302.

³⁰⁷ Tom Wengraf, *Qualitative Research Interviewing* (Sage Publications, 3rd ed, 2001).

³⁰⁸ See Toby James 'Whatever happened to Regulation theory? The Regulation approach and local government revisited' (2009) 30 *Policy Studies* 181; Christopher Carrigan and Cary Coglianese 'The Politics of Regulation: From New Institutionalism to New Governance' (2011) 14 *Annual Review of Political Science* 107; and Orfoe Fioretos 'Capitalist diversity and the international regulation of hedge funds' (2010) 17 *Review of International Political Economy* 696.

³⁰⁹ Paul Dimaggio and Walter Powell 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields; (1983) 48 *American Sociological Review* 147.

³¹⁰ Charles Tilly, *Big Structures, Large Processes and Huge Comparisons* (Sage Publications, 3rd ed, 1984).

electricity market. Such an examination necessarily entails an historical investigation of ASIC's predecessor, ASC.

The historical institutionalism movement has increased the scope of institutional examination.³¹¹ It acknowledges historical and non-legal factors which may result in the current form and composition of institutions.³¹² This is critical, as institutions may take a form greatly different to their initial design.³¹³

Central to this concept is the notion of dependent paths.³¹⁴ Originating in economics,³¹⁵ a dependent path is a course of behaviour set by an earlier decision.³¹⁶ Deviation from the dependent path comes at an increased cost, challenging the notion of a static Pareto equilibrium as the basis from which all decisions are made.³¹⁷ For historical institutionalism, this means that historic events may set an institution on a set trajectory which will only alter if there is a significant impetus for change.³¹⁸

In examining these dependent paths the history of institutional development, rather than rational choice or current circumstance, can be used to provide a greater understanding of institutional pressures and futures.³¹⁹ It is generally accepted that the collective condition of institutions may also offer insight into politics and society.³²⁰ For this thesis, historical institutionalism is used in a more limited but focused sense, examining the composition of a single complex regulatory institution in relation to a single complex commercial market.

³¹¹ Paul Pierson and Theda Skocpol 'Historical Institutionalism in Contemporary Political Science' in Ira Katznelson and Helen Milner (eds) *Political Science: State of the Discipline* (W W Norton & Company, 2002).

³¹² Richard Scott, *Institutions and Organizations* (Sage Publications, 2nd ed., 2001).

³¹³ John Meyer and Brian Rowan 'Institutionalised Organisations: Formal Structures as Myth and Ceremony' in Walter Powell and Paul DiMaggio (eds) *The New Institutionalism in Organisational Analysis* (University of Chicago Press, 1991).

³¹⁴ Giovanni Capoccia and Daniel Kelemen 'The Study of Critical Junctures. Theory, Narrative, and Counterfactuals in Historical Institutionalism' (2007) 59 *World Politics* 341.

³¹⁵ Ibid.

³¹⁶ Pierson and Skocpol, above n 309.

³¹⁷ Ibid.

³¹⁸ Daniel Drezner 'Is historical institutionalism bunk?' (2010) 17 *Review of the International Political Economy* 791.

³¹⁹ James Mahoney 'Path Dependence in Historical Sociology' (2000) 29 *Theory and Sociology* 513.

³²⁰ Ruth Collier and David Collier, *Shaping the Political Arena: Critical Junctures, the Labor Movements and Regime Dynamics in Latin America* (University of Notre Dame Press, 1991).

Of particular importance to this thesis is the development of dependent paths. Historical institutionalism relies on critical junctures as important positions that shape institutions. This thesis identifies three critical junctures which have shaped the development of ASIC in relation to the secondary electricity market. These critical junctures are explored in chapter 4, chapter 5 and chapter 6. Chapter 4 will examine the first critical juncture, being the creation of the institution of ASIC on an ideology which aimed to promote investment and appease regulatory burden. Chapter 5 will examine the second critical juncture, being a shift in regulatory approach and responsibility as the institution changed from the Australian Securities Commission to ASIC. Chapter 6 will examine the final critical juncture, being the rapid increase in worldwide derivatives trade and the response taken by ASIC. It is argued in Chapter 7 that these three critical junctures have placed ASIC on a dependent path which makes responding to the secondary electricity market extremely costly and possibly completely undesirable.

B *Criticisms of Historical Institutionalism*

Historical institutionalism is not without its critics. Some academics have criticised historical institutionalism for lacking methodological guidance.³²¹ While economic tools abound for examining the presence and cost of a dependent path, there is little academic thought on how to identify the cause of a dependent path.³²² The lack of discussion surrounding the methodology for identifying the cause of dependent paths has resulted in a lack of literature engaging with the basic historical premise of historical institutionalism.³²³

While this is a valid criticism, it fails to look beyond the strictures of economics. As a social scientific tool, historical institutionalism can borrow and rely on a vast array of empirical research methodologies to identify historical events. Both quantitative and qualitative research

³²¹ Sven Steinmo 'Historical Institutionalism' in Donatella Porta and Michael Keating (eds), *Approaches and Methodologies in the Social Sciences: A Pluralist Perspective* (Cambridge University Press, 2008).

³²² Capoccia and Kelemen, above n 314.

³²³ Scott Page 'Path Dependence' (2006) 1 *Quarterly Journal of Political Science* 1.

tools have been used to identify the cause of dependent paths.³²⁴ Even within economics, academics are developing qualitative tools for investigating the cause of dependent paths.³²⁵ As this thesis has drawn its theoretical methodology from its research methodology, the lack of research methodology specific to historical institutionalism is of minimal concern.

An alternate criticism of historical institutionalism from within the social sciences is that it is too heavily tied to empirical investigation.³²⁶ Gunnarsson presents the criticism that historical institutionalism is ‘an unrealistic and basically empirical research programme which pose[s] no challenge to the classical or neoclassical hegemony’.³²⁷ Inherent in this criticism are the dual assumptions that empirical research is of limited value and that a theoretical methodology must somehow challenge traditional thought. The broad criticism of empirical research is addressed in detail in chapter 3 of this thesis. The criticism that a research methodology must challenge traditional thought is simultaneously without basis and nonetheless satisfied by this thesis. Gunnarsson offers no argument in favour of rejecting conservatism as a valid ideology, nor does he identify the desirability of a world in which all research methodologies constantly challenge orthodoxy. Nonetheless, this thesis has implemented historical institutionalism as a framework for examining a legal, regulatory problem. Historical institutionalism remains relatively unutilised in legal scholarship. This scarcity of historical institutionalism studies and qualitative empirical research in law mean that this thesis meets Gunnarsson’s challenge to historical institutionalism.

Historical institutionalism has also been criticised for its abandonment of rational actor theory.³²⁸ Historical institutionalism has generally sought to explain human behaviour as irrational and

³²⁴ Mahoney, above n 319.

³²⁵ See Gary King, Robert Keohane and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton University Press, 2004); Capoccia and Kelemen, above n 314.

³²⁶ Anil Hira and Ron Hira ‘The New Institutionalism: Contradictory Notions of Change’ (2000) 59 *American Journal of Sociology* 267.

³²⁷ Christer Gunnarsson ‘What is New and What is Institutional in the New Institutional Economics? An Essay on Old and New Institutionalism and the Role of the State in Developing Countries’ (1991) 39 *World Scandinavian Economic History Review* 48, 50.

³²⁸ Ellen Immergut ‘The Theoretical Core of the New Institutionalism’ (1998) 26 *Politics and Society* 5.

motivated by complex psychological, social and historical forces.³²⁹ This is a direct challenge to traditional economic theory which has generally accepted the notion that rational self-interest and utility maximisation drive personal and institutional decision-making.³³⁰ If the rational actor model is accepted, then this challenge undermines the legitimacy of historical institutionalism. There is empirical evidence in favour of the rational actor model.³³¹ Both pigeons³³² and rats³³³ appear to be natural utility maximisers. The human, with a superior mind, could be concluded to be even more rational in the pursuit of utility. Even if this does not apply to all people, the rational actor assumption should be maintained so long as it provides worthwhile results in a predictive model.³³⁴

Behavioural economics and business scholars are quick to challenge this logic. From conspicuous consumption³³⁵ to Veblen goods³³⁶ to the effects of marketing and advertising,³³⁷ examples of irrational human behaviour are rife. The identification of this irrational behaviour and its effect on society has spawned an entire field of behavioural economics.³³⁸ This thesis rests on behavioural economic theory in dismissing the rational actor model and adopting the theoretical framework of historical institutionalism. The dismissal of rational actor theory and the acceptance of behavioural economic assumptions are necessitated by the institutional being

³²⁹ Pierson and Skocpol, above n 311.

³³⁰ Robert Ellickson 'Bringing Cultures and Human Frailty to Rational Actors: A Critique of Classical Law and Economics' (1989) 65 *Chicago-Kent Law Review* 23.

³³¹ Herbert Simon 'Rationality in Psychology and Economics' (1986) 59 *The Journal of Business* 209.

³³² Howard Rachlin 'Economic Concepts in the Behavioural Study of Addiction' in Nick Heather, Rudy Wuchinich (eds), *Choice, Behaviour, Economics and Addiction* (Elsevier Ltd, 2003) 140; Theresa Foster, Timothy Hackenberg, Manish Vaidya 'Second-order Schedules of Token Reinforcement with Pigeons: Effects of Fixed and Variable Exchange Rate Schedules' (2013) 76 *Journal of the Experimental Analysis of Behaviour* 159.

³³³ Howard Rachlin, Ray Battalio, John Kagel and Leonard Green 'Maximisation Theory in Behavioural Psychology' (1981) 4 *Behavioural and Brain Sciences* 371.

³³⁴ John Scott 'Rational Choice Theory' in Gary Browning, Abigail Halcli and Frank Webster (eds), *Understanding Contemporary Society: Theories of the Present* (Sage Publications, 2000).

³³⁵ Aron O'Cass and Emily McEwan 'Exploring Consumer Status and Conspicuous Consumption' 4 *Journal of Consumer Behaviour* 25.

³³⁶ Laurie Simon Bagwell and Douglas Bernheim 'Veblen Effects in a Theory of Conspicuous Consumption' (1996) 86 *The American Economic Review* 349.

³³⁷ Richard Pollay 'The Distorted Mirror: Reflections on the Unintended Consequences of Advertising' (1986) 50 *Journal of Marketing* 18.

³³⁸ Amartya Sen 'Rational Fools: A Critique of the Behavioural Foundations of Economic Theory' (1977) 6 *Philosophy and Public Affairs* 317.

examined. ASIC has adopted the responsive regulatory model,³³⁹ a model that owes its origins to sociological regulation theory,³⁴⁰ as well as regulatory capture theory.³⁴¹ As regulatory capture theory finds its origins in behavioural economics,³⁴² it is perhaps inevitable that ASIC's regulatory approach relies heavily on an assumption against the existence of the rational actor. This thesis likewise dismisses the rational actor in analysing ASIC's effectiveness as a regulator of the secondary electricity market.

The criticism of historical institutionalism rejecting rational actor theory must also be considered in light of the fact that the theoretical methodology of this thesis has been driven by the research methodology. Where the qualitative data reveals irrational actions, it is consistent to adopt a framework that accepts the possibility of irrational actors. The empirical data generated by this thesis reveals a set of beliefs held by the secondary electricity market which closely mirror the underlying assumptions of historical institutionalism. The results have also indicated that ASIC has diverged from other regulatory institutions, suggesting that equilibrium dependent models will be insufficient to analyse ASIC as an institution. In such circumstances, historical institutionalism is an ideal tool for analysing ASIC. While it would be beneficial for future studies to analyse this data in light of alternate and contrasting theoretical methodologies, a logical starting point is to accept the views of the research participants and explore them on their own terms.

C *Historical Institutionalism and New Institutionalism*

It has already been identified that many new institutionalism scholars challenge historical institutionalism on the basis that historical institutionalism has rejected the rational actor model.³⁴³ There is however, a greater degree of complexity to the divide between historical

³³⁹ Nagarajan, above n 1.

³⁴⁰ Ayres and Braithwaite, above n 28.

³⁴¹ Ibid.

³⁴² George Stigler 'The Theory of Economic Regulation' (1971) 3 *Bell Journal of Economics and Management Science* 3.

³⁴³ Immergut, above n 328.

institutionalism and new institutionalism. In fact, depending on the definition adopted, rational choice theory may fall completely outside the bounds of new institutionalism.³⁴⁴

New institutionalism has been criticised for its lack of cohesion.³⁴⁵ As a result, the label appears to be used to describe a large body of different theoretical perspectives that draw on historical institutionalism, but aim to modify, criticise or develop it in some way. For example, proponents of restoring the rational actor to historical institutionalism have been labelled by many as belonging to new institutionalism.³⁴⁶ Others have attempted to describe new institutionalism as offering something other than rational choice theory, labelling this model instead ‘rational choice institutionalism’.³⁴⁷ These scholars view new institutionalism as offering something other than historical institutionalism and rational choice institutionalism.

Others still have attempted to draw a distinction between new and historical institutionalism on the basis of the focus on the individual. The argument for such a distinction is that historical institutionalism has traditionally viewed the institution as being formed by large historical factors and momentous decisions made by key figures.³⁴⁸ The institution in turn shapes individuals within the institution.³⁴⁹ New institutionalism on the other hand, focuses on the role of individuals and groups within institutions.³⁵⁰ This distinction appears to overlook key literature on historical institutionalism. Much of historical institutionalism’s contribution to institutional examination was the ability to conceive of the individual as both product and driver of historical movement within institutions.³⁵¹

³⁴⁴ See Richard Scott, *Institutions and Organisations* (Sage Publications, 2nd ed., 2001).

³⁴⁵ Vivien Lowmpe ‘Varieties of New institutionalism: A Critical Appraisal’ (2007) 74 *Public Administration* 181.

³⁴⁶ Immergut, above n 328.

³⁴⁷ Ira Katznelson and Barry Weingast ‘Intersections between Historical and Rational Choice Institutionalism’ in Ira Katznelson and Barry Weingast (eds) *Preferences and Situations: Points and Intersections between Historical and Rational Choice Institutionalism* (Russell Sage Foundation, 2005) 12.

³⁴⁸ Charles Tilly, above n 310.

³⁴⁹ Ibid.

³⁵⁰ Robert Bates ‘Contra Contractarianism: Some Reflections on the New Institutionalism’ (1988) 16 *Politics and Society* 387.

³⁵¹ Pierson and Skocpol, above n 311.

Another attempt to separate historical and new institutionalism has been to draw a distinction between the focus on singular institutions and institutions as a whole. Under such a classification, historical institutionalism is seen as focusing on singular institutions and their composition.³⁵² New institutionalism sees institutions within an institutional environment.³⁵³ In this light, new institutionalism adopts a macro focus which offers insight into societal shifts and pressures much more effectively than can be gained from studying a single entity.³⁵⁴

These distinctions offer insight into the lack of clarity surrounding what belongs under the banner of ‘historical institutionalism’ and what belongs under the banner of ‘new institutionalism’. The only consistently identified difference between the two appears to be the time period in which they arose. Historical institutionalism, perhaps because of this longer existence, is relatively well defined.³⁵⁵ New institutionalism appears to be a newer body of scholarship seeking to alter historical institutionalism in some way. While this distinction offers none of the finesse of the definitions presented above, it is a workable definition for the purposes of this thesis.

Regardless of the exact differences between historical institutionalism and new institutionalism, this thesis will rely on historical institutionalism. This thesis has rejected the rational actor model. It also focuses on the historical development of a single institution. The events revealed by the data generated by this thesis are large legal and ideological moments, rather than the actions of smaller groups of actors. It is, regardless of which of the differential definitions of historical and new institutionalism are adopted, utilising an historical institutionalism theoretical methodology.

³⁵² Peter Hall and Rosemary Taylor ‘Political Science and the Three New Institutionalisms’ (2006) 44 *Political Studies* 936; and Vivien Schmidt ‘Give Peace a Chance: Reconciling Four (not Three) New Institutionalisms’ in Daniel Beland and Robert Cox (eds) *Ideas in Politics and Social Science Research* (Oxford University Press, 2011).

³⁵³ Royston Greenwood and Bob Hinings ‘Understanding Radical Organizational Change: Bringing Together the Old and New Institutionalism’ (1996) 21 *Academy of Management Review* 1022.

³⁵⁴ Meyer and Rowan, above n 313.

³⁵⁵ Colin Hay and Daniel Wincott ‘Structure, Agency and Historical Institutionalism’ (1998) 46 *Political Studies* 951.

This thesis identifies a series of critical junctures which have placed ASIC on a dependant path with regard to the secondary electricity market. Specifically, chapters 4, 5 and 6 each identify a critical juncture in the historical development of ASC and ASIC. Some historical institutionalism scholars have challenged the legitimacy of dependent paths, instead favouring the concept of a ‘reactive sequence’.³⁵⁶ An examination of these two concepts of how a dependent path is developed reveals that the critical juncture theory is better suited to an examination of ASIC, particularly given the empirical data generated by this thesis.

Many historical institutionalism scholars suggest that dependent paths are created and shifted at ‘critical junctures’.³⁵⁷ Critical junctures are major events which impact on an institution, causing it to undergo a period of rapid change.³⁵⁸ During this period of change, key decisions are made, new directions are established and ideologies are forged.³⁵⁹ Once the institutional stress of the major event has subsided, the institution is left with a dependant path.³⁶⁰ This dependant path can be changed, but is only likely to change if an event of equal significance and magnitude gives reason for the institution to re-examine its foundations.³⁶¹ Subsequent critical junctures may not only change dependent paths, but may also entrench them or add to them.³⁶²

Other historical institutionalism scholars argue that dependent paths are caused by ‘reactive sequences’. The reactive sequence does not require anything as dramatic or institution altering as a critical juncture.³⁶³ Rather, small but important decisions, personalities and political movements may lead to small shifts in direction and culture.³⁶⁴ This minor shift will lead to

³⁵⁶ Mahoney, above n 319.

³⁵⁷ Capoccia and Kelemen, above n 314.

³⁵⁸ Ibid.

³⁵⁹ Mahoney, above n 319.

³⁶⁰ Capoccia and Kelemen, above n 314.

³⁶¹ Ibid.

³⁶² Ibid.

³⁶³ Mahoney, above n 319.

³⁶⁴ Ibid.

further decisions and ideas in a similar vein.³⁶⁵ In this way, a reaction to a fairly minor stimulus may in time trigger a series of actions which form a dependent path.³⁶⁶

The results of this thesis have identified critical junctures, rather than reactive sequences. This is perhaps unsurprising, as all interview participants were drawn from outside ASIC. It is unlikely that the interview participants would have the necessary insight into the inner workings of ASIC to detect the minor but deepening paths forged by reactive sequences. This area of enquiry would benefit from further study involving ASIC and its staff members.

Instead, the interview participants identified major events which have shaped ASIC's dependent paths. It is on this basis that the critical junctures model will be utilised. As is demonstrated in chapters four, five and six, the accuracy of this external identification of critical junctures is questionable. The questionable nature of the results in itself offers profound insight into the current regulatory relationship between ASIC and the secondary electricity market.

VI ASIC, REGULATORY THEORY, THE SECONDARY ELECTRICITY MARKET AND HISTORICAL INSTITUTIONALISM

The ideas presented in this chapter provide the foundation for the examination of ASIC's effectiveness in the secondary electricity market. ASIC's effectiveness is examined against the goals of responsive regulation, the regulatory theory adopted by ASIC. Other key regulatory theories are used to provide greater insight into ASIC's application of responsive regulation, offering possible explanations for key areas where ASIC has been identified as being an ineffective regulator in the secondary electricity market. While responsive regulation thus forms the measure of ASIC's effectiveness in the secondary electricity market, historical institutionalism is used to examine the institutional factors which have resulted in the current relationship between ASIC and the secondary electricity market. Historical institutionalism both

³⁶⁵ Anna Grzymala-Busse 'Time Will Tell? Temporality and the Analysis of Causal Mechanisms and Processes' (2011) 44 *Comparative Political Studies* 1267.

³⁶⁶ Mahoney, above n 319.

informs and explains ASIC's lack of effectiveness as a regulator of the secondary electricity market. These theories are tied together not only by a common set of assumptions, but also by the empirical data generated by this thesis. Chapter 3 explains and justifies the empirical method by which that data was gathered and presents the results of the empirical study.

This chapter lays the foundation for further enquiry throughout this thesis. In particular, the measures of effectiveness used by ASIC and adopted by this paper have been identified and considered. The secondary electricity market has been defined and the key concepts of 'critical junctures' and 'historical institutionalism' have been defined. These concepts are central to chapters 4-7, which identify a series of critical junctures in ASIC's historical development and ultimately track ASIC's dependent path. This chapter also sets out the key regulatory theories which will be essential to answering the first research question: how do the subjects of ASIC's regulation in the secondary electricity market view the effectiveness of ASIC? This regulatory theory is also essential to answering the other research questions, owing to the fact that ASIC's measure of effectiveness will be adopted throughout the thesis.

CHAPTER THREE: EMPIRICAL FRAMEWORK

I OVERVIEW

The objective of this thesis is to examine the effectiveness of ASIC's regulation of the secondary electricity market. One of the difficulties in doing so is the lack of existing scholarship on the secondary electricity market. This difficulty is increased by the responsive regulatory theory adopted by ASIC and this thesis, which considers extra-legal sources of regulatory influence. This thesis attempts to address these difficulties by obtaining data about ASIC's regulatory effectiveness directly from the secondary electricity market in a manner which is able to take into consideration ASIC's regulatory aims. This chapter will establish the method by which all four of the research questions are answered.

This chapter first identifies the challenges associated with evaluating ASIC's effectiveness in a new market and in the absence of existing studies and data. The particular problems associated with conducting such an examination in the wider responsive regulatory framework adopted by ASIC are considered. Second, it sets out the empirical legal research method that has been used in this thesis in order to overcome those challenges. This research method is drawn from existing literature on regulatory research methodologies. Arguments are made for an alteration of existing regulatory research methodologies to ensure that they comply with the rigors of both sociological and legal research. Third, it considers the ongoing need for doctrinal research methods and establishes the areas and extent in which doctrinal research is used in this thesis. In particular, the value of extending existing doctrinal regulatory scholarship and historical institutionalism in analysing ASIC's regulatory effectiveness are considered. Finally, this chapter sets out the semi-structured interviewing and thematic analysis processes and establishes the central themes emerging from the data. These themes are the critical junctures which form the basis of the remainder of this thesis.

II METHODOLOGICAL CHALLENGES

There are three main methodological challenges present in investigating the effectiveness of ASIC in regulating the secondary electricity market. First, while the scholarship examining emerging and complex markets is increasing, the secondary electricity market is a new market which has been subject to few studies. Ford has examined the effectiveness of regulation in complex financial markets generally.¹ This thesis will focus specifically on the secondary electricity market, following in the footsteps of other studies which have examined specific complex and emerging markets.² Thus, while this thesis is able to draw on studies examining similar issues, there is limited scholarship on which to base any hypothesis about ASIC's regulatory effectiveness in the secondary electricity market. Likewise, there is little data or discussion on which to base a doctrinal investigation.

Second, the sociological origins of responsive regulation challenge traditional legal research methods. By expanding the scope of regulation beyond traditional legislation and other state-based sources of authority, responsive regulation calls for a research methodology which can move beyond traditional legal sources. Finally, traditional legal research methods call for a doctrinal investigation of ASIC's effectiveness. These research methods form an integral part of the investigation undertaken in this thesis, but are insufficient in themselves to answer the question 'is ASIC effectively regulating the secondary electricity market?' Accordingly these methods are dealt with in detail in this chapter laying down the foundations for examining the effectiveness of regulation.

¹ Cristie Ford 'Principles-Based Securities Regulation in the Wake of the Global Financial Crisis' (2010) 55 *McGill Law Journal* 257; Cristie Ford 'Macro- and Micro-level Effects on Responsive Financial Regulation' (2011) 44 *University of British Columbia Law Review* 589.

² See Peter Mollgaard and Claus Nielsen 'The Competition Law and Economics of Electricity Market Regulation' (2004) 25 *European Competition Review* 37 who examined the role of regulation in Europe's primary electricity market; and Markus Lederer 'Market Making via Regulation: The Role of the State in Carbon Markets' (2012) 6 *Regulation and Governance* 524, who examined regulatory approaches to emerging carbon markets.

One of the central problems with examining the secondary electricity market is that it is a relatively new market. Few studies have been conducted on the secondary electricity market. The studies which have been undertaken have generally been undertaken to examine a particular area of activity within the secondary electricity market, rather than considering the secondary electricity market as a whole. For example, the majority of the studies on the secondary electricity market have focused on issues of financial product pricing.³ Studies conducted outside of pricing have focused on risk, volatility and financial accounting practices.⁴ As a result, there has been significant progress in determining the financial environment in which secondary electricity market products operate, but there has been no real focus on the structure and regulation of the market itself.

Existing regulatory literature may nonetheless be theoretically applied to the secondary electricity market to consider the question ‘does ASIC have the potential to effectively regulate the secondary electricity market?’ However, without further insight from the secondary electricity market such an exercise cannot consider the question ‘is ASIC effectively regulating the secondary electricity market?’ The examination of this latter question requires a research methodology that is able to generate data about the secondary electricity market.

The qualitative empirical methodology adopted by this thesis generates data about the secondary electricity market which is necessary to conduct a detailed analysis of ASIC’s effectiveness as a regulator of the secondary electricity market. The research design has been shaped by the lack of

³ See Claudio Albanese, Harry Lo and Stathos Tompaids ‘A numerical algorithm for pricing electricity derivatives for jump-diffusion processes based on continuous time lattices’ (2012) 222 *European Journal of Operational Research* 361; Nikos Nomikos and Orestes Soldatos ‘Modelling short and long-term risks in power markets: Empirical evidence from Nord Pool’ (2010) 38 *Energy Policy* 5671; Iivo Vehvilainen ‘Basics of electricity derivative pricing in competitive markets’ (2002) 9 *Applied Mathematical Finance* 45; and Craig Pirrong and Martin Jermakyan ‘The price of power: The valuation of power and weather derivatives’ (2008) 32 *Journal of Banking and Finance* 2520.

⁴ See Shijie Deng and Schmucl Oren ‘Electricity derivatives and risk management’ (2006) 31 *Energy* 940; Pavel Pavlatka ‘Option Derivatives in Electricity Hedging’ (2010) 50 *Acta Polytechnica* 1; and Patricia Teixeira Lopes ‘Accounting for electricity derivatives under IAS 39’ (2007) 13 *Journal of Derivatives and Hedge Funds* 233.

existing data on which to base a hypothesis and the lack of existing studies on which to base considered doctrinal research. In this way, the research methodology overcomes the limitations presented by a lack of existing scholarship on the secondary electricity market.

B *Sociological Origins of Regulation*

This thesis measures the effectiveness of ASIC by the performance measures set out in chapter 2, being ‘confident and informed investors and financial consumers’, ‘fair and efficient financial markets’ and ‘efficient registration and licensing’. As was discussed in chapter 2, these performance measures have been drawn from the regulatory theory of responsive regulation. Responsive regulation finds its origins in sociology and extends its reach beyond traditional forms of command and control regulation.

As ASIC’s regulatory approach is based on community and industry engagement,⁵ education⁶ and human relationships,⁷ as discussed in chapter 2, the study of its effectiveness necessarily extends beyond legal doctrine. This may in itself pose a limitation on the effectiveness of doctrinal research and call for an empirical research methodology.

Doctrinal research nonetheless remains a critical component of the study of regulation and accordingly, this thesis. ASIC’s power to issue informal warnings and other discretionary penalties is found in statute,⁸ leading Kingsford Smith to adopt a wider definition of ‘law’ when studying regulation.⁹ Whether or not this wider definition of ‘law’ is adopted, the doctrinal examination of statute forms a critical part of examining a regulatory system.

This creates potential for doctrinal research to interrogate the effectiveness of ASIC in regulating the secondary electricity market. This potential is however, vexed by the informal and vague

⁵ Australian Securities & Investments Commission, *Annual Report 2012 – 2013*, 10 October 2013, 28.

⁶ Ibid 32.

⁷ Ibid 35.

⁸ *Australian Securities and Investments Commission Act 2001* (Cth) ss12GA – 12GO.

⁹ Dimity Kingsford Smith ‘Beyond the Rule of Law: Decentred Regulation in Online Investing’ (2004) 26 *Law and Policy* 439.

nature of traditionally considered non-legal sources of regulation.¹⁰ The traditional doctrinal tools used to examine a reasonably static parliamentary statute are unlikely to be effective in examining dynamic cultural and commercial influence.

Existing sources have developed methodological frameworks which are suited to engaging in this manner of research. While these frameworks contains their own challenges, they offer a workable starting point for developing an empirical research method which can examine the effectiveness of ASIC's regulation of the secondary electricity market. Arthurs offers a research classification model that expands the limits of 'law' for conducting legal research. Arthurs identifies a category of legal research which he deems 'fundamental research.'¹¹ This research is academic in nature but calls for an interdisciplinary methodology.¹² Legal research methodologies such as critical legal studies, law and economics or sociology of law may be adopted.¹³ It is research about law, rather than research in law.¹⁴ In this way, it opens legal research to the possibility of investigating the effectiveness of ASIC's approach in practise, rather than an examination only of the rules and regulatory authority it imposes.

Not only does the adoption of a 'research about law' approach address many of the issues presented by the sociological nature of responsive regulation, but it supports an interdisciplinary examination of law. As regulatory theory finds its origins in sociology,¹⁵ a sociology of law methodology is a logical choice for its examination. The adoption of a sociology of law methodology drives the structure of research method in this thesis.

¹⁰ Vicky Comino 'Effective Regulation by the Australian Securities and Investments Commission: the Civil Penalty Problem' (2009) 33 *Melbourne University Law Review* 802.

¹¹ Harry Arthurs, *Law and Learning: Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in law* (report produced for the Social Sciences and Humanities Research Council of Canada, 1983) 5.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

In adopting a sociology of law approach this thesis has developed a research methodology that complies with the rigors of both sociology and law. This has been necessitated by the lack of clarity as to whether sociology of law is a legal research methodology, a sociological research methodology or a unique research methodology connected to but independent of both law and sociology. While Arthur clearly identifies the sociology of law as an ‘interdisciplinary’ legal research method,¹⁶ other theorists maintain that sociology of law is merely a branch of sociology. Deflem identifies law as being a purely sociological field.¹⁷ He is not alone.¹⁸ If these theorists are correct, then any research into the sociology of law must ultimately be consistent with sociological research methodologies.

Banakar and Travers examine the history of the sociology and law movement and conclude that the sociology of law methodology draws from both sociological and legal origins.¹⁹ The fact that sociology of law research is likely to require examination of traditional doctrinal legal texts adds strength to this classification. In doing so, Banakar and Travers may resolve the debate as to the origins of sociology and law but they do not address how the rigors of each discipline are to be balanced.

Cotterrell offers a means of striking this balance. He suggests that sociology of law is independent of both sociology and law, forming its own field and methodology of research.²⁰ Cotterrell suggests that the sociology of law approach is grounded in both sociology and law, but has sufficiently developed to be considered its own field. His approach supports the use of empirical investigation in research projects while still acknowledging the interplay of empirical research methods and doctrinal examination.²¹ In this way research can be conducted about the

¹⁶ Arthurs, above n 11.

¹⁷ Mathieu Deflem, *Sociology of Law: Visions of a Scholarly Tradition* (Cambridge University Press, 2008).

¹⁸ See Zdenek Krystufek ‘Law and Sociology’ (1974) 45 *University of Colorado Law Review* 269; and William Evan, *Law and Sociology: Exploratory Essays* (Free Press of Glencoe, 1963).

¹⁹ Reza Banakar, *Merging Law and Sociology: Beyond the Dichotomies of Socio-Legal Research* (Galda + Wilch Verlag, 2003); Reza Banakar and Max Travers, *Introduction to Law and Social Theory* (Hart, 2002).

²⁰ Roger Cotterrell, ‘Sociology of Law’ in David Clarke (ed) *Encyclopedia of Law and Society: American and Global Perspectives* (Sage Publications, 2007).

²¹ Ibid.

law, while still considering the technicalities of the law. Such an approach may provide a more complete picture of the legal landscape.

In adopting a sociology of law approach, this thesis will comply with the requirements of both sociological and legal research methodologies. This should ensure that the benefits of a new field of study identified by Cotterrell can be adopted, while maintaining the standards required of both fields which may claim ownership to the sociology of law research field and methodology. For this reason the research methodology of this thesis is driven by and verified against the requirements of both legal and sociological research design requirements.

C *Traditions of Legal Research*

The use of an empirical research methodology presents few challenges to the conventions of sociological research. It does, however, present a challenge to the conventional legal research model. Legal research has traditionally adopted a doctrinal research methodology.²² This examination of law and legal concepts has, and continues to be, the dominant method of legal research design.²³ While this thesis continues to adopt elements of doctrinal research, it moves beyond doctrinal research.

In order for this approach to fit within the legal research framework, it is necessary to identify precisely what is meant by doctrinal research. Studies into the use of doctrinal research have traditionally used wide definitions such as ‘research into law’²⁴ or research which ‘moves from the particular to the general’.²⁵ While these definitions help to provide an understanding of what doctrinal research is, they fail to adequately address the boundaries between doctrinal and empirical research methodologies. For example, Ulen, Hutchinson and Duncan’s definition

²² Terry Hutchinson and Nigel Duncan ‘Defining and Describing what we do: Doctrinal Legal Research’ 17 *Deakin Law Review* 83.

²³ Desmond Manderson and Richard Mohr ‘From Oxymoron to Intersection: An Epidemiology of Legal Research (2002) 6 *Law Text Culture* 159.

²⁴ Hutchinson and Duncan, above n 22, 84.

²⁵ Thomas Ulen ‘Firmly Grounded: Economics in the Future of the Law’ (1997) *Wisconsin Law Review* 433, 433.

would class empirical research into the application of a particular legal principle as doctrinal research.

It is perhaps the difficulty of properly defining doctrinal research which has led scholars to question whether traditional legal studies have a research methodology. Posner states that law is 'not a field with a distinct methodology, but an amalgam of applied logic, rhetoric, economics and familiarity with a specialised vocabulary'.²⁶ Murphy and Roberts state 'legal theory has failed to provide any significant explanation or justification of what academic lawyers do... and thus of what academic law is or might be'.²⁷

These criticisms have been met by a number of justifications for doctrinal legal research.

Chynoweth identifies not only that doctrinal research involves an analysis of the internal logic of the law, but also that it incorporates epistemological and cultural features which justify its involvement in law.²⁸ Arthurs proposes a justification for doctrinal research which identifies it as analysis of legal doctrine and the systematic formulation of law in a particular context.²⁹

This debate draws out a number of benefits to doctrinal research which may be captured by adopting a sociology of law methodology that incorporates elements of both doctrinal and empirical research. Doctrinal research is a means by which law can be gauged and assessed.³⁰ It draws on the history and tradition of legal sources and offers insight into the operation of case law and legislation.³¹ It offers a consideration and critique of the internal logic and theory of law. At the same time, empirical research allows the examination to move beyond the internal logic to examine the effectiveness of an internally logical law in practise. An examination of internal

²⁶ Richard Posner 'Conventionalism: The Key to Law as an Autonomous Discipline?' (1988) 38 *University of Toronto Law Journal* 333, 345.

²⁷ Timothy Murphy and Simon Roberts 'Introduction (to the special issue on legal scholarship)' 50 *Modern Law Review* 677, 677.

²⁸ Paul Chynoweth 'Legal Research' in Andrew Knight and Les Ruddock (eds) *Advanced Research Methods in the Built Environment* (1st ed, 2008).

²⁹ Arthurs, above n 11.

³⁰ *Ibid.*

³¹ Chynoweth, above n 28.

logic may also assist in determining why a legal or regulatory regime is not working in practise.³²

While such an approach moves beyond the traditions of legal research, it does not necessarily conflict with them. Even the most challenging problem, the placement of empirical research in Arthurs' categorisation, can be reconciled. Arthurs identifies 'applied'³³ legal research as 'law reform research'.³⁴ 'Law in context'³⁵ research is considered as belonging to a multi-disciplinary research methodology,³⁶ but one distinct from a sociology of law approach.³⁷ This definitional issue may be explained by closer examination of Arthurs' use of 'applied' and 'law in context'.

Viewed in isolation, Arthurs' use of the term 'law reform research' suggests a form of normative research. Normative research in law has traditionally been viewed as providing guidance on what the law 'ought to be'.³⁸ Driving law reform requires not only an examination of the effectiveness of current law, but also an examination of improvements that could be made to the law.³⁹ This distinction between examination and action may provide a clearer understanding of Arthurs' categorisations. The distinction between 'applied (professional constituency)' and 'pure (academic constituency)' may be seen not as a distinction between the application of law and the theory of law so much as it may be seen as a distinction between research observing the application of law and research seeking to challenge the application of law.

This view of Arthurs' categorisation is supported by a number of sociology and law scholars who identify empirical research into the current operation of law as a matter for sociology of law research. Banakar identifies empirical research as a central part of sociology of law research,

³² Gregory Shaffer and Tom Ginsburg 'The Empirical Turn in International Legal Scholarship' (2012) 106 *American Journal of International Law* 1.

³³ Arthurs, above n 11, 19.

³⁴ Ibid 23.

³⁵ Ibid.

³⁶ Ibid 24.

³⁷ Ibid 25.

³⁸ Gary Melton 'Law, Science and Humanity: The Normative Foundation of Social Science in Law' (1990) 14 *Law and Human Behaviour* 315, 317.

³⁹ Peter Schuck 'Why don't law professors do more empirical research?' (1989) 39 *Journal of Legal Education* 323.

without the need for any normative consideration.⁴⁰ This is a view supported by Cotterrell⁴¹ and Pound.⁴² This strength of support for the use of empirical research as part of a sociology and law research methodology has been drawn upon for the formulation of the research methodology of this thesis.

III EMPIRICAL RESEARCH

The methodological challenges of investigating the effectiveness of ASIC in regulating the secondary electricity market have largely driven the research design of this thesis. In particular, the fact that the secondary electricity market is a new market and the fact that the responsive regulation theoretical framework adopted in chapter 2 both call for an empirical approach. This section of the chapter first draws on existing legal scholarship to establish a basis for the use of empirical research in law. It then considers the necessity of qualitative rather than quantitative research design. Finally, it considers the key qualitative empirical research methodology presented by regulatory scholarship. In doing so it argues for an alteration of the previously suggested qualitative regulatory research methodology to better fit within the conventions of legal research.

A *Empirical Research in Law*

While doctrinal research remains the primary method of legal research, empirical research has been well utilised. Empirical research is able to add to the examination of the effectiveness of the application of legal theory, rather than simply examining the internal logic of the theory itself.⁴³

⁴⁰ Banakar, above n 19.

⁴¹ Cotterrell, above n 20.

⁴² Roscoe Pound 'Sociology of Law and Sociological Jurisprudence' (1943) 5 *University of Toronto Law Journal* 288.

⁴³ Jennifer Robbennolt 'Evaluating Empirical Research Methods: Using Empirical Research in Law and Policy' (2002) 81 *Nebraska Law Review* 777.

It is this gaining of knowledge by observation or experience that is at the foundation of empirical research.⁴⁴

The use of empirical research as a tool for examining the effectiveness of legal principles is well established. Particularly in areas where the internal logic of a particular law is the subject of long and ongoing debate, empirical research may shed light on the practical impact of the debatable legal theory.⁴⁵ The practicality of an empirical research methodology has been shown repeatedly in the international law field, where the existence, merit and validity of international law continue to engage doctrinal research.⁴⁶

Regulatory theory shares some similarities with international law which make it an ideal candidate for empirical investigation. Like international law,⁴⁷ scholars continue to question whether it is a theory of law.⁴⁸ In both instances, the debate appears to have grown somewhat 'stale'.⁴⁹ One group of scholars continues to maintain that regulatory theory exists outside of proper legal regulation,⁵⁰ while another has continued to develop and progress regulatory theory.⁵¹ Continued debate and engagement between the two theoretical camps appears to be fairly minimal, with entrenched positions unlikely to move based on further logical argument.

⁴⁴ Pieter Strien 'Towards a Methodology of Psychological Practice: The Regulative Cycle' (1997) 7 *Theory Psychology* 683.

⁴⁵ Gregory Shaffer and Tom Ginsburg 'The Empirical Turn in International Legal Scholarship' (2012) 106 *American Journal of International Law* 1.

⁴⁶ See Shaffer and Ginsburg, above n39; Michael Reisman 'International Incidents: Introduction to a New Genre in the Study of International Law' (1984) 10 *Yale Journal of International Law* 1; Steven Ratner and Anne-Marie Slaughter 'Appraising the Methods of International law: A Prospectus for Readers' (1999) 93 *American Journal of International Law* 291; and Antony Anghie and Bhupinder Chimni 'Third World approaches to International Law and individual responsibility in internal conflict' in Steven Ratner and Anne-Marie Slaughter (eds) *The Methods of International Law* (American Society for International Law, Reprint Edition, 2004).

⁴⁷ Reisman, above n 46.

⁴⁸ Gary Becker 'Toward a more General Theory of Regulation' (1976) 19 *Journal of Law and Economics* 245.

⁴⁹ Reisman, above n 46.

⁵⁰ See Daniel Cole and Peter Grossman 'When is Command and Control Efficient? Institutions, Technology, and the Comparative Efficiency of Alternative Regulatory Regimes for Environmental Protection' (1999) 1999 *Wisconsin Law Review* 887; Winston Harrington and Richard Morgenstern 'Economic Incentives Versus Command and Control: What's the Best Approach for Solving Environmental Problems' in Gerald Visquilio and Diana Whitelaw (eds) *Acid in the Environment: Lessons Learned and Future Prospects* (Springer, 2006), 233.

⁵¹ Vijaya Nagarajan 'From command and control to open method communication: Theorising the practice of regulatory agencies' (2008) 8 *Macquarie Law Journal* 5.

These conditions suggest that empirical research is an ideal tool for examining and progressing regulatory theory. While doctrinal research will always be of fundamental importance in developing consistent regulatory laws and approaches, and law reform research will always remain necessary for the advancement of regulatory theories, empirical research offers a means by which the practical utility of current and past regulatory theories can be measured.⁵² Regulatory theory is now sufficiently established that its impact on the world can be observed using an empirical methodology.⁵³

Also like international law,⁵⁴ regulatory theory moves away from a traditional legislation and case law model toward a human relationship-centred approach to regulating behaviour.⁵⁵ When dealing with human behaviour it may be that logic is not the best indicator of effectiveness. Through empirical examination the strengths and faults of regulatory theory can be identified and inform future debate in both doctrinal and normative regulatory scholarship.

Empirical research is increasingly becoming a favoured tool for examining the application of regulatory theory to various industries.⁵⁶ Case studies of particular markets and contexts are prevalent.⁵⁷ Nielsen and Parker have repeatedly used empirical research to examine the effectiveness of the ACCC from the perspective of the ACCC's regulatory subjects.⁵⁸ Segerson

⁵² Robert Lawless, Jennifer Robbennolt and Thomas Ulen, *Empirical Methods in Law* (Aspen Publishers, 2010).

⁵³ Julia Black 'Regulatory Conversations' (2002) 29 *Journal of Law and Society* 163; Gary King, Robert Keohane and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton University Press, 1994).

⁵⁴ Joseph Starke, *An Introduction to International Law* (Butterworths, 1989).

⁵⁵ Jacinta Jordana and David Levi-Faur (eds) *The Politics of Regulation: Institutions and Regulatory Reforms in the Age of Governance* (Edward Elgar Publishing Limited, 2004).

⁵⁶ See Black, above n 53; Karin Jonnergard and Ulf Larsson 'Developing Codes of Conduct: Regulatory Conversations as Means for Detecting Institutional Change' (2007) 29 *Law and Policy* 4; Martin Lodge 'High-quality regulation: its popularity, its tools and its future' (2009) 29 *Public Money and Management* 145; and Bettina Lange 'Trust Based Environmental Regulation' (2010) 22 *The Science of the Environment* 408.

⁵⁷ See Kathleen Segerson and Miceli Thomas 'Voluntary Approaches to Environmental Protection: The Role of Legislative Threats' in Carlo Carraro and Francois Levenque (eds) *Voluntary Approaches in Environmental Policy* (Springer, 2010); Abdoul Sam and Robert Innes 'Voluntary Reductions and the Enforcement of Environmental Law: an Empirical Study of the 33/50 Program' 51 *Journal of Law and Economics* 271; Joseph Rees, *Reforming the Workplace: A Study of Self-Regulation in Occupational Safety* (University of Pennsylvania Press, 1988); and Richard Morgenstern and William Pizer, *Reality Check: The Nature and Performance of Voluntary Environmental Programs in the United States, Europe and Japan* (RFF Press, 2007).

⁵⁸ Vibeke Nielsen and Christine Parker 'Testing responsive regulation in regulatory enforcement' (2009) 3 *Regulation and Governance* 376; and Vibeke Nielsen and Christine Parker 'To what extent do third parties influence business compliance?' (2008) 35 *Journal of Law and Society* 309.

and Thomas have empirically interrogated data on the prevalence of environmental codes of conduct to question the effectiveness of voluntary codes of conduct.⁵⁹ Rees similarly used data on workplace injuries to consider the effectiveness of self-regulation in advancing occupational health and safety.⁶⁰ Most of these studies have been quantitative and focused on results,⁶¹ but post-positivist research approaches are increasingly common.⁶²

It is this emerging field of empirical regulatory research that is at the heart of this thesis. In the tradition of Nielsen and Parker,⁶³ this thesis utilises empirical research to examine the effectiveness of ASIC's regulation of the secondary electricity market from the perspective of the secondary electricity market. By doing so this thesis is able to overcome the methodological challenges presented by examining ASIC's regulation of the secondary electricity market.

B *Qualitative and Quantitative Research*

Most empirical research into regulatory theory has been quantitative in nature.⁶⁴ Quantitative research lends itself most easily to legal scholarship. Both generally adopt a positivist research epistemology.⁶⁵ The concept of an objective observable world creates little conflict with the philosophies of logic and rhetoric that underpin traditional doctrinal research.⁶⁶ Study designs are well established and basic quantitative data analysis tools are simple and offer a degree of independence from the personality undertaking the study.⁶⁷ Importantly, quantitative research can now justify and legitimise itself to the legal mind by referring to a large body of precedential quantitative studies.

⁵⁹ Segerson and Thomas, above n 57.

⁶⁰ Rees, above n 57.

⁶¹ See Segerson and Thomas, above n 57; Sam and Innes above n 57.

⁶² See Jonnergard and Larsson, above n 56; and Lodge, above n 56.

⁶³ Nielsen and Parker, above n 58.

⁶⁴ See Segerson and Thomas, above n 57; Sam and Innes above n 57; Rees, above n 57; and Morgenstern and Pizer, above n 57.

⁶⁵ Andrew Sayer, *Methods in Social Science: A Realist Approach* (Routledge, 2nd ed., 2002).

⁶⁶ Hutchinson and Duncan, above n 22.

⁶⁷ Henry Brady and David Collier, *Rethinking Social Inquiry: Diverse Tools, Shared Standards* (Rowman & Littlefield Publishers, Inc., 2010).

There has been valuable quantitative research into regulatory theory⁶⁸ and quantitative research is likely to continue to be a valuable tool in determining the objective outcome of regulation against measurable goals. This thesis however, aims to move beyond quantitative research in order to gain insight into a goal of regulation which is not quantifiable. Many of the goals of regulatory theory are based on personality and social interaction, which are not easily measured in an independent, quantitative way.

As was established in chapter 2, one of ASIC's key goals is its relationship with industry. A qualitative research design offers both a comprehensive and direct means of identifying the nature of the relationship between ASIC and the secondary electricity market. The effectiveness of qualitative research in this instance lies in the fact that the nature of the relationship is genuinely unknown.⁶⁹ Without an observable set of facts on which to base a hypothesis, any quantitative research design would be necessarily flawed.⁷⁰ The open and unassuming nature of qualitative research provides honesty in its evaluation which outweighs the loss of objective data analysis tools present in quantitative research.

Qualitative research also offers insight into ASIC's ability to meet the other goals set out in chapter 2. ASIC has, within its own report, presented quantitative data on ASIC's effectiveness.⁷¹ Further insight into the secondary electricity market could be generated by gathering industry specific data for the same quantitative measures. As ASIC has not been responsive to invitations to take part in this research project, there is little possibility of obtaining such data. Instead, qualitative research offers not only an insight into whether these quantitative measures are being met, but the reasons that the subjects of regulation may or may not be complying. By allowing the regulatory subjects to provide their own insights in their own

⁶⁸ See Segerson and Thomas, above n 57; Sam and Innes above n 57; Rees, above n 57; and Morgenstern and Pizer, above n 57.

⁶⁹ Delbert Miller and Neil Salkind, *Handbook of Research Design and Social Measurement* (Sage Publications, 6th ed., 2002).

⁷⁰ Sayer, above n 65.

⁷¹ Australian Securities and Investments Commission, above n 5.

language, qualitative research can minimise the assumptions and bias of the researcher which is present in quantitative survey design.⁷²

Qualitative research has thus been utilised based on both necessity and desire. Qualitative research is the only methodologically sound means by which many of ASIC's measures of effectiveness may be examined by a third party with no access to ASIC. Additionally, the openness of qualitative research allows for the identification of themes within the regulatory relationship which are unknown to the researcher and thus could not form the basis for quantitative research.

C *Regulatory Conversations and Positivist Research*

A qualitative research methodology for regulatory theory has been established by Black.⁷³ Black suggests the use of 'regulatory conversations' to assist in understanding the relationship between the regulator and its regulatory subjects.⁷⁴ Black advocates the use of discourse analysis coupled with a research style which observes the semiotic interaction of regulators and their regulatory subjects.⁷⁵ This research style allows for the respondents to provide their own narrative and offer their own insights.⁷⁶ The analysis of the discourse may reveal insights into relationship, language and power.⁷⁷ This form of data gathering and analysis overcomes one of the major hurdles in researching a regulatory relationship: the fact that the dynamics of the relationship are generally completely unknown to the researcher.⁷⁸

The regulatory conversation model may be a necessary development in regulatory research design. From command and control regulation to responsive regulation to really responsive regulation to meta-regulation and its associated theories, regulatory theory has been increasingly focused on extra-legal social influence and human dynamics. At the same time, the subjects of

⁷² Miller and Salkind, above n 69.

⁷³ Black, above n 53.

⁷⁴ Ibid 166.

⁷⁵ Ibid.

⁷⁶ Ibid 170.

⁷⁷ Ibid.

⁷⁸ Miller and Salkind, above n 69.

traditional doctrinal research (legislation and case law) have been declining in importance to successive regulatory theories. Legislation and case law is likely to be of far less concern to a meta-regulatory organisation than it would be to a command and control regulator.⁷⁹

As regulatory theory continues to move away from traditional legal logic and toward human and societal interaction, new research designs have emerged. The rise in quantitative research in regulatory theory reflects the greater emphasis on regulatory theories that aim to operate in an imperfect and irrational environment. The newly emerging qualitative research style is a further step toward understanding a regulatory theory which is increasingly subjective and sociological in outlook. The regulatory conversations method is part of this early qualitative development, countering the increasing difficulty in regulatory scholarship: measuring regulatory effectiveness requires an understanding of the norms and values of cultures which are observable only through discourse.⁸⁰

While relatively new to legal scholarship, qualitative research has been well developed in sociology. As a result, while the regulatory conversations model has received minimal methodological critique in legal scholarship, the process on which it is based – discourse analysis – has been subject to criticism and debate. The main criticisms of discourse analysis can be placed into three broad categories, each of which is addressed by the research design of this thesis. First, discourse analysis may be subject to bias. This can be seen in Reed's criticism of discourse analysis in organisational research, where he asserts that the involvement of the researcher in discourse analysis weakens the objectivity of the study.⁸¹ Second, discourse analysis is relatively untested. This claim is presented by Gergen, who argues that discourse analysis lacks the evidential backing and precedential value of quantitative research methods.⁸²

⁷⁹ Cary Coglianese and Evan Mendelson 'Meta-Regulation and Self-Regulation' in Martin Cave, Robert Baldwin and Martin Lodge (eds) *The Oxford Handbook on Regulation* (OUP Oxford, 2010).

⁸⁰ Black, above n 53.

⁸¹ Mike Reed 'The Limits of Discourse Analysis in Organizational Analysis' (2000) 7 *Organization* 524.

⁸² Kenneth Gergen, *Realities and Relationships: Soundings in Social Construction* (First Harvard University Press, paperback edition, 1997).

Third, discourse analysis abandons the quest for objective truth. This claim is presented by Newton, who challenges discourse analysis and criticises its tendency toward the specific, rather than the general.⁸³ As the regulatory conversations model is based on discourse analysis, all of these criticisms may be equally applied to the regulatory conversations model. The research design of this thesis aims to address each of these concerns.

1 *Researcher Bias*

The first claim, that the regulatory conversations model is subject to researcher bias, is perhaps no less true of traditional forms of legal research and quantitative analysis. Patton argues that objective and bias-free research is impossible, whether quantitative or qualitative.⁸⁴ Traditional research design, whether doctrinal or quantitative empirical, is limited by the hypothesis formulated for the study design. The hypothesis will be influenced by the knowledge and personality of the person who has designed the research project. In the words of Althusser and Balibar ‘there is no such thing as an innocent reading’.⁸⁵ By abandoning the testable hypothesis, qualitative research may give a greater degree of objectivity, allowing for research participants to provide unfiltered insight into a subject. While there is still risk of bias in the regulatory conversations model, this risk is not significantly greater than the risk of bias in other research models. The benefit of obtaining an unfiltered view from the regulatory subjects far outweighs any risk of increased researcher bias.

2 *Lack of Precedent*

The second of these categories of criticism, that qualitative research is relatively untested, can be dismissed by simple logic. The fact that something has not been done before is insufficient

⁸³ Tim Newton ‘Theorizing Subjectivity in Organisations: The Failure of Foucauldian Studies’ (1998) 19 *Organizational Studies* 415.

⁸⁴ Michael Patton, *Qualitative Research: Encyclopedia of Statistics in Behavioural Science* (Sage Publications, 2nd Illustrated Reprint Edition, 1990).

⁸⁵ Louis Althusser and Etienne Balibar, *Reading Capital* (Ben Brewster Trans, Radical Thinkers Edition, 1968), 7.

reason to say it should not be done at all. That noted, as legal knowledge is based on precedent, there remains some validity to rejecting untested ideas and research methodologies. The regulatory conversations model does not fit into the category of ‘untested’. While it is a development in research method, it is based on an empirical method which has been developed by research projects before it.⁸⁶ Further, it can draw on over 30 years of use and development in the social sciences.⁸⁷

3 *Abandonment of Objective Truth*

The third criticism of the regulatory conversations model is far more difficult to address. Discourse analysis is far from universally accepted in the social sciences.⁸⁸ This is even more so where, as is the case in the regulatory conversations model,⁸⁹ the discourse analysis is post-structuralist.⁹⁰ The regulatory conversations research method appears to be primarily deconstructionist. The discourse analysis set out in regulatory conversations focuses on Foucauldian discourse analysis. The main contentions of discourse analysis presented by Black are ‘communicative interactions produce meaning, coordination, and action’,⁹¹ ‘communicative interactions create identities’,⁹² ‘language, thought and knowledge’,⁹³ ‘language and power’⁹⁴ and ‘discourse and contestation’.⁹⁵ While the last three contentions require some interpretative assistance from Black’s scholarship, the titles of the first two contentions are enough in themselves to reveal an ontological post-constructivist thrust behind the regulatory conversations method.

⁸⁶ See Segerson and Thomas, above n 57; Sam and Innes above n 57; Rees, above n 57; and Morgenstern and Pizer, above n 57.

⁸⁷ Alan Swingewood, *A Short History of Sociological Thought* (Palgrave MacMillan, 2000).

⁸⁸ See Reed, above n 81 who sets out the key criticisms of discourse analysis.

⁸⁹ Black, above n 53.

⁹⁰ Art Berman, *From the New Criticism to Deconstruction: The Reception of Structuralism and Post-Structuralism* (Illini Books, 1988).

⁹¹ Black, above n 53, 174.

⁹² Ibid.

⁹³ Ibid 186.

⁹⁴ Ibid 190.

⁹⁵ Ibid 194.

While post-structuralism and post-modernism have made a strong impact on legal analysis, they are yet to gain mainstream acceptance.⁹⁶ The rejection of an objective truth is a rejection of both traditional legal logic and traditional legal research methodologies. Traditional legal theory is largely based on precedent and positivism.⁹⁷ These ultimately rest on the seeking of a perfect system of objective law and reason. Doctrinal research has traditionally aimed to question and challenge the internal logic and objective truth of law. Removal of an objective truth poses a significant challenge to traditional legal research.

While it is thus extremely difficult to make a clear statement as to the acceptable epistemology or epistemologies of legal research, many scholars have identified legal research as being primarily positivist. Teubner suggests that the epistemology of law is relatively unclear, but demonstrates a trend toward constructivism.⁹⁸ While making no reference to Australian research, Teubner presents a comprehensive review of legal sources and key trends in law. Such an analysis however, predates much of the post-modern movement in law. Conry and Beck-Dudley more recently analysed United States sources to suggest a current state of confusion in legal epistemology.⁹⁹ Nonetheless, it appears from this analysis that in 1996 the key epistemological approach in legal analysis belonged to modernity.¹⁰⁰ More recent investigations have yielded the same results. Allen found law to be driven by a modernist epistemology in 2001.¹⁰¹ Beecher-Monas reached the same conclusion in 2003.¹⁰² There does not appear to be any recent, significant review of legal epistemology focusing on Australia.

⁹⁶ Brendan Edgeworth, *Law, Modernity, Postmodernity: Legal Change in the Contracting State* (Ashgate, 2003).

⁹⁷ Raimo Siltala, *A Theory of Precedent: From Analytical Positivism to Post-Analytical Philosophy of Law* (Hart, 2000).

⁹⁸ Gunther Teubner 'How the Law Thinks: Towards a Constructivist Epistemology of Law' in Wolfgang Krohn, Gunter Koppers and Helga Nowotny (Eds) *Self Organisation: Portrait of a Scientific Revolution* (Springer, 1990).

⁹⁹ Edward Conry and Caryn Beck-Dudley 'Meta-jurisprudence: The Epistemology of Law' (1996) 33 *American Business Law Journal* 373.

¹⁰⁰ Ibid.

¹⁰¹ Ronald Allen 'Naturalized Epistemology and the Law of Evidence' (2001) 87 *Virginia Law Review* 1491.

¹⁰² Erica Beecher-Monas 'Enron, Epistemology and Accountability: Regulating in a Global Economy' (2003) 37 *Indiana Law Review* 140.

Given the modernist and positivist approach of traditional legal research, Black's post-constructivist discourse analysis model is altered in this thesis to ensure that it aligns with traditional legal logic. The aim is to retain the benefits of the regulatory conversations model while making it less of a 'hard sell'.¹⁰³ If the regulatory conversations model can be fit within a positivist research framework then it can more easily be justified within a system of precedent, something that cannot be achieved by a post-positivist model which rejects fundamental notions of precedent. This shift is achieved by keeping the general framework of the regulatory conversations model, but utilising thematic analysis in place of discourse analysis.

The key difference between the regulatory conversations method of discourse analysis and thematic analysis lies in the constitution of objects.¹⁰⁴ Post-constructivist discourse analysis views language as the base material of power, institutions, objects and societies.¹⁰⁵ Thematic analysis, born of the school of positivist qualitative research methods, views power, institutions, objects and societies as objective reality, with discourse providing only the means by which one may understand these objective realities.¹⁰⁶

In adopting an objectivist perspective, thematic analysis is able to avoid many of the criticisms aimed at discourse analysis. It remains grounded in the same objectivity that has traditionally been associated with doctrinal legal research methods.¹⁰⁷ It does not 'idealize meaning',¹⁰⁸ or 'marginalise the non-semantic aspects of economic and political reality',¹⁰⁹ in the same way as discourse analysis. It is not nominalist or determinist, as is frequently said of discourse analysis.¹¹⁰ Likewise, it does not overlook non-discursive cultural and political processes.¹¹¹

¹⁰³ Black, above n 53, 196.

¹⁰⁴ Gergen, above n 82.

¹⁰⁵ Derek Layder, *Modern Social Theory: Key Debates and New Directions* (UCL Press, 1997).

¹⁰⁶ Newton, above n 83.

¹⁰⁷ Raw Pawson and Nick Tilley, *Realistic Evaluation* (Sage Publications, 1997).

¹⁰⁸ Reed, above n 81, 525.

¹⁰⁹ Ibid 526.

¹¹⁰ Layder, above n 105.

¹¹¹ Ibid.

Thematic analysis thus leaves open the possibility of approaching regulatory conversations from a modernist perspective. The qualitative research benefits within the regulatory conversations method can be captured, without significant departure from legal research ideology. Thematic analysis is also easier to justify, being a less controversial analytical tool than post-structuralist discourse analysis.¹¹² The research design of this thesis is thus qualitative, but retains a positivist research design. It minimises researcher presence and aims to capture, as near as possible, objective and testable qualitative data sets. While this will not capture all of the benefits inherent in Black's regulatory conversations model, it will be able to capture the key benefits of obtaining the views of regulatory subjects in an emerging market. Any loss in data gathering is more than offset by thematic analysis's ability to advance legal qualitative research in a way that is consistent with the conservative development of law.

IV DOCTRINAL RESEARCH

While this thesis is adopting an empirical research methodology based on Black's regulatory conversations model, doctrinal research maintains significant relevance. First, doctrinal research will be used to inform the regulatory theories and theoretical framework which are used to analyse the data generated by the empirical research. Second, doctrinal research will be used to triangulate data. Third, doctrinal research has been used extensively in defining the secondary electricity market, regulation and other key terms set out in chapter 2. It is only the first of these uses which poses any significant challenge to the empirical methodology adopted by this thesis.

A *Doctrinal Research, Regulatory Theory and Empirical Methodology*

The use of doctrinal research to establish and inform a critique of data on regulatory effectiveness is well established. The regulatory conversations model itself is premised on the

¹¹² Virginia Braun and Victoria Clarke 'Using Thematic Analysis in Psychology' (2006) 3 *Qualitative Research in Psychology* 77.

notion that regulatory theory will be doctrinally analysed and applied to the results of the empirical research.¹¹³ It is the limitation of doctrinal research in obtaining the views of regulatory subjects which has driven the development of the regulatory conversations model.¹¹⁴ The result is an easy fit between doctrinal research on regulatory theory and qualitative empirical research.

B *Doctrinal Research, Historical Institutionalism and Empirical Methodology*

The relationship between doctrinal investigation of historical institutionalism and qualitative empirical research is well established. The study design of this thesis should pose no significant challenge to either its doctrinal or empirical methodologies in applying an historical institutionalism analysis to the qualitative data on ASIC and the secondary electricity market. Historical institutionalism has traditionally been investigated through empirical research.¹¹⁵ Its focus on the unofficial history of institutional development necessitates the use of empirical tools to uncover important personalities, ideas and events within institutions.¹¹⁶ To the chagrin of many new institutionalism scholars, much of this research has been qualitative.¹¹⁷

The non-assumptive nature of qualitative research makes it ideal for uncovering unofficial histories of institutions.¹¹⁸ Likewise, doctrinal investigation of historical institutionalism reveals an approach which takes a wide analysis of institutions. Given this, the unlimited nature of qualitative research is alluring.¹¹⁹ There are a near infinite number of possible driving forces of institutional development and quantitative research's reliance on hypothesis led investigation may hamper the ability to discover those forces.

¹¹³ Black, above n 53.

¹¹⁴ Ibid.

¹¹⁵ Giovanni Capoccia and Daniel Kelemen 'The Study of Critical Junctures: Theory, Narrative and Counterfactuals in Historical Institutionalism' (2007) 59 *World Politics* 341.

¹¹⁶ Colin Hay and Daniel Wincott 'Structure, Agency and Historical Institutionalism' (1998) 46 *Political Studies* 951.

¹¹⁷ Daniel Drezner 'Is historical institutionalism bunk?' (2010) 17 *Review of the International Political Economy* 791.

¹¹⁸ Tom Wengraf, *Qualitative Research Interviewing* (Sage Publications, 3rd ed, 2001).

¹¹⁹ Paul Pierson and Theda Skocpol 'Historical Institutionalism in Contemporary Political Science' in Ira Katznelson and Helen Milner (eds) *Political Science: State of the Discipline* (W W Norton & Company, 2002).

Empirical research has driven a doctrinal investigation and application of historical institutionalism in both sociology¹²⁰ and economics.¹²¹ This thesis has similarly derived its adoption of historical institutionalism from the results of empirical research. As a result, there is little challenge to using an historical institutionalism approach when analysing qualitative data.

C *Doctrinal Research of Historical Institutionalism and Positivism*

Despite the fairly well established complementary link between qualitative research and historical institutionalism, there is an uneasy relationship between historical institutionalism and the adapted form of the regulatory conversations method at the heart of this thesis. In an attempt to satisfy the traditional rigors of legal research methodology, this thesis has adopted a positivist qualitative research methodology. Discourse analysis has been abandoned in favour of structuralist thematic analysis in order to maintain empirical validity and a quest for objective truth. Yet, historical institutionalism has evolved from a direct rejection of positivist analysis of institutions.¹²²

Historical institutionalism rejects the notion of lineal history.¹²³ Path dependence and human irrationality stand in stark rejection of the traditional sociological view that institutions would develop toward a productive end.¹²⁴ By adopting historical institutionalism this thesis has necessarily rejected a positivist view of institutional investigation.

This uneasiness may be addressed in a number of ways. The first is to note that there is nothing inherently illogical in using a positivist research method to illustrate a post-positivist institutional theory. It is possible that positivism is the correct method of social inquiry, but not the correct explanation for society. In fact, if a research method is to remain positivist, it must accept post-

¹²⁰ See Sven Steinmo, Kathleen Thelen and Frank Longstreth, *Structuring Politics: Historical Institutionalism in Comparative Analysis* (Cambridge University Press, 1992).

¹²¹ See Tino Weishaupt, *From the Manpower Revolution to the Activation Paradigm: Explaining International Continuity and Change in an Integrating Europe* (Amsterdam University Press, 2011).

¹²² Vivien Schmidt 'Reconciling Ideas and Institutions through Discursive Institutionalism' in Daniel Beland and Robert Cox (eds) *Ideas in Politics and Social Science Research* (Oxford University Press, 2011).

¹²³ Ibid.

¹²⁴ Ellen Immergut 'The Theoretical Core of the New Institutionalism' (1998) 26 *Politics and Society* 5.

positivist data when it results from a properly structured study. Such results raise an ideological uneasiness, but it would be more so problematic if research data was rejected simply because it did not reveal a positivist ideology.

The second is to note that the positivist research methodology adopted in this thesis is necessarily not absolute. Qualitative research by its nature must incorporate elements of interpretivism.¹²⁵ It is perhaps more correct to identify that this thesis adopts an epistemology which is part positivist and part interpretivist, with the goal being to maximise positivism and minimise the necessary interpretivism. This is more easily paired with an ontology of historical institutionalism.

The third is to note that historical institutionalism does not reject the core concepts of positivism which have driven its selection as a research epistemology. Historical institutionalism is neither anti-positivist¹²⁶ nor post-positivist.¹²⁷ It does not adopt science as an ideology.¹²⁸ In fact, historical institutionalism has equally rejected the constraints of Weber's anti-positivist 'iron cage' institutional model.¹²⁹

Historical Institutionalism also does not challenge the possibility of an objective and knowable truth.¹³⁰ There is nothing inherent in historical institutionalism which suggests an abandonment of modernist research aims. Historical institutionalism may logically be approached from a post-modern perspective. This is common in studies adopting historical institutionalism.¹³¹ Historical

¹²⁵ Joseph Ponterotto 'Qualitative Research in Counselling Psychology: A Primer on Research Paradigms and Philosophy of Science' (2005) 52 *Journal of Counselling Psychology* 126.

¹²⁶ Andrew Wicks and Edward Freeman 'Organizational Studies and the New Pragmatism: Positivism, Anti-positivism, and the Search for Ethics' (1998) 9 *Organisational Science* 123.

¹²⁷ Alexander Clarke 'The qualitative-quantitative debate: moving from positivism and confrontation to post-positivism and reconciliation' (2002) 27 *Journal of Advanced Nursing* 1242.

¹²⁸ Steinmo, above n 120.

¹²⁹ Arthur Mitzman, *The Iron Cage: An Historical Interpretation of Max Weber* (Transaction Publishers, 2nd ed., 2002).

¹³⁰ Steinmo, above n 120.

¹³¹ See Schmidt, above n 122.

institutionalism may also logically be approached from a modernist perspective. This is also common in studies adopting historical institutionalism.¹³²

In rejecting positivism, historical institutionalism appears to have been primarily rebelling against positivism being the third and final phase of social investigation in relation to institutions.¹³³ It is for this reason perhaps, that it has not become associated with the anti-positivist and post-positivist sociological thinkers. This independence from epistemology is perhaps the driving force behind many of the criticisms of historical institutionalism discussed in chapter 2. Without a clear epistemology, historical institutionalism is left as a practical ontology. In such circumstances, empirical research becomes the necessary methodology for historical institutionalism, driving the concerns of Gunnarsson.

Historical institutionalism may thus be sufficiently broad to be viewed as an ontology without a related epistemology. In this way, the only real stricture on epistemology is the research methodology. The practical investigation of institutional history calls for an empirical methodology. This empirical methodology may bring its own epistemology. In this roundabout way, it may be not only possible, but also desirable for a positivist research method to be employed in the analysis of historical institutionalism. In relation to this thesis, this means that the positivist revision of the regulatory conversations model is a legitimate method of investigating ASIC and its relationship to the secondary electricity market. As this investigation has revealed a truth that ASIC has been subject to an historical development in line with historical institutionalism, the doctrinal interrogation and adoption of historical institutionalism is necessitated. Doing so remains entirely positivist, with no real challenge presented by the non-positivist roots of historical institutionalism itself.

V RESEARCH METHOD

¹³² Janet Box-Steffensmeier, Henry Brady and David Collier, *The Oxford Handbook of Political Methodology* (Oxford University Press, 2008).

¹³³ Auguste Comte, *A General View of Positivism* (J Bridges trans, 4th ed., 1880) [trans of: *Discours sur l'ensemble du positivisme*].

This section of the chapter sets out the specific research method adopted by this thesis. First, it sets out the means by which the regulatory conversations research method was conducted. In doing so, it argues for the necessity of semi-structured interviews in generating objective but meaningful data. Second, it sets out the specific method of conducting the regulatory conversations. Third, it sets out the specific method of data analysis. This chapter concludes with the presentation of the central themes that emerged from the analysis of data. These central themes form the critical junctures which are analysed in detail in chapters four, five and six. In order to fit with the historical institutionalism theoretical framework, the research method and data have been presented in accordance with the conventions of legal research, rather than sociological research. While all of the elements of a sociological method are present throughout the thesis, they are contained in this chapter, as well as chapters four, five and six.

A *Data Collection and Semi-structured Interviews*

The regulatory conversations model is not prescriptive about how the conversation between the researcher and the subject of regulation is to occur.¹³⁴ This thesis has adopted semi-structured interviews as the means of gathering data. Semi-structured interviews and thematic analysis have been developed and utilised in social science research for a number of years.¹³⁵ Semi structured interviews attempt to balance the need for empirical objectivity with the exploratory nature of qualitative research.¹³⁶ By preparing a series of uniform open questions, the researcher is able to direct the interview toward the subject matter to be investigated.¹³⁷ The researcher is also able to ensure consistency among major subject matter between research participants.¹³⁸ If properly

¹³⁴ Black, above n 53.

¹³⁵ Nigel King 'Using Templates in the Thematic Analysis of Text' in Catherine Cassell and Gillian Symon (eds), *Essential Guide to Qualitative Methods in Organizational Research* (Sage Publications, 2004).

¹³⁶ King, above n 135.

¹³⁷ Anthony Tuckett 'Applying Thematic Analysis Theory to Practice: A researcher's Experience' (2005) 19 *Contemporary Nurse* 75.

¹³⁸ Greg Guest, Kathleen MacQueen and Emily Namey, *Applied Thematic Analysis* (Sage Publications, 2011).

developed, this research method should assist in providing the consistency and researcher non-involvement that is sought in positivist research methodologies.¹³⁹

At the same time, the fact that the interview is semi-structured allows for the researcher to explore interesting comments or observations made by the research participant.¹⁴⁰ In this way new information and themes can be discovered and developed.¹⁴¹ In adopting this approach, this thesis has attempted to balance the need for consistency and traditional empirical method with the flexibility and possibility of qualitative research design.

Semi-structured interviews are thus able to develop a personalised data set around a consistent and uniform subject-matter. This type of data lends itself well to thematic analysis. Thematic analysis allows the researcher to identify and expand upon key thoughts and ideas which are expressed across the sample population.¹⁴² While there is no quantifiable data, a scientific approach can be adopted in comparing similar language, thoughts and ideas among multiple research participants.¹⁴³ Thematic development may be done through either a structuralist or post-structuralist analysis.¹⁴⁴ This thesis has adopted the former, as discussed earlier in this chapter.

Guest, MacQueen and Namey support the use of semi-structured interviews and thematic analysis in developing an understanding of the relationship between parties.¹⁴⁵ The non-assumptive data gathering process allows for a more complete development of expression than would be available in a quantitative survey.¹⁴⁶ The complexities of individual articulation can be

¹³⁹ Richard Boyatzis, *Transforming Qualitative Information: Thematic Analysis and Code Development* (Sage Publications, 1998).

¹⁴⁰ Guest, MacQueen and Namey, above n 138.

¹⁴¹ Boyatzis, above n 139.

¹⁴² Guest, MacQueen and Namey, above n 138.

¹⁴³ Ibid.

¹⁴⁴ Johnny Saldana, *Fundamentals of Qualitative Research* (Oxford University Press, 2011).

¹⁴⁵ Guest, MacQueen and Namey, above n 138.

¹⁴⁶ Saldana, above n 144.

captured by the semi-structured interview, with the thematic analysis eliminating individual idiosyncrasies from the results of the data.¹⁴⁷

This thematic analysis process is nonetheless subject to some limitations. Thematic analysis, like all qualitative research, is subject to the bias of the researcher.¹⁴⁸ The thematic analysis of data may be manipulated by a researcher misinterpreting (deliberately or otherwise) the dataset.¹⁴⁹ Researchers may be desperate to see themes and connections and thus discover what is not really present within the data.¹⁵⁰ It formulates a research direction based on results, which opposes the wisdom of traditional study design.¹⁵¹

The objectivity and bias issues have already been addressed in this thesis. This leaves the criticism that semi-structured interviews and thematic analysis draw direction from research data, rather than the other way around.¹⁵² This is perhaps not as significant an issue in legal research as it may be in social science. Legal research does not have a strong history of empirical research.¹⁵³ Law has largely borrowed from other disciplines in developing its empirical approach.¹⁵⁴ As a result, law does not have the same tradition of hypothesis led investigation as the social sciences, potentially legitimising a results-led analysis.

Even without the lesser burden of empirical research methodology in law, semi-structured interviews and thematic analysis have received significant support in social science research.¹⁵⁵ The ability of semi-structured interviews to meld to positivist research methodologies has led to a wider acceptance than more reflexive, post-positivist research with heavy researcher

¹⁴⁷ Paul Nestor and Russell Schutt, *Research methods in psychology: investigating human behaviour* (Sage Publications, 2011).

¹⁴⁸ Guest, MacQueen and Namey, above n 138.

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

¹⁵¹ Clarke, above n 127.

¹⁵² Monique Hennink, Inge Hutter and Ajay Bailey, *Qualitative Research Methods* (Sage Publications, 2011).

¹⁵³ Chynoweth, above n 28.

¹⁵⁴ Arthurs, above n 11.

¹⁵⁵ Guest, MacQueen and Namey, above n 138.

involvement.¹⁵⁶ The safeguards built in to the semi-structured interview process, and the scientific approach to thematic analysis, make this research method one of the least radical approaches to qualitative research.¹⁵⁷ The absence of data means that the research question for this thesis cannot be answered quantitatively. As such, a moderate qualitative approach is likely to be the safest and most traditional means of investigating the research problem. Semi-structured interviews are the safest starting point for such a moderate qualitative approach.

The adoption of semi-structured interviews is furthered by the goal of this thesis to present an acceptable advance to legal research methodology. As legal research epistemology has traditionally relied on modernity, this thesis has been designed with a positivist research epistemology. While positivism does not generally guide more recent qualitative research projects,¹⁵⁸ its earliest roots were in positivism.¹⁵⁹ Early qualitative legal scholarship traditionally attempted to develop a strong empirical rationality akin to quantitative research.¹⁶⁰ It was from this movement that semi-structured interviews were developed.¹⁶¹ Semi-structured interview designs traditionally focused on gathering observable data with an impartial and passive observer.¹⁶² As a result, semi-structured interviews are not only an ideal means of gathering relevant data, but are also the means of gathering qualitative data which are most acceptable to the legal research tradition.

B *Method of Data Collection*

1 *Participants*

¹⁵⁶ Joel Mitchell 'The Quantitative Imperative: Positivism, Naive Realism and the Place of Qualitative Methods in Psychology' (2003) 13 *Theory Psychology* 5.

¹⁵⁷ Ibid.

¹⁵⁸ Clarke, above n 127.

¹⁵⁹ Mitchell, above n 156.

¹⁶⁰ Swingewood, above n 87.

¹⁶¹ Ibid.

¹⁶² Ibid.

The participants for this research were sourced from a number of electricity trading firms, business consultancy practices and law firms throughout Sydney. Given the small size of the Australian secondary electricity market, an attempt was made to contact all organisations operating in the secondary electricity market in Sydney. Given that research was to be conducted by way of semi-structured interview, secondary electricity market participants outside of metropolitan Sydney were not contacted.

Emails were sent to all major electricity traders, business consultancy practices known to be advising secondary electricity market participants and law firms known to advise secondary electricity market participants. Email addresses were sourced from the researcher's previous experience with the secondary electricity market and through internet searches. The email sent to the potential participants assured confidentiality of participant response as well as confidentiality of the organisations involved in the study. A similar email was sent to ASIC. ASIC was assured anonymity of participant response but due to the nature of the research, ASIC was informed that it would be identified as the organisation from which certain responses were drawn.

A total of 23 emails were sent. 15 organisations responded to the email. Of these, 10 organisations declined to take part in the study. 5 organisations responded positively, providing names of staff members who could be contacted for interview. A follow up email was sent to the 8 organisations who did not respond. No organisation responded to this follow up email. ASIC was among the organisations which did not provide a response to either the initial or follow up emails.

A total of 22 potential participants were nominated by the participating organisations. Each of the individuals nominated by their organisation was contacted via phone or email to request their participation. Each potential participant was assured of their anonymity and was assured that their employer would not be provided with any information about the employee's participation

or responses. Each potential participant was also assured that nothing in the publication of the results would allow for the identification of any participant.

A total of 17 participants accepted to be part of the study. Of these, 11 were electricity traders, 3 were business consultants currently providing advice to secondary electricity market participants and 3 were lawyers currently providing advice to secondary electricity market traders. One of the electricity traders who initially took part in this study later withdrew his or her consent to be included in the results. The data collected from this participant was destroyed and the results were re-evaluated based on the remaining 16 participants.

Due to the relatively small size of the secondary electricity market, in depth demographic data cannot be provided without potentially identifying individual participants. Instead, global data on the participants is provided. Participants were between 27 and 64 years of age. Participants had some form of experience in the wholesale and secondary electricity markets ranging from four years to 31 years. 12 of the participants were already working in the electricity market at the time of the establishment of the National Electricity Market. Three of the participants were female and 13 were male. All participants had worked with secondary electricity market products.

2 *Materials*

The interview schedule set out in appendix 2 was developed. A private interview room was set up at 289 Sussex Street in Sydney. Participants were given the option of attending this interview room or a conference room at their place of employment. 13 participants attended the interview room at 289 Sussex Street. Three participants were interviewed in a conference room at their place of employment.

3 *Data Collection*

Participants were asked to attend a semi-structured interview of around one hour. The interview was not recorded. Participant responses were briefly noted during the interview, with further

information being added to these notes immediately following the conclusion of the interview.

All questions present on the interview schedule set out in appendix 2 were asked, with additional questions being used to explore themes and ideas which were raised by the participants during the interview.

The interview questionnaire (see appendix 2) and interview approach was developed based on the medical semi-structured interview approach suggested by Barriball and While.¹⁶³ The interview schedule included broad directing questions, allowing the respondents to answer in their own voice and style.¹⁶⁴ The interview pace and language was led by the participant, guided by the interviewer's topic selection.¹⁶⁵ The interviewer aimed for minimal presence in the interview, keeping questions directional, rather than probing for particular responses or ideas.¹⁶⁶

In accordance with the data verification methods suggested by Gaskell¹⁶⁷ and Arksey and Knight,¹⁶⁸ participants were contacted by phone to provide further information where verification of information and interpretation was required. Participants were also recontacted where additional areas of investigation were raised by subsequent interviews, in accordance with the follow up model suggested by Longhurst.¹⁶⁹ All follow up questions were limited in duration, none of which involved more than 4 minutes of a participant's time. In all instances participants were offered the opportunity to attend the interview room to respond in person and in all instances this offer was declined.

4 Interviewer Experience and Involvement

¹⁶³ Louise Barriball and Alison While 'Collecting Data using a Semi-Structured Interview: A Discussion Paper' (1994) 19 *Journal of Advanced Nursing* 328.

¹⁶⁴ Norman Denzin, *The Research Act: A Theoretical Introduction to Sociological Methods* (Transaction Publishers, 3rd ed., 1989).

¹⁶⁵ Raymond Gorden, *Interviewing: Strategy, Techniques and Tactics* (Brooks/Cole, 1975).

¹⁶⁶ Abraham Oppenheim, *Questionnaire design, interviewing and attitude measurement* (Bloomsbury Academic, 1992).

¹⁶⁷ George Gaskell 'Individual and Group Interviewing' in Martin Bauer and George Gaskell (eds) *Qualitative Researching with Text, Image and Sound: A Practical Handbook* (Sage Publications, 2000).

¹⁶⁸ Hilary Arksey and Peter Knight, *Interviewing for Social Scientists: An Introduction Resource with Examples* (Sage Publications, 1999).

¹⁶⁹ Robyn Longhurst 'Semi-structured interviews and Focus Groups' in Nicholas Clifford, Shaun French and Gill Valentine (eds) *Key Methods in Geography* (Sage Publications, 2nd ed, 2010).

In keeping with the guiding positivist research methodology, the researcher attempted to have minimal involvement in the research project.¹⁷⁰ As far as possible, questions were kept consistent between participants, with non-scripted questions being open and facilitating in nature.¹⁷¹

Rephrasing and more direct questions were asked only to aid in the interpretation of participant responses.¹⁷² Researcher non-intervention was important not only due to the positivist research methodology, but also due to a lack of researcher experience.

The researcher has over 5 years' experience working in the secondary electricity market, but lacks qualitative research experience. The semi-structured interview style was selected as it is largely regarded as the 'safest'¹⁷³ and 'easiest'¹⁷⁴ of qualitative research methods. Adopting a highly structured semi-structured interview allowed the interviewer to minimise errors that may arise as a result of a lack of interview experience.¹⁷⁵ Efforts were also made to minimise any interview errors through comprehensive verification of data.

5 *Data Retention and Anonymity*

Notes from the interviews are kept in a locked file without identifying information. Participants were assigned a number from 1 to 16. No file has been kept linking the participant to their number. Participants are identified by number throughout this thesis.

C *Method of Data Analysis*

1 *Method*

This thesis has utilised a thematic analysis in analysing the interview data. Manual thematic analysis was carried out through side by side comparison of the data sets. Data was read through completely and common words and phrases were identified. The data was then re-evaluated,

¹⁷⁰ Denzin, Above n 164.

¹⁷¹ Wengraf, above n 118.

¹⁷² Ibid.

¹⁷³ Sharlene Hesse-Biber and Patricia Leavy, *The Practice of Qualitative Research* (Sage Publications, 2010), 27.

¹⁷⁴ Carla Willig, *Introducing Qualitative Research in Psychology* (McGraw-Hill Education, 3rd ed, 2013), 51.

¹⁷⁵ Hesse-Biber and Leavy, above n 173.

with tallies kept of the occurrence of common words and phrases. A table was formulated which recorded tallies for both common word and phrase use within each participant’s interview and comparing use between participant interviews. Once individual words and phrases had been identified, the table was reviewed for synonymous and similar terms. Roget’s thesaurus was used to verify that words being treated as synonymous or similar were, in fact, synonymous. These common words were grouped together under main themes.

While software is available to conduct this process,¹⁷⁶ it was not used in this thesis. As is noted by Brown, Taylor, Baldy, Edwards and Oppenheimer, computer aided thematic analysis may lead to incomplete data analysis where multiple synonyms and language styles are present within the dataset.¹⁷⁷ The diverse age group and backgrounds of the participants, paired with an interview style which allowed participants to adopt their own language, resulted in diverse linguistic styles. The relatively small but diverse survey population lends itself to manual data evaluation.¹⁷⁸

Themes which displayed the highest level of use both within and between participant’s interviews were selected. Five themes were identified that had significantly higher incidence of usage than others. The least prevalent of these themes was used by the participants 44% more than the next most consistent theme. All 5 themes featured use by at least 12 of the interview candidates. These five themes are presented in Table 3.1.

Table 3.1
Themes Emerging From Data

¹⁷⁶ Lyn Richards, *Using NVivo in Qualitative Research*, (Sage Publications, 1999).
¹⁷⁷ David Brown, Chris Taylor, Rakhra Baldy, George Edwards and Edna Oppenheimer ‘Computers and QDA: Can they help it? A report on a qualitative data analysis programme’ (1990) 38 *Sociological Review* 134; for a more recent article reaching the same conclusion see Elaine Welsh ‘Dealing with data: Using NVivo in the Qualitative Data Analysis Process’ (2002) 3 *Forum: Qualitative Social Research* 2.
¹⁷⁸ Moya Morrison and Jim Moir ‘The Role of Computer Software in Analysis of Qualitative Data: Efficient Clerk, Research Assistant or Trojan Horse?’ 28 *Journal of Advanced Nursing* 106.

Theme	Data
ASIC is ineffective in its regulation of the secondary electricity market because its predecessor, the ASC, was formed as a ‘pro-industry’ body.	This theme was present in 14 interviews. See Chapter 4 for in depth analysis of data.
ASIC is ineffective in its regulation of the secondary electricity market because the change from ASC to ASIC led to a detrimental change in ASIC’s regulatory approach.	This theme was present in 14 interviews. See Chapter 5 for in depth analysis of data.
The work environment in the secondary electricity market promoted behaviour which the interviewee did not feel comfortable with, but could easily justify based on a lack of regulatory oversight.	This theme was present in 14 interviews.
ASIC is ineffective in its regulation of the secondary electricity market because the rapid growth in derivatives trade following the repeal of the Glass-Steagall Legislation ¹⁷⁹ resulted in ASIC being unable to regulate derivatives in a meaningful way.	This theme was present in 13 interviews. See Chapter 6 for in depth analysis of data.
The secondary electricity market was unlikely to ever be properly regulated because it was too complex to understand and too small to attract media attention	This theme was present in 12 interviews.

Table 3.1 Sets out the major themes present in the interview data

Of the five themes set out in Table 3.1, three (the first, second and fourth theme in the table) related to a single subject matter: historical events which had led to a poor relationship between ASIC and the secondary electricity market. The other two themes (the third and fifth theme) related to work pressure and public perception. Given the close relationship between the three themes relating to the relationship between ASIC and the secondary electricity market, these

¹⁷⁹ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

themes were selected for further analysis. An in depth analysis of the data forming these three themes is presented in chapters four, five and six.

2 *Data Verification*

The thematic analysis process should assist in eliminating individual bias in the dataset.¹⁸⁰ By investigating only themes that appear in multiple respondents' data, there is lesser risk of idiosyncrasies being present within the data which is analysed as the basis of this thesis.¹⁸¹ The possibility of researcher bias has been minimised through the use of a semi-structured interview and a non-interventionist and positivist interview style.¹⁸² Given the resources of this thesis, only one researcher was involved in conducting interviews. Further studies may benefit from a more diverse range of interviewers.

As is seen throughout this thesis, the responses of the participants have been verified against other academic research, legal doctrine and researchable facts. That noted, the aim of this thesis is to establish the thoughts and perceptions of the participants. Where their thoughts and perceptions are not aligned with independent fact, this is noted and the significance of the departure from independent fact is explored.

VI METHODOLOGY AND DATA

This methodology presented in this chapter forms the basis on which the empirical data for this thesis was obtained and analysed. In summary, the regulatory conversations model of qualitative investigation is altered to fit a positivist research methodology. This has been done by replacing discourse analysis with positivist thematic analysis. This altered regulatory conversations model

¹⁸⁰ Guest, MacQueen and Namey, above n 138.

¹⁸¹ Ibid.

¹⁸² Mitchell, above n 156.

is implemented by way of semi-structured interviews. Thematic analysis of the results reveals five major themes. Of these themes, three can be grouped into a single category: historical events that prevented ASIC from effectively regulating the secondary electricity market.

The three major themes discussed in this thesis lend themselves to an investigation through historical institutionalism. In this way these themes may be seen as critical junctures in the historical development of ASIC as an institution. Each of the three themes are considered in light of the empirical data, ASIC's goals, regulatory theory and historical institutionalism to establish ASIC's present relationship with the secondary electricity market. Each of the following three chapters of this thesis will provide this consideration by focusing on a single theme and critical juncture.

CHAPTER FOUR: THE FORMATION OF ASIC

I OVERVIEW

The data obtained from the qualitative empirical investigation outlined in chapter three revealed three clear and related themes: ASIC is ineffective in its regulation of the secondary electricity market because its predecessor, the ASC, was formed as a ‘pro-industry’ body; ASIC is ineffective in its regulation of the secondary electricity market because the change from ASC to ASIC led to a detrimental change in ASIC’s regulatory approach; and ASIC is ineffective in its regulation of the secondary electricity market because the rapid growth in derivatives trade following the repeal of the Glass-Steagall Legislation resulted in ASIC being unable to regulate derivatives in a meaningful way. This chapter investigates the first of these themes, identifying it as a critical juncture. The concept of a critical juncture is discussed in more detail in chapter seven, but may be considered a period of rapid change and volatility within an organisation. It then considers the critical juncture in light of ASIC’s goals and the regulatory literature discussed in chapter two. The remaining two themes will be explored in chapters five and six.

This chapter first sets out the data establishing the theme. It then argues that the theme represents a critical juncture. In order to do this, the claims of the secondary electricity market are verified against historical and theoretical evidence. The variations in interviewee response are considered and important distinctions are noted and explored. Finally, the importance of historical institutionalism, the critical juncture and their ongoing impact on ASIC’s regulation of the secondary electricity market is considered. This chapter considers the challenges imposed by the critical juncture in and of itself on ASIC’s regulatory function. This lays the foundation for a discussion of the combined effects of the critical juncture in forming a dependent path, which is set out in chapter seven.

This chapter provides the answer to the second research question set out in chapter 1: to what extent was ASIC’s predecessor, the ASC formed as a ‘pro-industry’ institution, and to what

extent does this affect ASIC's capacity to effectively regulate the secondary electricity market? The research examined in this chapter suggests that the secondary electricity market is justified in its belief that ASC was formed as a 'pro-industry' institution and that this has a lasting effect on ASIC's regulatory approach. This approach has a detrimental effect on ASIC's relationship with the secondary electricity market.

II THEMATIC EXPLORATION OF DATA

A *Data*

The thematic analysis process referred to in chapter three revealed a recurring focus on the ASC. 14 of the interviewees referred to the 'pro-industry' policies and ideology of the ASC as having a continued influence on the regulatory approach of ASIC.¹ When asked, the remaining two interviewees stated that they were not aware of the existence of the ASC.² As these were the two youngest interviewees, it is possible that they were unaware of ASC's existence due to the fact that it had ceased to exist before they entered the secondary electricity market.

Table 4.1 sets out a series of responses by the secondary electricity market³ that establish the views of the secondary electricity market.

¹ Interviews 1, 3 – 6 and 8 – 16.

² Interviews 2 and 7.

³ See appendix 1 and appendix 2 for interview process and questions.

Table 4.1		
Data Supporting First Theme		
Ref	Statement ⁴	Interview
1	I never trusted ASC and I'll never trust ASIC. They're the same [word omitted] thing... Both of them spend all their time trying to [solicit favour from me].	3
2	ASIC is [a poor regulator] because ASC was designed to remove regulation.	6
3	ASC came and went. All it left was an indelible mark of incompetent regulatory policy which hated regulation.	15

Table 4.1 Sets out statements which strongly support the existence of the first theme⁵

Each of the responses in Table 4.1 contain three separate elements. First, the ASC must have been formed on a 'pro-industry basis'. Second, that basis must continue to effect ASIC in its present regulation (that is, it cannot have changed its political or policy approach). Third, the unchanged basis must be detrimental to regulation. While the responses in Table 4.1 contained all three elements, most interviewees provided all three elements in separate statements.

Other interviewees made multiple statements which, taken together, provided support for the theme. Many did not address issues such as the possibility of ASC or ASIC policy reform, but rather worked on an assumption that no change had occurred. In these instances the interviewees were asked directly whether they believed either ASC or ASIC had reviewed its policy.

Likewise, some interviewees appeared to believe that the ASC's original regulatory policy was

⁴ Statements have been edited to remove profanities. Changes occur in square brackets.

⁵ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

detrimental, but did not state so. These interviewees were asked to comment further on the effects of the regulatory policy adopted by ASC.

Table 4.2 sets out key statements for each of the interviewees who provided support for the theme.

Table 4.2		
Data Supporting First Theme		
Ref	Statement ⁶	Interview
1(a)	The way it [the formation of ASC] was explained to us was that our lawyers now sent paperwork to one person instead of seven... for some reason the legal fees still went up.	1
1(b)	Interviewer: Do you think there has been any policy review since ASC was formed? Interviewee: Not that I'm aware of. I can imagine them starting one somewhere back in the 90's. It's probably still going on – draining the public purse and producing nothing of value.	1
1(c)	Look. I'm not saying I want to answer to some kind of Marxist-Leninist regulator who is hell-bent on shutting us down. But, I would like to see the regulator actually regulate.	1
2(a)	[The ASC was formed] because the government needed overseas cash. [Forget] the consumer. [Forget] the market. [Forget] everyone and everything – as long as money keeps rolling in from overseas and the corporations keep smiling.	4
2(b)	Interviewer: Do you think there has been any policy review since ASC was formed? Interviewee: Yeah. ASIC reviewed its policy. Just about every bloody	4

⁶ Statements have been edited to remove profanities. Changes occur in square brackets.

	week from memory... Their reviews were as useless as they are.	
2(c)	<p>Interviewer: Do you think there has been any policy review since ASC was formed?</p> <p>Interviewee: I doubt it. If they had have they'd have seen what a [omitted] disaster [their policy] was. If even the stupidest of their overwhelmingly stupid staff had thought about this for even a minute, ASIC would be a lot [omitted] better at regulating.</p>	4
3(a)	[The ASC was formed for] three things really. Help corporations earn more money. Help overseas corporations enter Australia. Hope the corporations will vote for Labor.	5
3(b)	<p>Interviewer: Do you think there has been any policy review since ASC was formed?</p> <p>Interviewee: Not that I've noticed.</p>	5
3(c)	Are you kidding? A good thing? My job is to make profit, any way that is possible. ASIC should be making sure that my 'ways possible' don't destroy society. A good thing? I guess if you like massive volatility in your energy prices.	5
4(a)	I don't think they're [ASIC] a real regulator... more a facilitator.	8
4(b)	<p>Interviewer: Do you think there has been any policy review since ASC was formed?</p> <p>Interviewee: Definitely not.</p>	8
4(c)	<p>Interviewee: I'm not the right one to ask. It helps me. Do you like the way ASIC regulates?</p> <p>Interviewer: If I knew what you knew, would I be happy with ASIC?</p> <p>Interviewee: If you knew what I knew? No. You wouldn't be happy.</p>	8
5(a)	When they formed ASIC back in the 80's [sic]... ⁷ they were trying to boost investment.	9

⁷ As ASIC was formed in the late 90's, this would appear to be a reference to ASIC.

5(b)	<p>Interviewer: Do you think there has been any policy review since ASC was formed?</p> <p>Interviewee: No.</p> <p>Interviewer: you seem very certain</p> <p>Interviewee: I am. I keep a close eye on all the regulators to make sure they aren't going to start regulating anytime soon.</p>	9
5(c)	All of them [government institutions] are soft and ineffective.	9
6(a)	The idea [behind forming the ASC] was to get Australia out of debt. ASC would get rid of all the regulatory confusion allowing for foreign greenfields investment.	10
6(b)	ASIC wasn't always ASIC, but it's always been the same organization	10
6(c)	A regulator who doesn't want to regulate business defeats the point.	10
7(a)	To understand ASIC's regulation you need to understand ASC.	11
7(b)	Policies aren't set in concrete but they require a big trigger for change... Australia has been far too stable over the past 20 years to shake up its regulators.	11
7(c)	From a professional standpoint I'm glad ASIC does what it does. As someone who owns shares and relies on electricity at home, I wish ASIC would do something different.	11
8(a)	They created the ASC to, you know, get out of the way. The ACCC, there was a real regulator. ASC? That was the government's way of making Australia competitive on a world stage.	12
8(b)	The same thing that caused them to make ASC is why they [sic] aren't doing their [sic] job now.	12
8(c)	No. They [ASIC] aren't good. They [sic] haven't done anything good.	12
9(a)	There was nothing ground breaking about ASC. It just followed the	13

	overseas model of regulation... It's one of the first times I've seen corporations happy to have a new regulator.	
9(b)	Both the ASC and ASIC review their policy every year. I think it's mandated by the ASIC Act... The reviews usually result in small changes. It's never ground breaking stuff. They are tweaking how they implement their regulatory approach. The policy reviews aren't for changing their approach.	13
9(c)	It's a bit of a balancing act really. A good regulator gets the job done without industry being aware that the regulator has done anything at all... ASIC goes unnoticed, but that isn't because it is doing a good job... ASIC is simply too busy to focus on unique segments of the financial market.	13
10(a)	If you need proof that ASC was a slave to business, just look to the second reading speech. The whole thing was about how regulation needs to meet business demands.	14
10(b)	ASIC is exactly the same [as ASC]... it just got superannuation.	14
10(c)	When the government prefers the interests of corporations to the interests of men, it is everyone's problem. Look to Enron. Look to the Asia crisis. Look to the GFC.	14
11(a)	ASC became ASIC but the politics stuck.	15
11(b)	Creating the ASC was sensible. Something had to be done about state duplication. The problems came later. ASIC has never sat down and asked itself whether the world's moved on. It has. ASIC hasn't.	15
11(c)	ASIC would be a good regulator if Australia's derivatives market was the same size it was in the early 90's... at the moment it [ASIC] is bringing a knife to a nuclear war.	15
12(a)	I mean they did everything they could for industry. Before ASC came into play there were real problems faced by business. Some were procedural – having to answer to 4 [sic] different regulators means a lot of wasted time. Others were simply a change in policy... The old	16

	regulators cared about consumers. They distrusted corporations and kept them on a tight reign. ASC changed all that. ASC was meant to favour corporations over consumers, the rich over the poor.	
12(b)	<p>Interviewer: Do you think there has been any policy review since ASC was formed?</p> <p>Interviewee: Yes. They have undergone quite a few reviews. I don't know what the outcome is. I can't really be bothered to read them... [the reviews] can't have achieved too much. If you took someone from the very early days of ASC and put them in a modern ASIC office, they might have a problem with the technology, but culturally, they'd fit right in.</p>	16
12(c)	I want it known that I don't think ASIC is a bad regulator when compared to other regulators. I'd prefer to deal with ASIC than the SEC ⁸ or SFC. ⁹ But that doesn't mean that it's a good regulator.	16

Table 4.2 Sets out statements which support the three separate elements of the existence of the first theme¹⁰

B Thematic Analysis

14 of the 16 interviewees expressed a belief that the policy adopted at the formation of ASC continued to affect ASIC's ability to regulate the secondary electricity market. This represents 88% of the interview population. Tables 4.1 and 4.2 set out the clearest response provided by each interviewee in relation to this theme. During the one hour interview, 13 of these interviewees referred to this fact on three or more occasions. All of the data set out in Table 4.1 and the data set out in Table 4.2 1(a) to 4(c) and 6(a) to 12(c) represent only a selection of the

⁸ United States of America's Financial Market Regulator.

⁹ Hong Kong's Financial Market Regulator.

¹⁰ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

discussion held on this theme with the interviewee. Interview nine provided the data set out at 5(a) to 5(c), but did not otherwise mention ASC's policy. The total number of mentions of the policy adopted at the formation of ASC was 49. This was the strongest of all of the themes explored in this thesis.

11 of the 14 interviewees who provided responses which led to the development of this theme believed that there had been no change or review of ASC or ASIC policy since the formation of ASIC. These responses are set out in Table 4.1 and Table 4.2 1(b), 3(b), 4(b), 5(b), 6(b), 7(b), 8(b), 10(b) and 11(b). The remaining three interviewees who contributed to this theme believed that ASIC had undertaken a policy review but that the review was ineffective. These responses are set out in Table 4.2 2(b), 9(b) and 12(b). Eight of the responses regarding the review of ASIC policy were contributed without prompting. Six interviewees were asked directly whether ASIC had reviewed their policy. While this data may support the theme that 'ASIC's policy is still substantially the same as it was at the formation of ASC', the difference in responses is important in evaluating the regulatory effectiveness of ASIC. 69% of interviewees hold the erroneous belief that ASIC has never undertaken a policy review. Both the validity and significance of this belief is examined in this chapter. Only 19% of the interviewees accurately identified that ASIC has undertaken a policy review. While this minority data is not strong enough in its own right to be considered a theme, it provides greater insight into the problems faced by ASIC as a result of the belief of the majority of the interviewees. For this reason the minority interviewees' responses are examined in this chapter.

All 14 interviewees contributing to this theme believed that the policy adopted by ASC has a negative impact on ASIC's ability to regulate the secondary electricity market. These responses are set out in Table 4.1 and Table 4.2 1(c), 2(c), 3(c), 4(c), 5(c), 6(c), 7(c), 8(c), 9(c), 10(c), 11(c) and 12(c). These responses suggested varied levels of detriment caused by ASC's initial policy choices. The response set out in 3(c) is indicative of the stronger responses provided by

interviewees. The response which suggested the least detriment is set out at 12(c). Even the weakest of these responses was clearly negative about the effect ASC's policy has on ASIC's regulation of the secondary electricity market.

Taken together, a strong theme emerges from this interview data. The interviewees believe that the policy adopted by the ASC at its formation continues to negatively affect ASIC's ability to regulate the secondary electricity market. This chapter identifies this theme as a critical juncture and discusses the effect that the interviewees' views have on ASIC's ability to be an effective regulator. It does so by first examining whether the interviewees are correct, or at least rational, in their views. Second, this chapter examines the relevance of the interviewee's responses for ASIC's current regulation in light of their accuracy. Finally, it considers this critical juncture in isolation and questions the possible courses of action ASIC may take to alter the views of the secondary electricity market.

III DISCUSSION OF THEME / CRITICAL JUNCTURE

This thesis identifies the formation of ASC as the first critical juncture in the development of ASIC's regulatory policy in relation to the secondary electricity market. As was noted in the thematic analysis, this critical juncture is formed by three separate elements. First, ASC was formed with a 'pro-industry' policy. Second, neither ASC nor ASIC has undertaken a review of policy. Finally, the 'pro-industry' policy has a detrimental effect on ASIC's regulation of the secondary electricity market. Each of these elements is considered in isolation before the critical juncture is examined as a whole.

A *ASC was formed as a 'Pro-industry' Body*

The term 'pro-industry' was used by only one interviewee,¹¹ but provides a useful umbrella term for a number of common ideas expressed by the interviewees. When the interviewee was asked

¹¹ Interview 16.

to explain what was meant by ‘pro-industry’ he or she provided the response set out in Table 4.2 12(a). There were 13 other responses which can be seen to fall within this definition. These responses are set out in Table 4.1 and Table 4.2 1(a), 2(a), 3(a), 4(a), 5(a), 6(a), 7(a), 8(a), 9(a), 10(a) and 11(a).

This thesis has adopted the term ‘pro-industry’ as an umbrella term for the views identified above. ‘Pro-industry’ is used throughout this thesis to refer to regulation which aims primarily to minimise impediments to business operations, improve and attract investment in businesses and financial markets and reduce regulatory costs and procedures faced by businesses. While all modern regulation is likely to have these goals,¹² regulation becomes ‘pro-industry’ when it prioritises these goals over competing goals such as consumer protection, fully informed markets and market stability.

1 *Accuracy of Industry Perception*

14 of the interviewees believed that ASC was formed on a pro-industry basis. An examination of academic theory and historical evidence reveals that this is a supportable view. A logical starting point for this examination is, as suggested by one of the interviewees,¹³ the second reading speech for the *Australian Securities Commission Bill*¹⁴ (‘ASC Bill’).

The second reading speech of the ASC Bill¹⁵ suggests that ASC was to be a pro-industry regulator. The speech contains numerous references to ‘*promoting efficiency*’¹⁶ and providing a ‘*framework for... business enterprise*’.¹⁷ The clear message of the speech is that ASC was to be formed to meet the requirements of international investment and business efficacy. The response that is offered is a more responsive regulator and an overall lower regulatory burden.

¹² Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (Oxford University Press, 2nd ed., 2011).

¹³ See table 4.2, response 10(a).

¹⁴ 1988 (Cth).

¹⁵ *ASC Bill 1988* (Cth).

¹⁶ Commonwealth, *Parliamentary Debates*, Senate, 25 May 1988, Lionel Bowen.

¹⁷ *Ibid.*

The second reading speech is further supported by the explanatory memorandum of the ASC Bill.¹⁸ The explanatory memorandum repeats the pro-industry sentiment and echoes the desire for uniformity, efficiency and responsiveness. The bill thus attempts to streamline regulation and reduce regulatory burden, even though it *prima facie* grants regulatory power.¹⁹

Both Baxt and Schoer identified that ASC was moving away from command and control regulation in favour of an approach that worked side by side with industry.²⁰ Their argument does not necessarily state that ASC was designed as an industry-friendly body, but it does support the argument that ASC was, from its earliest years, engaged in industry-friendly regulation. This, combined with the industry-friendly focus of the second reading speech and explanatory memorandum, strongly suggest that ASC was formed on a pro-industry basis.

This conclusion is made even more attractive when the views of the first chairman of ASC, Tony Hartnell, are taken into account. Hartnell provided clear support for the claims made by Baxt and Schoer by noting that ASC's success should not be judged on the basis of prosecutions, but rather ASC's relationship with the market.²¹ The idea expressed by the interviewees, namely that ASC was formed on a pro-industry basis, finds much evidence in policy documents and releases such as these.

There is, however, a dissenting view. Some critics viewed the introduction of ASC as something providing increased powers to a centralised regulator. Collett, Godfrey and Hrasky note that the formation of ASC greatly enlarged the regulator's powers over accounting practises.²² Longo is far more forthcoming in his criticism of ASC, suggesting that the *Australian Securities*

¹⁸ Explanatory Memorandum, *Australian Securities Commission Bill* 1989 (Cth).

¹⁹ *Ibid* pp 2, 5.

²⁰ Robert Baxt 'Thinking about Regulatory Mix: Companies and Securities, Tax and Trade Practices' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology, 1993) 117; Ray Schoer 'Self Regulation and the Australian Stock Exchange' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology, 1993) 107.

²¹ Tony Hartnell 'Regulatory Enforcement by the Australian Securities Commission' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology 1993) 25.

²² Peter Collett, Jayne Godfrey, Sue Hrasky 'International Harmonization: Cautions from the Australian Experience' (2001) 15 *Accounting Horizons* 171, 175.

*Commission Act*²³ ('ASC Act') resulted in a significant imbalance between the powers of state and the individual.²⁴

Collett, Godfrey and Hrasky's criticism reflects a much larger body of dissenting academia. The concerns about ASC's control over accounting standards was (and remained for many years), quite strong.²⁵ This dissenting voice seems to have largely disappeared. By the turn of the millennium most commentators seemed to accept the international harmonization of accounting standards as an inevitability.²⁶

Longo's view reflects a much less popular, but entirely rational concern. A short review of the ASC Act²⁷ reveals that Longo is justified in asserting that ASC had wider discretionary powers than any of the state corporate regulators it replaced. In particular, the implementation of the civil penalty provisions in 1993 provided ASC with new discretionary powers.²⁸ ASIC's use of these powers remains controversial, with recent discussions questioning the legitimacy of ASIC's implementation method.²⁹ Beyond civil penalty provisions, the ASC Act³⁰ also provided ASC with discretionary powers to call for the production of books, to demand a record of property, to require to acquisition and disposal of securities, and to hold public or private criminal or civil hearings.³¹ These powers are discretionary and bound only by the limited

²³ 1989 (Cth).

²⁴ Joseph Longo 'The Powers of Investigation of the Australian Securities Commission: Balancing the Interests of Persons and Companies under Investigation with the Interests of the State' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology, 1993) 43, 43.

²⁵ See Malcolm Miller 'Goodwill Discontent: The Meshing of Australian and International Accounting Policy' (1995) 5 *Australian Accounting Review* 3; and Stephen Zeff 'International Accounting Principles and Auditing Standards: Is it the Beginning or the End?' (1993) 2 *European Accounting Review* 403.

²⁶ See Philip Brown and Ann Tarca 'Politics, Processes and the Future of Australian Accounting Standards' (2001) 37 *Abacus* 267 and Kevin Davis 'Financial Restructuring in Australia' (1997) 16 *Economic Papers: A Journal of Applied Economics and Policy* 1.

²⁷ 1989 (Cth).

²⁸ Suzanne Le Mire "'It's not Fair!': The Duty of Fairness and the Corporate Regulator' (2014) 36 *Sydney Law Review* 445, 468.

²⁹ See Ibid 468 - 469; Vicky Comino 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' (2009) 33(3) *Melbourne University Law Review* 802; Vicky Comino 'The Enforcement Record of ASIC Since the Introduction of the Civil Penalty Regime' (2007) 20 *Australian Journal of Corporate Law* 183; and Michelle Welsh 'Eleven Years On – An Examination of ASIC's Use of an Expanding Civil Penalty Regime' (2004) 17 *Australian Journal of Corporate Law* 175.

³⁰ 1989 (Cth).

³¹ Ibid ss 39 – 53.

parameters set out in the act.³² Such powers were not as wide ranging under the state-based law.³³ While the policy makers of the time suggested that these powers would be used for pro-industry purposes, there was no guarantee that this would be the case. Indeed, the legislation had been passed under a Fabian prime minister. It is entirely consistent with Fabianism to suggest passing legislation to assist industry which was in fact an instrument of democratic socialism.³⁴

This analysis however, can only go to proving that Longo's views were rational. With the benefit of hindsight it can be seen that Longo's rational fears were never realised: ASC did not use its powers for socialist ends. In fact, the discretionary power given to ASC quickly became the basis by which ASC could adopt the 'compliance pyramid' proposed by Ayres and Braithwaite.³⁵

There is a final dissenting view which exists almost entirely in its defence. The ASC Act³⁶ contains fairly strong regulatory powers. A de-contextualised review of the legislation reveals the legislation to be a draconian tool of strict industry regulation. This is an argument that ASC appears to have been concerned with, but it is unclear whether it actually exists.

An address by Knott to the Australian Institute of Company Directors is typical of this concern.³⁷ He defends ASIC against the charge that ASIC stifles business with its heavy-handed regulation. It is quite possible, even likely, that these criticisms of ASIC and ASC do and did exist. They are a common sense criticism when the ASC Act is considered in isolation of all factors other than economic conservatism. Such an argument could be attributed to Longo, but to do so would be to overlook the complexity and nuance in his argument. Longo's primary concern is not with the

³² See *Australian Securities Commission Act 1989* (Cth) s 28 and s 40 which provide for the exercise of discretion provided such an exercise is in accordance with the purposes of the act.

³³ See *Companies Act 1961* (NSW); *Companies Act 1961* (Vic); *Companies Act 1961* (WA); *Companies Act 1961* (Qld); *Companies Act 1961* (Tas); *Companies Act 1961* (SA); *Companies Ordinance 1962* (NT); and *Companies Ordinance 1962* (ACT).

³⁴ Vernon Bogdanor 'Why Fabianism Could Not Survive' (1996) 127 *New Statesman* 28.

³⁵ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992).

³⁶ 1989 (Cth).

³⁷ David Knott 'ASIC – Friend or foe of business' (speech delivered at the Australian Institute of Company Directors, Perth, 9 July 2003).

extent of power, but the breadth of discretion.³⁸ If one does not misattribute this argument to Longo then the argument does not readily appear in the media or in academic studies.

A search for criticisms of ASC yields much the same response as a search for criticisms of ASIC. Media and academic studies are quick to point out failures in corporate litigation and ASIC's lack of regulatory focus.³⁹ These criticisms of ASIC are based on ASIC's inaction. These criticisms thus appear at the opposite end of the spectrum to those being defended against by ASIC. Searches of most legal and media academic databases for 'ASIC and Criticism' yield no results criticising ASIC for its overly regulatory approach.⁴⁰

The fact that this criticism does not appear to exist in any substantial and published form should be ground alone for its dismissal. The fact that ASIC is defending itself against potentially non-existent criticism may provide insight into a communication and ideological problem between the secondary electricity market and ASIC. This is an issue that may be explored in a future study. For now it is sufficient to note that such criticism does not form the basis of any notable public argument.

It is worth noting that the view that the ASC was formed under anti-industry legislation which promoted heavy regulation can only be maintained if the legislation is viewed in isolation. The ASC was formed to replace complex and often contradictory state-based regulation.⁴¹ While the ASC and its constituent legislation was still undeniably regulatory in nature, it was significantly less command and control than the regulation it replaced.⁴²

³⁸ Longo, above n 24.

³⁹ See Ben Woodhead, 'ASIC Hits and Misses', *Financial Review* (Australia), 3 May 2012; Norman O'Bryan 'Unfair Criticism of ASIC Oversimplifies Challenges', *The Age*, (Australia), 3 March 2010; and Alex Malley 'ASIC Should Listen to Criticism', *The Australian*, (Australia), 1 May 2013.

⁴⁰ Databases searched include: LexisNexis, LexisNexis AU, Westlaw, Lawbook Online, Hein Online, MediaScan and Communication and Mass Media Complete (EBSCO host).

⁴¹ Rob McQueen 'An Examination of Australian Corporate Law and Regulation 1901 – 1961' (1992) 15 *University of New South Wales Law Journal* 1.

⁴² Vijaya Nagarajan 'From "Command and Control" to "Open Method Co-ordination": Theorising the Practice of Regulatory Agencies (2008) 8 *Macquarie Law Journal* 5, 8.

The weight of evidence therefore suggests that the secondary electricity market is supported in its assertion that the ASC was formed as a result of pro-industry policy. While the ASC remains a regulatory institution, it sought to alleviate businesses of more complex and adversary state-based regulatory system. The fact that the secondary electricity market's view of ASIC is supportable creates a troubling regulatory problem for ASIC.

2 *Consequences of Industry Perception*

The fact that the secondary electricity market holds a negative perception of ASIC is in itself an indication of regulatory failure. Hartnell noted that a key measure of ASC's success was its relationship with industry.⁴³ This is in line with the goals of ASIC set out in chapter 2.⁴⁴ The co-regulatory model views regulation as an essentially human issue.⁴⁵ If one of ASIC's key concerns is influencing human behaviour,⁴⁶ then the most important factor for the regulator is not internal consistency and logic, but rather the regulator's relationship with those it seeks to regulate.⁴⁷ Whether or not the views of the interviewees are accurate or logical is of secondary importance.

This problem is exacerbated where the views held by industry are rational. If the perceived regulatory error is based on a factual error, then that error may be corrected by improvements in communication.⁴⁸ If, as is the case with the views of the interviewees in this instance, the perceived regulatory error is based on truth, then ASIC has three possible courses of action. First, it can convince the secondary electricity market that it is wrong, despite the evidence to the contrary. Second, it can attempt to convince the secondary electricity market that a pro-industry

⁴³ Hartnell, above n 21.

⁴⁴ Ayres and Braithwaite, above n 35.

⁴⁵ See: Julia Black 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 37; Ayres and Braithwaite, above n 35; and Robert Baldwin and Martin Cave *Understanding Regulation. Theory, Strategy and Practice* (Oxford University Press, 1999).

⁴⁶ Pauline McDonald 'The Legal Sociology of Georges Gurvitch' (1979) *British Journal of Law and Society* 24, 25.

⁴⁷ Robert Baldwin and Julia Black 'Really Responsive Regulation' (2008) 71 *Modern Law Review* 59, 63.

⁴⁸ Paul Almond 'Communication and Social Regulation: The Criminalization of Work-Related Death' (2012) 5 *British Journal of Criminology* 997.

regulatory approach is positive. Third, it can admit that ASC was formed on a pro-industry basis, confirm that this was a problem and demonstrate that the problem has been or is being corrected.

The first of these approaches is both undesirable and unlikely to work. ASIC is attempting to implement a responsive regulation approach which requires a level of trust between the regulator and those it regulates.⁴⁹ An attempt to deceive the market it is regulating is unlikely to produce any long-term gains.

The second of these approaches is possibly the most effective option for ASIC. It is possible for ASIC to extend the education component of its responsive regulation approach to include not only education on ASIC's regulatory goals, but the purpose of establishing those goals. The contrasting ideologies between ASIC and the secondary electricity market⁵⁰ mean that this will be an extremely long-term project, unlikely to yield any results in the short or medium term.

The final approach is one which can only be adopted if this industry perception problem is viewed in isolation. This problem represents only part of a single critical juncture in the development of a dependant path for ASIC. Chapter seven of this thesis establishes this dependent path and examines why it is undesirable for ASIC to simply change its regulatory approach to meet the needs of the secondary electricity market.

B *Neither the ASC nor ASIC has Undertaken a Policy Review*

11 of the 16 interviewees believed that neither ASC nor ASIC had undertaken a policy review since the formation of ASC. Three interviewees believed that ASIC had undertaken at least one policy review, but believed any review that was undertaken was ineffective. The divergence in views does not affect the identification of a critical juncture. Whether the review did not occur, or whether it occurred and was ineffective does not alter the current effect of the formation of

⁴⁹ Catherine Mitchell and Bridget Woodman 'Towards Trust in Regulation – Moving to a Public Value Regulation' (2010) 38 *Energy Policy* 2644, 2645.

⁵⁰ A discussion of these ideologies is set out in Part IIIC of this chapter.

ASC on ASIC's regulation of the secondary electricity market. The accuracy of these divergent views do however, identify the extent of potential regulatory failure.

1 *Historical Accuracy: No Policy Review Occurred*

This view is easy to dismiss. Only one review needs to be identified. ASIC frequently updates its regulatory guides and class orders.⁵¹ This alone may be sufficient to challenge the factual accuracy of the interviewees' responses.

Adopting such a dismissal may overlook a greater complexity present in the views of the interviewees. The interviewees may not have been referring to reviews of single regulatory guides, but a review of ASIC's fundamental regulatory approach. It is possible that ASIC could undertake numerous reviews to update its application of regulatory theory to fit a changing business environment without ever changing its regulatory theory. Given that the interviewees generally referred to major policy problems, rather than the detailed circumstances generally contained in regulatory guides and class orders, this is perhaps the better interpretation.

Even if this interpretation of 'policy review' is adopted, it is easily disproven. ASC and ASIC were extremely vocal about their adoption of the 'compliance pyramid' model of regulation in the early 1990's.⁵² The adoption of this model is well documented by regulatory scholarship,⁵³ as Comino tracks the use of ASIC's enforcement mechanisms against the responsive regulation model. The adoption of this model is also supported by evidence directly from ASIC, as Jeffrey Lucy in his speech to the Australian-Israeli Chamber of Commerce was explicit about

⁵¹ See Australian Securities and Investments Commission, *Regulatory Guide 146: Licensing: Training of Financial Product Advisers*, under review as at the date of the submission of this thesis; Australian Securities and Investments Commission, *Regulatory Guide 64: Failure to Lodge Documents*, under review as at the date of the submission of this thesis; and Australian Securities and Investments Commission, *Regulatory Guide 83: Reinstatement of Companies*, under review as at the date of the submission of this thesis.

⁵² Vicky Comino 'Towards Better Corporate Regulation in Australia' (2011) 26 *Australian Journal of Corporate Law* 6.

⁵³ See Vicky Comino 'The Enforcement Record of ASIC Since the Introduction of the Civil Penalty Regime' (2007) 20 *Australian Journal of Corporate Law* 183; and Vicky Comino 'The Challenge of Corporate Law Enforcement in Australia' (2009) 23 *Australian Journal of Corporate Law* 233.

Australia's adoption of the compliance pyramid.⁵⁴ This policy adoption has even been recognised by the Federal Court of Australia.⁵⁵

This information only proves the interviewees incorrect if the adoption of the compliance pyramid is the result of a policy review. This is a reasonably simple equation. The compliance pyramid was proposed by Ayres and Braithwaite in 1992.⁵⁶ Responsive regulation was not a theory that had been fully developed or explained at the inception of ASC. The adoption of a responsive regulatory approach is therefore proof of a change in policy.

There is a possible argument that a change in policy does not necessarily mean a review of policy. This is an argument that relies far too heavily on a precise definition of review. Whether or not a formal review process was undertaken, it is a logical necessity that some person in charge of making regulatory decisions determined that responsive regulation should be adopted. Whatever that person's thought process, it was still, in some form, a review.

Even if one still gives credibility to the argument that a decision is not a review, evidence exists of a proper policy review process within ASC. Hartnell participated in early studies and discussion on regulatory theory, even collaborating with John Braithwaite.⁵⁷ In addition, early reports produced by the Corporate and Markets Advisory Committee ('CAMAC') contained analysis of regulatory theory, reflecting the fact that ASC was clearly aware of its regulatory policy.⁵⁸ Perhaps even more critically, a legislative committee pre-empted the CAMAC reports in discussing the need for a regulatory policy review.⁵⁹

⁵⁴ Jeffrey Lucy 'Significant Regulatory Issues Facing ASIC and Australian Business' (speech delivered at the Australian-Israeli Chamber of Commerce, 4 August 2004).

⁵⁵ *ASIC v HLP Financial Planning (Aust) Pty Ltd* (2007) 164 FCR 487.

⁵⁶ Ayres and Braithwaite, above n 35.

⁵⁷ Hartnell, above n 21.

⁵⁸ See Corporations and Markets Advisory Committee, *An Enhanced Statutory Disclosure System* (1991); Corporations and Markets Advisory Committee, *Company Directors and Officers: Indemnification, Relief and Insurance* (1992).

⁵⁹ Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989) 80.

The fact that ASC was aware of its policy, chaired by a person who was engaged with regulatory policy, and changed its policy suggests that ASC underwent a policy review as early as 1993.

This was not the last review that the regulator undertook. Comino argues that ASIC has likewise adopted policy changes to reflect Sparrow's 'regulatory craftsmanship' and 'holistic enforcement'.⁶⁰ Comino's claim need not be investigated. A single policy review is sufficient to disprove the claim that ASIC never undertook a policy review.

It is clear that ASC has undertaken at least one policy review since its inception. As a result, a strong majority of the interviewees hold a factually incorrect view of the regulator. The consequences of this view for ASIC depend largely on the accuracy of the perceptions of the minority of interviewees who believed that ASIC underwent policy reviews, but that such reviews produced no significant change.

2 *Historical Accuracy: Policy Review Produced no Significant Change*

The perception that ASIC undertook policy reviews but produced no significant change is difficult to prove or disprove. Inherent in the claim is a subjective measure of what is and is not a 'pro-industry' approach. As no regulator exists entirely to assist industry, it must exist somewhere on a spectrum between being completely industry oriented to being completely hostile to industry. There is no clear line that can be drawn to determine when a regulator can be properly classified as 'pro-industry'. Accordingly, the analysis of interviewee responses does not aim to determine if they are correct in stating that ASC was 'pro-industry', but rather whether a rational person could support such a claim.

In 1993 ASIC undertook a major policy review leading to the adoption of responsive regulation as a regulatory theory.⁶¹ This policy review is considered first. Any subsequent policy shift to really responsive regulation, polycentric regulation or other regulatory theory will be

⁶⁰ Comino, above n 52.

⁶¹ Comino, above n 52.

significantly easier to analyse once the significance of the shift to responsive regulation has been established.

Nagarajan notes that responsive regulation is neither for nor against industry.⁶² Rather, it listens to the regulatory needs of industry before intervening.⁶³ It is entirely possible that the implementation of responsive regulation may have resulted in ASIC reviewing the market, determining that it was engaged in no meaningful regulation of itself and accordingly implementing heavy-handed regulation. Given relatively recent scholarship on civil penalties and compliance which continues to demonstrate a responsive regulation approach by ASIC,⁶⁴ this is highly unlikely.

In the case of ASC, there are two reasons to believe that the move to responsive regulation was pro-industry in its approach. First, command and control regulation is traditionally based on the concept that it is the regulator who determines the regulatory needs.⁶⁵ Any focus on the industry will result in a more industry-focussed regulator. Even if not acted upon, the recognition of needs is clearly not a step away from industry needs and is likely a step toward them.

Second, part of the success of responsive regulation is its ability to recognise non-legal sources of regulation. It has already been established that regulation can come in many non-legal forms.⁶⁶ As command and control regulation fails to recognise these factors, responsive regulation begins the regulatory approach with an idea that there may already be sources of regulation. At worst, a responsive regulator may view the industry and determine that it has no internal sources of regulation (a highly unlikely view in light of the work of Gurvitch).⁶⁷ A more likely outcome is that a review of industry will reveal numerous sources of regulation. The

⁶² Nagarajan, above n 42.

⁶³ Ibid.

⁶⁴ See Comino, above n 52; Comino, above n 53; and Comino, above n 53.

⁶⁵ Mitchell and Woodman, above n 49.

⁶⁶ Ayres and Braithwaite, above n 35.

⁶⁷ McDonald, above n 46.

regulator can then work on building and supplementing pre-existing regulation. This less interventionist approach is likely to be considered ‘pro-industry’.

If this argument is accepted, then it appears that the move to responsive regulation resulted in ASC’s policy being more pro-industry, rather than less. There are however, some concerning weaknesses in this argument that must be addressed. First, this argument relies on an assumption that less interventionist regulation is ‘pro-industry’. This has undoubtedly been the view of neo-liberal economic scholars.⁶⁸ While such a view may be open to challenge, its existence validates the rationality of the perceptions of the interviewees who believed that the ASC and ASIC’s policy reviews presented no challenge to its pro-industry policies.

This argument must also contend with more recent regulatory theory which suggests that responsive regulation is not particularly responsive to industry. Baldwin and Black have suggested that responsive regulation is primarily state-centric.⁶⁹ Nagarajan draws a similar conclusion.⁷⁰ These arguments are based on a comparison of responsive regulation to other, more flexible models of regulation. In determining the movements of ASC and ASIC, the relevant point of comparison is command and control regulation. Such a comparison suggests that responsive regulation –even if state based– is the less autocratic and interventionist option.

The interviewees thus appear rational in the belief that the adoption by ASC of responsive regulation was a move toward pro-industry policy rather than away from it. A consideration of subsequent moves from responsive regulation to other forms of regulatory policy similarly reveals the rationality of the belief of the interviewees. While ASIC has not been vocal about any move away from responsive regulation, it can be seen that any possible move that has been made has only furthered the legitimacy of claims of pro-industry regulation.

⁶⁸ Milton Friedman ‘From Galbraith to Economic Freedom’ (Occasional Paper 49 presented at Institute of Economic Affairs 1977).

⁶⁹ Baldwin and Black, above n 47, 60.

⁷⁰ Nagarajan, above n 42.

The last time ASIC explicitly referred to responsive regulation was in 2004.⁷¹ Comino notes subsequent statements by ASIC which, although not explicit, reveal a tendency toward ‘regulatory craftsmanship’ and ‘holistic enforcement’.⁷² The question then, is whether these theories are more or less ‘pro-industry’ than responsive regulation.

Regulatory craftsmanship suggests a focussed approach to regulation which identifies key problems and focuses limited resources toward fixing those problems.⁷³ In isolation this would appear to be a less industry-focused approach to regulation. This view is further enforced as Sparrow argues that regulation ought to focus on reducing risks to society.⁷⁴

It is possible that ASIC has, in the past 10 years, altered its regulatory focus toward a stronger societal protection. The alternate explanation would be that regulatory craftsmanship and responsive regulation need not be mutually exclusive. Regulatory craftsmanship provides a means of identifying regulatory issues and allocating resources to resolve them.⁷⁵ It does not mandate the way in which these problems may be resolved. If ASIC is equipped with the tools and experience developed during the use of the compliance pyramid, then those tools will be the most cost effective (and likely most effective) means of resolving problems. There is no reason to believe that ASIC may not be simultaneously responsively regulating and exercising regulatory craftsmanship.

A holistic approach to regulation is neither in favour of nor against industry. It simply offers a greater insight into the regulatory problems and their societal context.⁷⁶ As with regulatory craftsmanship, holistic regulation can sensibly work in conjunction with responsive regulation.

⁷¹ Lucy, above n 54.

⁷² Comino, above n 44.

⁷³ Malcolm Sparrow, *The Regulatory Craft. Controlling Risk, Solving Problems and Managing Compliance* (The Brookings Institute, 2000).

⁷⁴ Ibid 207.

⁷⁵ Sparrow, above n 73.

⁷⁶ Sparrow, above n 73, 149.

The fact that these potential shifts in regulatory policy have only further supported claims of pro-industry regulation may come as no surprise. A vast majority of current regulatory theory shares the same roots as responsive regulation (and in many instances has its roots *in* responsive regulation).⁷⁷ The chain of regulatory theory from responsive regulation through to modern thoughts on poly-centric regulation appears to share the same ideological basis. All of them are forms of the decentred regulation identified in chapter 2.⁷⁸ This alone suggests that whatever path has been adopted by ASIC, it is likely to be more pro-industry than the pre-responsive regulatory basis on which the ASC was formed.

3 *Consequences of Industry Perception: No Policy Review Occurred*

The perception of the majority, that neither ASC nor ASIC has undergone a policy review, is historically inaccurate. In many ways the historical inaccuracy of this perception is good news for ASIC. To correct this perception all that needs to be done is for ASIC to present the secondary electricity market with evidence of its policy reviews.⁷⁹ In other ways, the historical inaccuracy of this perception is a cause for concern. The fact that the secondary electricity market is unaware of ASIC's policy reviews, despite them being on the public record, suggests a communication difficulty between ASIC and the secondary electricity market.

Communication is critical to effective responsive regulation.⁸⁰ If the regulator is to rely on elements of self-regulation, co-regulation and deterrence, then it must have clear and effective communication with those it seeks to regulate.⁸¹ It should be noted that the communication difficulty faced here is not the difficulty suggested by Baldwin and Black (i.e. different logics lead to a lack of understanding).⁸² The communication difficulty faced here is the fact that information is simply not being received, rather than it not being understood.

⁷⁷ Nagarajan, above n 42.

⁷⁸ Julia Black 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1.

⁷⁹ Almond, above n 48.

⁸⁰ Baldwin and Black, above n 47, 71.

⁸¹ Almond, above n 48.

⁸² *Ibid.*

There may be any number of reasons for this information not being received. It is possible that ASIC is not communicating the information to the secondary electricity market. As the information is publicly available, this is a highly unlikely explanation. A more likely possibility is that the secondary electricity market does not consider communicating with ASIC a worthwhile venture. All of the secondary electricity market participants interviewed for this thesis were also participants in the wholesale electricity market. All of the interviewees suggested that either all⁸³ or a vast majority⁸⁴ of secondary electricity market participants were more heavily involved in the wholesale electricity market than the secondary electricity market. The primary electricity market's primary regulator is AER.⁸⁵ The relative unimportance of ASIC to the secondary electricity market is considered further in chapter 8.

It is also possible that the secondary electricity market becomes aware of policy reviews, but deems them so ineffective that they are soon forgotten. If this is correct, then the majority view and minority view on the possibility of ASIC having reviewed its policy are closer than they appear. Whether or not this is correct, ASIC faces a serious problem in correcting the factual accuracy of the interviewees' responses. ASIC will only benefit from demonstrating that it has undertaken a review, if that review has led to a meaningful shift in policy. This leads directly to the alternate view that both ASC and ASIC have undertaken policy reviews, but they have not eliminated the pro-industry policy.

4 *Consequences of Industry Perception: Policy Review Produced no Significant Change*

ASIC has two options for correcting the view that it has undertaken policy reviews, but that these reviews were ineffective. First, it can attempt to prove that its reviews have resulted in a shift away from pro-industry policy. Second, it can admit that it has maintained a pro-industry policy and attempt to correct it.

⁸³ Interviews 1-4, 7-12 and 14-16.

⁸⁴ Interviews 5-6 and 13.

⁸⁵ *Competition and Consumer Act 2010* (Cth), Part IIIA.

The first option would be extremely difficult, but not impossible. As there is no fact or evidence which could conclusively prove that ASIC is or is not ‘pro-industry’, it is possible for ASIC to convince the market that it is not pro-industry without having to engage in any level of dishonesty. The problem however, would be the need to convince the secondary electricity market of a definition of ‘pro-industry’ which the secondary electricity market does not currently hold. This would be a near perfect example of the miscommunication discussed by Baldwin and Black.⁸⁶ Baldwin and Black propose that the solution to this miscommunication is for the regulator to give consideration to the worldviews of its regulatory subjects, rather than attempting to force those regulatory subjects to adopt the worldview of the regulator.⁸⁷ While Baldwin and Black’s approach is sensible and consistent with the goals of responsive regulation,⁸⁸ it remains a legitimate option for ASIC to persuade the energy market that it is no longer ‘pro-industry’. Nonetheless, this would be a difficult and counter intuitive action for ASIC to take.

The alternative option for ASIC is to communicate and work with the secondary electricity market to change its regulatory policy to something less pro-industry. This can only be considered a legitimate option when this particular perception problem is viewed in isolation. The critical junctures identified throughout this thesis have placed ASIC on a dependent path which makes it highly undesirable, if not impossible, to shift its regulatory approach. This dependent path and its consequences are examined in chapter seven.

C *A Pro-industry Policy is Detrimental to ASIC’s Regulation of the Secondary Electricity Market*

The final element in understanding the first critical juncture is that the pro-industry policy adopted by the ASC has a negative effect on ASIC’s ability to regulate the secondary electricity

⁸⁶ Baldwin and Black, above n 47.

⁸⁷ Ibid 72.

⁸⁸ Ayres and Braithwaite, above n 35.

market. 14 of the 16 interviewees believed that the ASC's (or ASIC's) pro-industry regulatory focus had a detrimental effect on its ability to regulate. This belief cannot be verified by historical fact. More concerning, this view cannot even be proven to be irrational. Given the inability to test alternatives in an historical identical setting, the secondary electricity market participants will always be able to claim rationality in the view that ASIC could be regulating more effectively if using a different regulatory policy or approach.

Many of the interviewees sought to use empirical evidence to demonstrate ASIC's regulatory failure. Most pointed to significant historical market failures and related them to pro-industry policies. Table 4.3 sets out examples of the empirical evidence used by the interviewees.

Table 4.3 Examples of Empirical Evidence Used by Interviewees		
Ref	Statement ⁸⁹	Interview
1	The GFC would never have happened if regulators hadn't trusted business... Even after the GFC, ASIC is still trusting business.	6
2	We did okay in the GFC. We could have done better. The only reason Australia survived was because ASIC hasn't completely lost its soul. There's still a little bit of fight left in it... I think a useful analogy might be this: Australia suffered because ASIC was a friend of industry. The USA suffered a lot more because SEC and FINRA were slaves to industry.	12
3	Enron. There was nothing unique there. The type of relationship Enron had with the government is no different to the types of relationship any other business has with a friendly regulator... Regulators and business should be enemies, not friends.	13

Table 4.3 Sets out statements outlining the interviewee's evidence for regulatory failure resulting from the relationship between ASIC and industry.⁹⁰

These responses in Table 4.3 criticise ASIC on the basis that they did not achieve the supposedly better outcome that would have resulted from more industry-hostile regulation. Such responses do not form any measure of proof of regulatory failure. As is pointed out by Conglianese and Mendelson, the measure of an effective regulatory strategy is not whether it works perfectly, but whether it works better than the next best option.⁹¹

⁸⁹ Statements have been edited to remove profanities. Changes occur in square brackets.

⁹⁰ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

⁹¹ Cary Conglianese and Evan Mendelson 'Meta-regulation and Self-regulation' in Martin Cave, Robert Baldwin and Martin Lodge (eds), *The Oxford Handbook of Regulation* (Oxford University Press, 2011).

Ultimately, there is no possible way of testing an alternative regulatory approach in the same historical circumstances. As there is no way to test the rationality or accuracy of the secondary electricity market's views, it is difficult to assess the extent of regulatory failure. There is, however, one indicator of serious regulatory failure. The counter-intuitive nature of the secondary electricity market's views on pro-industry regulation hint at an ideological misalignment between ASIC and the secondary electricity market. This ideological misalignment may go some way to explaining the communication difficulties between ASIC and the secondary electricity market which are discussed throughout this chapter.

1 *Ideology of the Secondary Electricity Market*

The interviewees largely viewed ASIC as being within the control of financial product issuers or other industries that ASIC regulates. This thought parallels regulatory capture theory, which states that certain interest groups are able to dominate and control the regulator.⁹² Three interviewees suggested they were aware of and believed the accuracy of regulatory capture theory.⁹³ These three participants suggested that ASIC had not been captured by the electricity market, but rather by financial product issuers. 11 other interviewees used language indicative of a belief in regulatory capture.

The term 'in the pocket of' was used to describe ASIC 34 times across 11 interviews. Eight interviewees used language similar to ASIC 'does what we want it to'. This phrase was used 28 times. 14 interviewees stated ASIC was 'a tool of' industry or interest groups. This phrase was used 22 times. The phrase 'captured by' was used seven times across three interviews. All interviewees used at least one of these phrases when describing ASIC. This supports the conclusion that the secondary electricity market views ASIC as having suffered regulatory capture.

⁹² George Stigler 'The Theory of Economic Regulation' (1971) 2 *Bell Journal of Economic Management Science* 3.

⁹³ Interviews 13, 14 and 15.

A belief in regulatory capture theory does not prove that the interviewees do not also support responsive regulation. In fact, responsive regulation could easily be seen as an application of regulatory capture theory to behavioural economic assumptions. Braithwaite himself makes reference to the problems of regulatory capture on numerous occasions.⁹⁴ Responsive regulation was heavily influenced by the ‘twin dangers of public capture and private collusion / opportunism’.⁹⁵ It recognises the diffuse sources of power in modern society and seeks to implement a regulatory structure that allows the regulator to benefit from a limited capture.⁹⁶

This is encouraging for ASIC. A belief in capture theory could easily be matched with a belief in responsive regulation and newer regulatory theories. For this to be possible, it is necessary that the reasons that responsive regulation ties to regulatory capture theory are the same reasons that the electricity market believes regulatory capture theory to be correct.

In order to determine whether the belief in capture theory expressed by the interviewees assists or hinders the relationship between ASIC and the secondary electricity market it is necessary to determine the precise nature of capture theory subscribed to by the interviewees. The reasons for arriving at regulatory capture theory were not the same for all interviewees. While there are many conceptions of capture theory, only two conceptions were clearly evident in the interviews. These would appear to be the sort of capture theories Ayres and Braithwaite refer to when they state ‘*It is this diffuseness that we need to understand if we are to develop a more sophisticated... theory of regulation than the crude “capture” theories of the left and right*’.⁹⁷

An examination of interview responses reveals a belief by some interviewees in a Marxist originating capture theory and a belief by other interviewees in a Stigler originating capture

⁹⁴ See Peter Grabosky, Clifford Shearing and John Braithwaite ‘Introduction’ in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia’s Future* (Australian Institute of Criminology, 1993), 6; Ayres and Braithwaite, above n 35, 14; and John Braithwaite ‘The Essence of Responsive Regulation’ (2011) 44 *UBC Law Review* 475, 477.

⁹⁵ Braithwaite, above n 94, 477.

⁹⁶ Ayres and Braithwaite, above n 35, 54.

⁹⁷ Ibid 12.

theory. Table 4.4 sets out a number of interview comments relevant to the identification and classification of the view of capture theory held by the interviewees.

Table 4.4 Statements made by Interviewees Suggesting a Belief in Regulatory Capture		
Ref	Statement ⁹⁸	Interview
1	ASIC can't do a thing to us. We literally control the power. Forget paying off ASIC. We can just cut off the lights.	1
2	Let's get one thing straight. I'm not talking about capitalism. I'm talking about Enronism. Capitalism assumes a fair market. Enronism knows it isn't. Capitalism tells me I'm limited by the market. Enronism knows I can do whatever I want, so long as I'm big enough and creative enough. No-one can stand in my way.	3
3	I earn close to a million dollars a year from this [trade]. I'll buy and sell ASIC if I want to. You tell ASIC that they're a bunch of [deleted]. They can [deleted]. Tell them. They'll do it. That's what money buys you.	4
4	The state had its time. That time is over. This is the era of business. Business is powered by energy. The only people with more power than us are the people who own the resources. We'll bow before them. Not some state regulator.	5
5	Derivatives traders are the new emperors. They control the largest section of world trade. If you control world trade you take what you want – and that includes ASIC.	12
6	I don't think the energy industry has the kind of power it thinks it does. It could, if it lobbied more effectively. The problem is that they still think like government bodies. They think official letters get things done... Yes, I do believe ASIC has been captured. But not by the electricity market.	13

⁹⁸ Statements have been edited to remove profanities. Changes occur in square brackets.

7	The greatest problem with ASIC is secondments. You get the product issuers sending their junior staff to ASIC. ASIC takes them on, because ASIC doesn't have enough people who understand derivatives. Then you end up in a situation where a [known investment bank] staff member is approving a [same known investment bank] financial product. ⁹⁹	14
8	The power of the derivatives market over the regulator is education. These products are extremely difficult to understand. In all honesty, I often don't understand the PDS's I'm putting together. This then gets sent to ASIC, who have no money, little training and far too little time. They're under pressure to get things approved. How on earth is a graduate law student supposed to understand the pricing of a weather future?	15

*Table 4.4 Sets out statements outlining the interviewee's views on regulatory capture.*¹⁰⁰

Responses one to five in Table 4.4 provide evidence of a belief in a regulatory capture theory originating from the works of Marx.¹⁰¹ Marx's concern that big business could essentially buy control of the regulator¹⁰² was reflected in a number of the interviewee's responses. While these responses could arguably originate from a number of other variants of capture theory, they all share certain characteristics that suggest they most strongly belong to a Marxist-based capture theory. All of these responses share a belief that it is large business interests that are able to capture regulators. All responses also share the idea that size and money are the only requirements for regulatory capture to occur.

⁹⁹ This is a fairly serious allegation which the interviewee could not substantiate. The interviewee suggested that such a practice was 'common knowledge'. It should be taken only as a statement of the interviewee's belief, and not of any actual wrongdoing by ASIC.

¹⁰⁰ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

¹⁰¹ Susan Woodward 'Regulatory Capture at the U.S. Securities and Exchange Commission' (Paper presented at the Milken Institute Conference on Capital Markets, Santa Monica California, 16 March 1998), 1.

¹⁰² Ibid.

It is not clear in any of the above responses how this control is actually obtained. Marx suggested that large businesses were able to pay for control.¹⁰³ The responses seem to have evolved from Marx's 'large business pays for control' to 'having enough money to pay for control gives control'. This distinction is legally relevant but practically negligible. Both concepts share a belief that the market is an ineffective resource allocator. More importantly, both concepts share a belief that money, as a concentration of power, buys control and freedom from state influence.

Responses six to eight in Table 4.4 appear to favour a regulatory capture theory based on the ideas of Stigler. These interviewees saw the power for regulatory capture as coming not necessarily from size or money,¹⁰⁴ but more numerous factors. It is lobbying, information and informal networks that lead to regulatory capture.¹⁰⁵ While responsive regulation would reinforce ideas of capture under both the Marx and the Stigler originating view of capture theory, it is this Stigler originating view that it matches most closely. The effect that these two views have on ASIC's relationship with the secondary electricity market turns on the ideology adopted by ASIC.

2 *Ideology of ASIC*

ASIC has adopted a responsive regulation approach.¹⁰⁶ It has also possibly adopted some of the newer forms of regulatory theory.¹⁰⁷ These decentred regulatory approaches are based on a few generally unstated assumptions. First, they are based on sociological ideas of regulation.¹⁰⁸ Second, as identified in chapter 2, they require a belief in the market that most closely correlates to behavioural economics. The market remains an efficient means of allocating resources, but due to human and sociological factors it is ineffective.¹⁰⁹ The notion that societal and

¹⁰³ Woodward, above n 101.

¹⁰⁴ Stigler, above n 92.

¹⁰⁵ Ibid.

¹⁰⁶ Nagarajan, above n 42.

¹⁰⁷ Comino, above n 44.

¹⁰⁸ Ayres and Braithwaite, above n 35.

¹⁰⁹ Richard Thaler and Hersh Shefrin 'An Economic Theory of Self Control' (1981) 81 *Journal of Political Economy* 392.

psychological factors affect market behaviour stands in contrast to the classical economic view.¹¹⁰ It is thus difficult to place ASIC as maintaining a traditionally pro-market or anti-market ideology. The one consistent approach evident within ASIC is an acceptance of current standards and the adoption of a measured approach which aims to recognise both economic logic and human limitation. The safest categorisation may accordingly be that ASIC has adopted the ideology of conservatism.

3 *Consequences of Ideological Divergence*

In many ways ASIC's ideology is quite close to the secondary electricity market's ideology. Those who have adopted a Stigler originating view of capture theory are almost identical in ideology to ASIC. Those who have adopted a Marx originating view of capture theory present a single, major divergence.

There is a clear possible explanation as to why 11 of 16 interviewees arrived at a different conclusion about responsive regulation to ASIC. The divergence appears to come from a belief in the assumptions that underpin the capitalist market. In a classic economic model (the model critiqued by Marx), self-interested, profit-maximising behaviour is the moral course of conduct.¹¹¹ This does not sit well with the behavioural economic model which expects a more complex view of human behaviour.¹¹² 'It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner'¹¹³ but it is by the benevolence of the derivatives trader that ASIC expects its responsive regulation to function.

It may be suggested that this analysis is incorrect. Responsive regulation may in fact require no benevolence at all. After all, the 'compliance pyramid' has, at its peak, mandatory

¹¹⁰ Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962).

¹¹¹ Ibid.

¹¹² Stigler, above n 92.

¹¹³ Adam Smith 'An Enquiry into the Nature and Causes of the Wealth of Nations' (Oxford World's Classics, A selected edition, 1776) 13.

enforcement.¹¹⁴ Other market mechanisms exist to prevent self-interested behaviour. Partial industry regulation is meant to offset self-interested and opportunistic behaviour.¹¹⁵ This argument loses credibility when looked at in totality. The fact that mechanisms exist to reign-in rogue behaviour does not mean that the market itself is rogue. If ASIC were to believe, as it appears a majority of interviewees believe, that opportunistic, self-interested behaviour is the norm, then self-regulation would be the last sphere one would seek to place regulatory power. If all market participants are self-interested, then the only way self-regulation or co-regulation can work is if the market participants' interests are completely aligned with the regulator's proposed outcomes. If this is the case, then there need be no regulator at all.

ASIC then, appears to believe that the market exists in a state other than complete self-interest. This is not a view shared by at least 14 of the interviewees. Responses 3(c) and 10(c) of Table 4.2 provide an indication of a belief in a self-interested market. Table 4.5 sets out examples of other interviewee comments which indicate a belief in a self-interested market.

Table 4.5		
Examples of Statements Supporting Belief in a Self-interested Market		
Ref	Statement ¹¹⁶	Interview
1	I do have trouble sleeping at night. Not just because of the stress. You do some pretty awful things. You have to. You become a trader and the world is just numbers. The population of a nation is just an element of demand. The futures market is just a casino. You think about the people these things affect, but you put it out of your mind. Then you go home and try to do a little bit of good. Offset the whole lot of bad you do for a living.	1

¹¹⁴ Ayres and Braithwaite, above n 35.

¹¹⁵ Ibid chapter 5.

¹¹⁶ Statements have been edited to remove profanities. Changes occur in square brackets.

2	Let's put it this way. If I heard about a fire in an electricity generator, I would think of electricity prices first. It'd only be after I'd finished trading that I'd worry about whether there were people inside [the generator].	2
3	I don't really think about it I guess. I'm just maximising profit. It's not like I'm killing people.	4
4	I do what I'm told. [My employer] doesn't really care if I'm being a nice guy.	8
5	This isn't a game for weak players. If you can't man up and make money you won't be in a job for long.	10
6	It's one of the most aggressively masculine cultures I've ever seen. There's a real air of... pointless competitiveness. You get the impression from these guys that they'd push their mother down the stairs if it'd increase their bonus.	13
7	You hear a lot of criticism about traders. They're not bad people. They just play a role... the role the world tells them to play. This isn't some left-wing heart-bleed. Adam Smith knew what capitalism would do to people. Here it is. Put people in a pure market environment and they'll behave as profit maximisers... you have to wonder what sort of psychological strain it all creates.	16

Table 4.5 Sets out statements outlining the interviewee's views on self-interest and market economics.¹¹⁷

The results of the beliefs expressed in Table 4.5 are perhaps inevitable. ASIC engages in responsive and collaborative regulation on the basis that the secondary electricity market can be

¹¹⁷ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

trusted. The secondary electricity market, viewing itself as unable to be trusted, wonders why the regulator would seek their input. The logical answer is that ASIC is in their power.

The energy traders and lawyers are perhaps behave as classical economists only during work hours and not once they have ended their day's work. As suggested by responses one, four and seven in Table 4.5, the traders may be people who feel forced to engage in behaviour they find abhorrent. They seek a regulator who will give them the excuse they need to be something other than an opportunist. Yet the regulator, seeing who they are outside of work, leaves them to their devices. All the while sure they can be trusted.

The greater problem perhaps lies in the minority of energy traders who adopted the Stigler based capture model, ostensibly subscribing to a behavioural economic model. Their ideology lines up almost perfectly with ASIC. The reason they distrust responsive regulation may come down to any number of factors, but three are immediately obvious. First, they may have simply adopted their peers' dislike of ASIC. Second, they may believe that ASIC has been captured by someone other than the secondary electricity market. Third, they may believe there is some problem with responsive regulation such that it does not address regulatory capture.

The first possibility seems the most unlikely. The interviewees were universally forthcoming with their views. Other than the themes identified in this thesis, there were only a very small handful of issues where there was universal agreement. The industry appeared to favour bold individualism, rather than espousing a group mentality.

The second possibility is likely. All three interviewees who favoured the Stigler originating capture theory stated a belief that ASIC had been captured by financial derivative traders and not by energy traders. The issue is therefore less likely to be about the way ASIC addresses regulatory capture and more about the central focus of ASIC. This is a call from the secondary electricity market that responsive regulation is not responding to the secondary electricity market.

The final possibility is also considered unlikely. Two of the three interviewees in this group were aware of responsive regulation.¹¹⁸ Neither felt the theory was fundamentally flawed (although both favoured other forms of regulation). The final respondent had not heard of the theory. Even if this respondent did feel responsive regulation was flawed, he would be such an insignificant percentage of the sample that no further investigation would be warranted.

As a result, ASIC is at ideological odds with a majority of the secondary electricity market. ASIC has adopted a conservative behavioural economic approach to regulation. This is not matching up with the liberal classical economic approach adopted by the secondary electricity market. This is a problem for ASIC, but it is not the only concern. The minority of interviewees who shared ASIC's behavioural economic view are concerned that ASIC has been captured by industry interests which are not aligned with the secondary electricity market.

It should be a relatively straightforward task to correct the perception of regulatory failure among the interviewees that favour a Stigler originating capture theory. Assuming the analysis in this thesis is correct, what is required is a greater degree of secondary electricity market inclusion. Chapter seven will consider whether this is possible in light of the critical junctures and dependant path revealed in this thesis.

The far more difficult task is correcting the perception of regulatory failure among the majority of the interviewees that favour a Marxist originating capture theory. This would require one of three things. First, ASIC could attempt to change the ideology of the secondary electricity market. Second, ASIC could change its ideology to match the secondary electricity market. Third, ASIC could adopt a regulatory model that recognised the ideology of the secondary electricity market and respond to it (that is, it could adopt really responsive regulation).¹¹⁹

¹¹⁸ Interviews 14 and 15.

¹¹⁹ Baldwin and Black, above n 47.

Changing the secondary electricity market's ideology would be extremely difficult. A long-term campaign of education and persuasion would be necessary. It is questionable whether such a campaign could ever be a success. ASIC would need to overcome all of the influences that have led to the secondary electricity market adopting the ideology that it has. ASIC would likely be combating a lifetime of education, social interaction and work culture. That said, the extreme difficulty of this task does not mean it should not be considered. Although difficult, this may be ASIC's best option.

If ASIC were to adopt the ideology of the secondary electricity market, then it would require a complete shift in its regulatory approach. This is a possibility, but is highly impractical. The critical juncture identified in this chapter has, together with the critical junctures in chapters five and six, have placed ASIC on a dependent path from which divergence will be extreme difficulty. As set out in chapter 7, it is likely highly undesirable for ASIC to diverge from this dependent path at this time.

The remaining possibility then is for ASIC to work with the ideology of the secondary electricity market without adopting it. This is a semantic possibility, but not a practical one. It may be argued that ASIC can maintain its pro-industry ideology by responding to industry's request for ASIC to engage in anti-industry regulation. While theoretically possible, this is a practical nonsense. Anti-industry regulation remains anti-industry, whether or not industry calls for it.

IV CONCLUSION

When viewed through the lens of historical institutionalism, the data presented in this chapter reveals a clear critical juncture. As suggested in chapter 2, key moments in the historical development of institutions can shape future decisions and directions.¹²⁰ The formation of the ASC is one such moment. At this critical juncture, ASC adopted a pro-industry regulatory approach which continues to affect the regulation of the secondary electricity market. This

¹²⁰ Paul Dimaggio and Walter Powell 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields; (1983) 48 *American Sociological Review* 147.

moment is viewed as a critical juncture not simply because it represented the adoption of a regulatory approach (which could easily be changed) but because it led to a series of actions which shaped the direction of the future development of the institution. Not only did the rhetoric of Hartnell create a public commitment to pro-industry regulation,¹²¹ but Performance Measures were generated which aimed to measure ASIC's relationship with industry. Once it had been established that ASIC would measure its effectiveness against its relationship with industry, it committed to aiming to improve this relationship, starting its course down a dependent path.

As was set out in chapter 2, ASIC's measures of effectiveness align with the compliance pyramid. Having developed these measures, ASIC cannot meet the needs of a market who calls for command and control regulation while simultaneously meeting its own requirements. If ASIC were to be responsive to the views of the secondary electricity market presented in this chapter, it would be working towards failure by its own measure. ASIC cannot, without changing the way it evaluates its own success, take an action or adopt an ideology that views the market as its enemy. As is seen in chapters five and six, these difficulties are only further amplified by subsequent critical junctures.

¹²¹ Hartnell, above n 21.

CHAPTER FIVE: FROM ASC TO ASIC

I OVERVIEW

Chapter 4 examined the first of three clear and related themes which emerged from the empirical investigation outlined in chapter 3. This chapter examines the second of the three related themes: that ASIC is ineffective in its regulation of the secondary electricity market because the change from ASC to ASIC led to a detrimental change in ASIC's regulatory approach. Through a thematic analysis of the empirical data generated by this thesis, this chapter identifies this second theme as a critical juncture (a period of rapid change and volatility) in the historical development of ASIC. In doing so, the theme is analysed against regulatory theory and historical evidence. The variations in interviewee response and potential contradictions with the first theme are considered. Finally, the importance of historical institutionalism, the critical juncture and their ongoing impact on ASIC's regulation of the secondary electricity markets are considered.

In doing so, this chapter will answer the third research question set out in Chapter 1: to what extent did the shift from the ASC to ASIC result in ASIC adopting an anti-regulatory ideology, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market? Through an analysis of the interview data, it can be seen that a segment of the secondary electricity market has formed an erroneous view that ASIC adopted an anti-regulatory ideology. Historical investigation suggests that this belief is more likely a response to either an increased consumer-protection focus on behalf of ASIC, or the emergence of competition between ASIC and other regulatory bodies. While the nature of the historical development has been misidentified by the secondary electricity market, the interview data nonetheless reveals a critical juncture for ASIC.

II THEMATIC EXPLORATION OF DATA

A *Data*

A thematic analysis of the data generated by the empirical investigation outlined in chapter 3 revealed a recurring focus on the shift from ASC to ASIC. All 16 interviewees identified that the formation of ASIC was a key moment which had a negative effect on the ability of ASIC to effectively regulate the secondary electricity market. Fourteen of the interviewees identified this moment as the switch from ASX to ASIC.¹ The two interviewees who were unaware of the existence of ASX identified this moment as the formation of ASIC.² Given that these interviewees did not know of ASC, their statements about the formation of ASIC have been treated as if they were statements regarding the switch from ASC to ASIC. Taking this into consideration, the theme was unanimously identified. Table 5.1 sets out the response from each interviewee which most directly supports this theme.

Table 5.1

Data Supporting Second Theme

Ref	Statement ³	Interview
1	Can't really remember. '92? Was it 92 when they did all that financial sector privatisation?... Just around when they changed to ASIC... I'd say that's when they stopped caring [about non-consumer facing financial products].	1
2	ASIC was stuffed from the start... from the beginning they've been going on about increasing efficiency of markets... we increase efficiency, not them... isn't their job to keep an eye on us?	2

¹ Interviews 1, 3-6 and 8-16.

² Interviews 2 and 7.

³ Statements have been edited to remove profanities. Changes occur in square brackets.

3	ASC was a hands-off regulator, but ASIC is almost anti-regulatory... A product of the government at the time, it thinks the market can solve everything.	3
4	ASC was [omitted negative description] and ASIC is double [omitted negative description]...	4
5	ASIC is much worse [than ASC]. It's like they took the things ASC were doing wrong and multiplied them to the power of – I don't know, 10.	5
6	ASC was designed to remove regulation. They seemed to have achieved this. ASIC came into a space that had no regulation... its priorities reflect that.	6
7	The way I see it is, like, ASIC probably had, say, 10 chances to do something great. It didn't rise to the occasion once... probably the worst missed chance was when they were created. I don't know what they were doing, but they just kind of emerged... they never did anything to make anyone take them seriously.	7
8	[The lack of regulatory focus on non-consumer facing products] probably started around the time they [ASIC] became tied up with superannuation.	8
9	Interviewee: There was a point where ASIC lost relevance even to itself. Interviewer: When was that? Interviewee: 1998. Interviewer: 1998? Interviewee: Yeah. When they took on investments.	9
10	I think the real problem started around the time they [ASC] became ASIC...	10
11	The change [from ASC to ASIC] didn't really bring anything new. It just amplified existing problems.	11

12	<p>Interviewee: So, stick with the metaphor here. It's like ASC was tending to the garden. They were losing the battle with weeds and the grass was a bit long. Then someone comes and dumps a whole heap of [dirt] in the middle of the garden... So now ASIC is just worrying about the [dirt] and everything else is going to hell.</p> <p>Interviewer: Just so I understand you, the [dirt] is regulatory jurisdiction over investments?</p> <p>Interviewee: That and superannuation.</p>	12
13	We had a bit of an inside joke at the time. The 'i', we said, stood for 'incompetent'. I guess it's not all that funny when I think of it now.	13
14	You got the sense that ASC was off course but might one day find itself. The first few years of ASIC made it clear that it wasn't finding its way back.	14
15	The switch from ASC to ASIC was meant to increase ASIC's consumer protection focus. It worked... The secondary electricity market is pretty specific. It doesn't have any real consumer focus, I just don't see it as all that relevant to ASIC.	15
16	ASIC has a lot more responsibility than the ASC ever did... it was also more visible. ASIC was more of a public figure... a lot of its work became about maintain public perceptions. Their concern for the type of stuff you're [the interviewer] talking about is very minimal. If it can't be understood by the public, it isn't really a priority [for ASIC].	16

Table 5.1 Sets out statements which support the existence of the second theme⁴

B Thematic Analysis

All of the interviewees expressed a belief that the move from ASC to ASIC (or alternatively, the creation of ASIC) was a key moment which continues to detrimentally affect ASIC's regulation

⁴ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

of the secondary electricity market. Table 5.1 sets out a response from each interviewee in support of this theme. During the interviews, 9 of the interviewees referred to this theme on 3 or more occasions. The data set out in Table 5.1 1 to 4, 6, 10 to 12 and 15 represent only 1 of the responses provided by these interviewees. Four interviewees referred to the theme twice. The data set out in Table 5.1 8, 9, 14 and 16 represent only the stronger of the 2 references to the theme. Three interviewees referred to the theme only once. This reference is set out in Table 5.1 5, 7 and 13. The total number of mentions of the shift from ASC to ASIC was 42.

While all of the interviewees believed that the shift from ASC to ASIC had a detrimental effect on ASIC's regulation of the secondary electricity market, the nature of the shift varied between interviewees. Five interviewees attributed the detrimental shift to ASIC adopting a consumer protection focus. Some of the data for this is set out in Table 5.1 1, 6, 8, 15 and 16. Further data supporting this view is set out in Table 5.2 below. The remaining 11 interviewees believed that the shift from ASC to ASIC resulted in the adoption of 'neo-liberal policies'. Some of the data for this is set out in Table 5.1 2 to 5, 7 and 9 to 14. Further data supporting this view is set out in Table 5.4 below.

Taken together, a strong theme emerges from this data. At the point in time ASC became ASIC it shifted its regulatory approach in a manner which continues to affect ASIC's regulation of the secondary electricity market. The remainder of this chapter identifies this theme as a critical juncture and considers the effect that this data has on ASIC's ability to regulate the secondary electricity market. As with chapter 4, this chapter does so by first examining whether the interviewees are correct, or at least rational, in their views. Second, this chapter examines the relevance of the interviewee's responses for ASIC's current regulation in light of their accuracy. Finally, it considers this critical juncture in isolation and questions the possible courses of action ASIC may take to alter the views of the secondary electricity market.

III DISCUSSION OF THEME / CRITICAL JUNCTURE

This thesis identifies the move from ASC to ASIC as the second critical juncture in the development of ASIC's regulatory policy in relation to the secondary electricity market. This critical juncture is unanimously identified by the interviewees, but there is one discrepancy between the interviewees. While some interviewees maintain that the detrimental policy shift was an increased consumer focus, others identify that the detrimental policy shift was the adoption of 'neo-liberal policies'.⁵ In order to establish the existence of a critical juncture, each of these views is considered separately. First, the historical accuracy of each view is considered. Second, the significance of the views of the secondary electricity market for ASIC is considered. Finally, potential internal contradictions between the data establishing the first critical juncture and the second critical juncture will be examined. Once the critical juncture has been established, its effect on ASIC's regulatory effectiveness will be considered as a whole.

A *ASIC Increased its Consumer Focus*

Five of the interviewees believed that the shift from ASC to ASIC had resulted in an increased consumer protection focus. The responses set out in Table 5.1 1, 6, 8, 15 and 16 identify the moment that this shift occurred. All of these responses, other than Table 5.1 6, hint at the increased consumer protection focus. The reference to consumer protection was much stronger in other parts of each of these interviews. Table 5.2 sets out some of the responses which clearly identify an increased consumer protection focus of ASIC, albeit without reference to the particular juncture at which it arose.

⁵ The term 'neo-liberal' poses a definitional difficulty. Part B of this chapter discusses what is meant by this term and what the interviewees believe it to mean.

Table 5.2		
Data Supporting an Increased Consumer Protection Focus of ASIC		
Ref	Statement	Interview
1	There's less concern with us. If we all did whatever we felt like maybe a few big corporations would lose out some money. It's not like any pensioners are going to lose their retirement savings.	1
2	They [ASIC] just assume we know what we are doing. There's some legal thing where they call us smart investors which means we don't have to abide by the law. ⁶	6
3	ASIC is realistically only concerned with consumers.	8
4	I guess it's a good thing for the traders, but ASIC just doesn't have the funding to worry about them.	15
5	We'd have a lot more trouble if we sold derivatives to consumers	16

Table 5.2 Sets out statements which suggest that ASIC adopted a consumer protection focus⁷

The statements in Table 5.2, when taken together with the statements in Table 5.1, reveal a common view held by these 5 interviewees that the move from ASC to ASIC shifted ASIC's priorities toward consumer protection. These responses also reveal a common belief that the secondary electricity market does not involve consumers. As a market with no consumers, the secondary electricity market is, according to this group of interviewees, a low priority for ASIC. This lack of regulatory attention has resulted in the industry being under regulated and largely ignored.

⁶ This interviewee appears to be referring to the 'sophisticated investor' exceptions in chapter 6D of the *Corporations Act 2001* (Cth). Both the nature and scope of the exceptions has been misstated by this interviewee.

⁷ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

As with the discussion of the first critical juncture in chapter 4, the mere existence of these negative views suggests there may be a regulatory failing. For the reasons set out in chapter 4, the key issue is not whether ASIC is failing, but whether the industry perceives ASIC to be failing. This is in line with the goals of ASIC set out in chapter 2.⁸ As with the first critical juncture, it nonetheless remains important to identify the accuracy and logic of the interviewees in order to determine the possible extent of regulatory failure and the possible corrective action that may be taken by ASIC.

1 *Accuracy of Industry Perception*

The analysis of the historical accuracy of the view that ASIC adopted an increased consumer focus upon its transition from ASC to ASIC will be conducted in two parts. First, the legislation passed at the time ASIC was formed will be interrogated. Second, sources of non-legislative regulation will be considered.

(a) Analysis of Legislation

The first evidence suggesting that ASIC may have adopted a consumer protection focus can be found in section 1 of the *Australian Securities and Investments Commission Act*⁹ (**ASIC Act**). The ASIC Act provides that consumer protection is one of the purposes for ASIC's existence. This is a departure from the ASC Act.¹⁰ Section 3 of the ASC Act sets out the ASC's purpose at length, but does not mention consumer protection.¹¹ The closest reference to consumer protection is in sub-section (2)(b) which states that ASC is to 'maintain the confidence of investors in the securities market'.¹²

This alone would appear to suggest that the interviewees have some historical basis for believing that ASIC adopted a consumer protection focus upon its formation. That said, the responses of

⁸ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992).

⁹ 2001 (Cth).

¹⁰ 1989 (Cth).

¹¹ *Australian Securities Commission Act 1989* (Cth), s3.

¹² *Australian Securities Commission Act 1989* (Cth), s3.

the interviewees set out in Table 5.2 indicate that the consumer protection role of ASIC was prioritised over non-consumer protection duties. Three of the interviewees¹³ supported this opinion by offering evidence from Chapter 6D of the Corporations Act.¹⁴

Chapter 6D is a somewhat unusual place to start when considering ASIC's approach to the secondary electricity market. The sale of derivative financial products largely falls outside the scope of Chapter 6D. While some derivative instruments may fall within the definition of securities,¹⁵ derivatives as defined by section 9 are specifically excluded.¹⁶ Nonetheless, the sophisticated investor provisions referred to by the interviewees provide justification for a belief in an overly consumer-focussed ASIC. More importantly, they provide a gateway to a more convincing piece of legislative evidence that ASIC has swayed toward a consumer focus.

Chapter 6D is concerned with corporate fundraising. More particularly, it is concerned with the disclosure that must be given when raising money from the issue of securities. The disclosure rules are extensive.¹⁷ They ensure that investors are given 'all information that investors and their professional advisers would reasonably require to make an informed assessment'¹⁸ of the offer to issue financial products. The provisions that support the historical accuracy of this theme form the exceptions to this rule.¹⁹ The exception referred to by the interviewees was the 'sophisticated investor' exception. If a company sells its securities to very wealthy people,²⁰ people with a lot of money invested²¹ or people who earn a lot of money,²² that company is exempt from the disclosure requirements.

¹³ Interviews 6, 15 and 16.

¹⁴ 2001 (Cth).

¹⁵ *Corporations Act 2001* (Cth), s92.

¹⁶ *Ibid* s92(2)(d).

¹⁷ *Ibid* Division 3.

¹⁸ *Ibid* s710.

¹⁹ *Ibid* s708.

²⁰ *Corporations Act 2001* (Cth), s708(8)(c)(i).

²¹ *Ibid* s708(8)(a) and (b).

²² *Ibid* s708(8)(c)(ii).

It is possible that this exemption would apply to the interviewees, but it is likely that the interviewees were in fact referring to the Professional Investors exception.²³ A company may issue securities to individuals working for large trading entities without providing disclosure.²⁴ Given the size of the entities from which the interviewees were sourced, it is extremely likely that this exception would apply to them.

While it has been noted that these provisions are unlikely to have any real effect on the secondary electricity market (which is derivative-based), it does provide insight into the priorities and thoughts of ASIC. The thought behind both the sophisticated investor and professional investor exceptions appears to be that certain people within the community are knowledgeable enough that they do not require anyone to warn them of the risks of investing in securities. This thought process is confirmed by the second reading speech of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act*²⁵ ('CLERP 9').

It logically follows that the primary concern of ASIC is not individuals heavily engaged in securities trading, but rather individuals which may have less involvement in securities investment. This assumes that individuals heavily engaged in securities trading have an understanding of the products they are trading in. If this assumption is correct, then ASIC has not suffered any regulatory failure by adopting a focus on small scale investors.

Of the 3 interviewees who expressed concerns about Chapter 6D, 2 were lawyers (see appendix 1). These lawyers expressed concerns that the secondary electricity market, when viewed as a whole, could not possibly understand the price movements of derivatives. The remaining interviewee who expressed concerns about Chapter 6D was an energy trader. The energy trader was convinced that he or she was able to accurately determine price movements in the secondary electricity market, but believed that other traders could not. This, he or she argued, 'is why I'm at

²³ Ibid s708(11).

²⁴ Ibid s708(11).

²⁵ 2004 (Cth).

a better company and paid more than other energy traders'.²⁶ He or she conceded that notwithstanding his or her abilities, pricing a derivative was an extremely difficult process.

The view expressed by the lawyers is not a radical one. Successful traders such as Warren Buffet have expressed similar concerns about the pricing of derivatives, famously describing derivatives as 'financial weapons of mass destruction'.²⁷ It is also a view that was supported by an empirical test of the interviewees.

Each interviewee (excluding the lawyers and business consultants) was provided with details of a hypothetical energy swap, the price of which was stated to be dependent on three separate variables (see appendix 2). The interviewees were given the most recent hypothetical sale price of that swap based on current energy prices and weather predictions. The interviewees were asked to price the derivative in a hypothetical scenario where the Qatar/Dubai Dolphin Pipeline had suffered a major rupture.²⁸ This question was asked in order to determine the possibility and timing of accurately pricing a secondary electricity market product.

Three of the interviewees were able to provide a rough approximation in the interview. Four offered to work it out overnight and provide the answer (only 1 of the interviewees actually provided the answer).²⁹ Two maintained that they were able to work out the price, but did not have time to do so. One stated that he or she was not aware of the existence of the Dolphin Pipeline. Of the 4 interviewees who provided a response, 2 identified that the swap would increase in price. Two identified that the swap would not be affected by the burst pipe. The disparity appears to be a result of a disagreement between the traders as to the value of non-gas

²⁶ Interview 6.

²⁷ Berkshire Hathaway Annual Report 2002.

²⁸ The Dolphin Pipeline is a pipeline built to transport gas from Qatar to Dubai. It has special significance in energy pricing because the Qatar gas is 'wet' (i.e. surrounded by high quality oil). Mining of the gas is undertaken for the value of the oil rather than the gas and the gas is sold at a low price as it would otherwise escape. Dubai sources a majority of its gas power from this pipeline.

²⁹ This should not be taken as an indication that the other interviewees were incapable of working out the price. All interviewees were requested not to spend additional time pricing the hypothetical derivative.

liquids to the Dolphin project. Regardless of the reason for the disparity, it is significant to note that a disparity existed.

Perhaps more importantly, the calculation of the effect of any single event on the hypothetical swap took even the fastest of the energy traders several minutes to price (and even then, the price was only approximate). When asked whether it was realistic to calculate the exact price of a derivative product at any point in time, all interviewees suggested that the price would lag significantly behind any change in events and would at best take into account around three quarters of the factors that may possibly affect the price. All but 1 interviewee suggested that a derivative product with more than 2 variables was ‘near impossible’³⁰ to price with any level of accuracy.

While a more structured empirical test is required to draw any firm conclusions about the ability of energy traders to price derivatives, the inconsistent and often non-existent results indicate that there may be good reason for the interviewees to believe that effective derivative pricing may be beyond the reach of many energy traders. Given that the secondary electricity market frequently features derivative products with multiple pricing variables, it is rational to maintain that traders may not have a perfect understanding of the market. If the product is complex enough, then there is little difference between a lay investor and a professional or sophisticated investor. In these situations ASIC has no logical reason to focus on protecting one group and not the other.

This argument suffers from one major shortcoming. As mentioned earlier, Chapter 6D does not apply to derivatives. The argument presented by the lawyers and single energy trader appears to be: ASIC is concerned with lay investors and not sophisticated investors for the purposes of Chapter 6D, therefore ASIC must not be concerned with sophisticated investors for the purposes of Chapter 7. Further evidence is needed to support this assertion as it remains possible for ASIC to adopt a different view of investors in relation to different financial products.

³⁰ Interview 9.

There is such evidence that ASIC does favour protection of lay-investors. In 2009 Australia joined a number of other G20 countries in committing to ‘over the counter’ derivative regulation reform.³¹ This resulted in the introduction of Part 7.5A into the Corporations Act. Chapter 2 of this paper contains a more complete description of Part 7.5A. In brief, Part 7.5A is a broad provision which permits the creation of laws in relation to, inter alia, derivative reporting.³² Part 7.5A is not specifically limited to ‘over the counter’ derivatives, but it has been created for such a purpose.³³ It is likely that the rules to be made under Part 7.5A will apply specifically to derivatives available to the general public, and not the bulk of the complex derivatives being traded in the secondary electricity market.

Chapter 7.5A then, appears to be following Chapter 6D. Chapter 6D separates ‘normal’ investors from those who invest for a living. Chapter 7.5A separates products offered to ‘normal’ investors from the products offered to those who invest for a living. In the case of Chapter 6D financial products this may be logical, but, as established earlier, there is reason to believe that derivative products may not be properly understood by any investor, whether or not they trade securities for a living. The net result is regulation which focuses on the general public (that is, consumer protection), rather than focusing on the potential damage that irresponsible derivative trading may cause (that is, a focus on market integrity).

If this is correct, then professional investors are and will be left largely unregulated. The views held by the interviewees are supported by the current state of the law. ASIC does not focus on the secondary electricity market because it is assumed that the secondary electricity market knows exactly what it is doing. This is despite the fact that the secondary electricity market is not so sure it does.

³¹ Australian Securities and Investments Commission, *ASIC consults on trade reporting obligations for OTC derivatives* (March 2013).

³² *Corporations Act 2001* (Cth), Part 7.5A.

³³ Australian Securities and Investments Commission, above n 31.

The final piece of evidence that is needed to support the arguments of these interviewees is that the consumer protection focus arose during the switch from ASC to ASIC. The fact that Chapter 6D was introduced shortly after the switch offers some evidence of this fact.³⁴ More convincing evidence can be found when analysing the regulation that exists beyond legislative provisions.

(b) *Analysis of non-legislation regulation*

The fact that the move from ASC to ASIC involved a move to a consumer protection focus for ASIC is well supported. ASC became ASIC as it took over the Australian Consumer and Competition Commission's (ACCC) role of taking action against misleading and deceptive conduct in relation to financial products.³⁵ At the time ASIC and ACCC entered into a memorandum of understanding (*MoU*),³⁶ delineating how ASIC and ACCC would work together to enforce what was then section 52 of the *Trade Practices Act*.³⁷ This consumer focus was adopted simultaneously with the move from ASC to ASIC, suggesting that the interviewees correctly identified a key moment in the development of ASIC regulatory policy.

This shift in focus is of far greater consequence if ASIC adopted this consumer focus at the expense of its other regulatory duties. ASIC has many regulatory duties beyond consumer protection and only limited resources to fulfil these duties. This complexity of regulatory resource allocation has been considered by numerous studies.³⁸ As Bird notes, ASIC's mandate involves both business facilitation and consumer protection.³⁹ ASIC must regulate 'corporations,

³⁴ *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth).

³⁵ Department of Parliamentary Services 'Australia's Corporate Regulators – The ACCC, ASIC and APRA' (Research Brief No 16, Parliamentary Library, Commonwealth, 2005), 6.

³⁶ Memorandum of Understanding between Australian Securities and Investments Commission and Australian Consumer and Competition Commission dated February 1998.

³⁷ 1974 (Cth).

³⁸ See Vicky Comino 'Effective Regulation by the Australian Securities and Investments Commission: the Civil Penalty Problem' (2009) 33 *Melbourne University Law Review* 802, 815; Robert Baldwin and Martin Cave *Understanding Regulation: Theory, Strategy and Practice* (Oxford University Press, 1999); and Devon Garvie and Andrew Keeler 'Incomplete Enforcement with Endogenous Regulatory Choice' (1994) 55 *Journal of Public Economics* 141.

³⁹ Joanna Bird 'Regulating the Regulators: Accountability of Australian Regulators' (2011) 35 *Melbourne University Law Review* 739, 745.

consumer credit, financial markets and financial services.’⁴⁰ Within any one of these areas, ASIC must determine whether it is going to focus on producing outcome for consumers, society as a whole, market participants or any other number of stakeholders. This forces ASIC to allocate resources between divisions within divisions. If ASIC has adopted a consumer focus in one particular regulatory sphere, it is quite possible that it is both undermining its business facilitation role within that sphere and also subtracting resources from a different regulatory sphere. The result, as noted by Garvie and Keeler, is a choice between sub-optimal regulatory outcomes.⁴¹

ASIC’s latest annual report suggests that the interviewees are correct that ASIC’s primary focus is consumer protection. ‘Confident and informed investors and financial consumers’ is ‘priority 1’ for ASIC.⁴² While ‘fair and efficient financial markets’ is ‘priority 2’,⁴³ the detail of the report suggests that this priority is extremely broad and encompasses many things which are not traditionally considered part of fair and efficient financial markets. ASIC’s reporting on this second priority covers everything from phoenix companies to the recent James Hardie cases.⁴⁴

The connection between these types of issues and financial markets is tenuous. Phoenix companies no doubt represent a financial hazard, but this hazard is primarily to debtors and not to equity investors (who generally retain control over the sale of company assets). Likewise, while *ASIC v MacDonald and Ors*⁴⁵ was concerned with the disclosure requirements of the James Hardie directors, this was not the James Hardie case that was reported on. The decision referred to in the 2013 report (*ASIC v Hellicar and Ors*)⁴⁶ was primarily concerned with rules of evidence.

⁴⁰ Bird, above n 39.

⁴¹ Garvie and Keeler, above n 38.

⁴² Australian Securities and Investments Commission, *Annual Report 2012-2013*, 22.

⁴³ *Ibid* 33.

⁴⁴ *Ibid* 37.

⁴⁵ No 11 [2009] NSWSC 287.

⁴⁶ [2012] HCA 17.

While there remains much in the report which is directly relevant to financial markets, such as the insider trading and market manipulation goals,⁴⁷ the vast amount of tangentially relevant material suggests that ‘fair and efficient financial markets’ may be a very broad term encompassing multiple regulatory goals which are important, but not so important as the clearly delineated consumer protection goals.

On the basis of this evidence, it appears logical for the interviewees to conclude that ASIC has a resource allocation problem that has been resolved to the detriment of the secondary electricity market. By allocating limited resources to its first priority, consumer protection, ASIC is necessarily left with less to focus on other regulatory matters. The fact that fair and efficient markets appears to cover everything from insolvency fraud to rules of evidence supports the conclusion that ASIC may be spread too thin to devote sufficient resources to a market as small and specialised as the secondary electricity market.

2 *Consequences of Industry Perception*

The fact that the secondary electricity market believes itself to be inadequately regulated is cause for concern for ASIC. If ASIC wishes to engage in responsive regulation, it must be able to command the faith and respect of its regulatory subjects.⁴⁸ Correcting this problem is theoretically simple for ASIC. ASIC must simply make the secondary electricity market a priority. Unfortunately, this is not a practical possibility.

As noted by Bird, ASIC has a broad and unwieldy regulatory burden.⁴⁹ This burden cannot be solved perfectly; one area must be prioritised over the other.⁵⁰ This is even more so the case where regulatory goals are not complimentary, or may even conflict.⁵¹ The addition of the “I” to ASC took it from a corporate regulator to a regulator of corporations, financial products,

⁴⁷ Australian Securities and Investments Commission, above n 42, 36.

⁴⁸ Vijaya Nagarajan ‘From “Command and Control” to “Open Method Co-ordination”: Theorising the Practice of Regulatory Agencies (2008) 8 *Macquarie Law Journal* 5.

⁴⁹ Bird, above n 39.

⁵⁰ Garvie and Keeler, above n 38.

⁵¹ Bird, above n 39.

financial markets and consumer protection. The legislation, ASIC reports and academic studies appear to suggest that consumer protection has received the majority of ASIC's focus.

The prioritisation of consumer protection places ASIC in a difficult position. ASIC has developed systems and measures which are designed to ensure that consumer goals are prioritised and met.⁵² Senior ASIC staff members are held accountable for meeting these goals.⁵³ These measures make it difficult for ASIC to simply redirect its resources and focus. This is something that is explored further once this critical juncture has been fully examined and established.

B *ASIC Adopted a Neo-liberal Focus*

11 of the interviewees stated a belief that the shift from ASC to ASIC resulted in ASIC adopting a 'neo-liberal' focus. The term neo-liberal was used by 10 of the 11 interviewees. Critical to the establishment of this critical juncture is an identification of what is considered 'neo-liberal'. This section will first establish what the interviewees meant by the term 'neo-liberal'. This will then be compared to scholarship on neo-liberalism, revealing a definitional gap.

Table 5.3 sets out a sampling of the references made by the interviewees to 'neo-liberalism'.

⁵² Australian Securities and Investments Commission, above n 42, 36.

⁵³ Ibid.

Table 5.3**Interviewee References to Neo-liberalism**

Ref	Statement	Interview
1	ASC was a hands-off regulator, but ASIC is almost anti-regulatory... A product of the government at the time, it thinks the market can solve everything.	2
2	They sold the farm. Investments, superannuation and all that. Once it wasn't a government controlled asset they didn't care. The regulation just stopped.	4
3	[In using the term 'neo-liberal'] I mean the whole Howard view of life. Privatisation, economic rationalism, deregulation – you know what I mean?	5
4	ASIC was just one of many stupid decisions made by a government with a very poor conception of neo-liberal economic theory... The dole office wasn't perfect, so they sold it off and make [sic] a half-arsed effort regulating it. The pension seemed expensive, so they got rid of it and made us all pay for our own. I don't think it's even regulated. Workers and capital aren't getting along. Just get rid of regulation and let capital do what it wants. At least people caught on to that one.	7
5	The deregulation of the financial industry and the switch from ASC to ASIC was probably the boldest of the neo-liberal actions. Well, maybe not the biggest. Floating the Australian dollar would win that prize. But the financial deregulation would be a close second.	9

Table 5.3 Sets out statements which give insight into the interviewee's definition of 'neo-liberalism'⁵⁴

There are common features in the responses in Table 5.3 which assist in identifying the particular nature of neo-liberalism referred to by the interviewees. In order to obtain a definition

⁵⁴ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

of neo-liberalism, these common features will be examined in light of neo-liberal theory. In this way a definition of neo-liberalism can be identified which is consistent with both neo-liberal scholarship and the views of the secondary electricity market.

Neo-liberalism is a vexed term, having meant different things at different historical periods. One common usage was to describe a group of liberal scholars who broke free of classical liberalism in that they embraced government interventionism.⁵⁵ It has also been used to describe groups of social economists, the policy makers driving Pinochet's economic reform and market fundamentalists.⁵⁶ More recently, it has come to be associated with a group of economists and policies deriving from free-market economic scholars such as Friedman, Harberger, Hayek and the group of economists described by Becker and others as the 'Chicago Boys'.⁵⁷

Within this categorisation of neo-liberalism are a number of contradictory ideas. Placing Hayek and Friedman in the same category gives rise to troubling economic contradictions. Hayek advocated the liberal economic sentiments of French philosophy, championing Descartes and other theoretical rationalists.⁵⁸ While practical liberal economists such as Smith were also treated with regard, they appear to be a starting point, rather than a finishing point for Hayek.⁵⁹ Friedman on the other hand rests heavily on the practical liberty of Smith.⁶⁰ In both his writings⁶¹ and his television appearances⁶² he quotes readily from the *Wealth of Nations*.⁶³ Friedman's economic policy appears far more directed toward English liberalism than French liberalism. While Hayek's writings and theories may appeal to both the socialist and the capitalist, Friedman is unlikely to find much appreciation from the former.

⁵⁵ Taylor Boas and Jordan Gans-Morse 'Neoliberalism: from new liberal philosophy to anti-liberal slogan' (2009) 44 *Studies in Comparative International Development* 137.

⁵⁶ Boas and Gans-Morse, above n 55.

⁵⁷ See Noam Chomsky, *People over Profit: Neoliberalism and Global Order* (Seven Stories Press, 2007); David Harvey, *A Brief History of Neoliberalism* (Oxford University Press, 2008); and Gary Becker 'Latin America Owes a Lot to the "Chicago Boys"' *BusinessWeek*, 9 June 1997.

⁵⁸ Friedrich Hayek, *The Constitution of Liberty* (Routledge, 2013 reprint ed, 1960), chapter 4.

⁵⁹ *Ibid.*

⁶⁰ Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 6th ed, 1962).

⁶¹ Friedman, above n 60.

⁶² Milton Friedman, *Free to Choose* (1980), episode 1.

⁶³ Adam Smith, *An Inquiry into the Causes and Effects of the Wealth of Nations* (Barnes and Noble, 2012 revised ed, 1776).

The commonality between these two then appears to be a progressive system of minimal but still existent state intervention coupled with individual freedom. Their reasons for advocating this freedom are similar. Hayek draws on what was then recent history to illustrate the failures of various forms of economic organisation and governance.⁶⁴ He argues that only through a process of trial and error will the strongest governmental styles be found and improved upon.⁶⁵ Friedman likewise calls the reader to examine the history of oppression and discrimination caused by human rule, arguing that the vicissitudes of life are far fairer than the rule of man.⁶⁶ Neo-liberalism then, incorporates a notion of individual autonomy and aims for minimal state intervention. While Friedman appears to be more strongly in favour of ‘minimal state intervention’,⁶⁷ Hayek clearly advocates for the right of the individual to choose his or her own governmental system.

This conception of neo-liberalism fits well both with other neo-liberal scholars and the responses provided by the interviewees. Harberger and the Chicago Boys advocated deregulation, privatisation and lower levels of taxation.⁶⁸ These policies fit well with a philosophy of minimal government interventionism. They also lend themselves well to responsive regulation and the concepts expressed by the interviewees in Table 5.1.

Put simply, the definition of neo-liberalism adopted by this paper incorporates a desire for minimal state intervention,⁶⁹ privatisation,⁷⁰ deregulation⁷¹ and a respect for economic and social tradition.⁷² These are concepts seen throughout the responses in Table 5.3. All of these responses considered that neo-liberalism was based on or reflected in privatisation and deregulation. All

⁶⁴ Hayek, above n 58, chapter 2.

⁶⁵ Ibid.

⁶⁶ Friedman, above n 60.

⁶⁷ Hayek, above n 58.

⁶⁸ Juan Valdes, *Pinochet's Economists: The Chicago School of Economics in Chile* (Cambridge University Press, 1995).

⁶⁹ Harvey, above n 57.

⁷⁰ Friedman, above n 60.

⁷¹ Taylor Boas and Jordan Gans-Morse ‘Neoliberalism: from new liberal philosophy to anti-liberal slogan’ (2009)

⁴⁴ *Studies in Comparative International Development* 137.

⁷² Hayek, above n 58.

viewed neo-liberalism as a move away from welfare and state intervention toward individual and market autonomy. The only real divergence between the neo-liberal theory and the responses of the interviewees is a greater focus on Australian politics in the case of the interviewees. This is perhaps easily explained.

The definition of neo-liberalism adopted by this paper involves not only a progression toward political freedom and liberty but also a respect for tradition. Hayek and Friedman's respect for Smith lies not only in their adoption of his liberal views and economic tradition, but also in the advancement of successful and understood institutions.⁷³ This combination of economic rationalisation, liberty and respect for tradition was likely the reason that neo-liberal policies were largely adopted by conservative governments. Margaret Thatcher's Conservative Party,⁷⁴ Ronald Regan's Republican Party⁷⁵ and more recently George Bush Jr's Republican Party⁷⁶ and John Howard's Liberal Party⁷⁷ have all been identified as having a strong link to neo-liberal policy making.

It is the Howard brand of neo-liberalism which explains the Australian political focus of the interviewee responses. The Howard government presided over the change from ASC to ASIC, labour market deregulation and mass privatisations. The responses in Table 5.1 3 and 4 make clear reference to the Howard government, further supporting the definition of neo-liberalism adopted by this thesis.

The data generated by the empirical study outlined in chapter 3 of this thesis suggests a strong belief by the secondary electricity market that the shift from ASC to ASIC led to ASIC adopting neo-liberal policies. The statements in Table 5.1, 2-5, 7 and 9-14 identify the point at which

⁷³ Friedman, above n 60; Hayek, above n 58.

⁷⁴ Richard Toye and Julie Gottlieb, *Making Reputations: Power, Persuasion and the Individual in Modern British Politics* (I B Tauris, 2005).

⁷⁵ Richard Thornton, *The Reagan Revolution II: Rebuilding the Western Alliance* (Trafford Publishing, 2006).

⁷⁶ Tim Conlan and John Dinan 'Federalism, the Bush Administration and the Future of American Conservatism' (2007) 37 *Publius* 279.

⁷⁷ Geoff Boucher and Matthew Sharpe, *The Times Will Suit Them: Postmodern Conservatism in Australia* (Allen & Unwin, 2008).

ASIC adopted this neo-liberal policy. The statements in Table 5.1, 2, 3, 5, 7, 11 and 12 also indicate the adoption of neo-liberalism at this point in time. Other interviewees referred to neo-liberalism on a number of occasions, albeit without direct reference to the particular juncture at which it arose. These responses are set out in Table 5.4.

Table 5.4		
Data Supporting an Increasing Neo-liberal Policy Adopted by ASIC		
Ref	Statement	Interview
1	Of course ASIC was neo-liberal. It was created by a neo-liberal government.	3
2	ASIC was the result of a brief period in which people believed in capitalism. It was like everyone forgot the Asia crisis and the tech crash. All of a sudden economics could fix everything... ASC was never in the way of economics, but it was a symbol of the old world where the state had a role. It had to go. Fortunately, it wasn't doing anything anyway, so they just had to change its name.	9
3	I think the shift from ASC to ASIC wasn't so much about its role as it was about its importance. ASC was an important institution. ASIC was a stripped down version. More responsibility, less involvement. ASIC was going to be an anti-regulatory regulator.	10
4	ASIC always had a neo-liberal agenda.	14

Table 5.4 Sets out statements which suggest that ASIC adopted a neo-liberal philosophy⁷⁸

Taken together, the responses in Table 5.1 and Table 5.4 reveal a strong belief that the shift from ASC to ASIC brought with it a move toward neo-liberal regulatory policy. Importantly, this move was viewed by all 11 interviewees as having a negative result on ASIC's regulatory effectiveness. Table 5.5 sets out a number of statements by the interviewees that indicate that neo-liberal policies have a detrimental effect on ASIC's regulation of the secondary electricity market.

⁷⁸ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

Table 5.5		
Statements Suggesting that Neo-liberal Policy has a Negative Effect on Regulation		
Ref	Statement	Interview
1	A regulator who has a distaste for regulation really isn't any use at all.	3
2	Interviewer: you seem to have a strong emotional reaction to [the adoption of neo-liberal policies]. Can you tell me a bit more about why that is? Interviewee: Are you [omitted] kidding? [Omitted]. I sure [omitted] hope my taxes aren't in any way paying for you to come here and ask these [omitted] stupid questions. Did you miss the fact that neo-liberalism led to a complete worldwide financial [omitted] meltdown a couple of years back?	4
3	People get so confused by economics that they miss the obvious. The market may fix a lot of things, but it can't fix the market. Only proper regulation can fix the market.	12
4	ASIC tried to cut back on its involvement in the market... If they didn't want a regulator, they should have just gotten rid of the regulator.	14

Table 5.5 Sets out statements which suggest that ASIC's neo-liberal philosophy was detrimental to regulation⁷⁹

Considering the data in Table 5.5 together with the discussion in this chapter leads to a fully developed critical juncture. At the point in time where ASC became ASIC it adopted a neo-liberal outlook which continues to have detrimental effects on ASIC's ability to regulate the secondary electricity market. The effect and consequences of this critical juncture rest on the historical accuracy of the views of the secondary electricity market.

⁷⁹ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

There is some difficulty in ascertaining the accuracy of this industry perception, primarily because it is incomplete. The interviewees expressed that ASC existed in an era of regulation and that ASIC existed in an era of deregulation. Somehow, the dominant ideology of the era of creation resulted in certain policy choices. While it is possible to identify whether these ideological trends existed, it cannot be proven that they resulted in any policy change within ASIC. Further investigation still does not reveal a causal relationship between the dominant ideology and ASIC policy. There is a correlation, but no causation.

What is instead revealed through analysis of the relevant materials is a series of political movements. The complexity of competing ideologies and politics offers a number of alternative suggestions for any potential shift in ASIC policy. These alternative suggestions are a far more attractive explanation than that offered by the interviewees. This history is outlined in two parts, which together provide an explanation and historical justification for the views of the secondary electricity market. First, the personalities who originally headed ASIC and ACCC are considered. Second, the general political movement toward superannuation is considered. An alternate and preferable view on the competition between ASIC and ACCC is then considered.

(a) ASIC and ACCC

The politics and personality of ACCC and its head, Alan Fels, are important components in understanding the policy of ASC and ASIC. Before taking on the role of chairman of ACCC, Fels had identified that the forces motivating business self-regulation were decreasing and that the necessity and desire for government regulation was increasing.⁸⁰ This was a view that did not appear to change in any significant way either before or during Fels' appointment to ACCC.⁸¹

It should be noted that Fels' belief that forces motivating self-regulation were decreasing does not mean he believed they were non-existent. The Trade Practices Commission (the forerunner to ACCC) explicitly adopted Ayres and Braithwaite's responsive regulation model.⁸² By the time

⁸⁰ Allan Fels 'The Political Economy of Regulation' (1982) 5 *University of New South Wales Law Journal* 29.

⁸¹ See Allan Fels 'Globalisation and Competition Policy' (2001) 13 *Sydney Papers* 152; Allan Fels 'Competition and Consumers in Telecommunications: Industry-specific Competition' (2000) 96 *Media International Australia* 49; and Fred Benchley *Allan Fels: a Portrait of Power* (John Wiley Press, 2003).

⁸² Brent Fisse and John Braithwaite *Corporations, Crime and Accountability* (Cambridge University Press, 1993).

ACCC was formed, responsive regulation was an established part of its regulatory policy.⁸³ The importance of Fels' beliefs was not in whether ACCC applied a responsive regulatory approach, but how much 'soft' regulation ACCC was prepared to accept under that model. Nielson and Parker have noted that ACCC, while adopting responsive regulation, was initially more inclined to use command and control regulatory methods.⁸⁴

During this period the then head of ASC, Tony Hartnell, appears to have adopted a different view of regulation.⁸⁵ While maintaining the same belief in economic rationalism as Fels, Hartnell appears to have had a greater degree of trust in the market, with ASC adopting a more industry friendly approach to regulation (this historical moment forms the first critical juncture of this thesis). The results are predictable, Hartnell appears to have created less controversy and ASC received less criticism for its regulatory approach. While Hartnell has been criticised for his tenure as chairman of ASC, most of this criticism appears to be focused on his taxation obligations and dealings in horses.⁸⁶ Fels, on the other hand, attracted significant criticism for his period as chairman of ACCC.⁸⁷

One subject of ACCC regulation stated that 'ACCC would have made the Nazis in WW2 Germany look like sissies from where we sat'.⁸⁸ Another criticised them by stating 'things that are efficient and good for the company will never happen because ACCC will never let them through'.⁸⁹ These types of criticism are plentiful, prompting Fels to suggest that a good regulator will be heavily criticised by those it seeks to regulate.⁹⁰

⁸³ Vibeke Nielson and Christine Parker 'Testing Responsive Regulation in Regulatory Enforcement' (2009) 3 *Regulation and Governance* 4, 18.

⁸⁴ Ibid.

⁸⁵ Tony Hartnell 'Regulatory Enforcement by the Australian Securities Commission' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology, 1993) 25.

⁸⁶ See Vanda Carson 'A Harvey Norman loan, a stable of horses and a tax battle' *Sydney Morning Herald* 16 March 2009; and Vanda Carson 'Hartnell defends big tax claim in horse venture' *Sydney Morning Herald* 23 February 2009.

⁸⁷ Benchley, above n 81.

⁸⁸ Christine Parker and Vibeke Nielson 'What do Businesses Really Think of the ACCC, and Does it Matter?' (2007) 35 *Federal Law Review* 187, 213.

⁸⁹ Ibid.

⁹⁰ Malcolm Maiden 'The Bell Tolls for Fels at ACCC Kennel' *The Age* 21 June 2003.

There was no necessity that either ASC or ACCC should triumph over the other. The two could co-exist. They had separate regulatory functions which were delineated by their respective legislation.⁹¹ This regulatory demarcation would be challenged in 1998, as a result of events dating back to the 1980's. It was these events and the shift to ASIC that potentially provide the missing link between the neo-liberal policy driving the creation of ASIC and the policy adopted by ASIC.

(b) ASIC and the Ideology of Superannuation

Both the ideological and physical impetus for the shift from ASC to ASIC lay in superannuation. This challenges the ideas presented by the secondary electricity market. If the move from ASC to ASIC lies in superannuation, and the policies adopted by ASIC are the dominant ideologies of the time, then the logical starting point for examining ASIC's regulatory policy would be the government that pioneered the superannuation scheme.

The superannuation movement finds its origins in an unexpected place and time: the union movement of the 1980's. Long before the Keating government introduced the superannuation guarantee, national and state unions had negotiated a number of collective agreements calling for employer superannuation contributions.⁹² By the early 90's union leaders were placing pressure on the Hawke government to legislate mandatory superannuation.⁹³ Mandatory superannuation became a reality in 1992, with the introduction of the *Superannuation Guarantee (Administration) Act*.⁹⁴

If this history is considered then the views of the secondary electricity market are open to challenge. A union-based and Labor Party implemented scheme is not a natural fit with a neo-

⁹¹ The *Corporations Act 2001* (Cth) and the *Trade Practices Act 1974* (Cth) respectively.

⁹² Rosemary Kelly 'Superannuation and the marketisation of retirement incomes' (1997) 8 *Labour and Industry: a journal of the social and economic relations of work* 57.

⁹³ Bill Kelty *Speech to National Press Club* (Speech delivered 31 July 1991 to the National Press Club).

⁹⁴ 1992 (Cth).

liberal and deregulatory agenda. This however, was not the end of the development of superannuation and its relationship with ASIC.

The superannuation guarantee fast evolved into a privatisation of the welfare system.⁹⁵ It was possibly the union involvement which made it possible for the privatisation of welfare to be so readily accepted, a surprising result given the ideological basis of unions. Welfare became the safety net for those who had failed in their superannuation investments, while the wealthy-while-working would be assured a satisfactory retirement sum.⁹⁶ Superannuation, in effect, ensured that wealth inequality could continue after retirement. It had the added bonus of convincing those who were previously entitled to a state sponsored pension that they were now owners of capitalist investment, a move directly in line with the privatisation movement of Thatcher.⁹⁷

While two of the interviewees were incorrect in referring to John Howard as the prime minister responsible for the superannuation guarantee ('Howard's superannuation scheme'⁹⁸ and 'when John Howard got rid of the pension'⁹⁹), they were correct that superannuation played a significant role in the shift from ASC to ASIC. The influence of superannuation on ASIC was both ideological and practical. By 1998, John Howard was in power and promoting neo-liberalism as the dominant ideology of Australian politics and policy.¹⁰⁰ There was no secrecy to this promotion, with Howard publically praising the work of Reagan and Thatcher.¹⁰¹ It is possible that when ASC became ASIC it not only took on a role in superannuation, but also an ideology. It is this possibility that suggests the views of the secondary electricity market may be justifiable.

⁹⁵ Kelly, above n 92.

⁹⁶ Ibid.

⁹⁷ Chomsky, above n 57.

⁹⁸ Interview 7.

⁹⁹ Interview 5.

¹⁰⁰ Kevin Rudd 'Howard's Brutopia. The Battle of Ideas in Australian Politics' *The Monthly* November 2006.

¹⁰¹ John Howard 'Address to the Quadrant Magazine 50th Anniversary Dinner' (Speech delivered at Quadrant Magazine 50th Anniversary Dinner, 3 October 2006).

Under Howard, ASC was given the powers that allowed it to become ASIC. In doing so, ASIC was provided with a partial intrusion into the regulatory space of the Australian Prudential Regulatory Authority ('APRA') and a far bigger intrusion into the regulatory space of ACCC. By giving ASIC regulatory power over misleading and deceptive conduct, the government was enlarging ASIC's regulatory scope while narrowing the scope of the other regulators. There can be no clear evidence that this was the case, but it is possible to deduce that ASIC was rewarded for its ability to work with and stay out of the way of industry. ACCC, with its distrust of industry, did not fit the neo-liberal model.

This supports the views of the interviewees. Superannuation thus provided both the practical and ideological reason to shift from ASC to ASIC. ASIC's 1997-1998 annual report declared the shift as a major achievement.¹⁰² While superannuation is provided as the impetus for the change, the not-so-veiled subtext is that ASC had adopted the correct regulatory approach. ASIC goes as far as to declare 'we are in transition, absorbing wider responsibilities for consumer protection in banking, insurance and superannuation. *We will continue the broad philosophy of regulation established under the ASC*' [emphasis added].¹⁰³

The minor disparity between Hartnell and Fels was thus cemented into a 'philosophy'. Trust of the market and non-intervention were rewarded while business confrontation was punished. Both ASC and ACCC were using responsive regulation; the historical events leading to the superannuation scheme simply confirmed that ASC was using it correctly. ASIC trusted the market and it received more funding and more power. Like Pavlov's dog, ASIC had been taught to trust the market and stay out of the way of business, something that would sensibly make its way into the future conduct of ASIC.

While this is an alluring conclusion, it is not the only one. If the politics of inter-agency regulation, and in particular the role of non-state regulators, is considered in more depth, an

¹⁰² Australian Securities and Investments Commission, *Annual Report* 1997-1998.

¹⁰³ Ibid 5.

alternate explanation arises. The logic that has been offered in support of the interviewees' opinions is troubling for ASIC, but it is much less so given that an alternate explanation can be sensibly offered.

(c) Conflict of Regulators: An Alternate View

If there were nothing more to the events of 1998, then it would be easy to conclude that the secondary electricity market is correct in its views. ASIC was being positively reinforced for its anti-interventionist regulatory approach. The effects of the reinforcement would last so long as ASIC believed there were rewards to be had. Due to the redistribution of regulatory authority, ASIC could be assured that there were plenty of government rewards and punishments well into the future.

It is this notion of the redistribution of regulatory authority that leads to an alternate conclusion. Redistributing regulatory authority brings to the fore the concept of regulatory space. While the concept of regulatory space is usually used to examine the interaction of private regulatory sources,¹⁰⁴ it can nonetheless be applied to understand ASIC's role within large governmental regulators. ASIC must not only define its role against private regulatory forces, but must also compete against other state regulators. Lodge has conducted a similar investigation into regulatory space between large public regulators, suggesting that ASIC and ACCC may be viewed as competing for regulatory space.¹⁰⁵

With the newly formed ASIC entering consumer protection and financial product markets, the boundaries between the large state regulators were blurred. ASIC had taken on part of ACCC's role in prosecuting misleading and deceptive conduct and part of APRA's role in regulating financial service markets. As far as consumer protection was concerned, ASIC's enlarged role

¹⁰⁴ See Leigh Hancher and Michael Moran, *Capitalism, Culture and Economic Regulation* (Oxford University Press, 1989), 271; and Baldwin and Cave, above n 38.

¹⁰⁵ Colin Scott 'Analysing regulatory space: fragmented resources and institutional design' (2001) *Public Law* 329.

had intruded on ACCC's regulatory space, resulting in decreased funding and decreased power for ACCC.

In order to draw some kind of clear boundary, ASIC and ACCC entered into the MoU.¹⁰⁶ While the MoU is drafted in the language of co-operation,¹⁰⁷ its purpose is to make clear how the two regulatory agencies are to divide up the regulatory space. The MoU served as a useful tool in minimising inter-regulatory agency disputes, but is a significantly weaker set of regulatory boundaries than a legislative instrument.

As noted by Scott, where multiple participants are contesting regulatory space, a competitive environment is created.¹⁰⁸ Regardless of any MoU, ASIC was now not just in competition with the forces of self-regulation and private regulatory bodies, but also with ACCC and APRA. ASIC had scored a major victory over its competitors, essentially by minimising its intrusion in its own pre-existing regulatory space. While ASIC and ACCC had both adopted responsive regulation,¹⁰⁹ ACCC had adopted a far greater regulatory presence. A smaller intrusion into regulatory space leaves more room for business self-regulation and private regulatory methods to prevail.¹¹⁰ As noted earlier, this complimented a government and ideology which wished to minimise state regulation. When the same issue is viewed through the prism of regulatory space, the message to ASIC was even clearer.

ACCC and ASIC had been playing two very different political games. ACCC had tried to occupy the regulatory space of consumer protection, to the point where other private regulators (including business groups and corporate self-regulation) complained about this intrusion and fought against it. ASIC played a quieter regulatory game, allowing others to take their fill of regulatory space, intruding only where there was a regulatory vacuum. ASIC would co-ordinate

¹⁰⁶ Memorandum of Understanding between the Australian Securities and Investments Commission and the Australian Consumer and Competition Commission dated February 1998.

¹⁰⁷ See the numerous references to 'co-operation', 'sharing' and 'assistance' throughout.

¹⁰⁸ Hancher and Moran, above n 104.

¹⁰⁹ Comino, above n 38.

¹¹⁰ Hancher and Moran, above n 104.

regulatory resources, acting almost as a small field meta-regulator,¹¹¹ whereas ACCC took a more controlling role.

In this way it can be seen that neo-liberalism was not the cause of ASIC's regulatory approach, but rather its compliment and environment. Although nowhere near the level of complexity as current meta-regulatory theory,¹¹² ASIC was showing early signs of co-operative regulatory co-ordination within its own legislative mandate. As a result its mandate was increased. While a neo-liberal ideology likely contributed to government preference toward ASIC's regulatory approach, other factors such as cost-effectiveness would likely also have played a role in this decision. If the question of effectiveness is put to one side, ASIC's approach was cheaper, raised less complaints and was more in line with progressive regulatory theory. This perhaps explains why ASIC's anti-interventionist regulatory approach has endured shifting social ideologies. Minimum incursion into regulatory space leads to less political conflict and lower cost.

This strategy has apparently paid off again for ASIC. ASIC, staying true to its regulatory approach, assumed control over the Australian Securities Exchange from ASX Limited (**ASX**) in 2010.¹¹³ As if to make the point abundantly clear, ASIC entered into a memorandum of understanding with ASX in 2011,¹¹⁴ ostensibly based on the same precedent as the memorandum of understanding between ASIC and ACCC.

While effectiveness is an extremely important question, the purpose of this paper is not to determine whether ASIC or ACCC has the more effective regulatory approach. This analysis is conducted only to verify the claim of the secondary electricity market that ASIC adopted a neo-liberal regulatory approach. This is a sensible conclusion, but it is not the most attractive conclusion. The most attractive conclusion is that neo-liberal policy merely cemented ASIC in a

¹¹¹ Christine Parker, 'Meta-Regulation: Legal Accountability for Corporate Social Responsibility' *University of Melbourne Legal Studies Research Paper* No 191.

¹¹² See Bronwyn Morgan 'The Economization of Politics: Metaregulation as a form of non-judicial legality' (2003) 12 *Social Legal Studies* 489.

¹¹³ *ASIC Market Integrity Rules (ASX Market)* 2010 (Cth).

¹¹⁴ Memorandum of Understanding between Australian Securities and Investments Commission and ASX Limited dated October 2011.

progressive regulatory path. Social factors simply reinforced ASIC's regulatory aims, rather than shaping them.

2 *Consequences of Industry Perception*

Based on the above discussion it can be concluded that the secondary electricity market holds a justifiable but potentially inaccurate view of the impact of neo-liberalism in the shift from ASC to ASIC. This gives rise to a twofold regulatory problem for ASIC. First, the secondary electricity market believes ASIC's regulatory approach is a product of an outdated ideology. Second, while it is likely that the secondary electricity market has drawn an erroneous conclusion, it is a conclusion that is logically sound. Nonetheless, this is a problem for ASIC that is able to be solved.

The simplest solution for ASIC would be for ASIC to simply change its regulatory approach. It is questionable whether this can be done. APRA and ACCC are still competitors for regulatory space. Cost and complaints are still real factors in government allocation of regulatory power. It is possible that ASIC is now in a competitive environment which requires its dedication to a particular regulatory approach. The competition of other regulators strengthens the assertion that this is a critical juncture that has placed ASIC on a dependent path. This concept is explored fully in chapter 7.

Given the existence of this critical juncture, ASIC cannot change its regulatory approach. The simplest solution is for ASIC to convince the secondary electricity market that the secondary electricity market's views are incorrect. Given ASIC's silence on regulatory theory, this is a possibility. The last clear statement on regulatory policy was released in 2004.¹¹⁵ Some studies have noted a shift in ASIC's regulatory policy since this period,¹¹⁶ but this change has never been confirmed by ASIC. If ASIC's regulatory approach is not a neo-liberal one, then clear

¹¹⁵ Jeffrey Lucy 'Significant Regulatory Issues Facing ASIC and Australian Business' (speech delivered at the Australian-Israeli Chamber of Commerce, 4 August 2004).

¹¹⁶ See Malcolm Sparrow, *The Regulatory Craft. Controlling Risk, Solving Problems and Managing Compliance* (The Brookings Institute, 1st edition, 2000); and Comino, above n 38.

communication with the secondary electricity market may improve the relationship between ASIC and the secondary electricity market. Regardless of the effects of this critical juncture in forming a dependent path, this increased communication on an ideological level would be of benefit to ASIC's ability to regulate the secondary electricity market. Failures may continue to exist on a deeper level, but there is scope for improvement without challenging ASIC's historical development.

C *Conflict between the First and Second Critical Junctures*

There is ostensibly an internal logical error with the two critical junctures identified so far in this thesis. Part of the first critical juncture was a belief that neither ASC nor ASIC had undergone any meaningful policy review. This second critical juncture suggests that there was a shift in regulatory approach that arose during the change from ASC to ASIC.

A closer inspection of the data and themes suggests that this may not be logically inconsistent. The first theme suggested that ASC was formed as and remains a 'pro-industry' body. The second theme can only be consistent if the regulatory shift from ASC to ASIC was to become more 'pro-industry'. This appears to be the case. The definition of pro-industry drawn from the thematic analysis in chapter 4 suggests that a regulator is pro-industry where it aims to minimise impediments to business operations, improve and attract investment in businesses and financial markets and reduce regulatory costs and procedures faced by businesses. The responses of the interviewees set out in Table 5.1 suggest that these pro-industry regulatory approaches were amplified, rather than challenged, in switching from ASC to ASIC.

There remains a logical fault in the responses of some participants. Those who claim ASIC adopted a consumer focus suggest that ASIC moved away from being 'pro-industry'. The adoption of a consumer focus would traditionally be to the detriment of industry.¹¹⁷ One of the

¹¹⁷ Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (Oxford University Press, 2012).

interviewees in this category had already stated that ASC and ASIC had undergone policy reviews, but there had been insufficient change to ASIC's pro-industry regulatory approach.¹¹⁸ Even so, it would appear inconsistent that ASIC should on the one hand have not had sufficient change in policy to warrant a reclassification as 'pro-industry' while on the other hand ASIC has changed so strongly toward a consumer-focus that the consumer-focus is now resulting in sub-optimal regulatory outcomes. The solution to this contradiction likely lies in the fact that the secondary electricity market does not contain many consumers. It is possible that ASIC's pro-industry stance has not changed in the experience of the interviewees because there are no consumers in the secondary electricity market for ASIC to protect. Thus, while ASIC may have been increasing its regulatory outlook, its regulation in relation to the secondary electricity market was decreasing. The two themes, while thus somewhat inconsistent, remain logical when viewed only in relation to the secondary electricity market.

IV CONCLUSION

Viewing the data generated by this thesis through the lens of historical institutionalism reveals a clear critical juncture. The shift from ASC to ASIC has impacted on ASIC's policy in a way that continues to affect ASIC's ability to regulate the secondary electricity market. As suggested in chapter 2, an historical moment in the development of an institution that shapes future decisions and directions can be identified as a critical juncture.¹¹⁹

While the timing of this critical juncture is unanimously determined by the interviewees, the exact nature of the critical juncture is inconclusive. If the minority view that ASIC adopted a consumer protection focus at this juncture, then ASIC is faced with the same difficulty that arose at the first critical juncture. ASIC has prioritised consumer protection and must now meet the standards it has adopted. This problem is perhaps not as significant as that posed by the first

¹¹⁸ Interview 16.

¹¹⁹ Paul Dimaggio and Walter Powell 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields; (1983) 48 *American Sociological Review* 147.

critical juncture. Responding to the demands of the secondary electricity market in this instance would simply require a reallocation of resources. While this would pose a challenge to ASIC and its ability to meet consumer protection goals, it is a theoretical possibility. For this reason, the second critical juncture, when viewed in isolation, may be seen as a lesser concern for ASIC than the first critical juncture, which could only be resolved by the abandonment of its measures of effectiveness and consequently, its regulatory approach.

If however, the majority view that ASIC adopted a neo-liberal policy at this critical juncture is correct, then ASIC is faced with a far more significant difficulty. While the interviewees are historically inaccurate in putting forth this idea, it finds sound basis in the competition between regulators for regulatory space. This second critical juncture can thus be seen to introduce a new element to ASIC's regulatory environment: competition. The introduction of competition to ASIC's regulatory responsibility significantly increases the cost and difficulty in changing regulatory policy to meet the needs of the secondary electricity market. ASIC's current approach is proving competitive. Any change to ASIC's regulatory approach in pursuit of effectiveness carries the risk of making ASIC less competitive. In this environment, the chances of ASIC being responsive to a small sub-section of its regulatory jurisdiction are likely to be limited.

The difficulties presented to ASIC by this critical juncture are amplified when considered together with the critical juncture identified in chapter 4 and the critical juncture that will be identified in chapter 6. Not only do these critical junctures provide regulatory difficulties in their own right, but taken together they have placed ASIC on a dependent path. This dependent path will be considered in detail in chapter 7.

CHAPTER SIX: THE DERIVATIVES BOOM

I OVERVIEW

Chapters 4 and 5 examined the first two of the three clear and related themes which emerged from the empirical investigation outlined in chapter 3, namely: that the secondary electricity market views as critical junctures the formation of ASC and the transition from ASC to ASIC. This chapter examines the final of the three related themes: that ASIC is ineffective in its regulation of the secondary electricity market because the rapid growth in derivatives trade following the repeal of the Glass-Steagall legislation¹ resulted in ASIC being unable to regulate derivatives in a meaningful way. This chapter examines this theme and identifies it as a period of rapid change and volatility, a ‘critical juncture’, in the historic development of ASIC.

A majority of the interviewees suggested that the growth in derivatives trade has had a negative effect on the ability of ASIC to regulate the secondary electricity market. While various dates were offered by interviewees for when this growth occurred, the majority specified that this occurred following the repeal of the Glass-Steagall Legislation.² This chapter will identify this critical juncture through an analysis of the interview data. It will then reconcile the differences in dates identified by the interviewees.

This chapter will then verify the accuracy of the theme by testing it against historical and theoretical evidence. Once this has been done, this chapter examines the relevance of the interviewee’s responses for ASIC’s current regulation in light of their accuracy. Finally, this chapter considers this critical juncture in isolation and questions the possible courses of action ASIC may take to alter the views of the secondary electricity market.

¹ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

² Ibid.

In doing so, this chapter answers the fourth research question set out in chapter 1: to what extent did the boom in derivatives trade following the repeal of the Glass-Steagall Legislation³ result in ASIC refocusing its resource allocation away from the financial markets, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market? The secondary electricity market appears to have correctly identified that the growth in derivatives trade has not been matched by an increase in ASIC funding. Rather, ASIC's regulatory approach has had to evolve to deal with increasingly complex regulatory challenges while simultaneously dealing with more limited resources. The result is regulation that does not have the capacity to respond to the secondary electricity market.

II THEMATIC EXPLORATION OF DATA

A *Data*

A thematic analysis of the data generated by the empirical investigation outlined in chapter 3 reveals frequent references to the negative effect that a growth in derivatives trade has had on ASIC's ability to regulate the secondary electricity market. Thirteen of the interviewees referred to this theme. Unlike the data which formed the first two critical junctures discussed in chapters 4 and 5, the 13 respondents who identified this theme were united in their views on how the growth in derivatives trade had led to ineffective regulation. Table 6.1 sets out the response from each interviewee which most directly relates to this theme.

³ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

Table 6.1**Data Supporting Third Theme**

Ref	Statement ⁴	Interview
1	I wasn't around much before the 1980's, but some of the older guys seemed to hold ASIC in some sort of regard... Within the first few years of trading everyone knew that ASIC was overwhelmed... If you got caught, you were just unlucky.	2
2	Once they got rid of the restrictions on banks owning derivatives, all bets were off... I don't think any regulator could keep up, never mind ASIC.	3
3	ASIC was too stupid to prepare itself. It had to see that derivatives were about the get [omitted] huge... It did nothing, so we just did what we wanted.	4
4	ASIC was [omitted] once the savings banks could start trading.	5
5	The [derivatives] boom of the 80's... left ASIC behind.	6
6	The Glass Act [sic] was the last straw. If derivatives had remained small then ASIC might have caught up.	7
7	I'd say the 1990's were the turning point. A few guys used to deal in exotic products, but it became seriously big business in the 90's.	8
8	... Glass-Steagall... I wouldn't call it a big moment in the development of ASIC... I'd call it the end of ASIC.	10
9	Interviewee: You know as well as I do what happened following Glass-Steagall. What's the world's derivatives trade last year? Interviewer: From memory about \$1.2 quadrillion. Interviewee: I thought it was 1.5, but yeah. How's ASIC going to	11

⁴ Statements have been edited to remove profanities. Changes occur in square brackets.

	regulate that? It's bigger than world GDP... If ASIC is going to regulate derivatives then they should realistically be a bigger organisation than the entire government.	
10	Derivatives became global... by the time ASIC has considered one derivative product license [sic] the world has traded a few thousand derivatives.	12
11	[ASIC was] never all that effective... but if you are looking for an exact moment when they crossed the Rubicon, it was the repeal of the Glass-Steagall Legislation.	13
12	It really wasn't ASIC's fault. The 1980's were the wild west of finance. If ASIC had dedicated itself to dealing with hedging instruments and swaps then they [sic] would have completely missed the junk bond scandal.	15
13	I don't think ASIC was a particularly well planned institution, but the extent of their problems isn't entirely due to bad planning... It's as if they built a fairly mediocre school for 100 students just before a million kids moved into the enrolment zone.	16

Table 6.1 Sets out statements which support the existence of the third theme⁵

B *Thematic Analysis*

Thirteen of the 16 interviewees referred to the growth of the international derivatives trade as having a detrimental effect on ASIC's ability to regulate the secondary electricity market. Some of their responses are set out in Table 6.1. During the interviews 10 of the interviewees referred to this theme 3 or more times. The response from each of these interviewees that is most directly related to the theme is set out in Table 6.1, 1-4, 6-9, 12 and 13. The remaining 3 interviewees

⁵ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

referred to the theme twice. The response of these interviewees that is most directly related to the theme is set out in Table 6.1 5, 10 and 11. The total number of mentions of the theme was 39.

While the interviewees that contributed the data which forms this theme were united in their belief about both the existence of this theme and its operation, there was divergence as to the exact timing of the theme. Four of the interviewees identified the growth of derivatives as occurring in the ‘late 80’s’ or ‘early 90’s’. Examples of this are set out in Table 6.1 5 and 7. Seven of the interviewees identified the growth of derivatives as occurring following the repeal of the Glass-Steagall legislation.⁶ Examples of this are set out in Table 6.1 2, 4, 6, 8, 10 and 11. Two of the interviewees identified the growth of derivatives as occurring in the ‘1980’s’. Examples of this are set out in Table 6.1 1 and 12. While the exact timing is not necessary to establish the existence of the theme, it is of utmost importance to developing the theme as a critical juncture. Accordingly, the timing of this theme is identified and the interviewee responses reconciled throughout this chapter.

The interviewees were also divided in the measure that was used to gauge ASIC’s effectiveness. Nine of the interviewees believed that ASIC’s effectiveness decreased when measured against the interviewee’s own concept of effectiveness. Four of the interviewees stated that ASIC’s ineffectiveness increased not only when measured against the interviewee’s own concept of effectiveness, but also when measured against ASIC’s concept of effectiveness. This will also be explored throughout the chapter.

Despite the divergence in dates and measures, the data supporting this theme is clear. 81% of the interviewees referred to the growth in derivatives trade as having a negative effect on the ability of ASIC to regulate the secondary electricity market. Moreover, despite the fact that dates may not align, all of the interviewees contributing to this theme identified a point in time when

⁶ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

derivatives trade grew at a rapid rate, rather than identifying a general steady growth pattern. The remainder of this chapter identifies this theme as a critical juncture.

III DISCUSSION OF THEME / CRITICAL JUNCTURE

This thesis identifies the point in time when worldwide derivatives trade rapidly increased as the third critical juncture in the development of ASIC's regulatory policy. The data provided by the interviewees is far from united as to when this occurred. In order to establish the existence of a critical juncture, this chapter will first reconcile the dates referred to by the interviewees and identify that the actual date of the critical juncture is the point in time when the Glass-Steagall legislation⁷ was repealed. This chapter will then consider some limitations in the data used throughout the rest of the discussion.

Once the dates and limitations have been identified, this chapter verifies the historical accuracy of the interviewee responses. As the interviewees used two different measures of effectiveness, each of these will be addressed in turn. The consequences of the views of the interviewees for ASIC's relationship with the secondary electricity market are then considered. Once the critical juncture has been established, its effect on ASIC's regulatory effectiveness will be considered as a whole.

A *The Exact Moment of the Critical Juncture*

1 *Growth in the 1980's and 1990's*

Four of the interviewees specified that the increase in derivatives trade occurred either in the late 1980's or early 1990's. A further 2 interviewees specified that the increase in derivatives trade occurred in the 1980's. All of these interviewees in both these groups specified that the increased derivatives trade had led to a decrease in ASIC's effectiveness. ASIC was not formed until

⁷ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

1998.⁸ While it is possible that the interviewees were referring to ASIC's predecessor, ASC, this explanation offers little clarity. The ASC was not formed until 1989,⁹ post-dating most of the period specified by the interviewees. Even if the period from ASC's formation onward is considered, no real insight can be obtained as ASC did not have responsibility for regulating financial markets.

This casts a shadow over the credibility of these responses. Interviewees were contacted and questioned about the discrepancy of dates. Two interviewees maintained that ASIC 'or some kind of ASIC'¹⁰ existed during the 1980's. The other four interviewees revised their statement, saying that the increase in derivatives trade must have occurred later than they initially reported. This suggests that the exact moment of this critical juncture was not in the 1980's or early 1990's.

2 *Growth following the Repeal of the Glass-Steagall Legislation*

The alternate date provided by the remaining 7 interviewees is far more plausible. These interviewees identified the growth in derivatives trade as occurring sometime in relation to the Glass-Steagall legislation.¹¹ A brief overview of the Glass-Steagall legislation,¹² its timing and its effect is provided in order to reconcile the differences in understanding between the interviewees.

The first *Glass-Steagall Act*¹³ was passed in the United States of America in 1932. A year later the provisions of this act were incorporated into the *Banking Act*.¹⁴ The terms 'Glass-Steagall Act' and 'Glass-Steagall legislation' appear to have been used by the interviewees to refer to the

⁸ *Australian Securities and Investments Commission Act 1998* (Cth).

⁹ *Australian Securities Commission Act 1989* (Cth).

¹⁰ Interview 2.

¹¹ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

¹² *Ibid.*

¹³ 12 U.S.C. 80 (1932) ('*Glass-Steagall Act*').

¹⁴ 48 Stat. 162 (1933) ('*Banking Act*').

provisions in the Banking Act¹⁵ which were originally set out in the Glass-Steagall Act.¹⁶ The provisions of the Glass-Steagall Act¹⁷ which were incorporated into the Banking Act¹⁸ will be referred to as the ‘Glass-Steagall legislation’ throughout this thesis.

The purpose of the Glass-Steagall Act¹⁹ was to protect bank deposits.²⁰ This was deemed necessary to restore confidence in the banking system following the Great Depression,²¹ however some scholars (both pre- and post-global financial crisis) assert that this was an unnecessary measure.²² The means of restoring confidence was two-fold. First, it insured deposits, essentially underwriting commercial banks.²³ Second, it prevented deposit taking banks from engaging in speculative underwriting and trading.²⁴ The provisions of the Glass-Steagall legislation²⁵ most relevant to this thesis are sections 19 to 21 of the Banking Act,²⁶ which set out:

- Banks were prevented from trading securities (except where doing so on behalf of a customer).²⁷
- Banks were prevented from being connected with companies which traded financial products.²⁸

¹⁵ 48 Stat. 162 (1933).

¹⁶ 12 U.S.C. 80 (1932).

¹⁷ Ibid

¹⁸ 48 Stat. 162 (1933).

¹⁹ Ibid.

²⁰ Jill Hendrickson “The Long and Bumpy Road to Glass-Steagall Reform: A Historical and Evolutionary Analysis of Banking Legislation” (2012) 60 *American Journal of Economics and Sociology* 849; Randall Korszner and Raghuram Rajan ‘Is the Glass-Steagall Act Justified? A Study of the U.S. Experience with Universal Banking Before 1933’ (1994) 84 *The American Economic Review* 810.

²¹ Michael Bordo, Claudia Goldin and Eugene White, *The Defining Moment: The Great Depression and the American Economy in the 20th Century* (University of Chicago Press, 1998); and George Kaufman and Larry Mote ‘Glass-Steagall: Repeal by Regulatory and Judicial Reinterpretation’ (1990) 107 *Banking Law Journal* 388.

²² See Bevis Longstreth ‘Glass-Steagall: The Case for Repeal’ (1986) 31 *New York Law School Law Review* 281; George Benston ‘The Federal “Safety Net” and the Repeal of the Glass-Steagall Act’s Separation of Commercial and Investment Banking’ (1989) 2 *Journal of Financial Services Research* 287; and Fariborz Moshirian ‘The Global Financial Crisis and the Evolution of Markets, Institutions and Regulation’ (2011) 35 *Journal of Banking and Finance* 502.

²³ Hendrickson, above n 20; Trevor Sykes ‘The Prospects of Another Global Financial Crisis (2010) 54 *Quadrant* 30, 30.

²⁴ Hendrickson, above n 20; Carolyn Curry ‘The Banking Crisis of the New Millennium: Why it was Inevitable’ in Greg Gregoriou (ed) *The Banking Crisis Handbook* (CRC Press, 2009).

²⁵ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

²⁶ 48 Stat. 162 (1933).

²⁷ *Banking Act of 1933*, 48 Stat. 162 (1933), s19.

²⁸ Ibid s20.

- If a bank did trade financial products, it was not allowed to take deposits.²⁹

While this understanding seems to have been shared by all of the interviewees who referred to the Glass-Steagall legislation,³⁰ its implementation and repeal was not. Many of the interviewees referred to the passing or implementation of the Glass-Steagall legislation³¹ as having led to an increase in derivatives trading. Others referred to the repeal of the Glass-Steagall legislation³² as having led to an increase in derivatives trading.

While the latter view is more logical, it is difficult to ascertain the date that the Glass-Steagall legislation³³ was repealed. As the Glass-Steagall Act³⁴ is a reference to provisions within the Banking Act,³⁵ and as the Banking Act³⁶ has not been repealed, there has been no technical repealing of the Glass-Steagall Act.³⁷ Rather, the effect of the Glass-Steagall legislation³⁸ was eroded over time through a series of legislative amendments.³⁹ The strongest of these amendments was the passing of the *Gramm-Leach-Bliley Act*⁴⁰ ('GLB Act') in 1999.⁴¹ The GLB Act⁴² removed the restriction on banks acting as insurance brokers or financial product traders.⁴³ As this is the legislation most immediately preceding the growth in the international derivatives trade,⁴⁴ it will be assumed that the passing of the GLB Act⁴⁵ is what is meant by the interviewees

²⁹ *Banking Act of 1933*, 48 Stat. 162 (1933), s20.

³⁰ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

³⁴ 12 U.S.C. 80 (1932).

³⁵ 48 Stat. 162 (1933).

³⁶ *Ibid.*

³⁷ 12 U.S.C. 80 (1932); and Hendrickson, above n 12.

³⁸ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

³⁹ Helen Garten "The Consumerization of Financial Regulation" (1999) 77 *Washington University Law Quarterly* 287.

⁴⁰ *Banking Modernization Act*, 113 Stat. 1338 (1999).

⁴¹ Garten, above n32.

⁴² 113 Stat. 1338 (1999).

⁴³ Hendrickson, above n 12.

⁴⁴ Adrian Blundell-Wignall "On the Necessity of Separating Investment and Commercial Banking" (2011) 46 *Intereconomics* 298, 230-231.

⁴⁵ 113 Stat. 1338 (1999).

when they refer to either the passing of the Glass-Steagall Act⁴⁶ or the repeal of the Glass-Steagall Act.⁴⁷

This conclusion is drawn both on the basis that the dates correlate with ASIC's regulation of financial markets and on the basis that the passing of the GLB Act⁴⁸ has, of all the potential dates for this critical juncture, the most relevance to the secondary electricity market. The derivative financial products traded by the secondary electricity market are the securities that the GLB Act⁴⁹ allowed deposit taking banks to trade. More importantly, the derivative products which experienced growth following the passage of the GLB Act⁵⁰ are the derivatives products subject to the same legislation as the derivatives traded by the secondary electricity market.⁵¹ The passing of the GLB Act can thus be seen as the moment when ASIC's regulation of derivative financial products became 'overwhelmed' according to the interviewees (Table 6.1 1).

B *Limitations with Data*

This chapter relies heavily on data about the international and national derivatives trade. The data on the national derivatives trade is inconsistent in both its presence and its value. Two different sources often quote different figures for the derivatives trade over the same time period. Regulators and government institutions often release data on only certain types of derivatives or may only release data on derivatives every few years.

This thesis has relied on the figures provided by Australian Financial Markets Association ('AFMA') in its annual market reports. The figures provided in these annual reports rely on the voluntary submission of data from the Australian Securities Exchange Limited ('ASX') and members of AFMA. While there is no reason to suspect that members of AFMA would be dishonest in their submission of data, there is no assurance that this is not the case. The data has

⁴⁶ 12 U.S.C. 80 (1932).

⁴⁷ Ibid.

⁴⁸ 113 Stat. 1338 (1999).

⁴⁹ Ibid.

⁵⁰ Ibid.

⁵¹ *Corporations Act 2001* (Cth), Chapter 7.

nonetheless been used because of its consistency. It is the only publicly available source of data which uses a consistent measure of Australian derivatives value from 1998 to 2013.

A further problem arises in relation to the secondary electricity market. Secondary electricity derivative market data is collected and published by AFMA. It has not been used in this thesis as AFMA's reporting on the secondary electricity market is inconsistent. In certain years the monetary value of the secondary electricity market has been reported. In other years, the total kilowatt hours traded has been reported. As it has not been possible to reconcile the two measures, this data has not been included in the analysis presented below. The secondary electricity market is an extremely small part of the overall derivatives market, so should not affect the overall data. While it is unfortunate that this data should be excluded from any part of a thesis about the secondary electricity market, this particular chapter does not rely on the data to make a point about the value of derivatives in the secondary electricity market. Rather, the data is used to analyse ASIC's workload in relation to derivatives generally.

C ASIC's Effectiveness Measured against the Secondary Electricity Market's Performance Measures

Nine of the interviewees believed that the increase in derivatives trade led to a decrease in ASIC's regulatory effectiveness when using the Performance Measures adopted by the interviewee. When further questioned as to whether ASIC had declined in effectiveness against ASIC's Performance Measures, 2 of the interviewees stated that ASIC may have different Performance Measures but that any such Performance Measures would be inappropriate. One of these interviewees stated that ASIC 'may have' improved against its own measures, but such an improvement would be 'meaningless'.⁵² One interviewee suggested that ASIC would 'definitely'

⁵² Interview 13.

have improved against its own measures, because ‘ASIC would just generate a measurement that showed improvement’.⁵³

The remaining 7 interviewees stated that ASIC used or should use the same measure of effectiveness as the interviewees. A selection of these statements is included in Table 6.2.

Table 6.2 Data Suggesting that the Interviewee and ASIC used the same Performance Measures		
Ref	Statement	Interview
1	There’s nothing complex here. You’re either effective or you’re not. ASIC wasn’t.	4
2	If ASIC isn’t measuring its regulation by measuring how well it’s regulating, then that’s what you need to be writing about.	6
3	I’ve never really thought about it. I assumed ASIC was just trying to prevent people from breaking the law. Aren’t they?	7
4	Ultimately, any attempt to measure effectiveness comes down to two things. Are they doing a good job and do people think they are doing a good job.	16

Table 6.2 Sets out statements which suggest that the interviewees believed that they were using the same performance measures as ASIC⁵⁴

Despite unanimously strong views about ASIC failing against the interviewee’s own Performance Measures, the interviewees were often unclear on what these Performance Measures were. In describing the Performance Measures they used to measure ASIC, most of the interviewees offered measures of effectiveness that were plagued by circularity. Table 6.3 sets

⁵³ Interview 2.

⁵⁴ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

out a number of the responses provided by the interviewees that described the Performance Measures they used to measure ASIC's effectiveness.

Table 6.3 Data Identifying Interviewees' Performance Measures		
Ref	Statement	Interview
1	[ASIC is effective] if the law is working.	4, 6, 10
2	If ASIC was effective I couldn't get away with half of what I do.	4
3	I remember once seeing [company name] selling electricity futures. They kept describing them as electricity futures, but they were just a contract for difference. They didn't even have electricity as an underlying asset. It was just some ridiculous financial product which derived its value from electricity prices – I think, somehow, you just ended up buying a loan. Until ASIC stops us from putting this type of [expletive omitted] into the market it isn't doing its job.	5
4	[ASIC is effective if] no-one's breaking the law.	2, 7
5	Let's say I put together a thoroughly inconsistent PDS. The fees in the director's letter don't match the fees in the back. I include a few sample calculations, but none of them actually take out any fees whatsoever. ASIC will rubber stamp it... If ASIC were effective those sorts of PDS's wouldn't be around.	10

Table 6.3 Sets out statements which reveal that interviewees use a different set of performance measures to ASIC⁵⁵

⁵⁵ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked

For the most part, the Performance Measures provided by the interviewees in Table 6.3 are riddled with circularity. The comments in Table 6.1 1 and 4 essentially state that ASIC's regulation is effective if it is effective. This type of circular evaluation was common throughout the responses in Table 6.1. Despite this circularity, the responses do reveal an important aspect of how the secondary electricity market evaluates the effectiveness of ASIC. The interviewees appeared to be of the belief that ASIC is effective if they perceive that no-one, or very few people, are able to violate legislation (see Table 6.1 1, 3 and 4). Inherent in this is a view that ASIC is not effective if the interviewee himself or herself is able to breach legislation without penalty (see Table 6.1 2, 5). Beyond this commonality, most of the interviewees appeared to have given little thought to the measure of effectiveness that they applied to ASIC. As one of the interviewees suggested, his or her measure of effectiveness was less a logical structure and more of a 'gut feel'.⁵⁶

Despite the difficulties in ascertaining a clear measure from these interviewees, there is sufficient commonality in their responses to identify major factors in their determination of ASIC's effectiveness. All of the interviewees in this group appeared to have a quantitative measure of effectiveness. This measure was based on number of legislative breaches. The more breaches of legislation that occurred, the less effective ASIC was as a regulator. Although not stated, all but one of the interviewees evaluated ASIC against this quantitative measure by using qualitative experience. All of these interviewees generalised a small number of known legislative breaches as representing a much larger quantitative failure on ASIC's behalf. The result of the qualitative evidence applied to a quantitative scale is an almost binary view of effectiveness. If the interviewee is unaware of any legislative breaches, ASIC is effective. If the interviewee is aware of a legislative breach, ASIC is ineffective.

1 *Accuracy of Industry Perception*

in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

⁵⁶ Interview 7.

The indeterminate nature of the interviewees' measure of effectiveness makes an evaluation of historical accuracy difficult. Nonetheless, by focusing on the commonalities in the interviewees' measures of effectiveness, some sense of historical accuracy can be determined. The first factor which is common to all of the interviewees is the view that the derivatives market experienced a rapid increase in value. The second factor common to all of the interviewees is that ASIC was unable to properly respond to the increase in the derivatives market. Although this cannot be absolutely verified, its logic can be tested by checking the growth in ASIC resources against the growth in the derivatives market. The final factor, which cannot be verified due to its subjectiveness, is that the number of unprosecuted breaches identified by the secondary electricity market has increased following the growth in the derivatives market.

(a) *Growth in the International Derivatives Market*

Any attempt to measure the growth in derivatives trade is problematic. Definitions of what constitutes a derivative vary both between countries and within countries.⁵⁷ Nonetheless, there appears to be significant support for the argument that the passing of the GLB Act⁵⁸ led to a large increase in the volume of derivatives being traded internationally.⁵⁹ By allowing deposit taking institutions to invest in derivative financial products, the potential source of investment funds was massively increased.⁶⁰ The rise of 'broad banking' also opened up the potential pool of financial professionals who could create and trade in derivative financial products.⁶¹ As will be shown later in this chapter, this growth in derivatives appears to have been reflected in Australia, where derivative trade grew immensely during the period 1998 to 2013.

⁵⁷ Alfred Steinherr, *Derivatives: The Wild Beast of Finance* (Wiley Press, 1998) 19.

⁵⁸ 113 Stat. 1338 (1999).

⁵⁹ James Barth, Dan Brumbaugh and James Wilcox 'The Repeal of Glass-Steagall and the Advent of Broad Banking' (2000) 14 *Journal of Economic Perspectives* 191; Ken Cyree 'The Erosion of the Glass-Steagall Act: Winners and Losers in the Banking Industry' (2000) 52 *Journal of Economics and Business* 343; Lawrence White 'The Gramm-Leach-Bliley Act of 1999: A bridge too far? Or not far enough?' (2010) 43 *Suffolk University Law Review* 937; William Topham 'Re-regulating "financial weapons of mass destruction": observations on repealing the commodity futures modernization act and future derivative regulation' (2010) 47 *Williamette Law Review* 133.

⁶⁰ Cyree, above n 40.

⁶¹ Abdullah Mamun, Kabir Hassan and Neal Maroney 'The Wealth and Risk Effects of the Gramm-Leach-Bliley Act (GLBA) on the US Banking Industry' (2005) 32 *Journal of Business Finance and Accounting* 351.

Despite the strength of academic support, there remains a problem with this argument. It is possible that the growth in derivatives was the cause of the GLB Act,⁶² rather than its effect. The Glass-Steagall legislation⁶³ was eroded over time, with amendments made in 1991 to allow banks to invest in swaps and over the counter derivatives.⁶⁴ The growth in swaps following these amendments was significant,⁶⁵ potentially placing pressure on legislators to widen the range of derivative financial products which could be traded by deposit taking banks. A bank which is too heavily invested in swaps may be of greater concern to financial stability than a bank with a broad derivatives portfolio. The inclusion of deposit taking banks in the swaps market also brought those banks into competition with investment banks,⁶⁶ providing argument for deregulation in order to foster competition.

Regardless of whether the GLB Act⁶⁷ was the cause or the effect of a growth in derivatives, it marks an important point in the growth of international derivatives trade. Even those who argue that the GLB Act⁶⁸ was caused by a growth in derivatives, rather than the cause of a growth in derivatives, acknowledge the increased rate of growth following the passing of the GLB Act.⁶⁹ For this thesis, the important element of this growth is not its cause, but whether or not it led to an increase in the regulatory workload of ASIC.

(b) Growth in Australian Derivatives Market

⁶² 113 Stat. 1338 (1999).

⁶³ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

⁶⁴ Cyree, above n 40.

⁶⁵ White, above n 40.

⁶⁶ Barth, Brumbaugh and Wilcox, above n 40, 193.

⁶⁷ 113 Stat. 1338 (1999).

⁶⁸ *Ibid.*

⁶⁹ *Ibid.*; Cyree, above n 40; and Barth, Brumbaugh and Wilcox, above n 40.

While there has been some academic interest in the Australian derivatives market,⁷⁰ it has been relatively limited. In particular, there has been little academic consideration of the rate of growth in Australia's derivatives market. This thesis instead relies on primary data on the value of Australia's derivatives market to identify any potential growth.

Table 6.4 sets out the value of Australia's derivative market for each financial year from 1998-1999 to 2012-2013. These figures were determined by adding all of the derivative financial products identified in each of the AMFA financial markets reports published between 1998 and 2013.⁷¹ The following categories of products were included in the calculation: repurchase agreements; swaps; overnight index swaps; forward rate agreements; interest rate options; credit derivatives; currency options; futures; options; derivative debt market turnover; derivative currency market turnover; and derivative equities market turnover.

Table 6.4

⁷⁰ See Paul Latimer 'Regulation of Over the Counter Derivatives in Australia' (2009) 23 *Australian Journal of Corporate Law* 9; Li-Ann Nguyen and Robert Faff 'Further Evidence on the Corporate Use of Derivatives in Australia: The Case of Foreign Currency and Interest Rate Instruments' (2003) 28 *Australian Journal of Management* 307; and Shaun Ansell 'The Regulation of Insider Trading in Derivatives' (1995) 13 *Company and Securities Law Journal* 476.

⁷¹ Australian Financial Markets Association, *Annual Financial Markets Report* 1999; Australian Financial Markets Association, *Annual Financial Markets Report* 2000; Australian Financial Markets Association, *Annual Financial Markets Report* 2001; Australian Financial Markets Association, *Annual Financial Markets Report* 2002; Australian Financial Markets Association, *Annual Financial Markets Report* 2003; Australian Financial Markets Association, *Annual Financial Markets Report* 2004; Australian Financial Markets Association, *Annual Financial Markets Report* 2005; Australian Financial Markets Association, *Annual Financial Markets Report* 2006; Australian Financial Markets Association, *Annual Financial Markets Report* 2007; Australian Financial Markets Association, *Annual Financial Markets Report* 2008; Australian Financial Markets Association, *Annual Financial Markets Report* 2009; Australian Financial Markets Association, *Annual Financial Markets Report* 2010; Australian Financial Markets Association, *Annual Financial Markets Report* 2011; Australian Financial Markets Association, *Annual Financial Markets Report* 2012; Australian Financial Markets Association, *Annual Financial Markets Report* 2013.

Growth in Value of Australian Derivatives Trade	
Year	Value of Australian Derivatives Trade
1998-1999	\$42,829,000,000,000.00
1999-2000	\$47,176,000,000,000.00
2000-2001	\$52,139,000,000,000.00
2001-2002	\$64,663,000,000,000.00
2002-2003	\$70,729,000,000,000.00
2003-2004	\$87,059,000,000,000.00
2004-2005	\$114,009,000,000,000.00
2005-2006	\$131,072,000,000,000.00
2006-2007	\$160,932,000,000,000.00
2007-2008	\$163,414,000,000,000.00
2008-2009	\$122,557,000,000,000.00
2009-2010	\$138,250,000,000,000.00
2010-2011	\$184,297,000,000,000.00
2011-2012	\$193,013,000,000,000.00
2012-2013	\$208,232,000,000,000.00

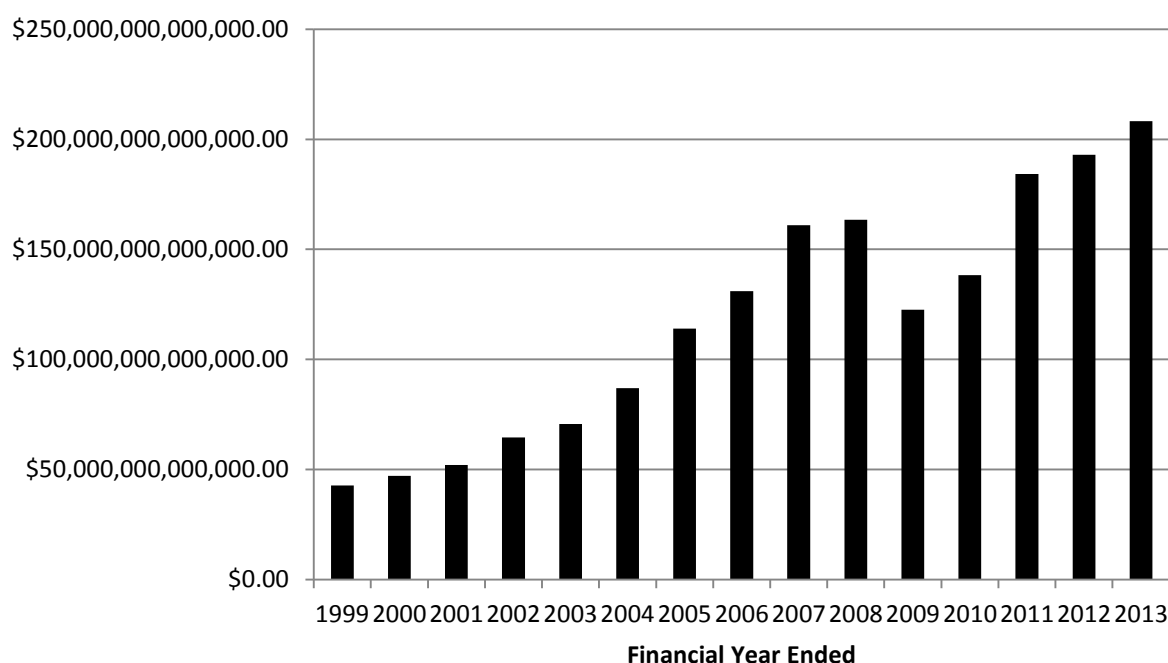
Table 6.4 Sets out the Value of Australian Derivatives Trader over Time

With the exception of the 2008-2009 and 2009-2010 financial years, Australia's derivatives trade has experienced significant growth in every year. The two exceptions are possibly explained by the occurrence of the global financial crisis.⁷² The total growth during the period starting 1998-1999 and ending 2012-2013 was 486%. Figure 6.1 graphs the growth rate of derivatives for the same period.

⁷² Claude Brown and Timothy Cleary 'Impact of the Global Financial Crisis on OTC derivatives in structured debt transactions' (2010) 5 *Capital Markets Law Journal* 218, 218.

Figure 6.1

Growth in Australian Derivatives Trade Financial Year Ended 1999 to 2013



This general upward trend suggests that the interviewees were correct in asserting that there has been a significant increase in the Australian derivatives market since the passing of the GLB Act.⁷³ While a growth rate of 486% over 14 years may not be as significant as the growth rate in some financial products for the same period, it should be noted that the 1998-1999 financial year value of derivatives was close to \$50 billion.⁷⁴ Both the gross monetary growth and the percentage growth of derivatives have shown a significant increase following the passing of the GLB Act.⁷⁵ This supports the first commonality in the interviewees' responses.

(c) *The Growth in Derivatives Trade was not matched by a Growth in ASIC Funding*

⁷³ 113 Stat. 1338 (1999).

⁷⁴ Australian Financial Markets Association, *Annual Financial Markets Report* 1999.

⁷⁵ 113 Stat. 1338 (1999).

The second conclusion common to all interviewees was that the growth in derivatives trade resulted in ASIC becoming ‘overwhelmed’.⁷⁶ The common idea was that ASIC’s ability to regulate did not increase in line with the size of its regulatory duties. While nothing can be known about increases in ASIC’s efficiency, it is possible to verify whether the growth in derivatives trade was met by an equal increase in ASIC funding.

Table 6.5 sets out the yearly government funding received by ASIC together with the yearly value of the derivatives trade. The yearly government funding figures have been sourced from ASIC’s annual reports for each year between 1999 and 2013.⁷⁷

⁷⁶ Interview 2.

⁷⁷ Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 1999; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2000; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2001; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2002; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2003; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2004; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2005; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2006; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2007; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2008; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2009; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2010; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2011; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2012; and Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2013.

Table 6.5 ASIC Funding Compared to Value of Australian Derivatives		
Year	Value of Australian Derivatives Trade	ASIC Funding
1998-1999	\$42,829,000,000,000.00	\$132,400,000.00
1999-2000	\$47,176,000,000,000.00	\$131,621,000.00
2000-2001	\$52,139,000,000,000.00	\$144,201,000.00
2001-2002	\$64,663,000,000,000.00	\$146,090,000.00
2002-2003	\$70,729,000,000,000.00	\$162,832,000.00
2003-2004	\$87,059,000,000,000.00	\$183,258,000.00
2004-2005	\$114,009,000,000,000.00	\$199,200,000.00
2005-2006	\$131,072,000,000,000.00	\$213,879,000.00
2006-2007	\$160,932,000,000,000.00	\$244,058,000.00
2007-2008	\$163,414,000,000,000.00	\$282,218,000.00
2008-2009	\$122,557,000,000,000.00	\$307,796,000.00
2009-2010	\$138,250,000,000,000.00	\$370,229,000.00
2010-2011	\$184,297,000,000,000.00	\$324,038,000.00
2011-2012	\$193,013,000,000,000.00	\$304,259,000.00
2012-2013	\$208,232,000,000,000.00	\$350,030,000.00

Table 6.5 Compares the Value of Australian Derivatives Trader to ASIC funding.

As can be seen from Table 6.5, while the Australian derivatives market grew 486% over the period starting 1998-1999 and ending 2012-2013, ASIC funding increased by only 264%. While not in any way proof of a decrease in effectiveness, this data does suggest that ASIC is currently being required to do significantly more with each dollar of government funding than it was required to do in 1999. The growth disparity is amplified when considered in terms of total value. While ASIC's funding has grown 264%, it has done so from a relatively modest base of

\$132 million.⁷⁸ The growth in the derivatives market started from a much larger base of close to \$50 billion.⁷⁹ If considered against the derivatives market, ASIC's funding has suffered a significant decline in both dollar value and percentage terms. As noted earlier, this decline is no proof that ASIC has become overwhelmed, but it does give some credibility to the beliefs of the interviewees. Figure 6.2 sets out ASIC funding against the growth in the Australian derivatives market. A different scale has been used for both, as the difference in total size renders a single scale unworkable.

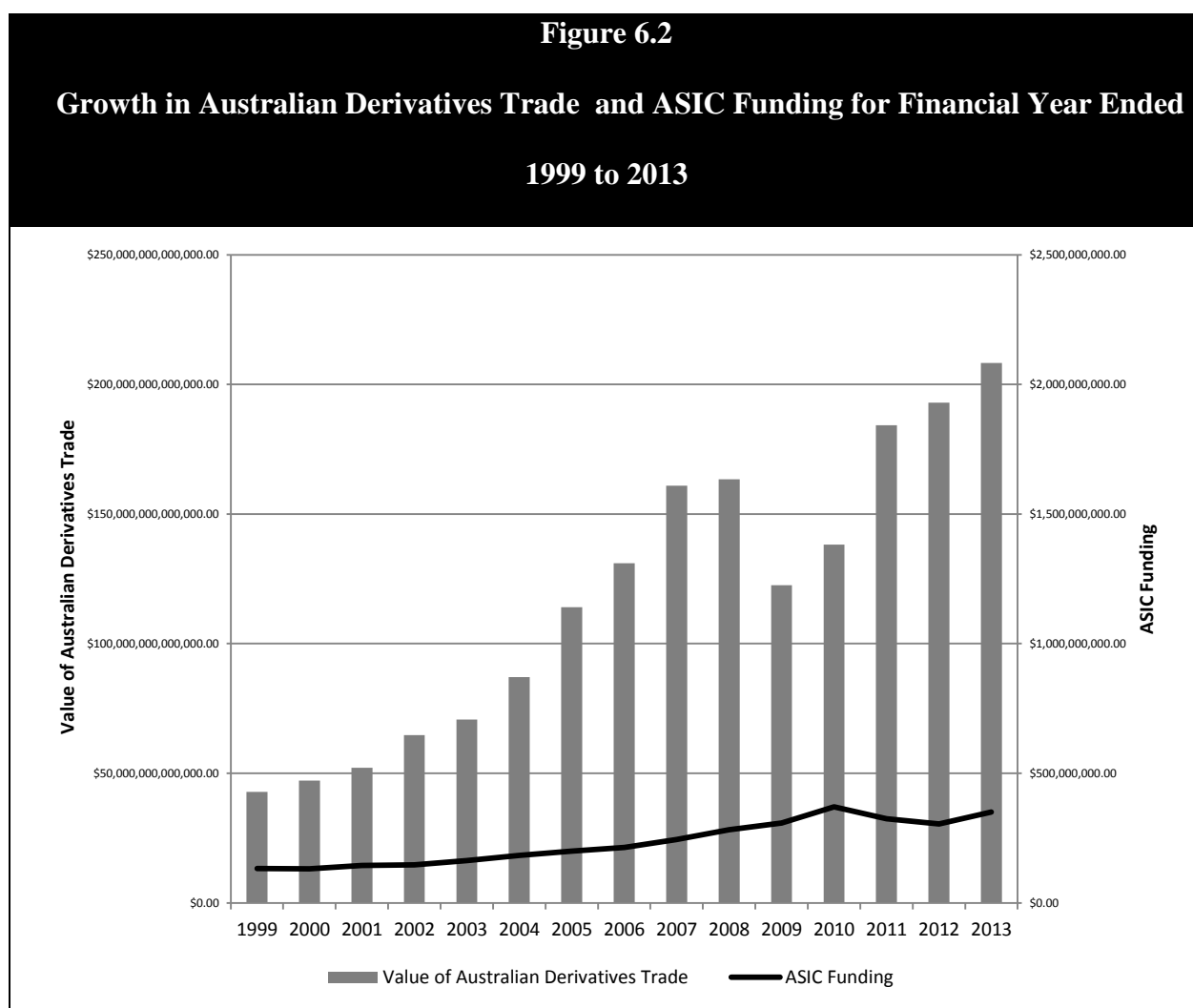


Figure 6.2 provides a graphic display of the disparity between the growth in ASIC funding and the growth in the Australian derivatives market. While not fully supporting the conclusions

⁷⁸ Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 1999*.

⁷⁹ Australian Financial Markets Association, *Annual Financial Markets Report 1999*.

drawn by the secondary electricity market, it suggests that those conclusions are rational. Given the extent of the disparity, it may go further to suggest that the conclusions drawn by the secondary electricity market are in fact not just logically supportable, but more likely than alternate possibilities.

(d) The growth in derivatives trade led may have led to an increase in unprosecuted legislative breaches

The final conclusion common to all interviewees was that the growth in derivatives trade led to more breaches of legislation. While ASIC publishes both the number of people licensed to provide financial services and the number of people prosecuted for breaching legislation, this data tells an extremely incomplete story. From a strictly pragmatic point of view, it cannot be known how many people are breaching legislation and not being caught. The effect of this unverifiable opinion is discussed after the critical juncture has been fully established.

2 Consequences of Industry Perception

As with the critical junctures identified in chapters 4 and 5, the extent of any regulatory failure on behalf of ASIC depends largely on whether industry is correct in its beliefs. In this instance, the beliefs cannot be properly measured. The extent of ASIC's regulatory failure instead depends on the rationality of the views held by the secondary electricity market.

It has been established that the interviewees were correct about the increase in Australian derivatives trade. It has also been established that they have reason to believe that ASIC has not been properly resourced to effectively respond to the increase in Australian derivatives trade.

What has not and cannot be established is whether ASIC has failed the third common element of the interviewees' criticism: that there has been an increase in unprosecuted legislative breaches.

The extent of ASIC's failure with regard to this third criticism will depend on the answer to three

related questions. These questions and their answers are set out in Table 6.6. These questions are discussed in more depth following Table 6.6.

Table 6.6 Questions and Answers Revealing Extent of ASIC's Regulatory Failure		
Ref	Question	Answer
1	Can ASIC meet the standards of the secondary electricity market?	No. The regulatory approach adopted by ASIC has departed too far from the expectations of the secondary electricity market.
2	Can ASIC change the measure of effectiveness used by the secondary electricity market?	Yes. Any such change will be in the long term, but opening a dialogue on this matter will minimise any harm in this area.
3	Can ASIC change its own measure of effectiveness?	Yes, but such a change is extremely costly and highly undesirable due to ASIC's historical development. The role of the critical junctures in developing a dependant path will be explored in chapter 7.

Table 6.6 Sets out key questions and answers to understanding potential regulatory failure

(a) Meeting the Standards of the Secondary Electricity Market

The question and answer set out in Table 6.6 1 poses a difficulty for ASIC and its relationship with the secondary electricity market. Table 6.3 identifies instances in which the interviewees used personal knowledge of unprosecuted legislative breaches to judge the effectiveness of ASIC. These experiences were qualitative in nature, with none of the interviewees providing exact numbers of known breaches. Four of the interviewees relied on only a single known instance of unprosecuted legislative breach to challenge the competence of ASIC.

Meeting such an unstructured qualitative standard is likely to pose extreme problems for ASIC,⁸⁰ but it is possible that ASIC could work toward such a standard. If the measure is perceived unprosecuted breaches of legislation, ASIC can improve its effectiveness by managing perceptions. It has been stated that ASIC already engages in this type of perception management.⁸¹ ASIC has been accused of targeting high profile cases and breaches to maximise media exposure.⁸² This is a claim which has historically been denied by ASIC, with ASIC instead claiming that it targets offenses, not people.⁸³ This may lead to the conclusion that ASIC is not seeking to maximise exposure or manage perceptions in any dedicated manner.

Business literature has long recognised the importance of perception management in ensuring confidence in corporate performance.⁸⁴ The communication of success forms an important element in developing and maintaining relationships between corporations and its shareholders.⁸⁵ Likewise, good perception management can form the basis of relationships between corporations and other stakeholders.⁸⁶ This literature can equally be applied to ASIC.

Implementing such a perception management strategy is a possible means for ASIC to improve its standing on the qualitative measure implemented by the secondary electricity market. Such a strategy is unlikely to be desirable for ASIC. First, it would require funding which would need to be taken from its current activities. Such a reallocation of funds would be particularly troubling given that funding is already decreasing when measured against the growth in ASIC's regulatory

⁸⁰ James Thompson and William McEwan 'Organisational Goals and Environment: Goal Setting as an Interaction Process' (1958) *American Sociological Review* 23, 23-25.

⁸¹ Elizabeth Night, 'Forrest Judgment Shows ASIC must lift bar', *Sydney Morning Herald* (Sydney), 3 October 2012.

⁸² Ibid.

⁸³ Australian Securities and Investments Commission, *ASIC targets wrongdoing, not individuals* (Press release 03-264) 21 August 2003.

⁸⁴ See Craig Fleisher and Darren Mahaffy 'A balanced scorecard approach to public relations management assessment' (1997) 23 *Public Relations Review* 117; Cynthia Clark 'Differences between public relations and corporate social responsibility' (2000) 26 *Public Relations Review* 363; Jacquie L'Etang and Magda Pieczka, *Critical Perspectives in Public Relations* (International Thompson Business Press, 1997); and James Hutton, Michael Goodman, Jill Alexander and Christina Genest 'Reputation management: the new face of corporate public relations' (2001) 27 *Public Relations Review* 247.

⁸⁵ Hutton, Goodman, Alexander and Genest, above n 64.

⁸⁶ Clark, above n 64.

duties. The improved perception of prosecuting legislative breaches may be at the expense of actually prosecuting those breaches.

Second, the minimisation of the perception of legislative breach is likely to work against the goals of ASIC. As identified in figure 2.1 in chapter 2, one of ASIC's key goals is to educate its regulatory subjects.⁸⁷ The more aware its subjects are of legislation, the more aware they will be of a breach of that legislation. The simplest and most cost effective perception management strategy would also be the most damaging to ASIC meeting its own measure of effectiveness: promoting ignorance of legislation. Likewise, by focusing on perception management rather than honest discourse, ASIC risks the long term relationship between itself and its regulatory subjects.⁸⁸

Other than perception management, the only real possibility is for ASIC to increase its regulatory effectiveness to such a point where unprosecuted legislative breaches become increasingly rare. With regulatory duties and subjects growing faster than funding, this is likely to be an increasingly difficult task. Even if ASIC were to prosecute every breach of legislation, the period between breach and prosecution would still present a public relations issue for ASIC.

The inability of ASIC to meet these standards is not a reflection of any shortcoming on ASIC's behalf. Rather, it reflects a greatly varied measure of effectiveness between ASIC and the secondary electricity market. This disparity is the symptom of a much deeper theoretical divide between ASIC and the secondary electricity market. This idea will be explored as this thesis considers whether ASIC or the secondary electricity market can be influenced to change their measure of effectiveness.

⁸⁷ Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report* 2013.

⁸⁸ John Braithwaite and Toni Makkai 'Trust and Compliance' (1994) 4 *Policing and Society: An International Journal of Research and Policy* 1.

(b) *Changing the Standards of the Secondary Electricity Market*

The question and answer set out in Table 6.6 2 offers an opportunity for ASIC to improve its current regulatory relationship with the secondary electricity market. As one of ASIC's key roles is to educate, it is within ASIC's power to persuade the secondary electricity market that the secondary electricity market is using an undesirable measure of effectiveness. Part of this education process will be relatively simple. Achieving any significant change will be difficult and potentially impossible for ASIC.

The most desirable outcome for ASIC is having the secondary electricity market adopt ASIC's own measure of effectiveness. A theoretical divide will likely prevent this from occurring in the short or even medium term. The measure of effectiveness adopted by the secondary electricity market is the number of unprosecuted breaches of legislation. This is reflective of a traditional command and control regulatory approach.⁸⁹ If regulation is legislation, then effectiveness is measured by the implementation and enforcement of that legislation.⁹⁰

As is noted in chapter 2, ASIC has rejected command and control regulation in favour of a decentred regulatory approach. Responsive regulation can be measured not only by its enforcement, but also by the number of breaches that occur, the outcome of those breaches and the quality of the legislation and enforcement process itself.⁹¹ A high rate of prosecution may be less desirable than a lower rate of breach, even if those breaches go unprosecuted.⁹²

For ASIC to convince the secondary electricity market of its measures of effectiveness, ASIC must first convince the secondary electricity market of the need for responsive regulation. This will be a difficult and long-term process. All of the interviewees were highly educated, having

⁸⁹ Darren Sinclair 'Self-regulation versus command and control? Beyond false dichotomies' (1997) 19 *Law and Policy* 529, 530.

⁹⁰ Mathew McCubbins 'The Legislative Design of Regulatory Structure' (1985) 29 *American Journal of Political Science* 721, 721.

⁹¹ Vibeke Nielsen and Christine Parker 'Testing Responsive Regulation in Regulatory Enforcement' (2009) 3 *Regulation and Governance* 376.

⁹² *Ibid* 378.

attained at minimum a bachelor's degree. It is highly unlikely that any would be unaware of at least the principles and arguments in favour of a sociological theory of regulation. Their acceptance of command and control regulatory theory is less likely to be based in ignorance and more likely to be based in a belief in the principles of command and control regulation. This belief appears to stem from a view that ASIC should oppose the market, rather than work with it.

The fundamental difference between the secondary electricity market and ASIC on this matter appears to run even deeper than differences in opinions on responsive regulation. An insight into a deep ideological split was presented by one of the interviewees who stated:

*'You have a situation where ASIC refuses to acknowledge the paradoxes of capitalism... the whole thing is going to devour society if every regulator is trying to grow the beast but there's no-one keeping it in its cage.'*⁹³

This appears to be a reference to Marx's paradoxes of capitalism, where he argues that capitalism must simultaneously legislate to create corporations and legislate to prevent the growth of corporations.⁹⁴ This paradox was present in less obvious ways in many of the interviews. Numerous statements along the lines of *"It's ASIC's job to stop me"*⁹⁵ and *"ASIC shouldn't be my friend... I should fear ASIC"*⁹⁶ suggest a view that the regulator and the market stand in opposition to one another. While in no way becoming Marxists, the interviewees appeared to accept Marx's proposition that capitalism required laws to simultaneously promote and prevent capitalist markets.⁹⁷

The difference between the ideological beliefs of ASIC and the secondary electricity market appears to be that ASIC holds a simultaneous belief that capitalism is both more and less effective than the secondary electricity market accepts. On the one hand, ASIC seems willing to

⁹³Interview 15.

⁹⁴Karl Marx, *Capital: Volume 1* (Ben Fowkes trans, 1867 Penguin Classics Reprint Edition) [trans of: Das Kapital], Chapter 31.

⁹⁵Interview 4.

⁹⁶Interview 7.

⁹⁷Marx, above n 74.

place its trust in the market system. Chapter 5 drew the conclusion that ASIC adopted a neo-liberal approach to regulation. Funding pressures and classical conditioning have ensured that free market principles continued to guide ASIC. This belief appears not to be shared by the secondary electricity market.

The opinions of the secondary electricity market appeared to be less trusting of market forces. The concept of necessary regulation fits more easily with a classical economic viewpoint than with the neo-liberal viewpoint adopted by ASIC. Misuse of market power,⁹⁸ the anti-competitive effects of corporations⁹⁹ and the necessity of regulation¹⁰⁰ are inherent in the interviewee's desire for a strong regulator working in opposition to the market.

On the other hand, ASIC seems more critical of market assumptions. Responsive regulation is based on theories of human motivation and socialisation.¹⁰¹ These are elements absent from the rational-actor model.¹⁰² The interviewees revealed a different view. It has already been stated that the interviewees called for regulation to curb their behaviour. The interviewees appeared to believe that their duty was to act as rational actors during work hours, regardless of any emotional complexities they may otherwise have. The differing beliefs in the existence of the rational actor model presents a deep theoretical divide between ASIC and the secondary electricity market.

Given that ASIC and the secondary electricity market have demonstrated different views on both the operation and fundamental basis of market economics, any efforts by ASIC to alter the secondary electricity market's view of regulation will need to be focussed on the long-term. In the interim period, ASIC will continue to experience a damaged relationship with the secondary

⁹⁸ Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (Tom Butler-Bowden 2010 edition, 1776).

⁹⁹ Richard Coase 'The Nature of the Firm' (1937) 4 *Economica* 386; Adam Smith, above n 78.

¹⁰⁰ Edwin West 'Adam Smith's Support for Money and Banking Regulation: A Case of Inconsistency' (1997) 29 *Journal of Money, Credit and Banking* 127.

¹⁰¹ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

¹⁰² Robert Ellickson 'Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics' (1989) 65 *Chicago-Kent Law Review* 23, 26.

electricity market and will not be able to meet the measures of effectiveness set by either itself or the secondary electricity market. It is possible however, to make small adjustments to the secondary electricity market's measure by working within the logic of the secondary electricity market.

Even without challenging the ideologies and assumptions of the secondary electricity market, ASIC may benefit from engaging with and educating the secondary electricity market. The interview responses set out in Tables 6.1, 6.2 and 6.3 reveal a rather piecemeal approach to measuring effectiveness. The common elements in this measure contain contradictions which could be easily removed through dialogue and education.

Simply engaging with the secondary electricity market on the matter of how ASIC measures its effectiveness is likely to be beneficial. By forcing the secondary electricity market to consider measures of effectiveness, ASIC may cause the secondary electricity market to produce a more logical and sequenced measure. It will also likely generate a level of inclusiveness and open a dialogue on goals and expectations. Even if this is not the natural result, ASIC can leverage the logical faults in the current measure adopted by the secondary electricity market.

First, ASIC may be able to draw attention to the fact that the size of its regulatory oversight has grown. The secondary electricity market appeared to have a fixed rate of legislative disobedience by which it measured ASIC. The fact that ASIC is now regulating 486% more derivatives suggests that an increase of 486% in legislative breach can be expected if ASIC has remained equally effective. By the same logic, ASIC may also benefit from drawing attention to a comparative decline in funding. Neither of these factors appears to be being communicated in ASIC's annual reports.

Second, ASIC may be able to draw attention to the problems of using qualitative experience to rate ASIC on a quantitative scale. This may be a more difficult argument as quantitative data on unprosecuted legislative breaches is extremely difficult to obtain. Nonetheless, opening a

conversation on this matter may cause the secondary electricity market participants to question the validity of their judgments.

Finally, ASIC may convince the secondary electricity market of the possible usefulness of legislative breach. Much of the corporations legislation that is enforced by ASIC is relatively vague. For example, the product disclosure requirements in section 1013D of the *Corporations Act*¹⁰³ state that the issuer of a financial product must provide:

*‘information about any significant benefits to which a holder of the product will or may become entitled... and information about any significant risks associated with holding the product.’*¹⁰⁴

In regulating these provisions, ASIC has adopted a purposive approach. When assessing a product disclosure statement, ASIC will use a *‘risk based approach to determine whether disclosure to consumers will be improved by the provision of further guidance’*.¹⁰⁵ ASIC also provides ‘good disclosure principles’ which seek to meet the spirit of the disclosure law.¹⁰⁶

Perhaps most revealing is the fact that ASIC states that in developing policy it *‘will pay particular attention to the objectives of the legislation to, among other things, provide investors with information so that they may compare a range of financial products and understand their risks.’*¹⁰⁷

As ASIC has turned its mind to the spirit of the legislation, technical legislative breaches may not be of primary importance. Responsive regulation calls for the creation of social values, something that is unlikely to be achieved or preserved through technical enforcement of the letter of the law.¹⁰⁸ In fact, many people who seek to comply only with the letter of the law may be more damaging to stable markets and informed consumers than people who seek to fulfil the

¹⁰³ 2001 (Cth).

¹⁰⁴ *Corporations Act 2001* (Cth), s1013D(1)(b)-(c).

¹⁰⁵ Australian Securities and Investments Commission, *Regulatory Guide 186 Disclosure: Product Disclosure Statements (and other disclosure obligations)* 6 September 2010, RG186.14.

¹⁰⁶ Ibid RG186.2.

¹⁰⁷ Ibid RG185.15.

¹⁰⁸ Vijaya Nagarajan ‘From “Command and Control” to “Open Method Co-ordination”: Theorising the Practice of Regulatory Agencies (2008) 8 *Macquarie Law Journal* 5.

purpose of the law, notwithstanding that the latter may technically breach one or more legislative provisions.¹⁰⁹

By shifting the focus of measurement from technical breach to the achievement of goals, ASIC may be able to further challenge the harsh standard adopted by the secondary electricity market. As was stated earlier, these challenges are unlikely to cause any significant shift in the secondary electricity market's fundamental beliefs about regulation. They nonetheless have potential to open meaningful communication between ASIC and the secondary electricity market. This communication may form the basis for further education which may in time shift the secondary electricity market's core beliefs about the purpose of regulation.

The potential effect of such conversations may, however, be limited. As discussed in chapter 2, Ford has suggested that financial markets may be too complex for effective responsiveness.¹¹⁰ Financial markets in particular pose a significant problem for regulators due to their global nature, the mobility of capital and the constant increase in technology.¹¹¹ As has been noted, since the repeal of the Glass-Steagall legislation¹¹² the boundaries between banking and financial market regulation have been increasingly blurred.¹¹³ As a result, ASIC is likely to find any attempt to engage with the secondary electricity market bound together with regulation of the banking, insurance and capital markets. This has occurred as a result of innovation in financial products which now transcend traditional categorisations.¹¹⁴ This may mean that ASIC simply cannot respond to the secondary electricity market in a meaningful way. Regardless, if ASIC wishes to maintain a responsive regulation approach in relation to the secondary electricity

¹⁰⁹ Daniel Ostas 'Cooperate, Comply or Evade? A Corporate Executive's Social Responsibility with regard to Law' (2004) 41 *American Business Law Journal* 559, 560.

¹¹⁰ Cristie Ford 'Macro- and micro-level effects on responsive financial regulation' (2011) 44 *University of British Columbia Law Review* 589, 592.

¹¹¹ Graeme Cooper, Michael Dirkis, Jennifer Hill, Sheelagh McCracken, John Stumbles, Greg Tolhurst and Richard Vann 'Regulation and Reforms to Enhance Financial Stability in the Post-GFC Era' (August 2014 Working Paper for the Centre for International Finance and Regulation).

¹¹² *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

¹¹³ Kevin Davis 'Regulatory Reform Post the Global Financial Crisis: An Overview' (2009) 42 *Australian Economic Review* 453.

¹¹⁴ Dan Awry 'Complexity, Innovation and the Regulation of Modern Financial Markets' (2012) 2 *Harvard Business Law Review* 235.

market, open communication and dialogue on these issues is perhaps its best – albeit likely ineffective – means of minimising regulatory failure.

(c) Changing the Standards of ASIC

The question and answer set out in Table 6.6 3 presents what may be the most difficult issue facing ASIC. While ostensibly the solution that is most in the control of ASIC, the historical development of ASIC may preclude ASIC from taking the simplest remedial action. The critical juncture explored in this chapter, the growth of the derivatives market, suggests that ASIC does not have the funding or resources to meet a new set of standards which would agree with the secondary electricity market. Even if this resourcing issue could be overcome, ASIC faces a much deeper problem. The critical junctures in chapters 4 and 5 have worked together with this critical juncture to place ASIC on a dependent path. This is discussed in detail in chapter 7.

D ASIC's Effectiveness Measured against ASIC's Performance Measures

Four of the interviewees identified that ASIC had declined in effectiveness against ASIC's own Performance Measures. While all four interviewees used a different measure of regulatory effectiveness to ASIC, they believed that ASIC had declined in effectiveness against both their own measure and ASIC's measure. Examples of these statements are set out in Table 6.7.

Table 6.7		
Data Identifying Interviewees' Conception of ASIC's Performance Measures		
Ref	Statement	Interview
1	It doesn't really matter [whether I use my own measure or ASIC's measure of effectiveness]. The massive growth [of derivatives trading] during that period meant ASIC got worse at everything.	3
2	ASIC was trying to educate and co-regulate and be quicker and be cheaper all at once. Then comes the 80's derivatives boom and all of a sudden ASIC is trying to regulate a thousand times more people than it used to... it's simultaneously trying to get cheaper. Even if they weren't incompetent, they couldn't have done it.	11
3	Let me use the example of Facebook. Before Glass-Steagall [sic] was like the time before Facebook. You had a few friends and you saw them often. Then comes Facebook. All of a sudden you have five hundred friends. You can call them friends, but you're never going to talk to them and you're never going to meet them.	12
4	I don't agree with what ASIC is trying to achieve, but there is a certain logic to it... The problem is ASIC has been getting worse at what they have been trying to do.	15

Table 6.7 Sets out statements which reveal interviewee's concept of ASIC's performance measures¹¹⁵

As can be seen in Table 6.7, all four interviewees demonstrated a knowledge of the regulatory goals and measures set out in ASIC's annual reports. Two of the interviewees were explicit in their awareness that 'relationship with industry' (see Table 6.7 2, 3) was a goal of ASIC.

¹¹⁵ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

Although this is not stated as a goal in ASIC's most recent annual report,¹¹⁶ chapter 2 of this thesis argues that it is nonetheless a goal of ASIC.

1 *Accuracy of Industry Perception*

As ASIC did not take part in the empirical part of this thesis, efforts have been made to eliminate potential bias against ASIC. For this reason, it has been assumed throughout this thesis that ASIC's annual report is an accurate reflection of the information and events contained within. Even a brief review of these reports suggests that ASIC was an effective regulator in the 1998/1999 financial year and continues to be an effective regulator in the 2002/2003 financial year. ASIC has consistently reported success across all of its key Performance Measures.

While it is possible that the secondary electricity market is simply incorrect in its view that ASIC is not meeting ASIC's own Performance Measures, it is also possible that the secondary electricity market simply has an incomplete understanding of ASIC's Performance Measures. This is a fairly unlikely possibility. While there were some minor discrepancies, the four interviewees who measured ASIC by its own Performance Measures provided a fairly accurate reflection of what those Performance Measures were. When asked what Performance Measures ASIC used, they provided the responses set out in Table 6.8.

¹¹⁶ Australian Securities and Investments Commission, above n 67.

Table 6.8		
Interviewee's Response when Asked about ASIC's Performance Measures		
Ref	Statement	Interview
1	It's very governmental. They've got all these KPIs. How fast they rubber stamp things. How many things they rubber stamp. How many times they win a court case. How much money they spend. How many complaints they receive.	3
2	Efficiency is their main goal. After that they want to ensure investor confidence... and finally protect the mum and dad investors.	11
3	They're trying to be fast, efficient and friendly.	12
4	From memory the main thing they are trying to do is get us to regulate ourselves. I guess they'd aim to measure how little they've had to do to keep things working.	15

Table 6.8 Sets out interviewee's responses when asked about ASIC's performance measures¹¹⁷

While the views expressed in Table 6.8 are largely accurate, they reveal the possible source of disagreement between ASIC and the interviewees. Some of the interviewees (Table 6.8 12 and 15) refer to an unstated measure of ASIC: how well it is communicating and co-operating with industry. It is perhaps on this point that the secondary electricity market has formed its view.

Much as the other measures of effectiveness could be concluded from ASIC's annual report, this measure of effectiveness can be concluded from the interviewees' responses. The fact that they believe that their relationship with ASIC is deteriorating would stand as proof that the

¹¹⁷ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

relationship is in fact deteriorating. While this would be a convenient explanation, it is not one that can be easily maintained.

Two of the same interviewees that measured ASIC by what he or she perceived to be ASIC's own measures also reported no significant change in his or her relationship with ASIC. When asked about their relationship with ASIC over time, the four interviewees offered responses set out in Table 6.9.

Table 6.9		
Interviewee's Response when asked about their relationship with ASIC		
Ref	Statement	Interview
1	I never had anything to do with them until recently. All this derivatives stuff is pretty recent.	3
2	I think it was a lot better before the switch [from ASC to ASIC].	11
3	They've been ignoring their duties for a few decades... The relationship can't improve if there isn't one.	12
4	As time goes on I'm seeing less and less of them.	15

Table 6.9 Sets out interviewee responses to questions about their relationship with ASIC¹¹⁸

The responses set out in Table 6.9 3 and 12 suggest that the relationship between the interviewee and ASIC has remained stable. The fact that 50% of the interviewees in this category see no deterioration in their relationship with ASIC prevents any conclusion that the interviewees are critical of ASIC due to its relationship with the secondary electricity market. While further analysis could be conducted, there is limited empirical value in a group of two interviewees.

¹¹⁸ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

Instead, on the assumption that ASIC has been honest in its annual reports, the most attractive conclusion is that the interviewees in this category are mistaken.

2 *Consequences of Industry Perception*

The most immediate conclusion that may be drawn from this analysis is that ASIC faces a very minor regulatory failure. ASIC has met its own measures and a segment of the secondary electricity market is willing to use those measures as its own. The only missing step is for ASIC to communicate the fact that it is meeting its measures.

This conclusion is made more attractive for ASIC as it offers a solution for the entire secondary electricity market. If ASIC can convince the remainder of the secondary electricity market to adopt ASIC's measures, then it can resolve the current perception of regulatory failure. It has been noted that such a change would be long and difficult, but it would offer a workable, extremely-long-term solution.

Such conclusions however, do not consider the major failure revealed by the interviewees' responses. The secondary electricity market appears to be either unaware or untrusting of ASIC's annual reports. Either way, the communication between ASIC and the secondary electricity market appears to be failing.

One possible reason for this failing is that ASIC and the secondary electricity market are simply not important enough to one another. The secondary electricity market forms a relatively small part of the derivatives trade¹¹⁹ and an even smaller part of ASIC's overall regulatory responsibilities.¹²⁰ There is no indication from ASIC that the secondary electricity market is even viewed as a market separate to any other derivative financial product buyer or retailer.

¹¹⁹ Australian Financial Markets Association, *Annual Financial Markets Report* 2013.

¹²⁰ *Corporations Act 2001* (Cth), Chapter 7.

Likewise, the secondary electricity market is largely made up of people who are also within the wholesale electricity market. As a result, they fall within the jurisdiction of the AER¹²¹ and ACCC.¹²² Two of the participants in the secondary electricity market were from a financial institution which adds an additional relationship with APRA.¹²³ As the AER and APRA are specialised regulators, it is likely that they are able to better communicate and engage with the interviewees. At best, ASIC is a secondary regulator to the majority of the secondary electricity market. This view was reflected in a number of the interviews. Examples of responses demonstrating this view are set out in Table 6.10.

Table 6.10		
Data Suggesting that ASIC may be of Secondary Significance		
Ref	Statement	Interview
1	Interviewee: I'm pretty sure APRA sets those laws [reviewing and approving disclosure documents]... No? Are you sure? Interviewer: Yes. Interviewee: I guess they do more than I thought.	3
2	I don't have time for ASIC. They have authority over about 1% of what I do yet I spend a disproportionate amount of time dealing with them.	4
3	I'm not sure why you're so focused on ASIC. They don't even do that much.	6
4	If I never spoke to ASIC again I'd have only won back about 10 minutes of my life.	9

¹²¹ *Competition and Consumer Act 2010* (Cth), Part IIIA.

¹²² *Competition and Consumer Act 2010* (Cth), Part II.

¹²³ *Australian Prudential Regulation Authority Act 1998* (Cth).

5	I know why you've drawn a distinction between energy derivatives and [other derivatives], but you may be splitting straws. To ASIC they're just derivatives... to the energy traders they're just unregulated.	15
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Table 6.10 Sets out statements by interviewees that suggest ASIC is not considered a key regulator¹²⁴

The responses in Table 6.10 lead to two much deeper problems for ASIC. First, it is possible that the secondary electricity market is taking its view of the role of a regulator from its primary regulator. While the ACCC (and consequently, the AER) have adopted responsive regulation,¹²⁵ Chapter 5 noted a significant ideological departure between ACCC and ASIC. This would potentially explain the view of many of the interviewees that ASIC should take a more oppositional approach. The second and related problem is that ASIC may be dealing with a market which believes it is answering to too many regulators.

There is a strong suggestion that too many regulators may in fact decrease regulatory effectiveness in a market.¹²⁶ Competing regulatory goals, approaches and philosophies have the potential to cause regulatory confusion and ultimately disobedience.¹²⁷ This is a problem which may be resolved by implementing a meta-regulatory strategy. The possibility and desirability of doing this will be discussed in chapter 7. Ultimately, any possible solution to this communication problem will rest on whether ASIC is able to commit to and make changes without disproportionate cost.

¹²⁴ Reference column is number used to refer to responses throughout. Interview column refers to number assigned to the interviewee to preserve anonymity. These numbers are used consistently throughout the thesis. Questions asked in semi-structured interview style and not included in appendix 2 are included in the table where necessary to provide context.

¹²⁵ Christine Parker 'Restorative Justice in Business Regulation? The Australian Competition and Consumer Commission's Use of Enforceable Undertakings' (2004) 67 *The Modern Law Review* 209.

¹²⁶ See Bruce Green 'Policing Federal Prosecutors: Do too many regulators produce too little enforcement?' (1995) 8 *St Thomas Law Review* 69; and Martin Minogue 'Governance Based Analysis of Regulation' (2002) 73 *Annals of Public and Cooperative Economics* 649.

¹²⁷ Roberta Romano 'Is regulatory competition a problem or irrelevant for corporate governance?' (2005) 21 *Oxford Review of Economic Policy* 212.

IV CONCLUSION

The analysis of the data generated by this thesis reveals a clear critical juncture at the repeal of the Glass-Steagall legislation.¹²⁸ The growth in the derivatives market led to a significant increase in ASIC's regulatory responsibility which was not matched by an increase in funding. Unlike the previous two critical junctures, this represented an external pressure on ASIC which was beyond ASIC's control. Nonetheless, the growth in derivatives continues to affect ASIC's ability to regulate the secondary electricity market. In particular, the regulatory workload will necessarily shape any future decisions and directions made by ASIC. It can thus safely be concluded that this represents a critical juncture in the historical development of ASIC.¹²⁹

The fact that this critical juncture arose external to ASIC compounds the difficulties facing ASIC if it is to attempt to mend its relationship with the secondary electricity market. The first critical juncture introduced a series of measures of effectiveness that significantly raise the cost of following a new regulatory theory. The second critical juncture reaffirmed ASIC's regulatory theory and introduced the threat of competition if any changes were to be made to ASIC's current approach. This critical juncture potentially kills off the possibility of meeting the regulatory approach demanded by the secondary electricity market. As examined in chapter 2, a command and control regulatory approach is generally the more expensive option.¹³⁰ The fact that growth in ASIC's regulatory responsibility is far outstripping growth in funding places a pragmatic limit on the regulatory approaches available to ASIC. As a cost effective alternative, responsive regulation may be cemented as ASIC's regulatory approach as a result of this critical juncture. The possibility of changing to more cost effective regulatory approaches will be explored in chapter 7.

¹²⁸ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

¹²⁹ Paul Dimaggio and Walter Powell 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48 *American Sociological Review* 147.

¹³⁰ See Bruce Ackerman and Richard Stewart 'Reforming Environmental Law' (1985) 37 *Stanford Law Review* 1333, 1345; Cass Sunstein, *Free Markets and Social Justice* (Oxford University Press, 1997).

On its own, the growth in the derivatives market makes it extremely difficult for ASIC to be responsive to the secondary electricity market. This is a problem which is amplified when this critical juncture is considered in the wider context of ASIC's historical development. Chapter 7 explore this development and its consequences for ASIC.

CHAPTER SEVEN: ASIC'S DEPEDENT PATH

I OVERVIEW

Historical institutionalism has traditionally viewed institutions as developing in two related phases.¹ The institution experiences periods of institutional stability which is occasionally punctuated by moments of rapid change and activity.² These moments of rapid change and activity have been termed critical junctures.³ It is these critical junctures which shape the future decisions and activities of the institution as the choices and commitments made during the period of change have a lasting effect on the institution.⁴ A juncture becomes critical where the decisions made close off alternatives and commit the institution to a trajectory that is difficult or impossible to alter.⁵

This chapter commences with an analysis of the periods of relative stability between the three critical junctures to determine the nature and features of the dependent path that ASIC is following. In doing so it will further consider the theory of historical institutionalism as well as examining the regulatory and legal theories relevant to the dependent path. Using the information developed through an analysis of the three periods between the critical junctures a complete picture is drawn of ASIC's present dependent path. The importance of this path in relation to the secondary electricity market is discussed and the possibility of developing a new means of regulating the secondary electricity market is considered. Finally, it is argued that it is both unlikely and undesirable that ASIC will increase its responsiveness to the secondary electricity market. As a result, it is argued that the regulatory responsibility for the secondary

¹ Giovanni Capoccia and Daniel Kelemen 'The Study of Critical Junctures. Theory, Narrative, and Counterfactuals in Historical Institutionalism' (2007) 59 *World Politics* 341, 343.

² Paul Pierson *Politics in Time* (Princeton University Press, 2004) 22.

³ Johannes Lindner and Berthold Rittberger 'The Creation, Interpretation and Contestation of Institutions – Revisiting Historical Institutionalism' (2003) 41 *Journal of Common Market Studies* 445, 445.

⁴ Capoccia and Kelemen, above n 1.

⁵ Guy Peters, Jon Pierre and Desmond King 'The Politics of Path Dependence: Political Conflict in Historical Institutionalism' (2005) 67 *The Journal of Politics* 1257.

electricity market should be re-examined, with particular consideration given to transferring regulation of this market to the Australian Energy Regulator.

II IDENTIFYING ASIC'S DEPENDENT PATH

In order to identify and explore the critical junctures in ASIC's historical development, this chapter will draw on the empirical data explored in the previous chapters. Chapters 4 to 6 identified three critical junctures and the key decisions made by ASIC during those periods of flux. The decisions made at each of these critical junctures has had not only an effect on the period immediately following that critical juncture, but also in forming and shaping future critical junctures and the responses taken by the institution in response.⁶ In analysing the dependent paths between the critical junctures in the historical development of ASIC this chapter will adopt the 'branching tree' metaphor proposed by Verba.⁷

The 'branching tree' metaphor aims to capture the fact that the developmental path of an institution diverges at critical junctures.⁸ Moments of institutional flux become points where potential trajectories for historical development are created, chosen and ignored.⁹ While the concept of depicting historical development as a 'branching tree' predates the development of dependent paths and punctuated equilibrium,¹⁰ it nonetheless serves as a consistent and useful metaphor in demonstrating the periods of change and calm in ASIC's development. Each of the dependent paths will be considered in turn.

⁶ Peters, Pierre and Kind, above n 5.

⁷ Sidney Verba 'Sequences and Development' in Leonard Binder, James Coleman, Joseph LaPalombara, Lucian Pye, Sidney Verba and Myron Weiner, *Crises and Sequences in Political Development* (Princeton University Press, 1971).

⁸ Kent Calder, *The New Continentalism: Energy and Twenty-First-Century Eurasian Geopolitics* (Yale University Press, 2012) 48.

⁹ Capoccia and Kelemen, above n 1, 342.

¹⁰ Ibid.

Chapter 4 identified the formation of ASC as a critical juncture in the development of ASIC. While it may be a fairly common sense conclusion that the formation of an institution is an important part in shaping its development, the particular circumstances surrounding the formation of ASC and the choices made in its early days of operation have significantly affected ASIC's present regulatory approach. Chapter 4 identified the key influences of the creation of ASC as being the adoption of a 'pro-industry' regulatory policy. The adoption of this policy was driven by both internal and external forces. Internally, the first ASC chairman adopted progressive regulatory policies which aimed to work with industry to generate regulation that would serve the needs of both the market and society.¹¹ Externally, the legislation forming ASC aimed to minimise regulatory burden and promote investment.¹² While the external pressure was beyond the control of ASC, both the fact that ASC complied with its mandate and the manner in which it complied had significant effects on the historical development of ASIC. The decisions of ASC during and immediately following its formation had two clear effects on the historical development of ASIC in so far as it is relevant to the secondary electricity market. First, the decision to comply with a 'pro-industry' mandate necessitated that ASC turn away from the command and control regulatory method.¹³ This in turn led ASC to adopt a sociological view of regulation.¹⁴ Second, the adoption of a sociological view of regulation was coupled with ASC's rejection of the rational actor model. A possible third impact on ASIC's historical development is also considered: the fact that ASC engaged with what was then progressive regulatory theory may have set a precedent for future regulatory development.

1 *Turning from Command and Control*

¹¹ Tony Hartnell 'Regulatory Enforcement by the Australian Securities Commission' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (Australian Institute of Criminology 1993) 25.

¹² Second reading speech, *Australian Securities Commission Bill 1989* (Cth).

¹³ Richard Stewart 'Environmental Regulation and International Competitiveness' (1993) 102 *Yale Law Journal* 2039, 2087.

¹⁴ Vijaya Nagarajan 'From "Command and Control" to "Open Method Co-ordination": Theorising the Practice of Regulatory Agencies (2008) 8 *Macquarie Law Journal* 5, 8.

As is set out in chapter 4, the formation of ASC was motivated by the need to minimise regulatory duplication and encourage international investment.¹⁵ This motivation was acted upon by the ASC, which adopted a regulatory style which focused on communication and conciliation with its regulatory subjects.¹⁶ The compliance pyramid (see chapter 2) which would eventually form the basis of ASC's regulatory theory was still years from being published,¹⁷ but ASC was nonetheless showing a move away from traditional command and control theories of regulation.

The secondary electricity market believes that this choice continues to affect ASIC's regulation of the secondary electricity market (see chapter 4). This view is justified by a review of ASIC's current regulatory approach, which is grounded in responsive regulation.¹⁸ ASC commenced its operations with a move away from command and control regulation and ASIC continues to do so. The causal link between these two temporal periods is explained by the fact that the decisions made by ASC placed ASC and ASIC on a dependent path.

The development of a dependant path is made far more significant where ASIC is unable to return to adopt an alternate path. Such a circumstance will arise where certain criteria are met that increase the cost of correcting a current course of action.¹⁹ Key factors which increase the cost of correct a course of action are: positive feedback, increasing returns, lock-in and self-reinforcement.²⁰ Positive feedback and increasing returns serve to reinforce the decision within the organisation and reduces the likelihood of reassessment.²¹ Lock-in often acts as a legal mechanism to prevent an alternative course of action.²² Self-reinforcement, particularly when coupled with public statements, further drives the organisation's commitment to the path and reduces the likelihood of choosing an alternate course of action. Where these factors are present,

¹⁵ Second Reading Speech, *Australian Securities Commission Bill 1988* (Cth).

¹⁶ Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992).

¹⁷ Ibid.

¹⁸ Nagarajan, above n 14.

¹⁹ Ruth Collier and David Collier, *Shaping the Political Arena: Critical Junctures, the Labour Movement and Regime Dynamics in Latin America* (Princeton University Press, 1991) 22.

²⁰ Scott Page 'Path Dependence' (2006) 1 *Quarterly Journal of Political Science* 87, 88.

²¹ Ibid.

²² Ibid.

it is likely that the choices made during a critical juncture will set an institution on an irreversible path.²³ For this reason, these factors will be used in determining whether ASIC is on a dependent path.

(a) *Positive Feedback*

Positive feedback can clearly be seen in ASC's choice to move away from command and control regulatory methods. In particular, three sources of positive feedback can be identified in ASC and ASIC's historical development: government feedback, feedback from regulatory subjects and feedback from regulatory theorists. All three of these have helped move ASC's initial choice to an irreversible trajectory.

Key to ASC's feedback was the fact that the ASC replaced a fragmented and often ineffective regulatory regime.²⁴ Dignam and Galanis identify a long history of ineffectual corporate law prior to the formation of the ASC.²⁵ Both state based regulation and non-governmental sources of regulation were largely ineffectual in Australia. State based regulation was weakened by different state regulators implementing different rules and targeting different behaviours.²⁶ Likewise, non-governmental regulation through the stock brokers and stock exchanges were present, but lacked enforcement.²⁷ The collapses that resulted from this system were not only a driver in the creation of ASC,²⁸ but helped to build positive feedback for the ASC's approach. Incomplete or unenforced regulation by a consistent, national regulator was likely to receive praise and positive feedback. Positive feedback was received, but potentially more as a result of the existence of a national regulator, than from the actual approach adopted by the regulator.²⁹

²³ Collier and Collier, above n 19.

²⁴ Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (Federation Press, 2nd edition, 2002) 62.

²⁵ Alan Dignam and Michael Galanis 'Australia Inside-Out: The Corporate Governance System of the Australian Listed Market' 28 *Melbourne University Law Review* 623.

²⁶ Dignam and Galanis, above n 25, 23.

²⁷ Ibid 22.

²⁸ Frank Clarke, Graham Dean and Kyle Oliver, *Corporate Collapse: Accounting, Regulatory and Ethical Failure* (Cambridge University Press, 2nd Edition, 2003).

²⁹ Dignam and Galanis, above n 25, 23.

This tendency toward positive feedback was furthered by the governmental feedback discussed in chapter 5. Both ASC and ACCC adopted responsive regulation as their guiding regulatory theory.³⁰ The fact that ASC utilised responsive regulation to focus on ‘soft’ forms of regulation, whereas ACCC rested more heavily on the command and control mechanisms within the compliance pyramid,³¹ ultimately led the government to redistribute regulatory authority from ACCC to ASIC.³² This may be seen as an official sanctioning of ASC’s decision to move away from command and control regulation.

Similarly, ASC’s regulatory subjects also provided positive feedback about ASC’s decision to move away from command and control regulation. Nielsen and Parker’s study of the subjects of ACCC’s regulation revealed a relative distaste for the approach of ACCC over ASIC.³³ ASIC’s annual reports likewise report on positive working relationships with both individual regulatory subjects and industry as a whole.³⁴ While the secondary electricity market may have adopted a negative view of ASIC’s regulatory effectiveness, it appears that many of ASIC’s regulatory subjects hold ASIC in high esteem (or at least higher esteem than they hold ACCC). This, together with the governmental feedback, is likely to galvanise the decision made by ASC to move away from command and control regulatory methods.

Finally, regulatory theorists have provided positive feedback for ASC. The decision by ASC to move away from command and control regulatory theory was followed by the introduction of the compliance pyramid by Ayres and Braithwaite.³⁵ The compliance pyramid shared ASC’s move

³⁰ Nagarajan, above n 14.

³¹ Vibeke Nielsen and Christine Parker ‘Testing Responsive Regulation in Regulatory Enforcement’ (2009) 3 *Regulation and Governance* 376, 377.

³² Department of Parliamentary Services ‘Australia’s Corporate Regulators – The ACCC, ASIC and APRA’ (Research Brief No 16, Parliamentary Library, Commonwealth, 2005); Memorandum of Understanding between Australian Securities and Investments Commission and Australian Consumer and Competition Commission dated February 1998.

³³ Nielsen and Parker, above n 31.

³⁴ See Australian Securities & Investments Commission, *Annual Report 2012 – 2013*, 10 October 2013; and Australian Securities & Investments Commission, *Annual Report 2011 – 2012*, 10 October 2012.

³⁵ Ayres and Braithwaite, above n 16.

away from command and control regulatory structures.³⁶ This is perhaps of little surprise, as ASC appeared to be engaged with Braithwaite and other regulatory theorists in developing its regulatory approach.³⁷ This compliance pyramid became the dominant regulatory theory adopted by Australian regulators.³⁸ As a result, ASC was affirmed to have made the correct decision in eschewing command and control as a preferred regulatory method. As has been noted, this feedback is strengthened by government and industry feedback, where the utilisation of the compliance pyramid in a way that minimised command and control elements was further rewarded.

(b) Increasing Returns

An increasing return is seen where an outcome in any given time period increases the probability of generating that outcome in the next time period.³⁹ When ASC moved away from command and control regulation it is possible that it set itself on a path of increasing returns, but such a conclusion is questionable. The argument in favour of increasing returns would be that the move away from command and control regulation led to ASC's regulatory subjects viewing ASC positively and that such positive sentiments increased the likelihood of future interactions between ASC and its regulatory subjects producing positive outcomes. There may be some merit to this conception of ASC's historical development. Relationships are built over time.⁴⁰ They are also influenced heavily by the initial meeting between the two people forming the relationship.⁴¹ A positive first step by ASC was likely the foundation on which ASC could build a relationship with industry which led to further positive associations in the manner of an increasing return.

This argument may, however, take the concept of corporate personhood too far. Relying on psychological concepts of relationship building to interrogate the interactions of a corporate

³⁶ Ibid.

³⁷ Hartnell, above n 11.

³⁸ Nagarajan, above n 14.

³⁹ Page, above n 20.

⁴⁰ Ellen Berscheid 'Interpersonal Relationships' (1994) 79 *Annual Review of Psychology* 79, 84.

⁴¹ Norman Anderson 'Primacy Effects in Personality Impression formation using a Generalised Order Effect Paradigm' (1965) 2 *Journal of Personality and Social Psychology* 1, 2.

person and a government institution overlooks the various loyalties, laws and moral hazards that guide the people within corporations and institutions. In particular, where ASC is regulating corporations, the corporation may be bound by law to act as a rational actor.⁴² While historical and future relationship may factor into an assessment of a rational path of action, the large number of variables in the relationship between a corporation and its regulator make a determination of increasing returns of relationship difficult, if not impossible.

Whether or not increasing returns of regulatory relationship can be established in the case of ASC is an important but not conclusive factor in understanding how ASC's decision to move away from command and control regulation became a dependent path. Page notes that increasing returns may be the least important factor in determining the existence of a dependent path.⁴³ Thus, while it cannot be said that ASC experienced increasing returns from its decision to move away from command and control regulation, it can be said that it is possible. With the strength of the other factors, it may nonetheless be concluded that ASC's decision placed ASC on a dependent path. Future studies may investigate the numerous factors at play in the relationship between ASIC and corporate subjects to determine if such increasing returns are present.

(c) Lock-in

Lock-in describes the phenomena where a particular action becomes preferable or more efficient because the same decision has been made by a sufficient number of people.⁴⁴ A popular example may be the prevalence of VHS video cassettes over Beta-Max video cassettes resulting from the greater amount of content produced for VHS.⁴⁵ ASC's rejection of command and control regulation may be seen to have produced lock-in for ASC and other regulators.

⁴² Hugh Grossman 'Refining the Role of the Corporation: The Impact of Corporate Social Responsibility on Shareholder Primacy Theory' (2005) 10 *Deakin Law Review* 572.

⁴³ Page, above n 20.

⁴⁴ Ibid.

⁴⁵ Stan Liebowitz and Stephen Margolis 'Path Dependence, Lock-in, and History' (1995) 11 *Journal of Law, Economics and Organisation* 205.

By moving away from command and control regulation toward a more co-operative and communicative regulatory model, ASC positioned itself to adopt Ayres and Braithwaite's compliance pyramid.⁴⁶ ASC did so, along with most of Australia's major regulators.⁴⁷ The fact that ASC, ACCC, the Australian Taxation Office and APRA all adopted a responsive regulatory model⁴⁸ suggests that lock-in may have occurred. With all of Australia's major regulators to some extent moving beyond command and control regulation a precedent is set which is difficult for any regulatory to break free from.

Government funding expectations are likely to be drawn from regulators utilising the responsive regulation model. If a regulator were to adopt a more expensive command and control model⁴⁹ then they would be unlikely to justify their cost when compared to other regulators. Similarly, inter-regulator discourse would be strained by an ideological divide were ASIC to revert to a command and control regulatory strategy. This straining of discourse is likely to extend to the subjects of regulation where those subjects are accustomed to the approach of other regulators. This was seen to some extent where ACCC utilised the compliance pyramid in a way that had a greater emphasis on command and control methods, leading regulatory subjects to resent ACCC.⁵⁰

It can thus be seen that ASC's decision to move away from command and control regulation has resulted in lock-in. The move away from command and control and toward responsive regulation was mirrored by other regulators. With a majority of Australia's large regulatory bodies adopting a similar regulatory theory the difficulty of a single regulator altering their regulatory approach is high. This is especially the case where the move would require a rejection of the fundamental

⁴⁶ Nagarajan, above n 14.

⁴⁷ Department of Parliamentary Services, above n 32.

⁴⁸ Ibid.

⁴⁹ Stephen Wilks and Ian Bartle, 'The Unanticipated Consequences of Creating Independent Competition Agencies (2002) 25 *West European Politics* 148, 153.

⁵⁰ Nielsen and Parker, above n 31.

tenants of that regulatory theory, as would be the case if ASIC were to adopt a command and control regulatory approach.

(d) *Self-reinforcement*

Self-reinforcement occurs where a choice puts in place forces which sustain that choice.⁵¹ This is perhaps the strongest force which drove the dependent path of ASC and ASIC. The decision to move from command and control regulatory theory toward a sociological model of regulation brought with it a set of ideals and measures around which ASC was structured. The Performance Measures adopted by ASC continue to entrench the regulatory approach adopted by ASC and make it extremely difficult for ASIC to move to a regulatory model which views ASIC and its regulatory subjects as being in opposition.

As was noted in chapter 2, ASIC has historically used and continues to use Performance Measures which mirror the compliance pyramid. In particular, ASIC reports stress the importance of education,⁵² warnings⁵³ and soft enforcement mechanisms.⁵⁴ These performance measures have become historically entrenched in the institution of ASIC. Each year ASIC works towards meeting the goals of a regulatory model that emphasises relationship with industry and the minimisation of command and control regulation. Perhaps more importantly, ASIC publishes its achievements in relation to these goals.⁵⁵ Were ASIC to change its regulatory approach and return to command and control regulation, it would be required to publish an annual report which showed failure against many measures. Education and warning Performance Measures would fail as resources are put into legislative development and enforcement. Likewise, ASIC's efficiency measures would likely decrease as ASIC would need to adopt a view that treated

⁵¹ Page, above n 20.

⁵² Australian Securities and Investments Commission, *Annual Report 2012 – 2013*, 10 October 2013, 28.

⁵³ *Ibid* 27.

⁵⁴ *Ibid* 23.

⁵⁵ *Ibid*.

industry with suspicion and oversight. More time would be needed to thoroughly check and review the actions of ASIC's regulatory subjects.

Likewise, the adoption of a particular set of Performance Measures prevents ASIC from simply changing its performance measures. With each passing year ASIC increases the reputational cost of significantly changing its performance measures. When ASC first published its achievements against responsive regulatory measures it made a public statement as to its commitment to those measures. The fact that both ASC and ASIC have proudly reported their success against this goal in every subsequent year⁵⁶ greatly increases this commitment. If ASIC were to revert to a command and control regulatory approach and adopt measures relevant to such an approach, it would raise questions with government, industry and the public as to why ASIC had been pursuing the existing responsive regulation measures for so long. It would, in conjunction with lock-in, also raise questions as to why ASIC was departing from the regulatory theory generally adopted by large regulators.

The problem of self-reinforcement is likely increased by bureaucracy. The fact that Performance Measures are historically entrenched means that the current staff members of ASIC are unlikely to be working towards goals which they have actively developed. Instead, staff members, including high ranking members, are likely to be measured against the pre-existing standards of

⁵⁶ Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 1999*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2000*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2001*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2002*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2003*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2004*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2005*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2006*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2007*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2008*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2009*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2010*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2011*; Australian Securities and Investments Commission, *Australian Securities and Investments Commission Annual Report 2012*; and Australian Securities and Investments Commission, above n 52.

the institution.⁵⁷ In this way, the institutional memory of ASIC may discourage new staff from developing new measures until they have been able to prove themselves against existing standards.⁵⁸ As staff members are assessed against the existing Performance Measures,⁵⁹ there is little incentive for staff members in taking the risk of arguing for changed Performance Measures or seeking to challenge Performance Measures where necessary.

(e) *Dependent Path*

The existence of positive feedback, lock-in, self-reinforcement and possibly increasing returns suggest that the decision of ASC to move away from command and control regulation toward responsive regulation placed ASC on a dependent path. While command and control and responsive regulation are not mutually exclusive (see chapter 2), the choice to pursue regulatory goals beyond command and control regulation is in itself a significant choice and dependent path. While ASC is thus not prevented from developing further regulatory theory, it is prevented from adopting command and control regulation. It is also likely prevented from adopting regulatory theory which does not share the basic assumptions of responsive regulation. ASIC is bound to a model of regulation which views regulation as something greater than legislation. It is also bound to a regulatory theory which rejects the rational actor.

2 *Rejection of the Rational Actor*

In moving away from command and control and toward responsive regulation, ASC accepted a sociological concept of regulation.⁶⁰ Responsive regulation is premised on the idea that people are for the most part regulated by social norms and values.⁶¹ This appears to include corporations, who may be regulated by social and market pressures, reputation and the values of

⁵⁷ James Walsh and Gerardo Ungson 'Organizational Memory' (1991) 16 *Academy of Management Review* 57, 60.

⁵⁸ Ibid.

⁵⁹ Ibid.

⁶⁰ Ayres and Braithwaite, above n 16.

⁶¹ Ibid.

its board of directors.⁶² In short, the adoption of this model of regulation abandons the notion that the subject of regulation is a rational actor whose only purpose is to maximise utility.

The rejection of the rational actor model is tied to the adoption of responsive regulation and the move away from command and control regulation.⁶³ Accordingly, the same indicia of dependent path development that applied to the move away from command and control regulation applies to the rejection of the rational actor model. It led to positive feedback from government, industry and regulatory theory. Other regulatory agencies followed the same path, creating lock-in. Performance Measures were developed which ensured a continual loop of self-reinforcement.

While seemingly a fairly small issue, the establishment of a dependent path which rejects the rational actor model has significant consequences for ASIC's regulatory approach. The most immediate consequence is that the rejection of the rational actor model limits the regulatory approaches that may be taken by ASIC in the future. This is, on further examination, of fairly minimal concern. Responsive regulation has an internal mechanism for dealing with regulatory subjects which behave in accordance with the rational actor model. The top layers of the compliance pyramid recognise that there may be regulatory subjects who are not bound by external sources of regulation and may only respond to traditional command and control methods.⁶⁴

The far greater concern is that the rejection of the rational actor model represents the adoption by ASIC of a conception of its regulatory subjects which may be contrary to the law governing those subjects. As was established in chapter 2, a vast majority of the secondary electricity market is comprised of corporations. Corporations are often viewed to behave as rational actors as they are bound by the shareholder primacy model to maximise returns to shareholders.⁶⁵

⁶² John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford University Press, 2002) 31.

⁶³ Siqiwen Li, *Emerging Trends in Smart Banking: Risk Management Under Basel II and III* (Business Science Reference, 2014) 69.

⁶⁴ Ayres and Braithwaite, above n 16.

⁶⁵ Gordon Smith 'The Shareholder Primacy Norm' (1997) 23 *Journal of Corporate Law* 277, 277.

While the shareholder primacy model has never been explicitly addressed in Australian common law,⁶⁶ it has generally been considered a valid representation of Australia's corporate law.⁶⁷ The *Corporations Act*⁶⁸ requires that directors act in the 'best interests of the Company'.⁶⁹ This does not necessarily equate to the best interests of the shareholders, but further consideration of this requirement suggests that it may.

The term 'best interests of the company' has been occasionally considered by Australian courts. The term was perhaps most famously used in *In re Smith v Fawcett Ltd*⁷⁰ which provided the 'best interests of the company' test. In the United Kingdom this term has been held to mean that the directors of a company must act in the best interests of the 'corporators as a general body' and not in the best interests of a general commercial entity.⁷¹ This statement was approved in the Australian case *Ngurli v McCann*.⁷² Similar sentiments were expressed in *Peters American Delicacy v Heath*, where it was suggested that the 'corporation' meant an 'entity consisting of all the shareholders'.⁷³

A stronger argument in favour of an Australian adoption of the shareholder primacy model may be found in section 203D of the *Corporations Act*.⁷⁴ Shareholders are given the power to appoint and remove directors of a company. This power should ensure that directors are acting in the interests of the shareholders.

There is nonetheless sufficient ambiguity that ASIC could use to support the rejection of a shareholder primacy model. Critics argue that the dispersed shareholding of modern corporations

⁶⁶ Malcolm Anderson, Meredith Jones, Shelley Marshall, Richard Mitchell and Ian Ramsey 'Evaluating the Shareholder Primacy Theory: Evidence from a Survey of Australian Directors' (2007) *University of Melbourne Legal Studies Research Paper No. 302*, 11.

⁶⁷ Smith, above n 54.

⁶⁸ 2001 (Cth).

⁶⁹ *Corporations Act 2001* (Cth) s180.

⁷⁰ [1942] Ch 304.

⁷¹ *Greenhalgh v Aderne Cinemas* [1951] Ch 286.

⁷² *Ngurli v McCann* (1953) 90 CLR 425.

⁷³ *Peters American Delicacy v Heath* (1939) 61 CLR 457.

⁷⁴ 2001 (Cth), s203D.

means that shareholder voting is more myth and ceremony than real power.⁷⁵ Other theorists suggest that shareholder primacy is far from a settled model, as its strength fluctuates over time.⁷⁶ Others still suggest that the long-term profitability of a corporation is sufficiently vague that any action can be justified in ‘the best interests of the company’.⁷⁷

While ASIC could use these theorists, it has not. ASIC has not taken any position on the shareholder primacy model. Instead, ASIC appears to have been entirely pragmatic in its adoption of responsive regulation and its related rejection of the rational actor model.

Responsive regulation ensures that ASIC does not need to settle the question of shareholder primacy or whether its regulatory subjects may by law be required to be rational actors. Rather, ASIC is able to engage in informal communications with its regulatory subjects, treat them as though they are not rational actors but retain enforcement mechanisms in case they are.⁷⁸

This element of pragmatism in ASIC’s dependent path has significant consequences for ASIC’s ongoing regulation. Chapter 2 provides a discussion of the dual pressures facing corporate regulation: the need to be pragmatic and respond to fast moving and innovative commercial enterprise; and the need for certainty in upholding the rule of law.⁷⁹ A clear statement from ASIC as to its views on the existence of the shareholder primacy model would provide meaningful guidance for the behaviour of ASIC’s regulatory subjects. It would however, also require ASIC to reject the shareholder primacy model and potentially contradict the current state of corporate law in Australia. By avoiding this quagmire, ASIC adopted a pragmatic course of regulation.

⁷⁵ Robert Clark, *Corporate Law* (Aspen Publishers, 1986) 721.

⁷⁶ Amitai Aviram ‘Conceptualising the Evolution of Corporate Law’ (2013) 53 *American Journal of Legal History* 431.

⁷⁷ Michael Useem, *The Inner Circle: Large Corporations and the Rise of Business Political Activity in the U.S. and U.K.* (Oxford University Press, 1984) 44.

⁷⁸ Ayres and Braithwaite, above n 16.

⁷⁹ See Omri Ben-Shahar ‘The Tentative Case Against Flexibility in Commercial Law’ (1999) 66 *University of Chicago Law Review* 781; and Max Weber *Max Weber on Law in Economy and Society* (Max Rheinstein and Edward Shils, trans, 1954 1st ed) 137.

The pragmatic course of regulation fits well with responsive regulation. Responsive regulation does not for the most part aim to provide complete and perfect regulation.⁸⁰ Rather, it attempts to maximise regulatory outcomes given available resources.⁸¹ More importantly, the pragmatic course of regulation was reinforced together with responsive regulation. The same feedback mechanisms, positive feedback and lock-in that cemented responsive regulation also cemented a pragmatic approach to regulation.

The rejection of the rational actor model may thus be seen as adding complexity to the dependent path resulting from ASC's choices at the first critical juncture. The decision to move away from command and control regulation not only set ASC on the path to responsive regulation, but also resulted in the rejection of the rational actor model and the adoption of a pragmatic approach to regulation. The remaining element to this dependent path is present in ASC's engagement with regulatory theory.

3 *Engagement with Regulatory Theory*

The final element in ASC's dependent path may be seen in its engagement with regulatory theory. From its earliest days, ASC was engaged with the development of regulatory theory.⁸² Not only did this lead to the adoption of responsive regulation, but it also established a precedent for ASC engaging with contemporary regulatory theory. This had the potential to form part of ASC's dependent path, but it is unclear whether it has done so. It is referred to here as it offers a possible means of improving the relationship between ASIC and the secondary electricity market, whether or not this move was incorporated into ASC's dependent path.

(a) *Positive Feedback*

⁸⁰ Ayres and Braithwaite, above n 16.

⁸¹ John Wright and Brian Head 'Reconsidering Regulation and Governance Theory: A Learning Approach' (2009)

³¹ *Law and Policy* 192, 200.

⁸² Hartnell, above n 11.

The positive feedback ASC received for engaging with regulatory theory is necessarily tied to the feedback it received for adopting its particular regulatory approach. That noted, the forms of feedback which were directly relevant to the engaging with theory (rather than the theory itself) were far more limited. There has been no real comment by government or industry supporting ASC's engagement with contemporary regulatory theory. The positive feedback was entirely sourced from regulatory theorists.⁸³ This provides feedback, but in a much lesser sense than the feedback which was provided for ASIC's regulatory approach as a whole.

(b) Increasing Returns

There is no evidence that ASC gained any increasing returns from engaging with regulatory theory. Having engaged with regulatory theory once and having chosen its particular regulatory approach, ASC is no more likely to engage with regulatory theory again. It is entirely possible that given the success of responsive regulation, ASIC is in fact less likely to turn its mind to contemporary regulatory theory.

(c) Lock-in

There is likewise no evidence that the decision by ASC to engage with contemporary regulatory theory resulted in any lock-in. The fact that other regulators adopted responsive regulation does not necessarily mean that other regulators were engaged with regulatory theory. They may have simply been following the example of other regulators. On the contrary, the lock-in of the regulators to responsive regulation may actively discourage continued engagement with regulatory theory.

(d) Self-reinforcement

⁸³ See Nielsen and Parker, above n 31; Ayres and Braithwaite, above n 16.

Finally, there is no real evidence that ASC set up Performance Measures or measures which would reinforce engagement with regulatory theory. Measures were established around a single regulatory theory. While the adoption of that theory was in itself progressive, nothing in ASIC's assessment of itself aims to ensure ongoing progressiveness.⁸⁴ There is nothing in ASIC's measure to prevent the adoption of newer regulatory theories which share the same foundation as responsive regulation, but at the same time there is nothing to compel such an engagement with theory.

That noted, there is a possibility that the institutional form of ASC may have generated a self-reinforcing mechanism. Attraction-Selection-Attrition theory posits that an institution will exert a homogenising force on the values and behaviour of its employees.⁸⁵ As has been noted, the ASC made public its regulatory approach. Individuals who strongly disagreed with such an approach are unlikely to apply for vacant positions within ASC. The institution thus attracts individuals who share the institutional values.⁸⁶ Further, the recruitment process would likely select people who supported the ASC's regulatory approach, rather than those who demonstrated hostility towards it.⁸⁷ Finally, those individuals who may have been drawn to and hired by the ASC, despite having contrary values and ideas, are more likely to quit or be fired.⁸⁸

In adopting a progressive regulatory approach and engaging with regulatory theory, Hartnell's public statements may have identified the parameters of attraction, selection and attrition within ASC. Those inclined to engage in regulatory theory and look for progressive regulatory mechanisms would likely have been attracted to an institution which was involved in

⁸⁴ Wright and Head, above n 70.

⁸⁵ Robert Bretz Jr, Donald Ash and George Dreher 'Do People Make the Place? An Examination of the Attraction-Selection-Attrition Hypothesis' (1989) 42 *Personnel Psychology* 561.

⁸⁶ Robert Bretz and Timothy Judge 'The Role of Human Resource Systems in Job Applicant Decision Processes' (1994) 20 *Journal of Management* 531, 531.

⁸⁷ Jennifer Chatman 'Matching People and Organizations: Selection and Socialization in Public Accounting Firms' (1991) 36 *Administrative Science Quarterly* 459, 460.

⁸⁸ Amy Kristof-Brown and Russell Guay 'Person-environment fit' (2011) 3 *APA Handbook of Industrial and Organizational Psychology* 3, 6.

symposiums and publications on regulation.⁸⁹ It is possible that the engagement with regulatory theory which was evident at the creation of ASC may have shaped a culture which continues to attract progressive employees and encourage a considered approach to regulation. It is also likely to reinforce this culture once individuals have been brought within the ASC.⁹⁰

(e) *Dependent Path*

There is simply a lack of evidence to conclude that engagement with regulatory theory formed part of ASC's dependent path. Nonetheless, there is some evidence to suggest that it may. More importantly, there is nothing in ASIC's historical development which is inconsistent with an ongoing engagement with regulatory theory. This concept is critical to the reforms suggested in this chapter.

4 *The First Dependent Path*

Following from the first critical juncture ASC had set a dependent path that involved both a move away from command and control regulation, the rejection of rational actor theory and the adoption of a pragmatic regulatory style. These elements of regulation are at the core of what the secondary electricity market deemed 'pro-industry' regulatory theory which, as identified in chapter 4, continues to guide ASIC's current regulation of the secondary electricity market. This dependent path is built upon by the two later critical junctures and is represented diagrammatically in figure 7.1. This 'branching tree' diagram is developed throughout the chapter.

Figure 7.1

⁸⁹ Bretz Jr, Ash and Dreher, above n 74.

⁹⁰ Corine Boon and Deanne Den Hartog 'Human Resource Management, Person-Environment Fit, and Trust' in Rosalind Searle and Denise Skinner (eds) *Trust and Human Resource Management* (Edward Elgar Publishing Press, 2011) 109.

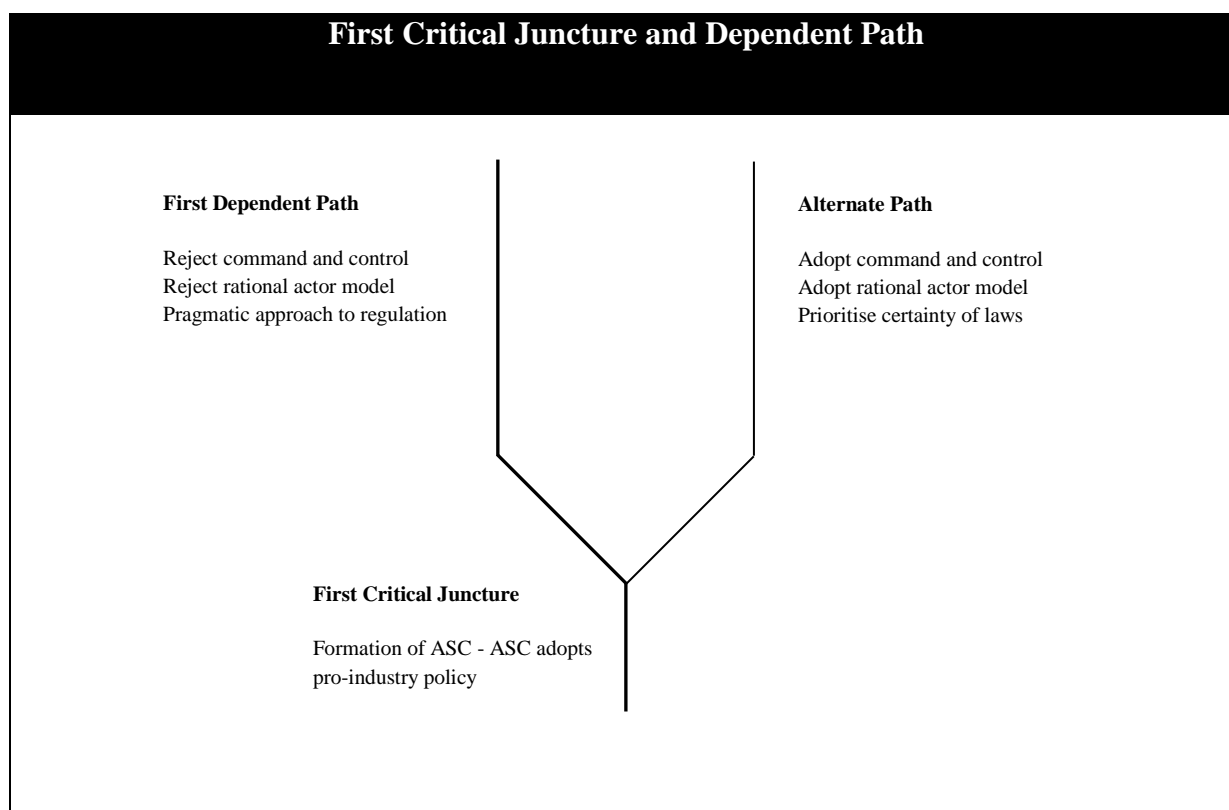


Figure 7.1 represents the dependent path generated by the first critical juncture. By choosing to develop a pro-industry regulatory policy, ASC followed the path represented by the thicker line. It is now precluded from the possibilities represented by the thinner line unless ASIC were to alter the historical form and design of its institution. While crossing to another path is always possible, it would come at significant cost.⁹¹

B *The Shift from ASC to ASIC*

In 1998 the jurisdiction of ASC was enlarged to incorporate oversight of investments and financial products.⁹² ASC became ASIC and entered areas of regulation formerly overseen by ACCC and APRA.⁹³ As set out in chapter 5, the secondary electricity market identified this shift from ASC to ASIC as a critical juncture in the development of ASIC. The secondary electricity market was unanimous in its suggestion that this was a critical moment in the historical development of ASIC but was split on the nature of the development. One group suggested that

⁹¹ Lindner and Rittberger, above n 3.

⁹² *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth).

⁹³ Department of Parliamentary Services, above n 32.

the shift from ASC to ASIC brought with it a neo-liberal regulatory policy. That is, ASIC is alleged to have chosen to reduce its regulatory role as a whole. The historical investigation in chapter 5 suggests that this was not the case, but was more likely a misconception arising from the fact that ASIC's response to an enlarged jurisdiction placed ASIC directly in competition with other regulators. The other group suggested that the shift from ASC to ASIC brought with it a greater consumer focus. The logic behind such a claim is that as ASIC took on an increased jurisdiction it was forced to prioritise its resources.

This second view is supported by Bird, Chow, Lenne and Ramsay's paper investigating the enforcement patterns of ASIC.⁹⁴ ASIC's court-based actions focused primarily on the middle of the compliance pyramid set out in table 2.1,⁹⁵ with a strong emphasis on penal enforcement.⁹⁶ Of particular relevance, enforcement was most likely to be taken against individuals rather than companies and was most likely to focus on social rather than economic regulation.⁹⁷ The interviewees, who primarily work for corporations and who engage in electricity and derivatives trading, are in a position where ASIC is unlikely to enforce.

The Bird *et al* study is limited by the fact that it only investigates court-based action.⁹⁸ While enforceable undertakings and other non-court-based enforcement is available to ASIC,⁹⁹ ASIC cannot implement an undertaking without the co-operation of the offender.¹⁰⁰ These measures of enforcement are thus unlikely to be viewed by the secondary electricity market as contributing to regulation, particularly given the views on regulation analysed in chapter 5. This perception of non-regulation is enhanced when the possibility of compliance with enforceable undertakings is considered. Nehme notes that compliance with enforceable undertakings is only likely where the

⁹⁴ Helen Bird, Davin Chow, Jarrod Lenne and Ian Ramsay, *ASIC Enforcement Patterns* (Research Report for the Centre for Corporate Law and Securities Regulation, 2003).

⁹⁵ Ibid 103.

⁹⁶ Ibid 94.

⁹⁷ Ibid 87.

⁹⁸ Ibid.

⁹⁹ See *Corporations Act 2001* (Cth) 93AA.

¹⁰⁰ Marina Nehme 'Enforceable Undertakings: Are they Procedurally Fair?' (2010) 32 *Sydney Law Review* 471, 473.

subject of the undertaking perceives there to have been a level of procedural fairness.¹⁰¹ For the secondary electricity market, this suggests that the regulation will be accepted where the subject of regulation believes the undertaking to be fair, and thus does not classify it as regulation.

Where there is a perception of unfairness in the issuing of the undertaking, the subject of regulation is able to enter the undertaking but comply only with the letter and not the spirit of the undertaking.¹⁰² While the former possibility may result in positive regulatory outcomes, it is unlikely to contribute to a perception of good regulation. The latter possibility will not only result in poor regulatory outcomes, but is likely to contribute to a perception of weak regulation.

Both of these views share commonalities but are sufficiently distinct that they are considered separately. In considering the exact nature of the dependent path created during the move from ASC to ASIC, two distinct features emerge. First, the enlarged jurisdiction forced ASIC to make choices which ultimately not only reinforced the existing dependent path but locked ASIC into an openly pragmatic risk-based regulatory approach. Second, the move from ASC to ASIC pushed ASIC directly into competition with other regulators. ASIC's response to this competition and its resulting success altered ASIC's regulatory environment in a way that committed ASIC to conservative and cautious regulatory development. With regard to the secondary electricity market's conception of ASIC as adopting a consumer focus an argument is presented to suggest that this is more a temporary result of the features of ASIC's dependent path rather than a critical feature in ASIC's dependent path.

1 *A Misconception of Neo-liberalism*

Chapter 5 identified that a number of interviewees believed that ASIC responded to its enlarged jurisdiction by adopting a neo-liberal ideology. The allegation was that the legislation that formed ASIC was passed by a neo-liberal government and that therefore the regulatory approach

¹⁰¹ Nehme, above n 100.

¹⁰² Ibid 477.

adopted by ASIC at this point was neo-liberal. The historical investigation in chapter 5 revealed that this was unlikely to be the case.

The more likely explanation for the perceived adoption of a neo-liberal ideology was that ASIC's increased jurisdiction resulted in two key movements. First, the increased jurisdiction resulted in ASIC attempting to regulate a wider group without any significant increase in resources (see figure 6.2 in chapter 6). Second, the increased jurisdiction brought ASIC in direct competition with other national regulators. These two factors delivered all four of Collier and Colliers's indicia of a dependent path.¹⁰³ Accordingly, the critical juncture at which ASC became ASIC may be seen to have resulted in not only a strengthening of ASIC's existing dependent path, but also as having added additional commitments to that path.

(a) *Positive Feedback*

The widening of ASIC's jurisdiction may be seen as positive feedback of ASIC's already established dependent path. By eschewing command and control regulation and rejecting the rational actor model, ASIC was rewarded with an enlarged jurisdiction. The shift also brought with it policy decisions within ASIC which were subject to their own positive feedback.

ASIC's response to an increased jurisdiction was to strengthen rather than re-evaluate its regulatory approach. Its commitment to responsive regulation remained and the enlarged jurisdiction was covered by further developments in decentred and pragmatic regulation. In particular, ASIC appears to have adopted a risk-based responsive regulation approach to deal with the increase in workload.¹⁰⁴ The goal of risk-based regulation is to focus resources on the

¹⁰³ Collier and Collier, above n 19.

¹⁰⁴ Australian Securities and Investments Commission, *ASIC's Submission to the Senate Select Committee on Superannuation and Financial Services*, response to the Inquiry into superannuation and financial services, January 2000, 12.

areas of regulation which present the highest risk.¹⁰⁵ ASIC has explicitly stated that it has adopted a risk-based approach since the switch from ASC to ASIC.¹⁰⁶

The adoption of risk-based regulation is in-line with the adoption of responsive regulation.¹⁰⁷ Rather than presenting a new regulatory theory, it offers a means by which responsive regulation can be implemented in environments with limited resources.¹⁰⁸ ASIC's response to an enlarged jurisdiction was thus to further develop responsive regulation, a move that has received positive feedback from government and regulatory theory.

ASIC's jurisdiction has been enlarged subsequent to the adoption of risk-based regulation.¹⁰⁹ More recently, ASIC gained oversight of the Australian Securities Exchange from the ASX. In the same way that the shift from ASC to ASIC may be seen as endorsing responsive regulation, the incorporation of the Australian Securities Exchange in ASIC's regulatory oversight may be seen as positive feedback for the risk-based approach to responsive regulation.

ASIC's adoption of the risk-based regulatory approach also received positive endorsement from regulatory theorists. The merits of risk-based regulation have been identified by Black and Baldwin, Hutter and others.¹¹⁰ Prominent ASIC staff members have presented the benefits of risk-based regulation to other regulators around the world.¹¹¹ While there have been some challenges to the validity of risk-based regulation,¹¹² feedback has been largely positive.

¹⁰⁵ Julia Black and Robert Baldwin 'When Risk Based Regulation Aims Low: Approaches and Challenges' (2012) 6 *Regulation and Governance* 2, 2.

¹⁰⁶ Australian Securities and Investments Commission, above n 104.

¹⁰⁷ Julia Black and Robert Baldwin 'Really Responsive Risk Based Regulation' (2010) 32 *Law and Policy* 181, 183.

¹⁰⁸ Black and Baldwin, above n 84.

¹⁰⁹ Memorandum of Understanding between Australian Securities and Investments Commission and ASX Limited dated October 2011.

¹¹⁰ Baldwin and Black, above n 84; Baldwin and Black, above n 86; Birdget Hutter 'The Attractions of Risk-Based Regulation: Accounting for the Emergence of Risks in Regulation' (2005) *London School of Economics and Political Science Discussion Paper No 33*; Henry Rothstein, Phil Irving, Terry Walden and Roger Yearsley 'The risks of risk-based regulation: Insights from the Environmental Policy Domain' (2006) 32 *Environment International* 1056.

¹¹¹ Jeremy Cooper 'The Integration Financial Regulatory Authorities: The Australian Experience' (paper presented at Securities Exchange Commission of Brazil, Rio De Janeiro, Brazil) 4 September 2006.

¹¹² Rothstein, Irving, Walden and Yearsley, above n 89.

The other result of the shift from ASC to ASIC which received positive feedback was ASIC's response to its incursion into the space of other regulators. Chapter 5 explores how the shift from ASC to ASIC involved ASIC entering the jurisdiction of ACCC. Put simply, ASIC's approach was to take the space that was given to it and to define the boundaries of its authority. This was done by entering into an MoU with ACCC.¹¹³

The positive feedback that followed this approach is evident in the absence of conflict. Given that ASIC was taking jurisdiction from ACCC it may be expected that ASIC would face ongoing difficulties with ACCC. There is no record of such conflict or difficulty arising. By choosing to clearly delineate boundaries and define space, rather than compromise or share regulatory oversight, ASIC appears to have been rewarded with minimal conflict. The success of this approach may be evident in the fact that ASIC entered into a near identical MoU with ASX when taking on supervision of the Australian Securities Exchange.

(b) Increasing Returns

Increasing returns appear to have resulted from ASIC's adoption of risk-based regulation. The evidence of these returns is fairly minimal, as a similar situation has arisen only once since the switch from ASC to ASIC. Nonetheless, this one example, together with a consideration of the internal mechanisms of ASIC, suggest that increasing returns are present with ASIC's adoption of risk-based regulation.

By utilising risk-based regulation to accept an increased jurisdiction ASIC committed to a mechanism which would allow ASIC to respond to any increase in jurisdictional scope.¹¹⁴ Once the risk-based regulatory approach was implemented, ASIC was far less likely to seek increased funding or resources for future jurisdictional increases. The adoption of the risk-based approach meant that ASIC had committed resources to developing and implementing an approach, making

¹¹³ Memorandum of Understanding between Australian Securities and Investments Commission and Australian Consumer and Competition Commission dated February 1998.

¹¹⁴ Baldwin and Black, above n 84.

it far more likely to continue with this approach rather than attempt to formulate a new response to similar situations in the future.

Likewise, ASIC's response to entering the regulatory space of ACCC has had increasing returns. The development of the MoU provided ASIC with not only a resolution to a present problem but with a tool that may be used in relation to similar future problems. The MoU became not only the cheapest mechanism for future jurisdictional overlap, but also the only proven mechanism. This greatly increased the possibility of ASIC using the MoU approach when faced with an intrusion into another regulator's jurisdiction. This is evidenced by the adoption of the MoU between ASIC and ASX.

(c) *Lock-in*

The decision by ASIC to adopt a risk-based regulatory response to increased jurisdiction has caused lock-in through external competitive pressure. ASIC adopted a successful and cost-effective model of regulation, responsive regulation, which has been rewarded with increased jurisdiction over financial products and consumer protection.¹¹⁵ Likewise, ASIC further this cost-effectiveness by adopting a risk-based regulatory approach, which has been rewarded with increased jurisdiction over the Australian Securities Exchange.¹¹⁶ In each instance ASIC decreased the cost of its regulatory approach while simultaneously increasing competition for its regulatory oversight. In seeking government resources ASIC must now contend with both ACCC and ASX as bodies which can adequately provide regulation over at least some of ASIC's current jurisdiction. This competition means that ASIC must offer a more valuable regulatory proposition than other regulatory institutions.

While it does not follow that ASIC is locked in to risk-based responsive regulation, ASIC is locked in to a means of regulating which is equally cost effective. Without external pressure, it is

¹¹⁵ Memorandum of Understanding between Australian Securities and Investments Commission and Australian Consumer and Competition Commission dated February 1998.

¹¹⁶ Memorandum of Understanding between Australian Securities and Investments Commission and ASX Limited dated October 2011.

unlikely that the exploration, development and implementation of an alternate regulatory model will offer any cost advantage (if for no other reason than the initial cost of implementation). ASIC may thus be seen to be locked-in to risk-based responsive regulation, or some similar cost-effective regulatory approach.

ASIC is more directly locked-in to its MoU with ACCC. The fact that ASIC entered into a legally binding document provides absolute lock-in. It is no longer an option for ASIC to explore an alternate means of negotiating jurisdiction with ACCC.

(d) *Self-reinforcement*

Self-reinforcement is perhaps the weakest of the indicia for the development of a dependant path incorporating risk-based regulation. ASIC does not appear to have developed any internal measures which would reinforce the adoption of risk-based regulation. Nonetheless, it has publically committed to risk-based regulation and has structured its resource allocation around risk-based regulation.¹¹⁷

While ASIC has not developed new Performance Measures to reinforce risk-based regulation, the existing Performance Measures structured around responsive regulation are well suited to risk-based regulation. They reward the allocation of resources to the cheapest and widest reaching parts of the compliance pyramid.¹¹⁸ They divide up ASIC's jurisdiction into prioritised areas,¹¹⁹ easily allowing ASIC to focus on high risk areas while still meeting its goals. This, coupled with a public commitment to risk-based regulation may be enough to create a self-reinforcing loop with regard to risk-based regulation.

ASIC's response to the ACCC has a much clearer self-reinforcing mechanism. As with lock-in, the fact that ASIC's response is incorporated in a legally binding document ensures ASIC's

¹¹⁷ The Senate Economics Reference Committee, Commonwealth of Australia, *Performance of the Australian Securities and Investments Commission* June 2014.

¹¹⁸ Australian Securities and Investments Commission, above n 53, 22.

¹¹⁹ Ibid 20.

ongoing compliance. Provided that ASIC is not seeking to breach its contractual obligations, the honouring of its jurisdictional scope and limits is reinforced by legal obligation.

(e) *Dependent Path*

Given the presence of the indicia of a dependent path, it may be concluded that ASIC's response to its increased jurisdiction resulted in both the cementing of existing elements of the dependent path and also the introduction of two new elements. Existing elements such as a move from command and control regulation toward responsive regulation were reinforced by the move to risk-based regulation. The adoption of a further decentred regulatory theory creates a greater commitment in ASIC to regulatory theory which moves beyond legislative control and enforcement.¹²⁰ The adoption of risk-based regulation may also be seen to strengthen ASIC's pragmatic regulatory approach. Risk-based regulation aims to achieve the best result possible with limited resources – a direct recognition of the impossibility of complete regulation.¹²¹

The introduction of regulatory competition acted to reinforce this path. The threat of losing jurisdiction likely strengthened ASIC's resolve to engage in cost-effective regulatory mechanisms. Importantly, ASIC's response to competitive forces became part of ASIC's dependent path. Rather than engage in direct competition or to enter into a co-operative regulatory space, ASIC entered an agreement with ACCC to clearly delineate the boundaries of its jurisdiction. The approach of accepting regulatory jurisdiction from another regulator and clearly defining boundaries became part of ASIC's dependent path. A further and related element of ASIC's dependent path may be seen in ASIC's adoption of a consumer focus.

2 *Consumer Focus*

¹²⁰ Australian Securities and Investments Commission, above n 53, 27.

¹²¹ Black and Baldwin, above n 83.

As identified in chapter 5, a number of interviewees identified that the move from ASC to ASIC was a critical juncture which brought with it an increased consumer focus. This is a view that accords with the existing analysis of the dependent path development of ASIC. In fact, consumer focus may be seen as the application of the risk-based regulation approach adopted in response to increased jurisdiction.

Chapter 5 demonstrated that an increased consumer focus was well supported by historical evidence. ASIC states that consumer protection is its top priority.¹²² As identified in chapter 2, ASIC directs most of its funding toward consumer protection.¹²³ This increased consumer focus suggests that consumer protection may be a higher risk than other areas of regulation. The risk-based regulation approach adopted by ASIC in response to its enlarged jurisdiction accordingly calls for a greater attribution of resources to consumer protection.

There is no reason to believe that the adoption of a consumer focus goes beyond a present application of risk-based regulation. None of the indicia of a dependent path are particularly strong. There is no public record of ASIC having received any positive feedback directly related to its increased consumer protection focus. There is no suggestion of increasing returns. ASIC could easily determine that consumer protection was only its secondary priority in the coming years and justify doing so by reference to risk-based regulation. There is no lock-in. Finally, there is little evidence of self-reinforcement. While it may be argued that ASIC's public commitment to consumer protection may lead to self-reinforcement, the public comments on consumer protection are temporally limited. ASIC has not committed itself to any consumer protection focus in coming years. The public comments about consumer protection are also unsupported by internal performance measures. The performance measures are sufficiently flexible for ASIC to shift its priorities.

¹²² Australian Securities and Investments Commission, above n 53, 6.

¹²³ Ibid.

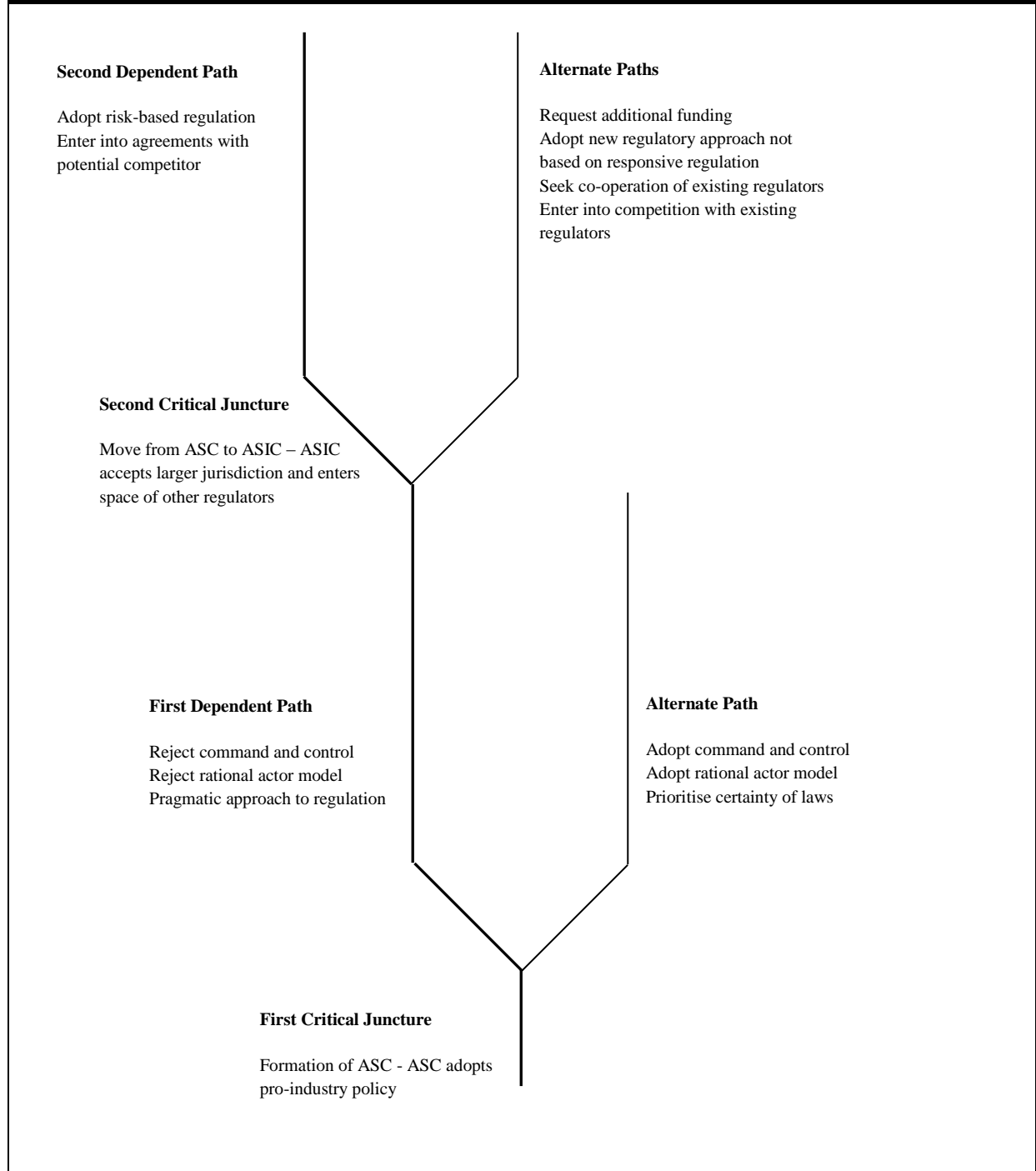
It is thus suggested that ASIC's increased consumer focus is a visible symptom of ASIC's dependent path, rather than a feature of that path itself. The second critical juncture led to an increased consumer protection focus only because consumer protection represented the greatest level of regulatory risk. If and when this ceases to be the case, it is likely that ASIC will shift its priorities.

3 *The Second Dependent Path*

Following from the second critical juncture ASIC had set a dependent path that reinforced the move away from command and control regulation toward responsive regulation and had strengthened its commitment to pragmatic regulatory approaches. Building on these elements, ASIC also committed itself to a risk-based regulation approach. At the same time ASIC committed itself to a particular approach when entering into other regulator's jurisdiction. Rather than allowing competition or reaching compromise in any given area, ASIC would divide regulatory jurisdiction and enter into an agreement with the potentially competitive regulator. This dependent path and its relationship with the first dependent path are represented diagrammatically in figure 7.2.

Figure 7.2

Second Critical Juncture and Dependent Path



Only one year after the second critical juncture a new critical juncture arose in ASIC's historical development. Chapter 6 explored the growth in derivatives trade following from the repeal of the Glass-Steagall legislation.¹²⁴ The secondary electricity market considered this to be an important moment in ASIC's historical development as it increased ASIC's workload and called ASIC to respond to an increasingly complex and high volume market. ASIC's response to the increased workload was similar to its response to the increased jurisdiction following the second critical juncture. Existing regulatory approaches and theories were strengthened and risk-based regulation allowed ASIC to swallow an increased workload without any significant increase in funding. The unique feature for ASIC's historical development arising from this critical juncture is ASIC's determination to categorise the derivatives market as a single market.

1 *Strengthening of Existing Elements of Dependent Path*

Given the temporal proximity of the second and third critical junctures it is perhaps unsurprising that ASIC responded fairly similarly to both. Both the shift from ASC to ASIC and the growth in derivatives enlarged ASIC's responsibility while offering no significant increase in funding (see table 6.2 in chapter 6). ASIC's response in both instances was to take a pragmatic approach, relying on risk-based regulation to do as much possible with the resources available.¹²⁵ The fact that 'as much possible' may be an ever decreasing amount of regulatory oversight did not cause ASIC to reconsider its regulatory approach or to re-evaluate its relationship with other regulators.

As has been explored, potentially competitive regulators, legally binding contracts, self-reinforcing Performance Measures and positive feedback ensured that the choice to adopt a pragmatic, risk-based regulatory response became part of ASIC's dependent path. ASIC had put

¹²⁴ *Gramm-Leach-Bliley Act* 113 Stat. 1338 (1999).

¹²⁵ Black and Baldwin, above n 83.

in place the mechanism to swallow the increased regulatory burden following the repeal of the Glass-Steagall legislation.¹²⁶ The rapid growth in derivatives could have challenged ASIC's approach, as ASIC may have responded by requesting ACCC or APRA to assist with the regulation of derivatives. Likewise, ASIC could have made a public appeal for increased funding to assist in managing the increased workload. The fact that there is no evidence of ASIC having taken either of these approaches not only confirms that ASIC was on a dependent path, but suggests that ASIC strengthened its commitment to that path.

ASIC's choice not to seek the assistance of other regulators also confirmed ASIC's commitment to its approach to divide regulatory jurisdiction rather than working co-operatively or competitively in the same regulatory space. ASIC's choice to 'go it alone' was cemented and increasingly cost-effective decentred regulatory approaches were utilised in the form of risk-based regulation. The strengthening of risk-based regulation necessarily strengthened ASIC's commitment to move beyond command and control regulation and ASIC's rejection of the rational actor model.

2 *Categorisation of the Derivatives Market*

The greatest development in ASIC's dependent path arising from the third critical juncture was ASIC's categorisation of the derivatives market as a single market. As explored in chapter 2, 'derivatives' is a term which covers a wide range of financial products. Options, forwards, futures, swaps, contracts for differences and many other financial instruments fall under the umbrella of derivatives.¹²⁷ More important for the development of the final dependent path, the consumers of derivatives are greatly varied. Many derivative market traders are primarily concerned with offsetting price fluctuations in supply elements of production.¹²⁸ Others are

¹²⁶ *Gramm-Leach-Bliley Act* 113 Stat. 1338 (1999).

¹²⁷ Dick Bryan and Michael Rafferty, *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class* (Palgrave MacMillan, 2006) 15.

¹²⁸ Helyette Geman, *Commodities and Commodity Derivatives: Modeling and Pricing for Agriculturals, Metals and Energy* (John Wiley & Sons, 2005) 7.

concerned with offsetting currency risk.¹²⁹ Many speculate,¹³⁰ or attempt to maximise the returns on investment portfolios which they oversee.¹³¹

The varied nature of the derivatives market participants presents a potential regulatory problem. A pie factory securing the future price of beef is likely to view derivatives in a different manner to the professional investment manager trying to hedge a risky share purchase. The two are also likely to view the regulation of derivatives in a very different manner. If ASIC is to be effective against its responsive regulation based performance measures, then ASIC must be able to effectively communicate and respond to both sets of derivatives consumers.

ASIC appears to have limited its ability to be responsive to these varied groups by simply categorising derivatives as ‘over the counter’ or not.¹³² ASIC’s annual reports refer to derivatives as a single item.¹³³ There does not appear to be any public discussion of the intricacies or variations in derivatives and their consumers by ASIC.

At first glance this categorisation of derivatives may appear to present little difficulty. ASIC makes no real distinction between the categories of consumers who invest in the share market. As with the ‘over the counter’ distinction, ASIC appears to distinguish only sophisticated and institutional investors from other investors.¹³⁴ Derivatives however, are dissimilar to shares in that they are often developed to offset industry specific risk.¹³⁵ Whereas shares offer universal benefits of equity and voting, the benefit of a derivative can often only be obtained by particular people in a particular field or industry. A forward purchase agreement for uranium is likely to be of value only to someone using large supplies of uranium.

¹²⁹ David DeRosa, *Currency Derivatives: Pricing Theory, Exotic Options and Hedging Applications* (John Wiley & Sons, 1998) 27.

¹³⁰ Geoffrey Poitras, *Risk Management, Speculation and Derivative Securities* (Academic Press, 2002) 102.

¹³¹ Edward LiPuma and Benjamin Lee, *Financial Derivatives and the Globalization of Risk* (Duke University Press, 2004) 61.

¹³² Australian Securities and Investments Commission, *Regulatory Guide 246: Derivative Trade Repositories*, July 2013.

¹³³ Australian Securities and Investments Commission, above n 53.

¹³⁴ Australian Securities and Investments Commission, above n 132.

¹³⁵ Poitras, above n 109.

ASIC was thus faced with two alternate paths. First, it could view derivatives as an extension to existing market groups. It could have seen the derivatives developed for and used by the wheat market as an extension of the wheat market, only loosely associated with the derivatives developed for and used by the electricity market. There is greater complexity in this approach, but also the opportunity for much greater responsiveness. Second, it could view derivatives as being defined by the properties of the product. This is the more cost effective path and the path taken by ASIC. Having made this decision, three of the four indicia of a dependent path arose.¹³⁶

(a) *Positive Feedback*

There is no evidence of any real positive feedback to ASIC's categorisation of the derivatives market as a single market. The closest thing to positive feedback provided to ASIC is the over-the-counter derivatives reforms incorporated into the *Corporations Act*.¹³⁷ The fact that legislation has categorised derivatives as a single unity should not however, be taken as positive reinforcement of ASIC's earlier decision to do likewise.

It is not legislation but rather the regulator which determines to define regulation by either product or industry. ACCC for example, is charged with the application of consumer protection laws.¹³⁸ Rather than viewing 'products' as a single entity, ACCC has engaged with separate industries to create industry specific codes of conduct which will ensure that the universal consumer protection laws are upheld.¹³⁹ The fact that ASIC has not followed this path does not find validation in broadly drafted legislation.

It is possible that ASIC has received non-public positive feedback for its approach to derivatives regulation. It is entirely possible that the majority of derivatives consumers are pleased with ASIC's regulatory approach. Without public record of such views, no conclusion can be drawn.

¹³⁶ Collier and Collier, above n 19.

¹³⁷ 2001 (Cth), Part 7.5A.

¹³⁸ *Competition and Consumer Act 2010* (Cth).

¹³⁹ Christine Parker 'Compliance Professionalism and Regulatory Community: the Australian Trade Practices Regime' (2002) 26 *Journal of Law and Society* 215.

Future research may provide insight into the general reception of ASIC's approach to derivatives regulation. For now, it cannot be concluded that ASIC has received any positive feedback.

(b) Increasing Returns

While there may be no positive feedback, ASIC's categorisation of the derivatives market has created increasing returns. A decision made in any time period will experience increasing returns if that decision makes it more likely that the same decision will be made in the next time period.¹⁴⁰ ASIC's decision to categorise derivatives as a single market meets this requirement.

The simplest factor in creating increasing returns is that ASIC has created a precedent in its categorisation of derivatives. Having defined the derivatives market, ASIC is unlikely to reconsider its definition, at least in the absence of a new critical juncture. More importantly, having categorised derivatives, ASIC has developed Performance Measures in line with this categorisation. ASIC annual reports measure derivatives as a whole.¹⁴¹ It is likely that ASIC trains staff in line with this categorisation, ensuring a set institutional approach to derivatives. ASIC's original categorisation of derivatives ensures that all future occasions to consider derivatives are likely to follow that categorisation.

(c) Lock-in

ASIC is locked-in to its current categorisation by many of the factors present in its existing dependent path. The pragmatic application of risk-based regulation ensures that ASIC focuses resources on areas which are of greatest risk. At present, financial markets are considered secondary to consumer protection.¹⁴² Derivatives form only one part of financial markets.¹⁴³ The size and diversity of ASIC's regulatory responsibility means that ASIC is unlikely to be able to

¹⁴⁰ Page, above n 20.

¹⁴¹ Australian Securities and Investments Commission, above n 41.

¹⁴² Ibid 8.

¹⁴³ Ibid 27.

justify devoting resources to developing new and industry specific categorisations of derivative financial products.

This lock-in moves beyond current regulatory priorities. Having developed a universal approach to derivatives regulation, ASIC's regulatory subjects will have structured their approach to dealing with ASIC. This investment by ASIC's regulatory subjects ensures that any decision by ASIC to review its categorisation of derivatives is likely to be met by resistance or resentment.

(d) Self-reinforcement

As with other aspects of ASIC's dependent path, the specific performance measures adopted by ASIC act as mechanisms for self-reinforcement. ASIC's annual reports define derivatives by product and not by market.¹⁴⁴ In working toward these Performance Measures ASIC entrenches the validity of its categorisation of the derivatives market.

Even if the categorisation of the derivatives market proves ineffective, the Performance Measure offers no means of redefining itself. ASIC may attempt new approaches to meeting its regulatory goals with relation to the derivatives market, but a universal measure does not lend itself to a re-categorisation of the derivatives market. In this way, the categorisation of the derivatives market becomes self-reinforcing.

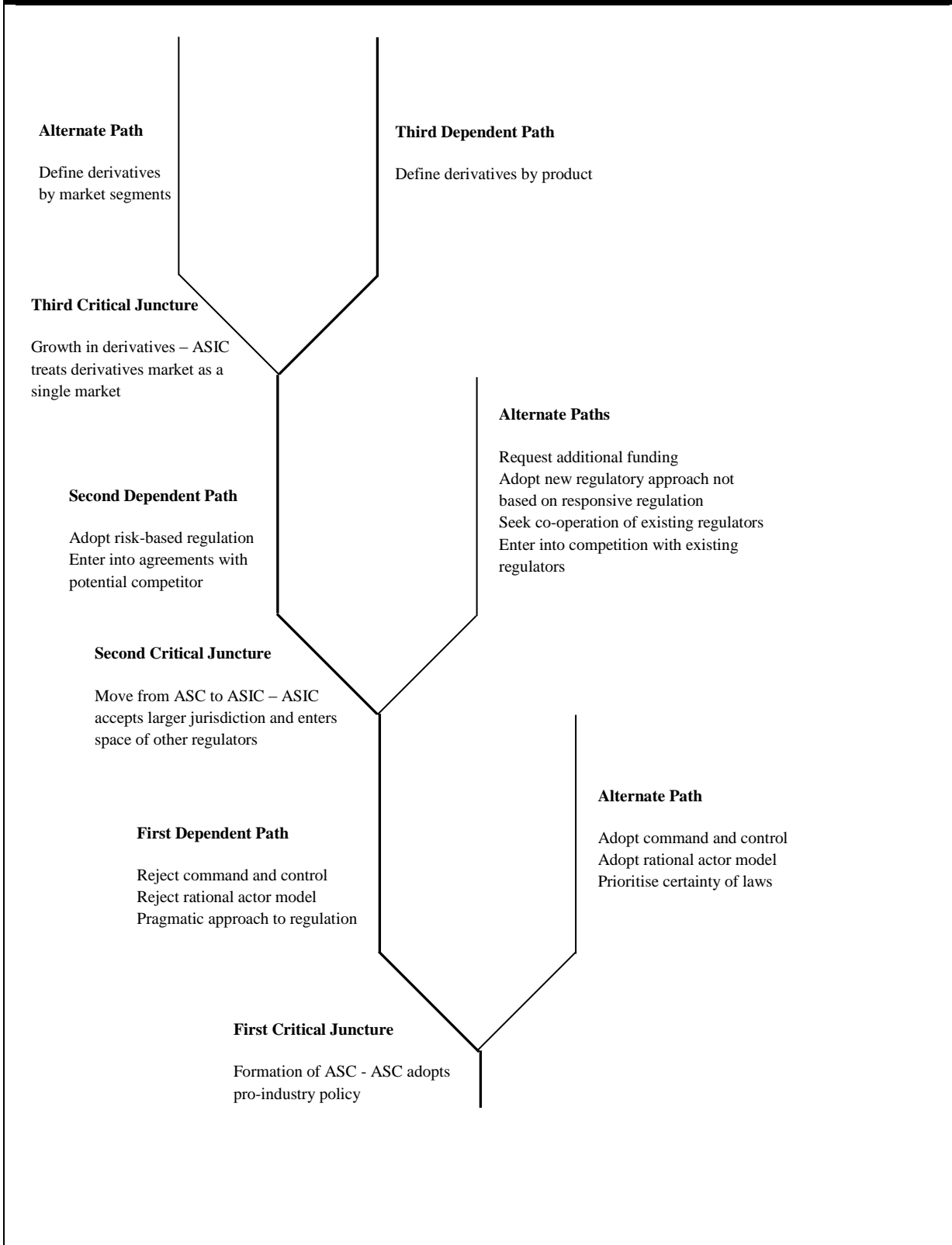
3 The Final Dependent Path

Following from the third critical juncture ASIC had clearly committed to its existing dependent path. Risk-based responsive regulation was affirmed and ASIC's approach to other regulators was bolstered. ASIC also developed a new element in its dependent path, categorising the derivatives market as a single market. This dependent path and its relationship with the first two dependent paths are represented diagrammatically in figure 7.3.

¹⁴⁴ Australian Securities and Investments Commission, above n 41.

Figure 7.3

Third Critical Juncture and Dependent Path



III ASIC'S DEPENDENT PATH AND THE SECONDARY ELECTRICITY MARKET

Figure 7.3 reveals ASIC's dependent path. It is presently a risk-based responsive regulator which adopts a pragmatic approach to regulation, draws clear divides between ASIC and other regulators and defines the derivatives market as a single market. These dependent paths are drawn from historical and theoretical investigation of the critical junctures identified by the secondary electricity market.

ASIC's dependent path development has been justifiable and largely in line with regulatory theory. When viewed in isolation there does not appear to be any problem present in ASIC's dependent path. When viewed through the responses of the secondary electricity market, a very different picture emerges. ASIC faces three major problems in meeting its regulatory goals in relation to the secondary electricity market. First, the secondary electricity market believes that ASIC is not being responsive to it. Second, if ASIC were responsive to the secondary electricity market it would be called upon to adopt a greater level of command and control regulation. Third, ASIC lacks the resources to engage with the secondary electricity market and to provide a dedicated regulatory response. This limitation is amplified by ASIC's historical response to other regulators.

1 *Responsiveness to the Secondary Electricity Market*

Chapter 5 identified the possibility that the secondary electricity market was dissatisfied not as a result of ASIC's lack of responsiveness, but as a result of ASIC's lack of responsiveness to the secondary electricity market. This perception was seen in chapter 4, where secondary electricity market participants viewed ASIC's consumer focus as depriving the secondary electricity market of proper regulation. It is also evident in chapter 4 where secondary electricity market

participants viewed ASIC as having been captured by interest groups outside of the secondary electricity market.

ASIC's critical path embodies these concerns. By identifying only a unified derivatives market, ASIC has effectively prevented itself from recognising that the secondary electricity market exists. The secondary electricity market exists only as a subsection of the derivatives market – meaning it is beyond recognition by ASIC.

Recognising and responding to the secondary electricity market would require ASIC to abandon its dependent path. This is possible but unlikely. The existence of a dependent path greatly increases the cost of taking an alternate course of conduct.¹⁴⁵ A dependent path also reduces the likelihood of alternate courses of conduct.¹⁴⁶ The indicia of the third dependent path would work against the possibility of ASIC recognising the secondary electricity market. ASIC's limited funding, commitment to risk-based responsive regulation and Performance Measures all reinforce the existence of only a singular, united derivatives market.

2 *The Secondary Electricity Market calls for Command and Control Regulation*

Chapter 4 identified that the secondary electricity market had adopted a negative view of responsive regulation. Table 4.2 1(c), 2(c), 3(c), 4(c), 5(c), 6(c), 7(c), 8(c), 9(c), 10(c), 11(c) and 12(c) reveal a preference for command and control regulatory approaches. This is perhaps explained by the responses in table 4.5, which reveals a belief by the secondary electricity market in the rational actor model. This suggests that even if ASIC were to overcome its dependent path and identify the secondary electricity market as a unique market requiring a unique regulatory approach, it would face a near impossible hurdle.

The possibility of ASIC reversing its dependent path to consider the derivatives market as a series of separate markets is costly but conceivable. While ASIC is locked into the path, a new

¹⁴⁵ Collier and Collier, above n 19.

¹⁴⁶ Ibid.

critical juncture could see ASIC reverse this approach without impacting on any other elements of its dependent path. The possibility of adopting a command and control based regulatory approach is almost entirely impossible. The move away from command and control regulation led to responsive regulation and risk-based regulation. It was the basis on which subsequent critical junctures were determined and subsequent dependent paths were formed. A return to command and control regulation would require a complete overhaul of ASIC's institutional history.

Such an historical revision would simply be impracticable. ASIC's prominence and public commitments, its funding, its relationship with regulatory subjects and its legislative necessity all work against ASIC completely re-evaluating its regulatory approach. The possibility of returning to command and control regulation is thus limited to a greater implementation of the harder regulatory approaches at the top of the compliance pyramid. As was noted in chapter 2, responsive regulation and command and control regulation are not dichotomous.

There is a possibility that such a suggestion may improve the relationship between ASIC and the secondary electricity market. The responses in table 4.5 1 and 7 and table 4.2 3(c) and 7(c) suggest that some secondary electricity market participants would be satisfied with stronger restrictions on their conduct. This would however, be a risky strategy. Other segments of the secondary electricity market appeared more concerned with the regulation of derivatives generally. The responses set out in table 4.2 1(c), 4(c), 5(c), 6(c) and 10(c) demonstrate this more generalised concern. It is quite possible that an effort to use more command and control regulation in relation to the secondary electricity market than ASIC uses in other markets would create resentment about the unequal treatment.

One of the key features that both formed and maintains ASIC's dependent path is the lack of resources available. With sufficient resources, ASIC could recognise any number of markets such as the secondary electricity market, engage in genuinely responsive regulation and achieve meaningful regulatory outcomes. The existing limitations caused by the dependent paths can be ultimately overcome by sufficient financial backing and time.

ASIC's dependent path largely limits ASIC's ability to seek further resources. By adopting a risk-based regulatory approach to cope with a widened jurisdiction, ASIC laid the foundation for dealing with all future increases in workload. ASIC absorbs workload pragmatically, determining to do the best it can with limited resources, rather than pursuing extra resources. The alternate paths that could have been taken at the second critical juncture are closed off. ASIC is unlikely to publically appeal for further funding, even where such funding is justified by an increase in regulatory jurisdiction.

Likewise, ASIC's approach to other regulators limits ASIC's ability to draw assistance from other regulators. The delineation between wholesale electricity market and secondary electricity market is clear. The MoU between ASIC and ACCC ensures that the former market is the responsibility of AER while the latter is the responsibility of ASIC. Given that ACCC regulates in a manner closer to that requested by the secondary electricity market, AER, a subsection of ACCC, may be the more appropriate regulator. ASIC could overcome many of its funding issues by handing jurisdiction of the secondary electricity market to a more suitable regulator. The response in table 4.2 8(c) suggests that this would be welcomed by at least some of the secondary electricity market. This possibility is discussed in more detail in considering the potential future directions for ASIC.

IV THE WAY FORWARD

This thesis suggests that ASIC is experiencing regulatory failure in relation to the secondary electricity market. This failure is not to be found at any particular point in ASIC's historical development, but rather in the secondary electricity market's perception that ASIC is failing.¹⁴⁷ This thesis also suggests that the historical development of ASIC means that ASIC is unable to respond to the secondary electricity market and correct this failing. Given the potential dangers of an under regulated secondary electricity market set out in chapter 2, this is a concerning position.

This thesis now considers three potential means by which ASIC may attempt to correct its relationship with the secondary electricity market. First, it considers whether ASIC can improve its responsiveness and meet the challenges presented by the secondary electricity market. Second, it considers whether ASIC may be able to pass its regulatory responsibility to another regulator. Finally, it considers whether current regulatory theory offers a workable solution for ASIC.

A *Improved Responsiveness*

The most immediately attractive option for ASIC may be for ASIC not to change its regulatory approach, but to simply be more effective at meeting its Performance Measures. A responsive regulator should be able to engage with the market and respond to its concerns.¹⁴⁸ As is noted in chapter 2, ASIC is aware that its relationship with the market is of fundamental importance. The solution would thus appear to be for ASIC to enter into discussions with the secondary electricity market and address its concerns.

The problem with this approach is that the outcome of such an engagement is already known. Chapter 4 set out the desires of the secondary electricity market for ASIC to return to command

¹⁴⁷ Ayres and Braithwaite, above n 16, 22.

¹⁴⁸ Ibid.

and control regulatory theory. Such a desire goes to the first critical juncture in ASIC's historical development and would require a complete overhaul of ASIC's dependent path. ASIC would be left with two choices, either engage in a very costly and lengthy overhaul of its historical trajectory and regulatory approach, or convince the secondary electricity market of the merits of responsive regulation.

The first of these two options is highly undesirable. According to ASIC reports, ASIC is enjoying a good working relationship with its regulatory subjects.¹⁴⁹ ASIC should not consider sacrificing a regulatory theory which is working with a majority of its regulatory subjects in order to appease a small group of its regulatory subjects. This is strengthened by the fact that ASIC would simply not have the resources to engage in the more costly and time consuming method of command and control regulation.¹⁵⁰

The second of these two options is desirable, but unlikely to offer any short or medium term gains. Being a responsive regulator does not necessarily involve doing what the subjects of regulation want.¹⁵¹ A responsive regulator only needs to consider the views of the market and engage with it.¹⁵² ASIC could engage with the secondary electricity market, hear its views and choose not to implement them. Without more, such an approach is only likely to breed resentment in the secondary electricity market. When combined with the responsive regulator's duty to educate, such an approach could offer a long-term improvement in ASIC's relationship with the secondary electricity market.

Persuading the secondary electricity market of the merits of responsive regulation will be difficult. ASIC's dependent path involves a number of historical decisions which have led ASIC to adopt a very different ideology to the secondary electricity market. The rejection of the

¹⁴⁹ Australian Securities and Investments Commission, above n 41.

¹⁵⁰ Wilks and Bartle, above n 38.

¹⁵¹ Ayres and Braithwaite, above n 16, 103.

¹⁵² Ibid.

rational actor model goes to heart of questions on economics, law and human nature.¹⁵³ If ASIC and the secondary electricity market are both starting from a very different view about the motivations of economic behaviour, then they are unlikely to see eye to eye. ASIC would need to slowly alter the ideological beliefs of the secondary electricity market participants, something that will only be possible in the extremely long-term.

Even if such a solution is extremely long-term, it is better than ASIC taking no action. Such a solution however, does require ASIC to retrace its steps. To engage with the secondary electricity market ASIC would first have to recognise the secondary electricity market. Doing so would potentially open ASIC to recognising numerous industry specific groups of derivatives consumers. This is a cost that ASIC is unlikely to be able to justify, especially if any gains resulting from the cost will not be seen for many years.

B *A Different Regulator*

As has been discussed, there exists a regulator which far better matches the regulatory desires of the secondary electricity market. This regulator, AER, regulates the wholesale electricity market. ASIC may choose to hand responsibility for the secondary electricity market to AER, or at least work co-operatively with the AER to regulate the secondary electricity market.

This is not an ideal solution. AER is a branch of the ACCC, a responsive regulator.¹⁵⁴ While chapter 5 noted that ACCC did not follow the same path as ASIC in moving away from command and control, the secondary electricity market will still be subject to responsive regulation under the AER. Any satisfaction of the secondary electricity market with such a move suggests that the secondary electricity market may not be necessarily rebelling against responsive regulation, but rather the particular way in which ASIC has implemented responsive regulation. This is an important factor in considering the third possible means by which ASIC

¹⁵³ Kristen Monroe and Kristen Maher 'Psychology and Rational Actor Theory' (1995) 16 *Political Psychology* 1.

¹⁵⁴ *Competition and Consumer Act 2010* (Cth).

may correct its relationship with the secondary electricity market. In considering the possibility of ASIC handing over jurisdiction of the secondary electricity market, it is sufficient to note that the AER offers a regulatory approach which is much closer to the desires of the secondary electricity market.

As with responding to the secondary electricity market, such an approach is made difficult by ASIC's historical development. Besides requiring a re-evaluation of the MoU, handing over jurisdiction of the secondary electricity market would require ASIC to retrace its steps and overturn a dependent path. First, it would have to identify the secondary electricity market as a unique market. Second, it would need to alter its relationship with ACCC. Such alteration would require careful consideration of legislative jurisdiction, as well as the future relationship between ASIC and ACCC where both may legitimately claim regulatory oversight. Given the fact that ASIC does not identify the secondary electricity market as a unique market (and is thus unlikely to be aware of any regulatory failing) and given the presence of alternate solutions to ASIC's relationship with the secondary electricity market, it is highly unlikely that jurisdiction over the secondary electricity market will be handed to AER.

While an unlikely solution, this is perhaps the most complete solution for ASIC and the secondary electricity market. The historical development of ASIC has placed it far from a common understanding with the secondary electricity market. ASIC does not have the resources to correct its relationship with the secondary electricity market, nor can it sacrifice its relationship with its wider regulatory subjects in order to do so. The AER, a specialist energy regulator, has a far more focused regulatory jurisdiction and is already accustomed to dealing with a majority of the secondary electricity market participants. Legislation only binds ASIC insofar as must be the body to give final approval to disclosure documents.¹⁵⁵ There is no reason that ASIC could not work with AER in a way that AER was to review disclosure documents and provide recommendations to ASIC. Other areas of regulatory oversight are already within the

¹⁵⁵ *Corporations Act 2001* (Cth), Chapter 7.

capability of AER, with many of the market manipulation and misleading and deceptive conduct rules being within the jurisdiction of both ASIC and ACCC.¹⁵⁶ The advantages such an approach may confer may justify ASIC retracing its dependent path. While it would be a costly and difficult process, it is not impossible.

C *A New Regulatory Theory*

The most likely means by which ASIC may improve its relationship with the secondary electricity market is hidden in its historical development. At its first critical juncture ASIC engaged with what was then contemporary regulatory theory.¹⁵⁷ While this did not form part of ASIC's dependent path, its presence at the first critical juncture ensured that nothing has developed in ASIC's dependent path that would prevent the adoption of contemporary regulatory theory. A review of modern regulatory theory presents a possibility that ASIC will be able to slowly correct the perception of regulatory failure in the secondary electricity market without having to depart from its dependent path.

The necessity of a new regulatory theory is hinted at by the failure of responsive regulation to respond to the secondary electricity market. Ford suggests that this empirically observed failure may not be unique to the secondary electricity market, but rather a natural occurrence in a complex market.¹⁵⁸ Ford's analysis of post-global financial crisis financial markets suggests that a responsive regulator will be unlikely to forge the personal relationships or define its regulatory scope in such a complex market.¹⁵⁹ This offers a clear insight into the problems currently faced by ASIC in the secondary electricity market. Responsive regulation may oversimplify the complexity of interpersonal relationships.¹⁶⁰ Responsive regulation is premised on a single regulator engaging with a single market, something that is undermined where multiple regulators

¹⁵⁶ Ibid; *Competition and Consumer Act 2010* (Cth).

¹⁵⁷ Hartnell, above n 11.

¹⁵⁸ Cristie Ford 'Prospects for Scalability: Relationships and Uncertainty in Responsive Regulation' (2013) 7 *Regulation and Governance* 14, 15 – 16.

¹⁵⁹ Ibid 16.

¹⁶⁰ Ford, above n 158, 15 – 16.

are talking to multiple markets.¹⁶¹ This may help explain the views of regulation arising in the secondary electricity market, which has more interpersonal relationship with AER and APRA than it does with ASIC. Likewise, ASIC is engaging with multiple derivative-trading industries and hearing multiple voices. This misalignment is likely amplified by the elements of ASIC's dependent path which categorised the derivatives market as a single entity.

ASIC is thus faced with an environment where it is one regulator of many trying to control a small, complex and important industry which has ill-defined regulatory boundaries. Adding to this complexity is the fact that ASIC has developed on an historical path which limits the responses that ASIC can take in relation to such a market. If this thesis is correct in that the secondary electricity market does not object to decentred regulation, but rather the particular way in which ASIC has utilised responsive regulation, then ASIC has a clear means of correcting its regulatory failure.

The solution for ASIC is perhaps best summed up by the response in table 4.2 9(c): 'a good regulator gets the job done without industry being aware that the regulator has done anything at all.'¹⁶² The solution is not for ASIC to improve its relationship with the secondary electricity market, but rather to become less visible to the secondary electricity market. Meta-regulation offers ASIC the possibility of doing so while strengthening its regulation of the secondary electricity market. As outlined in chapter 2, meta-regulation is a decentred regulatory theory which recognises the many non-legal sources of regulatory influence and attempts to regulate these regulatory forces.¹⁶³ In short, the regulator becomes a co-ordinator of existing regulatory forces.¹⁶⁴

¹⁶¹ Ibid 21.

¹⁶² Interview 13.

¹⁶³ Siona Listokin-Smith 'Meta-regulation of OTC derivatives contracts post-reform' (2013) 21 *Journal of financial regulation and compliance* 188, 189.

¹⁶⁴ Sharon Gilad 'It runs in the family: Meta-regulation and its siblings' (2010) 4 *Regulation and Governance* 485, 486.

There are a number of sources of regulation of the secondary electricity market and this number is likely to continue to increase. The secondary electricity market participants appear to be driven by the requirements of their employers. The responses in table 4.2 3(c) and 4.2 1, 4, 5 and 7 suggest that secondary electricity market employees will meet the requirements of their employer, even where those requirements are contrary to the participant's will. ACCC has had success in creating codes of conduct with employers and industry.¹⁶⁵ ASIC has the potential to harness this as one source of regulatory influence over the secondary electricity market, pushing the relationship between employer and employee rather than between ASIC and the secondary electricity market.

Likewise, the secondary electricity market is subject to pressure from market rules. Many secondary electricity market products are traded on public exchanges, bringing them within the jurisdiction of the market operator. Given that ASIC now has direct oversight of the Australian Securities Exchange and Australian Future Market,¹⁶⁶ it is in a position to work with the market operator to influence the behaviour of the secondary electricity market.

Similarly, ASIC could engage with shareholder groups and industry associations to utilise the private property motivations of corporate conduct.¹⁶⁷ When these sources of regulatory influence are considered alongside market forces, social opinion, media and other regulators including AER, APRA and ACCC, ASIC has at its disposal numerous potential sources of regulatory influence that would not require any direct contact between ASIC and the secondary electricity market. Whether or not ASIC chooses to recognise these regulatory sources, they are already present. Meta-regulation simply offers the means by which ASIC may harness these forces and use them to meet ASIC's regulatory goals.¹⁶⁸ Given that many of these forces are currently

¹⁶⁵ Parker, above n 139.

¹⁶⁶ Memorandum of Understanding between Australian Securities and Investments Commission and ASX Limited dated October 2011.

¹⁶⁷ James Walsh and James Seward 'On the Efficiency of Internal and External Corporate Control Mechanisms' (1990) 15 *Academy of Management* 421.

¹⁶⁸ Bronwen Morgan 'The economization of politics: Meta-regulation as a form of nonjudicial legality' (2003) 12 *Social Legal Studies* 489, 499.

undermining the effectiveness of responsive regulation, a meta-regulatory approach may be ideal for ASIC.

This approach is subject to two key limitations in the case of the secondary electricity market. First, an effective meta-regulatory approach will start with the identification of the existing sources of regulation. For the secondary electricity market, this will mean that ASIC must identify sources of regulation which are specific to that industry, for example, the AER. This approach will force ASIC to abandon its classification of the derivatives market as a single unit and thus require a re-evaluation of ASIC's dependent path. Given the self-reinforcement, lock-in and increasing returns holding ASIC's present path in place, ASIC is unlikely to make such a re-evaluation unless and until it reaches another critical juncture in its historic development.

Second, ASIC may not be the most appropriate meta-regulator for the secondary electricity market. The wholesale electricity market has a dedicated regulator. Given that the wholesale and secondary electricity markets are extremely closely related, it may be more sensible for ASIC's role in approving disclosure documents and maintaining market integrity to be viewed as a source of regulation to be harnessed by AER, rather than ASIC harnessing AER to control the secondary electricity market. This would appear to be a near ideal solution to the regulation of the secondary electricity market, were it not for the clearly defined boundary between the wholesale and secondary electricity markets. Bringing the secondary electricity market within the control of a meta-regulatory AER would not only require AER to adopt a meta-regulatory approach, but would also require legislation to bring the secondary electricity market within the consideration of AER.

Despite these limitations, the adoption of a meta-regulatory approach is the solution most likely to be adopted by ASIC. It is consistent with a vast majority of ASIC's dependent path. While the effectiveness of its implication will depend on a re-evaluation of the categorisation of the derivatives market, the adoption of a meta-regulatory approach is not. ASIC may thus find its

future not in improving its relationship with the secondary electricity market, but by gracefully bowing out of the relationship and regulating from behind the scenes.

CHAPTER EIGHT: CONCLUSION

I OVERVIEW

Improperly regulated, Australia's secondary electricity market has the potential to cause a failure in Australia's electricity supply. Despite this, there has been no investigation to date into the regulation of Australia's secondary electricity market. This thesis begins to fill that research gap. This thesis investigates the effectiveness of the primary regulator of the secondary electricity market: ASIC. It did this by answering four research questions:

1. How do the subjects of ASIC's regulation in the secondary electricity market view the effectiveness of ASIC?
2. To what extent was ASIC's predecessor, the Australian Securities Commission ('ASC') formed as a 'pro-industry' institution, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?
3. To what extent did the shift from the ASC to ASIC result in ASIC adopting an anti-regulatory ideology, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?
4. To what extent did the boom in derivatives trade following the repeal of the Glass-Steagall Legislation¹ result in ASIC refocusing its resource allocation away from the financial markets, and to what extent does this affect ASIC's capacity to effectively regulate the secondary electricity market?

These questions were answered through an empirical investigation which adopted and built upon Black's regulatory conversations model² to obtain data from the subjects of ASIC's regulation. The data revealed that the secondary electricity market was extremely dissatisfied with ASIC's regulatory oversight.

¹ *Glass-Steagall Act* 12 U.S.C. 80 (1932) and *Banking Act* 48 Stat. 162 (1933).

² Julia Black 'Regulatory Conversations' (2002) 29 *Journal of Law and Society* 163.

This thesis aims to contribute to legal and regulatory knowledge in three main ways. First, the method used to obtain data on the regulation of the secondary electricity market offers an advance in empirical scholarship in law. It does so through the positivist adaptation of Black's regulatory conversations, which now offers an advance in the possibility of qualitative research within a legal research framework. Second, results of the empirical research provide the first insight into the current state of regulation of the secondary electricity market. Third, the analysis of the results of the empirical research provides insight into the practical limitations of responsive regulation and offers an empirical justification for the adoption of newer forms of decentred regulation.

This concluding chapter highlights the main contributions and findings of this research. It then provides recommendations for overcoming the problems identified by the research. It concludes by noting the limitations of the current thesis and identifying areas for further research.

II CONTRIBUTIONS

A *Methodological Contribution*

This thesis adapted Black's regulatory conversations model³ in an effort to better fit the model into a traditional legal research framework. This approach is fully outlined in chapter 3 and required the adoption of semi-structured interviews and thematic analysis in place of the post-structuralist discourse analysis adopted by the regulatory conversations model.⁴ In the case of the current thesis, this approach appears to have yielded meaningful results. Participants were forthcoming and the semi-structured interview (see appendix 2) allowed for ideas raised during interviews to be pursued. Positivist thematic analysis identified meaningful results without challenging the positivist foundation of legal scholarship.

³ Black, above n 1.

⁴ Ibid.

This method of research is ideal for future studies which wish to investigate regulatory effectiveness from the perspective of the subjects of regulation. It is also ideal for future studies which wish to use an empirical research methodology to identify the historical development of an institution. While in this thesis the results of research led to the adoption of historical institutionalism, the research methodology may be used to investigate the historical development of institutions in papers which specifically aim to adopt an historical institutionalism approach.

B *Contribution to Knowledge of Secondary Electricity Market*

This thesis appears to be the first to investigate the regulation of the secondary electricity market. It is also one of only a few studies to consider the effectiveness of regulation from the perspective of the subjects of regulation. In relation to the secondary electricity market, this thesis has revealed a concerning regulatory failure and identified the complexities which limit the possibility of correcting this failure.

This thesis first identifies that the secondary electricity market believes that ASIC is an ineffective regulator. It then identifies that this is in itself a regulatory failure according to ASIC's own standards. Further, it identifies three key issues which the secondary electricity market believes are the particular areas where ASIC failed and continues to fail in its regulation of the secondary electricity market. The secondary electricity market believes that ASIC has failed in its regulation as a result of the policy with which the ASC was formed, the policy adopted when ASC became ASIC, and the increased workload that resulted from the growth in derivatives following the repeal of the Glass-Steagall legislation. The perception of these errors provides the first insight into both the effectiveness of ASIC in regulating the secondary electricity market and the potential causes of ineffectiveness.

Beyond identifying these perceived errors, this thesis analyses the theoretical and historical evidence to identify the reasons for the perceptions of the secondary electricity market. It presents the possibility that none of the events referred to by the secondary electricity market is

in itself a regulatory failing on the behalf of ASIC. Rather, the events identified by the secondary electricity market have both formed and influenced the historical development of ASIC. It is suggested that the secondary electricity market correctly identified the temporality of critical junctures in ASIC's historical development, but had not properly identified the complexity of the rift between ASIC and the secondary electricity market. Borrowing and expanding upon the diagram from chapter 7, it can be seen in figure 8.1 that one of the key contributions of this thesis is identifying the effect of ASIC's historical path in its relationship with the secondary electricity market. Each of the three critical junctures represents an answer to research questions 2, 3 and 4, while the existence of the dependent path answers research question 1.

Figure 8.1

Regulatory Failure, Critical Junctures and Dependent Paths

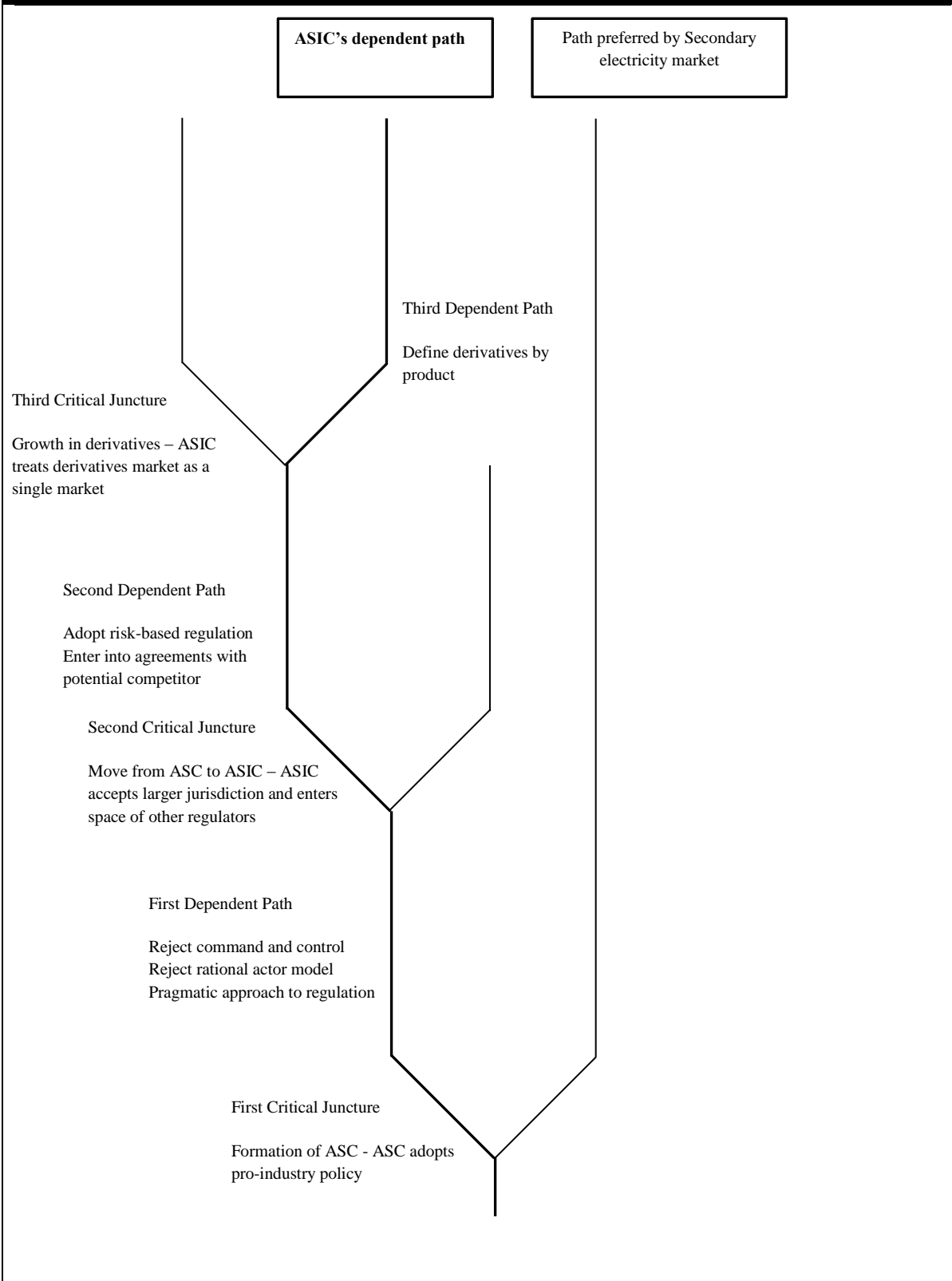


Figure 8.1 outlines the core finding of this thesis. The analysis of the empirical data reveals that ASIC's failing in relation to the secondary electricity market is not a series of small and correctable problems. Rather, ASIC has developed in a manner which prevents it from meeting the needs of the secondary electricity market. In fact, ASIC's historical development prevents ASIC from even recognising the possibility that the secondary electricity market may have views on ASIC's regulation. This finding lends empirical support to the recent criticism of responsive regulation offered by Ford.

C *Contribution to Regulatory Theory*

This thesis presents a number of contributions to regulatory theory. First, it provides insight into regulation from the perspective of the subjects of regulation. This is something which has previously been undertaken by Nielsen and Parker but is something which yet to attract a significant amount of attention.⁵ This thesis offers a much more focussed review of the experience of regulatory subjects than that undertaken by Nielsen and Parker. It does so by investigating a single industry. The results of this thesis assist in providing a more complete picture of responsive regulation which includes the views of the subjects of a responsive regulator.

The results of this thesis also reveal the complexity of the regulatory environment in which ASIC operates. This complexity, coupled with the regulatory difficulties faced by ASIC in relation to the secondary electricity market lends support to Ford's criticism of responsive regulation.⁶ The complexity of the regulatory environment also lends support to the possible necessity of meta-regulation as the next stage of ASIC's regulatory development. While this thesis does not advance meta-regulatory theory itself, it does provide an empirical example of where meta-regulation is not only possible, but called for.

⁵ Vibeke Nielsen and Christine Parker 'Testing responsive regulation in regulatory enforcement' (2009) 3 *Regulation and Governance* 376.

⁶ Cristie Ford 'Prospects for Scalability: Relationships and Uncertainty in Responsive Regulation' (2013) 7 *Regulation and Governance* 14.

III RECOMMENDATIONS

This thesis identifies that ASIC faces a complex problem in regulating the secondary electricity market. It also identifies a number of limitations that ASIC faces in addressing this problem. While this thesis does not offer a complete solution to ASIC's current regulatory problem, it does identify areas where ASIC may be able to improve its relationship with the secondary electricity market, or at least improve its regulation of the secondary electricity market.

First, it is recommended that ASIC engage with the secondary electricity market. This is a fairly cost-effective means by which ASIC may address its current regulatory difficulties. Opening a dialogue with the secondary electricity market requires recognition of the secondary electricity market but does not otherwise call for ASIC to significantly depart from its dependent path. If ASIC is to commit to a responsive regulation approach, then it may benefit from educating its regulatory subjects on the value of responsive regulation.

Second, it is recommended that ASIC re-engage with contemporary regulatory theory. In particular it is recommended that ASIC consider the possibility of moving towards meta-regulation. The circumstances in the secondary electricity market suggest that meta-regulation may offer a meaningful advance on ASIC's existing regulatory theory. It is likely that a considered review by ASIC may reveal other markets like the secondary electricity market which would benefit from a meta-regulatory approach.

Finally, it is suggested that the best solution for ASIC's relationship with the secondary electricity market is not within the power of ASIC. Legislative revision is needed to bring the secondary electricity market under the jurisdiction of AER. Even without a revision of regulatory theory, AER is likely to be a far more responsive and effective regulator of the secondary electricity market than ASIC. AER may be able to multiply these gains in regulatory effectiveness by adopting a meta-regulatory approach, but further research is needed on this point.

IV LIMITATIONS AND FURTHER RESEARCH

This thesis has some limitations that could be addressed in future research. While the semi-structured interview and positivist thematic analysis model aims to safeguard against researcher bias, this research was nonetheless conducted by a single interviewer with existing ties to the secondary electricity market. Further studies into the secondary electricity market utilising multiple researchers may help verify the results and limit any bias that is present in the results.

This research is also limited by the fact that ASIC declined to participate. Future research involving ASIC will help develop a far more accurate picture of both the regulation of the secondary electricity market and the historical development of ASIC. Such research may be able to offer further complexity to the current thesis by developing a reactive sequences model of ASIC's historical development, rather than the critical junctures model made necessary by the lack of inside information.

Despite these limitations this thesis provides a step forward in qualitative legal research, knowledge of the secondary electricity market and regulatory theory. Future studies into regulation of markets may benefit from adopting the adapted regulatory conversations model developed for this thesis. Such an approach may be further developed over time to move toward a structuralist discourse analysis or a post-structuralist thematic analysis. In this way, further studies can continue to bridge the gap between existing legal research standards and the regulatory conversations model.

Further studies may also build on the data presented in this thesis to investigate the secondary electricity market. The data may provide a meaningful starting point for an investigation into regulation driven by a theory other than historical institutionalism. More information and more perspectives are needed on the secondary electricity market and this thesis may offer a starting point from which to develop further insights and theories.

This thesis may also provide a model by which future studies examine product specific markets within the greater derivatives market. It is possible that other markets which trade in derivative financial products may not fit within the general derivatives market. If sufficient studies of this nature can be conducted a clear picture can be created to call for ASIC to segment its derivatives regulation by market features, rather than by product features.

APPENDIX 1: INTERVIEW PROCESS AND PARTICIPANT INFORMATION

I. INTERVIEW PROCESS

The interviewer used pre-existing knowledge of and relationships with companies and organisations within the secondary electricity market to identify relevant secondary electricity market participants. Given the small size of the secondary electricity market in Australia, all of the secondary electricity market trading firms in Sydney were contacted.

Prominent companies in the secondary electricity market, law firms specialising in the secondary electricity market and companies that hired consultants who frequently advised secondary electricity market traders were approached. These employers of potential participants were sent an email providing an overview of the research, its purpose, its method and confidentiality processes. Each company was requested to provide the contact details and first names of 5 to 10 willing interviewees.

The potential interviewees were then contacted on the provided contact details. They were informed of the research, its purpose, its method and confidentiality processes. The potential interviewee was asked to consent to participating in the research. Potential participants were informed that the study was completely voluntary and that they could decline or withdraw at any time. The potential participants were also informed that their employer would not be informed as to whether or not they took part in the research. Participants who agreed to take part in the research were then asked to provide times when they were available.

A total of 23 emails were sent to companies or organisations employing potential participants. Fifteen organisations responded to the email. Of these, 10 organisations declined to take part in the study. Five organisations responded positively, providing names of staff members who could be contacted for interview. A follow up email was sent to the eight organisations who did not respond. No organisation responded to this follow up email.

A total of 22 potential participants were nominated by the participating organisations. Each of the individuals nominated by their organisation was contacted. A total of 17 participants accepted to be part of the study. Of these, 11 were electricity traders, three were consultants currently providing advice to secondary electricity market participants and three were lawyers currently providing advice to secondary electricity market traders. One of the electricity traders who initially took part in this study later withdrew his or her consent to be included in the results. The data collected from this participant was destroyed and the results were re-evaluated based on the remaining 16 participants.

Interviewees were given a choice of being interviewed at their place of employment or at an interview room at 289 Sussex Street in Sydney. Thirteen participants attended the interview room. Three participants elected to be interviewed at their place of employment. Participants were asked the questions set out in appendix 2, together with individualised questions which arose from the semi-structured interview process.

Each interviewee was assigned an interview number. The demographic details of the interviewees were recorded, but were not assigned to the interviewee's number. All responses were recorded against the interview number to ensure anonymity. Responses are currently stored in a locked file. Names of participants have been deleted.

II. PARTICIPANTS

Due to the relatively small size of the secondary electricity market, in depth demographic data cannot be provided without potentially identifying individual participants. As a general overview, participants were between 27 and 64 years of age. Participants had experience in the wholesale and secondary electricity markets ranging from four years to 31 years. Twelve of the participants were already working in the electricity market at the time of the establishment of the National Electricity Market. Three of the participants were female and 13 were male. All

participants had worked with secondary electricity market products. Of the interviewees 11 were electricity traders, 3 were lawyers and 2 were management consultants.

While further investigation of the demographic data would provide meaningful insight into the research questions, the anonymity of the participants has been respected. No information which would link the participant to their responses has been provided in the thesis. Some quotes have been edited to remove identifying information, including age, race and gender.

APPENDIX 2: INTERVIEW QUESTIONS

The following questions were asked to all interviewees. Being a semi-structured interview, additional questions and discussions not appearing in this appendix were held with individual interviewees in order to explore ideas and concepts raised during the interview.

I. PRELIMINARY QUESTIONS

Could you please confirm that you are [an electricity trader involved in the secondary electricity market / a lawyer who advises the secondary energy market / an electricity market consultant who advises the secondary electricity market]?

How long have you been [an electricity trader / a lawyer who advises the secondary energy market / an electricity market consultant]?

II. YOUR PLACE IN THE MARKET

Can you briefly explain to me what you understand the secondary electricity market to be, and where you fit into it?

Hypothetically, if the major power supplier in NSW were to shut down, what thoughts would go through your mind?

What connection, if any, do you see between turning on a light switch in your house, and the secondary electricity market?

III. CURRENT REGULATION

A *Electricity Traders*

Are you familiar with which government body regulates the secondary electricity market market?

Do you know what legislation applies to electricity derivatives?

Can you tell me about how important you think your own moral code is in regulating your conduct when trading in the secondary electricity market?

Does your employer have a code of conduct? If so, can you tell me about how important you think your employer's code of conduct is in regulating your conduct in the secondary electricity market? Please note that your employer is not required to have a code of conduct. If you feel in any way uncomfortable answering this question about your employer, please let me know and we will move to the next question.

Can you tell me about how important you think external regulatory agencies are in regulating your conduct in the secondary electricity market?

B *Lawyers / Consultants*

Can you tell me how important you think external regulatory bodies are in regulating the secondary electricity market?

Can you tell me how important you think self-regulation is in regulating the secondary electricity market?

IV. RELATIONSHIPS

What do you think of the ASIC in terms of:

- its impact on secondary electricity market efficiency;
- its importance to the secondary electricity market;
- its impact on your ability to do your job in the secondary electricity market; and
- any other aspect you would like to comment on?

What do you think of self-regulatory devices (codes of conduct, employer rules, etc) in terms of:

- their impact on secondary electricity market efficiency;
- their importance to the secondary electricity market;

- their impact on your ability to do your job in the secondary electricity market; and
- any other aspect you would like to comment on?

How often do you have contact with ASIC?

Are you aware of the official correspondence between market participants and ASIC? If so, how well does the official correspondence reflect your view of ASIC?

V. EFFECTIVENESS OF REGULATION

If given the opportunity, are there any changes you would like to make to the current regulation of the secondary electricity market?

Hypothetically, if someone was to breach the current regulations, what, if any, response would you expect from:

- their employer; and
- ASIC?

Do you believe that ASIC is an effective regulator? If not, can you identify any particular areas of inefficiency?

Are there any aspects of ASIC's regulation which you believe are particularly effective?

Is there anything else you would like to add?

VI. ADDITIONAL QUESTIONS

Do you believe there is a lag between significant events which may affect the price of a secondary electricity market derivative and market reaction?

Do you use a risk free rate in your calculation of derivative pricing and if so, how do you calculate it?

Could you please tell me the effect that a rupturing of the Dolphin Pipeline would have on the price of [a then-relevant hedging instrument used by one of the major electricity traders to offset risk arising from an electricity future]? Could you tell me what the price should be? If you need additional information to work out the pricing, please let me know.

APPENDIX 3: ETHICS APPROVAL



MACQUARIE
University

DAVID MULLAN <david.mullan@students.mq.edu.au>

Conditions Met Final Approval - 5201200182(D)

3 messages

Faculty of Arts Research Office <artsro@mq.edu.au>

Thu, May 17, 2012 at 11:11 AM

To: Dr Vijaya Nagarajan <vijaya.nagarajan@mq.edu.au>

Cc: Faculty of Arts Research Office <artsro@mq.edu.au>, Mr David Mullan
<david.mullan@students.mq.edu.au>

Ethics Application Ref: (5201200182) - Final Approval

Dear Dr Nagarajan,

Re: ('Regulation of Emerging Markets')

Thank you for your recent correspondence. Your response has addressed the issues raised by the Faculty of Arts Human Research Ethics Committee and you may now commence your research.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/_files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Dr Vijaya Nagarajan
Mr David Mullan

NB. STUDENTS: IT IS YOUR RESPONSIBILITY TO KEEP A COPY OF THIS APPROVAL EMAIL TO SUBMIT WITH YOUR THESIS.

Please note the following standard requirements of approval:

1. The approval of this project is conditional upon your continuing compliance with the National Statement on Ethical Conduct in Human Research (2007).
2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 17th May 2013
Progress Report 2 Due: 17th May 2014
Progress Report 3 Due: 17th May 2015
Progress Report 4 Due: 17th May 2016
Final Report Due: 17th May 2017

NB: If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. If the project has been discontinued or not commenced for any reason, you are also required to submit a Final Report for the project.

Progress reports and Final Reports are available at the following website:
http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/

human_research_ethics/forms

3. If the project has run for more than five (5) years you cannot renew approval for the project. You will need to complete and submit a Final Report and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).

4. All amendments to the project must be reviewed and approved by the Committee before implementation. Please complete and submit a Request for Amendment Form available at the following website:

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

5. Please notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that affect the continued ethical acceptability of the project.

6. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University. This information is available at the following websites:

<http://www.mq.edu.au/policy/>

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/policy

If you will be applying for or have applied for internal or external funding for the above project it is your responsibility to provide the Macquarie University's Research Grants Management Assistant with a copy of this email as soon as possible. Internal and External funding agencies will not be informed that you have final approval for your project and funds will not be released until the Research Grants Management Assistant has received a copy of this email.

If you need to provide a hard copy letter of Final Approval to an external organisation as evidence that you have Final Approval, please do not hesitate to contact the Faculty of Arts Research Office at ArtsRO@mq.edu.au

Please retain a copy of this email as this is your official notification of final ethics approval.

Yours sincerely

Dr Mianna Lotz

Chair, Faculty of Arts Human Research Ethics Committee

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