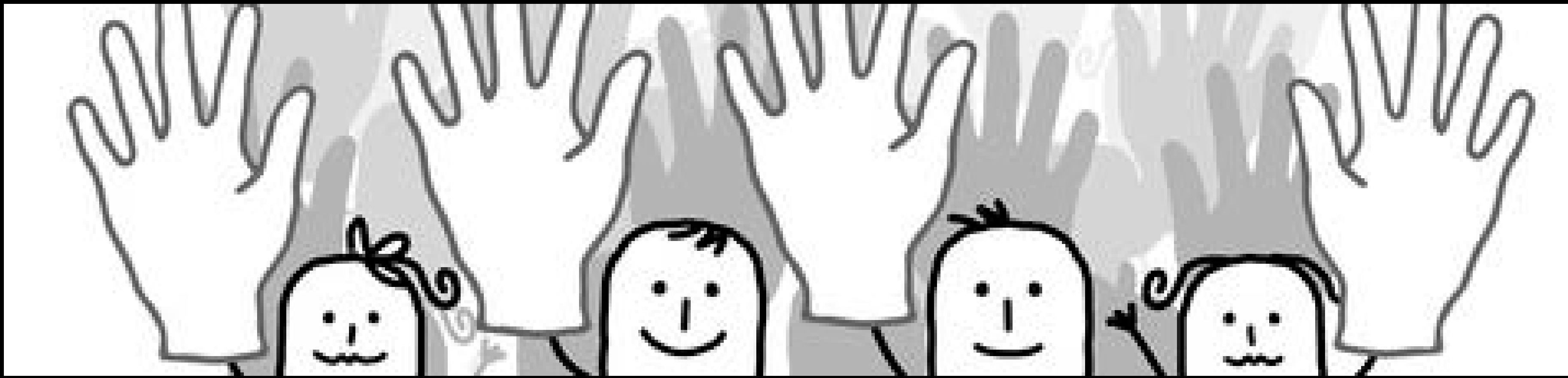
The Search for Legitimacy – The Roles of Regulation and Competition

XVth World Water Congress - Special Session SS2

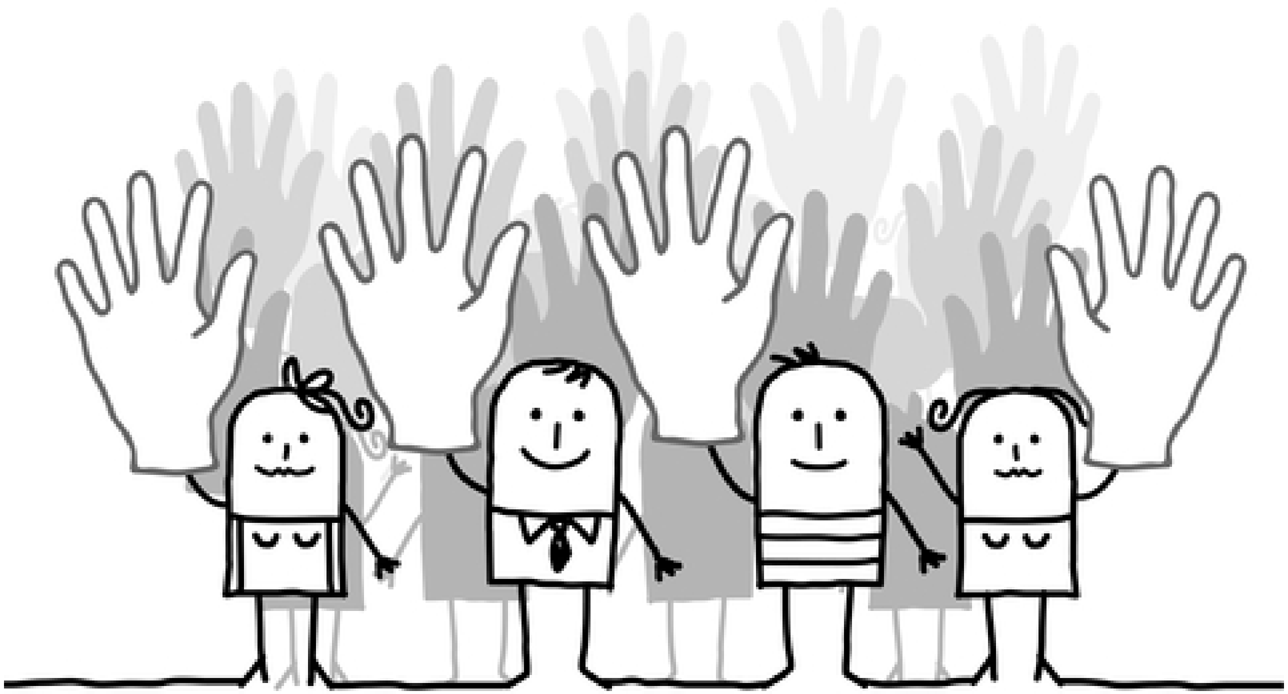


Session organised by Shepherd and Wedderburn LLP

27 May 2015

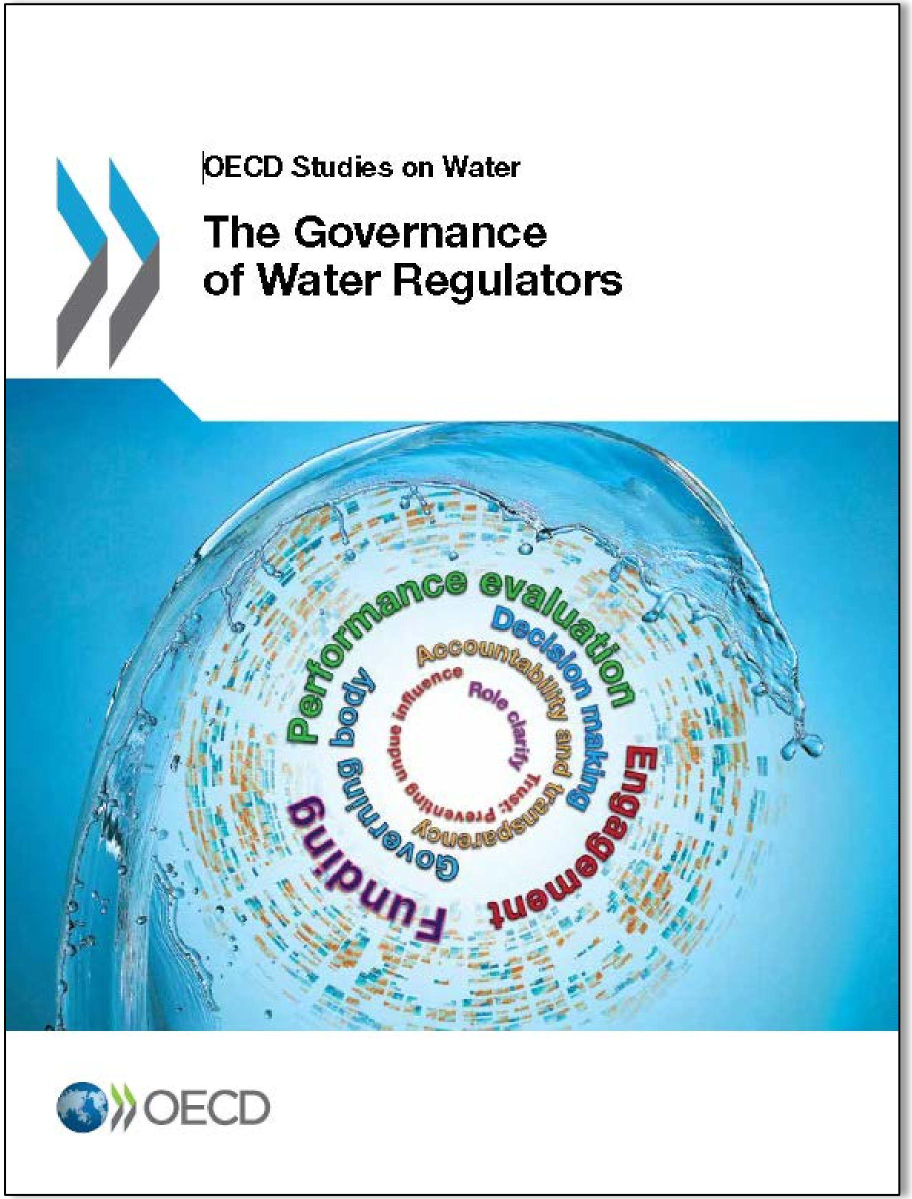
The Search for Legitimacy – The Roles of Regulation and Competition

Gordon Downie - Chair



The OECD Perspective

Céline Kauffmann



RECENT TRENDS IN THE REGULATION OF WATER SERVICES

Céline Kauffmann
Deputy Head
Regulatory Policy Division
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2015 IWRA
27 May 2015

OCDE
DES POLITIQUES MEILLEURES POUR UNE VIE MEILLEURE

Why regulate?

- Monopolist sector
- Asymmetry of information
- Balance economic, social and environmental interests
- Important externalities
- Fragmentation of actors

Alternative models of water service regulation

Regulation by government

Austria
Germany
Netherlands

Regulation by contract

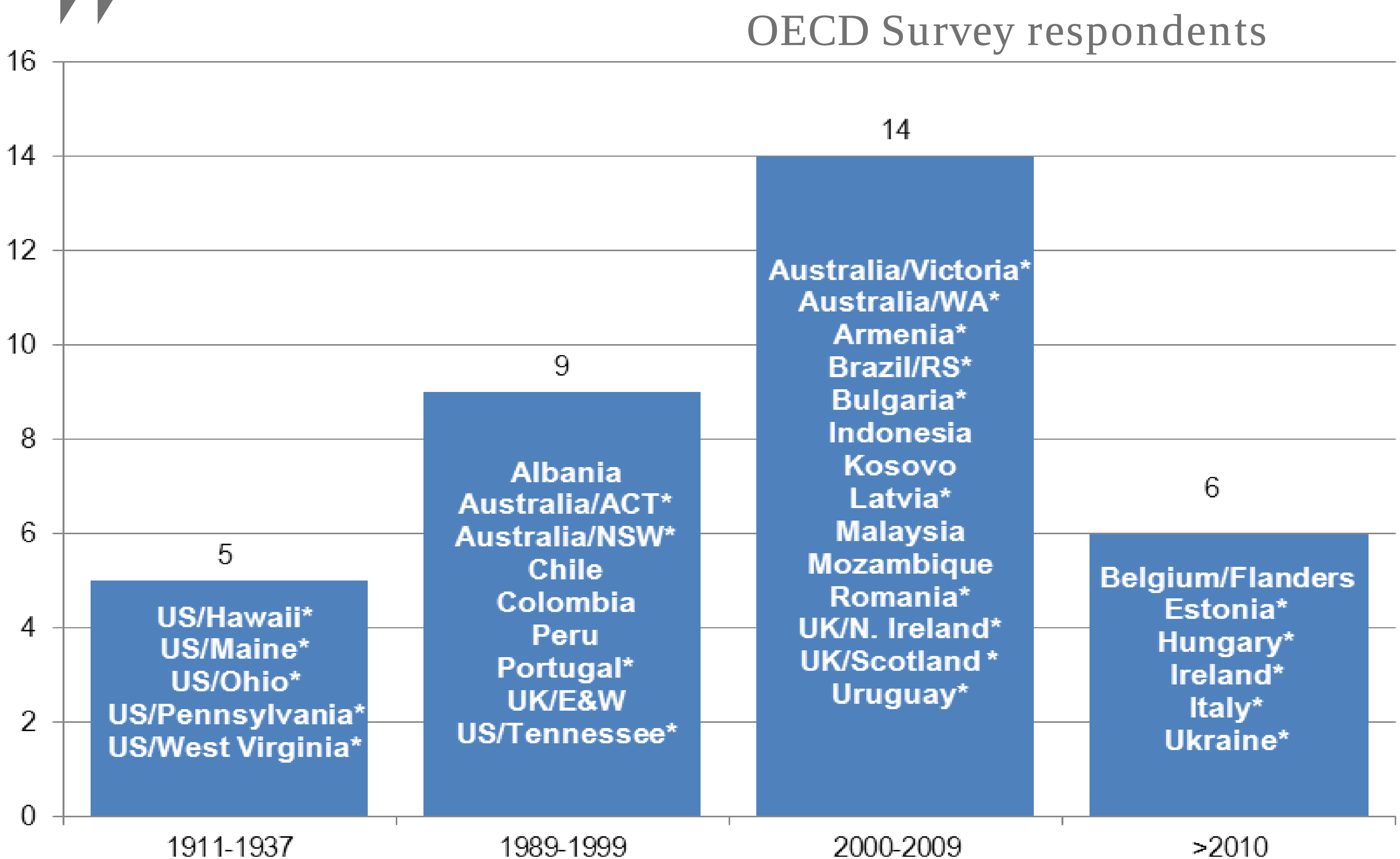
France

Independent regulation

UK
Italy
Portugal

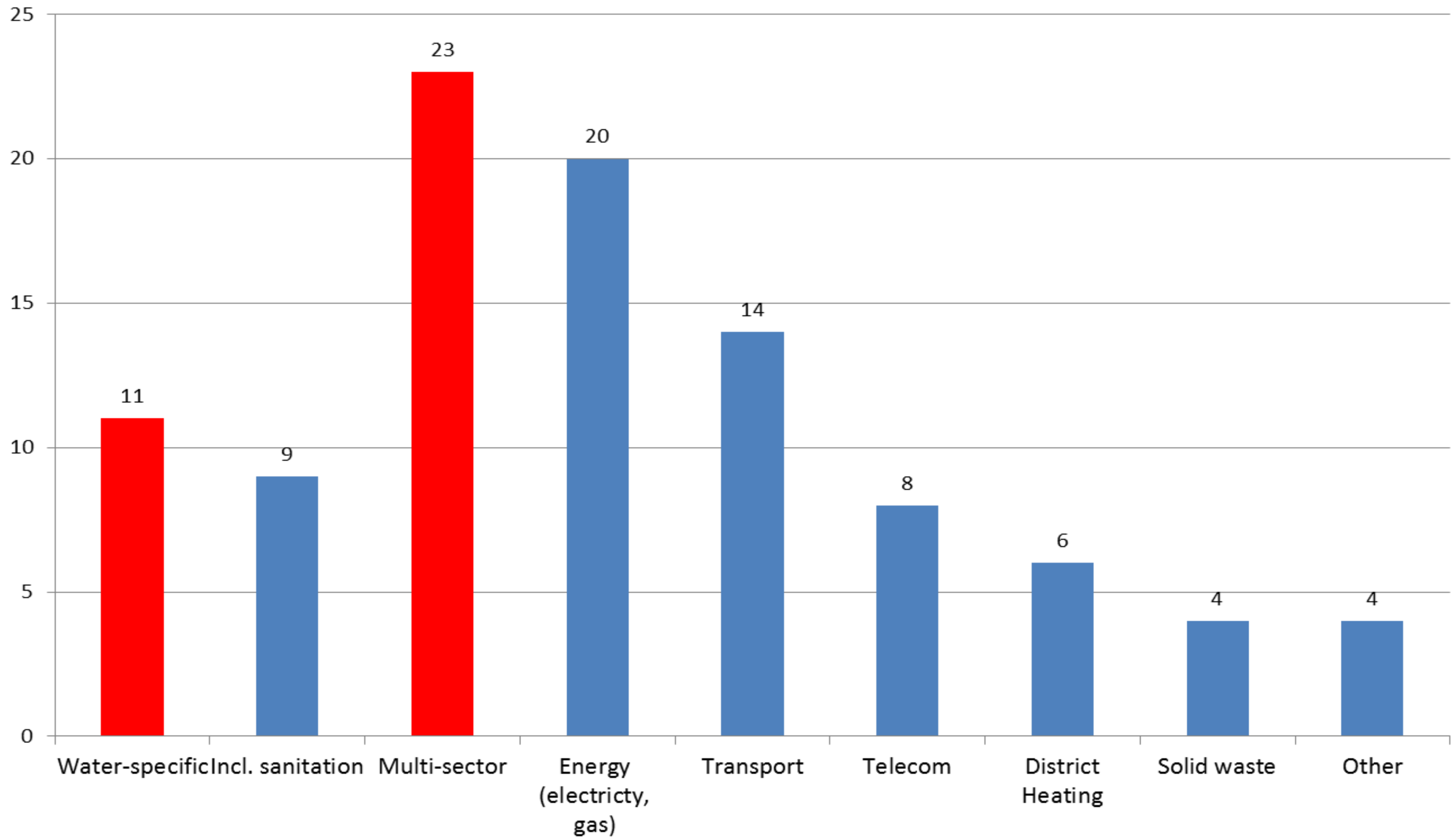
Regulatory functions for WWS
Tariff regulation
Quality standards for drinking water
Quality standards for wastewater treatment
Defining public service obligations / social regulation
Defining technical / industry and service standards
Setting incentives for efficient use of water resources
Setting incentives for efficient investment
Promoting innovative technologies
Promoting demand management
Analysing water utilities’ investment plans / business plans
Information and data gathering
Monitoring of service delivery performance
Licensing of water operators
Supervision of contracts with utilities / private actors
Supervising utilities’ financing activities
Carrying management audits on utilities
Customer engagement
Consumer protection and dispute resolution
Advice and advocacy

Establishment of water regulators



Source: OECD (2015), The Governance of Water Regulators

What is in their portfolio?

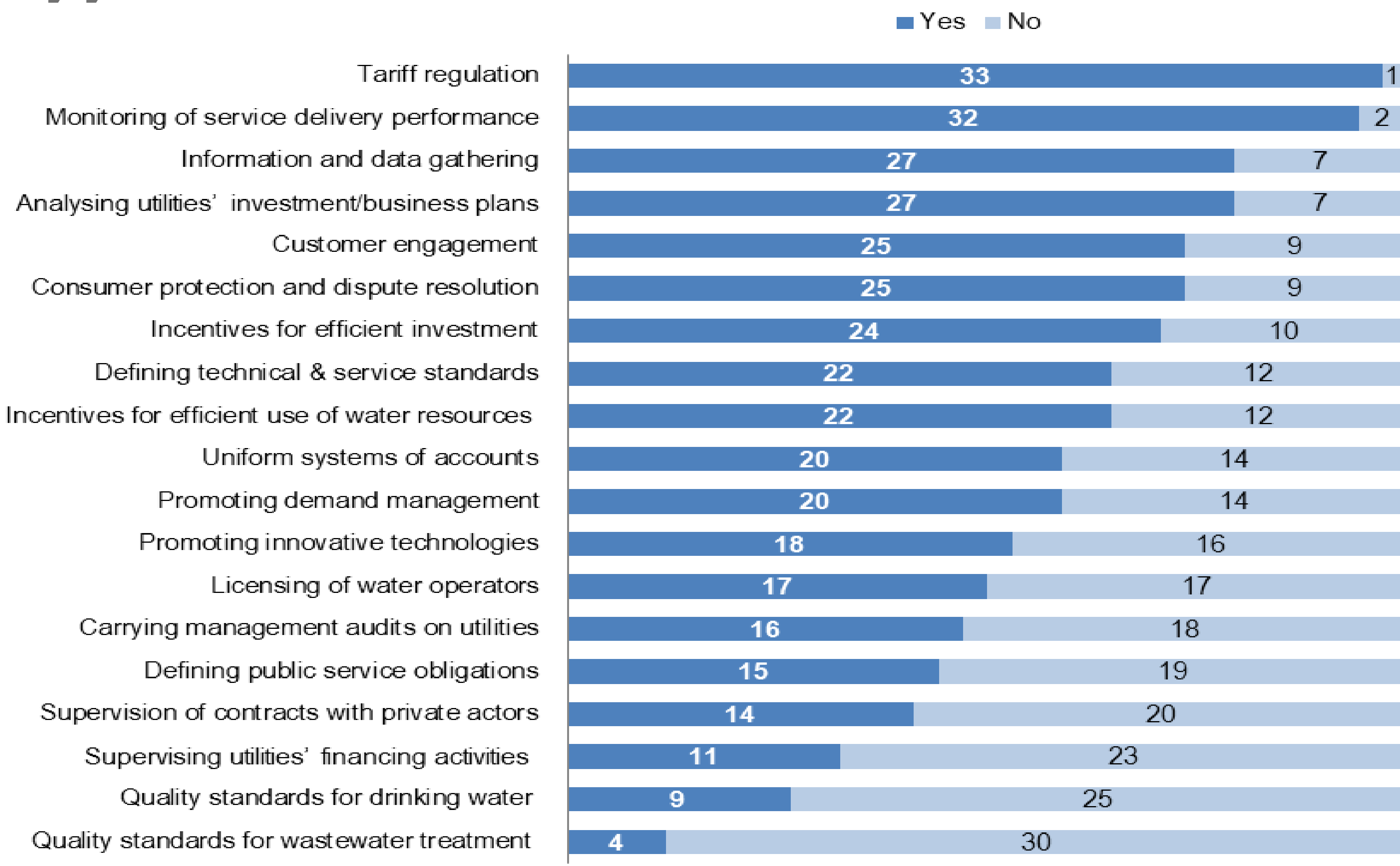


Source: OECD (2015), The Governance of Water Regulators

Why are water regulators established?

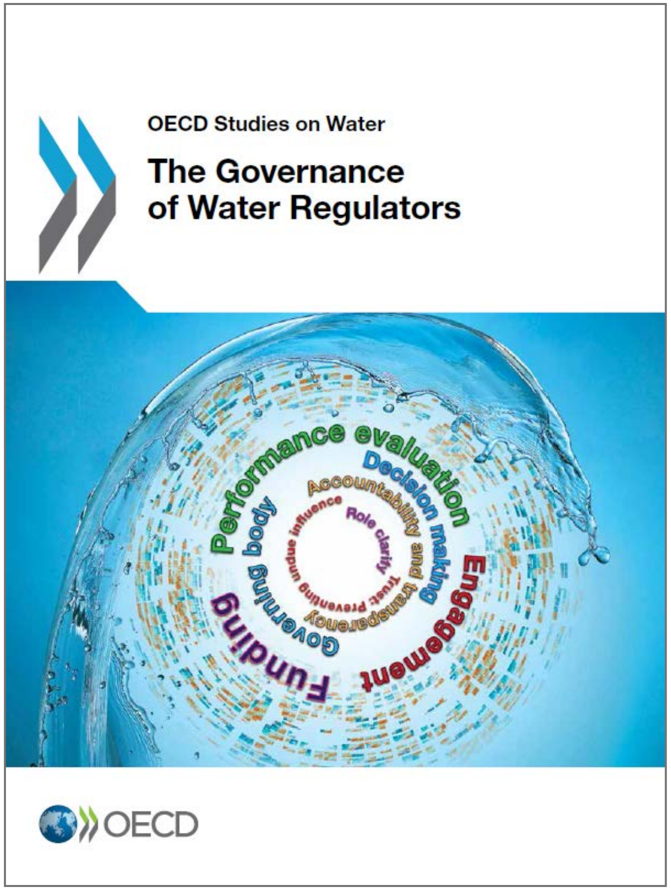
Source: OECD (2015), The Governance of Water Regulators

What do they do (functions)?



Source: OECD (2015), The Governance of Water Regulators

Thank you!



Documenting the features of a sample of 34 water regulators

Based on a detailed survey drawing on the Governance of Regulators Principles

Developed in close co-operation with the water regulators of the Network of Economic Regulators

Launched at the World Water Forum on 13 April 2015 in Korea

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www.oecd.org/gov/the-governance-of-water-regulators-9789264231092-en.htm

Their institutional landscape

National or State/Regional level

Government

Ministry of Environment
All but Mozambique

Ministry of Finance
Ex: Uruguay, Chile, Australia/NSW

Ministry of Transport and Infrastructure
Ex: Albania, Italy

Ministry of Housing
Ex: Bulgaria, Colombia, Indonesia, Romania, Ukraine,

Ministry/Department of Agriculture
Ex: US

Ministry of Health
All but Armenia, Estonia, Ireland, Portugal, UK/England & Wales, Uruguay

Ministry of Economic Development and Trade
Ex: Albania, Kosovo, Ukraine

Ministry of Economy
Ex: Bulgaria, Chile, Latvia, Uruguay

Ministry of public works
Ex: Belgium/Flanders, Bulgaria, Chile, Indonesia, Mozambique

Public agencies

Economic Water Regulator

Environmental agencies
Ex: Australia, Belgium, Scotland, Hungary, Ireland, Portugal, UK/England & Wales, US

Competition Authorities
Ex: Australia/ACT, Bulgaria, Portugal, UK/England & Wales, Ukraine

Other stakeholders

Ombudsman
Ex: Australia, Indonesia, UK/Scotland

Customer Association/Commission
Ex: Australia, Romania, UK/England & Wales, US

Water Association
Ex: Australia, Brazil, Bulgaria, Romania, US

Operators / Associations Operators
Ex: Australia, Bulgaria, Ireland, Italy, Kosovo, Portugal, UK/England & Wales, US

Association of regulatory agencies
Ex: Brazil/RGS, US

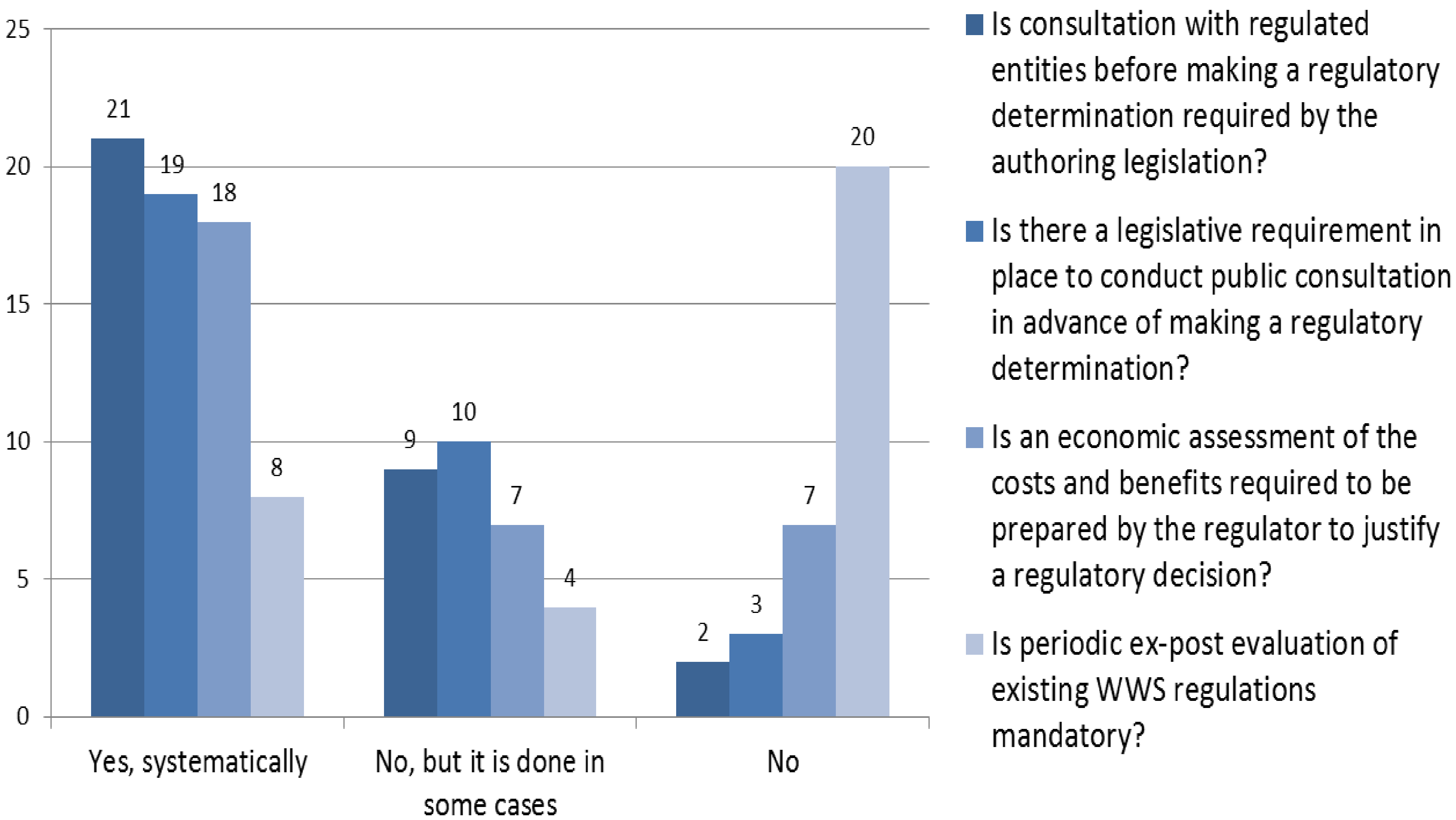
Local level

Municipalities and local authorities
Ex: Albania, Belgium/Flanders, Brazil/RGS, Bulgaria, Colombia, Estonia, Indonesia, Italy, Malaysia, Portugal

Operators

Source: OECD (2015), The Governance of Water Regulators

How do they ensure regulatory quality?



Source: OECD (2015), The Governance of Water Regulators

The Legitimate Role of the Economic Regulator

Alan Sutherland

water industry commission FOR SCOTLAND

XVth World Water Congress - Special Session SS2
The Legitimate Role of the Economic Regulator

Edinburgh International Conference Centre, Edinburgh
27 May 2015

Alan D A Sutherland
Water Industry Commission for Scotland

www.watercommission.co.uk

The OECD defines three principal models for the regulation of water and waste water services. Not surprisingly, the OECD's 'English' model dominates in the UK.

England & Wales	Scotland	Northern Ireland
Ofwat	Water Industry Commission for Scotland	Utility Regulator of Northern Ireland
Companies are privatised	Scottish Water is publicly owned	Northern Ireland Water is publicly owned
Ofwat's statutory duties are complex and go beyond simple price setting	The Commission has to set charges consistent with the Scottish Government's Objectives for the water industry and its principles of charging	Statutory duties are closely modeled on Ofwat's (because NIW was originally to be privatized)

How can we make economic regulation as effective as possible?

- How does a regulator address the inevitable asymmetries in information that exist with the regulated company?

- How does a regulator allow for and encourage innovative approaches by the regulated company?

- How does a regulator ensure that customers' interests are properly reflected in the trade-offs that have been made in the price-setting process?

How does a regulator address the inevitable asymmetries in information that exist with the regulated company?

- By creating change
- By asking broader questions
- By challenging the regulated company with reference to other sectors or customer experiences

How does a regulator allow for and encourage innovative approaches by the regulated company?

- By avoiding change!
- By open dialogue
- Focusing on cash, not total expenditure

How does a regulator ensure that the customers' interests are properly reflected in the trade-offs that have been made in the price-setting process?

- Competition where possible

- Involving customers, where it is not….

There are perhaps three key conclusions that can be drawn from the UK experience

Conclusion 1

- Clarity in the governance arrangements and in the respective roles of the different organizations is critical

Conclusion 2

- The mixed economy was vital in getting Scotland established on the right path
- But the profit incentive does not necessarily seem to be correlated with better performance, environmental compliance or innovation
- Rather it is reputation that seems to drive managements

Conclusion 3

- Customer engagement, both in deciding how to make the best of the current arrangements and also to help policy makers achieve better outcomes, is likely to become increasingly important.
- The Holy Grail is to achieve a water company that responds to its customers as if it could lose them…

The Role of Customer Engagement in Securing / Promoting Legitimacy

Stephen Littlechild

Regulation and the search for legitimacy: the Customer Forum

Stephen Littlechild

World Water Congress XV

Edinburgh, 27 May 2015

OECD Context

- Water is a highly capital-intensive and monopolistic sector, with important market failures where coordination is essential
- Water policy is inherently complex & linked to health, environment, agriculture, energy, regional development and poverty alleviation
- Principle 10: Engage with stakeholders within and outside the water sector for meaningful, informed and outcome-oriented contribution to decision-making and implementation

Customer engagement

- Can customer engagement increase legitimacy?
  - Monopoly – scope for water competition limited
  - Policy complex – need for government role
  - What impact on customers? Is it what they prefer?
  - If customers support policy, this aids legitimacy
- What forms can customer engagement take?
  - US: negotiated settlements
  - UK: customer engagement in airports
  - UK: customer engagement in energy and water
  - Scottish Water sector: the Customer Forum

US Negotiated Settlements

- “If you can agree, we don’t need to act”
- US Federal Power Commission 1960s - backlog of cases – resolved by settlements
- Fixed period rate freezes – more certainty for both parties, better efficiency incentives
- Florida PUC 1980s/90s – settlements got better terms for customers, better incentives
- Canada National Energy Board from 1997 - better incentives, better relationships

UK Customer Engagement

- Civil Aviation Authority 2005 proposed constructive engagement at airports
  - Asked airlines & airports to agree traffic forecasts, quality of performance standards, future investment
  - CAA retained responsibility for opex, cost of capital, financing and final price control
- Despite initial scepticism, it worked
  - And improved understanding and relationships
  - Repeated in 2010 where competition not possible

Water and energy networks

- Fast track reviews for well-prepared plans supported by informed customers
- Company plans reflected customer views
- Companies & customers very supportive
- Regulators praised process & outcomes
    - Except for operating cost projections
    - So only the “best” were fast-tracked, others rejected
- Was customer engagement pointless?
- Future challenge: how to reconcile fast-tracking with customer engagement?

Scotland, Water Regulation & Customer Forum

- Regulator (Water Industry Commission for Scotland - WICS) wanted more effective regulation & more customer representation
- Created the Customer Forum with Scottish Water (Co.) & Consumer Focus Scotland
- Remit: research programme to ascertain & represent customers views in price review
- Later: to seek to agree Business Plan with Scottish Water – basis of price control?

Customer Forum in practice

- Guidance: to be consistent with WICS views to be conveyed through the process
- WICS issued guidance notes throughout
  - On costs, capex, efficiency, performance standards
  - And responded to CF & SW enquiries & concerns
- Enthusiastic & effective participation by all
- Reached agreement on Business Plan
- WICS Draft Determination consistent with it

Conclusions

- OECD: Some aspects of water sector where competition not feasible, and
- Need to involve public interest guidance
- Customer engagement can harness customer views consistent with this
- E&W challenge to reconcile with efficiency
- Customer Forum achieved this: legitimacy
- Scope to extend to other countries too? Yes

Legitimising Customer Charges through Customer Choice

Liz McRobb

SHEPHERD+ WEDDERBURN

XVth World Water Congress

Retail competition: new markets, new regulation

Presented by **Liz McRobb**, Shepherd+ Wedderburn LLP.

EICC, Edinburgh, 27 May 2015

Why regulate to open markets?

The Scottish experience shows that regulation or "setting the rules" is a hugely important aspect of developing the conditions in which competition can flourish

The English experience is that negotiated access has not succeeded

- Privatisation without competition?
- Albion Water competition law challenge
- English reform: Water Act 2014 amending/building on the Water Industry Act 1991

"*Without referees and a rule book, competition becomes self-defeating. Much like giving all the players in the football game their own whistle" Alexander Italianer, DG for Competition, European Commission*

The case for regulated access

Without rules, new markets do not spontaneously erupt

With the wrong rules, markets do not flourish

- Water privatisation in England and Wales and the threshold for large customers – negotiated access, lack of switching

But often there is a need to start somewhere and move towards full market opening e.g. rail and energy – three EU regulatory packages with more work to do

Developing the legal and regulatory framework

The Scottish experience – discussed by others at this Conference

The English experience – in the midst of developing the rules that will support retail competition for business customers

Water Act 2014

DEFRA established High Level Group to oversee implementation – market opening April 2017

HLG set up industry Open Water Programme – developing the codes, agreements, market governance and central systems and processes needed to support retail competition

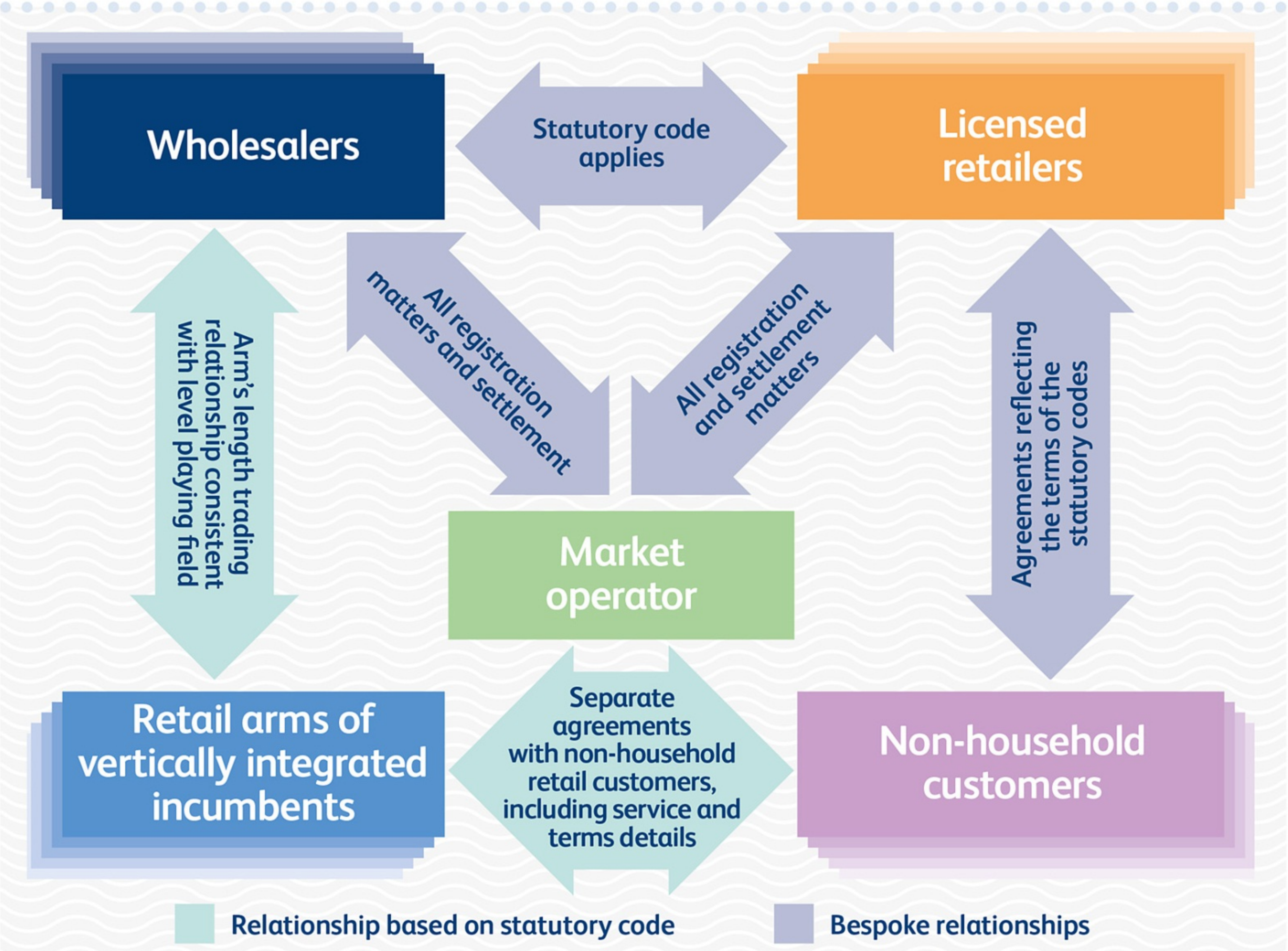
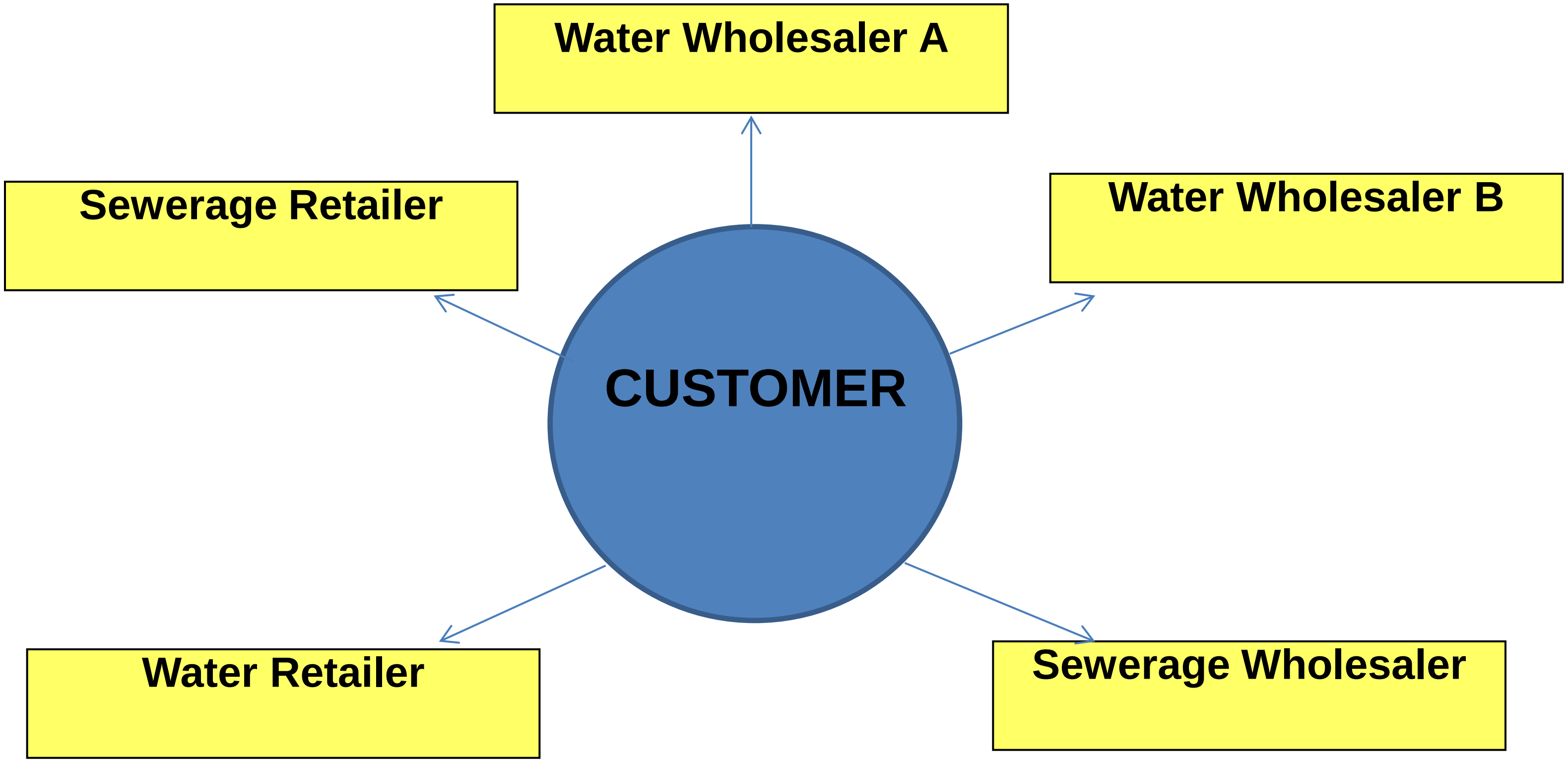


Figure 3: How the non-household retail market will work

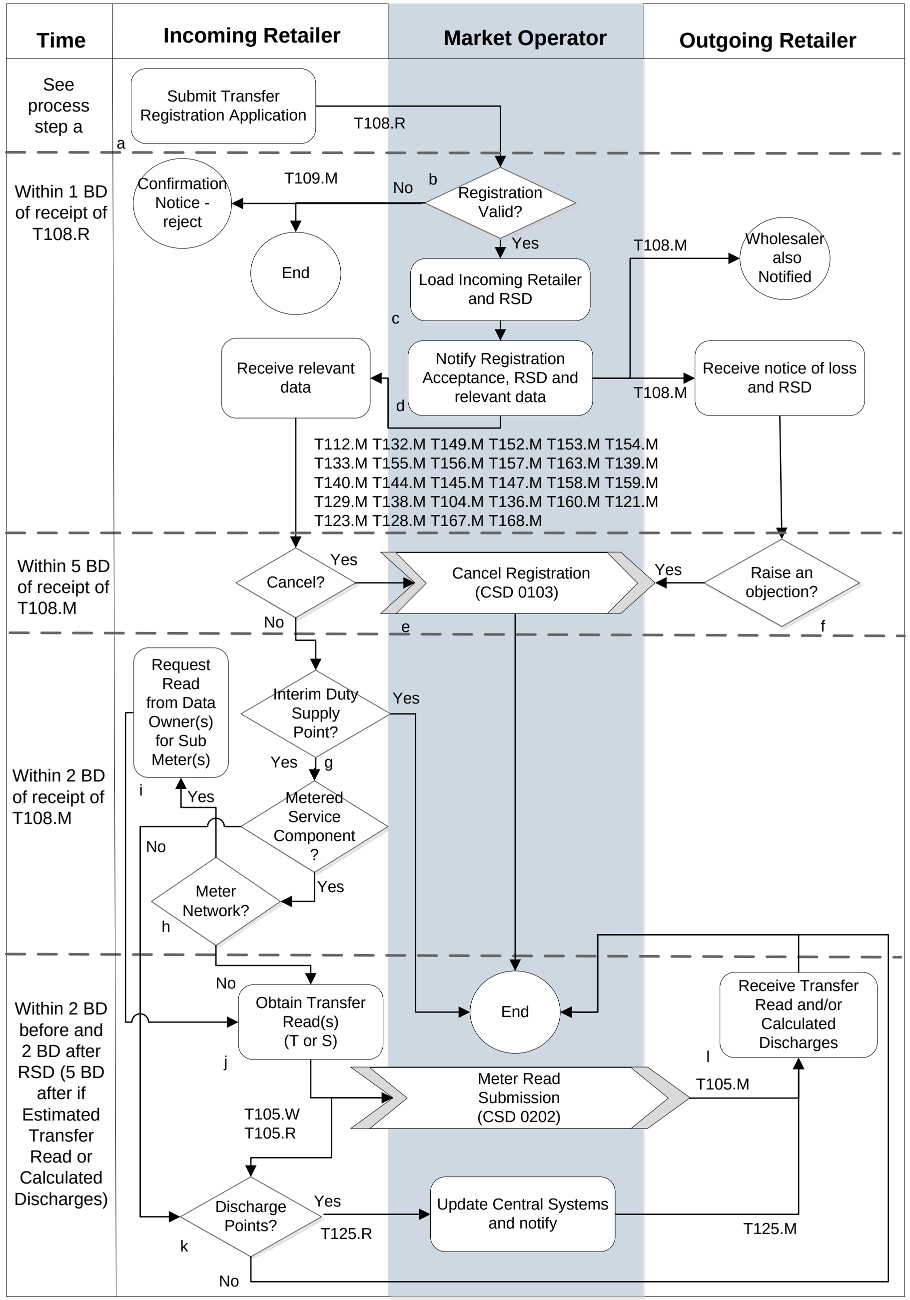
The main players and their roles

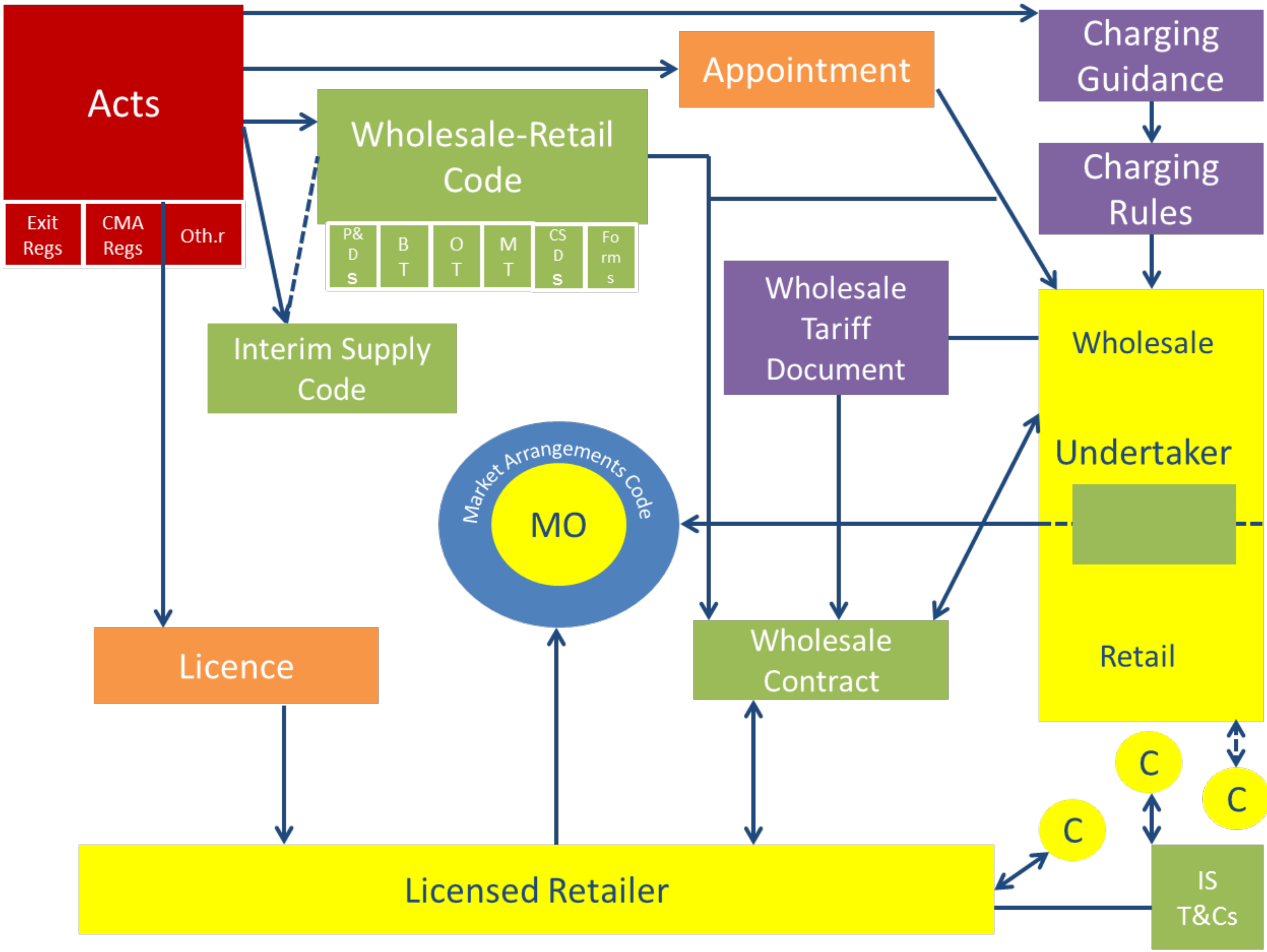
- Multiple wholesalers - water and sewerage companies, water only companies, inset appointments – wide variation in scale and sophistication
- Retailers – integrated within an incumbent monopoly business, legally separated within an incumbent’s group, new entrant retailers
- Market operator – industry owned not for profit – holds register of all customers, records switches, calculates sums due by each retailer to each wholesaler
- Government – setting policy via the 2014 Act, setting charging guidance, developing exit regulations, enabling regulations to support appeals of regulatory decisions to the CMA, timely commencement of legislation
- Ofwat – implementing policy by developing the statutory codes, licensing framework, charging rules, enforcing code compliance
- Other key stakeholders – Drinking Water Inspectorate, Environment Agency
- CUSTOMERS!

The need for standard rules – building customer confidence



Registration Transfer




Acts
Exit Regs
CMA Regs
Oth.r
Appointment
Charging Guidance
Charging Rules
Wholesale-Retail Code
P& D s
B T
O T
M T
CS D s
Fo rm s
Interim Supply Code
Wholesale Tariff Document
Wholesale
Undertaker
Retail
Market Arrangements Code
MO
Licence
Wholesale Contract
C
C
C
IS T&Cs
Licensed Retailer

Lessons learnt

- Creating the legal and regulatory framework is an art not a science
- Interaction of legislation, licensing and codes is crucial
- Essential to recognise it will never be “right”/”perfect”
- But essential to make a start and create the right governance conditions to allow the market rules to evolve with the market
- Results so far in Scotland
  - Annual Gross Value c. £375m/$580m
  - Estimated net customer saving £138m/$230m (‘09/10 prices)
  - C. 20% customers switched
  - Over 2/3rds of customers have negotiated a better price and/or service
  - £37m/$62m over 4 years direct public sector saving
  - Estimated set up costs £22.5m (’09/10 prices), pay back circa 5 years after market opening.
- What will we be able to say for England by 2020?

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Questions?

Thank you

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