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# The Search for Legitimacy – The Roles of Regulation and Competition

XVth World Water Congress - Special Session SS2

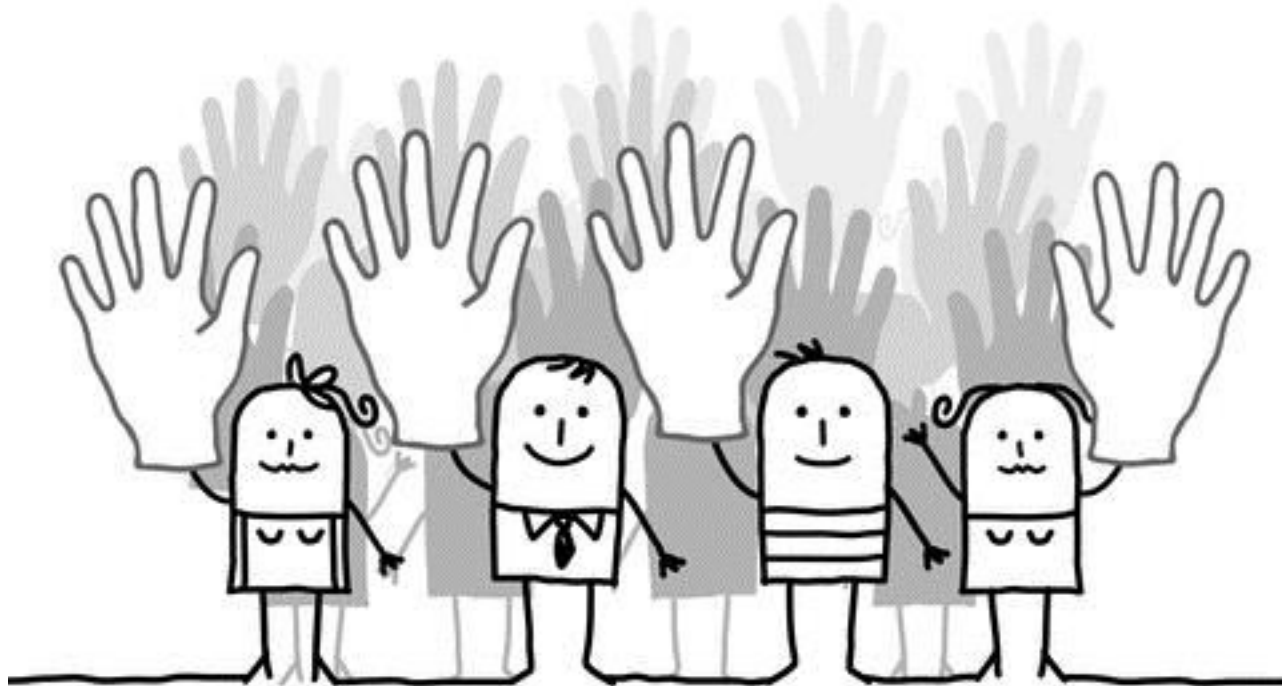


Session organised by Shepherd and Wedderburn LLP

27 May 2015

# The Search for Legitimacy – The Roles of Regulation and Competition

Gordon Downie - Chair



# The OECD Perspective

Céline Kauffmann

OECD Studies on Water  
**The Governance  
of Water Regulators**

Performance evaluation  
Decision making  
Engagement  
Funding  
Governing body  
Accountability and influence  
Role clarity  
Trust, preventing and transparency

OECD

# The Legitimate Role of the Economic Regulator

Alan Sutherland



# The Role of Customer Engagement in Securing / Promoting Legitimacy

Stephen Littlechild



# Legitimising Customer Charges through Customer Choice

Liz McRobb





# RECENT TRENDS IN THE REGULATION OF WATER SERVICES

Céline Kauffmann  
Deputy Head  
Regulatory Policy Division  
Public Governance and Territorial Development Directorate

2015 IWRA  
27 May 2015



# Why regulate?

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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**

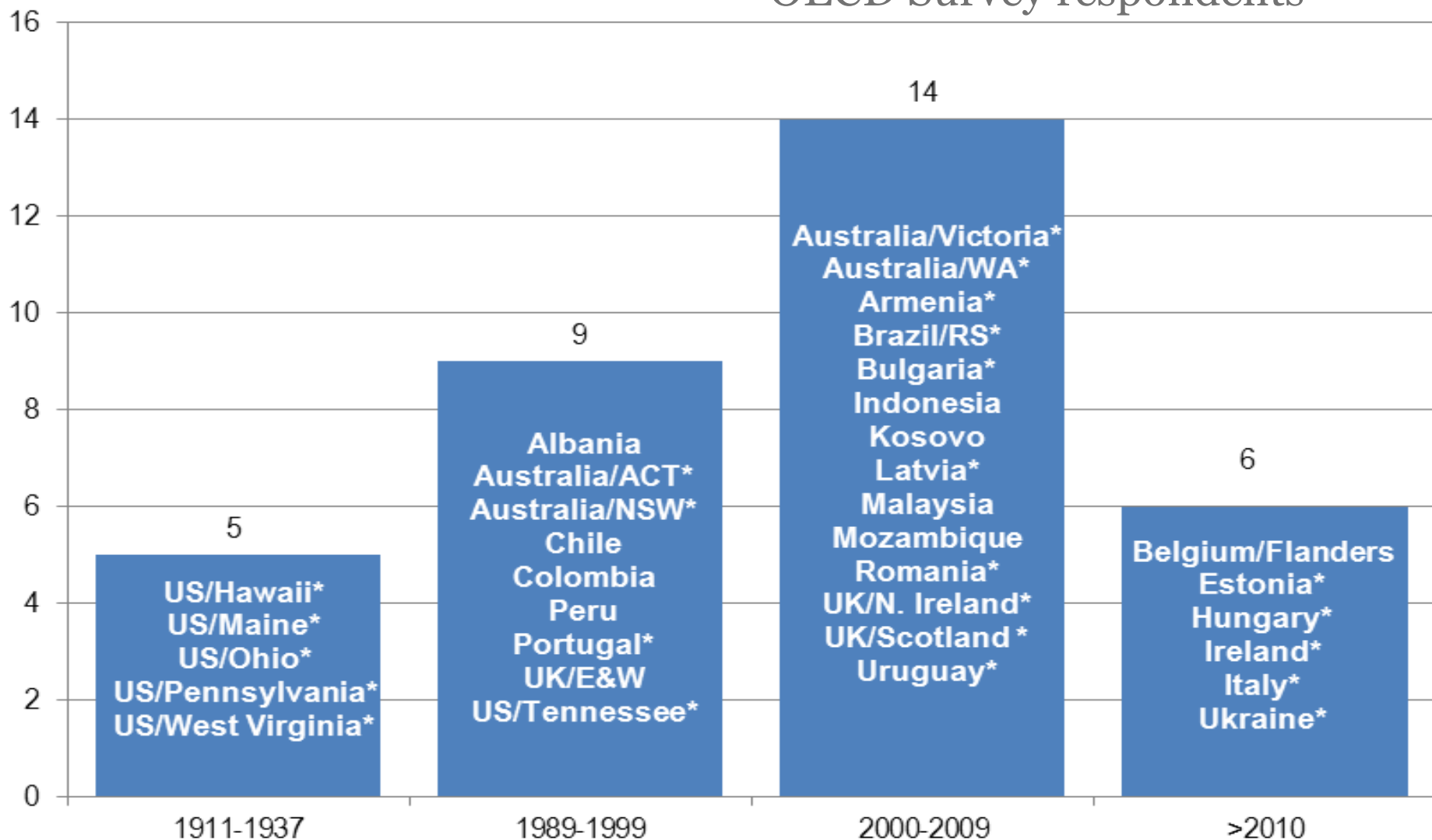
**Consumer protection and dispute resolution**

**Advice and advocacy**



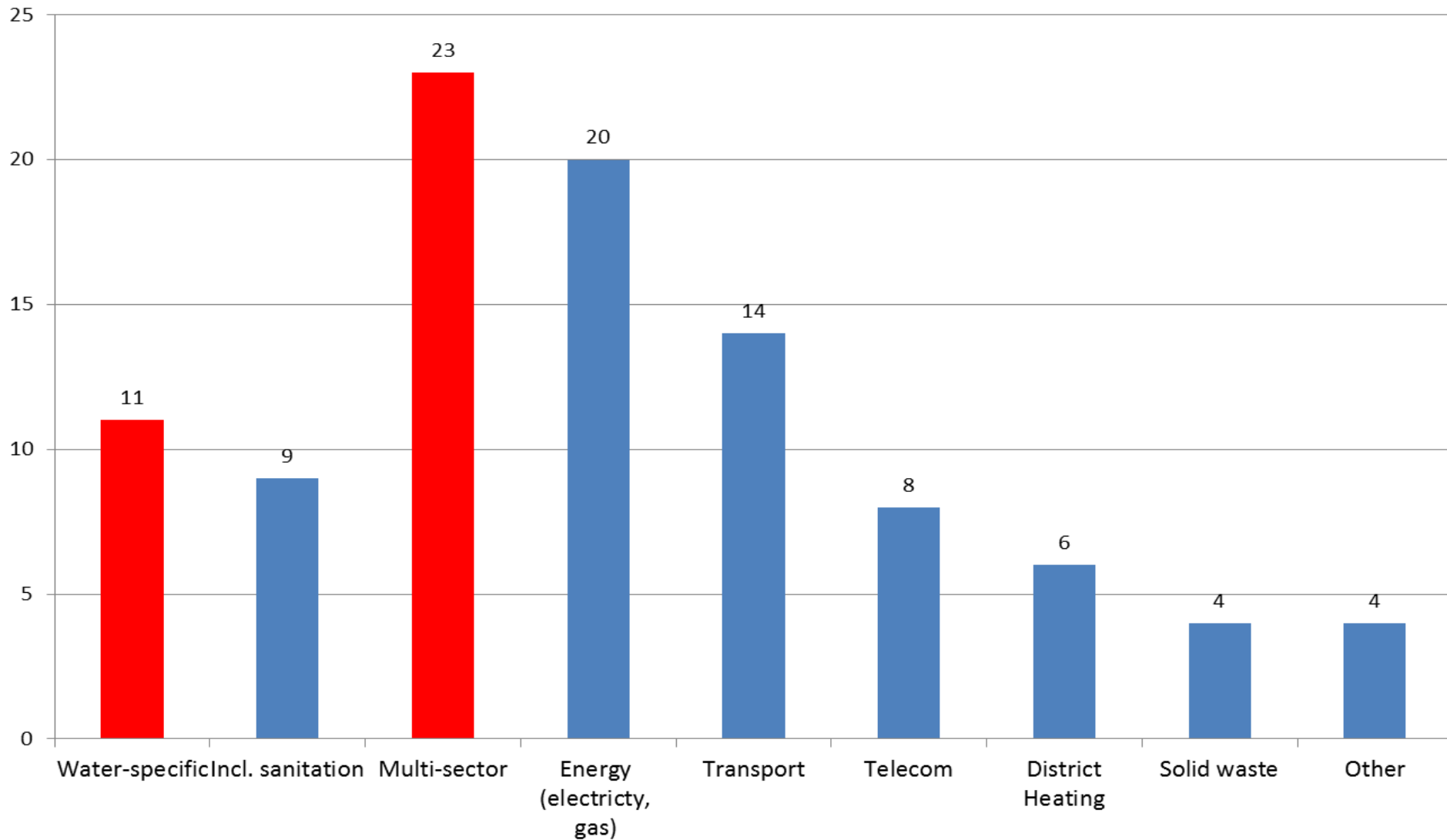
# Establishment of water regulators

OECD Survey respondents





# What is in their portfolio?



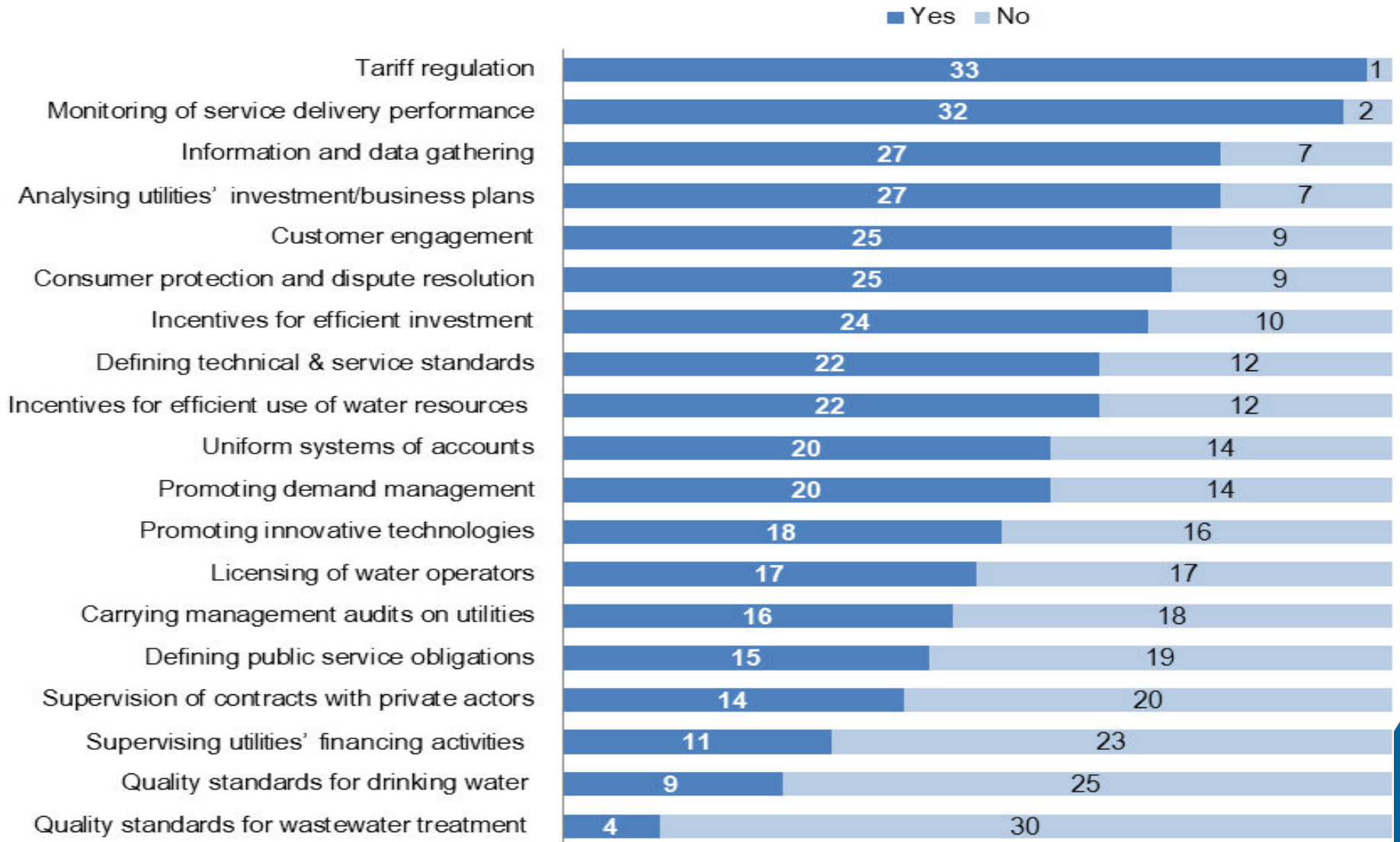


# Why are water regulators established?



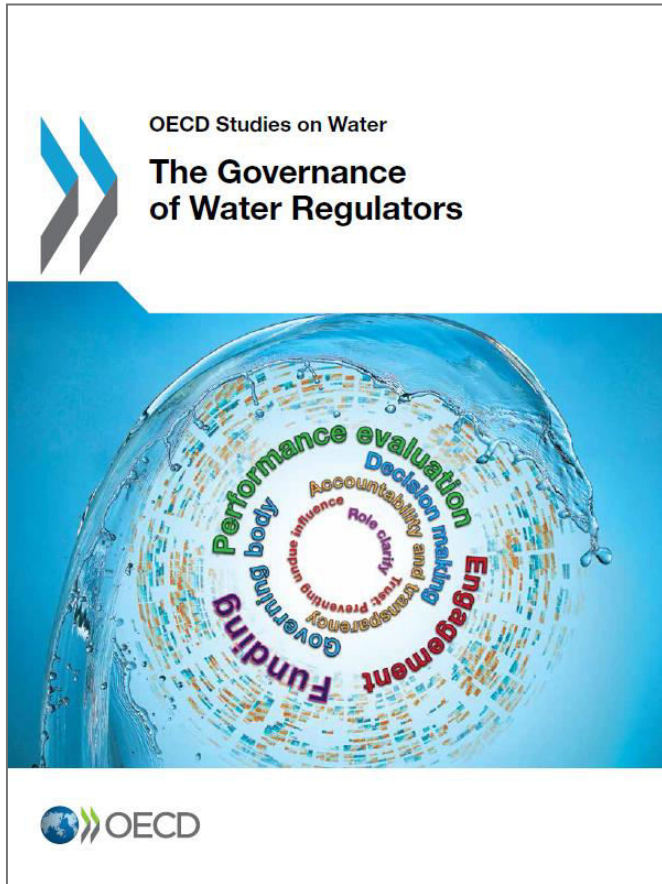


# What do they do (functions)?





# 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](http://www.oecd.org/gov/the-governance-of-water-regulators-9789264231092-en.htm)

# 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](http://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...

# 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



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# XVth World Water Congress

## Retail competition: new markets, new regulation



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

EICC, Edinburgh, 27 May 2015



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## Why regulate to open markets?

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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*



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## The case for regulated access

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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



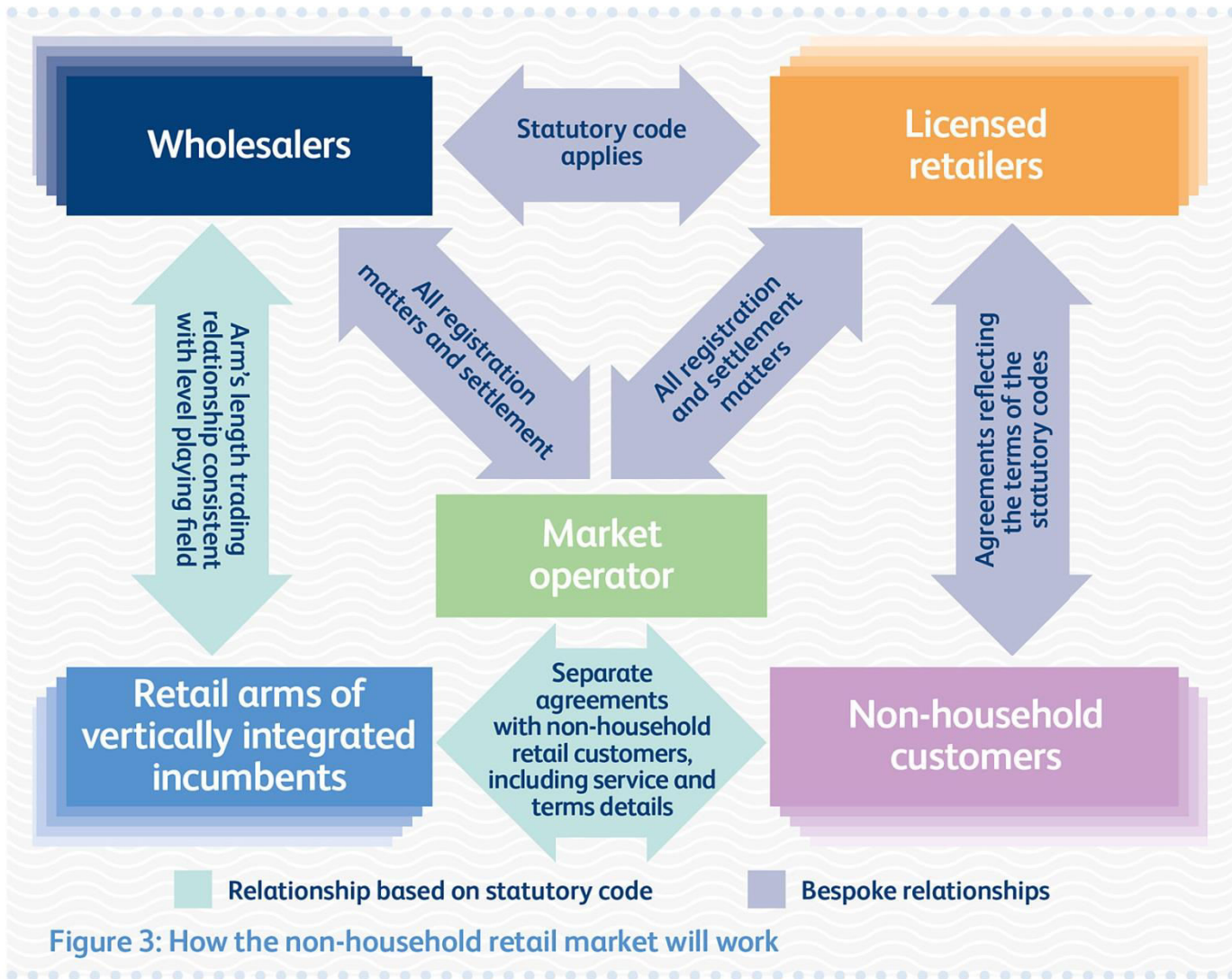


Figure 3: How the non-household retail market will work

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## The main players and their roles

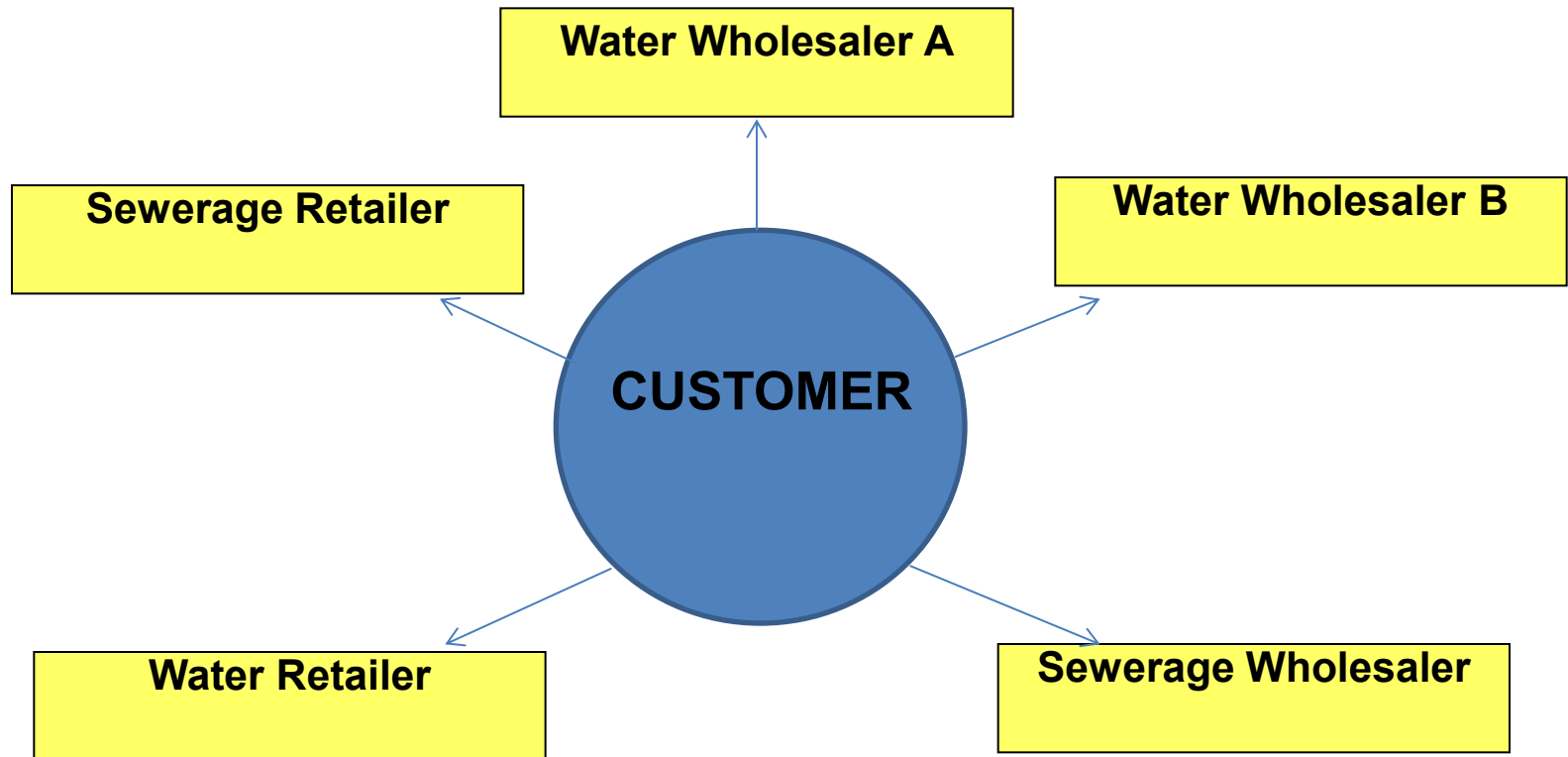
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- Multiple wholesalers - water and sewerage companies, water only companies, inset appointments – wide variation in scale and sophistication
- Retailers – integrated within an incumbent monopoly business, legally separated within an incumbent's group, 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!

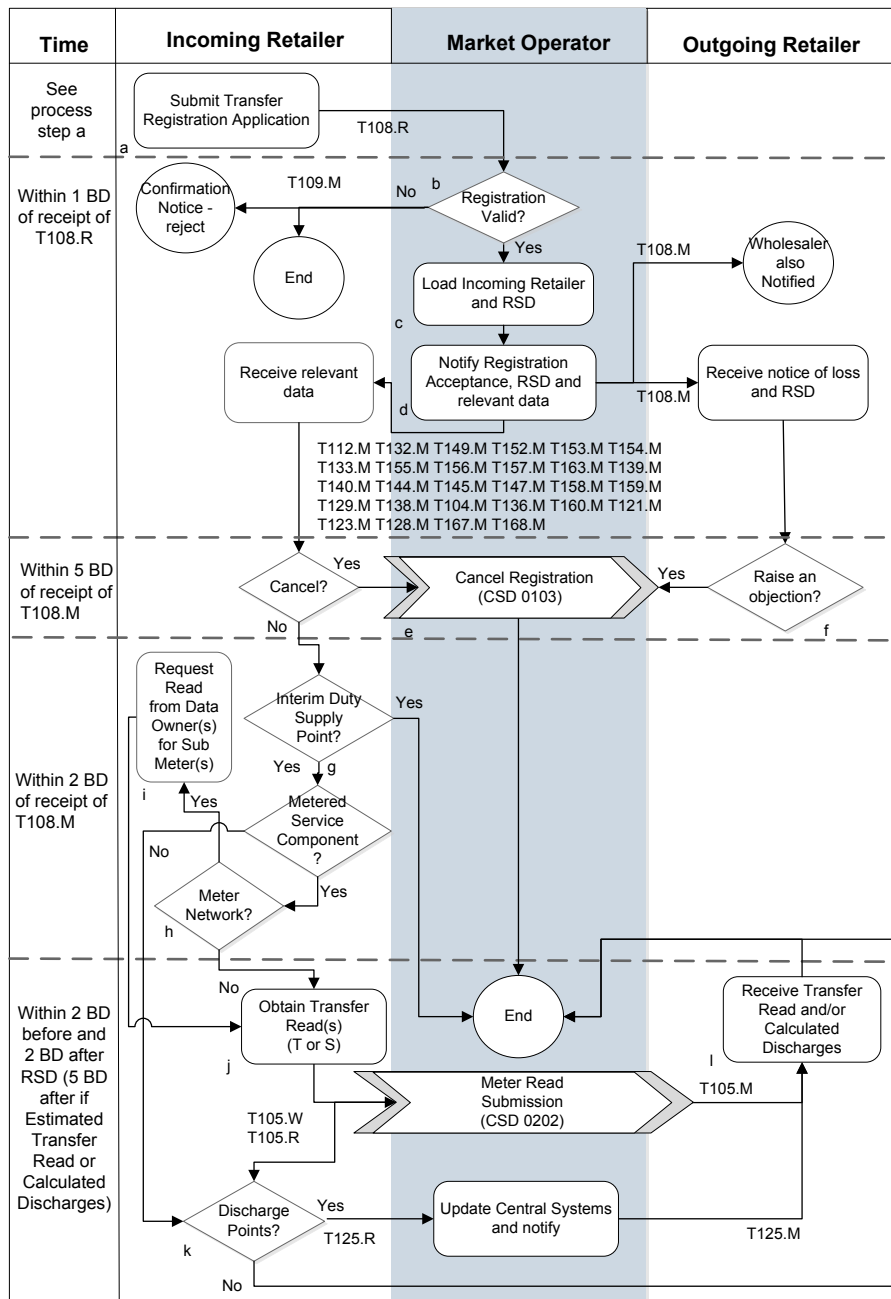
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## The need for standard rules – building customer confidence

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### Registration Transfer







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## Lessons learnt

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- 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?

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# Thank you

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