



*Incentivising Investments:
Ideas from the Americas*

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(with thanks to Stephen Littlechild!)



Regulating Investment

- Regulation of investment within RPI-X the least satisfactory part of UK regulation.
- In the future the demands are set to increase.
- Need proper incentives for innovation, quality, and cost control based on consumer preferences.
- Regulatory value added needs to be proven and risk of decisions shifted appropriately.
- This is especially important in the light of wide variety of futures that are possible (LENS).

Argentina background

- Argentina electricity reform 1992
 - Per UK: restructuring, privatisation, competition, incentive regulation of existing T and D networks
- Mistrust of regulation
 - Decided that transco & regulator should not be responsible for new transmission investment
- Public Contest method
 - Users to propose, vote & pay for major expansions
 - Construction O&M (COM) out to competitive tender

Fourth Line to Buenos Aires

- Congestion increasing on this corridor
- Sept 1994 3 generators proposed 4th Line
 - With COM fee about \$58m p.a. over 15 years
- Feb 1995 Public hearing 50% vote against
 - Surprise and concern, including by regulator
- May 1996 revised proposal - accepted
 - Proposed max fee \$55m p.a.
 - Nov 1997 winning bid \$35.5m p.a.

Competition in construction

- Bidding competitive: typically 2-3 bids (58 cases)
- $\frac{3}{4}$ won by independent cos
- 4th Line: 4 bidders 13 bids (alternatives)
 - introduced innovative technologies
- Cost reductions over time
 - pre-reform at least \$230k/km
 - 1st & 2nd tenders (Govt) \$267k/km, \$170k/km
 - 4th Line \$130k/km - so cost/km about halved
- Bidding to construct was very successful

Regulation in Florida

- Public Service Commission FPSC 1897
 - 386 staff, budget \$27m
- Office of Public Counsel OPC 1974
 - duty “to represent the general public of Florida”
 - staff 15, budget \$2.5m plus consultants
 - single incumbent Public Counsel 25 years
- Scepticism about US consumer advocates
 - limited effect? tend to favour larger users?
 - Is this true in Florida?

Stipulated settlements in Florida

- Public Counsel represents customers
 - by challenging utility in regulatory hearings
 - also by negotiating stipulated settlements with utility, then inviting FPSC to approve
- FPSC staff not involved in negotiations
- All stipulations accepted in total
 - no cherry-picking (unlike California)
- 29 earnings reviews with OPC stipulations 1976-2002.

Who benefits?

- Cost savings relatively small (<1% value)
- Customers: bigger and earlier rate reductions
 - Confirm larger users benefit more in some ways
- Utilities get what FPSC could/would not give
 - Removal of objections by others (e.g. to merger or in court)
 - Flexibility on accounting provisions (depreciation)
 - Price caps (up to 4-years) and revenue sharing (instead of profit caps or earnings sharing)
 - often despite initial objections of regulatory staff
 - More innovative forms of incentive regulation
 - Have almost superceded electricity hearings since 1995₈

Settlements at NEB in Canada

- NEB regulates oil and gas pipelines
- since about 1995 almost all regulatory issues here have been covered by settlements between pipelines and users (producers, shippers and consumers)
- this has halved number of hearings and halved average time per hearing, so total hearing time down by three quarters

Nature of settlements

- Scope of settlements has been very varied
 - tariffs, opex, ROE, service quality, capex programs
- multi-year incentive programs
- transition to light-handed regulation
 - with individual settlements
 - price discovery regime to facilitate new entry
 - complaint-handling & complaint-based regulation
- improvements in productivity, service design, communications & industry relations₁₀

Reasons for success

- Parties could negotiate mutually beneficial outcomes (not just cost-saving)
- NEB policy to encourage settlements
 - Initial cherry-picking discouraged interest
 - Now normally accept unopposed settlements
 - Not judge whether each element reasonable, but whether process reasonable (open, informed, agreed)
 - Generic Cost of Capital decision to fix benchmark, removing market power and leaving scope to agree premium for better service and innovative products

Conclusions

- Negotiated settlements in electricity and gas transmission well established.
- Competitive tendering can also yield large benefits.
- Choice and efficiency of **monopoly** investments separable.
- Possible to extend to Distribution? Counterparties?
- Consumer advocates useful on final prices – a role in quality/fuel poverty packages?
- The regulator has role as information provider to the negotiation and arbiter of negotiations.