



Potential for direct negotiations for price setting in the water sector

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Rob Francis, Frontier Economics Europe

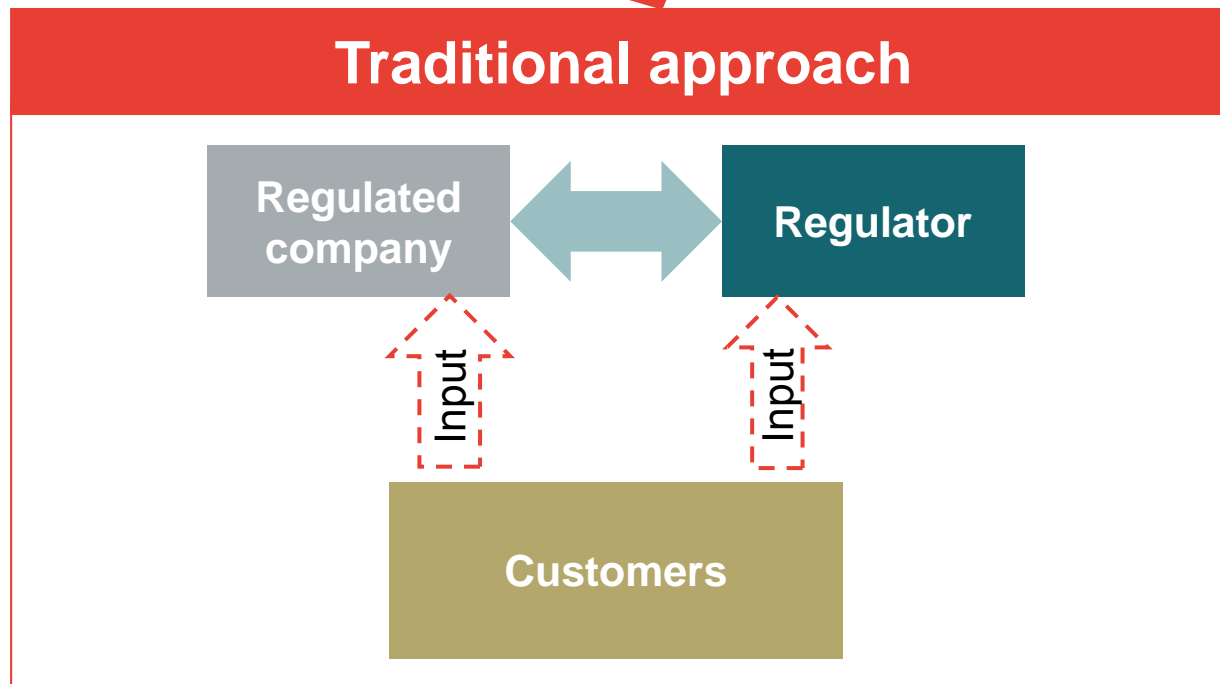
Context for this study

- Ofwat's *Water 2020* programme for PR19
- Increasing focus on customer and stakeholder involvement
- Study for Wessex Water on how direct negotiations could be applied in England & Wales
- <http://www.water.org.uk/policy/future-water-sector>



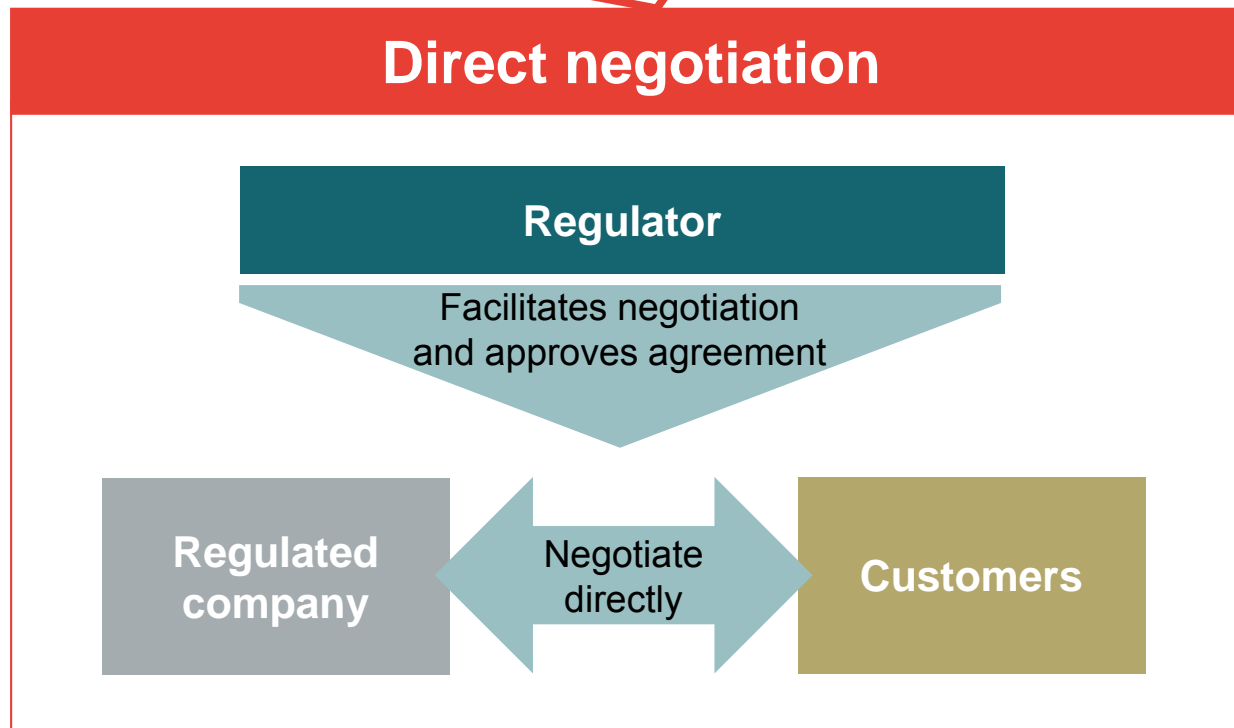
What do we mean by direct negotiation?

Under a traditional approach customers provide inputs to both the regulated company and the regulator that feeds into the determination made by the regulator

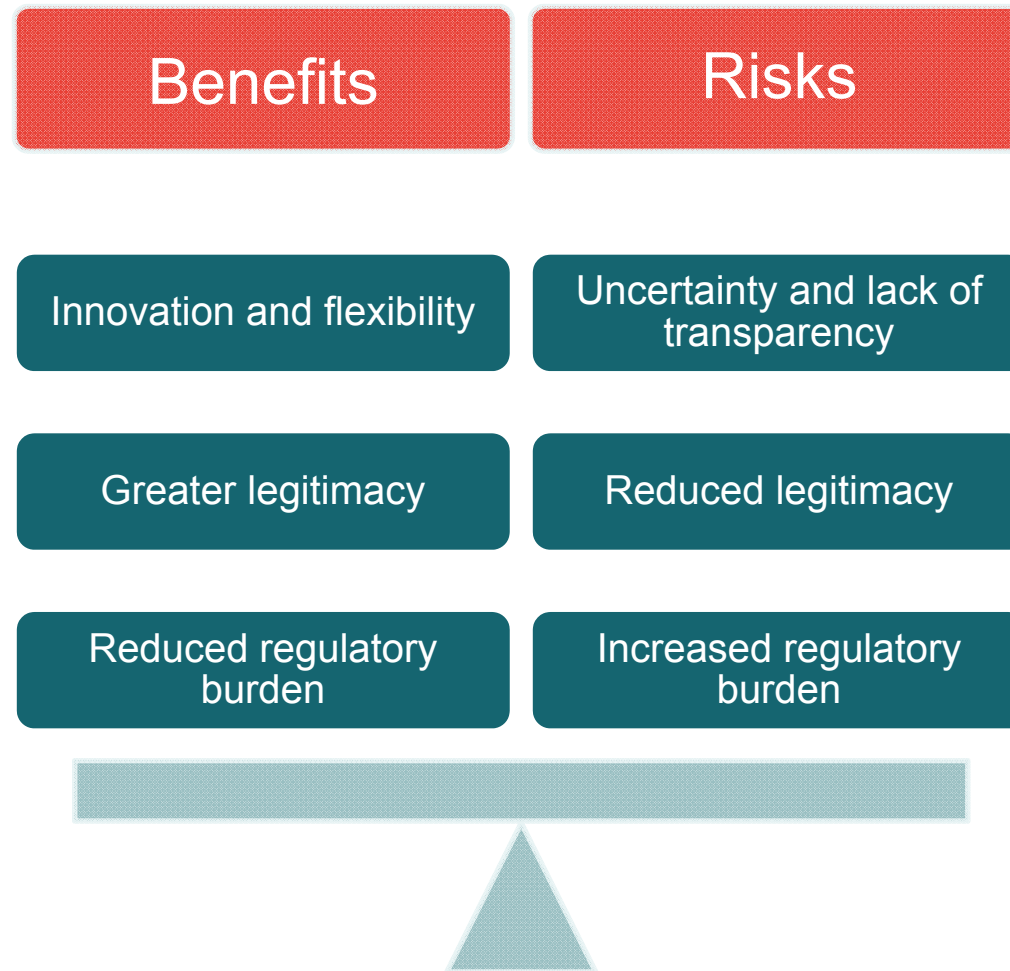


What do we mean by direct negotiation?

Regulators' role is to facilitate negotiation and agreement between the company and customers
– main interaction is between the company and customers



What are the benefits and risks of negotiated settlement?



A framework for negotiated settlement

Main areas to be addressed

- 1** **Customer representation**
 - Who would negotiate? How can all customers be represented? How will the “negotiator” trade-off different customers’ preferences?
- 2** **Role of regulator**
 - Does the regulator play an active or passive role? What type of analysis, decisions does it have to take? How can the regulator ensure this is a success?
- 3** **Scope of negotiation**
 - What is part of the negotiation? Whole plan or parts of the plan?

Customer representation

Who represents customers?

- Single body (CC Water)
- Individual representatives (airline example)

Knowing what customers want?

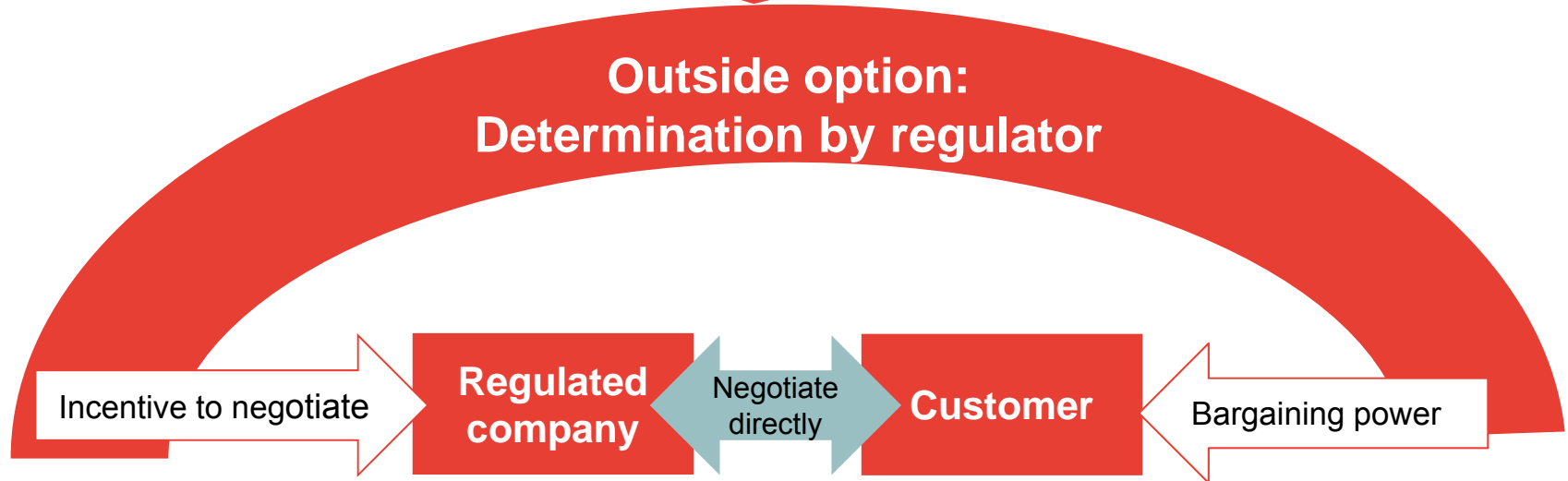
- Customer body undertakes research
- Regulator prescribes engagement
- Customer body agrees research programme with company

Resources and skills?

- Experienced representatives
- Access to independent experts through regulator
- Funding for staff / advisers

Regulator supports customer negotiating position

The threat of regulatory determination in the event of no agreement provides bargaining power to customers



Successful direct negotiation depends on the incentives of the parties to come to an agreement – both sides should believe that the 'back up' option is not in their interest

Role of regulator in process

Before the negotiation

- Set process and timetable
- Provide information
- Set expectations and outputs
- Clarity on 'success' and 'back up' options

During the negotiation

- Monitor progress
- Provide further information
- Do not intervene – but continue to develop 'back up' option

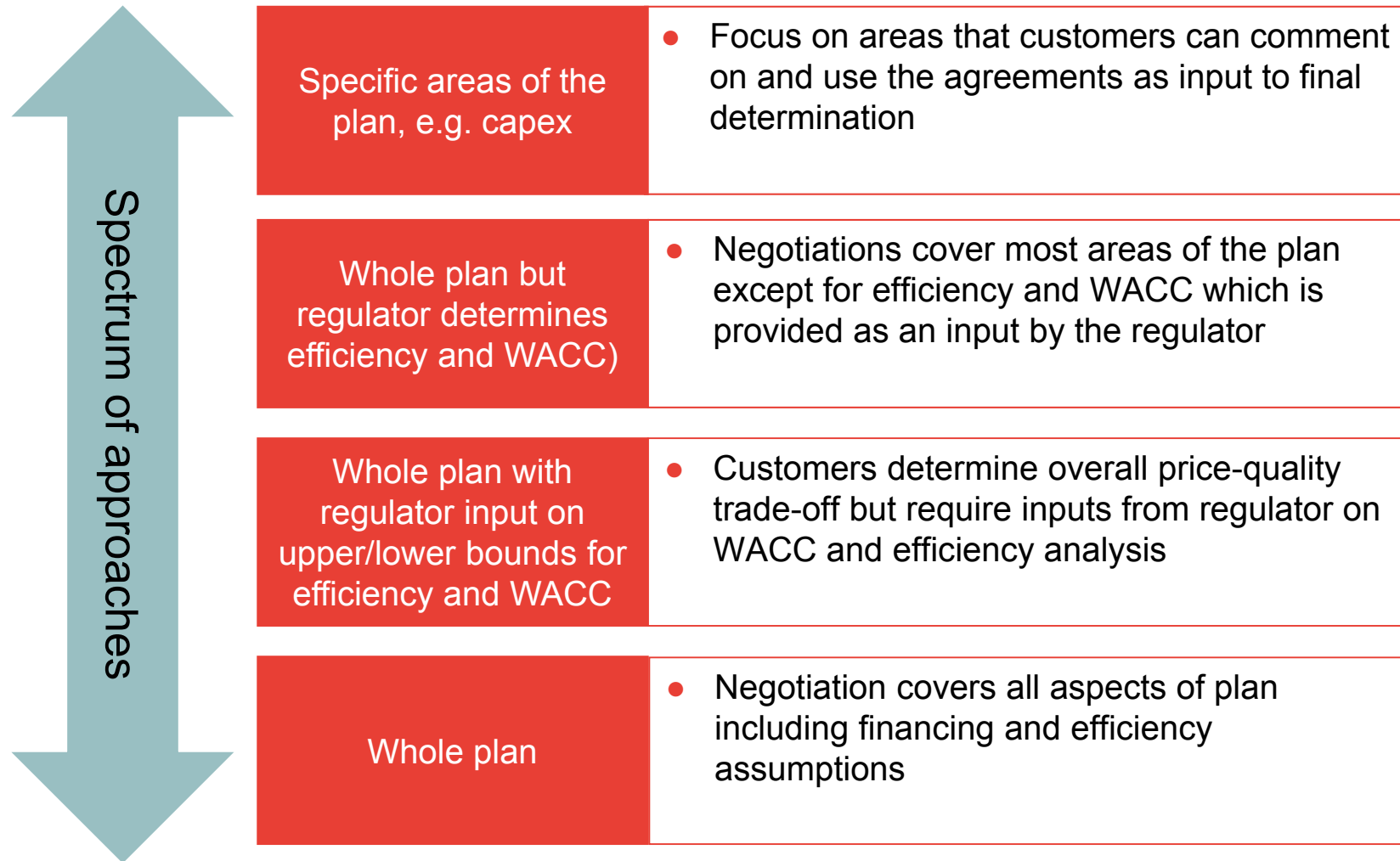
Agreement

- Assess against criteria
- Only intervene if in LT customer interest

No agreement

- Implement 'back up' option

Scope of negotiation – what is in and out?



Main lessons from regulatory precedent?

Lessons

Negotiated settlement usually applied where large customers exist

- Most of the precedent is from sectors where the regulated company can negotiate with large customers, e.g. airlines, coal producers, pipeline users
- With the exception of Florida (public office represents customers) and Scotland (Customer Forum)

A regulator that actively facilitates agreement appears to be the most successful approach

- Pro-active regulators appear to be most successful such as FERC in US, ACCC in Australia, WICS in Scotland
- In contrast, early experience with CAA not as positive

Incentives are crucial for success

- Negotiated settlement is successful when there are strong incentives to agree, for different reasons
 - Alternative much worse
 - Common reputational incentives

Summary of options

Nature of the negotiation	Scope of the negotiation	Role of regulator
Informal negotiation	Small number of specific items	Full detailed review in parallel
Formal negotiation	Parts of the plan	Review of remaining parts of plan
Structured process with formal agreement	Whole plan except efficiency and WACC	Review of efficiency and WACC only
Negotiated settlement with contract	Whole plan	Only intervene if negotiations fail



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FRONTIER ECONOMICS EUROPE LTD.
BRUSSELS | COLOGNE | LONDON | MADRID

Frontier Economics Ltd, 71 High Holborn, London, WC1V 6DA
Tel. +44 (0)20 7031 7000 Fax. +44 (0)20 7031 7001 www.frontier-economics.com