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UNECE Committee on Sustainable Energy
Panel on Regulation and Investment In Electricity

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Regulation

- “Regulation represents third party intervention by a government agency as an arbitrator by a government agency between the company and the customers it serves.”
- Principles of Public Utility Rates by Bonbright, Danielson, & Kamerschen

“... a matter of degree”

- “...it will become apparent that while a differentiation can be made between regulated and unregulated industries on the basis of economic characteristics, the distinction is frequently a matter of degree.”
- The Regulation of Public Utilities, Dr. Charles Phillips, Jr.

A early view of the corporation

- “It is not because a corporation has a large capital or transacts a large and profitable business that it is an injury to community or a menace to prosperity. On the contrary, the development and growth of modern business have made large aggregations of capital absolutely necessary, and such capital is fairly entitled to a reasonable and legitimate profit. The wrong is done and the injury inflicted when such combination of capital are enabled, by means adopted for the purpose, to control prices, stifle competition and create a monopoly.”
- Edited papers of Robert La Follette, U.S Senator and Governor of Wisconsin edited by Robert S. Maxwell

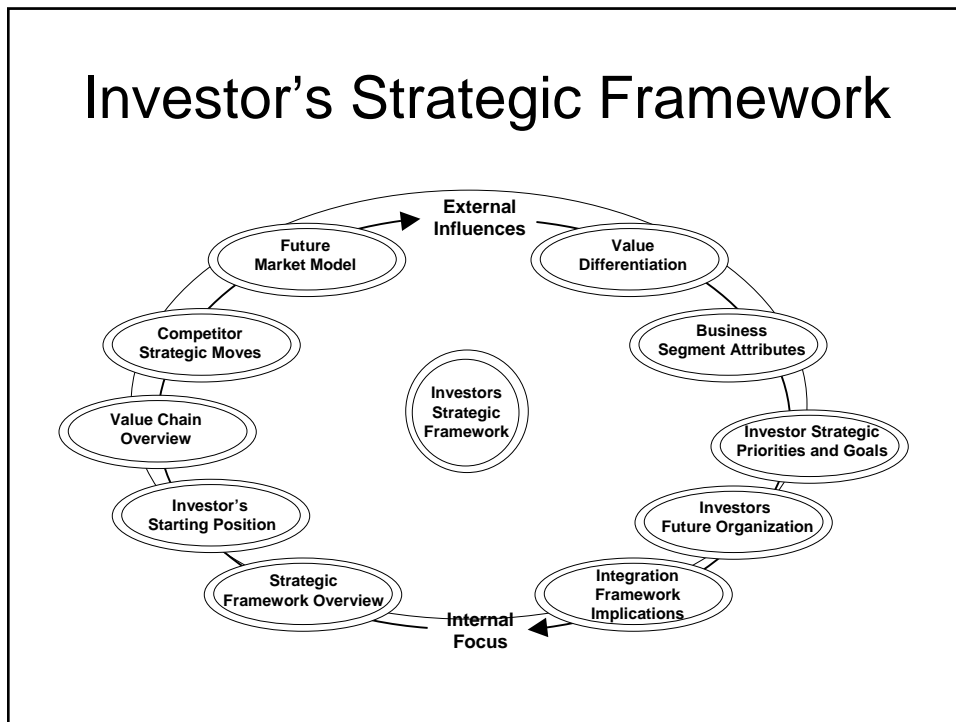
Value Definition

- “The value of an asset is the present value of the expected cash flows generated by it”
- Prof. A. Damodaran
- [The Dark Side of Valuation](#)

Regulation Affects Value Decisions

- Government policy, implemented by regulation, has a direct affect on the value of existing investment and subsequent decisions to make new capital investments.

Investor's Strategic Framework



First: Government Policy

- Stable government and economic policies
- Predictable regulation
- Recognition by regulators of requirements of capital markets
- Desire to maintain national economic competitiveness

International Consensus:

- World Bank: “..market structure, competition, and regulation”
- World Energy Council: “..liberalization, competition,..empowerment of consumers”
- International Energy Agency: “competitive and liberalized markets”

If Government Restructures

- Government must:
 - Clarify policy objectives
 - Select a workable market model
 - Establish adequate competition where competition will be introduced
 - Create non-discriminatory and transparent regulation for both the “market” and residual monopoly segments

Ms. Nemat Tallat Shafik, World Bank

- “healthy market criteria: secure legal framework, sound regulation, efficient banking, basic fundamentals to reduce risk perception.”

Government need to have clear energy policy objectives

- to seek efficiency
- to have supply reliability
- to sustain environmental programs
- to provide consensus level of social subsidy
- to remove energy subsidies

International Energy Agency

- World Energy Outlook 1999 Insights
“Looking at energy Subsidies: getting the Prices Right” (IEA November 1999)
- “removing energy subsidies would support the three principal aims of sustainable development: social welfare, environmental protection and economic growth.”

Ada Karina Izaguirre, World Bank

- Writing in Note 54 of World Bank’s “Public Policy for the private sector”
- “The most successful countries have been those that have found the political will to abandon a long history of subsidized tariffs and to establish regulatory frameworks that offer credible commitments to investors”

An International Investor's View

- CEO, Vivendi electric & water Senegal Morocco
- Discussing experience in developing countries “good regulatory system was a necessary factor for success.” called for World Bank to help train regulators

Capital attractive regulatory characteristics

- transparent process - how did this order come about
- timely- bad order preferable to no order
- balanced- public perception that interest were fairly represented
- review available - for legal merits and process
- stable- orders expected to stand, principles evenly applied
- independent- enough to gain public confidence

Another investor's view

- “the regulatory structure is the main factor to determine how attractive that country is to outside investment capital”
- “..in Europe the regulations are there-but the regulatory structure needed to carry them out is NOT there”
- From the CEO of Southern International (now Mirant Corp.)

Bonbrights's Four Primary Functions of Public Utility Rates

1. The Production-Motivation or Capital Attraction Function
2. The Efficiency-Incentive Function
3. The Demand-Control or Consumer Rationing Function
4. The Income Distribution Function

Reasonable Rates Regulation

- Recognition “reasonable” costs of production
- Full recovery of depreciation
- Taxes as a cost of service
- Opportunity to earn a “fair” return on investment

Fair Return Opportunity

- Realistic chance to obtain a market derived cost of capital
- Opportunity for higher profits for exceptional performance
- Incentives for innovation and improvements

Summation

- Regulation affects investment decisions before and after privatization
- Private capital is available to meet all needs.
- But attracting private capital at reasonable cost requires good regulatory policy and performance.
- The parameters of good regulation are knowable from international experience.

A Special Reminder

“The Law of Unintended Consequences” is a reality.

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