Advisory

Negotiated Settlements
The Dutch Case?

Symposium on Jean Tirole



Confidential

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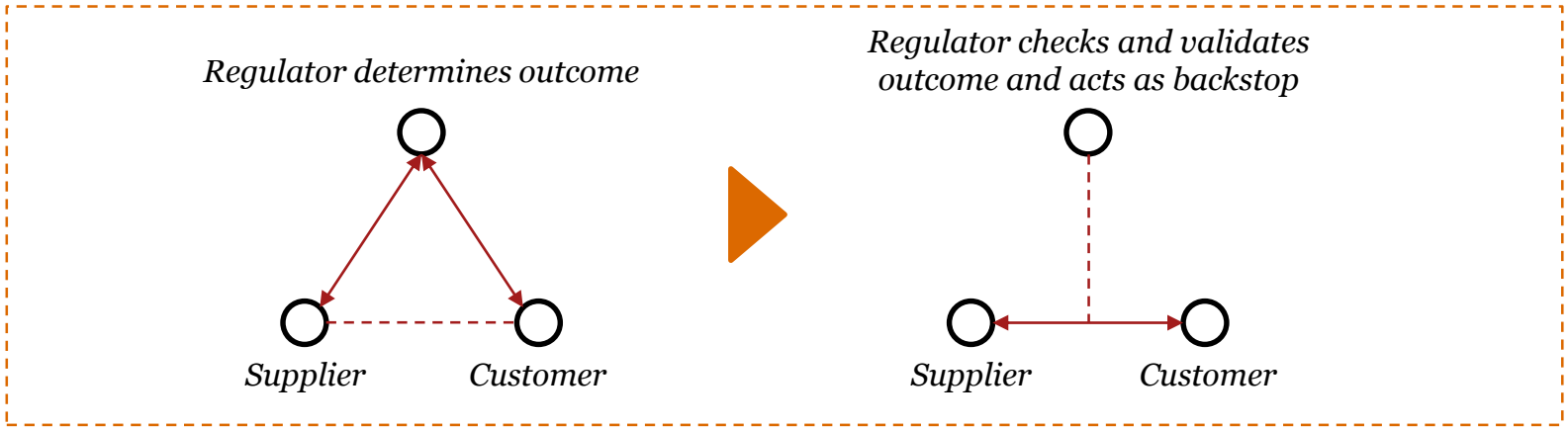
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The traditional regulatory process in the Netherlands leads to an unfavourable outcome for all parties

	Regulator	*Customer*	*Supplier*	*Ministry*
Protracted process which (usually) ends in **litigation**	✓	✓	✓	
Extensive discussions over allowed return, efficiency benchmarking, exceptions and unique conditions	✓	✓	✓	
Pressure to deliver **lower tariffs**, and minimise tariff increases	✓	✓		✓
Focal point of attention from Customer, Supplier, and Broader stakeholders – (perceived) **responsibility for outcome and risks**	✓			✓
Focus on tariffs and not necessarily on quality of service and investments	✓		✓	✓
Short term focus on short term results	✓	✓	✓	✓

Negotiated settlements give stakeholders a different role in the regulatory process and place greater emphasis on the Supplier – Customer relationship

- Settlements common in USA since 1960's
- Short-cutting of standard procedures
- Examples: Interstate Gas Pipelines (**USA**), Electricity Transmission (**USA**), Florida Utility, **Australia** (Airports, Freight Rail Services), and being considered for electricity and gas in Australia, and due to partially implemented by Ofgem (**UK**)
- Rather than Regulator setting and (re)defining Contract between Supplier and Customer every regulatory period, make Supplier and Customer **jointly responsible** for Contract set-up and maintenance



There are significant benefits when compared to the traditional regulatory process…

- Negotiated settlement:
  - **quicker** than conventional regulation
  - more **innovative** than conventional regulation
  - **better outcomes** because customers, rather than regulators, determine trade-offs
  - **reduces uncertainty** about outcomes, compared to traditional regulation
  - **better mutual understanding** of network service providers and their customers

*Littlechild (2009) concludes that through settlements, **consumers have gained rate reductions**, refunds and **innovative service quality incentives**. The utilities have gained commitments on conduct (**moratoria** on requests for rate reviews for agreed periods), **greater flexibility** on accounting policy, and the evolution from rate of return regulation to incentive regulation*

...but there are also some concerns

- Possible **transfer of power** from Regulator to Supplier and Customer – who can have market power
- **Asymmetry** of information between players
- Different Customers could have **different priorities**, leading to a frustration of the process
- Customers may be more **myopic** than Regulator, foregoing long-term benefits for short-term gains
- Lack of **transparency**
- Parties are **unlikely to agree** to an outcome that is less favourable than available from Regulator

How settlements work at the FERC level…

- Office of Energy Market Regulation (OEMR) receives applications from pipelines to increase rates.
- Advises FERC Commissioners whether to approve settlements or “Initial Decisions” by Administrative Law Judges
- Office of Administrative Law Judges (ALJ) resolves contested settlements through “Initial Decisions”. Where settlements are uncontested, the ALJ certifies settlements
- The staff of the Office of Administrative Litigation (OAL) are called “trial staff”. The staff play a key role in facilitating settlement by analysing proposals by pipelines and recommending outcomes based on those proposals
- OEMR Advisory Staff and OAL Trial Staff are prohibited from communicating with each other during a settlement review

...and by the Canadian National Energy Board (NEB)

- Parties to negotiated settlements for pipelines include pipelines, producers, shippers, marketers, large users and their associations and provincial governments
- First settlement for inter-state occurred in 1985 and arose spontaneously when the pipeline (TQM) agreed the terms of proposed rates (tolls) with its customers (gas producers and shippers)
- TQM and its customers then jointly presented a non-severable agreement to the NEB for approval. NEB insisted on a point-by-point assessment and varied the agreement. NEB was accused of "cherry-picking"
- By 1994 the NEB was actively promoting settlements and stated that it did not require line-by-line assessment:

"*consensus of the affected parties as to what was fair and reasonable did not need to be subjected to further scrutiny in accordance with some higher ideal of the public interest that existed in the eye of the regulator. In other words,* ***the consensus of the affected parties was a good measure of the public interest***"

Why is this a good idea?

- Legalistic approach to regulation by ACM…
  - Once bitten, twice shy
- …with little or no innovation as a result
  - If it ain't in the law, we ain't doin' it
- No one ever asks the customer what they really want
  - Besides wanting to pay nothing – but we already know that!
- Counterparts like e.g. Enexis, VEMW, E.On are well-informed professional parties that can negotiate and express their preferences
  - Although they may need some help
- No substitute for ACM, but role changes
  - Perhaps even introduces some competition for the ACM…!

Thank you.

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