

Legal and Regulatory

The Regulatory Framework

Regulation in a PPP context is about economic regulation, tariffs, licenses, provision and market control in general, not technical regulation.

Countries have different legal systems but frequently higher level PPP laws have implementing regulations. Such laws and regulations cover the whole PPP cycle (as discussed in Module 4 – Laws and Contracts), while regulators are generally only concerned with PPP projects once implemented.

All infrastructure provision is regulated through some body or another. Many regulators are internal departments of line ministries, some are external departments of line ministries, some are in other ministries (i.e. not the line ministry) and some are independent or semi independent bodies.

Generally, market forces will normally be preferred to economic regulation.

Functions of the Economic Regulator

Typically, the economic functions of a regulator include the authority to:

- Issue, review and cancel licenses
- Establish standards for the terms and conditions of supplying goods and services
- Regulate rates (tariffs) and other service charges
- Make market rules for the sector
- Monitor performance of the regulated entities.
- Arbitrate and settle disputes within the sector.

The economic regulations which govern transport are important in situations where:

- the transport infrastructure or service involved is a natural monopoly (such as a bridge or tunnel where there is no effective alternative), and/or
- where it confers significant market power (for example a highway where the alternatives are not attractive e.g. congested or difficult driving conditions etc.); and/or
- when the rights and obligations contained within a PPP or concession agreement rely on regulatory interpretation.

Normally, where the establishment of a regulatory entity can be justified on public interest grounds, independent regulation rather than regulation by a government department is generally favored. However, fully independent regulation is not always achievable in the short-term, but it should be an explicit or longer term objective and should be reflected in the way that service is regulated from the outset.

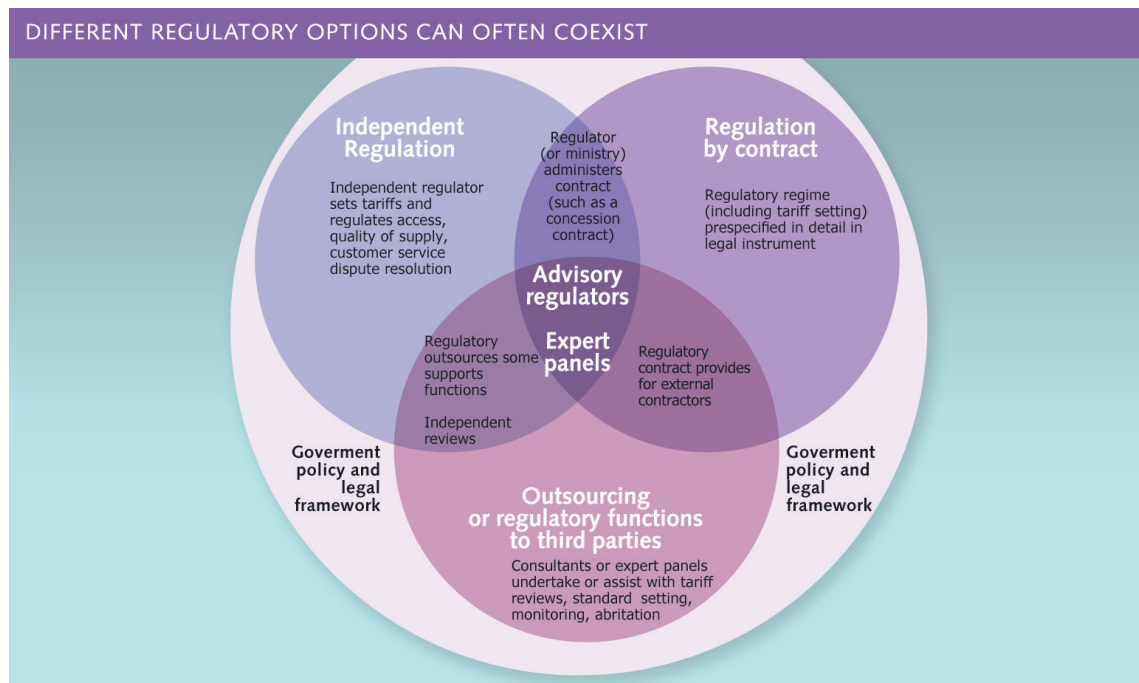
Even where independent regulation is established, experience suggests it can be ineffective, captured or subverted by special interest groups, including government. The basis of any proposed regulatory structure should be fully analyzed, namely:

- its real independence from special interests of any of the parties to the regulation, including any government-owned participants in the industry;
- the effectiveness of its legal rights and obligations to meet its regulatory objectives; and
- the skills and resources available to it to carry out its functions on a continuing basis. In some countries resource constraints may suggest the desirability of a multi-sector regulator or the contracting out of some regulatory functions.

Specialist PPP units or departments, IFIs and advisors should consider how to give support to governments to establish appropriate regulatory regimes. They should also try to ensure availability of financing and skills for at least a basic regulatory system:

- PPP procedures
- asset valuation,
- regulatory accounting methods,
- efficiency measurement techniques,
- consultation processes

Monitoring of regulatory performance should thereafter be an important part of the project monitoring.



Source: GRIDLINES NOTE N°23 - May 2007, Anton Eberhard



Matching Regulatory Design To Country Circumstances, Anton Eberhard, PPIAF Gridlines, 2007

How the Regulator operates

The regulator should:

- operate in a transparent manner and pro-actively provide information to stakeholders about regulatory matters under consideration, decisions taken and the rationale for decisions.
- encourage stakeholder participation in regulatory decision-making by convening public meetings on regulatory matters at which stakeholder comments would pro-actively solicited.
- set forth the principles and procedures by which it will review and approve tariffs.
- also help create an environment that encourages private sector participation (PSP) and PPPs.

Type of Regulators

There are, generally, three generic types of regulatory arrangements:

- **Embedded Regulators** – A regulatory organization that is comprised of one or more offices or functional groups within a ministry that compiles information, conducts analyses and makes recommendations on regulatory issues to the minister.
- **Separate Regulators** – A separate organization that gives regulatory advice to a higher authority (e.g. a minister or via a minister to the president) but does not necessarily take a final regulatory decision.
- **Independent Regulators** – an organization set up outside of a ministry that has final authority over licenses, tariffs and service quality.

The necessary levels of institutional and regulatory capacities

The creation of a regulator alone (i.e., the passage of enabling legislation) is not enough, particularly in transitional economies where there is neither institutional history of regulation nor adequate training in regulatory principles for those who are charged with the responsibility of being regulators.

Thorough organizational planning, including the recruitment and training of regulators and their staffs should precede operationalization of the regulatory body.

A principal objective of the independent regulator is the creation of an environment that will provide prospective private sector investors with a degree of security and that encourages investments critical to the nation's economic development.

A newly constituted regulator including organizational issues such as insufficient or untrained staff and inadequate secondary legislation (rules, regulations and procedures) will convey to potential investors a high degree of risk that could have a negative impact on their interest in PPP projects.

The timing of regulatory start-up is also important with respect to PPP projects that are well along in the pipeline. Serious investors who have been working with the Government

for many months (or even years) to approach a deal with respect to an important infrastructure project may be apprehensive about the possible implementation of a regulator.

Without a track record, what certainty does the investor have that its long-term deal with the Government will survive under their purview? Bilateral contracts – i.e., Regulation by Contract – may address these concerns over the near term, but it is only over time and with dedication to implementing internationally accepted best practices that the regulator will develop the credibility that an effective regulatory framework” is intended to provide.

Regardless of the interim structure, the elementary principles of freeing the conditions of market entry and the level of market pricing from unilateral control (either political, or the influence of one stakeholder group) are not in dispute. They form the generally accepted preconditions for the attraction of investment in infrastructure and utility services that are essential for the development of national and regional economies.



Where Do We Stand on Transport Infrastructure Deregulation and Public-Private Partnership?
Antonio Estache and Tomás Serebrisky World Bank Policy Research Working Paper 3356, July 2004.

A recent World Bank Working Paper (No. 14, 2003) considers the merits of specifically setting out the specific rights and obligations of the public and private parties, within PPP structures, rather than relying on the interpretation of a regulatory body. Creating “regulatory contracts” or regulation by contract could be used for specific projects rather than industry-wide regulation.

Toll-road concessions and long-term ports and airport concessions are often regulated by contract. A regulatory entity may not required if there is sufficient confidence that contract law and arbitration arrangements can provide a remedy to the parties in the event of dispute.

Safety regulation is not an explicit part of regulation but is essential for transport operations. However, economic regulation, introduced alongside private sector approaches, should be structured in a way which will enhance safety incentives and not create safety disincentives.



Regulation by Contract: A New Way to Privatize Electricity Distribution?
Baković, T., B. Tenenbaum, and F. Woolf. Working Paper No 14. World Bank. 2003.

Technical and safety regulations would fall outside the scope of PPP regulation. However, the need for technical and safety regulation remains high and would operate in addition to, and has integrated with links with, economic regulation.

The aim of regulation and regulatory systems is to on the one hand encourage low cost, reliable service provision and on the other promote financially viable and increased, new

investment in the infrastructure sectors especially where there are natural monopolies or market failures.

The most widespread feature of infrastructure reform in developing and emerging economies has been the establishment of new regulatory laws, systems, contracts and processes. According to A. Eberhard/ Working Paper 4 in the source below it is estimated that some 200 regulators in 130 countries in infrastructure sectors have been created.

The conclusions of Working Paper 4 indicate that:

- While these new models of regulation (Independent and other) have not been trouble free and could have worked better, there remain problems with the old models of direct regulation by government.
- Therefore, there remains the need for policy intervention for better regulatory systems
- However, the need is for government and decision makers to examine and design regulatory systems that are more focused and appropriate to the country context and especially commitment, capacity and other frameworks.
- Practical advice includes focusing on:
 - Selected parts in a value in rather than all parts
 - Develop regulator competency
 - Consider consumer complaints to build legitimacy
 - Areas such as building in and or developing incentives for efficiency and cost reductions need further consideration
 - Widespread access to affordable services remains an important objective and regulators have an important role in encouraging and monitoring activities that support wider transport access and not just the most viable toll roads

The last piece of advice suggests that ‘mantras’ should not become substitutes for thinking. Decision makers should select from the ‘menu’ those options, possibly hybrid, that are appropriate to their country, recognizing that these rules will probably need to change over time, as PPPs and the country develop and change too.



Infrastructure Regulation in Developing Countries, A Eberhard, World Bank Working paper N. 4. PPIAF. 2007.