

GRID LINES

Sharing knowledge, experiences, and innovations in public-private partnerships in infrastructure

Relying on expert panels to help settle regulatory disputes

Lessons from Chilean experience

Alejandro Jadresic and Lorenzo Bertolini

Starting in the 1980s Chile initiated wide-ranging economic reforms, paving the way for private sector involvement in major infrastructure sectors. With these reforms came new regulatory rules, institutions, and processes to manage the interests and expectations of such diverse stakeholders as the government, consumers, and service providers. One innovative feature is the use of expert panels—specialized, independent, ad hoc entities affiliated with neither the government nor the sector regulator—to resolve disputes arising from regulatory decisions. The Chilean experience with these panels offers useful lessons for policymakers.

Regulatory conflicts are common in infrastructure sectors. Regulators and service providers may take different views on how to set tariffs, enforce obligations on the quality of service, or assess compensation for past investment. Conflicts may also arise between regulated companies or between service providers and users—for example, on interconnection charges, transmission fees, or service standards.

Different regulatory governance models have been developed to resolve conflicts and reduce regulatory risks for private investors. Approaches typically range from enshrining detailed regulatory mechanisms into legal instruments such as licenses and contracts (with possible appeals to the judiciary) to entrusting a specialized, autonomous agency with administering regulatory decisions on the basis of preestablished rules and processes.

Implementing these governance models is challenging, especially in developing countries. Contract provisions are often relatively general and require other institutions to help in reaching agreement on such key elements as periodic tariff

adjustments.¹ Existing legal institutions may prove inadequate for reaching technically complex decisions (such as in comprehensive tariff reviews) because of such issues as the scarcity of specialized judges or the long and time-consuming procedures typical of ordinary courts. The regulatory agency model requires adequate institutional capacity as well as safeguards for autonomy in decisionmaking, both of which are difficult to ensure in countries with fledgling institutions and scarce human and financial resources.

Another option is to create a specialized, independent, ad hoc entity—affiliated with neither the government nor the regulator—that can be called on to provide a decision or opinion on a dispute. Known as an expert panel, this mechanism has long been used to resolve disputes on the interpretation of commercial contracts and conflicts relating to foreign investment and international trade. But its use in economic regulation is less well known.² In principle, such panels can support regulatory institutions and legal processes—whether well established or newly developed—or provide an alternative to them.

How expert panels do their work

Chile established expert panels as part of the regulatory regimes it created in the past three decades to promote private participation in several regulated industries, including power,

Alejandro Jadresic is the dean of the Faculty of Science and Technology of the University Adolfo Ibáñez and president of the permanent Panel of Experts for the Chilean electricity sector. He was minister of energy of Chile in 1994–1997. Lorenzo Bertolini is PPIAF's regional program leader for West and Central Africa.



telecommunications, water and sanitation, and public works concessions (in such sectors as jails, airports, irrigation, and toll roads).

Expert panels in these sectors share some common features:

- Their functions are defined narrowly by law and involve resolving regulatory disputes between government regulators and private companies (in the electricity sector they can also settle disputes between companies).
- The panels are not intended to replace sector regulators or the courts, but they may take over some of their traditional duties.
- Their aim is to resolve specific regulatory conflicts based on economic and technical criteria defined in laws, contracts, and other instruments.
- And the panels coexist with other entities that also serve as appeal bodies, such as the courts.

Power sector

Chile's Electricity Law, enacted in 1982, sets out the sector's market structure and regulatory framework, including mechanisms for determining distribution and transmission fees. The law was amended in 2004 partly to modernize the mechanisms for resolving regulatory disputes. For that purpose the law established a permanent expert panel to resolve the wide range of disputes that arise in the power sector between the regulator and the regulated companies (for example, in calculating the asset base for distribution companies to determine transmission fees and investments; box 1). The expert panel can also consider disputes arising between companies (such as on transfer payments due to power and capacity exchanges between generation companies).

The permanent expert panel consists of seven members with six-year staggered terms nominated by the Competition Tribunal through a competitive public process. Establishing a permanent panel, rather than an ad hoc one for each dispute, was aimed at fostering greater independence, consistency, and specialization over time.

Decisions by the panel are binding, strengthening its powers of conflict resolution, though the panel is required to pick the proposal of one of the parties to the dispute. The obligation to choose among the positions of the parties is aimed at preventing excessive demands. It also makes the panel's work easier: the panel does not need to identify the optimal solution, only the least worst solution. The law sets out detailed rules and procedures for

the panel so as to ensure transparency and due process (a specified calendar, mandatory hearings, justification and publication of decisions). The panel's costs (approved annually by the National Energy Commission) are paid by all power sector companies in proportion to their fixed assets.

Between 2004-2006 the permanent expert panel has successfully resolved 33 disputes. Most were long-standing conflicts between generation companies about energy transfer payments. Others related to tariffs for services provided by distribution utilities or the terms of reference of studies on transmission fees and the actual fees charged by transmission companies.

Telecommunications sector

Ad hoc panels are used in the telecommunications sector, particularly during tariff reviews. Unlike in the power sector, however, their input is not binding. Under the 1982 Telecommunications Law and the 1987 tariff regulations, regulated tariffs and access charges are reviewed every five years on the basis of the "model company approach." In this approach a tariff analysis is carried out based on estimates of the costs that an efficient company would incur in providing the services.

To guide this tariff study, the regulator sets specific criteria and assumptions based on a proposal filed by the regulated company. If the company disagrees with these terms of reference—or with the tariffs that the Ministry of Telecommunications later sets on the basis of the tariff study—it can request the opinion of an expert panel. In setting the final tariffs the ministry is supposed to follow the panel's proposal, but it need not do so if it considers the proposal inconsistent with the law or government policy.

Each panel is formed of three acknowledged experts—one nominated by the regulated company, another chosen by the undersecretary of telecommunications, and the third selected by agreement. Rulings in 1998 and 2003 set requirements aimed at promoting equity and transparency, including consultation, publication of documents, and written justification of decisions. Costs related to the panels are shared equally by the parties.

Of 18 tariff reviews completed in 2004 and 2005, 10 involved an expert panel. These included reviews of the consumer tariffs and access charges of the three fixed line telephone companies defined as dominant by the competition authority and the access charges of the four mobile phone companies operating in Chile. Though the opinion of

Expert panels can support regulatory institutions—or provide an alternative

BOX 1**Calculating the asset base of distribution companies**

The Chilean electricity law calls for adjusting consumer tariffs every four years for all distribution companies. The new tariffs are calculated on the basis of the replacement value of “model companies”—models that are constructed assuming that services are provided efficiently by companies that earn a 10 percent rate of return.

Both the National Energy Commission (CNE)—with data provided by the Superintendency of Electricity and Fuels—and the distribution companies hire consultants to prepare cost studies, and their results are averaged (with two-thirds weight to the CNE study) to calculate the tariffs. A consistency check is then done to ensure that the actual rate of return that the companies would earn with these tariffs is within the 6–14 percent range. If not, the final tariffs are adjusted to bring the rate within that range.

A key variable in the consistency check is the replacement value, or asset base, for each distribution company. The asset base is calculated every four years by each distribution company and presented for review to the Superintendency of Electricity and Fuels which sets its value. If the company disagrees, it can ask the expert panel to determine the final value of the asset base.

During the last asset base review, for 35 distribution companies in 2003, the Superintendence discounted the asset bases proposed by the companies by an average 39 percent, while the ad hoc expert panels reduced them by an average 16 percent. Transparency and due process were ensured: the assumptions made by the expert panels to determine the final values, and the position of the panel members on each dispute, were explained in a written report signed by all members and presented to the participants. The final report was accepted by both the regulator and the companies, none of which filed any appeal or complaint with the courts. The expert panel reached its decisions in about a month.

Expert panels can step in to resolve conflicts on complex and delicate issues

a panel is not binding, in most cases there was a significant revision in the tariff after the opinion was issued. Indeed, while the regulator initially reduced the annual long-run total cost (a proxy for the tariff) proposed by the companies by an average 25 percent, the final average reduction was just 17 percent.⁴

Water supply and sanitation sector

Chile reformed its water supply and sanitation sector through four laws enacted in the late 1980s. These established rules and regulations on tariffs, the concession regime, subsidies for poor customers, and the role of the Superintendency of Sanitation Services. Under the Law of Tariffs of 1988 and its amendment of 1997, tariffs for water supply and sanitation services are reviewed every five years using the model company approach, with expert panels involved as needed to resolve disputes.

Once the superintendency has prepared a tariff study, the regulated company may state its objections to it. If the two parties are unable to agree on the new tariffs after 45 days, the regulator has to set up an expert panel to resolve the dispute.

The panel must choose either the values of the parameters used in the company’s tariff study or those used in the superintendency’s study. The final tariffs are then calculated by the regulator, using the values chosen by the panel, and set in a decree by the minister of the economy.

Each panel consists of three experts, one named by the superintendency, another by the regulated company, and the third selected by the regulator from a list agreed on by both parties at the beginning of the review process. Decisions by expert panels are final and mandatory for both parties. The law does not specify procedures for the panels (beyond requiring that their costs be shared equally by the parties), though it does give some guidance on the calendar for reaching decisions and require publication of proceedings.

Expert panels have been used often to resolve tariff disputes in the water supply and sanitation sector, especially since the state-owned utilities were privatized. Six of the 21 tariff reviews between 2000 and 2004 relied on expert panels. Only two of these involved state-owned companies, suggesting that agreement with the regulator

was more frequent when companies were owned by the state. But even though most of the companies have now been privatized, just a few recent tariff reviews have ended in expert panels, probably because the use of criteria set by past panels has tended to narrow the differences.

Emerging lessons

Expert panels in Chile appear to have been effective overall in resolving regulatory conflicts both between the regulators and private companies and between companies—including conflicts on such complex and delicate issues as tariff reviews or energy transfer payments. This experience might be useful for developing countries with weak or fledgling institutions.

The structure and performance of these panels have evolved over time and differed across sectors. Even so, a few lessons can be drawn from this experience:

- A panel's functions, composition, and relationships with other authorities should be defined very precisely, ideally in the law.
- When setting up panels, tradeoffs between costs and benefits need to be analyzed carefully. Permanent panels may allow greater specialization, consistency, and independence than ad hoc panels, but they may also prove too costly in some sectors or countries.
- Clear rules, realistic deadlines, and well-defined procedures are essential. Public hearings and other means of public participation should be considered if a decision affects third parties. Requiring panels to justify all decisions and publish all materials used in the process strengthens the legitimacy and quality of their decisions.
- Panel members must be highly qualified and independent from the parties to a dispute.

Different schemes can be used to identify members. Allowing the parties to nominate some or all of them may promote confidence and aid conciliation,

though it may also diminish independence and eventually make the decision dependent on the view of just part of the panel (such as the president). Clear rules regarding ineligibility help promote independence and legitimacy of the panel.

- Expert panels can help establish the credibility of the regulatory process among operators, particularly where the capacity or objectivity of the regulator is not yet established and regulatory risks for investors are high.

References

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Notes

This note is based on a paper "Expert Panels in Regulation of Infrastructure in Chile," Available at www.ppiaf.org under Working Papers by Alejandro Jadresic (2006).

1. Regulation by contract has been successful in water in Senegal, but with the support of a range of institutions—the government-owned asset-holding company in supervising the contracts, committees in facilitating the tariff review process, and outside experts and donors in resolving disputes.

2. For a more detailed review of the regulatory governance debate and some experiences with expert panels in infrastructure regulation, see Shugart and Ballance. (2005)

3. For an overview of the reforms, see Jadresic (1997).

4. These figures are greatly affected by the review process for Telefonica CTC, where the parties' initial proposals differed the most. Excluding this case, the average initial reduction is 21 percent, and the final one 13 percent.



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