

**DEPARTMENT OF WATER AFFAIRS
PRICING AND, ECONOMIC REGULATION REFORMS (PERR) PROJECT**

**(Pricing Strategy Review, Development of Infrastructure Funding Model and the Establishment
of Economic Regulation)**

Minutes of a meeting of the Economic Regulation Work Stream

Date: 15 November 2012
Time: 9:00–11:00
Venue: Protea Hotel, Waterfront, Centurion

Present:

Department of Water Affairs

Bofilatos, E

Ismail, F

Mochotlhi, D (Chairperson)

Morodi, C

Moshidi, S

Mupariwa, Z

Ramorula, R

Sigwaza, DP

Van den Berg, O

Stakeholder representatives

Opperman, N Agri SA

Raphela, A Magalies Water

Brink, M Mhlathuze Water

Nyandoro, T Rand Water

Nyembe, M Rand Water

Sithole, F Rand Water

Moraka, W South African Local Government Association (SALGA)

Bosman, D Trans-Caledon Tunnel Authority (TCTA)

Holden, R TCTA

Gevers, N Umgeni Water

Professional service providers (PSPs)

Cupido, A Pegasys

Madinginye, TDS Pegasys

Pegram, G Pegasys

Schreiner, B Pegasys

Erasmus, H Write Connection (Scribe)

Sussex, A Write Connection (Scribe)

1. OPENING, WELCOME AND PURPOSE OF THE MEETING

The chairperson, Ms Deborah Mohotlhi, opened the meeting. The purpose of the meeting was to discuss the outcomes of the economic regulation round table meeting. The institutional and financial models would also be discussed. The chairperson allowed a round of introductions.

2. ADOPTION OF THE AGENDA

The agenda was adopted without amendments.

3. ADOPTION OF THE MINUTES

The minutes of the meeting held on 8 August 2012 were adopted without amendments.

Proposed: Mr Madinginye

Seconded: Ms Sigwaza

Item 1	Mr Moraka said that some work had been done on regulation strategy and he would try to locate the relevant document for context as well as some of the key functions that an economic regulator could consider.
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The document had not been received yet.

Ms Nyembe asked whether the input that had been received from SALGA on the pricing component did not sufficiently address item 1.

Chairperson said that item 1 arose from a request from SALGA, and did not need to be dealt with in the meeting. Mr Moraka would in any case join the meeting later that morning and could comment then if necessary.

Item 2	Mr Mqina would communicate the working group meeting date to members, and would prepare the agenda.
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Item 2 had been completed.

Item 3	The PMO would include the issues raised during the meeting on 8 August 2012 in a comments register.
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Item 3 had not been completed.

Item 4	The deadline for the submission of comments on the Inception Report was 17 August.
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The deadline had been extended to incorporate comments from the round table discussion that was held on 1 and 2 November 2012.

Item 5	The technical team would take the following into account in finalising the Inception Report and in future tasks: ...
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Item 5 had been completed.

4. MATTERS ARISING FROM THE MINUTES

Item 3 had not been completed (the issues raised during the meeting on 8 August 2012 would be included in the comments register).

Action: Project Management Office

5. ROUND-TABLE OUTCOMES

The chairperson said that the round table discussion had been well attended. There had been inputs from the presidency, planning commission, National Energy Regulator of South Africa (NERSA) and the DWA.

The chairperson presented the outcomes of the discussions, which had focused on the institutional and financial models of the regulator.

The chairperson said that the objective of the economic regulator work stream was to identify, evaluate and recommend a coherent and innovative model for economic regulation across the entire water value chain, and to develop proposals for the establishment of an economic regulator.

Current status:

- Legislative mandate:
 - Constitution
 - Water Services Act
 - National Water Act (Act 36 of 1998).
- There was a need for an economic regulator for the water value chain (inclusive of water services and water resources)
- Scope
 - Not well defined
 - Fragmented and not well aligned with other functions.

Regulation principles (NERSA perspective):

- Clarity of roles (policy making vs. regulation)
- Independence
 - Authority
 - Accountability
- Integrity, transparency and public participation
- Predictability
- Efficiency
- Appropriate institutional operating framework.

Whether the economic regulator would be independent vs. in-house would be determined by the elements and issues that need to be regulated within the water value chain.

Enablers for a sustainable regulator:

- Skills and capacity
- Independent decision making
- Funding.

The economic regulator design should highlight the following:

- Define the problems and objectives in the sector
- Determine whether regulation is well suited to the objectives
- Define the specific regulatory functions needed to achieve those objectives
- Decide which legal instruments are best suited to embody the regulatory rules and which organisations are best suited to perform the regulatory functions.

Ms Mahotli said that the economic regulator design had to take into account that South Africa was a developmental state.

Legislative framework should reflect the economic regulator's responsibility on:

- Enforcement
- Credibility
- Ability to raise funds and enter into long term commitments within the sector.

Economic regulation should ensure that regulated services are:

- Efficient

- Effective
- Sustainable
- Accessible to all.

The following items had to be finalised for the economic regulator:

- Institutional model
- Scope
- Implementation.

The chairperson hoped that the latter three items would be discussed that day and encouraged the group to come up with a variety of proposals. She said that there was a view held by some people that an independent regulator would not be feasible. When discussing the option of an independent regulator, she encouraged the group to bear the concerns of the detractors in mind, and also to consider what elements would be compromised were the regulator to be in-house. A balanced and informed view could prevent the need for rework.

With regard to scope, the issue was whether it would be feasible to include the full water value chain in the scope of the economic regulator model at that point. There were those who believed it was impossible to not to consider the whole value chain, given the interdependence of the different components. Phased implementation was a possible approach, in which case priorities would need to be identified.

Thought needed to be given to the implementation of whichever model was selected, and how that implementation would impact on current institutions and the institutional realignment project that was underway.

Mr Nyandoro said that the word 'independent' was contradictory in different contexts. He felt that there should be an economic regulator that was housed within the department. Water was both a public and private good, and independence would have specific requirements in either case. Having an independent regulator for social goods had proven unsuccessful, for example in the case of NERSA.

Mr Nyandoro said that the role of an economic regulator was to implement policy that was developed by the department. An economic regulator could not be expected to implement issues around the developmental state. Accountability and responsibility needed to reside with the department.

The chairperson asked Mr Nyandoro for clarity on what he perceived to be the contradiction. The issue of the separation of policy development from the implementer had been discussed.

Mr Holden said that the issue was around independence. He asked whether a regulator could reside in the department that it was effectively regulating. If the economic regulator was in the department, the shareholding of all boards should be removed from the department. He asked whether the project should be considering a water sector regulator or a multi-sectorial regulator.

A member of the work stream requested clarity on whether the group was working from a mandate that had already identified the kind of regulator required. She hoped that that was not the case, and asked what the group was attempting to achieve. She mentioned the need for clear role segregation; an economic regulator should apply the water sector policies and legislation, as set by the minister, in an equitable and transparent manner.

Ms Nyembe attempted to compare the feedback from the round table discussion to the discussion that had taken place on the international reviews. She asked whether a gap analysis had been performed on the feedback from the round table discussion, and whether any principles from the international review could address the gaps. In the presentation it was stated that the economic regulator had to gain access to funding and enter into long term commitments. She asked what the rationale was behind that statement.

Chairperson responded to Ms Nyembe said that the feedback items had been discussed at the round table meeting. The purpose of the feedback was to start deliberations on the items with a view to

adopting those that were considered pertinent by the group. The project team would incorporate the relevant items into the process.

The chairperson addressed the previous question about working to a mandate. In the presidency there was currently an expectation that the economic regulator would be independent. The DWA wished to remain open to alternatives, and to present the pros and cons of the alternatives. The DWA did, however, want to see a clear separation of roles and responsibilities, whichever approach was adopted.

Ms Sigwaza said that the DWA had been engaged on the issue for the past seven years. It was agreed that there would be an economic regulator. Provided the groundwork was done properly, and the options clearly communicated to the politicians, the politicians would select the best option. She felt that constructive suggestions would be more helpful than questions at that juncture.

Mr Holden said that the two approaches (in-house and independent) were diametrically opposed. He asked how there could be a separation of roles when the regulator and the department reported to the same Director General (DG).

Ms Schreiner felt that the discussion was happening in advance of the work that still needed to be done. The institutional and financial models were due in April 2013; the purpose of that work was to analyse the pros and cons of the different approaches and to make recommendations.

Ms Nyembe asked what had been achieved to date, apart from the inception report.

Ms Schreiner responded that the inception report had been completed, as had the international best practice review, and principles had been devised. The round table discussion had taken place, from which the feedback was being presented. The next step was the institutional and financial model presentation in April 2013.

Ms Nyembe asked whether the economic regulator work stream had adopted the principles that Ms Schreiner had mentioned. Ms Schreiner responded that the principles had largely been accepted, but it had been agreed that they needed to be a 'living' set of principles that could evolve over time rather than a fixed set of principles.

Ms Nyembe asked about the principle of independence and whether it was open enough to allow for the options analysis.

Ms Schreiner argued that independence was not necessarily a principle; the concept of independence carried a large amount of ideological 'baggage'. What had been discussed previously, was fair and responsible regulation rather than independence; independence implied an institutional arrangement. Once the best model was identified, the institutional model would follow.

Ms Schreiner said that there were a number of institutional models that could be considered. For example, in terms of the in-house approach, there was something known as a 'government component': a separate unit in a department that reports only to the minister and not the DG. That was one option of many that could be looked at as a means of achieving a level of independence.

6. THE WATER VALUE CHAIN AND THE REGULATOR

Ms Schreiner hoped that the work that would be done on the project would depoliticise the debate (between an in-house and standalone approach) and encourage open discussion.

The bigger picture:

- Funding models for water resources infrastructure – March 2013
- Draft Raw Water Pricing Strategy – March 2013
- Institutional and financial models for an economic regulator – April 2013

Ms Schreiner presented diagrams describing the problem statement and underlying concepts of the economic regulator value chain. Printed copies were handed out to the work stream members.

There was no doubt that stronger economic regulation was required; the shape that that regulation would take needed to be determined.

There were three areas that were of concern:

- Local government
- Water boards
- Water resources infrastructure.

Mr Holden pointed out that TCTA did not sell water; the DWA sold water. He mentioned that the reason for having an economic regulator was that the first thing that had to be paid out of the tariffs was debt. The TCTA was completely dependent on water tariffs.

Mr Nyandoro mentioned knowledge management, and said that a regulator needed to know what both parties (consumer and supplier) required. Knowledge management had to be premised on good human resource policies and research and verification capabilities. The research conducted by regulators needed to cover asset verification and advisory consultations. Communication between all stakeholders was important; for example, if a regulator approved a tariff, all parties needed to understand the need for that tariff.

Ms Gevers said that Ms Schreiner had highlighted how complex the problem was. She asked how a regulator would decide whether to regulate one tariff across the value chain, as opposed to tariffs at various points in the chain, or tariffs per customer.

Ms Schreiner replied that the pricing strategy was the policy, and that determined what the economic regulator did. It was important when developing pricing strategy to consider implications for the economic regulator.

Ms Schreiner said that the concept of knowledge management mentioned by Mr Nyandoro was interesting. A balance was required between how much a regulator knows and understands and how much the regulated body knows and understands. If the regulated body had greater knowledge and capacity than the regulator, it would be difficult for the regulator to regulate the body effectively. The converse was also true; it would be difficult to regulate a body that had very low levels of knowledge and competency.

Ms Schreiner mentioned something that had been spoken about at the round table discussions. In countries that had highly developed economic regulation systems, there was typically a pool of regulators that could be drawn from. As South Africa did not yet have that pool, it would be necessary to train people on the job. Ms Schreiner said that an incremental process should be considered, starting with what was critical, and built up over 10 years in a targeted fashion.

The chairperson said that most of the issues that had been deliberated would help to shape the model. She hoped to avoid a situation where the funders of the function controlled the regulator. Funding an in-house regulator vs. an independent regulator had different implications.

William Moraka joined the meeting.

The chairperson said that the concerns from SALGA had been circulated and should be noted. William Moraka said that the issues raised were important for the economic regulator in the long term, but in the meantime a process had been agreed with DWA to address the issues.

7. WAY FORWARD

The chairperson said that the way forward was determined by the deliverables of the project, the project plan and milestones. The next milestone was the institutional and financial model of the economic regulator, due for finalisation by April 2013.

The draft model was due by mid-February 2013, two weeks prior to the next economic regulator meeting that would be held in the second half of February 2013.

Action: Technical team

The DWA expected that the draft would incorporate the updated inception report and the principles that would be incorporated in the model for adoption at the meeting. The two options (independent or in-house) would be included along with the pros and cons of each, as well as an indication of how the regulator would be funded.

Independent decision-making was central to the draft; without it the models were likely to fail. Another issue was that of the TCTA, the water boards and the shareholders proposing to report to public enterprise whilst belonging to the water sector.

8. CLOSURE

The chairperson encouraged everyone to attend the next meeting in order to critically examine the proposed models.

The meeting closed at 11:00.

APPENDIX 1: LIST OF ACRONYMS

Agri SA	Agri South Africa
DG	Director General
DWA	Department of Water Affairs
NERSA	National Energy Regulator of South Africa
PERR	Pricing, Economic Regulation Reforms
PMO	Project Management Office
PSC	Project Steering Committee
SALGA	South African Local Government Association
TCTA	Trans-Caledon Tunnel Authority

APPENDIX 2: ACTION ITEMS ARISING FROM THE PERR ECONOMIC REGULATION WORK STREAM MEETING OF 15 NOVEMBER 2012

	Task	Responsible party	Due date (where indicated)
1	Item 3 from the previous meeting had not been completed (the issues raised during the meeting on 8 August 2012 would be included in the comments register).	PMO	
2	<p>The draft model was due by mid-February 2013, two weeks prior to the next economic regulator meeting that would be held in the second half of February 2013.</p> <p>The DWA expected that the draft would incorporate the updated inception report and the principles that would be incorporated in the model for adoption at the meeting.</p> <p>The two options (independent or in-house) would be included along with the pros and cons of each, as well as an indication of how the regulator would be funded.</p> <p>An issue was that of the TCTA, the water boards and the shareholders proposing to report to public enterprise whilst belonging to the water sector. That should also be addressed in the drafted model</p>	Technical team	Mid-February 2012