

HELM
TALKS

LECTURE TWO

REGULATORY MODELS

PRESENTED BY

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AGENDA

LICENCE VS. CONTRACT REGULATION

RATE OF RETURN

PRICE CAPS & RPI-X

SYSTEM OPERATOR MODEL

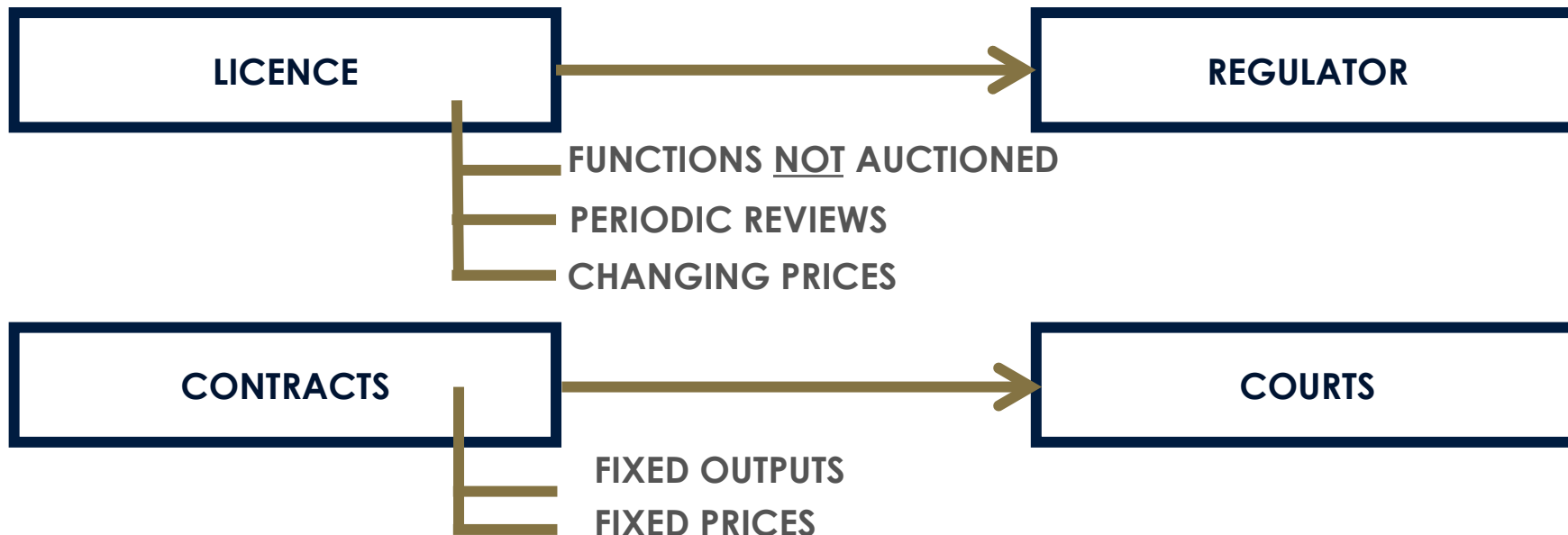
STATE & MUNICIPAL OWNERSHIP

LICENCES VS. CONTRACT REGULATION

- Incomplete contracts and licence functions
- Transfer of uncertain obligations requires duty to finance functions
- Back up with regulators with discretion

vs.

- Contract and specification of outputs
- Contract auctioned without financial guarantees
- Contracts require arbitration - courts not regulators



RATE OF RETURN REGULATION

IN THEORY

- Costs ++
- Assets-in-the-course-of-construction
- Guarantee to normal rate of return
- Equity risk to customers

IN PRACTICE

- Cost logging up & down
- Periodic adjustments
- Used-and-useful test
- Efficiency tests

EQUITY RESEMBLES DEBT

DEBT FINANCE MODEL

PRICE CAP REGULATION

IN THEORY

- Prices mimic perfect competition
- Prices set *ex ante*
- No within period interventions
- Profits can be abnormal (+ve/-ve)
- Periodic reviews rebase costs
- CAPEX on pay-when-delivered basis

IN PRACTICE

- Prices embed starting point levels
- Prices are always political
- Interference within period on prices, outputs & obligations
- Periodic reviews complex
- Rate-of-return with a lag

COMMON INFORMATION BASES FOR RATE OF RETURN & PRICE CAPS

To set prices ex ante or reflect costs ex post

- OPEX
- CAPEX

To set price level

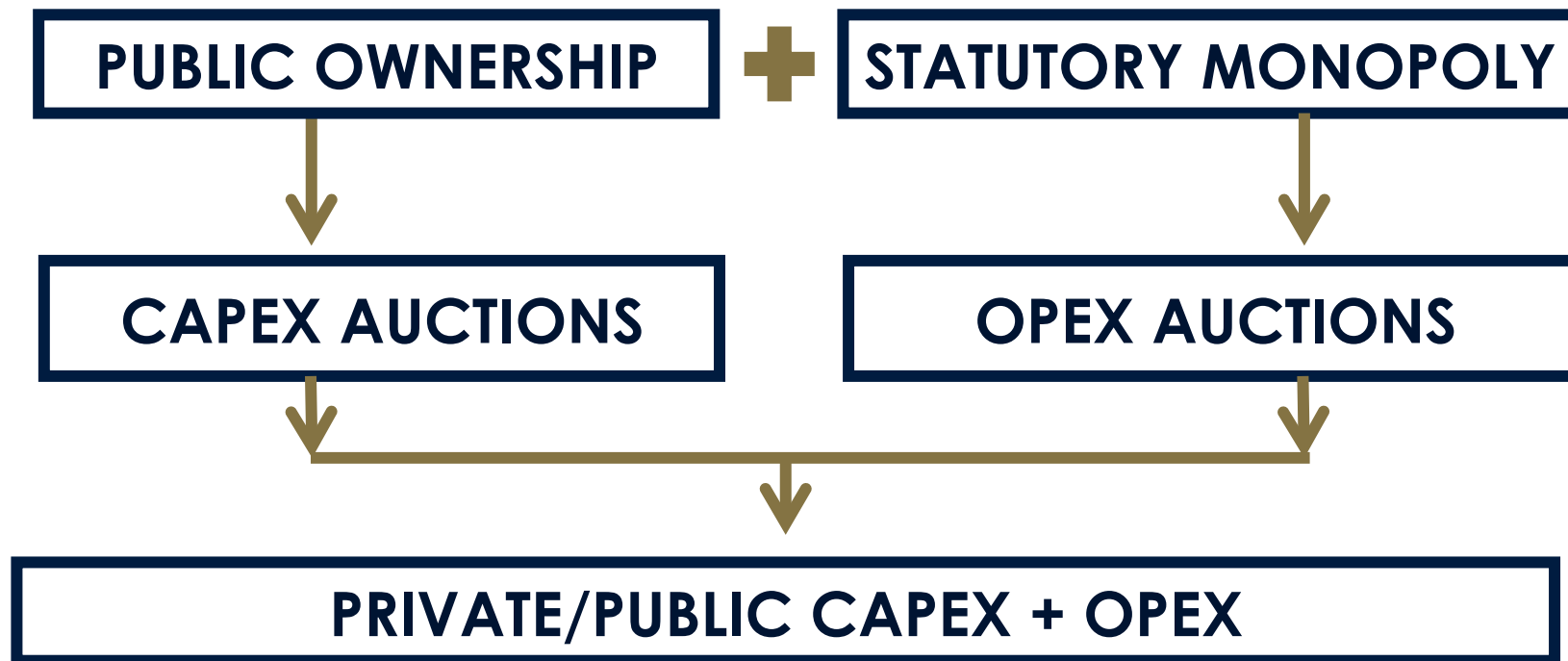
- Regulated Asset Base
- Cost of capital



THE SYSTEM OPERATOR MODELS



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SUMMARY LECTURE TWO

- **FUNDAMENTAL CHOICE BETWEEN RULES VS. DISCRETION**
- **PRICE CAP VS. RATE OF RETURN HAVE MUCH IN COMMON**
- **FOCUS ON INFORMATIONAL REQUIREMENTS AND ADJUSTMENTS**
- **SYSTEM OPERATOR MODEL MAXIMISES COMPETITION FOR OPEX AND CAPEX**
- **POLITICAL ELEMENTS ALWAYS PRESENT**
- **ALL MODELS NEED SOME SORT OF REGULATORY ASSET BASE (RAB)**

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LECTURE RECORDINGS AVAILABLE AT

DIETERHELM.CO.UK

THANK YOU

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