

THE REGULATORY FRAMEWORK

**On the Privatization of METRO MANILA
WATERWORKS and SEWERAGE SYSTEM**

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The Privatization of MWSS

- **RA 6234** - An act creating the Metropolitan Waterworks and Sewerage System (MWSS) and the dissolution of the National Waterworks and Sewerage Authority (NAWASA). The area of jurisdiction was limited to Metro Manila, Rizal Province and portions of Cavite.
- **RA 8041** - The Water Crisis Act of 1995, recognizing the need to address the water problem of Metro Manila.
- **EO 286** - Implemented the Water Crisis Act of 1995. It mandated the reorganization of MWSS and the Local Water Utilities Administration (LWUA).
- **EO 311** - Mandated MWSS to enter into arrangement that will result in the involvement or participation of the private sector in any or all of the segments, operations and or facilities of MWSS.

Notes:

- RA - Republic Act, a law of the Republic of the Philippines
- EO - Executive Order issued by the President

Private Sector Participation

- MWSS as Owner – retains ownership of all facilities and the facilities to be installed by the concessionaire at the end of the concession.
- Concessionaire as Operator acts as a contractor to perform certain functions and as agent for the exercise of certain rights and powers under the Charter, the sole right to manage, operate, repair, decommission and refurbish the facilities including right to bill and collect for water and sewerage services.
- Two Concession Areas – to promote competition and benchmarking, the MWSS Service Area was divided into two: EAST ZONE under MWCI and WEST ZONE under MWSI.

Contractual Arrangement

- **Concession Agreement**

The Concession Agreement (CA) defines the general obligations and functions of MWSS and the Concessionaires, Maynilad Water Services, Inc. (MWSI) and Manila Water Company, Inc. (MWC). It also sets the service target obligations, defines the water rate adjustments, Early Termination Procedures, dispute resolution and the creation of the Regulatory Office (RO).

MWSS Regulatory Office

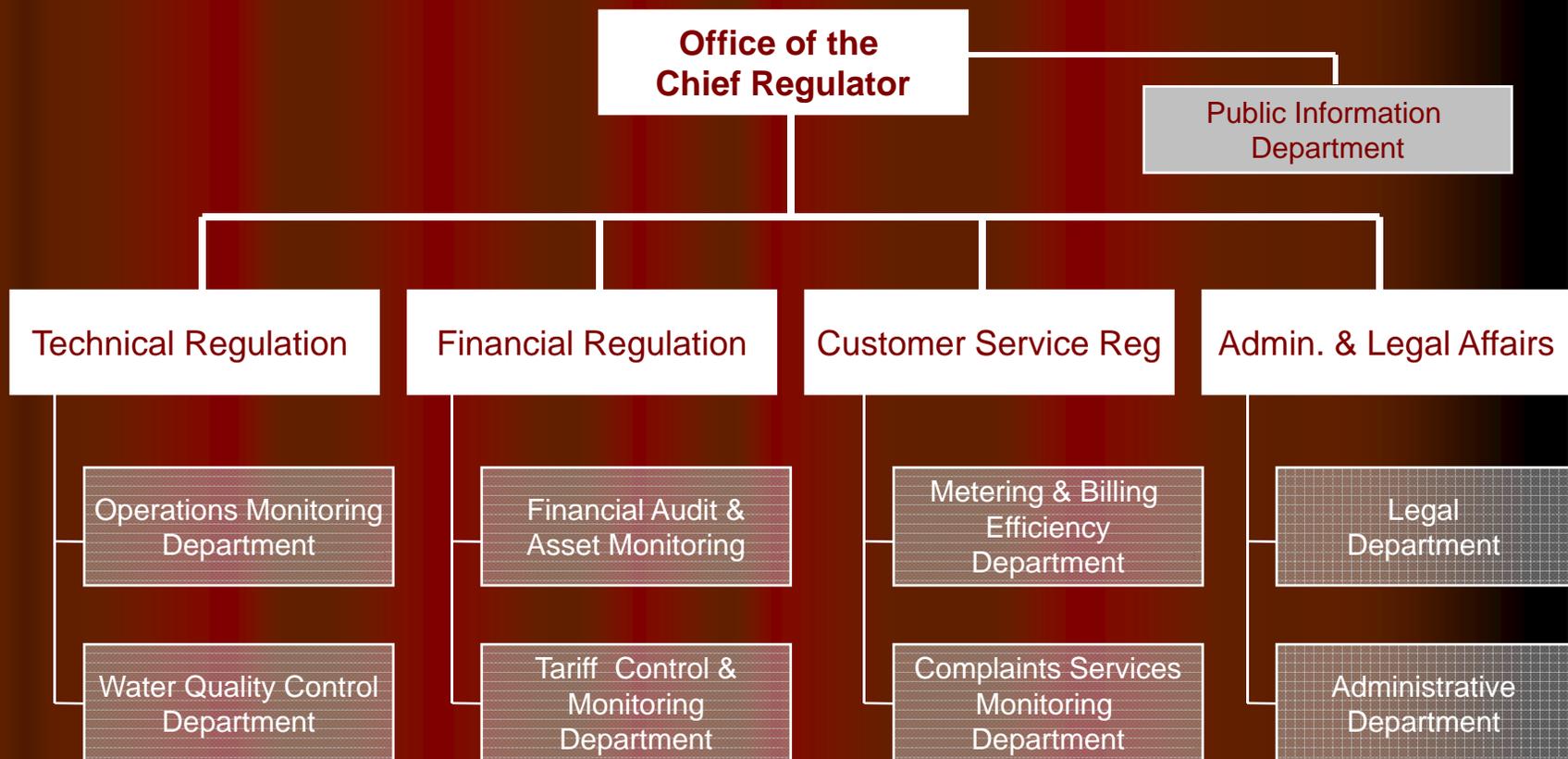
Creation

The MWSS Regulatory Office (RO) was organized by virtue of the Concession Agreement between the MWSS representing the Philippine Government and the two concessionaires, Manila Water Company Inc. (MWCI) and Maynilad Water Services Inc. (MWSI). The RO was established under the jurisdiction of the MWSS Board of Trustees pursuant to MWSS charter and applicable laws and legislation.

As mandated by the Concession Agreement, the Regulatory Office is headed by a Senior Deputy Administrator (SDA) acting as Chief Regulator, and four Deputy Administrators (DA).

The Regulatory Office has 4 Regulation Areas namely: The Technical Regulation, Customer Service Regulation, Financial Regulation and Administration and Legal Affairs.

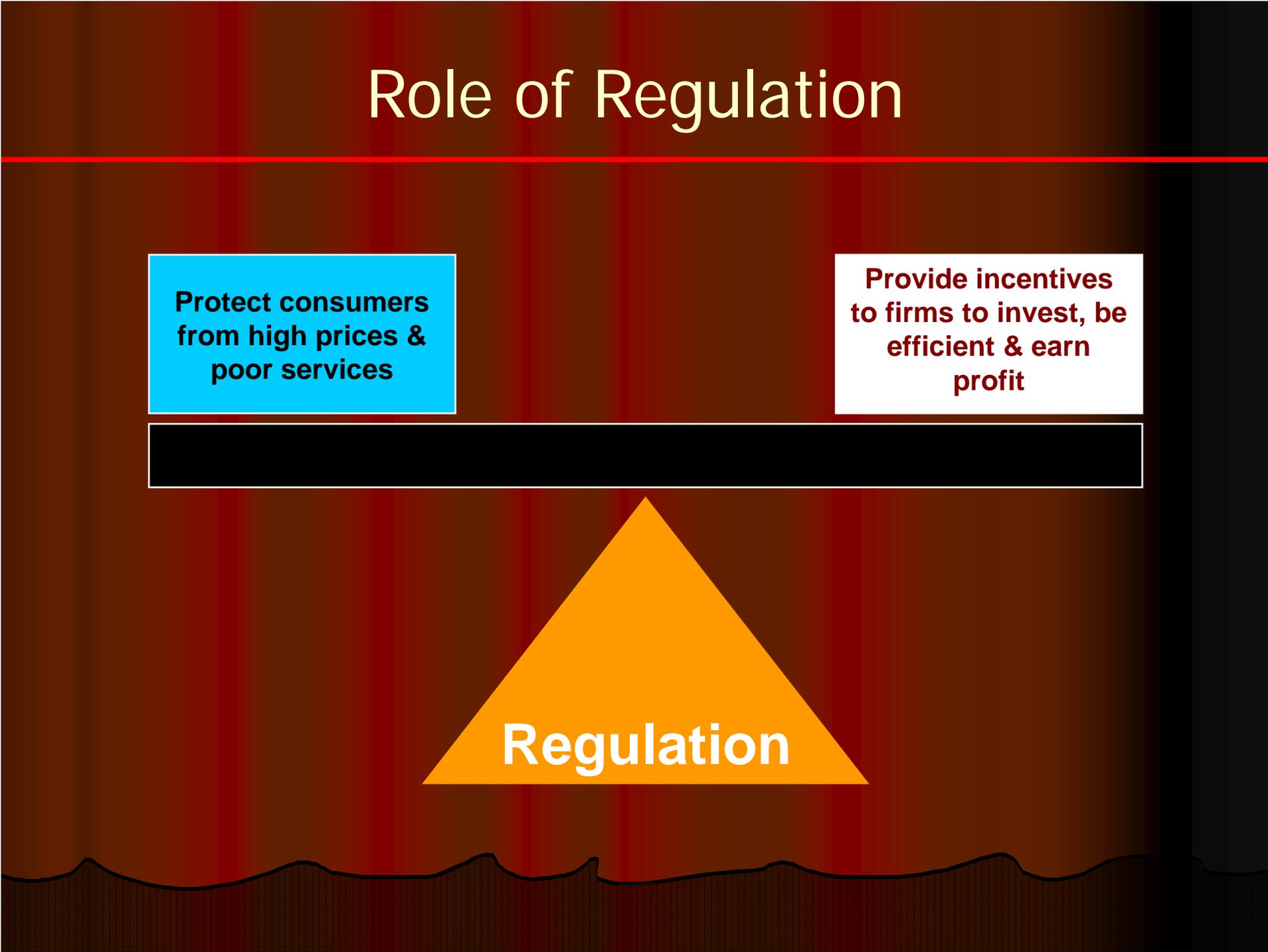
Organizational Structure



Role of Regulation

**Protect consumers
from high prices &
poor services**

**Provide incentives
to firms to invest, be
efficient & earn
profit**



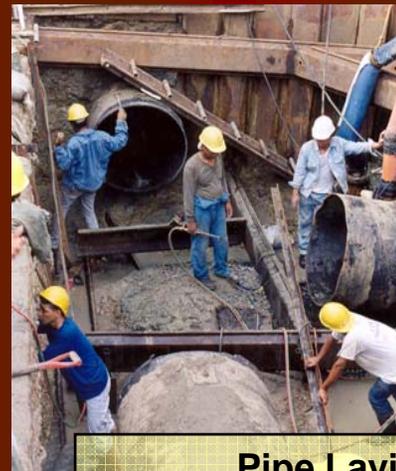
Regulation

Functions of the Regulatory Office

Monitoring Functions

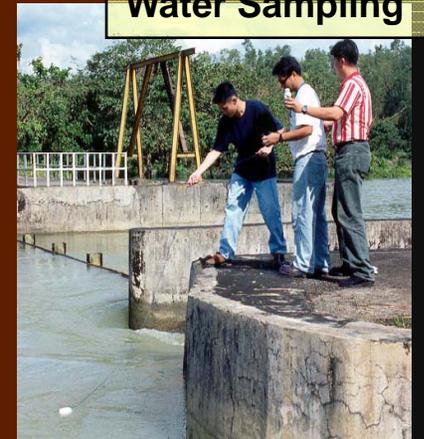
- ✓ Compliance with drinking water and waste water quality standards
- ✓ Water supply, sewerage and sanitation development, programs and projects vis-à-vis required population coverage and required year to attain targets
- ✓ Repair and Maintenance of Assets
- ✓ Non-revenue Water Reduction Targets
- ✓ Collection Efficiency Target
- ✓ Customer Service Standards
- ✓ Operational Cost Efficiency

Leak Repair



Pipe Laying
(infrastructure dev't proper)

Water Sampling



Determining Functions

- ✓ Extraordinary Price Adjustment (EPA)
- ✓ Rate Rebasing
- ✓ Early termination Amounts
- ✓ Assessments of Penalties



Public Consultation



Rate Rebasing

Objectives of Privatization

The MWSS was privatized in August 1997 to attain the following objectives:

- Improve water service in terms of availability, pressure and quality.
- Expand water, sewerage and sanitation coverage.
- Promote customer satisfaction.
- Eliminate fiscal burden on government.

THE REGULATORY FRAMEWORK

SERVICE OBLIGATIONS TARGET MONITORING

The Concessionaire has set the targets for meeting their service obligations on water, sewerage and sanitation services.

Water Services Obligations

⇒ Water Supply and New Connections

The concessionaire shall offer water supply services to existing connections and make at least sufficient connections to meet the coverage target percentages of the population in the designated municipality.

⇒ Continuity of Supply

The Concessionaire shall ensure the availability of an uninterrupted 24 hour supply of water. At all times, water shall be supplied at a level of positive pressure sufficient to secure the system against the ingress of untreated water or contaminants.

⇒ Obligation to Make Connections

The concessionaire shall make a connection as reasonably practicable to a water main located less than 25 meters from the connection point. The customer shall pay a connection fee of P 3,000.00 subject to Consumer Price Index adjustment every year after 1997.

⇒ Drinking Water Quality Standards

The concessionaire shall ensure at all times that water supplied to consumers complies with the Philippine National Standards for Drinking Water.

⇒ Water for Public Purposes

The concessionaire shall make available adequate supply of water for fire-fighting and other public purposes as maybe requested by the municipalities. No charges shall be assessed for fire-fighting but may charge for all other water used for public purposes.

⇒ Water Other Than Through Water Main

In case of water interruption of more than 24hours and contamination of water mains, alternative supply of water shall be made available to customers. In circumstances where no connection to a water main exists, the concessionaire may make supply of water available to customers other than through a water main at a fee equal to the costs reasonably and efficiently incurred to supply such water.

Sewerage/Sanitation Services Obligations

⇒ Sewerage Service and New Connections

The Concessionaire shall service existing sewerage connections for domestic sewage and industrial effluents compatible with available treatment processes. The concessionaire shall meet the coverage target percentages of the population in the designated municipality.

⇒ Connections to a Public Sewer

A sewer connection shall be made by the concessionaire upon request from the consumer. A connection fee shall be assessed in the amount of P 3,000.00 for connection less than 25 meters. The fee shall be adjusted yearly based on CPI.

⇒ Wastewater Standards

The concessionaire shall comply to all national and local environmental laws and standards relating to treated wastewater.

⇒ Septic and Sanitation Cleaning

The concessionaire shall offer septic and sanitation cleaning services and shall meet the coverage target percentages of the population in the designated municipality.

Customer Service Standards

The concessionaires shall provide the highest quality services to its customers by:

- ⇒ giving prompt responses to inquiries and complaints;
- ⇒ giving notices at least 48 hours in advance of any planned interruptions;
- ⇒ providing alternative water supplies for planned interruptions;
- ⇒ effecting urgent restoration of water supplies for any unplanned interruptions;
- ⇒ taking measures to prevent sewerage flooding;
- ⇒ providing invoices. Identifying clearly services, charges, period covered, forms of payment and penalties.

WATER RATE ADJUSTMENTS

Concession Agreement (as amended) Provisions for Water Rates Adjustment

- ⇒ C - Consumer Price Index (CPI) based on NSO official figures (annual)
- ⇒ E - Extraordinary Price Adjustment (EPA) based on 11 grounds for EPA
- ⇒ R – Rate Rebasing (every 5 years)

11 Grounds for EPA

1. Amendment to the Service Obligation
2. Change in law, government regulation, rule or order
3. Breach of Concession Agreement (CA)
4. Receipt of a Grant / Below Market Financing
5. Increase in Consumer Price Index (CPI) $> 12\%$
6. Devaluation of Peso vs. Dollar $> 2\%*$
7. Unpaid penalty amount
8. Bid assumptions proven to be incorrect in a material way
9. Increase in Concession Fee due to the Umiray-Angat Tunnel Project (UATP) delay
10. Financial Performance affected by UATP beyond 1999 target completion
11. Force Majeure

Replaced by Foreign Currency Differential Adjustment (FCDA) per Amendment of the Contract

Extra-ordinary Price Adjustments (EPA)

- ⇒ Based on 11 grounds
- ⇒ Prudent and efficient expenditures incurred are recovered
- ⇒ Effectivity – next charging year after RO evaluation/determination

$$\Rightarrow \text{EPA Adjustment (\%)} = \frac{\text{Net Present Value of Incurred Expenditures}}{\text{Net Present Value of Expected Receipts}}$$

- ⇒ EPA percentage – applied to the current tariff to determine adjustment

Rate Rebasing

Under the Concession Agreement as Amended

- ⇒ **Mandates** the parties to re-set or rebase water rates every five (5) years.
- ⇒ Allows the Concessionaires to undertake **new investments** and expand water infrastructure

What is Rate Rebasing?

Rate Rebasing involves a general rate revision. The bases for the original bids of the concessionaires such as Capital Expenditures, Revenues and Operating Expenses are, revisited, examined and revalidated in order to determine whether the tariff rates being charged are still sufficient to earn a reasonable rate of return.

⇒ **Review**

⇒ **Examination**

⇒ **Revalidation**

⇒ OPEX

⇒ CAPEX

⇒ Revenues

⇒ ADR

⇒ Service Obligations

Key Elements

- ⇒ Examination of all cash flow elements in the cash position
- ⇒ Evaluation of future capital and operating expenditures
- ⇒ Determination of appropriate discount rates (commencement date and rate rebasing date)
- ⇒ Evaluation of past and future service obligations targets

Rate Rebasing Framework

$$\text{NPV of OCP} = \text{NPV of Future Cash Flows}$$

Where:

NPV is Net Present Value (Value of money at 2003 Prices)

OCP is Opening Cash Position (Historical Revenues and Expenditures prudently and efficiently incurred)

Future Cash Flows = Future Revenues – Future Expenditure

How is Water Rate Adjusted?

$$RAL = C \pm E + R$$

where:

RAL = Rate Adjustment Limit

C = Consumer Price Index

E = Extraordinary Price Adjustment

R = Rate Re-basing

Dispute Resolution Mechanism

DISPUTE RESOLUTION MECHANISM

Disputes or disagreements, concerning the interpretation or implementation of the Concession Agreement, including all the decisions of the RO may be resolved through:

- ⇒ Mutual Consultation and Negotiation – use reasonable efforts
- ⇒ Arbitration
 - Creation of Appeals Panel
 - Proceedings in accordance with the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL)

Composition of the Appeals Panel

To be appointed not less than 30 days prior to the commencement of each Rate Rebasing period
(before 01 December 2002/2007/ 2012/2017)

For Major Disputes:

MWSS RO and Concessionaire, each appoint a Member;
International Chamber of Commerce (ICC) *Chairman*
designates a third member as Appeals Panel Chairman

For Minor Disputes:

MWSS RO and Concessionaire, each appoint a Member;
The 2 appointed Members designate a third member as
Appeals Panel Chairman

Major Disputes

- ⇒ Rebasing Dispute
- ⇒ EPA Determination
- ⇒ Termination Amount Calculation
- ⇒ Amount & Price of the cross-boundary flows
- ⇒ Delegation of responsibilities in the Joint Venture
- ⇒ Notice of Termination
- ⇒ Removal from office of a Regulator

Minor Disputes

- ⇒ All Disputes other than Major Disputes

Qualifications

- ⇒ Each Member of the Appeals Panel (other than the Appeals Chairman) shall be a resident (but need not be a citizen) of the Philippines
- ⇒ Must be individuals of good business reputation who have no prior business connection with any of the parties to the Agreement or with the Other Operator
- ⇒ Any member may be reappointed for more than one Rate Rebasing period

Procedures

- ⇒ Proceedings shall be in English and shall be held in Manila
- ⇒ Written Notice served to the Chairman, setting out in reasonable detail the circumstances of such dispute
- ⇒ Appeals Panel shall make a decision within 90 days from receipt of Dispute Notice
- ⇒ Decision must have the written concurrence of at least two of the three members of the Appeals Panel
- ⇒ Any decision of the Appeals Panel shall be final and binding

Appeals Panel Costs

- ⇒ Out-of-pocket expenses incurred shall be apportioned as the Panel shall direct; concessionaire's share of the costs shall be treated as an Expenditure
- ⇒ Appeals Chairman shall be entitled to a per diem compensation recommended by the ICC3; other Members shall each be entitled to a per diem compensation equal to P2,500 (automatically adjusted by the CPI, 2003 = P 3,539 ≈ US\$ 67)
- ⇒ Secretarial and administrative support services to be provided by the RO free of charge

Public Auditing and Regulation

Public Auditing and Regulation

- ⇒ Regulatory Office is a creation of the Concession Agreement and not thru legislation
- ⇒ Regulatory powers limited to those set forth in the Concession Agreement
- ⇒ The System of Public Audit / Regulation
 - ⇒ Contract overseer / administrator
 - ⇒ MWSS Water Rate determination / recommendation
 - ⇒ Board of Trustees retains power to approve water rates
 - ⇒ Disallowances of expenditures are done after facts or during rate rebasing exercise w/c is every 5 years
- ⇒ Section 6.5.3 of the CA. "technical audit of the accuracy and completeness of any asset condition report and /or the Concessionaires' compliance with its obligations
- ⇒ Section 13.2 of the CA, Audit of Concessionaire books and records

The Stakeholders

- ⇒ The Owner
- ⇒ The Concessionaires
- ⇒ The Public
- ⇒ The Regulatory Office

The Appeals Experience

- ⇒ Minor Dispute re: proper price for inter-zone water transfers between the two service areas
- ⇒ Major Dispute UNC 24/H6N/OL MWCI vs. MWSS and its Regulatory Office issues include, among others, the interpretation of the contract as to the frequency of determination of the Appropriate Discount Rate (ADR)
- ⇒ Major Dispute UNC38/HGN/KGA MWSI vs. MWSS – this was withdrawn after the parties came to an amicable settlement