OOCUR/CRRC 1

FUNDING THE REGULATOR
THE BAHAMIAN FRAMEWORK

By Kathleen Riviere-Smith[1]

ABSTRACT

The paper will review some best practices/theories developed with respect to the funding of the regulator. The paper will compare the Bahamian Framework with those best practices/theories, which will demonstrate to the audience/reader the economic advantages of multisectoral regulators in small countries or states, the need for reliable funding, and the requirement for transparency, objectivity and proportionality in developing the funding framework.

The Bahamian framework for funding the regulator has been fairly successful. Based on informal discussions with other regulators in the Caribbean, some of these agencies are experiencing difficulties in securing adequate and predictable funding. It is hoped that the Bahamian experience may be useful to these agencies as they proceed to develop the required funding mechanisms needed to become effective regulators.

INTRODUCTION

In many developed and developing countries, the utility companies were state/government owned monopolies, which a few had regulatory responsibilities where there was limited competition. Once governments started to divest their investments in these utility monopolies and liberalize the respective sectors, it became apparent that a new regulatory framework had to be developed and implemented. By and large this has led to the establishment of the independent economic regulators.

THE DESIGN OF THE REGULATOR

The design of the regulator is very important as it has a direct impact on the cost of regulation. The main choices of design are sector specific or multisectoral regulator.

There are advantages and disadvantages of each design. The advantages of a multisectoral regulator are as follows:

---

[1] The writer is employed as a Financial Analyst with the Public Utilities Commission in The Bahamas. She qualified as a Certified Public Accountant in 1993. The views expressed by the writer are her own and should not be attributed to the Public Utilities Commission. The writer is responsible for all errors.

- Synergies are developed by regulating more than one sector, which facilitates cross training across sectors. There is also the convergence of some subsectors making it practical to have a multisectoral regulator.
- The multisectoral regulator is less likely to be captured by any sector, which it regulates.
- Resources such as professional and administrative staff are shared resulting in greater efficiency with respect to costs.
- There are economies of scale, which lower the cost of regulation from a national standpoint.

The offsetting disadvantages are:

- A multisectoral regulator may lack sufficient specific sector expertise or focus.
- Placing the responsibility of regulating more than one sector in a single multisectoral regulator is tantamount to "putting all of your eggs in one basket". If the regulator fails its impact would be on all of the regulated sectors.
- Multisectoral regulators are appropriate only for small countries or member states of a federation. However, the arguments for a multisectoral regulator are very strong in these cases.

It would appear that in the larger more developed countries/states, the preferred choice is for sector specific regulators. While in countries where regulatory expertise is scarce, small populations and economies, the argument for multisectoral regulators is strong. However, note that the state of California, USA which has a population of over 34 million, a Gross State Product of US$1.4 trillion and the 5th largest economy in the world has a multisectoral regulator and Trinidad and Tobago has a sector specific regulator for telecommunications with a population of 1.2 million and a GDP of US$10billion.

Tables 1(a) and 1(b) provides some examples of the designs adopted in some countries:

Table 1(a) – Sector Specific Regulators

COUNTRY & AGENCY	**REGULATED SECTOR**
USA	
FCC – Federal Communications Commission	Communications via wire, cable, radio, television, satellite
FERC – Federal Energy Regulatory Commission	Gas, oil, electricity

UK	
OFCOM – Office of Communications	Telecommunications, cable television, radio broadcasting, radiocommunications
OFWAT – Office of Water Services	Water and sewerage
OFGEM – Office of Gas and Electricity Markets	Gas and electricity
CANADA	
CRTC – Canadian Radio-Television and Telecommunications Commission	Telecommunications, cable television and radio broadcasting
NEB – National Energy Board	Energy
GERMANY	
RegTP – Regulatory Authority for Telecommunications and Posts	Telecommunications and Postal
INDIA	
TRAI – Telecommunications Regulatory Authority of India	Telecommunications
FRANCE	
ART – Autorite de regulation des telecommunications	Telecommunications

Table 1(b) – Multisectoral Regulators

COUNTRIES/STATES	**REGULATED SECTORS**
PANAMA – ERSP, Ente Regulador de los Sevicios Publicos	Telecommunications, electricity, water & sanitation, radio & television
JAMAICA – OUR, Office of Utilities Regulation	Telecommunications, electricity, water, ground transportation
CALIFORNIA – PUC, Public Utilities Commission	Electricity, telecommunications, natural gas, water and transportation
TEXAS – PUC	Telecommunications, electricity
OKLAHOMA – OCC, Oklahoma Corporation Commission	Electricity, gas, telecommunications, water and irrigation
FLORIDA – PSC, Public Service Commission	Electricity, natural gas, telecommunications, water and wastewater

The Bahamas is a small country with a population of 308,000 and scarce regulatory expertise. The Public Utilities Commission (PUC) Act, 1993 and as amended in 1999 created the legal framework for the

establishment of the regulatory agency. The country established a multisectoral regulator with the purview of telecommunications, electricity and water and sewerage. With the exception of sector engineers, professional staff work across all of the sectors. The PUC, which was established on March 25, 2000 currently, only regulates the telecommunications sector and will commence regulation of the other sectors only on such date as the Minister appoints.

THE FINANCIAL CHALLENGES OF RECRUITING AND RETAINING PROFESSIONAL STAFF

In order to be an effective regulator the need for sufficient financial and human resources must be satisfied. Best practice is that "small is beautiful" in staffing the regulator to keep costs to a minimum. Generally, regulators require regulated companies to be efficient. Likewise the regulator should be efficient in its operation including its staffing and not create excessive costs.

Best practice in recruiting qualified staff has been to exempt the regulator from civil service salary restrictions, which tend to be less than competitive. The regulator should benchmark salaries and benefits with the regulated entities as well as other private sector entities that use similar skills. By offering competitive salaries and benefits, the regulator has a fair chance of recruiting and retaining qualified staff as it is competing directly with the private sector and the regulated companies for the required staff.

The Bahamian PUC has been exempt from civil service salary restrictions. The PUC offers competitive salaries and benefits including continuous training opportunities. However, it has not been easy to recruit qualified staff at the PUC. There is the novelty of the organization and the workforce is uncertain of the PUC's permanence when compared with other statutory authorities. There is also a very competitive market for some professionals in The Bahamas. Attorneys, accountants and engineers employed in larger private sector firms can earn substantial salary and benefits packages including profit sharing and bonuses. On the other hand there are limited opportunities in the country for professionals such as economists resulting in a very limited pool of qualified persons. The PUC has a complement of 18 full time professional and administrative staff. The planned complement of staff is 30 in total once the electricity and water sectors are regulated.

SOURCES OF FINANCIAL FUNDING

A regulator must have adequate and reliable funding to be effective. However, it must be emphasized that a regulator should only carry out the duties it is legislated to do, no more no less. Funding the regulator is

always challenging. The general populace does not want to be taxed for something that it is not sure it will benefit from nor do consumers want any increase in the utility rates. So how does the regulator obtain financial funding?

Funding options available are as follows:

1. Budgetary allocations – The government would allocate an amount in its annual budget for the regulator. This method leaves the regulator susceptible to political interference as the regulator could be penalized by the political directorate (reduction in its budget) for an unpopular decision that it made.

2. Impose levies/licence fees on the regulated sector. This method is preferred as it gives the regulator control over its financing and reduces the reliance on budgetary allocations. The levy/licence fee should not be burdensome and there are generally laws establishing the maximum levy/licence fee to be charged, e.g. Florida has established maximum levies on the industry revenue as follows: electricity – up to 0.5%; telecommunications – up to 0.25%; water and wastewater – up to 4.5%.

3. Usage or service fees – This relates to fees for specific services and activities conducted by the regulator. Licence application and filing fees could be charged for services. Funds from usage and service fees tend to be limited and less reliable as they are dependent on the level of services provided.

4. Any combination of the 3 options above.

The guiding principles for the selection and implementation of a system in determining the levy/licence fees and the national or budget allocation are as follows:

1. Transparency – The fees should be set in a manner that is clear and understandable for the regulated sectors and public at large.
2. Objectivity – The fees set should be seen as fair to the entities or the regulated sectors.
3. Proportionality – Fees should be set so that each regulated sector covers the cost of its own regulation and contributes to common costs shared across sectors.

These levies/licence fees are generally expressed as a percentage of gross revenue of the entity or sector regulated, which may result in different percentages per sector. This method is seen as equitable as experience has indicated that there is generally a relationship between the gross revenue and the volume of regulatory work generated. It should be noted that the regulator should be vigourous in the collection of the levies/licence fees.

In The Bahamas, the PUC currently regulates only the telecommunications sector and as such its experience will be drawn principally from that sector. The PUC currently uses a combination of all three funding options. The PUC has a budget of B$2.9 million for fiscal year 2003/2004. Approximately 86%, 14% and less than 1% of that budget will be funded by licence fees (telecommunications and radiocommunications), government allocation and service fees, respectively.

The PUC Act enables the PUC to levy and collect fees from the regulated utilities to defray its budgeted costs and expenses. The legislation also provides for any costs and expenses not recovered by the fees levied to be charged upon and paid out of the Consolidated Fund. In accordance with the Telecommunications Act, 1999, the PUC charges fees for both section 9 and 30 licences. The section 9 licences are for provision of telecommunications services while the section 30 are radiocommunications licences for the use of spectrum. There are instances where a licensee has to pay 2 sets of fees, e.g. SRG pays a fee for its Fixed Wireless licence (telecommunications) and a fee for its spectrum usage (radiocommunications).

The PUC also charges service fees for telecommunications licence applications. Application fees are charged and payable in advance based on the estimated licence fee for licence type applied. If the applicant is successful in obtaining the licence, then the application fee is applied to the actual licence fee determined and the applicant makes no further payment if covered. However, if the applicant is unsuccessful in obtaining the licence then 50% of the application fee is retained by the PUC to cover processing costs and the other 50% is refunded to the applicant. This also assists in controlling frivolous applications being made to the PUC.

The PUC inherited the telecommunications and radiocommunications licence fees established by legislation when the government owned telecommunications company, Batelco was also the regulator. Those fees, which were out of date, many being established over 25 years ago, were not covering relevant costs. Therefore, the PUC carried out a comprehensive review of those licence fees in 2001 and established new licence fees effective August 1, 2001 as indicated in Attachment 1. The PUC has also put in provisions in the section 9 licences for the payment of a supplemental licence fee to reflect costs incurred are in excess of the licence fee. If the licensee was overcharged, it would be credited the excess during the following year, and conversely if the licensee were undercharged then it would be charged a supplemental fee. However, the PUC has not had to exercise this provision to date and strives to avoid such a situation. The licence fee revision process started by the PUC estimating its annual operating costs. The Telecommunications Act, 1999 indicates that the Commission is to “set fees only so as to recover from licensees on an equitable basis, the aggregated amounts required to defray costs incurred or anticipated by the Commission in connection with its functions and powers in relation to telecommunications” for the

section 9 licences and "set fees only so as to recover from licensees, on an equitable basis, the aggregated amounts required by the Commission in connection with its functions and power in relation to radiocommunications" for section 30 licences. The cost of radiocommunications functions and the number of licensees (actual and potential) were estimated, rate of inflation over the period for which fees had not changed was identified and the licence fees in other countries were also reviewed and analysed. Those principles formed the justification for developing the new radiocommunications licence fees.

The costs of radiocommunications functions is deducted from the annual operating costs which provides the cost of regulating the telecommunications as well as some common infrastructure for the electricity and water sectors. These remaining costs are then allocated among the regulated sectors based on estimates of the amount of regulatory work each sector generates. The telecommunications sector's gross revenue is projected based on historical and forecasted data. This is then used to calculate the percentage of gross revenue needed from the sector to cover the cost of regulation. In the case of the telecommunications sector all licensees that provided telecommunications services pay a licence fee of 0.524% of gross revenue subject to a minimum licence fee of $2,600.

Let us look at a hypothetical example:

		$
PUC's estimated annual costs		200,000
Cost of radicommunications functions		(50,000)
Costs to be allocated to other sectors		150,000
Telecommunications (section 9) – 66.67%	100,000	
Electricity – 20%	30,000	
Water – 13.33%	20,000	
Total allocation to other sectors		150,000

Telecommunications sector's estimated gross revenue $10,000,000

Percentage of telecommunications sector revenue needed for regulation = $\frac{100,000}{10,000,000} \times 100 = 1\%$

Therefore, section 9 licensees in the telecommunications sector would be charged a licence fee of 1% of gross revenue per annum.

The PUC was established on March 25, 2000. In fiscal years 2000/2001 and 2001/2002, most of the PUC's financing came from budgetary allocations. This was in line with the recent establishment of the agency

and a transitional period to renew and issue licences and collect the respective licence fees. The initial primary reliance on budgetary allocations was challenging resulting in the rate of development being set by the government. The government would only provide what it deemed as adequate and as a result this prolonged the capacity building of the PUC. In fiscal year 2002, once the new licence fees were established and the PUC aggressively collected the licence fees, its reliance on government's budgetary allocations decreased significantly. Also, the government owned telecommunications company, Bahamas Telecommunications Company (BTC formerly Batelco), was assessed a licence fee like all other licensees and this provided the PUC with additional funding from licence fees. The PUC still relies on the government for some budgetary allocations for assessed costs. The PUC cannot regulate the electricity and water sectors until such date that the Minister shall appoint. As a result, the PUC receives budgetary allocations as a substitute for the licence fees that would have been paid by the electricity and water sectors.

BTC challenged the PUC's authority to charge a licence fee in 2002 because it was already paying a franchise fee to the government. This challenge of the PUC's authority created some uncertainty in funding for the PUC for a short period. The issue was resolved and BTC paid the licence fees as assessed. There are penalties in place for late and non-payment of licence fees. Licensees can pay accrued interest, at the rate of 3% above the Bahamian Prime Rate (currently 6%), on the unpaid balances or the PUC may revoke the licence in accordance with section 34 of the Telecommunications Act.

Going forward, the PUC looks towards regulating the electricity and water sectors. With those two sectors being regulated, the PUC can charge licence fees to the regulated entities. This would eliminate the budgetary allocations received from the Government except for the provision that cost and expenses of the PUC not recovered by licence fees would be charged to the Consolidated Fund.

INDEPENDENCE AND ACCOUNTABILITY

What does independence mean for the regulator? Best practice includes the following:

1. Political Autonomy – The regulator should be insulated from the pressures of the government, the regulated companies and other interest groups. The regulator must also be perceived to be insulated from pressure by any group in its decision making process.
2. Organizational/managerial autonomy – The regulator manages its own day to day affairs including setting salaries and conditions of employment. This includes exempting the regulator from civil service salary restrictions in order to recruit and retain highly motivated and qualified staff. The technical expertise developed by the professional staff

in combination with political autonomy leads to improved decisions and enhances the regulator's credibility and authority.

3. Access to earmarked funding – The regulator must have adequate and reliable funding to carry out its mandate and facilitate the recruitment of qualified professional staff.

After developing a funding regime, the regulator cannot be left to its own devices. There needs to be a balance between independence and accountability. Checks and balances need to be in place to ensure that the regulator is (a) carrying out only the duties within its mandate, (b) not involved in corruption and (c) grossly inefficient.

Some of the measures that are used to ensure accountability are:

1. Transparency requirements – The regulator should publish its proposals on any general instructions intended to be issued.
2. Prohibiting conflicts of interest.
3. Providing an effective appeal process of the regulator's decisions.
4. Scrutiny of the regulator's budget by the legislature.
5. Subjecting the regulator's conduct and efficiency to scrutiny by independent auditors and/or other public watchdogs.
6. Allowing the removal of the regulator from office for proven misconduct or incapacity.

The PUC by legislation has its mandate outlined in the PUC and Telecommunications Acts. The PUC Act outlines the following:

- Professional criteria for the appointment of commissioners,
- The requirement for the disclosure of interest in any undertaking with proceedings before the PUC, and
- The tenure of office and the criteria for removal from office of commissioners.

The commissioners are appointed by the Governor General on the advice of the Prime Minister and after consultation with the Leader of the Opposition. The PUC does have organizational autonomy and does have access to earmarked funding as discussed earlier.

The legislation also requires the PUC:

- To publish its proposals on licensing procedures and the like,
- To have an appeal process through the Supreme Court,
- To subject its budget to approval by the Minister,

- To have its accounts audited annually by auditors and provide the Minister with audited accounts within four months of the financial year end, and
- To send an operational report to the Minister within three months of the financial year end.

All of these requirements ensure that the PUC is accountable to the Government and public at large for its actions and the use of funding. However, that may not be sufficient for the PUC in the future. Other regulatory agencies have taken accountability to the next level. Regulators are now subject to operational and other non-financial audits, e.g. the Michigan Public Service Commission had a performance audit conducted in 1999 for the period October 1, 1996 to August 31, 1999. Amongst the audit objectives were 1. to assess the soundness of the performance measures to evaluate the goals and objectives of the agency and 2. to determine the accuracy of the utility assessments (levies/licence fees). The PUC looks forward to the next level of accountability with possible operational and efficiency audits in the future.

CONCLUSION

In the last decade, many countries have established or are in the process of establishing regulatory agencies. The design of these regulatory agencies should depend on amongst other criteria the size, needs, financial and human resources of the country. The design of the regulator, single sector or multisectoral will impact the costs of establishment and operations. In order for the regulator to recruit and retain qualified professional staff, it should be exempt from civil service salary restrictions. The regulator should have adequate and reliable funding to be effective in its mandate. Whilst the regulator should be independent (free from government and special interest groups) to make its decisions, it must be accountable and able to withstand public scrutiny.

Bibliography

Smith, Suzanne, editor *The Private Sector in Infrastructure Strategy, Regulation, and Risk* Washington. D.C.: The International Bank for Reconstruction and Development / The World Bank, 1997.

Guasch, Luis J., and Pablo Spiller, *Managing the Regulatory Process: Design, Concepts, Issues and the Latin America and Caribbean Story*. California: 1998.