

Approved Pilot and Demonstration Activities  
**Rationalizing Tariffs for Private Water Utilities Under the National Water Resources Board**

**Basic Information**

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| Activity Title                    | Rationalizing Tariffs for Private Water Utilities Under the NWRB  |
| Proposer                          | Almud Weitz, Urban Economist, Social Sectors Division (SESS), Southeast Asia Department, Asian Development Bank |
| Request Date                      | 4 December 2003   |
| Activity Start Date               | January 2004  |
| Activity End Date                 | July 2004   |
| Country                           | Philippines   |
| Cost Estimate                     | \$50,000.00   |
| Implementing Organization Contact | Ramon B. Alikpala<br>Executive Director<br>National Water Resources Board (NWRB)                                |
| Consultant Identified             | IDP Consult, Inc.   |
| If so, Consultant(s) Contact      | Edna Balucan<br>President   |

**1. Background and Rationale**

The National Water Resources Board (NWRB) is the government coordinating agency for all water resources development activities. In addition, its jurisdictional powers, functions and duties pursuant to Section 11 par “e” of PD 1206 include “supervise and control all waterworks utilities and their franchises, and other properties; regulate and fix the water rates to be charged by waterworks operators, except those falling under the jurisdiction of MWSS and the LWUA and Water Districts”. With the recent issuance of EO 123<sup>1</sup>, NWRB’s responsibility for tariff regulation has further increased and now includes water districts (which used to be covered by LWUA) in addition to LGU run water systems, and private water utility operators except those covered by special concession and joint venture agreements. Private water utility operators essentially refer to water operators in subdivisions<sup>2</sup> which are required to secure a CPC/CPCN<sup>3</sup> from NWRB as well as approval of their respective water tariffs prior to operating their respective water systems.

Although the coverage of the sector is extensive, the major focus of NWRB operations at present is in the issuance of Certificate of Public Convenience (CPC)/Certificate of Public Convenience and Necessity (CPCN) and the corollary tariff review activities for private water utility operators. Consequently, NWRB has determined that enhancement of its performance in the area of economic regulation of private water utility operators is a

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<sup>1</sup> EO 123 transferred responsibility for the approval of water district water tariffs from LWUA to NWRB.

<sup>2</sup> Subdivisions also include condominiums, townhomes and compounds

<sup>3</sup> Certificate of Public Convenience (CPC) is a formal written authority issued by NWRB to a qualified applicant upon notice and hearing authorizing him to operate and maintain a waterworks supply service and for which a franchise is not required by law. Certificate of Public Convenience and Necessity (CPCN) is essentially the same as CPC, with the difference that a certificate of public convenience and necessity is issued to an applicant for the operation of a public service for which a franchise is required by law.

priority matter. NWRB is still in the process of defining its regulatory role<sup>4</sup> in the economic regulation of other areas.

Table-1 shows that 250 private water systems<sup>5</sup>, most of which serve low income housing communities and comprising more than 170,000 households, have already been granted CPC/CPCN by NWRB. In addition, there are at least 85 pending requests at NWRB not to mention the water operators who did not submit the necessary application for the issuance of CPC/CPCNs. The number of private water operators under NWRB is expected to further increase as more subdivisions, condominiums, townhomes and compounds are being developed throughout the country.

**Table-1**

|   | <b>Total</b> | <b>Metro Manila</b> | <b>Other Luzon Areas</b> | <b>Visayas</b> | <b>Mindanao</b> |
|---|--------------|---------------------|--------------------------|----------------|-----------------|
| Total no. of water systems which have been granted CPC/CPCN and have had their initial tariffs approved and implemented | 250          | 77                  | 131                      | 28             | 14              |
| Total no. of households   | 171,430      | 47,971              | 88,949                   | 24,080         | 10,430          |
| No. of water systems with pending request for CPC/CPCN/ initial tariff  | 85           | 19                  | 46                       | 18             | 2               |

Through Board Resolution No. 265-4 series of 1985 dated September 9, 1985, the NWRB approved the guidelines in establishing rational water rates for waterworks system featuring two methods: 1) Return on Investment Method and 2) Break-even scheme (for waterworks system in subdivisions).

**Observation on Current Practices:**

While there have been no known serious problems regarding the application of the above methodology, several observations indicate that existing practices are not consistent with international best practices on economic regulation as follows:

Tariff Setting

- o The existing NWRB practice of using a one year analysis as the basis for setting tariffs is not consistent with the nature of the investment since water utility assets are long term and need more than a year in order to be able to realize the desired returns.
- o Tariffs are set based solely on historical asset costs and without regard to project revenue requirements in order to maintain and upgrade the assets. The methodology

<sup>4</sup> For example, the tariff review and approval function over the water districts have recently been transferred from LWUA to the NWRB through EO 123.

<sup>5</sup> Data as of 30 Sept 2003. Includes subdivisions, condominiums, townhomes and compounds. Excludes small-scale water providers since prices for these are market-driven and are self-regulating due to competition.

also raises the issue of double charging customers resulting from inclusion in the tariff setting of a return on assets which have already been paid for by the homeowners vis-à-vis consumers<sup>6</sup>.

- The methodology does not consider levels of service as agreed with the consumers and fails to utilize the tariff as a tool to encourage the operator to improve its service. As a regulator, NWRB assumes the responsibility of making sure that the tariff is reasonable vis-à-vis agreed levels of service.
- The methodology does not consider the affordability level of the customers.
- The methodology likely results in the distortion of required tariffs due to several practices specifically the use of estimates for non-revenue water (20%), consumption (34 cum per household per month for initial tariffs for new subdivisions even low income housing) and consumption based on the highest level within a block (for tariff adjustments)<sup>7</sup>.

### Monitoring

- There is minimal monitoring of financial performance of the water operators. Water operators are required to submit annual reports, submission of which are being monitored however only because it serves as the basis for the computation of the annual Supervision and Regulation Fees (SRF)<sup>8</sup>.
- While the reports are being audited annually, the statutory audit is confined to providing an opinion as to the accuracy of the financial data and not whether the expenditures are prudent<sup>9</sup> and efficient, whether planned investments have actually been undertaken, etc. In a number of instances, 5 to 10 year business plans are also submitted by water operators but since tariffs are set only for the immediate subsequent year, the business plans are not considered at all. A review of operations will only be undertaken the next time the operator applies for increase in tariff.
- The penalty and/or rewards system for private water operators appears inadequate. While NWRB is authorized to impose a fine on violations<sup>10</sup>, it is not clear for example what sanction can be imposed on subdivision water operators which have not secured the necessary CPCs/CPCNs, or water operators that do not meet level of service targets such as reduction in non-revenue water.

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<sup>6</sup> It has been argued that costs of the water facilities have actually been imputed in the development costs of the subdivision and as such have already been paid for by the lot buyers/ homeowners/ consumers. Therefore, charge these very same consumers a rate that provides a return on an asset which they have paid for becomes double charging.

<sup>7</sup> For example there are 10 customers whose consumption levels are within the first block of 1 to 10 cum. For tariff setting purposes, total consumption is computed at 10 customers multiplied by the maximum consumption of 10 cum. or 100 cum. per month. In reality, the actual consumption may be less than 10 for some households.

<sup>8</sup> Pursuant to Public Service Act Section 40, 2(e), CA 146 as amended: For annual reimbursement of the expenses incurred in the supervision of other public services and/or in the regulation or fixing of their rates, NWRB will impose and collect annual Supervision and Regulatory fees from CPC/CPCN holders on or before 30 Sept of each year, equivalent to fifty centavos for each one hundred pesos or fraction thereof, of the capital stock subscribed or paid, or if no shares have been issued, of the capital invested, or of the property and equipment, whichever is higher.

<sup>9</sup> For example, there have been instances where questions have been raised whether the salaries actually paid to the operators were reasonable.

<sup>10</sup> Under Board Resolution No. 03-0596 (May 27, 1996)-203<sup>rd</sup> Board meeting, the Board is authorized and empowered to impose a fine on public service violating or failing to comply with the terms and conditions of a certificate, orders, decision or rules and regulation of the Board.

- NWRB gets its funding for its various operating and other activities from the GOP (Government of the Philippines) budget. As an incentive, NWRB is also entitled to 50% of incremental total collections (total SRF, annual water charges and other fees collected this year less those collected last year), if any.

For the period January to October 2003, total SRF collected amounted to P7.7M. However, all SRF collections are remitted to and retained by the National Treasury. With this set-up, the SRF are not being fully utilized to serve its purpose which is essentially to provide funding for all the tariff review and financial monitoring functions of NWRB.

## 2. Objectives

The general aim of the proposed activity are to improve the delivery of water supply service particularly to poor communities and to enhance economic governance consistent with ADB's country strategy. Specific objectives are:

- To review and identify issues relating to the current regulatory arrangement particularly the tariff setting and supervision and monitoring by the NWRB of subdivision water operators and gauge their effectiveness/performance against economic regulatory principles and practices;
- To identify ways to improve the NWRB rate setting methodology and prepare guidelines on tariff setting consistent with levels of service, affordability and other economic regulatory principles;
- To identify ways to enhance governance through transparency/ accountability in the performance monitoring system for subdivision water operators;
- To encourage stakeholder participation in problem analysis and formulation of recommendations through workshop/consultations to ensure acceptability of the recommendations and promote advocacy of regulatory mechanisms;
- To introduce institutional reforms in order to strengthen the capacity of NWRB as the economic regulator in the water sector with the aim of preparing them to better handle their regulatory function in the sector. This will allow NWRB and its staff to align itself with the practices of other regulatory agencies and prepare itself for other bigger regulatory responsibilities particularly in the area of protecting customers (with special emphasis on low income households); and
- To assess various institutional options (including the use of private service providers), determine preferred options and develop appropriate proposals for implementable arrangements considering NWRB's organizational and resource constraints.

## 3. Scope of Work / Description of Activities

The project will be undertaken in four (4) workstreams, as follows:

- Legal – consists of a review of legal issues and determination of legal implications of proposed changes.
- Institutional/Training – covers examination of existing institutional arrangements within NWRB and with the consumers and operators of private

water utilities and subdivisions covered by the agency, and development of institutional proposals to improve tariff review and financial monitoring systems. This includes organization, staffing, and training. This workstream also includes a public dissemination plan through newspaper ads and distribution of primers.

- C. Tariff Review and Design – includes a review of current practices, development of methodology/guidelines considering applicable international best practices on tariff setting, and pilot implementation of the methodology using at least five actual cases.
- D. Financial Management / System – comprises evaluation of the current functions and accomplishments of the NWRB staff in performance monitoring and development of performance monitoring systems to enhance NWRB's role as economic regulator. This includes preparation of guidelines for performance monitoring and benchmarking including establishment of key performance indicators (KPIs) and the design of benchmarking model.

Please see Annex A for detailed tasks under each workstream.

#### **4. Implementation Schedule, Institutional Management Arrangements, and Proponent Qualifications**

##### A. Implementation Schedule

The project is estimated to be implemented over six (6) months to ensure that recommended work processes are thoroughly examined and confirmed effective. The consultants are expected to commence work on January 2004, with completion scheduled for end of June 2004.

Please refer to Annex A for detailed schedule.

##### B. Institutional Management Arrangements

NWRB will be the Implementing Organization, under the responsibility of the Executive Director. Inputs will be provided by a team of consultants with expertise and experience in financial advisory services particularly on tariff setting and review and performance monitoring of water utility operations. The team of 4 specialists will be led by a Team Leader/Institutional Expert who will work closely with the NWRB.

##### C. Proponent Qualifications

ADB has been fully supportive of the water sector's efforts to improve regulatory framework and mechanisms, and to strengthen capabilities of water utilities through the undertaking of various projects addressed to reach these goals.

As the government's coordinating agency for all water resources development activities, NWRB also recognizes the importance of these goals particularly through the recently completed Capacity Building Project for the Regulatory Office of the Metropolitan Waterworks and Sewerage System (ADB TA 3703-PHI). This TA project published guidelines on economic regulation for water supply and wastewater utilities, established a reference library, and conducted more than 20 workshops attended by officers of the various agencies in the

water sector, including NWRB. As a matter of fact, two of these workshops, for topics on Water District Tariff Setting/ Design and Review, were exclusively conducted for NWRB.

The TA project ultimately resulted in increased appreciation by NWRB of the importance of its role in economic regulation and intensified its desire to improve its performance as an economic regulator. However, during its implementation period, it failed to fully maximize the TA project's benefits because they were not appropriately represented in the workshops. This coupled with recent developments in the agency's organization and roles in the water sector, now makes it imperative for NWRB to undertake the proposed Pilot and Demonstration Activity to institute much needed institutional reforms.

## **5. Expected Results (outputs/outcomes/impacts)**

### **A. Outputs**

The major project deliverables include revised guidelines for rationalizing water fees for subdivisions / waterwork systems and for performance monitoring. Other outputs include:

- 2 stakeholder consultation workshops (one in Manila and one outside Manila) for Phase 1 – Review and another 2 workshops for Phase 2 – Development of Guidelines
- at least 10 workshops and seminars, as well as skills development programs and related training materials
- Progress reports (Inception Report, Midterm Report and Final Report).

Please refer to Annex A for the Schedule of Deliverables.

### **B. Outcomes**

- Empowered NWRB through the enhancement of its economic regulation functions and capacity building of its staff
- Appropriate levels of tariffs consistent with agreed levels of service
- Empowerment of consumers (particularly the poor customers staying in low income housing subdivision) resulting from published information and benchmarking of operational performance of their private water utility operators

### **C. Impacts**

- Improved levels of service in the subdivisions
- Homeowners/consumers satisfied with the tariff as well as the water supply service
- Operators reasonably satisfied with their water supply investments and their service to the consumers
- Investors will be encouraged to invest for the improvement of the water supply facilities

## **6. Measurable Performance Indicators**

- Development of guidelines on tariff setting and performance monitoring
- Pilot implementation of tariff setting in at least five actual cases
- Trained NWRB staff

## **7. Stakeholder Participation**

Stakeholder participation is key to the successful implementation of the project since it enhances collaboration between NWRB, the water utility operators it regulates and the consumers. Stakeholder consultation workshops will be conducted:

- to facilitate data gathering and develop solutions to problems encountered by consumers and subdivision water operators using a participative approach;
- to get their support and appreciation for the objectives of the proposed pilot and demonstration activity; and
- to promote advocacy for regulatory mechanisms

It is expected that housewives will participate in the workshops thereby increasing the project's sensitivity to gender issues.

Stakeholder consultation will be carried out in two phases, the first phase to facilitate data gathering and problem analysis and the second to assess options as a starting point for the development of guidelines. There will be two consultations to be held for each phase, one covering Metro Manila and the other covering the region outside Metro Manila.

## **8. Scope for Replication/Use in Other DMCs**

The methodology can be replicated in other DMCs where the regulatory agency has been established but for which agency-specific guidelines on tariff setting and performance evaluation need to be established. These DMCs could adopt the guidelines and use the other outputs of the project including the training modules. Given generally similar conditions, only little work will be needed to bring-to-scale.