

THE ROLE OF PUBLIC UTILITY REGULATION: OVERSIGHT OR ONSITE?

Public utility regulation in the US, especially electric and gas utility regulation, produces results that are often the exact opposite from those intended many years ago when Congress and the respective state legislatures perceived the need for federal and state public utility commissions (PUCs). While there was a great deal of variation among the states, the first two decades of the twentieth century saw legislation imposing state regulatory controls over most electric, gas, and telephone companies. But the authority vested in a PUC in a typical jurisdiction was only to regulate the maximum rates of existing companies and to restrict competition in order to avoid price wars and what was viewed as competitive instability. Today, regulation is far more extensive than originally intended, and the cost of regulation to the US economy is perhaps in the billions of dollars.

Over the years, especially since the Arab oil embargo in the 1970s, PUCs have increased their control over utilities. As a result, multi-million dollar, even billion dollar, decisions that should be made by utility executives are being made, directly or indirectly, by PUCs. As legislatures and PUCs subject more utility functions to regulatory approval (for example, capital structures, construction budgets, plant type, fuel procurement, financing arrangements, advertising, forecasting), a utility's output becomes the product of some regulator's "notion." That regulator is often without the training or experience to make an informed decision, or he or she has incomplete information on which to base his or her actions. Worse yet, the regulator often attempts to be equitable by requiring something from everyone, for example, approving recovery of the cancellation cost of a power plant, but having the stockholder and ratepayer share the costs. In the real world, however, the ratepayer pays the entire cost. Stockholders simply sell their shares if they disapprove of the regulators' decision, and that action may actually increase the cost of capital to the ratepayers.

Regardless of the regulators' particular "notions," we never find out if they were right or wrong. Even if it were less costly for the ratepayer to pay for a plant cancellation at today's capital costs rather than at tomorrow's, no regulator will be held accountable. We don't have *ex poste* "what if" scenarios to judge the judges. Few, if any, decisions of regulators are judged to see if they in fact benefited the public as intended.

Since most major utility decisions need various federal and/or state regulatory approvals, the regulator, implicitly or explicitly, makes the decisions that management should be making – indeed is paid to make. The problem is exacerbated by ever-increasing regulation. For example, take a perceived societal problem like high utility rates. Legislators and regulators try to fix the problem by

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increasing regulatory oversight. The problem just gets worse, and the legislators and regulators come to the rescue with . . . even more regulatory oversight. This is like trying to douse a fire with kerosene. As former Secretary of Treasury, William Simon, writing in *The Wall Street Journal* some years ago, aptly said: "the more the government tinkers with the markets, the worse things get."

Even more dramatic than the shift from private to public utility management decision-making, through legislative "tinkering," is the revelation that utility regulation does not lower prices; instead it causes them to rise. Textbooks are replete with the assumption that regulation pushes prices down and pushes quantity out. Regulation was intended to prevent the monopolist from maximizing profits by lowering prices, which would result in increased output. But regulation has not performed that function for years. Today, regulating major public utilities means "pulling prices up." Public utility regulation, once envisioned by economic purists as "oversight" of monopolies, today, for all practical purposes, is "onsite" command and control.

Fortunately, a few state legislatures and PUCs, like Virginia's, have made a noble attempt to ensure that regulation is "oversight" – not "onsite." In those states, we have seen instances of deregulation (or streamlined regulation) of electric, gas, and telephone utilities, cable television, cellular telephone companies, paging, and other telecommunication companies. The resulting competition has produced quantum leaps in options for customers, particularly in the telecommunications industry. The consumer will benefit accordingly, assuming the proper balance in regulation. To paraphrase economist Milton Friedman: "[m]any people want the [regulator] to protect the consumer. A much more urgent problem is to protect the consumer from the [regulator]."

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