Regulating Public Utility Performance

The Law of Market Structure, Pricing and Jurisdiction

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Regulatory Law:
Purposes, Power, Rights and Responsibilities

Market Structure:
From Monopolies to Competition—Who Can Sell What to Whom?

Pricing:
How Much Can Sellers Charge—and Who Decides?

Jurisdiction:
State, Federal and Future

The Traditional Utility Monopoly

Periods of regulation

Rights to regulate

Obligation to serve

Exclusive retail franchise

Eliminating the legal monopoly at retail

Historical summary

Reducing non-facility entry barriers

Constitutional questions

Quality of service

Eminent domain

Limit on negligence liability

Making Competition Effective

Effective Competition: Definitions, goals and metrics

Unbundling: Reshaping the incumbent’s control of essential facilities

Anti-competitive pricing

Tying

Market manipulation

Upstream Actions and mechanisms: Who bears the costs of sufficiency and waste?

Rethinking separation

Prudent actions for uncertainty outcomes: Who bears the cost of bad luck?

Variations on cost bases

Departures from cost bases

"Just and Reasonable" Prices in Non-Competitive Markets: Cost-Based Rates Set by the Regulator

The rate-setting equations

Seller-set prices can be "just and reasonable" if seller lacks market power

Seller’s obligations: To prevent market power, regulators must screen and monitor

"Just and Reasonable" Prices in "Competitive" Markets: Market-Based Rates Set by the Seller

Impediments: Techniques and procedures for assessing and monitoring

Are scarcity prices just and reasonable?

The future of market-based rates

Undue discrimination

Due discrimination

Federal commissions decide state commissions

Commission decisions constrain courts

Commission must respect its own rates

Application to market-based rates

Application to antitrust law

Application to non-rate terms and conditions

Fraud does not block the filed rate defense

Discrimination: When Is Favoritism "Undue"?

Filed Rate Doctrine: The "Rate on File" Is the Only Lawful Rate

Retroactive Remaking: The Prohibition and the Exceptions

Mobile-Sierra Doctrine: When Does Contract "Sanctity" Give Way to Government-Ordered Amendments?

Three bases

Four Illustrations

Seven exceptions

Principle: The commission cannot let parties out of their contracts

The "public interest" exception

One standard—Duplex models of federal-state interaction

Three ways to preserve the regulator's role

Escape from the presumption: Fraud, duress, illegality

Special applications

Jurisdiction:
State, Federal and Future

The Federal-State Relationship

Limits on federal action

Market Structure

Limits on state action

Federal-state jurisdictional relationships

Regulating within the limits: Six models of federal-state interaction

Jurisdiction's Future

The future of public utility regulation

Corporate structure and changes in control
Regulatory Law: Purposes, Power, Rights and Responsibilities

Purposes of regulation
- Economists: Exploit economies of scale, address market imperfections
- Residential customers: Protect us from abuse
- Industrial customers: Set rates so we can compete globally
- Shareholders: Give us a chance for a fair return
- Lenders: Ensure cash flow sufficient to pay off debt
- Competitors: Lower entry barriers, give us a shot
- Environmentalists: Limit environmental damage

Purposes of regulatory law
- Powers
- Responsibilities
- Rights
- Procedures

Subjects and sources of regulatory law
- Subjects
- Sources
The Traditional Utility Monopoly

**Exclusive retail franchise**
- Exclusivity express in statute
  - Seven variations on exclusivity
    - New service offered by non-incumbent
    - Customer self-service
    - Group self-service
    - Adjacent monopolies as rivals: Locational and fringe competition
  - Exclusive franchise for a specific service
  - Competition for the exclusive franchise
  - No statutory exclusivity
- Franchise revocation
- Revocation authority
- Revocation justifications

**Obligation to serve**
- Regulatory options for franchise accountability
  - The anti-discrimination objective
  - The citizen access objective
  - The economic development objective
  - Limits on the obligation to serve
  - Contracts that undermine the obligation

**Consent to regulation**
- Statutory bases

**Quality of service**
- Components of quality: Traditional and new
- Regulatory requirements
  - Legal sources: Rules, statutes, and orders
  - Types of regulatory requirements: Inputs and outcomes
  - Remedies: Financial penalties and directed actions
  - The "management prerogative" constraint

**Eminent domain**
- Power, purposes, and limits
- Public–private overlap
- Federal roles

**Limit on negligence liability**
- General limitation and its justifications
- Parties and defenses
- Exceptions to the general rule
- No immunity: Gross negligence
- Federal–state relations
Monitoring Competition for Anti-competitive Behaviors

Anti-competitive pricing
  - Price squeeze
  - Predatory pricing

Tying
  - Definition and examples
  - "Technology tying" in utility industries

Market manipulation

Rethinking separation
  - Sufficient competition scenario
  - Insufficient competition scenario
"Just and Reasonable" Prices in Non-competitive Markets: Cost-Based Rates Set by the Regulator

- **The rate-setting equations**
- **What does "just and reasonable" mean?**
- **Imprudent actions and inactions: Who bears the costs of inefficiency and waste?**
- **Prudent actions but uneconomic outcomes: Who bears the cost of bad luck?**

- **Statutory purpose: Seller and buyer interests**
  - Regulator’s duty: Honor shareholders’ legitimate expectations
  - Substantive expectation: Opportunity to earn fair return
  - Procedural expectation: Opportunity for hearing

- **Constitutional constraint: The Takings Clause**
  - Limits on shareholders’ legitimate expectations
  - Prudential actions
  - Impediments to use reasonable management practices

- **Regulatory discretion under the “just and reasonable” standard**
  - Roles of legislature, commission and court
  - Poor performance relative to objective indices
  - The imputation solution

- **Statutory purpose: Seller and buyer interests**
  - The imputation solution
  - Imputation analogy: Who gets the gain on sold-off capacity?

- **Constitutional constraint: The Takings Clause**
  - Imprudent actions
  - Impediments to use reasonable management practices
  - Failure to oversee contractors and employees

- **Prudential actions**
  - Defense against disallowance: The "management prerogative"
  - Failure to use reasonable management practices
  - Impeachment: Who gets the gain on sold-off capacity?
  - Deference to utility expertise

- **Prudential actions**
  - Burdens of proof on prudence and imprudence
  - Financial consequences of cost disallowance
  - Deference to utility expertise

- **Prudential actions**
  - Financial consequences of cost disallowance
  - General rule: Rebuttable presumption of prudence
  - Deference to utility expertise

- **Prudential actions**
  - Prudence does not guarantee cost recovery
  - Three points on the risk-assignment spectrum
  - Four limits on regulatory actions

- **Variations on cost bases**
  - Area rates
  - Price caps
  - Alternative form of regulation

- **Departures from cost bases**
  - Is the departure necessary to carry out a statutory purpose?
  - How does the rate compare to cost?
  - Loosening the connection between rate and result

- **Prudential actions but uneconomic outcomes: Who bears the cost of bad luck?**
  - Prudence does not guarantee cost recovery
  - Three points on the risk-assignment spectrum
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"Just and Reasonable" Prices in "Competitive" Markets: Market-Based Rates Set by the Seller

Seller-set prices can be "just and reasonable"—if seller lacks market power

Paths to regulatory withdrawal

Wholesale electricity: Seller-by-seller review

The courts speak: To prevent market power, regulators must screen and monitor

The obligation to screen

The obligation to monitor

The agencies act: Techniques and procedures for screening and monitoring

Screening sellers

Monitoring sellers and punishing violators

Market power screens: Horizontal and vertical

Horizontal market power

Vertical market power

Are scarcity prices just and reasonable?

Other entry barriers

Affiliate transactions

The future of market-based rates
Discrimination: When Is Favoritism "Undue"?

Undue discrimination:
- Rate differences not justified by cost differences
- Rate differences with anti-competitive effect

Due discrimination:
- Different customer profiles
- Different settlement strategies and contract histories
- Price discounting to retain customers
- Product differences

Cost allocation within holding company systems:
- Systems that plan and operate utility assets centrally
- Systems that mix utility and non-utility businesses
Filed Rate Doctrine:  
The "Filed Rate" Is the Only Lawful Rate

- Filed rates: Purposes and principles
  - Federal courts
  - State courts

- Commission decisions constrain courts

- Federal commission decisions constrain state commissions

- Commission must respect its own rates

- Application to market-based rates
  - Antitrust and contract damages unavailable
  - "Retroactivity" allowed if seller has violated a market rate condition

- Application to antitrust law

- Application to non-rate terms and conditions

- Fraud does not block the filed rate defense
Retroactive Ratemaking: The Prohibition and the Exceptions

Three bases
- Statutory basis
- Constitutional basis
- Policy basis

Four illustrations
- Tax payments lower than estimates
- Tax depreciation differences
- "Direct billing" of gas production costs
- Someone else's cost

Seven exceptions
- Regulatory "notice"
- Utility "deferral" of expenses
- Affiliate transactions
- Hard-to-predict costs
- Commission self-correction
- Judicial reversal of commission rate decisions
- Disgorgement of illegal gains
Mobile-Sierra Doctrine:
When Does Contract "Sanctity"
Give Way to Government-Ordered Amendments?

Principle: The commission cannot let parties out of their contracts

The "public interest" exception

One standard—with a rebuttable presumption

Three ways to preserve the regulator's role

Escape from the presumption: Fraud, duress, illegality

Special applications

- Market-based contracts
- Non-signatories
- Application to tariffs
The Federal–State Relationship

Limits on federal action
- Commerce Clause
- Tenth Amendment
- Agency statutory authority

Limits on state action
- Dormant Commerce Clause
- Supremacy Clause
  - Occupation of the field preemption
  - Express preemption
  - Discrimination
  - Burden

Regulating within the limits: Six models of federal–state interaction
- Bright line divisions
- Federal enlists state
- State enlists federal
- Joint boards
- Regional compacts
- Overlapping jurisdiction

In general
- Interstate–intrastate
- Retail–wholesale
- Bundled–unbundled
- Local distribution and bulk power system

State review of retail utility purchases under FERC-jurisdictional contracts

Within Congress’s Commerce power

Outside Congress’s Commerce power
Jurisdiction's Future

Market structure
- Evaluating alternative arrangements
- Defining obligatory service
- Universal service
- Other features

Pricing

Federal–state jurisdictional relationships
- Interdependencies
- Obligation to serve
- Infrastructure readiness

Corporate structure and changes in control