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# Why Regulate?

## Basic Regulatory Principles

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## What is a “public utility?”

- A diverse group of business that have been subjected to detailed local, state and federal regulation of rates and services. Can be divided into two classes:
  - Those that supply continuous or repeated services through permanent physical connections between the plant of the supplier and the premises of the consumer (fixed utilities)
  - Public transportation agencies



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## Why regulate?

- Utilities are often referred to as “natural” monopolies
  - One firm can produce a desired output at lower social cost than two or more firms (economies of scale) i.e, it would be wasteful to have multiple providers of utility service in one territory.
  - Regulation represents a bargain between society and the utility
    - Free market is substituted for regulation as marketplace competition is wasteful and costly
    - Society grants the utility a generally exclusive market and receives the right to regulate certain aspects of the utility operations
  - Provides justification for the creation of statutory monopolies
  - Some industries may provide services that are deemed to be essential to the public interest and market forces are inadequate to protect the public from predatory pricing



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## Traditional utilities: Inherent Traits

- Electricity, natural gas, water, telecommunications, transportation services
- “Affected with a public interest” by virtue of providing essential services or necessities (public health, safety, welfare issues)
- Play an integral role in local and national economies and primary and secondary markets and economic development.



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## Privately Owned Utilities

- In contrast to many other industrialized nations, United States relies primarily on privately owned firms, controlled by state and federal agencies to provide services that are more or less essential and “public in their nature”
- Private ownership + public control = inevitable conflicts
  - Privately owned firms are economically motivated but they render a public service and therefore have been subjected to detailed government regulation supervised by the judicial system to ensure balance of competing interests
  - Profit maximization versus service at lowest possible price



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## Privately Owned Utilities, continued

- Both the public utility and customers are entitled to “due process of law” in administrative proceedings and to judicial protection of private property
  - This frequently may result in lengthy regulatory proceedings
  - BUT, legal requirements and protections are vital part of the regulatory process.



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## Utility Rights and Obligations

- Rights
  - Legal protection of private property
    - Cannot force utility to operate at a loss
  - Utilities have the right to render service subject to reasonable rates and regulations
  - Right of protection from competition from an enterprise offering the same service in the same area (exclusive service territory)
  - Right of “eminent domain,” or taking of private property for public use when necessary to the proper conduct of business



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## Utility Rights and Obligations, continued

- Obligations
  - Must be prepared to serve any customer who is willing and able to pay for service
    - Must provide capital investment in rural areas where it is not profitable to do so
  - Must render safe and adequate service
    - e.g., voltage regulations
  - Serve all customers on nondiscriminatory terms
  - Charge only just and reasonable rates



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## De-regulation and development of competition

- In the late 1990's, the Pennsylvania Legislature approved legislation that allowed for the creation of competitive markets in the supply of natural gas and electricity
  - For the first time, consumer were afforded the opportunity to choose who they wanted to supply their natural gas and/or electricity
  - Supply only, distribution is still a monopoly



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## De-regulation and development of competition

- Rationale
  - Consumers were indifferent as to who actually supplied energy
  - Theory of “natural monopoly” did not apply to generation and supply
  - Market forces would result in more efficient, economical generation and supply



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## De-regulation and development of competition

- Results
  - Results initially encouraging
  - Enron scandal resulted in a slow down in the development of retail energy markets
  - Some states have halted their efforts to de-regulate and others have scrapped plans to do so
  - Continuing efforts to further the development and enhancement of retail market competition underway in Pennsylvania