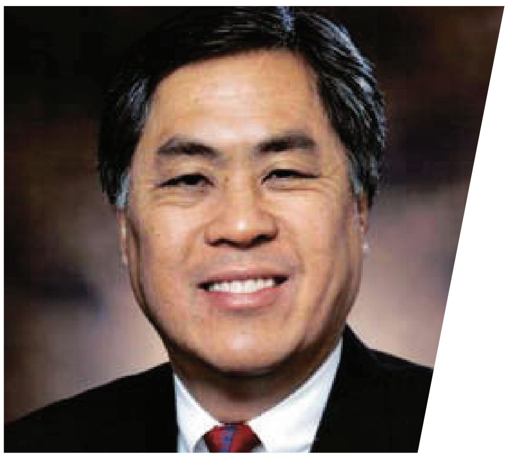
Regulators on the soapbox: **price control versus proliberal**

Applying "gradualism" to avoid electric shocks

Robert Gee, former Chairman of the Texas Public Utility Commission, thinks regulators will be under pressure from consumers to minimize price increases, citing the need for gradualism



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Robert has 30 years' experience as a seasoned Washington and Texas-based senior public official, attorney and executive, performing complex assignments involving major energy and telecommunications issues at the state, national, and international level. His Washington DC-based consulting firm provides policy analysis, advocacy and litigation support services for the energy, utility and critical infrastructure industries.

Q: Should the regulator control prices?
A: Prices are rising because of escalating energy commodity and infrastructure costs and, in most regulatory schemes, fuel costs are a pass-through cost of service item. While there is anxiety, the regulator's options are limited. Some may be tempted to defer cost recovery to future years, or depress power prices artificially to buy political peace. But this is bad public policy and simply creates headaches for future years. Utilities are trying to get consumers to use less power, and if they don't pass on real costs in the rates, it sends the wrong price signal. Moreover, the US Supreme Court has had occasion to overturn State Utility Commission decisions when their rates were set too low, as this was judged to be "confiscatory" and in violation of the US Constitution.

Q: Should regulators influence future needs – like new infrastructure?
A: In the previous vertically integrated world, the philosophy was to police behavior, but not to second guess utilities' business decisions. Today, there is a more proactive attitude. Deregulation and competition were intended to reduce regulation, but ironically they have heightened the role of the regulator. Deregulation was intended to allow markets to make decisions – but they tried that, and it scared political leadership to an extent that they now demand that regulators take a much stronger role in understanding how markets function to prevent power shortages and price spikes.

Q: Will the role of the regulator change in future?
A: I think they will try to find a way to minimize the rate shock caused by escalating power prices. They will look hard at utilities that want to increase the delivery charge for fixed-cost recovery, to ensure these costs are really necessary to maintain power quality and availability. It will be vital to ensure that utilities are not passing through charges which "goldplate" investment. At the same time, some regulators talk about utilities increasing investment in new technologies such as "smart meters" to enable customers to control their demand in real time. But all this new investment will certainly result in upward pressure on rates.

On fuel prices, regulators obviously can't do anything directly about actual energy commodity costs. But in states where generation is still regulated, they can require their utilities to have a diverse resource portfolio that hopefully will blunt price surges of one specific supply or fuel resource. They can also try to find ways to encourage customers to participate in conservation programs to minimize the impact of total bills. Finally, they will increasingly rely on the utility ratemaking precept of gradualism, citing the need to avoid shocking the ratepayer with an extraordinary spike in utility rates. This will prompt them to find ways to defer or spread out cost recovery over greater lengths of time. But they can only do so much without running afoul of the law.

Q: What can the energy sector learn from the current financial crisis?
A: One key lesson is the need for transparency. A lot of what was going on in banking was unregulated, or not transparent to the regulator. We need absolute vigilance to avoid similar aberrations in power trading markets.

The shrinking availability of credit will also have immediate effects on the price and availability of power since independent power producers, who are highly leveraged, will be required to pay more for debt. Rising demand means that infrastructure investment is needed, but turmoil in the financial markets make the cost of capital for that new investment even higher, while fuel and commodity costs are rising. At the end of the day, regulators will be challenged to explain all this to consumers, and hope that they understand.