Reforming State Utility Regulation

Utility regulation facilitates recovery on invested capital and provides a utility with a return on that investment. This is an arrangement that would never develop in a market atmosphere where profits are dependent on satisfying consumer demand without regard for the amount of money invested in meeting that demand. The flaws in this regulatory system are now highlighted by the current drive to close coal-fired power plants and replace the generating capacity with renewable sources of power. The system of utility regulation already creates a natural bias for capital investment as it is and current public policy increases this mal-investment and less-than-optimum use of capital.

Under the current regulations electric utilities can abandon a still useful power plant while collecting the remaining capital and earning a profit on that book value. One alternative is to install expensive carbon capture processes on an existing generator, again satisfying the regulatory incentive to make large capital outlays and increasing profits.

The non-market, policy-driven investment in renewable energy that is to replace coal generation is another investment opportunity. Worse, renewable generation requires additional investment in a large amount of quick-acting back-up natural gas-fired generation.

When we look for solutions to counter this regulatory-created incentive to overinvest in generation assets, we should not focus on tinkering with state regulation but seek ways to free market forces to enact utility reforms. We can never know exactly how a market in electricity will evolve, but we have examples in other sectors of the economy providing direction. In an untampered market an enterprise seeks to minimize capital not maximize it as with regulation. Competition is the key to rational behavior. Already in lightly regulated wholesale power markets a healthy rivalry between power generators is forcing prices down to marginal costs.

To some extent market incentives to hold down costs exist in certain states where consumers have a choice for electricity suppliers. A utility that does not have captive customers for the underlying electricity commodity behaves differently. When recovery of capital losses is no longer near-guarantee under regulation, wiser investments follow.

Even with customer choice for the energy itself we still have the monopoly on the electricity delivery system itself. Too often policy makers have turned to mandatory common carriage as remedy for monopoly-owned networks. This route to reform is unnecessary and tramples on property rights. Removing defined utility territories or franchises will allow neighboring utilities to encroach on the areas served by badly-run incumbent utilities. The argument against this is that it involves duplication of the wiring infrastructure. However, there would be little of this when the incumbent utility that is losing customers realizes the competitor is taking its customers. The loser can salvage some of his cost by selling or renting his wires to the aggressive energy provider.

Better yet the threatened incumbent will shape up, make better use of capital and cut operating costs.

The solution to regulated utility over-investment is removal of the monopoly status through ending exclusive territories and allowing customer choice. Repeal the laws granting monopoly privilege. Faced with real competition utilities will reform themselves without increasing governmental mandates.

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