

Ratemaking and Price Regulation



NARUC Energy Regulatory Partnership Program

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Objectives of Economic Regulation

- ❖ Economic efficiency
- ❖ Fair prices, to consumers, producers and regulated entity
- ❖ Reasonable service, with non-discriminatory access
- ❖ Adequate quality and reliability
- ❖ Other policy consideration (social objectives)



Additional Goals of Economic Regulation

- ❖ Attracting Investment
- ❖ Supporting Privatization
- ❖ Rights and obligations must be clear and enforceable
- ❖ Transparent and predictable regulatory process and outcomes
- ❖ Clear franchises
- ❖ Enable fair competition where possible



Price Regulation

- ❖ Intended to address each of the objectives outlined above
- ❖ Mechanism
 - rate levels (revenue requirement - cost-plus)
 - rate structure (rate design)
- ❖ prevent excessive prices or discrimination
- ❖ Ensure adequate earnings and enable company to attract capital
- ❖ Service
- ❖ Safety
- ❖ Management efficiency



Elimination of subsidies

- ❖ Definition - prices below long run marginal costs (economic)
- ❖ Problems - wrong price signals
 - encourages consumption of prices too low
 - discourages consumption if artificially high



Discriminatory Pricing

- ❖ Often occurs to meet social or economic goals
- ❖ **If not cost-based**, who decides what goals should be supported
 - Low income
 - Economic development
 - Environmental concerns
- ❖ Solution - cost-based rates.
- ❖ Variations must be justified based upon actual cost differences



Sectors Subject to Price Regulation

- ❖ Electricity
- ❖ Transmission (federal regulation)
- ❖ Distribution (state regulation)
 - Generation - not directly regulated (except through distribution company rates and siting)
 - Includes all in-state generators



Sectors Subject to Price Regulation (cont'd)

❖ Natural Gas

- Transmission (interstate pipelines subject to federal jurisdiction)
 - ◆ Both siting and pricing (latter now deregulated)
- Distribution (state regulation)
- Gas marketers (not in states that have deregulated)

❖ Telecommunications



Sectors Not Subject to Price Regulation

- ❖ Fuel Oil
- ❖ Propane (except for safety and limited price regulation of propane systems)



Intrastate Operations

- ❖ In areas Subject to Price Regulation,
Rate regulation includes all aspects of
intrastate operations
 - Actual distribution plant
 - Generation facilities
 - Purchase power/purchased gas contracts



Rate Setting (Legal Standard)

- ❖ it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with risks on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.



Price Regulation Options

- ❖ Revenue Requirements Supported by Cost-of-Service
 - “Cost-plus” ratemaking
 - Rate Base
 - Expenses
 - Return on Investment
- ❖ Overall standard - Just and reasonable rates
- ❖ Yardstick Competition



Alternative Regulation

- ❖ Earnings Caps
- ❖ Revenue sharing
- ❖ Price Caps
- ❖ Fuel adjustment clauses
- ❖ Productivity Factors