

Regulation Resources

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Retail Regulation

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About the Author...



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Abstract

This paper focuses on the new regulatory bargain and the accompanying role of Regulatory Commissions to protect consumers from market power of dominant providers. As elements of competition are introduced to infrastructure industries everywhere, and as the number of market participants grows more diverse, Regulatory Commissions are increasingly focused on retail prices, customer service and end use reliability. Where companies and their customers are working together to maximize the benefits of retail service delivery, there will be greater success in the regulatory process and greater opportunity for further investment for expanded services.

I. Introduction

The paper focuses on retail aspects of utility regulation. What is retail regulation? Why do we want to focus on it? Why does it matter to consumers? To investors, donors, banks? Regulated companies in these changing markets are conscious of the need to focus on retail issues. Here we will zoom in on some strategies that make the job of retail regulation more likely to meet the needs of the consumers, and thereby provide a basis for sustainability in a liberalized infrastructure industry.

II. Key Points

Point A. Retail Regulation

Regulation is governance by an administrative agency issuing rules or orders having legal force. Retail regulation sets the time, amount and degree of retail services by setting standards for licenses, retail tariffs, quality of service standards and monitoring practices. Retail regulation focuses on the end use. It impacts directly on the consumer.

Retail regulation is regulation that focuses on rules and orders relating small quantities of service sold directly to the ultimate consumer.

The key drivers of retail regulation are a focus on end use tariffs, customer service, public participation, consumer advocacy and the growth of customer-oriented regulatory commissions.

Sometimes it will seem as though the role of the Commission is to act as Referee, just as happens in a competitive sports match. There are rules, which have been issued by the Commission. These are then applied regularly, as a means of testing the operation of the retail

market.

Point B. Competition

The fundamental justification for regulation is existence of some monopoly. To regulate a monopoly market of any kind, the Regulatory Commission is faced with 3 basic choices:

1. Protect customers and new entrants from monopoly
2. Reduce scope of monopoly
3. Manage transition to increased competition; both (1) and (2).

Competition can provide levels of efficiency that have not occurred under regulation. Yet there is a growing awareness that as more utilities compete for customers, retail service may suffer. Quality of service may deteriorate. Reliability may drop. Expectations for enhanced service and more choices may not be realized. Regulatory Commissions, acting as rule makers and referees, will want to take action to ensure this does not happen. They will want to be sure that service quality standards are in place and that they are met.

As markets become more complex, the regulatory response must be more sophisticated. Easy solutions may no longer be appropriate or efficient.

Problems arise for policy-makers and regulatory commissions when there is a combination of both monopolistic characteristics and competitive characteristics in the market place. Allowing competition in some areas while retaining the regulated monopoly arrangement in other areas does create some significant problems. A utility can use its monopoly position to subsidize the competitive portions of its operations. Unless constrained, a utility can under price its competitive services, recouping any resulting losses by increasing its prices in the monopoly portion of its operation.

There is a natural propensity for a utility's management to under price competitive items. This tendency may be magnified by the fact that the utility's stockholders (or the government) need not absorb any losses resulting from under pricing. The safest path for such companies is to under price competitive services, making up for the resulting losses by overpricing those services where competition does not exist, and thereby minimize the danger of competitive failure. New monopolies exhibit market power in a partially competitive environment. The new regulatory bargain holds that regulation will protect consumers from unlawful exercise of market power.

Point C. Market Power

Market power is a market failure that occurs when one or more of the participants have the ability to influence the price or other outcomes in some general or specialized market.

Why does the wholesale market configuration affect the retail customer? Retail regulation is concerned with price regulation, licenses, quality of service standards and also public participation, customer service and end use reliability. These are strongly affected by the influence of different companies in the marketplace. They are all linked very closely together. Regulatory Commissions are increasingly looking at these factors in a holistic way, recognizing the impact of them collectively on the end use customer.

Point D. Challenges

Retail regulation poses several challenges to Regulatory Commissions. Under pricing can dampen competition. Such pricing can result in larger and more frequent overall rate increases. If a utility is inefficient or badly managed, under pricing of competitive services will help hide this effect.

Since competitive services are used primarily by large business subscribers, competitive under pricing tends to result in discrimination in favor of large business subscribers. There is no legitimate reason why small business and residential subscribers should be forced to subsidize large business subscribers

How can the advantages of competition be introduced to the utility industries without losing the benefits of regulation for those portions of the industry that are inherently monopolistic? Regulators could segregate monopolistic and competitive portions of the industry. Regulators can also specifically seek out and prohibit utility under pricing of competitive services.

III. Conclusion

Issuing rules and orders that keep consumers at the front of the argument, not an afterthought, will assist many policy-makers in bringing about lasting change. Alternatively, if regulation does not focus on retail customers, it is very likely that liberalization, and all the promises it brings, will not be successful. **Good retail regulation is at the heart of successful infrastructure reform.**

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