A public utility ordinarily has an assigned field of operation where undertakings offering similar service do not function. The general view is that public utilities are monopolies, but this statement is subject to many qualifications, in that as instances an electric utility has to contend with other forms of illumination and motive power, and a transport undertaking has to compete with other modes of transport. It would therefore be more correct to say that public utilities are limited monopolies, which result from the desirability of avoiding duplication of power lines, telephone lines, railroad tracks, and gas or water mains in the areas served. The limited shielding from competition in the classical sense has led to the need for regulation so as to ensure reasonable rates to the public and a fair return to the undertaking.

Indian Scheme

Regulation of the Electric Supply Industry in India has been the theme of Electricity legislation since the law was codified in 1910, but a more conscious design to promote the ends of regulation came with the enactment of the Electricity (Supply) Act in 1948. In effect the principle of regulation by legislation was established with the passing of the 1948 Act which has since been modified in several respects by the Electricity (Supply) (Amendment) Act, 1956. The Act has thus supplied the 'yard stick' by which regulatory authorities created under the Act, namely the State Electricity Boards and the Central Electricity Authority, as also the regulated undertakings, are to be guided.

The financial principles embodied in the Electricity (Supply) Act, 1948, are, by and large, based on United States rate regulation practice and a study of the ruling principles of utility regulation established by State and Federal Courts and Power Commissions in U.S. is therefore of great interest to the regulating authorities, public utility managements and the legal and accounting professions in this country. The rate of return to be permitted to public utility undertakings is the central core of the problem of regulation and this has been discussed in the first of the volumes published by the U.S. Public Utilities Reports Inc.* A reasonable rate of return is vital to the health functioning and continuation of public utility undertakings and extensive re-examination of rate factors has been undertaken in recent years by Courts and regulation commissions in the U.S.A. The volume presents in a condensed form authoritative rulings covering the decisions in rate proceedings.

Fundamentals of Regulation

U.S. regulation practice stems from the Fifth and Fourteenth amendments to the Constitution which between them provide that no person shall be deprived of life, liberty or property without due process of law, nor shall private property be taken for public use without just compensation and none shall be denied the equal protection of laws. The basic principles adumbrated above were applied in a decision by the U.S. Supreme Court as early as 1898 in the case Smyth v. Ames where it was laid down that under the presence of regulation, an undertaking cannot be forced to carry on operations without adequate reward.

The traditional procedure in the U.S. for fixing the return is to determine the 'Rate Base' (Capital Base in the Indian Law) representing the investment in the business, reckon the permitted operating expenditure and decide upon a percentage figure, applied to the rate base, so as to determine the return to be allowed—a process outlined in the Indian Statute. Many State Courts and Commissions have grappled with these fundamentals and the essence of what constitutes a fair return was propounded in the famous Hope case (Federal Power Commission v. Hope National Gas Co. 1944) where it was laid down that the process of regulation should square up with the "end result" that a utility should be allowed enough return to continue to operate successfully, to maintain its financial integrity to attract capital, and to compensate investors for the risks assumed. The actual words used in the decision was that the undertaking should be permitted to earn a reasonable return so as to enable it to raise funds in the market necessary for the proper continuity of its public duties.

Similar phraseology occurs in the Statement of Objects and Reasons appended to the Bill resulting in the Indian Electricity (Supply) Act, 1948, and so the Legislature in India did not contemplate and end-results dissimilar to what has been regarded as the central core of U.S. rate regulation practice. Nevertheless we have witnessed in India in recent years the time consuming pageant of Rating Committees of practically little value resulting in greater exercise of police functions and many a time arriving at conclusions based on intuition with little regard to the 'yard stick' prescribed by law.

Risks and Returns

The power to regulate is a positive process with accent on development, and therefore it is a firmly settled policy in U.S. that the prohibition of taking away property without due compensation extends to earning power as well. Otherwise low rates might result out of regulation. Right to earnings is as much a property as the right to the property which can produce the earnings.

What it may be asked, is risk in a public utility? Those who invest money in the electric supply industry take a good deal of chances as persons engaged in other business. Like other industries, it must satisfy the consumers, run the gauntlet of good and bad times, strikes within and in industries it supplies and revolutions in technological development. Minor changes in the field of technology, attach a risk to various parts of the undertaking's installation. A possible risk is that the regulatory process might make a mistake which, until rectified, might well result in greatly reduced earnings. A special character is that the business, unlike others, cannot be abandoned at will. These characteristics have led to the recognition that the strong arm of Law cannot be used to reduce charges resulting in loss. Therefore the principle has come to be accepted that just as the law is powerless to

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Principles for Utility Regulation

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prevent injury (in case where economics of operation impose difficulties), BO likewise it should not be instrumental in causing injury.

Unlike the Indian law which provides a yardstick to cover all units of the electric supply industry, rate making in US is not a procrustean bed upon which the undertaking must be stretched or trimmed to suit any given dimension. Therefore on the basis of a pattern established by case laws, individual cases are adjudged with considerable elasticity. This has led to returns ranging from 5.75 to as high as 8½% being permitted, the guiding principles being to ensure safety of investment and incentive for further investment in a rapidly growing industry.

Law of Competition

A utility may have characteristics of a limited monopoly, but capital is subject to the law of competition, flowing to the highest bidder, other considerations being equal. It is also a truism that one cannot commandeer capital for public utility purposes; to attract, the yield must be adequate.

That money cannot be attracted unless there is hope of adequate return was recognised by the Hardley Railroad Securities Commission appointed by the New Deal Administration of President Roosevelt, when it stated:

"We cannot secure the immense amount of capital needed unless we make profits and risks commensurate. If rates are going to be reduced whenever dividends exceed current rates of interest, investors will seek other fields."

In this context, the ruling of one Commission is marked by refreshing candour.

"And while the Commission wishes to assure the great army of patrons of public utilities in this State that it will be vigilant in securing for them adequate service at reasonable rates, it is equally desirous of making it plain that capital invested in construction, development and extension, and especially in planting them in sections not now served, will receive consideration sufficiently favourable to make it an object to come here. When we lose sight of this duty, we become an instrument to kill enterprise, not to regulate it"

It is obvious that capital will not flow to an undertaking which faces the difficulty of paying a fair return to the investor. As the saying goes, "one cannot make bricks without straw"; so either the community served furnishes the needed return or the supply is curtailed. The awesome truth must also be faced that for necessary capital, one must compete with a world in need.

If a great and indispensable public utility is denied earnings to ensure a reasonable return, it is hardly to be expected that it will grow. Therefore it is only proper that there must be a definite acceptance of the principle that the true welfare of the public is best served by the maintenance of a rate large enough to earn a return which will attract capital; which will readily permit of expansion and extension of the utility service and keep it in a high state of efficiency; which will attract the best type of sound, economical, enterprising managerial ability and in other ways stimulate productive activity. As one Commission has rightly stated,

"Capital is not attracted to an enterprise which must constantly travel near the financial deadline which divides prosperity from bankruptcy".

In other words a utility should grow with the growth of the community it serves or even leavens the growth of the community. Therefore, the interests of the two cannot be separated, and in the strict sense do not clash.

The pattern of regulation of the electric supply industry in India having already been set by law, the fundamentals are no longer a matter of dispute. But no living entity can remain stagnant. It must either grow or failing opportunities to do so, decay. It can only be hoped that legislative thinking in the country will march in step with the needs of the situation, and the study of the US regulation practice presented in the masterly survey by Mr Ellisworth Nichols should promote this.