# The Committee of Inconsistent Capitalists:
# Is Your Utility a Member?

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Capitalism, defined objectively, is an economic system that seeks to serve consumers by channeling private capital to the most efficient producers. Our utilities' lifeblood is private capital, yet some are hostile to capitalism. How well do we address this irony?

As customers, utilities favor capitalism. Needing underwriters to market their bonds and their shares, they select these sellers competitively. But when they seek new customers, their commitment to capitalism weakens. As shown by the examples below, they want regulators to channel capital not to the most productive actors but to their own favored ventures. It's back to the 1950s—choosing the boss's kid over the best candidate.

Isn't pursuit of self-interest the core of capitalism? Yes—but only in true capitalism, where the pursuer is disciplined by effective competition. A typical utility is not disciplined by effective competition. When it competes in new markets, it enjoys unearned advantages because it faces no competition in its home market. Freedom from competition is not true capitalism. It means that the utility's claimed strengths—its brand, its access to capital and its employees' readiness—are all assisted by its monopoly position: a century-long position not earned by merit but granted by government.

No business gives up its advantages, earned or unearned, voluntarily. For utilities, that self-interest leads to inconsistency. For while when raising capital they depend on capitalism, when seeking regulatory support they oppose capitalism—routinely and unembarrassedly. Consider five examples.

## Contradicting Capitalism: Five Utility Positions

***Job production:*** An Illinois statute requires utilities to create a specified number of jobs, whose cost ratepayers must fund. The new workers will build smart grids and other infrastructure, the profit from which ratepayers also must fund. *See* 220 ILCS 5/16-108.5. If the legislature wants to create jobs and build infrastructure, why hand the role to a monopoly protected by government rather than an entrepreneur selected by a competitive market? Ask the utilities who drafted the statute.

***Mergers and acquisitions:*** State commissions have conditioned merger approvals on applicants' agreement to construct headquarters buildings, build hiking trails and construct large-scale solar farms, among other activities—all outside the utility's obligation to serve (otherwise these things would be happening without the mergers). The merging utilities often propose these conditions themselves, or agree to them to eliminate opposition (a practice misnamed "settlement," as explained in my essay ""Regulatory Settlements": When Do Private

Agreements Serve the Public Interest?"). Small potatoes next to these multibillion-dollar deals—but again, why hand these activities to the utility rather than to the most efficient actor, selected competitively?

As for the mergers themselves: Since 1985 our commissions have approved nearly a hundred transactions. They have halved the number of independent utilities, consigning most to minority status within complicated, debt-leveraged holding company systems—conglomerates bearing no resemblance to the conservative investments historically indispensable to any prudent investor's portfolio. By viewing each transaction isolated from the others, we have created a cumulative result remote from any one commission's vision. Indeed, in 34 years of regulatory practice I have never met a regulator who had such a vision, for the number and type of utility companies appropriate for that regulator's region and for the nation. Instead of regulatory vision there is regulatory deference, to utilities who dishonor capitalism. In true capitalism—competitive capitalism—the shareholder and consumer goals are aligned. In utility merger-land they are misaligned. They are misaligned because a monopoly utility is not disciplined by competition; it must be disciplined by the regulator. But in mergers, regulators do not replicate competitive forces. They allow their utilities to choose the highest bidder rather than the most competent acquirer. This practice maximizes shareholder gain at the expense of customer benefit. True capitalism works the other way around. In mergers subject to effective competition, the acquirer offering the most is the one able to produce the most. The shareholder and customer interests are aligned; by maximizing customer benefit, shareholders get their gain. Our utility merger policies defer to utilities who dishonor capitalism.

***Electric vehicles:*** Electric vehicles need charging stations. Charging stations are a new product. In true capitalism, new products are provided by the most efficient producer—the one offering the best combination of quality and price. But plenty of utilities expect to get that new profit stream automatically, through regulatory approval rather than competitive merit. We do need our utilities to help interconnect charging stations with the existing electricity network. But that role is not incompatible with using competition to find the best charging station providers. Why undermine capitalism?

***Distribution system platform provider:*** Storage, distributed generation, solar and wind farms, automobile batteries and demand management all offer paths to low-cost, renewable, non-polluting power. Integrating these diverse sources with existing facilities will require distribution-level "air traffic controllers"—entities responsible, within to-be-defined geographic areas, for planning, attracting, scheduling and dispatching these resources to ensure reliable, least-cost supply. This new job requires new skills and cultures—entrepreneurial skills and non-entitled cultures not typically associated with our century-old monopolies. Yet some utilities expect to receive, and profit from, this new job without competing for it. That's not capitalism.

***Penalty avoidance:*** When the felon Pacific Gas & Electric (convicted of crimes relating to the San Bruno pipeline explosion) stood before the California Commission to be penalized, it sought leniency to protect its profitability. California statutes in fact required the Commission to consider this anti-capitalist plea—which the Commission did. (PG&E is neither the first nor the last utility to get government favors a real capitalist would never seek. In the late 1980s Gulf States Utilities Company persuaded the Louisiana Commission, and the Louisiana Supreme

Court, to make ratepayers bear $600 million in nuclear costs the Commission deemed imprudent, just so the utility could stay solvent. *See Coalition of Cities for Affordable Util. Rates v. Pub. Util. Comm'n of Texas*, 798 S.W.2d 560, 562-64 (Tex. 1990)). Protecting the incumbent, when plenty of others would be pleased and prepared to replace it—What could be more hostile to capitalism?

## Are Regulators Aware of the Irony?

Utilities stake these claims without embarrassment because they have a sense of entitlement. Based on what? Do they expect regulators to practice "good enough" regulation, "path of least resistance" regulation and "you have to be realistic" regulation—rather than "best performance" regulation? Then there's "the-devil-you-know-is-better-than-the-devil-you don't"—a phrase that feigns savvy to hide passivity. Do we all practice "emperor has no clothes" regulation, where everyone actually sees the irony—capitalism undermined by capital-dependent utilities—but no one dares to speak it aloud?

I once heard a state commission chair criticize Germany's solar energy policies: "Their utilities lost one-third of their value. We can't let that happen here," she said, as if protecting private share value were a government's primary responsibility. About Germany's solar policies, reasonable people can disagree. But the basis for that disagreement must be the benefit-cost ratio for the public as a whole, not the share value of any given company. Do we need to compensate capital sufficiently to attract the amount we need? Of course. But just as the purpose of antitrust law is to protect competition, not particular competitors (*Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)), the purpose of regulation is to produce performance, not protect particular performers. When our utilities accept that simple proposition, they can claim to support capitalism.