consumers, groups focused on the process of government, and small business alliances, to name just a few.

The 1980s and early 1990s saw the resolution of many highly contentious issues. By the end of the 1980s, all of the nuclear power plants were either canceled or included in rates; natural gas prices had been deregulated at the wellhead, and large gas users could purchase gas directly from producers; and the AT&T monopoly had been broken up into separate companies to provide local, long-distance, and equipment services. By the mid-1990s, utility rate cases were becoming rare events, prices were stable and starting to decline again, and large consumers of utility services had competitive options available to them. These options include cogeneration technologies that provide electricity and heat, direct purchases of natural gas from dozens of suppliers, and hundreds of companies that sell long-distance telecommunications services. In addition, during the 1990s, several utility commissions adopted alternative regulation plans designed to keep rates stable without requiring periodic rate cases.

With the ever-decreasing cost of computer technology (leading to greatly reduced costs in telecommunications and increased efficiency in all utility industries), advances in natural gas drilling equipment, and combined cycle power plants that produce electricity at less than most utilities' average cost of production, it appears that we are back to "business as usual" in the utility industry. That is, it looks like we are again in a declining-cost era, where utility rates will be stable or decline as new technologies replace older, less-efficient plant and equipment.

Yet, all is not normal in the utility industry. Rather than settling back and watching rates decline, the utility industries are seeing new issues emerge: competition and deregulation. Instead of suggesting a return to the first 60 years of utility regulation (infrequent rate cases usually leading to a decline in rates), the industry and many consumers are following the path of other previously regulated industries—trucking, airlines, railroads, savings and loans—and seeking to deregulate portions of the utility industries.

The Energy Policy Act of 1992 went a long way to opening up the wholesale electricity market to competition. Subsequent orders of the Federal Energy Regulatory Commission (FERC) all but deregulated that market. The price of natural gas at the wellhead was deregulated in the late 1970s. By the mid-1980s, FERC had restructured and deregulated nearly all portions of the wholesale gas market, allowing large consumers to purchase their own gas and have it transported to their business. The interstate long-distance telecommunications market has become increasingly competitive during the past ten years and is now largely deregulated. The Telecommunications Act of 1996 encourages states to follow suit and
bring competition to and deregulate intrastate, and even local, telecommunications services. The utility industry in the late 1990s looks very different than the industry of the 1970s and 1980s. The purpose of this report is to investigate the role of utility consumer advocacy in this new era of deregulation and competition. Specifically, this report seeks answers to the following questions: What are the roles of consumer advocacy organizations in this new utility market? How do consumer advocacy organizations need to change to respond to these new forces in the utility industry? What types of expertise do they need? What should be the source of their funding?

Organization and Methodology

This report is based on in-depth interviews with representatives of ten consumer advocacy organizations from throughout the United States and on research into the effects of deregulation on other industries. In addition, the report has been guided by a project advisory committee, consisting of researchers and utility consumer advocates from across the country.

Chapter 2 of this report reviews deregulation in the airline, trucking, and savings and loan industries, focusing on consumer-protection issues that arose as a result of deregulation in these industries and the effect of deregulation on consumer groups. This section of the report is based on a review of relevant economic, public policy, and legal literature.

Chapter 3 provides an overview of competition and deregulation activities in the telecommunications, electricity, and natural gas industries, based on interviews with representatives of consumer advocacy organizations in several states. This section examines what restructuring means in each industry, what has happened so far, and what activities can be anticipated during the next few years.

Chapter 4 focuses on utility consumer advocacy organizations and the impact utility industry restructuring may have on these organizations. Chapter 4 also discusses ways in which these organizations have been changing to meet the different needs of a partially deregulated utility industry. It includes a discussion of a number of issues that consumer advocates will confront as the nature of the industry and regulatory process change over the next several years. This section is based primarily on in-depth interviews that were conducted with representatives of ten consumer advocacy organizations throughout the United States.

Chapter 5 discusses the implications for the future of utility consumer advocacy. More specifically, this section addresses a number of changes that consumer advocacy organizations will need to undertake to assure that the new utility industry provides safe and reliable service to all consumers at affordable prices.
Chapter 2: Deregulation of Previously Regulated Industries

A brief review of deregulation in three industries—airlines, trucking, and savings and loans—is a useful starting point for examining potential issues in utility deregulation. The focus in reviewing these industries is on the impact of deregulation on consumers and the way in which consumer protection and consumer advocacy have changed as a result of deregulation. In attempting to assess what the experiences of the airline, trucking, and savings and loan industries mean for the coming deregulation of the utility industries, it is first important to recognize that most utility deregulation proposals involve the partial deregulation of an industry. This leads to a series of issues that were not present in other industries (such as concerns with cross-subsidization and unfair dealing between regulated and unregulated portions of the same corporation).

Beginning in 1975, the Civil Aeronautics Board (CAB) began lessening restrictions on the airline industry. In this regard, the CAB focused on regulations pertaining to route changes, the review of airline fares, and the entry of new carriers into the market. The movement toward deregulation was a function of many factors, including economic theory about the benefits of competition, and pressure from entrepreneurs who saw an opportunity to provide better service at lower cost than the existing airline companies.

Since 1978, the effects of deregulation in the airline industry have been studied by dozens of economists and policy analysts (1, 2, 4, 7, 12, 16, 23-24, 26-28, 34, 35, 39). With 20 years of experience under deregulation, the airline industry offers an interesting case study of the impact of deregulation on consumers and the ways in which consumer protection and consumer advocacy change when a previously regulated industry becomes deregulated.

At the outset, it is important to note that the airline industry was not fully deregulated in 1978. Concern for the immediate impact of deregulation on small communities prompted the U.S. Congress to include special provisions to subsidize and protect air service to small communities. (2) In addition, the federal government continues to regulate safety, some aspects of consumer protection (such as deceptive advertising), and mergers within the industry.

Analysts disagree about the effect of competition on airline consumers. In the aggregate, it appears that deregulation and increased competition was beneficial for many consumers. Average airfares have declined in most

Airline Industry
parts of the country, the number of people flying has increased tremendously, and most measures of the quality of service show that service is improving. (1, 16, 26) However, these results are not true for all consumers. Some small communities have lost air service completely, while in many other communities, prices have increased, and the frequency of service has declined. (2, 32, 34) In fact, in the first six years after deregulation, 114 small communities lost all air service. (34) While average fares throughout the country declined between 1979 and 1994, several communities saw average fares increase by more than 20 percent (as measured in constant dollars) during this same period. (1, 32) During the first ten years after deregulation, some of the fare changes were even more dramatic. Although fares were generally falling, the fares on several routes—even those involving some large cities—doubled or tripled during this period. (2) Moreover, these calculations do not consider the dramatic decline in fuel prices since 1978, which would have resulted in fare decreases, even under regulation. (7)

The results of deregulation have also varied significantly by region of the country. Areas of the country experiencing high levels of growth tend to see benefits from competition: more airlines providing service, more flights, and lower fares. In contrast, those parts of the country declining in population or economic activity are not benefiting from deregulation: fewer airlines provide service and fares tend to be higher. (1, 32) As the General Accounting Office (GAO) concluded in 1996: “the largest decreases [in fares] occurred at airports serving communities of various sizes in the West and Southwest. In contrast, . . . the airports serving several communities—particularly small and medium-sized communities in the Southeast and Appalachian region—have experienced sharp increases in fares since deregulation.” (32)

One public opinion expert has stated the problem succinctly: “For the American public, the litmus test of deregulation is a pragmatic one: Has deregulation produced the benefits it promised? The standard used to judge is, frankly, self-interest: have lower prices, more choices, and greater convenience been the outcome? According to these criteria, the verdict on deregulation is a mixed one. Americans perceive both successes and failures . . .” (14) Indeed, while the public originally supported airline deregulation, by 1988, 45 percent of the public thought that deregulating airline routes was working against the public interest, and only 51 percent believed that the deregulation of airline fares was working. (14) Similarly, a 1995 study revealed consumers’ express concern about the “reduction in services, or higher costs, to smaller cities and rural areas” as well as concerns about airline safety. (9)
The deregulation of the airline industry provides useful information about the effect of deregulation on consumer protection in general and on the process of protecting the consumers' interest in particular. When airlines were deregulated, nothing was done to ensure that the consumer protection functions previously performed by the CAB would be carried on by the federal government. The 1978 legislation gradually phased out the responsibilities of the CAB and completely abolished the CAB effective January 1, 1985. In fact, it was believed by some analysts that “consumer protection may actually improve with less regulation.” (24) This was based on replacing airline tariffs with more traditional consumer protection activities such as lawsuits. Airlines' tariffs, similar to the tariffs of public utilities, often limited the airlines' liability or imposed conditions on consumers, such as requirements to reconfirm flights several hours before departure. It was believed that these kinds of restrictions would not survive in a free market and that consumers would receive more protection as a result.

By 1984, however, it became apparent that this approach would not work. In June of that year, the GAO recommended that Congress enact legislation that would clearly provide for a continuation and transfer of the CAB's consumer protection functions. (35) The GAO concluded that the failure to provide for a strong consumer protection function within the government “could well lead to an increase in expensive and unnecessary litigation and a reduction in consumer protection.” Specifically, it concluded that in the absence of Congressional action, “a decline in consumer protection is likely to occur,” and increased litigation would result “as consumers and airlines attempt to determine their respective rights and obligations.”

Congress responded by passing the CAB Sunset Act of 1984, which transferred the consumer protection responsibilities of the CAB to the Department of Transportation (DOT). (31) These responsibilities include policing fraud and other deceptive trade practices as well as reviewing mergers.

In subsequent reports, GAO reviewed consumer protection issues resulting from airline deregulation. (30, 31) These reports found that several new kinds of consumer protection issues arose from deregulation. Among the most significant were misrepresentations and outright fraud in the tour industry (essentially resellers of airlines' services) and misleading advertising. The GAO found that the federal government was ill-equipped to deal with some of these abuses and other consumer advocates—primarily state attorneys general—were attempting to resolve some of the concerns. Airlines were arguing, however, that the states did not have the legal authority to deal with these issues. The airlines asserted that Congress had given the federal government the exclusive right to regulate these aspects.

The Challenges and Changing Mission of Utility Consumer Advocates 1606

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of the airline industry. For example, several state attorneys general challenged
airline advertising that quoted very low fares between cities but in fine print
stated that the fares covered the price of a one-way ticket and were available
only if a round-trip ticket were purchased. The airlines successfully challenged
the states' authority to review their advertising because DOT had some authority
in this area. (15, 30) GAO also found that DOT’s enforcement efforts were lax
in some areas, particularly in regulating tour operators. Coordination between
the federal and state governments, and even between DOT and the Federal
Trade Commission (FTC), also were noted as enforcement problems in this
area. In several areas, it was unclear whether the state or federal governments
had jurisdiction to resolve a consumer complaint, and the communication
between DOT and states was very poor. (30) In other cases, particularly in the
area of telemarketing of tours, the FTC was exercising jurisdiction, even though
federal auditors later found that DOT should have been made aware of the
problems and taken action to resolve them. (31)

Trucking Industry

The interstate trucking industry was deregulated by the Motor Carrier Act
of 1980. The interstate trucking industry is really two separate industries:
the truckload industry (that is, shipments where the shipper fills an entire
truckload) and the less-than-truckload, or LTL, industry (where numerous
small shipments must be aggregated to fill a truck). The truckload industry
provides for point-to-point shipping — that is, a truck is loaded in one
location and delivers the load directly to its destination. The LTL industry
takes the shipment to a terminal, where it is consolidated with other ship-
ments bound for a nearby location. The effects of deregulation on large
(truckload) and small (LTL) shippers have been very different.

While deregulation has increased competition within the truckload industry
by allowing small, independent businesses to enter this segment of the
industry, competition in the LTL industry has all but disappeared. (8, 22)
The key difference between these segments of the industry appears to be
the amount of infrastructure that is required. To compete successfully in
the LTL market, a company must have a large network of trucks and
terminals so that shipments can be aggregated efficiently. In the nearly two
decades since deregulation, it has become increasingly difficult for new
companies to enter this market. Before deregulation, the four largest LTL
carriers controlled about 20 percent of the market. Within five years of
deregulation, they controlled 35 percent of the market, and by the early
1990s, they had roughly 40 percent of the market. (22) In fact, in the first
six years after deregulation, “more than 54 percent of the LTL trucking
companies went out of business,” and there have been no new entrants into
this market. (22) Another study of the industry summarizes the effect of
deregulation in the LTL market in this way: By 1986, “the ten largest LTL
carriers accounted for 60 percent of LTL shipments and 90 percent of its
While the truckload market appears to be very competitive, that industry has problems as well. Excess capacity in the market (that is, too many trucks) has created a large disparity between the prices paid by very large shippers (such as large factories that ship thousands of truckloads per year) and those paid by smaller shippers (such as small factories that might ship a few truckloads per week). In fact, some analyses show that very large shippers are demanding, and getting, below-cost rates just so that trucking companies can generate some cash and keep their fleets in business. (8)

The result is that many smaller truckload shippers pay higher rates than they would otherwise so that trucking companies can recover some of the losses they incur on the business from large shippers. (8)

Evidence of rising safety concerns within the industry is also mounting. The truck fleet is aging, maintenance is being deferred, and drivers are pressured to drive for long hours. (8, 13) Since deregulation, accident rates are increasing, and the overall level of safety is decreasing. (8, 13)

The savings and loan crisis of the 1980s was caused, at least in part, by the relaxation of regulations over the financial integrity of those institutions, coupled with incentives for them to pay higher interest rates to depositors. This, in turn, led them to lend money to riskier enterprises that would pay higher interest rates. Many of those riskier loans involved real estate development. When the recession of the early 1980s led to a decline in demand for real estate and a decline in real estate values, many savings and loans saw the value of their assets decline enough to put them in partial or total default. (22, 37)

It would be improper, though, to blame deregulation for the entire problem. Deregulation of interest rates and the costs of financial services was designed to provide more choices to consumers and to help savings and loans retain business that they were losing to brokerage firms that could sell “money market” accounts. Up until the late 1970s, savings and loans were prohibited from paying interest on checking accounts and were strictly regulated in the amount of interest they could pay on other accounts. With interest rates reaching 15 percent or more, brokerage firms were attracting savings and loan customers by offering “money market” accounts that paid market interest rates and worked very much like checking accounts. Deregulation of interest rates and other services was seen as a way to keep savings and loans viable by allowing them to compete more effectively with brokerage accounts. (22, 33, 37)
Deregulation did have the intended effect. It enabled savings and loans to retain business and compete more effectively for deposit accounts. The downside, however, was that savings and loans engaged in riskier activities in order to generate enough funds to pay those higher interest rates. When those riskier investments failed, a crisis resulted.

It is too easy to say that deregulation was a failure. Savings and loans might have failed in even greater numbers had they been unable to attract and retain depositors. What is clear, however, is that the combined deregulation of interest rates and relaxation of regulatory controls on safety (the adoption of more lenient rules for valuing assets, among other factors) created an unstable business environment. The relaxation of controls on safety also made it more difficult to detect outright fraud and other criminal activities.

Another important question about savings and loan deregulation, and one that is often overlooked, is the impact on consumers. Before the crisis occurred, the GAO examined the effect of deregulation on the prices that consumers paid for banking services. (33) In 1987, the GAO concluded that low-income consumers (those with annual incomes under $10,000 per year) were paying significantly more for banking services than they were before deregulation. In contrast, higher-income consumers (those with annual incomes above $50,000) were receiving much higher interest rates on deposits, which more than offset any fee increases. (33)

The results of the GAO study and other studies led many to seek federal legislation to require financial institutions to offer "lifeline" services to low-income and older consumers. (33) Efforts to adopt legislation were not successful, but they did draw attention to the concern that some segments of the population were having trouble affording basic financial services.

There is every indication that since the GAO study in 1987, the problem is worsening. Banks are reporting ever higher earnings from the fees that they charge, while interest rates on basic accounts have declined to under 2 percent. (17)

**Lessons Learned**

Consumers and consumer advocates can learn from the experiences of other industries. Obviously, if there is deregulation in an industry, it means that rates and the other terms of service will no longer be regulated. For large consumers and large communities, choices are likely to increase and prices to decline, but for small communities and small or low-income consumers, choices may decrease and prices rise; some areas have suffered the complete elimination of the service.
Once there is deregulation, the typical consumer protection function in a regulated industry (trying to keep rates low and ensuring that the terms of service are reasonable) no longer apply. Fraud and misrepresentation will become important issues, not only among resellers and other new entrants into the industry but also among established industry participants. The federal and state governments have not always seen eye-to-eye on who has the responsibility to protect consumers from fraud, unfair trade practices, or other improper practices. At least in the case of airline deregulation, Congress did not make it clear who has the responsibility to provide needed services to low-income consumers, small communities, and others whom the market may not protect. Further, even within the federal government, there has been some confusion over which agencies have the responsibility to perform some of these functions. Similar confusion has occurred in some states over the jurisdiction of state agencies to deal with consumer protection concerns.

If the utility industries follow the path of other once-regulated industries, major mergers among large utility companies will continue, and some large companies will seek protection from the bankruptcy courts or even go out of business completely. These actions raise additional consumer protection concerns, such as the consumers' recourse when a supplier defaults on a promise to deliver a certain service.

Finally, deregulation also can lead to additional concerns about public safety and the quality of service that consumers receive. Airline deregulation has been handled in such a way that the safety of service has been retained or even enhanced, in large measure because the federal government continues to regulate the safety of airline service. On the other hand, deregulation in the trucking and savings and loan industries has led to very serious concerns about safety and quality of service within those industries.

Thus far, none of the efforts at deregulation have been able to ensure the availability and quality of service to all consumers. Despite promises at the outset that consumers would benefit and that neither public safety nor the quality of service would decline, deregulation has, in fact, led to increased concerns about public safety and a diminution in the quality or availability of service for at least some customers. Some communities and consumers lost service as a result of deregulation; others continue to receive service but at higher prices or lower levels of quality. At the same time, some consumers benefit from new services and lower prices. (5)

The complete deregulation of an industry does not appear to be consistent with the protection of public safety. The experience in the airline industry shows that it is possible to deregulate an industry financially while maintaining regulations over the safety of the service that is provided. The result can be the provision of enhanced levels of service for many consumers.
The challenge is to strike an appropriate balance between price deregulation and regulation of safety and service. (5) This challenge has been described as follows: “If deregulation is not carried out carefully, disaster—such as the savings and loan crisis—will result. On the other hand, regulatory reform can unleash a torrent of creativity, innovation, and increased competition. The challenge for regulators is to craft regulations that will yield these outcomes.” (22)

Efforts to deregulate portions of the telecommunications, electricity, and natural gas industries are well underway throughout the United States. A complete review of the status of deregulation is beyond the scope of this report and would
Chapter 3: Deregulation of the Utility Industries

be out of date before the report could be printed. Instead, this chapter will provide a brief overview of the ways in which deregulation is being pursued in these industries and how consumers may be affected by deregulation within the next few years.

The telecommunications industry is really two industries: interstate long-distance service and local service. Interstate long-distance service is under the jurisdiction of the federal government, while local service is regulated by each state Public Utilities Commission (PUC). The federal government has largely deregulated long-distance service, while local service remains a regulated monopoly in all states.

Long Distance

The market for long-distance telecommunications services, on paper, is highly competitive. Hundreds of companies sell long-distance service to consumers. Different pricing plans, "dial around" services, on-peak rates, off-peak rates, flat rates, and week-end discounts are just some of the options offered to consumers.

A closer look at the industry, however, reveals that just three companies — AT&T, MCI-WorldCom, and Sprint — provide most of the service within the industry. Depending on the measure used (revenues, number of minutes, or number of telephone lines), AT&T controls between 55 percent and 70 percent of the market. (11) Collectively, the "big three" control between 82 percent and 91 percent of the long-distance market.3 (11) Thus, while the market for long-distance telecommunications appears to be a highly competitive, in fact, the market is an oligopoly, dominated by three large firms.

Much of the apparent competition within the long-distance industry is the result of companies’ buying services at wholesale prices from the big three and then reselling those services to retail customers. There are hundreds, perhaps even thousands, of telecommunications resellers, but in reality nearly every consumer in the United States is purchasing long-distance service from one of three companies.

It does not appear likely that a fourth major provider of residential long-distance service will develop any time soon. While companies continually enter and leave the market, most new entrants that install their own facilities and begin to develop a substantial market share quickly become

3 These figures are based on market shares before the merger of MCI and WorldCom. That merger is expected to slightly increase the share of the combined company, but MCI was required to divest its Internet assets before the merger, which could lead to a loss of some long-distance customers.
candidates for a merger or acquisition. Other companies enter the market with facilities, but focus their efforts on large business customers.

Going from a monopoly (AT&T) in 1984 to an oligopoly in the late 1990s has had some advantages for consumers. Long-distance prices have fallen, and pricing options have increased. Offsetting these changes, though, has been the increase in the cost of local telecommunications service, prompted in large part by the reallocation of costs from long-distance companies to local consumers. For example, from 1984 through 1994, the price that long-distance companies had to pay for one minute of access on a local telephone network dropped from an average of 17 cents per minute to an average of 6 cents per minute. (11) The local phone companies passed on the difference to local residential consumers. The charge for local phone service has risen from a nationwide average for residential consumers of $11.58 in 1983 to $19 in 1994. (11) The net effect has been a sustained price reduction for consumers who make a large number of long-distance calls and a net price increase for consumers who make relatively few long-distance calls. Overall, during the period from 1984 (when the AT&T system was broken up by order of a federal court) until 1994, the average monthly telephone bill for a residential consumer increased from approximately $38 to about $61 - a 60 percent increase in 11 years. (11)

The advent of competition in the long-distance market also has given rise to consumer fraud. One of the most common types of fraud created by telephone utility industry competition is "slamming"—the unauthorized change of a utility service provider. Slamming often occurs in the context of high-pressure and deceptive marketing telephone contacts or as part of "contests" in which participants are not fully informed that they have authorized a change in their service provider. As a direct result of deregulation, slamming has become a major consumer-protection problem in the long-distance telecommunications industry.

**Local Telecommunications Service**

Local phone service for residential consumers and for most business consumers remains a virtual monopoly everywhere in the United States. The only exception is for business consumers in some of the country’s largest cities, where Competitive Local Exchange Carriers (CLECs) are beginning to install their own facilities. In a few places, CLECs have successfully entered the market and taken large business customers away from the local phone company. Few markets in the country have CLECs serving individual residential consumers in other than token numbers. (3) The Telecommunications Act of 1996 was supposed to change this. That law was designed to enhance the level of competition for local phone service and, at
the same time, allow local phone companies to enter the market for long-distance services. The expectation was that this would improve the level of competition in both markets simultaneously.

In reality, though, the law has not accomplished these objectives. The long-distance market continues to be dominated by the three major companies. The local phone market—particularly for residential consumers—remains a monopoly, and those monopolies are getting larger through mergers. In 1996, there were eight large “local” telephone companies. If the currently pending mergers between SBC-Ameritech and Bell Atlantic-GTE are approved, there will be just four in the near future. Further, cable television systems, which were believed to be the natural competitors of the local phone monopolies, have largely decided not to compete against the local phone companies. While this may change with the proposed merger of AT&T and TCI, the extent and timing of that competition remains a matter for much speculation.

In several states and at the federal level, movements are underway to introduce vigorous competition in the local market. So far, these efforts have turned into massive regulatory battles between the local phone monopoly and the long-distance oligopoly. Little has changed, and as of mid-1998, the prospects for vigorous local phone competition and the entry of the regional phone companies into the long-distance market appear to be months, if not years, into the future.

One serious consequence of the movement towards local phone competition already is apparent. The proliferation of CLECs, cellular telephone companies, paging companies, and other entrants into specific segments of the local phone market have led to the proliferation of new area codes. Each new entrant is assigned telephone numbers for an entire exchange (the first three digits of the telephone number after the area code). Each exchange consists of 10,000 phone numbers, but each area code has fewer than 1,000 exchanges available. Thus, even if a paging company needed only 100 telephone numbers, it is assigned 10,000 numbers. This highly inefficient allocation of telephone numbers has resulted in the premature “exhaustion” of available phone numbers in many area codes. This practice, in turn, has led to either the division of area codes, forcing consumers to expend substantial resources to notify others of their new area code (printing new stationery, notifying friends and customers, reprogramming telephone equipment and fax machines, etc.), or the creation of area-code overlays (multiple area codes serving the same area, with new competitors being assigned to the new area codes), leading to confusion among consumers and discrimination against new competitors who must convince potential customers to change their phone number as well as their phone company.
Several states with high electricity costs are embarking on efforts to restructure the electric utility industry to make it more competitive. At the forefront of this effort are states in the West (California, Nevada, and Arizona), Midwest (Illinois and Michigan), and Northeast (Maine, New Hampshire, Massachusetts, Rhode Island, Connecticut, New York, and Pennsylvania). Several other states also are looking for ways to open their electricity markets to more competition.

**Electricity**

The status of electricity restructuring changes almost daily, as each state studies the possible effects of restructuring in that state and various interest groups continue to reassess their options. Two years ago, New Hampshire conducted the country's first test in electric competition and enacted the nation's first comprehensive restructuring legislation. This experiment, however, got bogged down in court challenges and New Hampshire is only now getting back to the task of designing and implementing an electricity choice program. So, rather than attempting to review the status of competition in each state, a few general observations will be made about what it means to restructure the electricity market and what is likely to occur over the next few years.

Competition for the generation or supply of electricity is the issue. No state so far is even considering the possibility of deregulating the distribution of electricity. For the foreseeable future, the electricity industry will likely consist of two distinct markets: the generation of electricity, which may become largely unregulated, and the distribution of electricity (the wires, transformers, and substations that are needed to get electricity to the consumer), which will remain regulated. It is for this reason that most people are referring to the "restructuring" of the electric industry, rather than its deregulation. While a portion of the industry may be deregulated (the supply side of the industry), the distribution, or "wires," side of the industry will remain a regulated monopoly.

For the past 20 years, the national policy has been to encourage the production of electricity by independent companies rather than by the local utility. That policy has given rise to many independent power producers in some regions of the country as well as many large commercial and industrial consumers that generate at least some of their own electricity. Since the passage of the Energy Policy Act of 1992, competition has emerged in the wholesale electricity market, making it easier for utilities to buy power from the lowest-cost source in the market.

The latest step in this process is giving these diverse generating companies direct access to retail consumers. Rather than being required to sell only to large utilities, electricity-generating companies would be allowed to sell directly to consumers. In addition, companies (and even cities and nonprofit organizations) are being encouraged to buy electricity at wholesale and resell it to retail...
consumers as a way of further broadening the
electricity market. The hope is that by giving consumers direct access to
the electricity generator, consumer choice will increase, the quality of
service will improve, and prices will decline.

It is too soon to tell whether electric industry restructuring will be able to
achieve these objectives. At this writing, a few states have begun to set the
rules and establish the framework for retail competition, while others are in
varying stages of investigating their options. Thus far, the biggest single
issue is the recovery of "stranded costs" (or above-market costs) by electric
utilities. Stranded costs are the difference between the market value of the
utility's assets and the amount that the utility has been including in its
regulated rates (typically, the actual cost of the assets). In the case of some
very expensive assets, like nuclear power plants, the disparity between the
asset's market value and its actual cost is large. The issue becomes what to
do with the difference: Does it get recovered from the utility's customers?
If so, over what period of time? Should the utility's investors be required
to absorb some of the cost and, if so, how much?

It appears that until these stranded costs are recovered, achieving substan-
tial reductions in electric rates will be difficult. While some states are
hoping for 10 to 15 percent reductions in rates in the early years of restruct-
uring, the larger savings—some analysts estimate on the order of 40
percent or more—will not be achievable until stranded costs are removed
from the utility's bills. That could take from five to ten years.

Restructuring also raises questions about what portions of the industry
should remain regulated. Are billing and metering services part of the
distribution of electricity (a regulated service) or part of the supply of
electricity (a competitive service)? Is the presence of generation near large
groups of customers part of the supply of electricity or part of the safety
and reliability of the distribution network? Added to these questions are
concerns about the potential for cross-subsidization between parts of the
same company that perform services for both regulated and unregulated
businesses.

Restructuring the electricity industry is not a simple task. If the experiences of
California, Pennsylvania, Illinois, and Maine are any indication, once the state
legislation is passed, restructuring could involve on the order of 15 or 20 sepa-
rate proceedings in each state to establish the basic ground rules for restruc-
uring. In addition, each electric utility will need to file a new set of rates to sepa-
rates the costs of supplying electricity from the costs of distributing that electricity
to consumers. A wide variety of interests can be expected to be represented in
those proceedings, among them utilities, various consumer groups.
environmental organizations, labor unions, independent power producers, marketing companies, local governments, and rural electric cooperatives.

A few states also are beginning the process of restructuring the natural gas market. In the mid-1980s, the wholesale market for natural gas was deregulated on the federal level. Since then, large gas consumers have been able to buy gas directly from gas producers and have it transported directly to their place of business. Current efforts to restructure the gas industry are aimed at giving smaller consumers, including individual residential consumers, the same right.

**Natural Gas**

As this is being written, large-scale test programs are underway or will begin shortly in several states to give consumers the right to buy gas from their supplier of choice. In addition, a few states (Georgia, Montana, and Oklahoma) have enacted legislation that would restructure the retail gas industry in those states, and other states are studying the issue. In each instance, the local gas utility would remain a regulated monopoly and would deliver the gas to the customer, ensure that enough gas is available to meet demand during the winter, and otherwise oversee the safety and reliability of the local gas system.

It appears that restructuring the gas industry will result in much smaller savings to consumers than are possible from restructuring the electricity industry. Much of the savings in natural gas was achieved ten years ago or more, when large consumers were allowed to shop for their own gas supplies. In fact, between 1990 and 1995, the average national price of gas paid by electric utility and industrial gas consumers declined by 36 and 24 percent respectively. (10) By now, large gas producers and marketing companies are selling gas directly to virtually every large gas user in the country. Further, the presence of competition for those large gas supplies put increased pressure on gas utilities to shop for the best prices to serve the remaining small consumers.

This combination of a well-developed gas market and few large consumers who are not already purchasing gas from their supplier of choice makes it unlikely that large savings will result from further restructuring the gas market. Early results from some of the test states appear to have created some savings for consumers, at least during the relatively mild winter of 1997-98, but it is difficult to assess the long-term effect of these programs on the price and supply of natural gas.

If these early programs show signs of success, it is likely that other states will follow suit, particularly in those states that are restructuring their electricity industries. If consumers can successfully purchase one form of
energy in a competitive market, it is likely that they will want to purchase other forms of energy in the same manner or from the same supplier.

Although utility industry deregulation is just beginning in most places, utility consumer advocates are already examining their future roles. This chapter focuses on the changing roles of three types of consumer advocacy organizations: state consumer agencies authorized to represent the interests of consumers before the public utility commission (PUC); private, nonprofit organizations representing consumers on utility-related issues; and legal services organizations representing the interests of low-income consumers. Traditionally, each of these types of organizations plays a distinct role in the regulatory process.
Chapter 4: Effect of Deregulation on Utility Consumer Advocates

State agencies usually have the responsibility to represent the consumer interest in general. Often, state consumer agencies act without consulting individual consumers; rather, they use professional judgment to determine the actions that are in the best interests of consumers collectively. This approach may lead to particular groups of consumers being affected differently. State agencies usually have substantially greater resources than most other consumer organizations involved in a utility case (except organizations of large industrial consumers)—professional staff (attorneys, accountants, engineers, consumer specialists, and others) and a budget to hire consultants with expertise for a particular case.

Private organizations usually represent a specific membership base. This base may include consumers with specific characteristics (such as AARP’s representation of older persons), those who live in a relatively small geographic area (neighborhood associations), or those who share some common interest (such as environmental organizations). The resources of these organizations vary tremendously, from the small community group with no professional staff and a limited budget to highly sophisticated national organizations with professional staffs and multi-million dollar budgets. These private organizations usually educate their members about utility issues and often become formally involved on specific issues of concern to their members in cases before a PUC.

Legal services organizations represent the interests of low-income consumers. Legal services organizations tend to have relatively few resources to devote to utility issues, perhaps one or two attorneys for a city or a small office to cover an entire state. However, these organizations often have much greater expertise in a broad range of consumer protection issues, expertise which may prove invaluable as the utility industry becomes less regulated and begins to look more like other consumer services industries. Legal services organizations usually represent individual consumers with utility problems but also become formally involved on issues affecting low-income consumers in cases before a PUC.

The movement toward deregulation is changing the traditional role of utility consumer advocacy organizations. In states where utility industry restructuring is occurring, the issues with which consumer organizations must deal are increasing, particularly in the following areas:

The Challenges and Changing Mission of Utility Consumer Advocates 1619

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1. Consumer education,
2. Consumer complaint handling and consumer protection,
3. Market oversight and merger review, and

**New and Increased Responsibilities**

These changes in the focus of consumer advocacy organizations are a function of the proposed changes in the utility industry and the need for consumers and policymakers to ensure that the transition to a different market structure does not adversely affect consumers. These activities are in addition to continuing regulatory responsibilities for the distribution of electric and gas service, ensuring the provision of universal telephone service, and other ongoing regulatory issues.

Moreover, while some consumer advocacy organizations play a role in serving as watchdogs over the quality of utility service, the importance of this responsibility will increase significantly. Traditionally, the quality of utility services has been monitored by many consumer advocates to ensure that utilities are maintaining the safety and reliability of their systems and are remaining focused on the needs of their customers. In a more competitive environment, however, there will be tremendous pressures on utilities to shift resources from their regulated operations to their unregulated operations. Consequently, consumer advocates will need to focus carefully on any change in resource allocation to ensure that such action will not have an adverse effect on the safety, reliability, and overall quality of utility services. Organizations that have not focused on these issues in the past may find that it is now necessary to do so. Organizations that have developed some expertise on quality of service issues may find that they will need to enhance their capabilities in this important area.

**1. Consumer education**

Consumers are not used to shopping for electricity, natural gas, or local telephone services. Numerous questions will arise about how to determine the best deal, how to evaluate offers that are not expressed in comparable terms, and how to evaluate the value of bundles or packages of services. In the past, many consumer advocates have not found it necessary to expend significant resources on educating consumers, but that is changing.

One of the best ways to protect consumers in a competitive market is to educate the consumer about how to participate in the market. Consumer advocates now find it necessary to educate consumers about their utility bills and services. Most consumers have no idea what it means to use a kilowatt-hour of electricity or a cubic foot of gas. They do not understand how the prices of gas and electricity in the marketplace vary during certain times of the year, or even during certain times of day. Advocates must
make these concepts clear to consumers. Consumer advocates will need to spend much more time and money educating consumers, using various media—brochures, newsletters, and meetings with community organizations.

In California and Pennsylvania, PUCs are directing massive, statewide education efforts designed to inform consumers about the opportunity to choose electricity providers. Those multi-million dollar efforts have focused on consumer “awareness” that electric choice is available. They have not yet provided the basic information that consumers will need to understand what competition involves (such as what a kilowatt-hour means, how utility bills can be lowered through conservation, and what the risks are of having energy prices vary with the time of day or season of the year). Whether and how this information will be provided remains to be seen.

2. Consumer complaint handling and consumer protection

Everything does not always go according to plan. That unfortunate truism means that problems will arise between consumers and utility companies or other suppliers. Whether the problems are the result of honest mistakes or dishonest activities or consumer confusion, consumers need a place to turn.

In most states, that place has been the PUC consumer complaint division. However, as utility services become deregulated, the PUC may lose jurisdiction to deal with many complaints. In other states, PUCs find their consumer staff ill-equipped to deal with the volume and nature of consumer inquiries that arise as utility industries are becoming more competitive.

Consumer advocacy organizations, small and large, are attempting to fill this gap by increasing their ability to respond to consumer complaints and questions. The problem, of course, is that this can be an expensive proposition, requiring additional staff, telecommunications resources, and a commitment to providing timely, responsive service to consumers. Many consumer advocacy organizations do not have the budget or the staff to provide service to a large number of consumers.

Smaller organizations are trying to fill this need by establishing better links with other organizations. These networks of consumer advocacy organizations may include several state agencies (attorney general, PUC, governor’s office), nonprofit organizations, local governments, and the utility companies themselves. Larger organizations are increasing their consumer complaint handling capability...
so that they can respond to more consumer inquiries directly. They are not only increasing the staff and physical equipment of the office but also expanding the ability of the office to respond to inquiries in languages other than English.

3. Market oversight and merger review

Helping ensure that a new market becomes and remains competitive is one of the most difficult and complex tasks that a consumer advocacy organization can undertake. Traditionally, utility consumer advocates did not need to worry about these issues at all—by definition, the utility was a natural monopoly. It did not have any competition. With restructuring, however, assurance that the market is competitive and is not being abused is needed. Part of this assurance is the review of proposed mergers to ensure that consumers and competitors will not face higher prices or poor service as a result of the combination.

Within the past two years, the merger activity in the utility industry has been overwhelming. If all currently pending mergers are consummated, the telecommunications industry will have gone from eight major local telephone companies to four, all within the two years since the Telecommunications Act was enacted in 1996. At the same time, numerous mergers are being proposed in the energy industry, further draining the resources of utility consumer advocates.

Overseeing the market requires more than reviewing proposed mergers. Mechanisms need to be created to deal with allegations of unfair competition and policies and procedures need to be developed to prevent cross-subsidization between regulated and unregulated operations within the same company. Consumer representatives will find themselves negotiating with utility companies, independent marketing companies, marketing affiliates of the utility, and local businesses (such as fuel oil dealers). Each interest has a different set of issues that concerns them, and each wants to ensure that the new market begins on a level playing field, rather than one slanted to the benefit of one participant or another.

4. Coalition-building

Restructuring utility industries is neither simple nor straightforward. Tradeoffs and inter-relationships are often complex and not always readily apparent. Is it better to achieve immediate rate decreases or to provide incentives for consumers to shop for utility services? Should a utility be prohibited from entering the market for competitive services if it has a monopoly on other related services or should it be allowed to compete and encouraged to provide the best deal that it can for consumers? Should stringent consumer protection requirements be put in place, or should marketers be given the flexibility to develop products and services that meet the needs of certain portions of the market?
There are no easy answers to these types of questions. Each involves a series of tradeoffs that ultimately will determine whether a competitive market can work for consumers. No one organization can be expected to figure out all of these complex inter-relationships or decide what is in the best interest of all consumers in an entire state. The result, in many states, is that utility restructuring provides a magnet to attract organizations that often have been on opposite sides of the table in utility cases, such as industrial plants, low-income consumers, and small businesses. The task of building a coalition among these groups is difficult, time-consuming, and not always successful.

Typically, the state consumer agency provides the catalyst for bringing together these diverse groups to develop a set of principles to which they can all agree. Forming the coalition, finding a set of common principles, keeping the organization on task, and allowing differences to get resolved can be a full-time job. From the experience of consumer advocates in several states, however, it appears that coalition-building is a critically important component of a restructuring process that protects consumers while developing a competitive market.

In those states where utility industry restructuring is occurring, consumer advocates will almost certainly find that they have an increased work load, a need for different expertise, new incentives to coordinate with other consumer advocates, and inadequate funding. An advocacy organization’s effectiveness will depend on its ability to cope with these three issues.

**Work load**

The complexity of utility industry restructuring should not be underestimated. It is not simply a matter of enacting legislation or changing commission policy and watching a free market develop. The process is time-consuming and can seriously strain the resources of a consumer organization.

California, Pennsylvania, Maine, and Illinois are each in various stages of restructuring their electricity industries. All four states have enacted restructuring legislation, but that is just the beginning. In each state, there have been, or will be, at least two dozen separate proceedings covering topics as diverse as the licensing requirements for electricity suppliers, metering standards, electronic data exchange requirements, permissible activities of utility affiliates, codes of conduct for relationships between utilities and their unregulated affiliates, and utility bill formats. In addition to these generic proceedings, each electric utility is required to start a highly complex legal and financial proceeding so that the utility’s charges can be divided between its regulated

**Issues Associated with New Responsibilities**

The Challenges and Changing Mission of Utility Consumer Advocates 1623

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services (the transmission and distribution of electricity) and its unregulated
services (the sale of kilowatt-hours of electricity) and its "stranded costs" can be
determined.

In essence, then, in the space of a year or two in these states, consumer
advocacy organizations are faced with an unprecedented workload: 20 or
more nearly simultaneous generic proceedings coupled with complex cases
for every electric utility in the state.

On top of these statutory mandates to implement restructuring is the
unprecedented level of merger activity in the energy and telecommunications
industry. Nearly every state has had at least one major utility merger
during the past two years; many states have faced several such cases.
Evaluating a merger, determining its impact on consumers and the market-
place, and developing recommended solutions to any problems are not
easy tasks. A major utility-industry merger can be as complex as a multi-
million dollar rate case. Every state also is dealing with the requirements
of the federal Telecommunications Act of 1996. That law requires each
local telephone utility to go through numerous proceedings in each state in
an attempt to open up the market for local telephone service and to provide
local telephone companies with the ability to offer long-distance services.
In addition, some states have separate legislation that governs the regula-
tion of telephone utilities. In Pennsylvania, for instance, 19 small local
telephone companies recently filed plans to modernize their networks and
change the way in which they are regulated. These applications came at
the same time that the state is restructuring its electricity industry and
evaluating pilot programs to allow consumers to purchase natural gas directly
from suppliers. At the same time, the state is evaluating a proposed merger
between two of its largest energy companies and another merger that involves its
two largest telephone companies.

Simply put, many utility consumer advocacy organizations are busier than
they have ever been. Their responsibilities are expanding and changing, but their
old work is not going away. Expectations are rising that consumer organizations
will help educate consumers about utility markets and the effects of restructuring.
In addition, many of these same organizations are expected to help consumers
resolve problems they have with utilities.

Need for Different Expertise

Changing the structure of the utility industry, breaking apart utility rates into
separate components, writing rules for consumer protection in a competitive
market, and evaluating mergers and acquisitions in a competitive market are new
responsibilities for most consumer advocates. Finding and developing expertise
in these new areas is not a simple task.
Utility consumer advocacy organizations tend to rely on their internal expertise, coupled with a relatively small number of outside consultants who regularly work on utility-related issues for consumer advocates. As an example, the National Association of State Utility Consumer Advocates lists just 50 consulting organizations in the entire country that advertise their services to utility consumer advocates. (18) Most of these consultants have experience on the more traditional issues involved in utility regulation (such as estimating the cost of capital, determining the appropriate levels of investment and expenses, estimating future revenues, and designing rates to recover the utility’s revenue needs). While many consultants are developing the expertise needed to help consumer advocates deal with restructured utility industries, many gaps remain in the available expertise.

Jim Hurt, the director of the Utility Consumers’ Counsel in Georgia, states that on issues like market power and antitrust, “we’re flying by the seat of our pants. Most consultants are still thinking in terms of traditional ratemaking. There are not many consultants who understand these issues. We’re finding out about issues before the consultants are. It’s hard to find consultants who understand these issues and are out in front of them.” This concern is echoed by several other consumer organizations. It seems that as each state begins dealing with these new issues, consumer organizations are left to develop some or all of the necessary expertise in house. Hiring a consultant is not sufficient. Mr. Hurt suggests that it would be worthwhile for consumer advocates who deal with issues first to help other consumer advocates, not just in an informal way, but actually as consultants and expert witnesses.

The lack of readily available expertise poses several problems for consumer advocacy organizations. It makes it more difficult for them to participate in negotiations or litigation involving these highly complex issues. Even after identifying a consultant, more time is needed to develop positions, strategy, and testimony. Often, time is something that is in very short supply in many of these cases.

As more states go through utility industry restructuring, it is anticipated that some of the issues will become more routine and that consultants will be available who have been through these issues in other states. It may take several years, however, for this to occur. In the meantime, it will continue to be difficult for consumer organizations to find and develop the expertise that they need to participate fully in many of these proceedings.
Coordination with Other Organizations

The significant changes in the utility industry have highlighted areas where consumer advocacy can be improved and strengthened. One of those areas is the coordination and communication among organizations with similar interests.

In Maine and the District of Columbia, this has involved the creation of coalitions of consumer organizations. In Maine, the formation of a coalition was prompted by the introduction of legislation to restructure the electric utility industry. In the District of Columbia, the driving force was the proposed merger of the local electric utility, Potomac Electric Power Company (PEPCO) with a neighboring utility, Baltimore Gas and Electric Company (BG&E). In both instances, these major policy and consumer protection issues resulted in usually disparate consumer groups (including industrial customers, other small and large business groups, low-income consumers, labor unions, and others) coming together, putting aside their differences, and finding a common set of issues on which they could agree. Betty Noël, the People’s Counsel for the District of Columbia, highlights the strength of the consumer alliance that was formed: “We have seen an alignment of consumer interests across the spectrum—business, government, labor, consumer groups, and others were aligned against the PEPCO merger. This was the first time that we had a chance to appreciate how powerful the alliance was. Utilities were very surprised by the strength of the alignment, too.” She is hopeful that the coalition will be able to remain in place for other important issues, including the potential restructuring of the electric industry in the District.

This type of concerted effort has not occurred in other states. Instead, each group of consumers has taken its own approach, with large consumers of utility services seeking to reduce their expenses, either at the cost of the utility or at the cost of smaller utility consumers. For example, in California, there is no permanent consumer alliance following electric restructuring activities. As different issues arise, the coalitions shift such that groups may support one another on some issues but oppose each other on different issues. Nettie Hoge, the executive director of The Utility Reform Network (TURN) in California, explains the problem this way: “It’s becoming harder to put together a coalition. The issues aren’t as clear cut and the utilities are working harder to divide and conquer. Agendas for various groups are different than they once were (for example, small business interests may not coincide with residential interests anymore) because of the complexity of the issues.”

The relationship between consumer advocates and PUCs also is changing. In some states, consumer advocates and PUCs have a very cooperative relationship, while in others the relationship is much more confrontational. Proposals to restructure the utility industry and to change the nature of regulation have placed additional strain on some of these relationships. In