Regulating Public Utility Performance:
The Law of Market Structure, Pricing and Jurisdiction

Chapter Seven

"Just and Reasonable" Prices in "Competitive" Markets: Market-Based Rates Set by the Seller

Scott Hempling
Attorney at Law LLC

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Without empirical proof that . . . existing competition would ensure that the actual price is just and reasonable, [the Commission's approach] retains the false illusion that a government agency is keeping watch over rates, . . . when it is in fact doing no such thing.[1]

7.A. Seller-set prices can be "just and reasonable"—if seller lacks market power

7.A.1. Paths to regulatory withdrawal

When policymakers convert monopoly markets to competitive markets, they begin with market structure. They (1) authorize entry by new competitors; (2) make competition effective by unbundling the competitive from noncompetitive services and reducing entry barriers; and (3) monitor the results to prevent anti-competitive action like price squeeze, predatory pricing and tying. Those were the subjects of Chapters 3, 4 and 5. We now turn from structure to pricing. Chapter 6 explained how, in regulated monopoly markets, the regulator sets the prices. When we authorize competition in previously monopolistic markets, should we let sellers set the prices?

The answer has been yes, with two distinct approaches to the regulator's role: statutory repeal and administrative withdrawal. *Statutory repeal* is straightforward: A legislative body repeals price regulation. Doing so removes the regulator's rate authority entirely, leaving entrants to price at will. Examples are state statutes authorizing retail competition in gas and electricity. In those markets, the new competitors set their prices without regulatory review. There is no "just and reasonable" limit and no regulatory role.[2] *Administrative withdrawal* is less straightforward. The statutory "just and reasonable" standard remains on the books; but the regulator, using implicit or explicit authority and subject to varying procedures, withdraws from price-setting. The assumption is that competitive market forces will keep prices just and reasonable. Under this administrative withdrawal umbrella, there are four main variations.[3]

1. Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486, 1510 (D.C. Cir. 1984).
2. Caution: While the competitive retail sellers in these states can price at will, the provider of "default" service (also known as "standard offer" service or "last resort" service) is usually subject to some state commission price regulation. *See supra* Chapter 3.B.2.
3. In each of these variations, the regulator puts no boundaries on the prices. Recall from Chapter 6.E that regulators can also grant sellers pricing discretion within regulator-set boundaries. These price caps and their cousin "alternative form of regulation" (AFOR) are actually a variation on cost-based rates, because they have a foundation in some measure of cost, such as the carrier's last cost-justified rate. Price caps and their relatives have at least three common features: (1) The statutory just and reasonable standard remains in place, (2) the regulator assumes that competitive forces will keep prices just and reasonable, and (3) the formulas and quantities used to set the caps are periodically reviewed to see if they are producing excess or insufficient profit because of the relationship of price to cost.

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Variation #1: Regulator removes price regulation for some but not all sellers. In the 1980s and early 1990s, the FCC allowed "non-dominant" (mostly long-distance) carriers to set their prices, but continued to subject the "dominant" carriers (such as the RBOCs and other ILECs) to price regulation (the form of which changed over time).[4] The non-dominant carriers' pricing freedom was not unlimited. They remained subject to (a) Title II's requirements relating to "common carrier" status, including the requirements that rates be just and reasonable and non-discriminatory; and (b) enforcement of those requirements through Title II's complaint procedures.[5]

Variation #2: Regulator removes price regulation for an entire category of services. Two examples are wireless and long distance. Commercial mobile radio service (CMRS) is wireless common carrier telephone service available to the public (as opposed to "private" wireless used to dispatch emergency vehicles and taxis). In 1982, Congress authorized the FCC to exempt CMRS from the Act's tariff-filing requirement, but not from the Act's common carrier obligation or its requirement that rates be just, reasonable and non-discriminatory. Congress also retained customers' ability to enforce those requirements by complaint.[6] Before allowing the exemption, the FCC had to find that (a) the tariff-filing requirement was not necessary (i) to ensure just and reasonable and non-discriminatory charges and practices or (ii) for the protection of consumers; and that (b) its removal was consistent with the public interest.[7] The FCC granted the exemption to wireless in 1994, finding that "market forces are generally sufficient to ensure the lawfulness of rate levels, rate structures, and terms and conditions of service set by carriers who lack market power."[8] Thus exempted from the tariff filing requirement, wireless providers could offer

4. In allowing the non-dominant carriers to set their own prices, the FCC relied on its general authority under the Communications Act to construe, administer and adopt rules. 47 U.S.C. §§ 151, 154(i), 201(b). The terms "dominant" and "non-dominant" distinguished between carriers with and without market power. *See* Policy & Rules Concerning Rates for Competitive Common Carrier Services & Facilities Authorizations Therefor ("*Competitive Carriers*"), First Report and Order, 85 F.C.C.2d 1 (1980); Second Report and Order, 91 F.C.C.2d 59 (1982); Policy Statement and Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95 F.C.C.2d 554 (1983), *vacated*, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992); *Competitive Carriers*, Fifth Report and Order, 98 F.C.C.2d 1191 (1984); Sixth Report and Order, 99 F.C.C.2d 1020 (1985), *rev'd*, MCI Telecomms. Corp. v. FCC, 765 F.2d 1186 (D.C. Cir. 1985). *See also* Policy & Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6787, P 1 (1990); U.S. Tel. Ass'n v. FCC, 188 F.3d 521, 524 (D.C. Cir. 1999).
5. The FCC attempted to prohibit tariff filings by non-dominant carriers, and later, to make their tariff filings optional. The courts rejected the FCC both times, because 47 U.S.C. § 203(a) required that carriers "shall" file tariffs. MCI Telecomms. Corp. v. FCC, 765 F.2d 1186; MCI Telecomms. Corp. v. AT&T Co., 512 U.S. 218 (1994). This problem was resolved by Section 10 of the Communications Act, 47 U.S.C. §160, added by the Telecommunications Act of 1996. It gave the FCC authority to forbear from applying the requirements of Title II of the Act, including the tariff-filing requirement.
6. Section 203(a) of the Communications Act has the tariff-filing requirement; Section 201 the common carrier obligation; Section 202 the just, reasonable and non-discriminatory rate obligation; and Section 208 the enforcement of these obligations by complaint.
7. 47 U.S.C. § 332(c)(1)(A).
8. Implementation of Sections 3(n) & 332 of the Communications Act, Regulatory Treatment of Mobile Services, 9 FCC Rcd. 1411 (1994) (Second Report and Order).