Case Western Reserve Law Review

Volume 30 | Issue 2 Article 3

1980

Foreword

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Case Western Reserve Law Review

Volume 30 Winter 1980 Number 2

FOREWORD

FOR MUCH OF this century, decreasing electric prices[1] relegated the subject of regulation of electric utilities to the backwater of academic and trade journals. Since the mid-1960's, however, a combination of factors has increased costs and consumer prices dramatically, and the serenity the industry enjoyed in past years is now a memory. The technological innovations of modern boiler technology and the economies of scale gained through interconnection and coordination have been gradually exhausted, while rising fuel and interest costs have led to higher "nominal unit electricity costs."[2] Increases in the costs of construction, of meeting environmental concerns, and of plant site restrictions, have caused the marginal cost of new units to outstrip even the inflation rate.[3] The resulting price increases to consumers have led to intense scrutiny of the electric utility industry. In particular, the visibility of the respective states' Public Utility Commissions (PUC's) and their regulatory policies has dramatically increased. Debate over high sulfur coal, acid rain, fuel adjustment clauses, peak load pricing, and elected versus appointed commissions now occupies the public media as well as scholarly writing.[4]

The papers presented in this symposium concern important in-

1. "From roughly 1917-1950 costs of producing electricity actually fell due to technological innovations and the growth of demand for electricity which allowed economies of scale to be obtained, lowering per unit costs," while in the period 1948-68, prices rose only five percent. Schiffel, *Electirc Utility Regulation: An Overview of Fuel Adjustment Clauses*, 95 PUB. UTIL. FORT. 23, 24 (June 19, 1975).

2. Joskow, *Public Utility Regulatory Reform Act of 1978: Electric Utility Rate Reform*, 19 NAT. RES. J. 787, 791–92 (1979).

3. *Id.* at 792.

4. *See, e.g.*, the recent discussion of acid rain in one of the major Cleveland newspapers, *Acid Rain is Called Serious Hazard to Crops and Water*, The Plain Dealer, Apr. 19, 1980, § A, at 14, col. 1.

dividual threads in the whole cloth of electric utility regulation. Although this foreward obviously cannot undertake to define how each article fits into the entire framework of regulation, it is possible to identify some of the major issues in electric utility regulation today in the hope of delineating the terrain in which the specific articles should be placed.

The key problem facing the electric utility industry is that of rapidly increasing costs, passed on in prices, which in turn become the focus of increasing consumer resentment and political action. As noted very recently by a stock analyst, the utilities' costs "are out of control and more and more money is being used to buy smaller usable capacity. . . . A lot of people don't like utilities and don't fully understand their problems. . . . They think the utilities are getting rich when they are having trouble staying afloat."[5] This consumer resentment and the resulting political pressures are generating a new regulatory climate in which the long-run prospects for private utility ownership may be threatened.

Most disturbing, perhaps, is that electric utilities have little control over the major sources of these rising costs. Consider, for example, the high costs necessarily attached to the nation's increasing reliance on coal and nuclear power. Fossil fuels give rise to serious emissions problems, and the environmental legislation designed to control air quality also results in greatly increased costs. Especially as to coal-burning power plants built after 1970, the increased costs of environmental compliance are being internalized and passed on to consumers.[6] Still to be fully accounted for and absorbed are the costs associated with the phenomenon of acid rain. The Environmental Protection Agency reports that fossil fuel plants, primarily burning coal, annually discharge approximately 50 million metric tons of sulfur and nitrogen oxides into the air.[7] The chemical composition of the atmosphere transforms these oxides into sulfuric acid[8] which may fall—and has

5. Lawless, *CEI's Money Problems Mirrored by Industry, Stock Analysts Say*, The Plain Dealer, Apr. 4, 1980, § A, at 1, col.1.

6. *See generally* 1 A.KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 69 (1970). It is estimated that fifteen percent of new plant construction costs go for antipollution equipment. Dodosh, *Electric Utilities, Hit by Cost of Money, Rate Increase Delays, See Lackluster Year*, Wall St. J., Mar. 22, 1979, at 40, col. 1.

7. EPA Research Summary, *Acid Rain*, EPA-600/8-79-028 (Oct. 1979).

8. *See* Likens, Wright, Galloway & Butler, *Acid Rain*, 241 SCI. AM. 43, 45-46 (Oct. 1979); Mendelsohn & Orcutt, *An Empirical Analysis of Air Pollution Dose-Response Curves*, 6 J. OF ENVT'L ECON. AND MGT. 85 (1979).

fallen—to earth far from its point of origin in the form of acid rain or snow, and which appears to be extremely harmful to human health and wildlife.[9] It seems likely that as the dangers of acid rain are further defined, there will follow significant new abatement measures and accompanying compliance costs.[10]

The potential for increasing costs for nuclear power generation is even more striking. Nuclear plant construction delays and design changes triggered by the accident at Three Mile Island in the spring of 1979 will have an important impact on the utilities' capital spending throughout the 1980's. One commentator has broken down the effects of the Three Mile Island accident into five areas:

1) Increases in the [allowances for funds issued during construction] of a nuclear unit . . . as a result of delays.
2) Design changes required by the NRC.
3) Increases in building costs stemming from the impact of inflation on a lengthened construction timetable.
4) Acceleration of construction schedules of non-nuclear units to ensure adequate reserve margins in the face of delays in the completion of nuclear units.
5) Cancellation of nuclear units now scheduled for operation in the late 1980's and early 1990's.[11]

This list does not include the higher cost of acquiring capital being incurred by all utilities using nuclear power in response to the uncertainties introduced by Three Mile Island.[12] Even without this cost, the accident at Three Mile Island may produce increases in utility capital spending of $10 to 12 billion, mainly for engineering, safety, and general construction delays, compounded by inflation, over the next five years.[13] Yet a spectre even more dismal than rapidly rising costs exists. If the public and political reaction to Three Mile Island results in abandonment of the nuclear option, including breeder development, one industry predic-

9. Likens, Wright, Galloway & Butler, *supra* note 8, at 45–46, 49; G. Wetstone, *Air Pollution Control Laws in North America and the Problem of Acid Rain*, 10 ELR 50001, 50001–02 (1980).

10. *EPA to Move Against Acid Rain in 1980, But Will Face Legal, Scientific Problems*, Wall St. J., Apr. 10, 1980, at 2, col. 1.

11. Studness, *Utility Capital Spending in the Aftermath of Three Mile Island*, 105 PUB. UTIL. FORT. 36 (Mar. 13, 1980).

12. Metz, *Post-Accident Costs May be Biggest Hurdle for Nuclear Expansion*, Wall St. J., Apr. 24, 1979, at 1, col. 5. One utility had to accept a fifty percent higher interest fee on a construction bond only one week after Three Mile Island. As the article's title suggests, "electricity [produced by nuclear power] threatens to become so expensive—more than tripling in price over the next decade . . .—that some critics believe cost, not safety, is the major hurdle facing the nuclear-power industry." *Id.*

13. Studness, *supra* note 11, at 36–37.

tion is that there will be a potential serious electricity supply shortfall sometime after the year 2000.[14]

Another source of public ire has been the automatic fuel adjustment clause. The first automatic fuel adjustment clauses appeared in 1917, and by the mid-1920's they had become a widely accepted method of utility ratemaking.[15] These clauses were necessitated by the enormous fluctuations in utilities' fuel prices, due mainly to coal strikes and transportation difficulties. Without automatic fuel adjustments in utility rates, there would have been too many rate cases for the regulatory bureaucracy to handle.[16] Although most states have utilized automatic adjustment clauses,[17] it was not until the fuel cost explosion from the Arab oil boycott in the fall of 1973[18] that they experienced much public scrutiny. Professor Leaffer's article cogently explores the legal and economic issues connected with automatic adjustment clauses.

The upward cost spiral and its painful manifestation in automatic fuel adjustment clauses have stimulated interest in electric utility rate reform. Some analysts have focused on the application of economic principles to the process of ratemaking. Given the staggering cost of new plants, estimated, for example, to be $1,700 per kilowatt for nuclear units scheduled for completion in 1990 or 1991,[19] and given the projected impact of new plants on the environment, peak load pricing based on marginal cost pricing principles has seemed to some to offer a means of reducing the need for more generating facilities.[20] Such methods of setting rates, how-

14. *Id.* at 38, quoting William McCollam, Jr., President of the Edison Electric Institute.

15. Trigg, *Escalator Clauses in Public Utility Rate Schedules*, 106 U. PA. L. REV. 964 (1958).

16. Welch, *Pages with the Editor*, 96 PUB. UTIL. FORT. 6, 8 (Dec. 18, 1975).

17. Carver, *Developments in Regulation: Adjustment Clauses*, 53 DEN. L.J. 663, 663 (1976).

18. To illustrate the fuel cost explosion, consider that between July 1973 and July 1974, the average price of all fuel purchased in the South Atlantic region rose 123%. Utility coal prices in the same period rose 172% for thermally equivalent coal, and Appalachian Power raised consumer prices 86%. Schiffel, *supra* note 1, at 24.

19. Studness, *supra* note 11, at 36.

20. Both the theory and application of peak load pricing are still evolving, but the basic economic principle is simple. Alfred Kahn points out that "if the same type of capacity serves all users, capacity costs *as such* should be levied only on utilization at system peak." 1 A. KAHN, *supra* note 6, at 89–103 (emphasis in original). This is nothing more than a recognition that since utilities must carry capacity capable of meeting peak demand, the marginal opportunity cost of an additional unit of consumption at peak is very high,

ever, will not produce lower rates for ordinary households.[21]

A rate reform which is preferred by consumer groups is the utilization of cross-subsidization of rates among customers to achieve income redistribution goals. These so-called "lifeline rates" would reduce the prices charged for retail customers consuming relatively small amounts of electricity.[22]

Although utility regulation issues have historically been resolved at the state level, the depth of public concern about rates and energy policy led to major federal intervention in the form of the Public Utility Regulatory Policies Act of 1978 (PURPA).[23] The Act directs states to examine a variety of ratemaking issues relating primarily to economic efficiency criteria such as marginal cost pricing; lifeline rates, although not aimed at efficiency, are also favored. As Joskow points out, "the consideration and adoption of the appropriate standards for ratemaking remains largely up to the states, although there is the threat that states which do not comply may find themselves faced with further federal initiatives in a few years."[24] The impact of new federal legislation on the state regulatory process is discussed in Professor Jones' article. In this area, it is important to note that the limited usefulness of economic theory under noncompetitive conditions may blunt this federal threat. A recent cautionary note was sounded by the Ontario Energy Board, which concluded that "economic efficiency cannot be achieved through electricity rate structures."[25] In the Board's view, such an approach is a futile theoretical exercise as applied to a single electric utility. This is particularly true "in an energy sector that is an imperfect mix of public and private industry and investment with massive and continuing intrusion by government on pricing."[26]

Consumer pressures have been directed at three additional areas: managerial competence, alternative methods of selecting PUC commissioners, and public ownership as an alternative to privately-owned and managed electric utilities.

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and peak users' rates should be correspondingly higher. In off-peak periods, marginal opportunity costs of consumption are relatively low. *Id.* at 89.

21. Peak prices, under these principles, would be higher and it is the ordinary consumer who is the chief peak user. *Id.* at 100–01 & n.41.

22. Joskow, *supra* note 2, at 793.

23. Pub. L. No. 95–617, 92 Stat. 3117 (1978) (codified in scattered sections of 15, 16, 30, 42, 43, 47 U.S.C.).

24. Joskow, *supra* note 2, at 797.

25. Smart, *Pages with the Editor*, 105 PUB. UTIL. FORT. 5 (Feb. 28, 1980).

26. *Id.*

In regard to managerial competence, it should first be noted that PUC's have rather myopically focused on limiting utilities' profits. PUC's could hardly be expected to serve as second-line management;[27] yet this area may hold the key to lower costs. The problem faced by PUC's is that no one knows the method or methods which will produce at lowest cost since no one has perfect knowledge of all available production or management techniques. In addition, there are production and management innovations which will lower costs but are as yet unknown. The best that can be done here is to create movement toward more efficient production by motivating utility managers to collect and use the existing information on production and management technique, and by motivating managers to seek out innovation. If the present management cannot or will not do this, or is too incompetent from the outset, then there must be a mechanism to replace it.

What conditions are needed to motivate or replace management and therefore facilitate movement toward efficiency? First, since no one person or group knows *a priori* the most effective method of production, there must exist a number of persons or groups offering alternative methods of production. Second, to remove inefficient methods of production there must be a mechanism for elimination. This can be accomplished by what could be called "natural selection," that is, the elimination of producers by some independently operative constraint. For example, observe that firms in a competitive market which cannot maintain a normal (or economic) profit eventually stop producing, whereas the more efficient firms which do have normal profits can continue production. This automatic elimination of unprofitable firms is an example of natural selection. The elimination of inefficient producers can also be achieved by factors external to the market. For example, elimination could be accomplished by some agency which has evaluated the production process by using a performance indicator. It should be understood that the choice of performance indicator will have wide-ranging effects on the behavior of management since management survival now depends on what is being required. The choice of performance indicator should direct this behavior toward desired ends.

The third condition for facilitating efficient production is the existence of some source for new input into the production processes. Since innovation depends on new viewpoints, this vari-

27. 1 A. KAHN, *supra* note 6, at 29–31.

ation must be achieved at least in part by the introduction of new managements. There will also be variation in production processes due to the remaining managements who are now faced with the strong motivating force of survival of the fittest. When new variations of production arise, the process of selection and further variation should begin again.[28]

Of course PUC's have not attempted to impose these conditions on the electric utility industry, and have in fact shortsightedly focused on limiting profits while granting only passing attention to the operating expenses and capital outlays which are the most important component of rate levels.[29] Although detailed transaction by transaction PUC review would accomplish nothing,[30] the possibility exists that multiple regression analysis could be used to isolate the effects of differences in managerial efficiency on the production of electric power by electric utilities.[31] The results of such comparison could serve as the performance indicator mentioned earlier.

The incentive effects of any performance indicators, however, are diluted, if not eliminated, by the fact that attempts to penalize the inefficient firm by reducing its rate of return will simply cause the price of its stock to fall, the interest rate on its bonds to rise, and its cost of capital to increase. Thus, when PUC's reach into the quiver of regulatory incentives, the only arrow to encourage efficiency may be the phenomenon of regulatory lag. During the period of time between one rate adjustment and the next, the utility must live within its income and must bear the cost of any failure to do so.[32]

The public has also recently begun to advocate the election, rather than appointment of PUC commissioners. Most states currently use a system of gubernatorial appointment to the PUC; in two states, appointments are made by the state legislature; and in

28. The importance of these elements in ensuring lowest cost production was pointed out long ago by Adam Smith, who argued that efficient management "can never be universally established [except] in consequence of that free and universal competition which forces everybody to have recourse to it for the sake of self defense." A. SMITH, AN INQUIRY INTO THE WEALTH OF NATIONS 147 (Mod. Lib. ed. 1937).

29. *See* F. SCHERER, INDUSTRIAL MARKET STRUCTURES AND ECONOMIC PERFORMANCE 527–28 (1970); 1 A.KAHN, *supra* note 6, at 29.

30. *See* 1 A. KAHN, *supra* note 6, at 29–30.

31. W. IULO, ELECTRIC UTILITIES—COST AND PERFORMANCE 4–8 (1962); J. SMITH, THE MEASUREMENT OF ELECTRIC UTILITY EFFICIENCY 11–34 (1975).

32. T. MORGAN, CASES AND MATERIALS ON THE ECONOMIC REGULATION OF BUSINESS 249 (1976).

thirteen states, the offices are filled by direct election.[33] Contrary to popular notions, it appears that elected—and thus politically accountable—commissioners do *not* necessarily accomplish more effective control over skyrocketing rates. One political analyst tested to determine the degree to which several regulatory attributes—the ratio of staff members to commissioners, the method of commissioner selection, and commissioners' educational level—affected the average regulated residential rate per kilowatt hour for each state. Regarding methods of selecting commissioners, he concluded that

> [i]n both residential and industrial markets and for each cross section in time the elective mode of selection was associated with higher utility rates. . . . The results clearly indicated that this presumed institutional corrective against agency capture and permissive regulation has had a perverse effect and has shifted electric rates upward by substantial margins.[34]

Elected commissions thus apparently offer little solace to consumers desiring lower rates. Although this public bias toward election of PUC commissioners is not supported by the data, the interest in elected commissions suggests at least a growing lack of confidence in present regulatory institutions.

The basic assumption underlying regulation of private utilities—that private incentives for wealth will induce more efficient operation—are increasingly questionable.[35] The fact that private ownership under regulation gives no assurance whatever of efficient production is gaining increasing public and investor attention. As a practical matter, under conditions of high inflation and mushrooming environmental costs, it may be politically impossible to raise rates at a pace sufficient to provide an adequate rate of return. These uncertainties are already causing investor hesitation.[36]

Public ownership of the industry is often discussed as a possi-

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33. T. Pelsoci, *The Energy Crisis and the New Breed of Regulators: A Case Study of State Public Utility Commissions* 8 (1979) (unpublished, on file with the author of this foreword).

34. T. Peloci, *Commission Attributes and Regulatory Discretion: A Longitudinal Study of State Public Commissions* 22 (unpublished paper 1978).

35. Peltzman, *Pricing in Public and Private Enterprises: Electric Utilities in the United States*, 14 J. OF LAW AND ECON. 109, 111–12 (1971).

36. *See* Lawless, *supra* note 5. The problems have not gone unnoticed on Wall Street. Standard and Poor's Index of twenty-two electric utility stocks declined twelve percent during 1978 (while the index of 500 stocks rose one percent). Dodosh, *supra* note 6, at 40, col. 1.

ble means of checking the upward spiral in electric rates.[37] This country has had substantial experience with publicly-owned electric systems. Two thousand, two hundred and twenty three local publicly-owned systems accounted for 10.3% of the total electric operating revenues in 1978.[38]

> Consumer-owners of the nation's local publicly owned electric utilities continue to enjoy significantly lower electric rates than consumers of private power. . . . In 1978, for example, the average residential consumer in a local public power system used 34.7% more electricity than the average residential customer of the private power companies, but the public power consumer paid 6.3% less on the average for his 34.7% greater annual consumption.[39]

Some scholars point out that the cheaper rates provided by publicly-owned utilities are illusory and attributable only to the avoidance of taxes, especially property taxes, and the lower interest costs obtainable through the issuance of tax-exempt bonds.

> The avoidance of property taxes and other local taxes is largely fictitious, however, inasmuch as the government takeover simply results in a shift in the tax burden previously borne by the utility (but collected from its customers through the rate schedules) directly to utility customers and other taxpayers.[40]

The conclusion that the entire rate differential between publicly-owned and privately-owned utilities is attributable to transfers of the tax burdens is, however, premature and untested.[41] Existing data suggests that

> administrative and general expenses reported by public systems were lower than private power companies on the basis of expense per $100 of revenue ($4.64 to $5.11) and on the basis of kwh sold (1.13 mills per kwh for the publicly owned systems compared to 1.79 mills per kwh for the private companies).[42]

No theory has been advanced which adequately explains this differential in managerial efficiency. This may be due to the fact that, in contrast to the vast outpouring of literature on regulation in the United States, little attention has been given to the issues of control and efficiency of publicly-owned industry generally or electric utilities in particular. The work that has been done is

37. *See* Richardson, *On Government Takeovers of Investors-Owned Electric Utilities*, 98 PUB. UTIL. FORT. 19 (Nov. 4, 1976).

38. *Electric Utility Statistics*, 38 PUB. POWER D–2 (Jan.– Feb. 1980).

39. *Public Power Costs Less*, 38 PUB. POWER 36 (Jan.– Feb. 1980).

40. Richardson, *supra* note 37, at 25.

41. See, for example, Richardson's conclusory discussion of managerial accountability in publicly-owned electric utilities. *Id.*

42. *Public Power Costs Less*, *supra* note 39, at 37.

highly generalized and has resulted in superficial conclusions.[43]

Since each type of industry in which government enterprise might operate has a different set of applicable constraints, the inquiry into governance of public enterprise must focus on the specific practical problems of a particular industry and on the formulation of an optimal structure for that industry. Such an inquiry has been attempted for the mass transit industry.[44]

A similar industry-specific inquiry is necessary to analyze the optimal governance scheme for publicly-owned electric power. Public ownership in this industry may in fact present opportunities to satisfy the conditions for lowest cost production mentioned earlier.[45] A publicly-owned utility may avoid the dilemma faced by private owners whereby a reduction in the rate of return disrupts the utility's ability to attract needed capital. For example, it may be possible to introduce competitive pressure by having contract management firms bid for the opportunity to manage the utility system. The objective (and measure of performance) would be to extend reliable service to all who seek it at the lowest cost per kilowatt hour. The available plant and equipment should be delineated. Complete data on the system's previous operations

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43. For example, one analyst concludes her book by summarizing some criteria for effective public enterprise:

> First, there must be a popular and official acceptance of the enterprise as legitimate government activity to be conducted for explicitly public purposes. . . . Second, the financial policies of the enterprise should be integrated with the government's general financial policies and budget plans. . . . Third, there must be strong leadership of elected officials and their executive officers. . . . Fourth, a system must be devised to facilitate accommodations with other agencies and programs in related policy areas. . . . Fifth, adaptability to changing circumstances, popular demands, and shifts in the policy priorities of elected administrations is needed. . . . Sixth, the public and government must have access to information. . . . Seventh, management must be open to representative viewpoints from society. . . . Eighth, strong and stable executive leadership and continuing emphasis on management improvement, performance controls, and administrative decentralization are needed. Finally, there must be steady access to capital funds at a pace and under conditions that reflect fiscal responsibility, careful financial planning, and reasonable public control over burdens on the taxpayer.

A. WALSH, THE PUBLIC'S BUSINESS: THE POLICIES AND PRACTICES OF GOVERNMENT CORPORATIONS 343–46 (1978).

The reader will find it exceedingly difficult to make the above criteria operational. For example, it would seem to be beyond the ken of an imperfect democratic system to create mechanisms which guarantee a popular and official acceptance of the government enterprise (#1 above), or to guarantee strong leadership (#3 above) or to guarantee adaptability (#5 above). It is difficult even to measure these desired outcomes, let alone create mechanisms which guarantee their existence.

44. *See* N. HAMILTON & P. HAMILTON, GOVERNANCE OF PUBLIC ENTERPRISE: A CASE STUDY OF URBAN MASS TRANSIT (in the process of publication by D.C. Heath-Lexington Books).

45. *See* text accompanying note 28, *supra*.

should be available to all bidders. Contract management firms could then make management proposals, including a budget, outlining what performance levels could be obtained with rate revenues. Proposals should recommend a rate structure for the various services and customer groups. The contract management fee, within defined reasonable limits, should be included as one of the costs in the budget.[46]

The term of the management contract should be short. Long term contracts could not be satisfactorily specific under conditions of uncertainty as to future policy and investment objectives, costs, and consumer demand.[47] Two year contracts, for example, would facilitate sequential decisionmaking. As Williamson points out, "[t]he future is permitted to unfold and adaptations are introduced, at contract renewal dates, only to those events which actually materialize. . . . Sequential decisionmaking procedures economize greatly on bounded rationality."[48] The responsibility for long term investment planning must be borne by the utility's governing board, by utilizing an independent outside planning staff, or outside consultants.[49]

The board should first screen all proposals on the basis of the already-established competence of the firms to accomplish the task. The board would then select that proposal which committed management to the highest levels of performance in terms of the criteria set out in the bidding instructions. The contract would provide for a base payment if all criteria were met within the budget; relatively severe penalties should be assessed for failure to stay within the budget. Scaled penalties should also be provided for failure to meet performance criteria. If performance exceeds the contractually agreed terms, scaled rewards should be granted.

A comprehensive review at the end of each contract period would be necessary to determine whether the criteria, including the budget constraints, had been satisfied. The review should be focused on determining the degree of performance, not on second-guessing management decisions.

Any form of continuous review should be avoided. If the

46. Note that the higher the fee, the less funds available for programs to meet the performance criteria.

47. *See* Williamson, *Franchise Bidding for Natural Monopolies—In General and With Respect to CATV*, 7 BELL J. OF ECON. & MGT. 78–79 (1976).

48. *Id.* at 83.

49. Crain & Ekelund, *Chadwick and Demsetz: On Competition and Regulation*, 19 J. OF LAW AND ECON. 149, 161 (1976).

board required assurance during a contract period that management was performing adequately, the board could spot-check whether performance criteria are being met in selected areas.[50] If error were clearly apparent, further inquiry could be made, and the board should be empowered to terminate on short notice following a hearing.

The introduction of a bidding system for recurrent short term management contracts has a number of attractive features, not the least of which is the introduction of competitive pressures as a spur to efficiency. Of course the incumbent has advantages of specialized knowledge, and perfect bidding parity at contract renewal may not be attained,[51] but these effects should be outweighed by the survival threat created in the first instance by the necessity of renewal.[52]

There are other advantageous features. This approach to business accountability is considerably simpler and more effective than engaging in management audits and other conventional accountability measures. The board's attention is properly focused on policies, operating objectives, and criteria. Once performance criteria are set, the monitoring of management performance poses relatively limited problems of data collection and interpretation. Management is relieved from the burdens of generating a number of reports. Inadequate managerial performance should also be quickly apparent and could continue no longer than the duration of a short term contract.

Finally, the effectiveness of the contracting process should improve over time. Each subsequent round of comprehensive review and contract negotiations should provide feedback to assist in examining policies, objectives, and criteria.

Under the present scheme of private ownership under regulation, electric utilities are caught in the middle between the upper and nether grindstones of higher operating costs and inflationary erosion of revenues. These conditions are leading utilities to "pancake" rate increase requests. For example, Cleveland Electric Illuminating Co. received 60 million dollars in higher rates in

50. Conventional accountability could also benefit from spot-checking, rather than continuous monitoring. Spot-checking tends to be directed at results of management decisions, and not the wisdom of the decisions themselves. *See* Drucker, *The Real Duties of a Director*, Wall St. J., June 1, 1978, at 20, col. 3.

51. *See* Williamson, *supra* note 47, at 84.

52. *See* Roberts, *An Evolutionary and Institutional View of the Behavior of Public and Private Companies*, 65 AM. ECON. REV. 415, 420 (1975).

May, 1979, started hearings on an 80 million dollar request in April, 1980, and said in the same month it would seek an additional 165 million dollars in higher rates next year.[53]

Predicting the long run results of these trends is difficult, but if the result is to bring into focus the failure of regulation to achieve any assurance of operating efficiency, the result will be beneficial. Alternatives may be explored, including the possibility that public ownership could provide a vehicle to introduce conditions that might better approximate those necessary for lowest cost production. Such a result would surely lead to greater public confidence that rising utility prices are nonetheless as low as efficient production will permit. Thus, current consumer resentments and the concomitantly expensive, delay-generating political pressures might fade.

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53. *See* Lawless, *supra* note 5; Diemer, *Revised PUCO Starts Hearings on Rate Hike of $80 Million for CEI*, The Plain Dealer, Apr. 9, 1980, § B, at 8, col. 1.

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