

**NEW MODELS OF REGULATORY COMMISSION PERFORMANCE:
THE DIVERSITY IMPERATIVE**

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EXECUTIVE SUMMARY

In this era of rapid change, a diverse set of organizational roles and regulatory models may provide options for public utility commissions seeking to provide effective public utility regulation in an era of rapid change. Further, traditional quasi-judicial, command-and-control regulation is not likely to continue to provide effective regulation of the public utilities. Those commissions that continue to rely on it as the sole or even predominant method of regulation will face mounting public and legislative pressure.

There are three ways to characterize the current state of the traditional regulatory model. First, the locus of regulatory policy making is being shifted away from public utility commissions to the legislatures. Increasingly, state legislatures are making policy in areas once reserved to regulatory agencies, they are reaching into public utility commissions to make changes in organization and functioning, the traditional model is being criticized as being too cumbersome and not capable of reacting with the sweeping changes necessary in the rapidly evolving utility marketplace, state commission staff are under duress, and the tensions between commissioners and staff are increasing.

Second, the “consent” of the parties to participate in the traditional regulatory model is eroding, probably because some of the parties found better alternatives to the regulatory regime. A new, workable model, which has the consent of the parties, is necessary.

Third, changes in society at large mitigate against the maintenance of the traditional regulatory regime. Those changes include a power shift from sellers

to buyers, the development of new models of decision making, and the demise of institutional solutions.

In order to continue to serve the public, commissions should adopt a variety of regulatory models. That argument for a diverse approach can be (and is) illustrated from four perspectives: biological systems models, financial portfolio theory, organizational models, and a combined organizational/biological model. This report argues for four alternative models for regulatory commissions: the legislative or policy model, the regulation by information model, the regulation by negotiation model, and the consumer protection model. Each of these models is described in a separate chapter. Many commissions have begun to adopt portions of these models; some have been using elements of these models for some time.

It is not suggested herein that commissions fully abandon the quasi-judicial model or that they fully rely on any one of the models. Rather it is suggested that commissions evaluate these models, take what is best from each, and create a regulatory regime best suited to the needs of the jurisdiction. It is also not suggested in this report that commissions will eventually go out of business. Rather it is argued that public interests are embedded in the provision of utility service and that government oversight of these interests will be necessary even under workably competitive market conditions.

The quasi-judicial process, which is derived from the Interstate Commerce Commission process and the 1946 Administrative Procedures Act, suffers from four significant shortcomings with regard to policy making. It functions best for retrospective fact finding, emphasizes fairness over outcomes, and is reactive rather than proactive; consensus building and the introduction of innovation are particularly difficult under it. In addition, if commissions are to shift more toward a policy model of regulation, several fundamental changes are required. They include a change in the role of staff, changes in the use and flow

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of information, and changes in the way commissions interact with other agencies.

To make policy, commissions can employ alternative dispute resolution, including such techniques as negotiated rulemaking, workshops, technical conferences, advisory committees, task forces, and scientific panels. These processes can be fair if adequate notice is given and if all parties are given the opportunity to be heard. Commissions might also consider methods of procedural streamlining, such as arbitration, mediation, and summary proceedings. If commissions cannot effectively make policy within the existing administrative constraints, some relaxation of current procedural rules may be necessary. In general, however, there is opportunity within current administrative requirements to apply modified, simplified, and streamlined processes. Other keys to commission use of the policy model are flexibility, stakeholder buy-in, a partnership with the legislature, and issue anticipation.

The Massachusetts Board of Railroad Commissioners, created in 1869, provided an early example of regulation by information. Regulation by information, as described herein, contains two interrelated elements: empowering consumers by providing them with information and ensuring the existence of an information infrastructure able to support more competitive utility markets.

For decades, utility regulatory commissions focused their attention on the provider of utility service and regarded consumers as helpless pawns of the geographic monopolies. As more competitive utility markets emerge, consumers will have more ability to act in their own best interests. Providing useful information to consumers and policy makers and ensuring that information about utility markets and choices flows freely are methods that have the goal of creating a body of well-informed consumers. Properly constituted, the provision

of information may create a system of self-regulation, perhaps more effective than traditional norms.

Regulation by information can also be defined more expansively than providing information to consumers. It can also include the creation of a network of information—the information infrastructure—that knits together service providers, consumers, and regulators in a manner that allows competitive markets to flourish or that minimizes the inefficiency of monopoly markets. Three hypotheses drive commission involvement in the information infrastructure: 1) that utility service providers will shift from reliance on the physical infrastructure to reliance on the information infrastructure to seek competitive advantage, 2) that competitive markets require the creation and maintenance of an information infrastructure, and 3) that public utility commissions will shift their attention from traditional issues to the information infrastructure as a way to ensure the effective and efficient provision of utility service.

The objectives of this information infrastructure will include ensuring that effective competition can take place by creating clear price and quality signals, easy movement of customers from one provider to another, easy entry of competitors into markets, and measurement of the extent of competition; ensuring that utility markets function efficiently by creating easy vendor-to-vendor communications and efficient public markets for utility services and companies; accomplishment of public policy objectives including reliable service, universal service, and national defense and emergency management; and the fair use of information, which includes minimization of attempts to deceive the public.

Though the private sector can be relied on to create much of the utility information infrastructure, there will be roles for public utility commissions, which are ultimately responsible for public interest outcomes. Examples of agencies

that have employed regulation by information are the Federal Reserve System, the Securities and Exchange Commission, and the new European regulatory agencies. Keys for commission use of regulation by information include the establishment of agency credibility, identification of the kinds of information necessary, the establishment of networks and alliances, and forbearance in the application of regulatory power.

The key to introducing innovation into regulatory processes may be the use of more extensive forms of collaboration—regulation by negotiation. Commissions have begun to adopt this method by involving stakeholders in regulatory change initiatives and becoming involved in the negotiation of interconnection agreements.

Regulation by negotiation attempts to move participants in regulatory issues further toward consensus models of decision making. Its methods are less formal than adjudicated methods and permit people to have more active involvement in and control over the processes for solving problems. They have been employed at the federal level in part due to the Administrative Dispute Resolution Act (1990), which authorized and encouraged federal agencies to employ consensual methods. Federal agencies have also had success in using negotiations to establish government rules (known as reg-neg). The Negotiated Rulemaking Act (1990) identified standards for agencies to apply to reg-neg.

Critical issues for state commissions attempting to employ regulation by negotiation include establishing a negotiation culture at commissions, which includes moving away from processes that limit information flow, presume that the utility issues are “zero-sum” games, limit outcomes to the parameters of formal records, created short term solutions, and do not attempt to create long-term workable relationships with stakeholders; introducing the public interest into negotiations; identifying the parties to include in negotiations, and anticipating the judicial reaction to negotiated solutions. Commissions may also become

involved in the mediation of ancillary disputes—those between parties not traditionally subject to commission regulation. Examples are disputes between consumers and unregulated market participants or between utility service providers.

Keys for commissions to the use of regulation by negotiations include identifying the public interest, bringing all affected parties to the table, minimizing resource disparities, creating a negotiations infrastructure, ensuring that no party has a better alternative to negotiations, changing commission culture, retaining the ability to walk away from negotiations if necessary, trusting the negotiations process, and protecting the reputation of the commission.

As consumers take on more risk and are required to make more decisions in competitive markets, consumer protection is often suggested as an emerging role for public utility commissions. There are three other reasons for commissions to become more fully involved in consumer protection. First, as competition develops some commission “customer” groups (e.g., utility shareholders and managers), who will be freed to operate in competitive markets, will no longer be subject to the same types of commission protection. Those who remain will be residential and small business customers, those who may benefit least from competition. Second, many new utility market entrants will likely compete, not for commodity service, but by adding value to utility service. As a result, utility service will be harder to define and utility service providers will be harder to identify. Consumers of utility service will, however, remain clear and easily identifiable. Third, emerging markets will likely present opportunities for consumer fraud and deception.

Under traditional regulatory regimes, consumer protection was accomplished through the creation of proxies for competitive markets. Consumers were protected from external market failures, which were the result of there not in place a market structure that allowed customers to have a full

range of choices. The movement to introduce competition into utility markets is an attempt to protect consumers from external market failure using different means than employing regulation as a proxy for markets. As competition develops, commissions are paying more attention to protecting consumers from internal market failure, which results from unfair trade practices and include covert coercion, undue influence, deception, incomplete information, or needlessly confusing information. With the commission movement from protecting consumers from external market failure to internal market failure came a second movement--from consumer protection to consumer enabling, that is providing them with the tools to make wise choices in competitive markets.

In the future, commissions will still need to monitor markets to ensure that consumers are protected from external market failure. Two sets of questions commissions might ask about utility markets are listed in Chapter 5. Commissions will also need to protect consumers from internal market failures even in competitive markets. In order to accomplish this function, commissions should be prepared to set criteria for licensing as a screening function, respond quickly to unfair marketing and advertising practices, and umpire disputes between competitors and between customers and their suppliers.

It is sometimes suggested that the consumer protection function would be better accomplished by another agency. There are several reasons, however, why the protection of utility consumers should be retained at public utility commissions. They include the expertise commissions hold in this complex field, the complaint handling infrastructure commissions have built, the fact that consumer protection is not easily separated from enforcement, and the substantial credibility that commissions have developed with consumers and the typical association in the minds of consumers between utility issues and the commission.

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This report does not recommend that any one of these potential commission roles would ever completely serve commissions. Indeed it is argued that commissions should craft a unique mixture of these roles that best fits state needs. These proposed roles also represent visions for the future of public utility commissions, a future in which they continue to serve the public interest. Though a variety of commission futures might be envisioned, it is fairly clear that 1) commissions will share the “regulatory space” with other organizations and agencies, 2) information exchanges between utilities and consumers and between utilities will increase in importance, 3) the power of regulatory agencies will be based on their effectiveness rather than their statutory authority, and 4) oversight of utility service will continue to be necessary. Whether commissions can accomplish these missions without substantial change to the regulatory framework or accomplish them by extension of current practice and administrative procedures is a matter of debate. The answer may vary by jurisdiction.

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FOREWORD

For the past several years, Dave Wirick has traveled the country working with state public utility commissions, helping them make change, facilitating retreats, making presentations, solving problems, and listening to commissioners and staff detail their challenges. This report puts into print what he has learned and the conclusions he has drawn from that experience. It draws on a variety of sources to put the current challenges of state commissions into perspective and presents an exciting vision for their future.

Sincerely,

Raymond W. Lawton
Director, NRRI

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CHAPTER 1

THE NEED FOR NEW PUBLIC UTILITY REGULATORY MODELS AND THE BENEFITS OF ROLE DIVERSITY

In this era of rapid change, a diverse set of organizational roles and regulatory methods can provide options for public utility commissions seeking to provide effective public utility regulation in an era of rapid change. This report further posits that the traditional quasi-judicial, command-and-control model of regulation is not likely to continue to provide effective regulation of public utilities, and as a result, those commissions that continue to rely on it as the sole method of regulation will face mounting public and legislative pressure. Those pressures may ultimately cause the undoing of those commissions. What is presented here as an alternative is a model of regulatory diversity that requires commissions to become skilled at a variety of functions and able to apply the regulatory method that works best for the specific problem at hand. Four alternatives to the traditional, quasi-judicial model are explored here. Those models can complement the quasi-judicial model and eventually, in some areas, may replace it.

Before we explore these alternative models for regulatory commissions, it makes sense to pause to determine the need for regulatory change. If the old model (the quasi-judicial model) is widely esteemed and effective, little effort should be expended in the pursuit of new ways of doing business. If the first argument in the preceding paragraph holds and regulatory commissions cannot succeed in their pursuit of the public interest in this rapidly changing environment through the continued uni-dimensional application of the quasi-judicial model,

new models and methods are required. It is my assertion, based on evidence and observations¹ that will follow, that the prevalent model suffers from a number of flaws and that those flaws are of sufficient magnitude to threaten the existence of an agency that relies primarily or solely on it. There are three ways to describe the current shortcomings and perceptions of the quasi-judicial model. Those descriptions are presented in turn; the problems with the quasi-judicial model do not apply in every state. This chapter also presents an argument for a diverse array of approaches by examining the arguments for diversity from the biological, financial, organizational, and managerial perspectives.

Argument #1: The Battle for the Development of Regulatory Policy

There is a battle being waged for control of regulatory policy making across the United States. The battle, which is being fought in the halls of legislatures, corporate boardrooms, the offices of consumer advocates, and in public agencies, has been joined because of the need to create policies for the utility sector of the economy in the face of rapid technological, social, economic, and political changes that are transforming these key industries. In general, state public utility commissions, the traditional locus of regulatory control over

¹ The NRRI's "Commission Transformation" program has afforded the author the opportunity to spend a considerable amount of time in the past three years visiting state commissions, discussing commission change with a wide array of commissioners and staff, doing research on commission change (as evidenced by a body of written reports), working closely with the NARUC Staff Subcommittee of Executive Directors, assisting state commissions with specific problems pertaining to organization and change, and making presentations on commission change to a wide array of groups. The author is indebted to all of those persons, including his NRRI colleagues, who shared their time and insight.

these important industries, are losing that battle.² Their power is waning, their resources are constrained, and, though many commissions have undertaken the hard work of reconfiguring themselves, public service commissions may, if trends continue, go the way of other historical anachronisms.

Federal regulatory agencies have always battled state commissions for jurisdiction of utility matters, but today, the clearest indicator of the waning power of state public utility commissions to control the development of regulatory policy is the growing involvement of state legislators in creating utility policy. Of course, substantive changes in utility policy require changes in state enabling law. State legislatures have not, however, simply created law in response to regulatory policy initiatives proposed by state commissions. They have been the driving force for many of the changes shaping the new public utility landscape. The extent to which state commissions have been active participants in that legislative process, merely observers given the responsibility for implementation, or deliberately excluded from participation varies by state.

More seriously, in many cases, state legislators have expressed their dissatisfaction with utility commissions by reaching into those agencies to make changes in organization and functioning, arguably sometimes attempting to limit the ability of public utility commissions to maintain active oversight of the utilities. For various reasons, three state public utility commissions have been dissolved and reformatted in recent years.³ In California, a bipartisan, independent oversight agency, the “Little Hoover Commission,” submitted a report in late 1996 recommending that the California Public Utility Commission be focused

² The generalizations made in this and other sections of this report about the regulatory process and about commissions clearly do not apply in every state.

³ Commissions have been dissolved (and recreated) in Tennessee, New Mexico, and Alaska.

solely on telecommunications regulation and that it establish clear standards for when the PUC will cease economic regulation.⁴ The Little Hoover Commission recommended that the other current PUC functions be transferred to other agencies or that those functions be recognized as obsolete. In other states, legislators have attempted to reorganize commissions, occasionally targeting specific commission staff. The net result is that state public utility commissions are finding their role limited, their functions changed, and their resources limited by forces outside their control.

The regulatory process itself is also under fire from a variety of sources, including criticism by some commissioners and staff. (A more detailed description of the shortcomings of the quasi-judicial process is provided in Chapter 2.) The quasi-judicial regulatory process is increasingly being regarded as being too cumbersome, too slow, unduly complex, subject to never-ending reconsideration, and incapable of reacting with the necessary sweeping policy changes in a rapidly evolving utility environment. The traditional process has emphasized fair representation, perhaps at the expense, some would say, of effective and timely decision-making. Some now question whether or not the process has created mechanisms that over-represent parties that are capable of self-protection. Some wonder if the advocacy role of commission staff is cost-effective under current circumstances. Others are also concerned that commissioners are becoming overburdened and unable to exercise appropriate oversight over all utility sectors given the complexity of those sectors and the

⁴ Little Hoover Commission, *When Consumers Have Choices: The State's Role in Competitive Utility Markets*, December 1996. The official title of the Little Hoover Commission is the Milton Marks Commission on California State Government Organization and Economy. Copies of the publication are available from the Little Hoover Commission at 660 J Street, Suite 260, Sacramento, California, 95814 (phone: 916-445-2125). The price is \$5.00. The Commission e-mail address is little.hoover@lhc.ca.gov; its website is at www.lhc.ca.gov.

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pace of change. Finally, the quasi-judicial model is seen as an impediment to the ability of commissioners to receive the staff support necessary to keep them informed.

State commission staff, a pivotal force in the development of regulatory policy in the past, are under duress. With the movement toward more competitive markets, state commission workloads have increased instead of being decreased. Morale at many commissions is poor, likely reflective of the increased workload, uncertainty about the future, and the general societal disregard for regulatory processes. Staff turnover is high and commission staff in some states are bearing the brunt of the regulatory “brain drain,” which occurs as able staff are recruited away for much higher salaries by utilities and new entrants. With the salaries available to state commissions, recruiting replacement staff is difficult, if not impossible.

With the high levels of stress being placed on the regulatory process, the tension between commissioners and staff is increasing. There has always been a difference in role and perspective between commissioners and staff; in the past, those differences gave a richness to the regulatory process providing a blend of technical expertise with broader policy level oversight. Today, however, the differences between commissioners and staff are more pronounced than in the past and potentially disruptive. Commissioners, sometimes appointed by the governor with a mandate to make change, too often see staff as wedded to the existing regulatory process and unwilling to change. Staff, who have weathered the regulatory battles, see commissioners as unwilling to consider to benefits of deliberative, sometimes confrontational regulation. The result is a bifurcation of the resources necessary for effective oversight.

Unfortunately for utility consumers, more is at stake in this battle than the continued existence of these peculiar agencies. What is at stake is the public interest. The establishment of new regulatory policy for utility service delivery

requires the application of considerable expertise, expertise that resides in unmatched quantities at state public utility commissions. What is required for effective protection of the public interest is to unfetter that expertise from any unnecessary constraints of the current regulatory system and to find mechanisms that allow for the rapid creation of policy that continues to protect the public for whom utility service is a necessity.

Argument #2: The Erosion of “Consent”

Regulatory agencies, and indeed all public agencies, exist based on the consent of those they regulate or oversee. This concept is embedded deeply in American government and found its early expression in the Declaration of Independence.

Though the traditional U.S. regulatory regime was created in response to court mandates, it has survived for nearly 100 years because it best suited the interests of regulatory stakeholders given the constraints established by those courts and policy makers. It represented a loose confederation of agreement between utility managers, shareholders and bondholders, business consumers, residential consumers, and regulators. There were periodic differences of opinion and considerable conflict, but those disputes took place within a system of regulation that was largely accepted by the parties.

As Thomas Jefferson noted, that as governments (and government agencies) derive their power from the consent of the governed, it is the right of those so governed to alter or abolish the relationship if it no longer fits. It can be argued that in recent years the consent of those regulated under the traditional regulatory regime has eroded and that the arrangement is being terminated. Initially, rate-base/rate-of-return regulation gave way in favor of more

performance-based forms of rate setting. The current drive toward more competitive markets represents a further erosion of the old regulatory bargain. Ultimately, dissatisfaction with the regulatory regime may cause assault on the regulatory institutions themselves, particularly if their relevance cannot be easily determined. Indeed, the examples cited in the previous section indicate that the assault on the regulatory regime may have already begun.

The consent of certain stakeholders to participate in the traditional regulatory regime may have begun to erode because of perceptions of regulatory abuse. If that were the case, regulators could simply moderate their behavior and consent might be reestablished.

It is more likely, however, that consent eroded because some participants sought and found other and better options to the traditional regulatory regime. Technology and markets have ended the importance of geography as the primary determinant of utility service, and geographic limits are no longer set by franchise. A regulatory regime that presumes that utility service can be defined geographically simply does not fit the current and future reality of service delivery. Withdrawing from the traditional regulatory agreement, utilities and large consumers of utility service went off seeking other venues for the establishment of regulatory policy. State public utility commissions were left to try to fashion a regulatory regime out of those who remained while these important stakeholders pursued their interests in legislatures and at the federal level. Under these circumstances, “better” behavior by state regulators within the current framework is not likely to reestablish consent.

Some public utility regulators may regard the idea that the regulatory regime exists only by consent of all the regulatory stakeholders, including utilities, to be anathema. Nonetheless, government functions in the U.S. only by agreement. A challenge for utility regulators in this environment is to find new mechanisms around which the consent of all the governed can be established.

The “negotiations” model of regulation presented later in this report may hold particular promise for reestablishing effective relationships. Without the establishment of an effective, consensual model of regulation, the regulatory process may be at best unworkable.

Argument #3: Lack of Societal Fit

It should come as no surprise to posit that society is rapidly and radically changing. Some of those changes work against the maintenance of traditional methods of economic and administrative regulation. Three of the trends emerging as part of modern society that are particularly relevant to public utility regulation are explored below.

A Power Shift from Sellers to Buyers

In nearly all facets of our lives, consumers have more power than before. They have choices and information and are far more demanding of quality and service. Consumers of utility services will likely increase their expectations for service delivery and value. In the utility field, “decommoditization” may occur as market entrants attempt to add value to service offerings and increase margins on sales. According to Don Peppers and Martha Rogers, “Having the size necessary to produce...vast commodities of standardized products won’t be a precondition for success. Instead, products will be increasingly tailored to individual tastes...(and) inexpensively addressed to individual consumers.”⁵

⁵ Don Peppers and Martha Rogers, *The One to One Future: Building Relationships One Customer at a Time* (New York, NY: Doubleday, 1993), 5.

Regulatory commissions will experience increased demands for individualized attention from their customers as well. David Osborne and Ted Gaebler say that, "...standardized, "one-size-fits-all" services are not up to the challenges of a rapidly changing information society and knowledge-based economy."⁶ Regulatory models that treat every issue as a trial are not likely to be able to craft creative solutions tailored to the circumstances.

The Development of New Models of Decision Making

Increasingly, the involvement of affected persons is expected in decision making, and the development of consensus is the norm as opposed to authoritarian decision making. As an example of the changes in decision making occurring all around us, in 1987, 28 percent of the largest U.S. companies employed some form of self-directed work groups; by 1996, 78 percent used them.⁷ Several commissions have involved stakeholder groups, including utilities in their change initiatives. This trend toward more participation in decision making also has implications for organizational design. According to Frances Hesselbein, "...in a world where no individual can possibly have all the answers, it is the inclusive organization that excels. Leaders of such organizations know that they must disperse leadership across the organization, banish the hierarchy, and create more circular, flexible, and fluid management systems based on

⁶ David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* (New York, NY: Penguin Books, 1993), xviii.

⁷ John A Byrne, "The Global Corporation Becomes the Leaderless Corporation," *Business Week*, August 30, 1999, 90.

collaborative relationships and mutual respect.”⁸ The same might be said for regulatory regimes.

The Demise of Institutional Solutions

In a fast-changing society, people are less willing to trust institutions. Many, if not most, organizations are struggling to find new missions and identify how they can change to serve their stakeholders as those stakeholders themselves go through large-scale change. They are focusing on ways to provide value rather than relying on institutional loyalty that may have once sustained them. The demise of institutional solutions has had a clear impact on government agencies. Government bureaucracies are increasingly failing to deliver in the current environment.⁹ What is necessary today are “institutions that are extremely flexible and adaptable.....responsive to their customers, offering choices of nonstandardized services.”¹⁰ In the current environment, Osborne and Gaebler identify the need for government agencies that are catalytic (they steer rather than row), community-owned, competitive, mission-driven, results-oriented, customer-driven, enterprising, anticipatory, decentralized, and market-oriented.¹¹

⁸ Frances Hesselbein and Paul M Cohen, Editors, *Leader to Leader: Enduring Insights from the Drucker Foundation's Award Winning Journal* (New York, NY: Peter M. Drucker Foundation for Nonprofit Management, 1999), xiii.

⁹ David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* (New York, NY: Penguin Books, 1993), 15.

¹⁰ Ibid.

¹¹ Ibid., ix-x.

Given these identified trends, traditional public utility commissions, employing one-dimensional processes that centralize decision making, are out of step with significant societal directions. Over time, the public is likely to demand regulatory processes that deliver customized services to unique segments of society; the public will also expect that regulatory processes match its vision of how an organization should function within and relate to society.

The Diversity Imperative

It may be asking a lot for public utility commissions, or any complex organization, to master several models of performance at once. It is, after all, hard enough for an organization to master one. In a stable environment, doing one thing well may be the best strategy. Increasingly, however, particularly as business environments become less certain, models of individual and organizational success based on specialization are being replaced with models of success that value diversity of approach. These models suggest that individuals and organizations function most effectively when they synthesize activities into a coherent whole, with each activity enhancing the value of the others.¹² According to Peter Coy and Neil Gross, "...in these volatile times, the smart idea is to pursue multiple paths and not be afraid to change direction."¹³ The value of a multi-functional model can be further illustrated from four perspectives: biological systems models, financial portfolio theory ,

¹² These models do not address corporate diversification into new product lines far afield from the traditional corporate product line. Some suggest that these types of diversification are not generally successful.

¹³ Peter Coy and Neil Gross, "21 Ideas for the 21st Century," *Business Week*, August 30, 1999, 82.

organizational models, and a combined organizational/biological model. These are discussed in turn.

Biological communities are organized, according to Fritjof Capra, to ensure sustained success. Elements of sustainability include shifts of perception from the parts to the whole, the recognition of the cyclical nature of processes, the interdependence of elements, pervasive cooperation, flexibility, diversity, and balance.¹⁴ With regard to diversity and balance, Capra says:¹⁵

All ecological fluctuation takes place between tolerance limits. There is always the danger that the whole system will collapse when a fluctuation goes beyond those limits and the system can no longer compensate for it. The same is true of human communities. Lack of flexibility manifests itself as stress. In particular, stress will occur when one or more variables of the system are pushed to their extreme values, which induces increased rigidity throughout the system. Temporary stress is an essential aspect of life, but prolonged stress is harmful and destructive of the system. These considerations lead to the important realization that managing a social system—a company, a city, or an economy—means finding the optimal values for the system's variables. If one tries to maximize any single variable instead of optimizing it, this will invariably lead to the destruction of the system as a whole.

This implies that slavish attention to a single model of regulation, despite its temporary success can weaken the regulatory system. It also implies that the stress being felt by regulatory agencies may be symptomatic of the fact that the system variables are being pushed beyond their tolerance and that the common organization reaction to stress—increased rigidity—could further contribute to

¹⁴ Fritjof Capra, *The Web of Life: A New Understanding of Living Systems* (New York, NY: Anchor Books, Doubleday, 1996), 299-304.

¹⁵ *Ibid.*, 302-303.

commission problems if that is how commissions choose to respond. A better, more sustainable approach would be to optimize, not maximize, system variables, which might include the pursuit of specific regulatory objectives or regulatory methods. Diverse, optimized models, according to Capra, are more tolerant of stress; the more complex a network or system is, the more complex its patterns of interactions and the more resilient it will be.¹⁶

Successful biological systems also provide some insight into how organizations ought to be arranged. According to Peter Cochrane, head of research at BT Labs, “You only have to look at biological systems to see that there are no big hierarchical stacks. Everything is low and flat, very adaptable, and very cruel.”¹⁷

Financial portfolio theory provides another assertion of the idea that diversity can increase system success. Knowledgeable analysts have long asserted the value of diversification of assets to reduce risk. Even “naive” diversification can reduce risk toward the systematic level of risk in the market.¹⁸ Dr. Harry Markowitz in 1952 further proved that the risk of a portfolio can be reduced by combining assets that are less than perfectly correlated.¹⁹ Put more simply, Dr. Markowitz proved that the risk of a portfolio as a whole can be reduced under certain circumstances even if an asset riskier than the others in the portfolio is added to it.

¹⁶ Ibid., 303.

¹⁷ Peter Cochrane as quoted by John A Byrne, “The Global Corporation Becomes the Leaderless Corporation,” *Business Week*, August 30, 1999, 89.

¹⁸ Jack Clark Francis, *Investments: Analysis and Management* (New York, NY: McGraw Hill, 1980), 479.

¹⁹ Harry Markowitz, “Portfolio Selection,” *Journal of Finance*, March 1952, p. 89 as cited in Jack Clark Francis, *Investments: Analysis and Management* (New York, NY: McGraw Hill, 1980), 486.

For public utility commissions, this implies that overall system risk can be minimized if a portfolio of tools and methods is applied. An agency, it would imply, performing a variety of diverse functions is less at risk than one that places all its bets on one. That risk would be further reduced if the functions were not similar.

Robert Quinn argues that all organizations balance four organizational cultures at all times and that those organizations that are most successful are those that create effective mixes that match the needs of their environments. The four cultures held in balance are:²⁰

1. The adhocracy culture (or open-systems model) supports an organization that focuses on external positioning with a high degree of flexibility and individuality. It is a dynamic, entrepreneurial, creative place to work. The glue that holds the organization together is the commitment to experimentation and innovation.
2. The market culture (or rational systems model) supports an organization that focuses on external positioning with a need for stability and control. This is a results-oriented organization whose major concern is getting the job done. Its leaders are hard-driving competitors.
3. The hierarchy culture (or internal process model) supports an organization that focuses on internal maintenance with a need for stability and control. It is a very structured and formalized place to work. Leaders are efficiency minded organizers.
4. The clan culture (or human relations model) focuses on internal maintenance with flexibility, concern for people,

²⁰ Robert E. Quinn, *Deep Change: Discovering the Leader Within* (San Francisco, CA: Jossey-Bass, 1996), 184. The Quinn model was discussed at greater length in the NRRI report David Wirick et al., *Organizational Transformation: Ensuring the Relevance of Public Utility Commissions*, (Columbus, OH: NRRI, 1998).

and sensitivity to customers. It is a friendly place to work. The leaders are considered to be mentors or even parent figures. The organization is held together by loyalty.

Each of these cultures has its place; none are incorrect. The key to success is not to choose one culture and pursue it single-mindedly. The key in Quinn's model is for the organization to build and foster the appropriate cultures, with the understanding that the appropriate balance will shift over time. Success is found in the Quinn model by mixing the right amount of this with the right amount of that.

Under the traditional regulatory model, commissions emphasized the characteristics of the internal process model. As competition further develops, it may be more appropriate for commissions to more emphasize the open-systems model or the human relations model without fully abandoning the internal process model. Successful commissions will seek to find a balance between disparate cultures, models, and methods of regulation rather than attempting to identify a single path to success.

Lastly, Arie De Geus has profiled organizations that have survived for decades and, in his book, *the Living Company: Habits for Survival in a Turbulent Business Environment*, has drawn parallels between organizations and living systems.²¹ According to De Geus a critical factor in the success of companies that have lasted a very long time is *tolerance*. According to De Geus, "To tolerate a variety of life forms within oneself gives a company the resilience to withstand stress and even disaster."²² His book suggests that every long-lived company has had to experience profound periods of adaptation, in some cases

²¹ Arie De Geus, *The Living Company: Habits for Survival in a Turbulent Business Environment* (Boston, MA: Harvard Business School Press, 1997), 142-147.

²² *Ibid.*, 143.

several times. The key, he asserts, is that "...systems that deliberately introduce diversity into the product line...and allow activities to go on undisturbed at the margin of the field, have greatly enhanced chances of survival across the generations."²³ For example, public utility commissions are now discovering the importance of consumer affairs, a function that might have once been regarded as operating "at the margin of the field" of commission activities. These types of activities, which developed at the periphery of commission activities, may hold the key to success in the future.

These varied perspectives, which often cite tolerance and diversity, imply that a commission pursuing the public interest through a varied set of models and regulatory methods would be more successful than one that relies principally or exclusively on one. Particularly in this period of rapid utility and regulatory change, it would seem to make good sense for a state commission to build a variety of competencies and "hedge" their bets in their pursuit of the public interest.

Some business strategists would argue that organizations should not attempt to accomplish multiple missions. In 1982, Tom Peters and Robert Waterman argued that successful companies "stick to the knitting."²⁴ In more recent work, however, Tom Peters suggests that in an era of rapid change specialization of service offerings, the creation of customer niches, and differentiation were key to success.²⁵ What is suggested here for public utility commissions is not a movement away from their core mission of serving the

²³ Ibid., 146.

²⁴ Thomas J. Peters and Robert H. Waterman, *In Search of Excellence* (New York, NY: Warner Books, 1982).

²⁵ Tom Peters, *Thriving on Chaos* (New York, NY: Harper and Row, Publishers, 1987).

public but a change in the methods they use and an expansion of the tools they employ. In the process, they might begin to define themselves differently and others, like legislators, might sense that redefinition and become convinced of the ongoing value of public utility commissions.

The Purposes of This Report

The general objective of this report is to present several alternative models for regulatory commissions, models that might replace the traditional, and arguably failing, quasi-judicial model. Many public utility commissions have made forays into the use of these models and, in some cases, are making fairly extensive use of them. In some cases, they have used elements of these tools for extended periods. If they are adopted on a larger scale, those models might increase the ability of state commissions to remain relevant in the current environment and in the ever-changing environments that may follow. Four models are explored:

- The “legislative or policy making” model
- The “regulation by information” model, which includes building and maintaining the “information infrastructure” necessary for more competitive markets
- The “regulation by negotiations” model
- The “consumer protection” model²⁶

²⁶ This model was originally differently titled. The author is indebted to Barbara R. Alexander, a Consumer Affairs Consultant, who pointed out that the functions being described were consistent with consumer protection.

Each of these models has been implemented in some manner by state commissions. Their major features are summarized on Table 1.1.

It is not suggested here that state commissions fully abandon the quasi-judicial processes that have been their mainstay. Indeed, traditional norms of public utility regulation can be argued to have been highly successful, and those traditional processes may continue to optimally serve certain purposes and be best suited for the resolution of some issues. Given the presumed familiarity of the readers of this report with traditional regulatory methods, no chapter is dedicated to their description. Since they are widely used, no argument is given for their adoption.

Nor is it expected that any commission will fully adopt any one of the models presented here. Rather, it is suggested that commissions evaluate these models, take what is best from each, and create a regulatory regime best suited to the needs of the state. A state regulatory commission is not a monolithic entity, unvaried from state to state. They, in fact, vary considerably based on local conditions and the scope of authority granted to them. They will each need to craft a unique approach to meeting their needs.

Some of these roles and models might be temporary and might be eclipsed by different models not thought of today. Indeed, according to Peter Drucker, "A new program...should be enacted for a limited...period of time, with a clear statement of the results it is expected to achieve within that period, and with explicit commitment to abolishing it if it should fail to produce the promised results."²⁷ However, it is not presumed in this report that public utility commissions will go out of business. Public utility commissions are not, as some have argued, merely proxies for competitive markets that can be dismantled as

²⁷ Peter Drucker, *The New Realities* (New York, NY: Harper and Row, Publishers, 1989), 68.

Table 1.1

Five Models of Commission Performance					
	Quasi-Judicial	Legislative/ Policymaking	Regulation by Information	Regulation by Negotiation	Consumer Protection
Primary Focus	Fair process	Effective decisions	Free flow of information, informed consumers	Negotiation of win-win	Monitoring markets, focus on service recipients
Tools	Administrative process	Information gathering, decision making	Information collection, dissemination, education	Mediation, facilitation	Fraud prevention, economic monitoring
Success Indicators	Balance, perceptions of fairness	Rapid, effective decision making	Free flow of information, informed consumers	Creative outcomes, effective relationships	Maintenance of competitive markets, fraud reduction
Functions Best	In a stable environment	In a rapidly changing and novel situation	Where no party has ability to dominate flow of information	Where there is a need for innovation, relative balance of power	Under mostly workable competition
Examples, Metaphors, Models	Courts	Legislatures, corporations	SEC, <i>Consumer Reports</i>	Reg-reg, federal ADRA	Law enforcement, social welfare
Current Regulatory Applications	Regulatory proceedings	State use of ADR, NYSPC electric industry efforts	Consumer education, labeling, complaint handling	Telco intercon. Agreements, FERC/NYSPC ISO negot.	Slamming, cramming

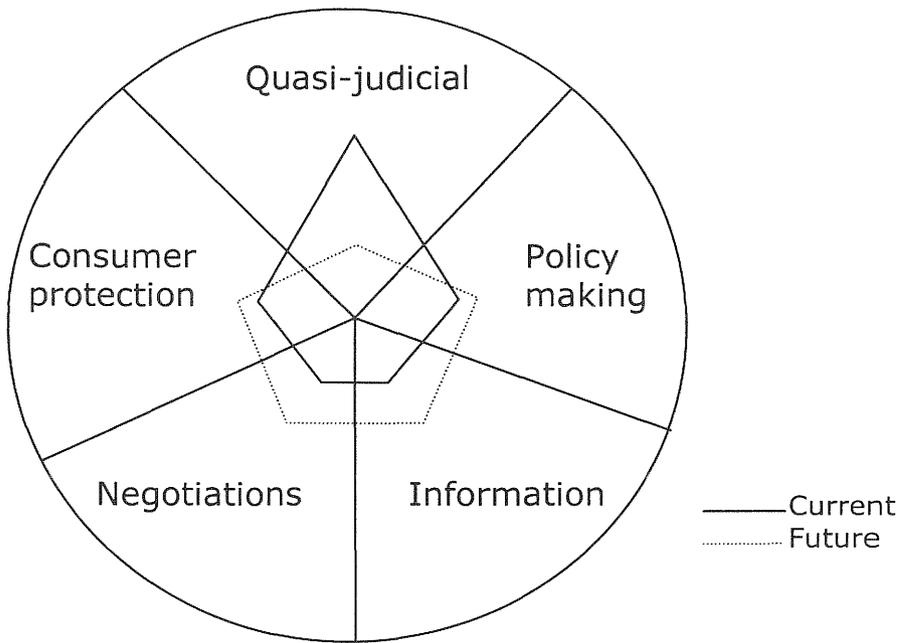
soon as competitive markets are created. Public utility commissions exist to serve the public interest, a public interest that is embedded in utility service. Even if competitive markets are successful, it will be necessary for government to attend to these public interests, which include service reliability, universal service, economic development, safety, and environmental concerns. Competitive markets will also need to be closely monitored to ensure that external market failure (discussed in Chapter 5) does not occur.

In addition, those roles will vary across time and vary by utility sector because the sectors will not evolve evenly over time. Figure 1.1 illustrates the types of balance among the five proposed commission models (the four new ones and the existing quasi-judicial model) for a commission as a whole (understanding that the emphasis will vary by utility sector). The solid line indicates the current balance that commissions may have created; the dotted line indicates a potential future balance. If commission resources remain the same, the areas inside the pentagons should be the same. While an infinite number of solutions can be derived, it is posited here that less emphasis will be placed in the future on the quasi-judicial model. Determining the optimal balance would be a useful exercise for each commission.

Making the transformation from traditional regulatory models to the ones described here will not be simple. Making fundamental changes in regulatory agencies while they are in the midst of overseeing industry upheaval may be as complicated as, “trying to rebuild a 747 while in flight,” as Chairman Kennard recently said of FCC reform.²⁸ Nonetheless, the alternative to creating effective

²⁸ William Kennard as cited by Jenna Greene, “FCC, Facing Critics, Starts to Send New Signals,” *Legal Times*, August 13, 1999, downloaded from CALLAW at www.callaw.com/stories.

Figure 1.1. Relative Balance Between Commission Models: Current and Future



Source: Author's construct.

and pervasive change is to be rendered irrelevant and to cede the field to those less able to shape the future of public utility markets and less able to protect the public.

CHAPTER 2

FOCUSING ON OUTCOMES: THE PURSUIT OF THE PUBLIC INTEREST THROUGH POLICY MAKING

The History of the Quasi-Judicial Process as Applied to Policy Making

Since the late 1880s, most state and federal public utility regulatory commissions have modeled themselves on the Interstate Commerce Commission, which set rates using adjudicatory, trial-type proceedings.¹ Those quasi-judicial proceedings typically required the filing of a rate request, discovery, sometimes a prehearing conference, oral or written direct testimony, cross-examination, oral or written rebuttal testimony, possibly an administrative law judge's opinion, and the commission decision or order.² These procedures were required for public utility commissions following determinations by the courts that rate setting by legislatures did not adequately protect the property rights of the utilities for whom the rates had been set. The quasi-judicial process was, therefore, rooted in judicial concern for the fair treatment of the property rights of individual firms and designed to provide a visible process amenable to judicial oversight and review.³

¹ Robert E. Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: NRRI, 1988), 2.

² *Ibid.*

³ In addition to the use of the report cited, the author is indebted to Robert Burns for his comments and explanation.

The ability of commissions to make industry-wide rules, as opposed to acting on specific utility issues, was an innovation of the 1946 Administrative Procedures Act and the following Model State Administrative Procedures Act (MSAPA), which has been adopted in some form in most states. Under the most recent version of the MSAPA (1981), industry-wide rulemaking by commissions takes place through detailed public notice including a statement of the purpose of the rule, the specific legal authority of the commission, the full text of the proposed rule; written or oral testimony; in some cases, detailed cost-benefit analysis of the likely effect of the rule; and the issuance of the rule.⁴ Despite these provisions, today most state commissions do not regularly use a rulemaking process to make major industry-wide policy decisions,⁵ and largely for historical reasons, still rely heavily on quasi-judicial proceedings to make industry-wide policy.⁶ Some exceptions are noted later in this chapter.

The Limits of the Quasi-Judicial Process

Though most would agree that these quasi-judicial proceedings have served commissions well in the past for ratemaking, they may not have been ideal for policy making and are not likely to be well suited to future commission decision making. They suffer from four significant shortcomings with regard to policy making.

First, the quasi-judicial process functions best in retrospectively determining facts. In rate cases, even those states that used a future or

⁴ Robert E. Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: NRRI, 1988), 3-5.

⁵ *Ibid.*, 5.

⁶ *Ibid.*

partially-projected test year used a historical test year as the basis of the projection.⁷ As more utility industry issues address projections and expectations of future events and market conditions, it becomes cumbersome, at best, to rely on quasi-judicial procedures.⁸

Second, the quasi-judicial process tends to emphasize the fairness and integrity of the process of regulation over its outcomes. According to Thomas McGraw, author of the book *Prophets of Regulation*:⁹

On balance...it seems clear that the concern about the legal process has controlled the outcome of regulation more often than has the concern about the substance of economic efficiency. In economists' language, this means the concern for equity has generally triumphed over the quest for efficiency. In lawyers' terms, it means that in regulation the judicial model has usually triumphed over the legislative and administrative model.

Though some would argue to the contrary, most agree that the quasi-judicial model has provided a fair opportunity for parties to represent their views and that it has overcome some of the information and resource asymmetries that exist between the parties to a regulatory proceeding. For those reasons, the quasi-judicial model will continue to have its supporters. Unfortunately, the attention given to the fairness of the process may have handicapped its effectiveness. It may be that the quasi-judicial model implicitly gave fairness priority over effectiveness. While not abandoning the pursuit of fairness, it may be that the

⁷ Ibid.

⁸ Ibid., 5-6

⁹ Thomas K. McGraw, *Prophets of Regulation* (Cambridge, MA: Harvard University Press, 1984), 302 as cited in Robert Burns, *Administrative Procedures for Proactive Regulation*, 7-8.

time has come to assign a higher priority to effectiveness and amend regulatory processes to reflect the change.

Third, the quasi-judicial process tends to be reactive rather than proactive. It is largely event-based, requiring events to transpire, such as a rate case being filed or motion by staff to reduce rates, before a procedure can be initiated. According to Former FERC and Illinois Commerce Commission member Charles Stalon:¹⁰

It is not too surprising that an agency that has taken its role to be passive, to respond to pressure by others, never carved out one of the very important tools to exercise its power. The reason goes to the heart of this organization and many other regulatory bodies... There is this tendency to be judicial. To adjudicate disputes. To be passive.

Lastly, the quasi-judicial model may not produce good, or good enough, results. In particular, consensus building and the introduction of innovation are particularly difficult. "Thinking outside the box," the over-used euphemism for thinking creatively, is specifically prohibited once the quasi-judicial process has been initiated. According to Robert Burns:¹¹

...because the commission must limit its decision in a trial-type procedure to the record as presented by the parties, certain innovative ideas and solutions might not be brought to the commission's attention. Commissioners may be restricted from using their own best judgements and ideas because of an inadequate record, yet the adjudicatory format can preclude the opportunity for commissioners, acting as judges, to introduce their

¹⁰ "Commissioner Stalon: A Natural in FERC's Economic Regulatory Mission," *FERC Monitor*, June 13, 1985, p. 1, 10 as cited in Robert Burns, *Administrative Procedures for Proactive Regulation*, 6.

¹¹ Robert Burns, *Administrative Procedures for Proactive Regulation*, 6.

own expert opinions. This may not lead to the best resolution of the issues.

In describing the rulemaking allowed under the MSAPA, Burns further states:¹²

A rulemaking procedure does not necessarily provide an opportunity to probe the assumptions behind the comments, nor does it necessarily provide a forum for the decision-makers to use their expertise to consider and determine what might be the best resolution of the policy issues under consideration. Building a consensus among the interested parties and gaining a better understanding of the areas of agreement and disagreement among the parties through the use of a dialogue with the commission decision-makers as experts are difficult to achieve in rulemaking.

If these criticisms hit the mark in 1988 (the year of the Burns' report cited), they are even more likely to be accurate in 1999 and more accurate still in the future as the regulatory environment becomes even more unsettled and demanding of rapid, industry-wide responses on the part of regulators.

In the past, the regulatory environment could have been regarded as being circular, with issues and companies repeatedly and regularly coming to the attention of regulators. The current environment is linear, with decisions made once for industry sectors as a whole rather than for individual companies. The pace of movement along that linear axis is accelerating, and it is unlikely that the traditional quasi-judicial models that protected the public in the circular environment can provide effective regulation without the aid of other models amid the breakneck pace of linear policy making.

¹² *Ibid.*, 8.

Implications of the Policy-Making Role for Commissions

The application of different administrative processes is not the only difference between the quasi-judicial functioning of a public utility commission and quasi-legislative or policy making role. To be sure, different administrative procedures are required. They are discussed later in this chapter. The shift to the policy model also presupposes several more fundamental changes, including changes in the role of staff, the collection and use of information, and interaction with other agencies. Table 2.1 summarizes the major attributes of the policy model for public utility commissions.

Table 2.1

The Policy Model	
Desired outcomes	Effective decisions
Staff role	Decision support
Tools	ADR, procedural streamlining
Linkage to other agencies	Constant, significant
Information flows	Distributed, near-chaotic
Keys for commissions	Flexibility, stakeholder buy-in, legislative partnership, issue anticipation

Source: Author's construct

In the quasi-judicial model, particularly one that is coupled with a fairly strict *ex parte* interpretation, the role of most commission staff is to create an evidentiary record. In those cases where some staff are designated as advocacy staff, they are split from commissioners and exercise that role by advocating the staff position, which is intended to represent the public interest. In other instances, staff are regarded as “participants” in the process but not “parties,” which gives them more ability to “round the record” by entering a range of information and positions into the record. “Advisory” staff, those typically assigned directly to the commission in the split-staff model, provide information and advice directly to commissioners outside the official record. A major challenge for commissions operating under the split-staff model is to ensure that the concerns of commissioners are addressed “on the record” by staff analysts.

Commissions have attempted to find ways to reduce the complications caused by the split between advocacy staff and commissioners. They have attempted to break down or reduce the impact of the “wall” between commissioners and their staffs by:

- Identifying staff as “participants” rather than “parties.”
- Distinguishing between and applying less stringent *ex parte* rules to rulemaking than ratesetting.
- Moving staff to the commissioner side of the wall.
- Moving the advocacy function to another agency. For example, in Minnesota the Department of Public Service is separate from the Public Utilities Commission and serves the traditional staff advocacy function.
- Finding ways (like circulating “issues lists” between staff and commissioners) to ensure that issues commissioners would like to have addressed are included in the case record.

- Designating only some staff by memorandum on each case as advocacy and allowing the remainder to serve in an advisory capacity.

In a policy model, the role of staff is simply to inform decision makers, that is, to assist them make the best decisions possible. Decision makers working within a policy model gather information from a variety of sources and are not restricted to making a decision supported by a formal record. They make decisions with limited information and limited time. The criteria for evaluating decisions in a policy model is, first, the effectiveness of the decision, which includes its timeliness, and only secondarily the fairness of the process. For example, no one questions the fairness of corporate or legislative decision making unless the personal financial gain of the decision maker is involved.

In a policy model, the independence of staff from commissioners would be reduced or eliminated. The focus of the entire commission would be the assembly of necessary information for informed decision making, and the “staff position” would be eliminated.¹³ Commission organization might need to be revised to support policy decision making, and the types of work products produced by staff would change. Instead of preparing legal arguments and statements, in a policy model staff might produce short briefing papers and analyses and might present their findings to commissioners in less formal formats like staff briefings.

In addition to losing a fair degree of their independence from commissioners, staff would of necessity be required to trust decision makers at least to the degree that they will provide decision support to them. In some

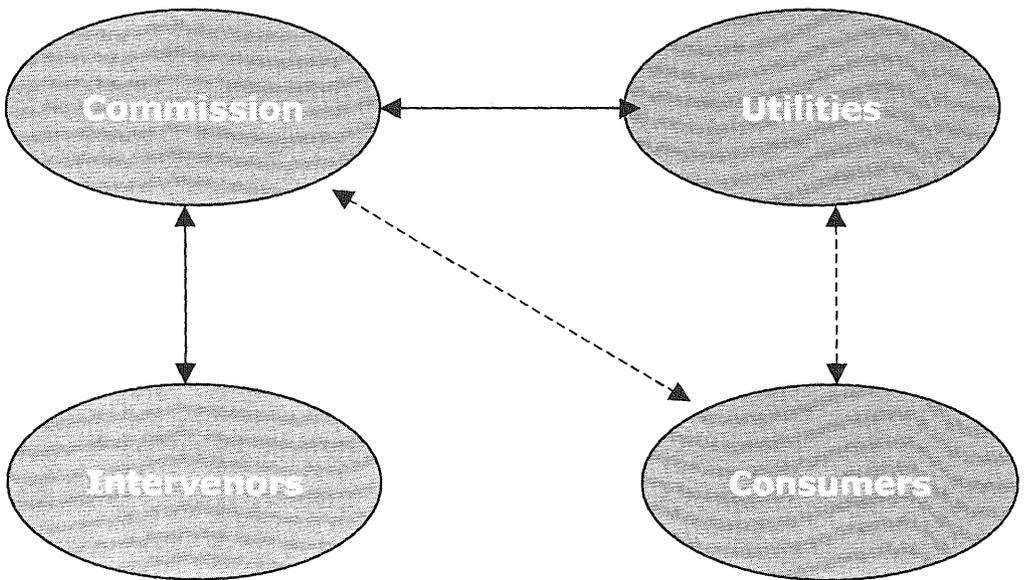
¹³ The fact that, under the current regulatory system, staff can establish a “position” independent of the commission and sometimes in opposition to the commission is a source of confusion to legislators, the public, and the press.

cases, commission staff have expressed reluctance to give commissioners a range of options, preferring instead to advocate for the option they feel most appropriate. Commissioners, they argue, would not make the “right” decision given a full range of options. Not all staff advocacy is inappropriate; advocacy is a valid technique for establishing the record. Advocacy is inappropriate, however, if it is employed to restrict information flow to commissioners.

Information is the fuel of effective decision making. As indicated in this discussion of the role of staff, in a policy model the flow of information would be different than in the quasi-judicial model. In the quasi-judicial model, information flows through rigid “information pipes” established by the administrative process and eventually ends up as part of the official record. That rigid and limited information flow is shown in Figure 2.1. In that model, consumers are barely involved by their linkage to commissions for complaints and their linkage to utilities for billing and periodic “bill stuffers” on special topics. That flow had its advantages. Most notably, the quasi-judicial process subjected information to cross-examination, allowing it to be verified and tested.

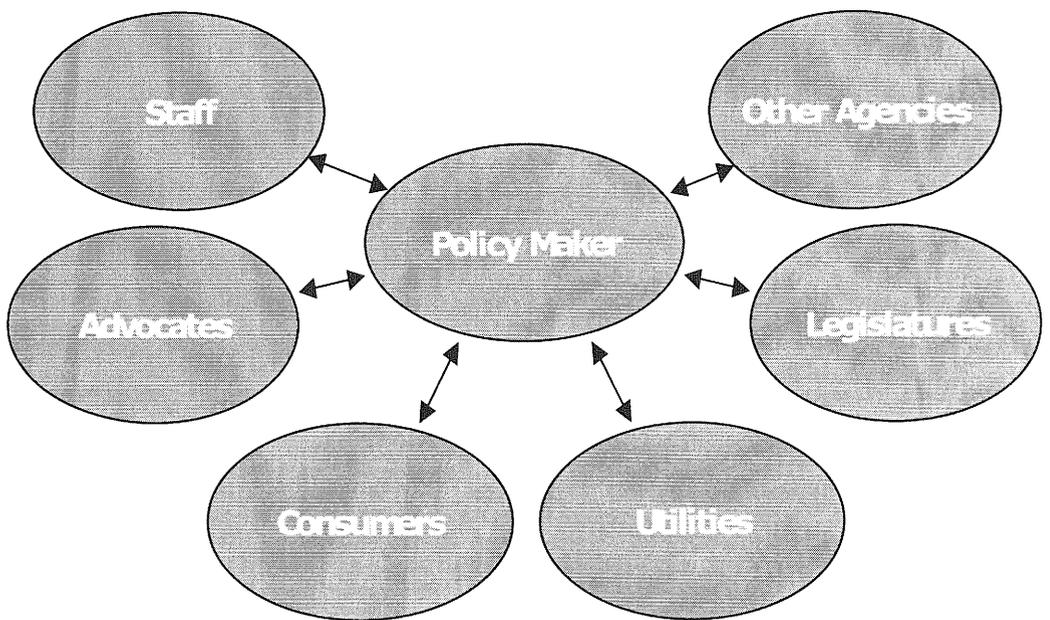
In a pure policy model, such as the one used by legislators, the information flow is more chaotic. All parties have a Constitutional right to be heard, but information gathering is not circumscribed by process nor limited to the information received through formal channels. Information is gathered in bits and pieces, some of it formal and deeply analytical and some of it less so. Figure 2.2 shows information flows in a policy model. The role of decision makers and their staff is to refine, synthesize, and organize that information so that rational decisions can be made. To create a full policy-making model for regulatory commissions, *ex parte* and *sunshine* requirements would need to be substantially relaxed.

Figure 2.1
Traditional Commission Information Flows



Source: Author's construct.

Figure 2.2
Policy Model Information Flows



Source: Author's construct.

In a system of distributed information flows, the key to fairness is to require relatively equal access to decision makers. In a quasi-judicial system, parties not only have the right to access, they also have a right to monitor the other parties' access because all information is provided publicly and on the record, and is subject to cross-examination to test its veracity. In policy-making systems, input is provided to decision makers in a variety of forums and formats. Those systems are criticized for their unfairness when it appears that one party has established a monopoly on input or that access is unbalanced. Decision makers in political policy systems need to take great care to ensure that access is open and that all viewpoints are fairly considered. Ultimately, the proof of adequate open access is a body of sound, fair decisions that are responsive to a full range of stakeholders.

Lastly, in a policy model commissions would necessarily interact differently with other agencies and the legislature. Commissions, operating under the quasi-judicial model, were relatively autonomous, interacting only with the courts when challenged. Some argued that interaction with the legislature was not only unnecessary but inappropriate. Commissions functioned like courts, they argued, and courts do not cater to the whims of the legislature.

Those attitudes are quickly changing. Successful commissions are reestablishing links with their legislatures, and overall, a shift is occurring in the way commissions interact with a variety of agencies. Commissions, recognizing that they are one player among many in the regulatory environment, are forming regulatory partnerships. As an example, the Florida Public Service Commission, recognizing the significant challenges it faces in water resources allocation, health, the environment, and cost of service, now solicits the participation of the Florida Department of Environmental Protection and the five Water Management Districts early in case processing in order to investigate and address their concerns and to coordinate and agency efforts.

These types of efforts signal the end of the autonomous commission and recognize that commissions exist within a “living” environment, much like the biological models described in Chapter 1, which requires interaction with other agencies and entities with constantly shifting power and responsibility. As commissions pursue the policy model, their interactions with these other entities will become increasingly important. Linkages and alliances with these entities will become a substantial part of the power of commissions and a key to their effectiveness. In Kentucky, for example, the Public Service Commission formed an alliance through the Office of Aging Services with a vast “Aging Network” to disseminate information about utility changes.

With regard to commission interaction with these other entities, one word of caution is necessary. Commissions cannot assume a policy making role that usurps or competes with the authority to make policy asserted by the legislature. In some instances, the legislature will allow nearly all public utility policy to be made by the commission. In others, legislatures will reserve substantially more authority for themselves. To fail to recognize the role of the legislature and to compete for authority with the legislature will undoubtedly result in the undoing of the commission.

However, even though legislatures will retain the ultimate authority to make public utility policy, commissions should not presume that their role is purely limited “implementation” of legislative policy. Every agency implements the will of the legislature, but in doing so, necessarily makes policy. To assume that the legislature will allow no latitude to agencies is to fail to understand how the legislative process functions.

Administrative Procedures That Better Enable Policy Making

Robert Burns, in the report cited earlier, identifies a variety of alternative administrative procedures that can be employed by public utility commissions under existing legal parameters. Though they may fall short of establishing a full corporate or legislative policy model, they do hold promise. The methods include negotiated rulemaking, workshops, technical conferences, advisory committees, task forces, and scientific panels;¹⁴ they can be loosely be grouped as methods of alternative dispute resolution (ADR). According to Burns, judicially-sustainable administrative procedures have two Constitutionally-mandated requirements of procedural due process—notice and an opportunity to be heard.¹⁵ The key to making ADR processes fair is to make certain that notice of the procedure is given and that all parties are given an opportunity to be heard.¹⁶ To the extent that early and effective public participation can be provided the procedure becomes more fair.¹⁷

In addition to meeting the two Constitutionally-mandated requirements noted above, commissions can reduce the risk of judicial review of their use of ADR by employing the following eight procedural guidelines:¹⁸

1. The procedure chosen should lend itself to a rational formulation of commission policy by being well suited for

¹⁴ Robert E. Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: NRRI, 1988), vi.

¹⁵ *Ibid.*, 93-94.

¹⁶ *Ibid.*, vi.

¹⁷ *Ibid.*

¹⁸ *Ibid.*, v-vi.

NEW MODELS OF REGULATORY COMMISSION PERFORMANCE

its purpose. Each of the methods cited above have particular strengths and weaknesses; each is best suited to a particular type of issue.

2. Public notice of the application of the alternative procedure should be given. All parties should thoroughly understand the process and how it is to be applied in the particular instance.
3. All parties should be represented during the policy formulation stage of the procedure.
4. The procedure should provide for the collection of the information and data necessary for consideration of the policy issues.
5. The procedure should provide for an advisory report to the commission or a record that summarizes what occurred and has a discussion of the recommendations to the commission, including a review of all plausible alternatives.
6. Once the alternative procedure has concluded, public notice should be given that the commission is considering an advisory report or record and that there is an opportunity for the public to be heard before the commission makes its final determination.
7. Commissioners must retain the role of ultimate decision makers responsible for making a decision that is in the public interest and consistent with applicable law.
8. The commission should announce its decision with a contemporaneous explanation of it in the form of a commission order or decision.

In addition to these forms of ADR, commissions might also consider several techniques of procedural streamlining. These include arbitration (in which the parties agree to be bound by the decision of a third party), arbitration-

mediation (in which an independent party is empowered to attempt reach a consensus through mediation and to arbitrate any remaining issues), mediation (in which an independent third party helps the parties reach a consensus), and summary proceedings (in which proceedings rely solely on written submissions, paper hearings without oral arguments, or other abbreviated hearings).¹⁹

Public utility commissions have made some use of these types of proceedings as an alternative to the traditional process. For example, the Montana Public Service Commission has initiated roundtable discussions in the form of pre-rulemakings or information sessions in which any party with a valid interest can participate. In December 1998, it convened a roundtable discussion on the future of the telecommunications industry in Montana which was attended by most stakeholders including legislative personnel.²⁰ At the New York State Public Service Commission, dispute resolution techniques have been used for some time to address a wide range of issues, including the transition of electric, gas, and telecommunications industries from a fully regulated environment to a competitive market. A variety of ADR techniques are employed.²¹ For the transition of the electric industry to competition, the NYPSC approach involved several years of collaboration among numerous parties.²² At both of the NARUC/NRRI Commissioners Summits (1995 and 1998), commissioners

¹⁹ *Ibid.*, iv.

²⁰ Dave Fisher, Montana PSC Chair, e-mail, May 10, 1999.

²¹ Judith A. Lee, "Alternative Dispute Resolution at the New York Public Service Commission," a paper presented to the 111th NARUC Annual Convention, November 9, 1999.

²² *Ibid.*

expressed strong preferences for the use of more collaborative methods to resolve disputes.²³ Other state examples could be cited.

At the federal level, the FCC allowed the states to apply mediation or arbitration to the negotiation of interconnection agreements. Interest in these methods has grown in recent years. In addition, according to the FERC Strategic Plan:²⁴

...it has developed a number of alternatives to lengthy and costly formal hearings. It has made extensive use of technical conferences, settlements, settlement judges, and mediators in its casework. It has also made use of generic rules and blanket authorizations where possible....It also uses technical conferences, local public meetings, and collaborative processes to promote understanding and compromise among the parties at various stages of the proceedings.

In early 1999, FERC announced the formation of a Dispute Resolution Service, an independent office within the agency that will promote alternative dispute resolution procedures within the FERC and the regulated industry. The staff assigned to that office will act as neutrals and convene sessions to initiate ADR processes, work to increase ADR awareness, and provide training, information, and resources to FERC offices and the industry.²⁵

²³ Staff of the NRRI, *Missions, Strategies, and Implementation Steps for State Public Utility Commissions in the Year 2000: Proceedings of the NARUC/NRRI Commissioners Summit* (Columbus, Ohio: NRRI, 1995), 21 and Staff of the NRRI, *Proceedings of the Second NARUC/NRRI Commissioners Summit* (Columbus, Ohio: NRRI, 1998), 5-6.

²⁴ Federal Energy Regulatory Commission, "Federal Energy Regulatory Commission Strategic Plan," included as an appendix to the FY 1999 Congressional Budget Request, page 97-98, available at www.ferc.fed.us.

²⁵ FERC News Release, "Directors Appointed to Head New Commission Offices," February 24, 1999.

Conclusions

State and federal public utility commissions have clearly made some effective use of ADR. Two factors—the movement toward more industry-wide rule making and the need to develop methods that are responsive to current conditions—may combine to allow or require more comprehensive use in the future. As noted earlier, the quasi-judicial process was instituted for public utility regulation because of judicial concern that the value of individual, private firms was being impacted by legislative rate-making without adequate due process. As commissions move further toward policy-making for entire industries, some of the concerns that gave rise to the quasi-judicial process should be mitigated. Quasi-judicial processes may still be required for actions involving individual firms, but within the administrative constraints applied to rule making by any agency (i.e., public notice and the chance to be heard), public utility commissions should be allowed the latitude to develop policy in pursuit of the public interest. After all, most public agencies make policy affecting economic conditions without the types of quasi-judicial processes currently applied to public utility regulation.

In some circumstances, effective policy making by public utility commissions may require some relaxation of the current procedural rules. If that relaxation is not forthcoming, commissions still have opportunities within current administrative requirements to apply modified, simplified, and streamlined processes. The key is to identify and employ processes that create a balance between procedural safeguards and the pursuit of the public interest. In the future, the traditional, quasi-judicial process may become the “alternate” procedure, used only when other policy-making processes cannot be applied.

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Other keys to the effective use of the policy model of regulation are:

1. Flexibility. Leadership in state utility policy development will vary by state and by issue. In some cases, the state legislature may take the lead with the commission providing support. In other cases, legislatures may prefer to have commissions take the lead in proposing policy initiatives. Effective communications with the legislature to identify the appropriate commission role is a must.
2. Stakeholder buy-in. Policy cannot be made in a vacuum. Open communications with stakeholders will be required in that, if stakeholders attempt to thwart policy making by inducing judicial oversight, policy making may be frustrated.
3. A legislative partnership. State legislatures have, by definition, primacy in policy making. Effective use of the expertise of state commissions will require the establishment of a partnership between the legislature, the executive branch, and state commissions.
4. Issue anticipation. To be optimally useful to state legislatures and positioned to be in the center of the policy debate, commissions will need to anticipate those issues likely to be of concern and be prepared to provide effective input.

CHAPTER 3

EMPOWERING CONSUMERS AND BUILDING THE INFORMATION INFRASTRUCTURE: REGULATION BY INFORMATION

Regulatory organizations have always been collectors, processors, and distributors of information, which is defined by Peter Drucker as “data endowed with relevance and purpose.”¹ If regulatory organizations are successful, they transmit information that has value for the organizations and individuals that are its stakeholders. Regulatory organizations are efficient if they collect the right data, analyze it in a timely and effective manner, and present it so that appropriate actions are taken by stakeholders.²

As a result, public utility commissions have always been “knowledge based” organizations, that is they are “...composed largely of specialists who direct and discipline their own performance through organized feedback from colleagues and others.”³ In the future, they are likely to become even more “knowledge based” than they are now, and the manipulation and transmission of information is likely to be an even more prominent role of public utility regulators.

¹ Peter F. Drucker, *The New Realities in Government and Politics/ in Economics and Business/ in Society and World View* (New York, NY: Harper and Row, 1989), 209.

² John Borrows, letter to the author, September 10, 1999.

³ Drucker, *The New Realities in Government and Politics/ in Economics and Business/ in Society and World View*, 207.

This use of information by regulatory agencies can create a system of “regulation by information.” According to Giandomenico Majone:⁴

One mode—direct regulation—relies on orders, prohibitions, legally binding standards, and on other command-and-control techniques. The second mode attempts to change behavior indirectly, either by changing the structure of incentives of the different policy actors, or by supplying the same actors with suitable information.

There is at one early precedent in the field of utility regulation for the application of regulation by information. In an era in which the principal concern of regulatory commissions was the prevention of price discrimination, the Massachusetts Board of Railroad Commissioners, created in 1869, issued no legally binding orders except for orders to produce information, adopting a regulatory model referred to by some as a “sunshine commission.” By doing so, the Massachusetts Board avoided the “embarrassing impotence” of earlier, more interventionist commissions. The first chairman of the Massachusetts Board, Charles F. Adams, was convinced that in many cases “regulation by publication was a sufficient form of control and that in other cases an information strategy was preferable to badly designed or poorly implemented statutory regulation or forms of self-regulation not sufficiently open to public scrutiny.”⁵

Regulation by information as described in this chapter consists of two inter-related elements: empowering consumers by providing them with information and ensuring the existence of an information infrastructure able to support more competitive utility markets. After discussing those two elements,

⁴ Giandomenico Majone, “The New European Agencies: Regulation by Information,” *Journal of European Public Policy*, 4:2, June 1997, 265.

⁵ *Ibid.*, 265-266.

we will examine two more instances where public agencies have successfully applied regulation by information. The final section lays out a few conclusions. Table 3.1 lays out some of the elements of regulation by information.

Table 3.1

Regulation by Information	
Elements	Empowering consumers with information; building and maintaining the information infrastructure
Objectives of the information infrastructure	Ensuring that effective competition can take place, efficient markets, accomplishment of public policy objectives, fair use of information
Precedents	Massachusetts Board of Railroad Commissioners, SEC, Federal Reserve System, European Regulatory Agencies, <i>Consumer Reports</i>
Keys for commissions	Credibility, identification of information needs, establishment of networks and alliances, forbearance in the application of regulatory power

Source: Author's construct.

Empowering Consumers with Information

For decades, public service commissions have focused their attention on the providers of utility service. Though the objective of regulation was to protect consumers of utility service from monopoly abuse, the tools of regulation and the attention of regulators were directed toward service providers. Natural monopolies and economies of scale limited each geographic area to one service provider. The role of regulation was to simulate the benefits of free markets through the price regulation of that provider. No utility operations were regarded as being beyond the reach of regulators, and elaborate processes and systems of information collection were created with which to accomplish oversight of monopoly utilities. While consumer protection was the ultimate objective of utility regulation, consumers were not involved in any significant way.

Increasingly, geographic boundaries are less important in all markets, including utility markets, and, because of the penetration of alternate suppliers of utility service, consumers are now able to make choices in some segments of their utility markets. Under traditional regulatory methods, consumers were regarded as helpless pawns of the geographic franchise monopoly were it not for the vigilance of the regulator. Those consumers, while not as powerful as they will certainly one day be, now have some ability to act in their own best interests in utility markets.

Empowering consumers, in lieu of limiting the power of utility monopolies, is another role that public service commissions may take on. It is a different role than consumer protection, which assumes that consumers are less than fully able to make choices in their own best interest. (Consumer protection will likely continue to be a role for public utility commissions; it is described later in this report.) Providing useful information to consumers and policy makers and ensuring that information about utility markets and choices flows freely are

methods that have the goal of creating a body of well-informed utility consumers. These are methods that are in tune with the times, less-coercive than traditional methods, and particularly appropriate at the frontiers of technology.⁶ Some have described this function as “the *Consumer Reports* function” of commissions.

Properly constituted, the provision of information can create a system of self-regulation, perhaps more effective than traditional norms. In competitive or partially competitive markets, it may be a challenge to transmit effective price and quality information about utility service to consumers, but that information is transmitted with regard to other complex consumer products. Ultimately, if consumers have enough information and are socialized to expect full information, it will be more difficult to deceive them and markets will be free to work their magic. It will also be a challenge to identify what types of information might usefully be transmitted to consumers in those instance where monopoly service provision is still the norm. There too, however, information might help consumers ensure that they receive the services they are entitled too.

State public utility commissions and the NARUC community in general have begun to address the need to provide information to consumers. Examples are power “labeling, the Ohio “apples-to-apples” comparisons of utility rates, attempts to correct misleading advertising, and efforts to inform consumers about industry restructuring and the choices available to them. The new NARUC Committee on Consumer Affairs is very active in this regard.

The Information Infrastructure

The provision of information necessary to sustain competitive markets can be as simple as educating consumers about choices available to them or

⁶ Ibid., 264.

ways to file complaints or seek redress from monopoly providers. It can also be regarded more expansively as ensuring that a network of information exists—the information infrastructure—that knits together service providers, consumers, and regulators in a manner that supports and allows competitive markets to flourish or that minimizes the inefficiency of monopoly markets. Three central hypotheses drive commission involvement in that infrastructure. They are:

1. Utility service providers will shift from reliance on the physical infrastructure to “mining” information infrastructures for competitive advantages.
2. Competitive markets require the creation and maintenance of an information infrastructure.
3. Public utility commissions will likely increasingly shift their attention to information infrastructure issues as a way to ensure the effective and efficient provision of utility services.

Information infrastructures support commerce in all goods and services. These partially informal networks emerge naturally and link customers, manufacturers, commodity producers, retailers, to the extent that the industry is regulated, government agencies. For the most part, the information infrastructure grows without explicit attention and is left to the devices of the private sector. In the case of utility service, however, the public has a stake in the provision of economical, reliable, and universal service; one factor in the international economic competitiveness of the United States and each individual state is inexpensive and reliable utility service. Because of those public interests embedded in utility service, public agencies charged with oversight of public utilities and protection of utility customers will need to ensure that an effective infrastructure is created and maintained.

The utility industries have always been infrastructure dependent. The traditional utility service infrastructure was composed of an interconnected network of poles, wires, pipes, control systems, computer programs, and system interfaces that was largely physical. Whereas, in the past, the key to utility provider success was successful utilization of that physical infrastructure, the key to success for the utility provider of the future (and, perhaps, of the present in some instances) will be successful application of an information infrastructure. Indeed, in the future value-added service utility providers will not interact with the physical infrastructure at all. However, all utility service providers will interact with the information infrastructure. Indeed, the more turbulent the environment becomes the greater the need to compete with information and knowledge.⁷

These providers of utility services will be forced by changes in their environments to become, like nearly every other enterprise in modern society, “information-based” organizations, which implies that they will create or exploit opportunities for profits based on their accumulation and analysis of information. Even utility service providers in monopoly markets will be more information dependent as they interact with the competitive side of the market. According to Blake Ives and Sirkka L. Jarvenpaa:⁸

This changing environment will necessitate major changes in the way organizations collect, store, process, and distribute information. In the past information processing technology was an enabler of management control. In the future it will become central to the knowledge-creation and -dissemination process of an organization. *An organization's key distinctive competency will*

⁷ Blake Ives and Sirkka L. Jarvenpaa, “Competing with Information: Empowering Knowledge Networks with Information Technology,” in *The Knowledge Economy: The Nature of Information in the 21st Century* Annual Review of the Institute for Information Studies, 1993-94, 57.

⁸ *Ibid.*, 54.

be its ability to integrate new information with existing expertise. Modern information and communications technology, in turn, will define the battlefield on which organizations, armed with their knowledge based competencies will compete. (Emphasis added)

According to the Electric Power Research Institute's (EPRI) *Electric Technology Roadmap*, this type of shift is occurring now in the utility industry. EPRI says:

A new mega-infrastructure is emerging from the convergence of electricity and communications. This will open the gateway to new "intellectric" services that place unprecedented levels of individualized comfort, convenience, speed, efficiency, and adaptive intelligence at the customer's fingertips....This [the microprocessor] is shifting the energy business dynamic from the supply of commodity-value electricity to the delivery of value-added services through intelligent, customer-managed service networks.⁹

As competition among utility providers shifts to competition based on knowledge derived from information, the focus of regulators will also shift from concern over the physical infrastructure to concern over the information infrastructure. It can be argued that market imperfections that occurred in monopoly or less than competitive markets were the result of imperfections in information flow (i.e., an inadequate information infrastructure).¹⁰

Recent problems with "slamming" and "cramming," alleged delays in transferring customers from one provider to another, and the Y2K experience indicate that the current utility information infrastructure is also flawed. In the

⁹ Electric Power Research Institute, *Electricity Technology Roadmap: 1999 Summary and Synthesis*, (Palo Alto, CA: EPRI, 1999), x.

¹⁰ John Borrows, e-mail to the author, September 10, 1999.

case of slamming, that component of the information infrastructure that allows customers to move from one provider to another was flawed in that it did not require adequate transaction verification before initiation of the change. In the case of Y2K, the flaws in the infrastructure were apparent to those attempting to measure and ensure utility preparation. Brenda Buchan of the Florida Public Service Commission stated:¹¹

As a result of the lessening of regulation (i.e., competition) there appeared to be "gaps" in the free market system that did not address issues related to Y2K preparation including coordinating information or even getting all utilities to prepare.

In ensuring that an effective infrastructure is created and maintained, the objectives of public utility regulators will include:

1. Ensuring that effective competition can take place. This includes:
 - A. Clear price and quality signals to consumers making it easy for consumers to differentiate between service offerings.
 - B. Easy but accurate movement of customers from one provider to another.
 - C. Easy entry of competitors into utility markets.
 - D. Measurement of the extent to which competition takes place.
2. Ensuring that utility markets function efficiently (because efficient markets provide an edge over competing jurisdictions). This includes:

¹¹ Brenda Buchan, e-mail to the author, September 16, 1999.

- A. Easy utility vendor-to-vendor communications. Peter Schwartz, Chairman of the Global Business Network, says that, "The Amazons of the world get all the press, but the real growth in electronic commerce in the next five years is going to be in the business-to-business market."¹²
 - B. Efficient public markets for utility services and companies, which provide efficient and public pricing signals.
3. Accomplishment of public policy objectives, which include:
 - A. Reliable service.
 - B. Universal service.
 - C. National defense and public emergency management.
 4. The fair use of information, which includes minimization of attempts to deceive the public, public disclosure of information necessary to support public interest objectives, and privacy concerns.

Elements of the utility information infrastructure may include:

- Service "labeling," which provides consumers with necessary and accurate information about the services they are about to purchase.
- Clear articulation by trusted sources of price and quality data.

¹² Peter Schwartz as quoted in Steve Lohr, "In E-Commerce Frenzy, Brave New World Meets Old," *New York Times*, October 10, 1999, 5.

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- Standards for competitively neutral operational support systems (e.g., OSS or back-office systems in telecommunications), which are capable of handling traffic volumes.
- Standardized communications between service providers (electronic data interchange), which standardizes customer data thereby allowing easy movement of consumers from one provider to another.
- National defense and emergency management linkages between utility providers and government agencies. The Department of Defense testified against the breakup of AT&T on the grounds that national defense coordination would be much easier if there were only one national telephone company. Today, there are many service providers and there are likely to be more in the future. The Y2K problem demonstrated how difficult it is to communicate with providers in all of the utility sectors.
- Mandatory linkages between service providers to ensure service reliability, which may require commission interconnection standards.
- Publicly available information on the location of hard to serve groups of consumers, which may include aggregation of these consumers and a provider of last resort.
- Effective wholesale markets and, to the extent practicable, public financial markets in utility service (i.e., further extension of the use of commodity markets like the natural gas futures market).
- Communication systems that allow customers in non-competitive markets to be aware of service standards and complaint mechanisms.

Those who might participate in the construction and operation of the utility information infrastructure might include the utilities; the financial markets; public agencies including the Department of Defense, emergency management agencies, public utility commissions, and departments of economic development; private entities, such as *Consumer Reports* magazine; regional utility organizations, like the ISOs and regional reliability councils in electricity; and new entities established explicitly to oversee information infrastructure issues and coordinate responses. Indeed, as market participants proliferate, the task of maintaining the information infrastructure will become more complex.

Without doubt, the private sector can be relied on to create much of the utility information infrastructure. But, as Peter Drucker states, we cannot expect the public interest to “emerge out of the welter and clash of competing interests.”¹³ Private companies, after all, have an interest in exploiting faults in the information infrastructure. Slamming and cramming provide two good examples of unethical behavior, though most exploitation of the information infrastructure will likely be ethical.

In creating an effective information infrastructure, there will be roles for private sector institutions, which assume some responsibility for the public good, and for public utility commissions, which are ultimately responsible for public interest outcomes in this critical sector of the economy. Robert Britt Horowitz reminds us that “...the construction and maintenance of infrastructures usually have been the responsibility of governments.”¹⁴

¹³ Drucker, *The New Realities in Government and Politics/ in Economics and Business/ in Society and World View*, 93.

¹⁴ Robert Britt Horowitz, *The Irony of Regulatory Reform: The Deregulation of American Telecommunications* (New York, NY: Oxford University Press, 1989), 12.

A useful example of public action to establish an effective information infrastructure for critical elements of the economy is the establishment of the Federal Reserve System, which not only implements monetary policy but also serves as the central, coordinative bank and, thereby, ensures effective communications between banks in the U.S. system. Among its other more widely known duties, the Federal Reserve manages a funds transfer system in which 10,000 depository institutions initiate funds transfers that are final and irrevocable when processed and provides comprehensive information on banks and other institutions through its National Information Center.¹⁵ In our efforts to restructure utility markets, it may be prudent to pause to ensure that policies and institutions are in place to create an adequate information infrastructure for this similarly critical component of the economy and society.

Models of Regulation by Information

This chapter has already mentioned the information provision activities of *Consumer Reports* magazine, the “sunshine commission” strategies adopted by the Massachusetts Board of Railroad Commissioners, and the establishment of the Federal Reserve System and its role in ensuring the efficient operation of the nation’s banking system. There are two additional models of regulation by information—the U.S. Securities and Exchange Commission and the new European regulatory agencies—that may provide some additional insight for public utility regulators seeking to create this regulatory model. They are discussed in turn.

¹⁵ Descriptive information about the Federal Reserve System is available at www.federalreserve.gov.

The U.S. Securities and Exchange Commission

To use the language employed in this chapter, in 1934 the Securities and Exchange Commission (SEC) was established to correct flaws in the information infrastructure for securities trading, flaws which contributed to widespread securities speculation in the year preceding the Great Stock Market Crash and, ultimately, the Great Depression. The purpose of the SEC is to protect investors and the public from false and misleading information and to prevent misrepresentation, deceit, or other fraud in the sale of securities.

To accomplish its purposes, the SEC was given broad power by the Congress. For firms subject to its jurisdiction, the SEC can:¹⁶

- compel obedience to disclosure requirements,
- prevent fraud and deception in the sale and purchase of securities,
- obtain court orders enjoining acts and practices that operate as a fraud upon investors or otherwise violate the law,
- suspend or revoke the registrations of brokers, dealers, and investment companies and advisers who willfully engage in such acts and practices,
- suspend or bar from association persons associated with brokers, dealers, investment companies and advisers who have violated any provision of the Federal securities laws,
- prosecute persons who have engaged in fraudulent activities or willful violation of those laws.

¹⁶ Office of the Federal Register: National Archives and Records Administration, *The United States Government Manual* (Lanham, MD: Bernan Press, 1993), 727.

In addition to those general powers, the SEC has specific power with regard to the utilities industry under the Public Utility Holding Company Act (PUHCA). Under PUHCA, for registered holding companies the SEC has the power to approve utility acquisitions and vertical nonutility acquisitions; approve of service, sales, and construction contracts and other activities between holding companies and affiliates; restrict acquisitions to utility-related businesses; approve of corporate and financial structures; and approve of securities sales.¹⁷

Despite those broad and extensive powers, the SEC has largely accomplished its mission by ensuring the existence of an effective information infrastructure for the operation of financial markets, relying extensively on the private sector to accomplish its objectives. Rather than to attempt to audit all of the firms that publicly trade securities, the SEC requires that the financial statements of firms be audited by independent auditors, who have committed to professional standards in their audits. Reflecting the increasing emphasis on protecting the public from flaws in the information infrastructure, audits in the first half of the 20th century moved away from ensuring that professional managers had not defrauded their absentee owners to determining whether financial statements gave a full and fair picture of the financial position of a firm.¹⁸ Even in the prevention of fraud, the SEC relies principally on mandatory disclosure requirements. Though there is no conclusive evidence that the SEC disclosure

¹⁷ Kenneth W. Costello, Edward H. Jennings, and Timothy W. Viezer, *Implications of a New PUHCA for the Electric Industry and Regulators* (Columbus, OH: The National Regulatory Research Institute, 1992), 13.

¹⁸ Kurt Pany and O. Ray Whittington, *Auditing* (Burr Ridge, IL: Richard D. Irwin, Inc., 1994), 9.

requirements have contributed to the prevention of fraud, they have at least supported the widespread view that the SEC is an effective agency.¹⁹

The SEC also has the authority to establish accounting standards and does issue several types of accounting guidelines. For the majority of accounting standards, however, the SEC again turns to the accounting community. From its inception in 1934 through 1938, the SEC issued no accounting standards. In 1938, the SEC provided an opportunity for the accounting community to establish standards by noting that statements filed using accounting standards for which “there is no substantial authoritative support” would be presumed to be misleading or inaccurate.²⁰ A succession of non-governmental organizations—the Committee on Accounting Procedures (1938 to 1959), the Accounting Principles Board (1959 to 1973), and the Financial Accounting Standards Board (1973 to the present)—have established standards that have met the SEC’s “substantial authoritative support” test.

The SEC has been criticized by some for its extensive reliance on the private sector. In 1977, a Subcommittee of the U.S. Senate issued a report that stated that, “A review of the SEC’s record on accounting and reporting matters shows clearly that it has seriously failed to protect the public interest and fulfill its congressional mandate.”²¹ A central thesis of that report was that the FASB was unduly influenced by the accounting profession and by the private interests of the

¹⁹ George Stigler, “Public Regulation of the Securities Market,” *Journal of Business of the University of Chicago*, 37(2), 117-42 as cited in Giandomenico Majone, “The New European Agencies: Regulation by Information,” *Journal of European Public Policy*, 4:2, June 1997, 266

²⁰ Securities and Exchange Commission, “Release No. 4,” April 25, 1938.

²¹ Subcommittee on Reports, Accounting, and Management of the Committee on Government Operations of the United States Senate, *The Accounting Establishment*, Document No. 95.34 (Washington, DC: U.S. Government Printing Office, March 1977), 173

groups that created it.²² Others argue, however, that the FASB and its predecessors have created effective accounting standards and highly effective financial markets. They further argue that the use of the private sector to ensure the accuracy of financial statements and set accounting standards has been a cost-effective method of protecting public interests.

Overall, the U.S. securities markets function extremely well, and where flaws have occurred, such as insider trading, the SEC has moved to correct anomalies and ensure that information flows benefit all investors fairly. The success of the SEC in creating this effective information infrastructure is both the cause and the result of the SEC's significant credibility and the substantial powers it has been given but which it uses with discretion.

The New European Regulatory Agencies

In 1993, when regulatory bodies were created for the European Community (the European Environmental Agency, the European Agency for the Evaluation of Medicinal Products, and the European Agency for Health and Safety at Work), they were not granted broad administrative regulatory authority, in part since the delegation to autonomous bodies of rulemaking and enforcement powers was always resented by the member states as being too intrusive.²³ That resentment may, though other forces might also be at work, mirror trends cited in Chapter 1 of this report that cause U.S. regulatory agencies exercising traditional regulation to be increasingly seen as being "out of step" with societal trends. Though these agencies have little track record and exist in

²² Ibid., 130.

²³ Majone, "The New European Agencies: Regulation by Information," 263.

a different organizational setting than U.S. public service commissions, their intention to employ regulation by information may provide an interesting example for state commissions.

These agencies have a statutory commitment to regulation by information.²⁴ But denied the normal powers of regulatory agencies, according to Giandomenico Majone, “with knowledge and persuasion as the principal means of influence at their disposal, the agencies could develop indirect, information-based modes of regulation that are actually more in tune with current economic, technological and political conditions than the coercive instruments that have been denied them.”²⁵

If they are to be successful, they must establish credibility and professional reputation. Again according to Giandomenico Majone:²⁶

- Policies based on information can affect expectations and behaviors only if they and the agency that established them are credible.
- Credibility is enhanced if decision making is delegated away from central decision makers.
- The independence and reputation of the agencies must be protected.
- The new agencies have been designed to make cooperation and networking unavoidable. The information network becomes, therefore, the bearer of reputation.

²⁴ Ibid., 269.

²⁵ Ibid., 264.

²⁶ Ibid., 270-274.

Unlike the SEC, these agencies do not have substantial backup power for enforcement. It is not clear that public service commissions could implement regulation by information without enforcement and licensure power though they should discipline themselves to forbear in its use unless absolutely necessary.

Conclusions

In an environment of rapid change, it may seem appropriate to react with more vigorous attempts at regulatory control. In fact, the exact reverse may be true. In addition, the growing complexity of public policy continues to erode the effectiveness of command-and-control techniques of regulation.²⁷ In the face of the ongoing assault on traditional regulatory models, it may be appropriate to try employ new methods. One that holds promise is regulation by information. Indeed, some of information suggests that regulation by information is often more effective than direct regulation.²⁸

If regulation by information is to be successfully employed as one model employed by a multi-dimensional public service commission, the keys may be:

- The establishment of agency credibility. The SEC and the Federal Reserve, for example, function well in part due to the high level of respect afforded them, respect that they have earned over time. Their backup power also contributes to their credibility.
- Identification of the kinds of information necessary for effective market functioning and increasing the information-processing skills of staff. Commissions are currently improving their ability to provide useful

²⁷ *Ibid.*, 268.

²⁸ *Ibid.*, 262.

information to consumers. A similar effort may be required for enhancing the commission's ability to deal with information infrastructure issues.

- The establishment of networks and alliances. In most of the examples listed above, the agencies extended their reach and their impact by enlisting others in the accomplishment of their mission.
- Forbearance in the application of enforcement or coercive powers, though retention of those powers may be critical to successful application of regulation by information.

Regulation by information has its limits. For example, it cannot be effective if any party has the ability to dominate information flows, though commissions can change information flows through mechanisms like codes of conduct. It also cannot function well if consumers have few options (i.e., it may not do much good to inform consumers about the prices and quality of the services they receive if they have no real options). Overall, however, regulation by information has the potential, proven by other agencies, to accomplish public purposes effectively and efficiently.

CHAPTER 4

CREATING INNOVATIVE, WIN-WIN OUTCOMES: REGULATION BY NEGOTIATION

According to Peter Drucker, amid the vast changes taking place all around us, “social innovation...may be of greater importance and much greater impact than any scientific or technical invention.”¹ If his assessment is true, the question looms, How can public utility commissions play a part in that social innovation? How can they introduce innovation into regulatory processes that have stood largely unchanged for a century? The key to innovation, says Rosabeth Moss Kantor, may be a new paradigm for it, “a partnership between private enterprise and public interest that produces profitable and sustainable change for both sides.”²

In Chapter 2 of this report, we examined the shortcomings of traditional forms of public utility regulation and argued that alternative forms of dispute resolution would produce better regulatory policies. This chapter takes a step further and argues that more extensive forms of collaboration might have the effect of introducing more creativity into regulatory decision making and that

¹ Peter F. Drucker, *The New Realities in Government and Politics/in Economics and Business/in Society and Worldview* (New York, NY: Harper and Row, Publishers, 1989), 227.

² Rosabeth Moss Kantor, “From Spare Change to Real Change: The Social Sector as Beta Site for Business Innovation,” *Harvard Business Review*, May-June 1999, 124.

commissions might effectively take on the role of resolving disputes as a regulatory methodology.

State public utility commissioners at the 1998 NARUC/NRRI Commissioners Summit in Denver expressed their support for these models, which are described herein as “regulation by negotiation.” They said that state public utility commissions should:³

- Adopt roles that include...collaborating with other agencies and organizations.
- Make collaboration an effective part of the regulatory process.
- Engage with more dialogue with key stakeholders.
- Consider more dispute resolution.
- Create structures that allow pursuit of alternative ways of settling disputes.

Commissions have begun to adopt these methods, in part, by involving stakeholders in regulatory change initiatives and becoming involved in negotiation of telecommunications company interconnection agreements. For example, the Federal Energy Regulatory Commission (FERC) and the New York Public Service Commission (NYPSC) established and implemented a collaborative process for governance issues related to the New York ISO. The

³ The Staff of the National Regulatory Research Institute, *Proceedings of the Second NARUC/NRRI Commissioners Summit* (Columbus, OH: National Regulatory Research Institute, 1998).

result was a joint motion in support of a governance structure that was filed at FERC by a coalition of about twenty parties representing diverse interests.⁴

This chapter argues that these types of collaborative processes can be more effective at creating innovative and accepted outcomes than traditional regulatory methods. It examines the growth of the use of mediation for settling public policy disputes, discusses the use of negotiations for rulemaking, explores four critical issues for public utility commissions seeking to employ regulation by negotiations—the establishment of a “negotiation culture” at commissions, the infusion of the public interest into dispute resolution, the identification of the parties and representatives to involve in negotiations, and the potential for judicial review-- briefly discusses the role of commissions in mediating disputes ancillary to their jurisdiction, and identifies keys for commissions attempting to use collaboration to a greater extent. Table 4.1 summarizes the major elements of regulation by negotiations.

The Growth of the Use of Negotiations for Settling Public Disputes

The publication in 1981 of the seminal work on dispute resolution, Fisher and Ury's *Getting to Yes*,⁵ sparked a revolution in dispute resolution. New methods of settling disputes have emerged in business, diplomacy, courts, and

⁴ Judith A. Lee, “Alternative Dispute Resolution at the New York Public Service Commission,” a presentation to the 111th NARUC Annual Convention, November, 9, 1999.

⁵ Roger Fisher and William Ury (and for the Second Edition, Bruce Patton), *Getting to Yes: Negotiating Agreement Without Giving In* (New York, NY: Viking Penguin, 1991).

Table 4.1

Regulation by Negotiations	
Objective	Creation of innovative, win-win, outcomes accepted by the parties
Focus	Mutual creation of regulatory policy; mediation of ancillary disputes
Critical issues	Establishment of a negotiations culture, introducing the public interest into negotiations, identification of parties to include, judicial reaction
Precedents	ADRA, reg-neg
Keys for commissions	Identification of the public interest, bringing all affected parties to the table, minimizing resource disparities, creating the negotiations infrastructure, ensuring that no better alternatives (BATNAs) exist, changing commission culture, retaining the ability to walk away, trusting the negotiations process, protecting the reputation of the commission

Source: Author's construct.

communities.⁶ Though they are diverse, these methods have the following elements in common:⁷

⁶ Linda R. Singer, *Settling Disputes: Conflict Resolution in Business, Families, and the Legal System* (Boulder, CO: Westview Press, 1994), 5.

⁷ Ibid.

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- They all exist somewhere between the polar opposites of doing nothing or of escalating the conflict.
- They are less formal and generally more private than ritualized court battles.
- They permit people with disputes to have more active participation in and more control over the processes for solving their own problems than do traditional methods of dealing with conflict.
- Most of the new methods have been developed in the private sector, although courts and administrative agencies now are borrowing and adapting some of the more successful techniques.

With regard to allowing people to have more active participation in processes for solving their own problems, these techniques attempt to allow participants to move toward the right on a “continuum of power” identified by Joel Edelman and Mary Beth Crain. That continuum ranges from pure dictatorship on one extreme to genuine consensus on the other. Between the two are sugarcoated dictatorship, enlightened despotism, advisory commission dictatorship, 800-pound gorilla power, arbitrated decision making, consensus input, consensus understanding, and consensus acceptance.⁸

On the power continuum, commissions typically operate between arbitrated decision making, in which the decision is based on a supposedly objective standard interpreted by a designated official (or group of officials), consensus input, in which all parties have an opportunity to provide input before a decision is made, and consensus understanding, in that commission orders are made public to all parties involved. Commission processes may result in

⁸ Joel Edelman and Mary Beth Crain, *The Tao of Negotiation* (New York, NY: HarperCollins, Publishers, 1994), 112.

decisions that approach “consensus acceptance” if the commission logic is accepted by all parties. Traditional commission processes fall short, however, of “genuine consensus.” It is at that level that solutions can be owned by all parties and at which the creative energies of participants can be most fully unleashed making innovation most likely.

The revolution in dispute resolution sparked by Fisher and Ury has spread to the resolution of public policy disputes. At the federal level, in 1990 Congress enacted the Administrative Dispute Resolution Act (ADRA), which authorizes and encourages federal agencies to employ forms of consensual ADR in a variety of administrative procedures. The ADRA requires that each agency must appoint a senior official to be the agency’s dispute resolution specialist and conduct training on ADR on a regular basis. Subsequent to the ADRA, a Presidential Executive Order required agencies to consider appropriate ADR alternatives whenever a government agency is party to litigation.⁹ A number of federal agencies, including FERC, have begun programs to employ ADR. As an example, a pilot program was created by the Department of Labor, which mediated disputes of alleged violations of wage and hour laws and workplace safety and health requirements. At the close of the pilot, it was reported that more than 76 percent of the cases sent to mediation had been settled and that some of them had resulted in “particularly creative settlements unlikely to have been reached in litigation.”¹⁰ Questionnaires and interviews of government participants and private parties revealed “considerable satisfaction.”¹¹

⁹ Singer, *Settling Disputes: Conflict Resolution in Business, Families, and the Legal System*, 141-142.

¹⁰ *Ibid.*, 142.

¹¹ *Ibid.*

The success of experiments like these has intrigued public agencies. Their challenge has been to find ways to make negotiations work in the public interest.

The Negotiation of Rules

In addition to their use of negotiations to resolve disputes, federal agencies have also found success in negotiating the establishment of government rules and regulations (called “reg-neg” for short). The use of reg-neg hopes to counter what has been described as the steady march of administrative law “toward reliance on the judiciary to settle disputes and away from direct participation of the affected parties.”¹² For example, 80 percent of EPA rules are challenged in court.¹³

In response to successful experimentation by federal agencies, Congress passed the Negotiated Rulemaking Act of 1990. That act:¹⁴

1. Defined reg-neg as the development of rules and regulations by the consensus of interested parties.
2. Allowed agency heads to determine if negotiation is in the public interest.
3. Required them to consider whether there is a need for the rule, whether there exists a limited number of identified interests that will be significantly impacted by the rule, whether a balanced representation of those interests can

¹² Philip J. Harter, “Negotiating Regulations: A Cure for Malaise,” *71 Georgetown Law Journal* 1 (1982) as cited in *Ibid.*, 146.

¹³ *Ibid.*

¹⁴ *Ibid.*, 148.

be assembled and has a reasonable possibility of success in a fixed period of time, whether the negotiations will not unreasonably delay the issuance of the rule, whether the agency has adequate resources to employ, and the extent to which the agency will rely on the negotiated version of the rule in its final rule.

Philip Harter distinguishes between models of regulatory negotiation, in which the regulator speaks first to one party and then another, and models of negotiated rulemaking, in which the parties sit together to address the issues.¹⁵ He also suggests that rules can be negotiated when:¹⁶

1. Countervailing power exists, that is, no party can overwhelm the others.
2. There is a limited number of participants.
3. The issues are sufficiently crystalized to permit resolution.
4. A decision is inevitable. That is, even if the participants do not reach a decision, some other agency will make that decision.
5. An opportunity exists for a win-win solution, that is, the issue under consideration is not a zero-sum game.
6. A fundamental value of any of the parties is not at stake.
7. More than one issue is under consideration so that parties can negotiate solutions and make trades.

¹⁵ Philip Harter, "Negotiating Regulations: A Cure for Malaise," 71 *Georgetown University Law Journal* 1 (1982) as cited in Robert Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: National Regulatory Research Institute, 1988), 23.

¹⁶ *Ibid.*, 23-24.

8. There is adequate information flow, that is, no party controls the information.
9. Implementation of the agreement by the agency is likely.

State public utility commissions have made some use of reg-neg, in most cases to develop rules for integrated resource planning or the consensus for legislation on gas and electric industry restructuring. The Pennsylvania Public Utility Commission use of collaboration for electric industry restructuring is cited as being exemplary.

The requirements of the NRA and the criteria suggested by Harter are relevant to public utility regulation. Despite decades of practice to the contrary, utility policy is not a zero-sum game. Utility issues are also complex, which is less a limiting factor than one that will allow the creation of innovative options. Ensuring adequate information flow will be a challenge, which is partly addressed by Chapter 3 of this report.

Critical Issues for State Commissions

Four critical issues may impede the use by state commissions of regulation by negotiations. They are the establishment of a culture at commissions and among regulatory stakeholders that allows and encourages negotiation, the infusion of the public interest into the negotiations, the difficulty inherent in identifying the appropriate parties to invite to the bargaining table, and the potential judicial reaction to negotiated solutions to public problems.

Establishment of a Negotiation Culture at Commissions

The culture of public utility commissions has not typically been conducive to negotiations. Instead, the culture often defined “wins” and “losses” in the context of rate cases. Involving all stakeholders in crafting negotiated solutions would have been regarded as anathema.

There are methods, however, by which the culture of commissions might be adapted to permit, or even encourage, the use of negotiations. According to Danny Ertel, the usual and dysfunctional negotiations cycle consists of a self-perpetuating loop of activities that includes:¹⁷

- Restricting information flows.
- Confirming suspicions and perceptions.
- Reducing risk taking and creativity.
- Creating a low-value deal.
- And, underinvesting in the relationship.

This cycle was typical of commission processes that limited information flow to data requests and utility filings, presumed that the outcome was a zero-sum encounter (i.e., if consumers “won,” a “loss” to the utility was presumed and vice versa), limited outcomes to the parameters of formal records, created short-term solutions, and did not attend to creating a workable relationship with all

¹⁷ Danny Ertel, “Negotiation as a Corporate Capability,” *Harvard Business Review*, May-June 1999, 64.

stakeholders. The objective of creating a “negotiations culture” within the organization is to replace this unproductive cycle with one that includes:¹⁸

- Sharing information about interests.
- Improving mutual understanding.
- Expanding the scope of discussions.
- Creating valuable options.
- And, improving trust and communications.

In this cycle, commissions would work towards gaining a deeper understanding of the objectives of all the stakeholders, generating an information flow that is multi-directional, engaging in discussions that move outside the boundaries of specific events or requests towards larger outcomes, brainstorming a wider array of options, and developing long-term relations with stakeholders based on mutual trust and commitment to public policy outcomes.

Fundamental changes in the culture and operations of commissions are required for these changes. Inherent in these changes are also an understanding of the differences between positions and interests and a commitment to preserving a workable relationship between the parties.

Interests represent the needs, desires, concerns, and fears of the parties.¹⁹ Moving the focus of discussions beyond stated positions to interests

¹⁸ Ibid.

¹⁹ Roger Fisher and William Ury (and for the Second Edition, Bruce Patton), *Getting to Yes: Negotiating Agreement Without Giving In* (New York, NY: Viking Penguin, 1991), 40.

widens the potential array of solutions. Focusing on positions, without pursuing interests, is inefficient, produces unwise agreements that may not address the key issues, gets worse when there are multiple parties, and can endanger existing relationships.²⁰

With regard to preserving the relationship between the parties, Ertel suggests that organizations need to eliminate the notion that individual deals and long-term relationships move like a seesaw; to improve one you must sacrifice the other.²¹ That is only the case for bad interactions, which cause parties to harden their positions and decrease their willingness to work together.

It can be argued that the long history of stakeholder relationships in the regulatory environment has created deep distrust that is hardly conducive to healthy communications. The reality of successful relationships, Ertel maintains, is that deals and relationships move in tandem. A strong relationship creates trust, which allows better information flow, which leads to more creative and valuable agreements, which creates a greater willingness to work together.²² There are, he argues, “relationship” problems and “deal” problems.²³ While relationship problems cannot be repaired in a single deal, and deal problems cannot be solved simply by creating a better relationship, they do operate synergistically. Reaching a deal can move the parties toward a better relationship, and creating a good relationship can help parties through the rough

²⁰ Ibid., 4-7.

²¹ Ertel, “Negotiation as a Corporate Capability,” 64.

²² Ibid.

²³ Ibid.

spots in deal making.²⁴ In some cases, however, negotiators must reserve the right to walk away from a deal.²⁵

Introducing the Public Interest into Negotiations

One shortcoming of the use of negotiations for resolving utility service issues is the difficulty inherent in ensuring that the public interest is protected and introduced into negotiations. Utility service providers, by themselves, cannot be expected to serve public interests. According to Milton Friedman:²⁶

So the basic question is, do corporate executives have responsibilities in their business activities other than to make as much money for their stockholders as possible? And my answer to that is, no they do not.

If commissions establish their role as being that of negotiator or mediator, their ability to serve the public interest is limited in that negotiators and mediators should be neutral and impartial. According to the Model Standards of Conduct for Mediators, "self-determination" is a fundamental principle of mediation.²⁷ This means that the goal of mediation is to allow parties to reach a voluntary, uncoerced agreement. Under the Model Standards, the interests of the parties,

²⁴ Ibid.

²⁵ Ibid., 66.

²⁶ Milton Friedman as cited in Louis E. Boone, *Quotable Business* (New York, NY: Random House, 1992), 198.

²⁷ American Arbitration Association, American Bar Association, Society of Professionals in Dispute Resolution, "Model Standards of Conduct for Mediators," pamphlet, 1.

not the interests of the public or the interests of the commission drive the mediated agreement.

Commissions employing regulation by negotiations, who wish to allow the negotiator to remain impartial, have three options. First, they can rely on others to represent the public interest. For example, if the public interest is coterminous with the interests of residential ratepayers, those representing residential consumers can protect the public interest as well. There may be some circumstances, however, in which the public interest is separable from the interests of any of the parties at the table.

In that case, commissions can employ the second option which would be for the commission to participate in negotiations using a third-party as negotiator. If acceptable to the other parties, a commission administrative law judge might serve as negotiator while other staff participate. This method has been frequently used at state commissions in the context of proceedings implementing the Telecommunications Act of 1996.

Lastly, the commission (and, in specific, the commissioners) could remove itself from the negotiations and reserve judgement until a negotiated agreement was brought before it. Under this option, which has been used by several states for industry restructuring negotiations, commission staff can participate in negotiations as negotiator or as parties. In one case, commission technical staff facilitated the negotiations but, in retrospect, were regarded by the participants as not adequately independent. For a second round of negotiations involving a different industry, hearing examiners were to assume the negotiator role.

Identification of Parties to Include in Negotiations

One of the biggest challenges for state commissions using regulation by negotiations is to identify all parties affected by an issue and identify their representatives. Failing to identify the full range of participants and include them in negotiations may be the single largest reason for adverse court reaction to negotiated agreements. These determinations of who should participate are made even more complex when policy issues have not reached the status of full-fledged disputes.²⁸ Once disputes arise, it is fairly easy to tell who is involved; when the full implications of future-directed policies are not entirely clear, it is difficult to identify all who might be impacted.

Under the Negotiated Rulemaking Act, the number of participants in federal rulemaking negotiations is limited to twenty-five, unless the agency head determines that more are needed.²⁹ Phillip Harter suggests that the number of parties to be included in a negotiated rulemaking can be determined by identifying all parties whose interests are so central to the negotiation that an agreement could not be developed without their participation.³⁰ Those parties should be invited to participate; those with more remote interests should be limited to written comments.

In the case of negotiations about public utility issues, it will also be a challenge to identify who will represent classes of consumers or other key

²⁸ Singer, *Settling Disputes: Conflict Resolution in Business, Families, and the Legal System*, 149

²⁹ *Ibid.*

³⁰ Philip Harter, "Negotiating Regulations: A Cure for Malaise," 71 *Georgetown University Law Journal* 1 (1982) as cited in Robert Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: National Regulatory Research Institute, 1988), 24.

interests. For example, when will an organization like AARP be invited to participate? Are the interests of AARP's target audience central to the issue, and, if they are, is AARP the best organization to represent those interests. Though the effectiveness of the negotiations process might be diminished somewhat, being inclusive might be the best policy.

Judicial Reaction to Negotiated Solutions

Peering over the shoulder of every regulatory process, is the specter of judicial review and reversal. How might the judiciary view negotiated processes that lack some of the procedural protection of standard quasi-judicial processes?

As mentioned earlier, the courts are most likely to overturn negotiated agreements if errors have been made on the "front end," that is that errors have been made in setting up the process, identifying necessary participants, and making adequate notice of the proceedings. Phillip Harter argues, in the case of negotiated rulemaking, that possible due process concerns that a party's interest was not addressed may be answered by the courts using the same logic that is applied to class action suits, that is whether those participating in the negotiation will fairly and adequately protect the interests of the unrepresented class. Parties alleging non-representation will need to prove that adequate notice was not given, that they applied for representation but were denied, and that they failed to exhaust administrative remedies.³¹

Harter also argues that the rarely used non-delegation doctrine has the potential to impede negotiated rulemakings, in that the doctrine states that the power to regulate an industry cannot be delegated to a private group because

³¹ Ibid., 26-27.

the authority to regulate is necessarily a government function.³² Robert Burns suggests, however, that the non-delegation doctrine need not impede negotiated rulemakings if the commission reserves final authority to determine the content of final rules.³³

Commission Mediation of Ancillary Disputes

In more competitive utility markets, disputes may arise between parties not traditionally subject to commission regulation. For example, disputes may arise between consumers and non-regulated market participants or between utility service providers. Some have suggested that commissions might become the mediator-of-choice for these types of disputes. For consumer-unregulated provider disputes, commissions may become involved by consumers who might request assistance not understanding the limitation of the commission's jurisdiction.

In the performance of this role, many of the constraints and concerns expressed earlier in this chapter would not apply. The participants will be easy to identify since a dispute will have already occurred. Involving others not directly involved in the dispute would, in most cases, be inappropriate. Commissions would still need to remain impartial and neutral. If they cannot, they should not negotiate.

In order to be successful in this role, commissions will have to convince participants that the negotiations service they provide has advantages over alternatives available to the parties. Those alternatives might include private

³² *Ibid.*, 27.

³³ *Ibid.*

mediation or recourse to the legal system. Commissions have the advantages of knowledge of the field, the ability to contact the parties and bring them together, resources, and a generally positive reputation. On the other hand, their prior relationship with the parties and their public interest mission may be significant enough to cause the commission to be less than impartial and neutral.

Keys for Commissions

If state public utility commissions are to make better use of negotiations as a regulatory model, there are several keys to successful implementation.

They are:

1. Clearly identify the public interest. As was mentioned earlier, one of the biggest challenges for commissions employing regulations by negotiation is to infuse the process with the public interest. The other parties cannot be expected to pursue any interests other than their own; it is, therefore, up to commissions to ensure that the public interest is represented. If it is to be represented, it must first be articulated so that all commission representatives can work toward the same ends.
2. Bring all affected parties to the table. Identification of the appropriate numbers of persons to include in negotiations will be difficult. Any parties excluded may challenge the results of the negotiation. Though there may need to be tradeoffs made between full representation and creating groups that are not unduly large and unwieldy, inclusiveness is, perhaps, the better path.
3. Consider the use of co-mediators. A co-mediation process was used in the FERC/NYPSC negotiations referenced earlier. The use of co-mediators allows mediators the opportunity to think, observe, and refresh while the other mediator is speaking, to brainstorm, and increase skills

and knowledge from one another. The result may be an enhanced outcome for the parties.³⁴

4. Minimize resource disparities. Imbalances between the parties will exist, but no party should be allowed to dominate the negotiations because of resource or information advantages. A key role of commissions will be to ensure that all interests have the opportunity to participate and to ensure that the ramifications of options are fully understood by all. Creating this balance without appearing to be biased will be a challenge.
5. Create a negotiations infrastructure. This implies that commissioners and staff must receive adequate training, that rewards are provided for those who engage in successful negotiations, that the organization is structured to give adequate attention and resources to negotiations, and that commission processes allow for negotiations as a regulatory tool. Staff and commission-wide performance measures should take into consideration the creation of long-term working relationships with the parties, rather than scoring wins and losses on individual cases. Commission staff will need to be provided training in dispute resolution.
6. Ensure that no BATNA exists. If parties have a BATNA (a “better alternative to a negotiated agreement”), they should be expected to employ it. For negotiations to work, therefore, the parties must not believe that their political or judicial options are better. If political avenues are not closed by the support of the legislature or governor for the commission negotiations process, parties will not fully participate or bargain in good faith, preferring to wait to take their chances in the political environment.
7. Change commission culture. As was also noted earlier, the typical culture of a public utility commission is not

³⁴ Lee, “Alternative Dispute Resolution at the New York Public Service Commission.”

conducive to negotiations, which require that interests be distinguished from positions and the issues be separated from individuals.

8. Retain the ability to walk away from a negotiation. There will be times when the negotiation ceases to support the public interest. When that happens, commissions should retain the ability to walk away. This implies that commissions must retain residual powers to accomplish public objectives through other means.
9. Trust in the negotiations process. The reality of negotiations is that the outcome does not hinge on the skill of the negotiator.³⁵ Instead, it hinges on the creativity and good will of the participants. Good facilitators and negotiators can create the conditions for a favorable outcome, but the outcomes cannot be managed. There can be little creativity expressed in a tightly managed process. Instead, favorable outcomes will emerge naturally, guided by the wisdom of the group involved.
10. Protect the reputation of the commission. If commissions are to become effective at regulation by negotiation, and particularly if they are to become trusted mediators of ancillary disputes, they must establish an unblemished reputation for fairness and effectiveness. That reputation can be compromised by a single perceived act of bad faith in negotiations.

These are significant challenges. However, the regulatory process is in need of more creative outcomes, which can only be generated from collaborative processes. Denying the opportunity at the commission-level for the parties to generate creative, win-win outcomes will force them to seek other opportunities and forums. The result may be a further erosion of commission ability to affect

³⁵ Danny Ertel, "Negotiation as a Corporate Capability," *Harvard Business Review*, May-June 1999, 58.

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public interest outcomes. Regulation by negotiation is a method that provides a closer match with societal decision-making trends, which value inclusiveness and consensus. It has the potential to overturn decades of combative relationships between stakeholders in the regulatory environment. For these reasons, it is likely to be worth the effort.

CHAPTER 5

THE COMMISSION AS “COP ON THE BEAT:” CONSUMER PROTECTION

As commissions and legislatures restructure utility markets, they are shifting the risk inherent in those markets. Regulatory commissions, under the traditional model, minimized the risk to market participants by limiting rate increases and providing companies the opportunity to earn a fair rate of return. In restructured markets, companies are freed to earn higher rates of return but have less or no guarantee of earning a minimum rate. Utility consumers too will be subject to more risk (e.g., the risk of higher rates in some cases, the risk of being defrauded in the market, and the risk of making poor purchasing choices). It is hoped that those risks will be offset by the gains consumers accrue due to competition.

In part because of the new risks to be assumed by consumers, consumer protection, which most assume to mean residential and small business consumers, is widely heralded as an emerging role for state public service commissions. Under this model, commissions will “...be more like a cop on the beat than someone involved in the business...In the future, the consumer will be viewed as the primary constituent.”¹ Table 5.1 lays out some of the characteristics of the consumer protection model of regulation. There are three reasons for commissions to focus more attention on consumer protection issues.

¹ Nicholas Allard as cited in Jenna Greene, “FCC, Facing Critics, Starts to Send New Signals,” CalLaw, August 13, 1999 available at www.callaw.com.

Table 5.1

Consumer Protection	
Reasons for commissions to focus on consumers of service	Diminishing responsibility for other stakeholder groups, proliferation of service offerings and service providers, opportunities for fraud and abuse in developing markets
Focus	Protection of consumers from external and internal market failure
Tools: external market failure	Market monitoring, analysis, research
Tools: internal market failure	Licensing, establishment of standards, response to deceptive and unfair practices, umpiring disputes
Issue evolution for commissions	From exclusive reliance on consumer protection, to a mix of protection and enabling consumers in developing markets, to an emphasis on enabling with some protection in mature markets
Reasons to maintain the consumer protection function at commissions	Expertise in the field, consumer protection and complaint handling infrastructure in place, inability to separate consumer protection from other commission functions, commission credibility

Source: Author's construct.

First, the role of protecting consumers is one that may fall naturally to public utility commissions as some of the groups traditionally protected by state commissions fall beyond the scope of commission oversight. Under the traditional regulatory model, public utility commission "customers" included an

array of parties ranging across utility shareholders, bondholders, managers, large business customers, small business customers, and residential consumers. Satisfying this diverse array of interests was difficult, and, in fact, commissions attempted to find a balance between these interests so that no party was inordinately advantaged while another was inordinately disadvantaged. Under this model it was unlikely that any commission customer would ever get all that it wanted, a factor that complicated the ability of commissions to gather stakeholder support if the commission was threatened.

As utility markets become more competitive, some portions of this array of commission customers falls away, left to fend for themselves. Utility owners and managers, freed to compete for higher rates of return than those allowed under regulation, are no longer subject as well to commission protection or guarantees. Large utility service users are generally regarded as having the resources and knowledge to act in their own best interests in more competitive markets. Those who remain under the benevolent wing of the regulatory commissions are residential and small business consumers.

Second, few new entrants to emerging or partly competitive utility markets are likely to attempt to gain a competitive advantage over incumbents through head-to-head competition. Head-to-head competition takes tremendous resources. It is likely that some new entrants will attempt to find niches within which they can unseat incumbents. To do so, they will attempt to add unique value to their service offerings. The telecommunications industry has already seen an explosion of service offerings, which include caller-ID, call-waiting, last-number-dialed, and internet connectivity. Indeed, the principal benefit of competition in utility markets may be an increase in service value rather than a decline in commodity prices.

As service offerings become more diverse, as utility service providers increase in number, and as more varied organizations become a part of the

service delivery mix, it may become more difficult for regulatory commissions to define or even identify service providers. The recipient of the service, however, will remain clear and easily identified. To accomplish public purposes, the focus of commissions will need, therefore, to shift from utility providers to utility service recipients. For example, telecommunications universal service subsidies are currently provided to utility service providers. If providers are difficult to identify, universal service subsidies could be provided to consumers much in the same way food stamps are provided directly to the consumer of the service rather than the producer or supplier.

Third, even the most vigorous proponents of competition usually admit that, even in competitive utility markets, consumers must be protected from fraud and deception. As these markets emerge there will be ample opportunity for unscrupulous operators to deceive the public to their own advantage, and the price and quality signals that allow mature markets to operate may not always be clear without commission oversight. Many also argue that some consumer niches may never be fully able to thrive in competitive markets without assistance and protection. In many cases, those consumers who feel disadvantaged or subject to fraud will seek out the public service commission as their most advantageous means of recourse. Monitoring markets to assure that they remain competitive is also a consumer protection function that commissions may assume.

This chapter pursues the commission change in focus from providers to consumers and explores the consumer protection model of commission operations. It examines the evolution of consumer protection, explores the commission role of protecting consumers from external and internal market failures, and explores the proper assignment of consumer protection activities within state government.

This commission mission is, in many respects, not new to commissions. Commissions have always fielded consumer complaints and pursued those attempting to defraud consumers. The difference today is the emphasis being placed on consumer protection as a central, if not the central, mission of commissions. This expansion of the consumer protection missions is well under way at many state commissions and has been placed near the top of the agenda of the National Association of Regulatory Utility Commissioners.

The Evolution of the Commission Consumer Protection Role

Under traditional public utility regulation, consumers had little power, and the principal role of public utility regulation was their protection from the abuses of monopoly providers. When it was concluded by some that commission regulation failed to adequately protect certain consumer groups, organizations such as The Utility Reform Network (TURN) in California were formed to provide more aggressive advocacy for consumer interests than was possible by utility commissions, which were, as mentioned earlier, mandated to serve the entire spectrum of interests, as was discussed earlier in this chapter.

Under traditional regulation, consumer protection, both by advocacy groups and commissions, was focused on the protection of consumers from external market failures. These external failures were created by the fact that there was not in place a market structure that allowed customers to have a full range of suppliers from which to choose; workable competition did not exist.² As will be discussed later in this chapter, protection of consumers from external

² Robert Burns et al., *Market Analysis of Public Utilities: The Now and Future Role of State Commissions*, (Columbus, OH: National Regulatory Research Institute, 1999), 2.

market failures will continue to occupy the attention of public utility commissions, though its relative importance may change in the future.

The movement toward introducing more competition into utility markets is an attempt to eliminate these external market failures through other means than economic regulation. If workably competitive markets could be created, external market failure, of the type that was the focus of commission regulation for nearly 100 years, so the theory goes, would disappear. Some argued that the elimination of the potential for external market failure would eliminate the need for commission regulation.

But the introduction of workably competitive markets has been slow, if not stalled for many utility services. In many areas, external market failures persist. But even if, or when, workably competitive markets ameliorate the need for commissions to attend to external market failure, commissions will still need to attend to consumer protection. In fact, if anything, commission attention to consumer protection will increase. Commissions will begin to focus more of their attention, however, on addressing internal market failures. Internal market failures result from unfair trade practices that are also violations of consumer protection laws in most states.³ They include covert coercion, undue influence, deception, incomplete information, or needlessly confusing information.⁴ The most recent activities in commission consumer protection (i.e., attention to slamming and cramming) fit into these categories.

The commission concern over external market failures is now likely to be supplanted with a growing concern over internal market failures. The tools and skills used will differ. Under traditional regulation, the entire commission

³ *Ibid.*, 3.

⁴ *Ibid.*

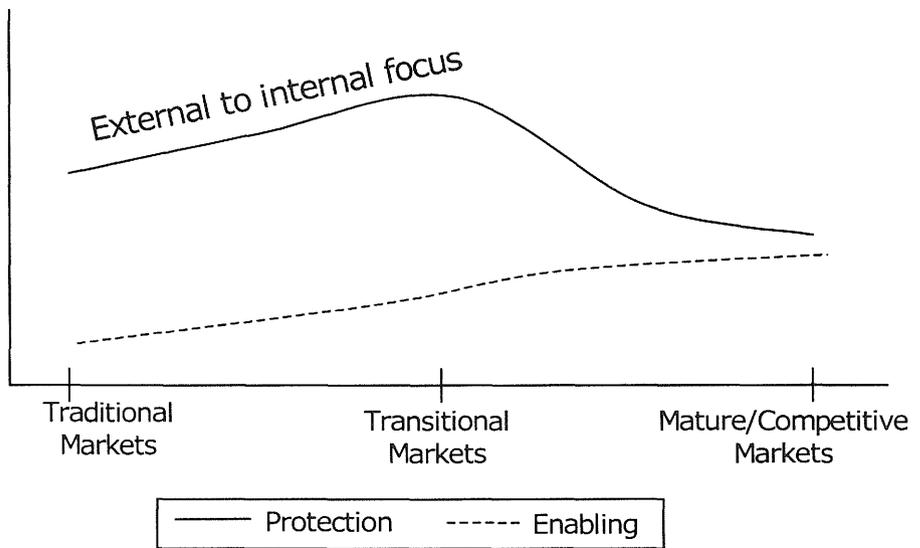
regulatory regime, which included all the tools of ratemaking, was directed at protecting consumers from external market failures by creating utility rates that substituted for market-determined rates. With increased competition, commissions will need to replace these traditional tools of ratemaking with increased market monitoring and analysis. The protection of consumers from internal market failure requires specialized skills, such as complaint handling, investigation, and the provision of information to consumers, that commissions may not have relied on in the past.

With the movement from the protection of consumers from external to internal market failures comes a second commission movement from protecting consumers to enabling consumers. “Protection” assumes that consumers are pawns in the face of utility providers and service decisions. But to what extent do consumers need to be protected? An earlier chapter in this report (Chapter 3 – Regulation by Information) presented the case for enabling consumers, that is providing them with the tools to make wise choices in competitive markets.

It can be argued that, while enabling consumers is the ultimate goal, protecting consumers will remain a high and necessary priority in transitional markets and a lesser priority even in mostly competitive markets. Consumers who have been dependent on public utility regulation as a proxy for making choices cannot be expected to quickly and easily make the transition to being fully informed consumers. It can also be expected that transitional markets will provide more opportunities for consumer abuse than fully developed ones. The early experience of partly competitive telecommunications markets has provided interesting examples of how unscrupulous parties can deceive consumers.

Figure 5.1 summarizes the potential relationship between commission consumer protection, enabling consumers, external market failure, and internal market failure. In traditional utility markets, those in existence for the past 100 years, commissions focused the majority of their resources on consumer

Figure 5.1
The Evolution of Commission Consumer Protection Roles



Source: Author's construct.

protection and little attention on enabling consumers, believing that consumers were structurally impeded from having any say over utility service offerings in the face of monopoly service provision. The attention of commissions was directed largely at providing a proxy for effective markets.

With the transition to competition, the era we are in at present, commission consumer protection efforts increased even though less attention is being paid to rate setting and market proxy activities. Commissions now are turning their attention to policing the abuses of these emerging markets and handling consumer complaints, which have grown significantly. One state commission reported a 700 percent increase in consumer complaints; other states are building call-centers and channeling resources into enforcement of anti-abuse provisions of their statutes. Others are considering ways to link customer complaints and analysis to determine the need for anti-abuse policy. As policy makers create conditions for competitive markets, they are also committing resources to educating consumers to make good choices in these new markets. These consumer enabling activities include the use of television advertisements, radio spots, and brochures, often in multiple languages.

What consumer protection activities will commissions undertake in the future? Figure 5.1 suggests that, if markets reach maturity (that is, if consumers are provided an array of competitive choices with clear price and quality signals), consumer protection activities will be reduced, though not eliminated. All but the most perfect economic markets will provide opportunities for consumer abuse and internal market failure. Commission-initiated consumer enabling activities may also wane to some extent as consumers become savvy shoppers and markets become transparent. Some consumer education may still be necessary in the foreseeable future as niche groups of consumers are provided the tools to participate in utility markets. As will be discussed later in this chapter, commissions will continue to monitor markets to ensure that external market failure does not develop due to market concentration or other factors. The types of consumer protection activities commissions might engage in are detailed in the following two sections.

Ongoing Protection of Consumers from External Market Failure

There are public interests embedded in utility service delivery, interests like universal service, safety, reliability, and economic development. As a result, it is unlikely that policy makers will (or should) turn the oversight of the utility service delivery system exclusively over to the private sector. At a minimum, public utility commissions will need to maintain a monitoring function to ensure that external market failures do not compromise the service delivery system.

Robert Burns suggests that commission monitoring activities include conducting an ongoing form of market analysis that is more complete and dynamic than what has traditionally been done.⁵ He suggests that commissions might address the following questions:⁶

- Are there regulatory barriers of entry that could be eased for competitors?
- Is the incumbent or its affiliate shifting costs to core customers?
- Is the incumbent in some manner raising the costs of competitors?
- Is there any form of exclusionary conduct that disfavors competitors in their efforts to provide service?
- Is the incumbent or its affiliate finding a way to covertly coerce customers to choose them?
- Are they exercising undue influence or deception?

⁵ Ibid., 4.

⁶ Ibid., 4-5.

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- Are they providing incomplete or needlessly confusing information about the customer choice process or other competitors?

In order to address the problems implied by these questions, Burns notes that commissions might need to determine the expectations for service delivery in each sector, create strategies that would mitigate or offset potential cost-shifting problems (e.g., accounting separations, functional unbundling, corporate or structural separation, affiliate codes of conduct, and divestiture of competitive service assets), consider market codes of conduct, and identify what information is needed for market analyses of each utility service market.⁷

Harry Trebing argues that those protecting consumers need to undertake an eight part research program to ensure that utility markets function appropriately in an era of utility deregulation. Those eight research agenda components are:⁸

- Oligopoly must be monitored.
- Price cap regulation must be subject to truing-up to bring prices into line with costs on a periodic basis.
- If full structural separation is not attainable, the governance of electricity and natural gas networks must be broadened to include representation from consumer and environmental groups.
- Large marketers will pose a challenge when achieving a position of geographic dominance sufficient to qualify them as virtual utilities.

⁷ Ibid., 6.

⁸ Harry M. Trebing, "New Challenges for the Consumer Movement in an Era of Deregulation," *NRRI Quarterly Bulletin*, Vol. 19 No. 4, Winter 1999, 433-434.

- Consumer activists should seek to establish yardsticks to review the performance of marketers, procurement aggregators, and successful bidders if auctioning is attempted.
- Reform experiments in different regions should be reviewed for applicability at home.
- The transmission and distribution network for electricity could be examined in terms of the criteria for expanding and pricing that network.
- Research into a number of social and public issues is needed. These issues include analysis of the distributional consequences of various options for funding universal service and the promotion of environmental goals.

Though not all commissions will embrace all of these suggested areas of investigation, market monitoring will require constant vigilance and extensive resources and analytic skills.

Protection of Consumers from Internal Market Failures

According to Barbara Alexander:⁹

Consumer protection issues are crucial to the move from monopoly regulation of electric and gas utilities to a competitive market for generation services. Most participants in the restructuring debate agree that the general public will not consider the prospect of theoretically lower prices in the future as a

⁹ Barbara Alexander, "Executive Summary: Blueprint for Consumer Protection," *NRRI Quarterly Bulletin*, Vol. 19 No.4, Winter 1999, 435.

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sufficient tradeoff if the new market also means an increase in fraud, customer confusion, complaints and inability to understand and participate in the new market structure.

State public utility commissions have taken on this challenge of ensuring that internal market failure does not compromise the movement toward more competitive markets or disadvantage consumers once those markets have been established. The staff of the California Public Utilities Commission has recommended that the following guidelines be established for (and priorities assigned to) consumer protection issues:¹⁰

- Danger to public safety
- Consumer fraud or abuse
- Utility actions that imperil the “level playing field”
- Utility violations of Commission instructions (i.e., more routine failures to carry out orders.

Commissions typically target their consumer protection activities toward residential and small business consumers, in part due to their sheer numbers and in part due to the fact that they have less time, money, or expertise than other consumers and are, therefore, more likely to be victimized.¹¹ In order to protect these consumers, commissions should be prepared to set criteria for licensing as a screening function to reinforce standards or norms defined in regulations; respond quickly to unfair and deceptive marketing and advertising

¹⁰ Staff of the California Public Utilities Commission, “Consumer Protection Roles and Responsibilities,” *NRRI Quarterly Bulletin*, Vol. 19 No.4, Winter 1999, 412.

¹¹ *Ibid.*, 408.

practices; and umpire disputes between competitors and between customers and their suppliers.¹²

To date, slamming and cramming have provided commissions an opportunity to hone their consumer protection skills in emerging utility markets. Among other lessons learned by commissions about consumer protection and responsiveness to consumers are that, if possible, consumers who call commissions should be contacted with a “live” person; consumer complaints should be tracked electronically to ensure that they have been responded to in a timely manner; consumer affairs staff should be trained in the provision of customer service; customer complaint data should be compiled, validated, and published; other commission divisions should ensure that providers are complying with commission rules; and minimum and consistent consumer protection rules should be adopted for both the telecommunications and energy industries so that consumers can understand their rights and responsibilities.¹³

**Closing Comments:
Assigning Consumer Protection Functions to Another Agency**

It is sometimes suggested that the protection of consumers in utility markets is a legitimate function but that it should be assigned to other state agencies, like the Office of the Attorney General, the Consumers’ Counsel (where one exists), or even social welfare agencies for certain purposes like universal service protection for customer niches. These arguments are

¹² Alexander, “Executive Summary: Blueprint for Consumer Protection,” 439.

¹³ These lessons have been adapted from Staff of the California Public Utilities Commission, “Consumer Protection Roles and Responsibilities,” *NRRI Quarterly Bulletin*, Vol. 19 No.4, Winter 1999, 413-419.

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commonly based on the argument that the principal function and expertise of public utility commissions is economic regulation. There are legitimate reasons, however, for the protection of utility service consumers to remain at public service commissions. Those reasons include:

- Commissions have a vast reservoir of expertise in this technologically complex field. Any other agency would need to develop expertise over time.
- Commissions have built a consumer protection and consumer complaint handling infrastructure that would need to be transferred to another agency with some disruption or replicated.
- The consumer protection function cannot be easily separated from other commission functions like enforcement. At least one commission, for example, has attempted to evaluate complaint data to identify the need for policy. Robert Burns and his co-authors suggest that commissions should utilize data from consumer complaints as a major source of information to determine where internal and external market failures are occurring and engage in appropriate remedial policy making.¹⁴
- Commissions have built substantial credibility with consumers and are typically associated in the minds of consumers with utility industry questions.

Even though an argument can be made for commissions to retain consumer protection functions, the commission of the future is not likely to operate autonomously. Other agencies will have an interest in aspects

¹⁴ Burns et al., *Market Analysis of Public Utilities: The Now and Future Role of State Commissions*.

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of utility oversight and may have expertise that may be useful to the commission. Where possible, alliances should be formed with them in pursuit of the public interest.

CHAPTER 6

CONCLUDING COMMENTS

This report has detailed four potential new roles for commissions but has not recommended that any one of those roles would ever completely serve commissions. Indeed, it is argued that commissions will craft a mixture of these roles that best fit state needs. The pace of technological change makes any prediction of the future difficult. Prediction is made even more complex by the fact that markets in each of the four utility sectors will evolve at different rates. The point, however, of this analysis is that utility markets will change, perhaps in fairly dramatic ways, and that public utility commissions, in order to serve the public as the market evolves, will also have to evolve and change the mix of methods and regulatory models they rely on.

Nor is it important that any of the new models proposed here for commission operations rule the day. These models are, in effect, visions for a future for public utility commissions, a future in which they continue to serve the public interest. Organizational visions combine three necessary elements: 1) an organization's fundamental reason for existence, 2) its timeless, unchanging core values, and 3) huge and audacious, but ultimately achievable, aspirations for its own future.¹ If commissions are to make their way through these tumultuous times, they will need visions that provide these three essential

¹ Jim Collins, "Aligning Action and Values," in Frances Hesselbein and Paul M. Cohen, Editors, *Leader to Leader: Enduring Insights from the Drucker Foundation's Award Winning Journal* (San Francisco, CA: Jossey-Bass Publishers, 1999), 237-238.

elements, if not the ones proposed in this report, then others to help them face the future and craft new ways of operating that will guarantee their relevance.

Though a multitude of visions might be crafted and a variety of commission futures envisioned, it is fairly clear that:

- Commissions will share the “regulatory space” with other organizations and agencies. The regulatory monopoly is gone, though monopoly markets will remain for at least some time in distribution and network functions. Many other players, including legislators, want to have a say in the development of utility markets and policies. Commissions will need to form alliances with them that make optimal use of the unique skills of each group.
- Information exchanges will increase in importance. In the past, consumers did not need much information about utility service, and utility and commission information exchanges were constricted into narrow information “pipes.” In the future, the stock-in-trade for consumers, incumbents, competitors, and regulators will be information derived from a variety of sources.
- The power of regulatory agencies (and their longevity) will be based on their effectiveness rather than on their statutory base. Credibility will count more than authority, though baseline authority is a precondition for success.
- Oversight of public utility service provision will continue to be necessary. Even if markets become workably competitive, there are public interests embedded in utility service, interests like safety, universal service, economic development, reliability, and environmental considerations.

A core question is whether or not the changes suggested in this report can be accomplished within existing administrative frameworks and the extension of current practices or require changes in state statute. Many believe that there is considerable room within current administrative law for significant

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change; others are more skeptical. The answer probably varies by state. What is clear is that substantial changes need to be made in the perceptions of those who oversee regulatory commissions. Unless they can be convinced that regulatory commissions are able to be effective and responsive, the future for commissions may not be bright.

Jean-Jacques Rousseau said, "There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success than to take the lead in the introduction of a new order of things." This is the challenge for public utility commissions—to create a new order of things—for the industries they oversee and for the commissions themselves. These are exciting times for commissions, but times that may cause some disruption and will certainly be shrouded in uncertainty. Public utility commissions should take heart in the fact that they have been successful in the past; with persistence and creativity, they will be successful in the future.

