



National Regulatory
Research Institute

Effective Regulation: Do We Have What It Takes?

**Scott Hempling, Esq.
Executive Director
National Regulatory Research Institute**

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Scott Hempling, Esq.¹
Executive Director
National Regulatory Research Institute

Introduction

My 25 years in utility regulation have coincided with an immense increase in issue complexity. There has been a commensurate expansion in regulators' roles and responsibilities.

In the late 1970s, utilities built infrastructure, sold energy, proposed rate increases. Commissions approved projects and set rates. At a dinner party, a regulator could answer the "What do *you* do?" question with a single sentence: "We protect customers from monopoly abuse—from inefficiency, sloth, cost overruns, excessive rates."

Today, regulators are not only consumer protectors. They are market makers, program designers, investment fund collectors, renewable energy incubators, energy efficiency promoters, hosts of interest group gatherings, resolvers of stakeholder differences, even political shields for executives and legislators paralyzed by the complexity of it all.

Embodying this tectonic shift is your Green Energy Act. The Act requires the Board to:

1. establish interconnection requirements and arbitrate interconnection disputes,
2. set mandatory conservation targets for distributors,
3. anticipate and address affiliate abuses,
4. promote renewable energy generally,
5. oversee planning and development of smart grid,
6. determine the infrastructure requirements necessary to accommodate the government's conservation and renewable energy goals,
7. collect funds for conservation and renewables programs, and
8. allocate cost responsibility for the new initiatives.

¹ B.A. *cum laude*, Yale University (Economics and Political Science, Music); J.D. *magna cum laude*, Georgetown University Law Center. Comments on this piece are welcome. Please send to shempling@nrri.org. The views expressed are solely the author's.

This list is not exhaustive. Thirty years ago, no one would have predicted this array of responsibilities.

What do these changes require for the practice of regulation? On a personal level, what must regulators be, and what must they do, to be effective? On the institutional level, how should we organize our resources to achieve these governmental goals?

To address these questions, I will cover two major subjects:

- I. **Attributes of Effective Regulators: Purposefulness, Decisiveness, and Independence**
- II. **Evidence of Effective Regulation: Do Successful Regulators "Balance" and "Preside," or Do They Demand Performance and Lead?**

After discussing these two areas, I will close with some suggestions on how to achieve success.

I. **Attributes of Effective Regulators: Purposefulness, Decisiveness, and Independence**

A. **Purposefulness**

The purposeful regulator defines her purpose. Regulatory statutes require regulators to make decisions "consistent with the public interest." This command presumes that private interests diverge from the public interest. Public regulation is necessary to align private behavior with the public interest.

The purposeful regulator starts by defining "the public interest." The phrase "public interest" has multiple possible meanings. Its breadth invites flexibility. But flexibility demands discipline; otherwise, we get arbitrariness, inconsistency, and unpredictability. The purposeful regulator—the disciplined regulator—defines "public interest" with clarity, and applies that definition consistently.

My own definition of "public interest" is a composite of economic efficiency, sympathetic gradualism, and political accountability.

Economic efficiency means biggest bang for the buck. In economic regulation, it means achieving the best feasible benefit-cost ratio. Consider the opposite: An inefficient outcome means someone foregoes something attainable. That is not a public interest outcome.

Sympathetic gradualism means smoothing economic efficiency's hard edges. Benefit-cost calculation is sometimes unsympathetic to citizens' short-term situations. Sympathetic gradualism means moderating efficiency's short-term pain to preserve the public acceptability necessary to long-term gain.

Political accountability means that the regulator must create political acceptance of the principles of economic efficiency and sympathetic gradualism. Political accountability does not mean caving in to interest groups. It means educating and explaining, adjusting the angle of change without compromising the core.

Understanding this difference between accommodating private and advancing the public interest is the prerequisite for purposefulness.

The purposeful regulator next understands how private interests diverge from the public interest. Absent this understanding, the regulator too easily slips into a role of placating private interests rather than advancing the public interest.

Regulation affects many private interests. Examples:

1. utility (profit maximization, market share maintenance, market share growth, solid community reputation)
2. utility CEO (all of the above, plus high salary, career enhancement, job satisfaction)
3. nonutility competitors (market entry, market share, access to bottlenecks)
4. consumer (reasonable prices, reliable service, responsive customer relations, community presence)
5. labor (reasonable wages, job stability, job satisfaction)
6. environmental organizations (clean environment, utility leadership on environmental issues)
7. shareholders (growth in company value, share price growth, financial stability, dividends)
8. bondholders (cash flow, interest coverages, conservative business aims, non-delinquency)

The public interest can accommodate these private interests—in their legitimate form. But private interests can tend toward the illegitimate—consumers' desire for below-cost power prices and above-average reliability, investor desires for above-market returns and below-market risks, management desires for market domination. The purposeful regulator grasps the difference between legitimate and illegitimate interests, honoring the former and avoiding the latter. The purposeful regulator establishes a centrifugal force, one that disciplines private expectations and hems in private behavior. That centrifugal force is the public interest.

B. Decisiveness

It has been a stereotype of political wisdom that the bureaucrat is ever ready to exercise authority arbitrarily. But there is the far greater danger that the second-rate, insecure personality who often finds his way into bureaucracy will become uncomfortable at having to exercise authority and will anxiously seek to placate as many interests as possible. This fear to offend, complaisance, and readiness to listen and be "fair" and "reasonable" clog the muscles of the will, and what begins in amiability can end in corruption.

L. Jaffe, "The Scandal in TV Licensing," copyright 1957 by *Harper's Magazine*, Inc. Quoted in A. Kahn, *The Economics of Regulation*, Vol. II at 88 n.122 (1988 ed.).

The decisive regulator makes decisions (1) required by the public interest, (2) when the public interest requires it, (3) using an active approach, (4) regardless of the discomfort felt.

1. "Required by the public interest": So much of regulation is driven by requests: rate increases, merger proposals, certificate seekers, siting proposals. The public interest is not the sum of these private requests. The decisive regulator asks not "What do these parties want?" but "What decisions does the public interest require?" Rather than answering only the questions posed by private parties, she identifies the questions no one has asked. She thus converts private pleadings into public interest dockets: investigations, inquiries, and rulemakings.

2. "When the public interest requires it": Decision avoiders speak in code: "We have to be cautious." "We don't want to box ourselves in." "Let's not get ahead of the other states." These words do not explain, or excuse, indecisiveness. I sometimes ask commissioners why their commission has no merger policy. I get one of two answers: "We have no merger pending, so we don't care about it" or "We have a merger pending, so we can't talk about it." Twenty years and dozens of mergers later, this regulatory indecisiveness has produced an incoherent series of opportunistic transactions rather than coherent, competitive market structures.

Decisiveness is not impulsiveness. Decisiveness includes deciding to inquire: "It has been ten years since anyone examined the mix of competition and regulation. Every five years we should reexamine. Let's begin." Like geological sediments, today's regulatory procedures comprise layer on layer of historic habit. The decisive regulator questions the status quo. She asks continuously, "Why do we do things the way we do?" and "Why not try another way?"

3. "Using an active approach": Analogizing to boxing, the regulatory legend Peter Bradford described a hierarchy of regulatory decisiveness: Rocky, Rope-a-Hope, and Canvasback. "Gorillas in the Mist: Electric Utility Mergers in Light of State Restructuring Goals," *NRRI Quarterly Bulletin* Vol. 18 No. 1. Lacking Bradford's metaphorical gifts, I will call these decisionmaking styles *active*, *reactive*, and *passive*.

The *active* decisionmaker asks her own questions and directs parties to answer them. This approach converts private requests into public interest inquiries. To avoid bogging herself down in parties' current filings, she refocuses them on future consequences.

The *reactive* regulator responds to the parties' questions, but does not direct the parties to answer her questions. Reactive decisionmaking involves some thoughtfulness, but is bounded by the parties' requests. Consider mergers. Reactive regulators ask "Is there any harm?" Active regulators ask: "What industry structure most likely will align private behavior with public interest?"

The *passive* regulator grants parties' requests without independent thought. The indecisive regulator can cover up passivity with wig-and-scepter sentences like "We find that the opponents' speculation does not satisfy their burden of proof." The real burden of public interest promotion belongs with the regulator, not with the opponent.

For those seeking an active approach, John F. Kennedy's inaugural speech, paraphrased, remains a reasonable guide. The active regulator tells parties: Ask not how regulation can advance your private interest; ask how your private behavior can serve the public interest.

4. "Regardless of the discomfort felt": In 1999, I was testifying before a state legislature, which was under pressure to pass legislation on retail electricity competition. Due to term limits, over half the legislature was new. One legislative leader complained to me, "Making novice legislators address an issue so complicated is unfair." Unfair to whom? Inexperience cannot excuse indecision. Decisiveness attaches to the oath of office.

Discomfort with decisiveness does have honest roots. The average regulator has only a few years' experience. Even the most experienced regulators face challenges without precedent. For honest regulators, inexperience breeds humility; humility breeds caution; caution, unguided, becomes indecisiveness. In a docket-driven environment, indecisiveness leads to reactivity. Policymaking becomes not the promotion of public interest but the sum of the approvals and disapprovals of private interest requests.

So what does the decisive-but-inexperienced regulator do? Decide only what one is competent to decide; for the remaining issues, put them on an accountable timeline, become competent, and decide. Instead of the platitudinous phrase "Now is not the time," try "We will master this issue and decide by April."

C. Independence

The third attribute of effectiveness is independence. But independence from what? If we are casual with the concept we will not appreciate its power. I will distinguish literal independence (unachievable, undesirable) from effective independence (essential, but hard to achieve).

1. *Literal independence:* Literal independence is unachievable. Court challenges, legislative overrides, financial markets, and public ire: These four pressures constrain independence, but they inject accountability.

Court challenges: To avoid judicial reversal, regulators must respect substantive and procedural statutes, root their decisions in the record, reason logically and clearly, and explain departures from precedent.

Legislative override: The commission is a delegate of the legislature, never fully independent of it. The breadth of the delegation—the extent of commission discretion—depends on legislative trust: trust that the judgment, expertise, and speed necessary for regulatory decisions is achieved best by a separate entity.

Financial markets: Utilities are capital-intensive. Capital intensity means capital dependency. The suppliers of debt and equity do not always act rationally, patiently, farsightedly, or public-spiritedly, but their confidence in commissions is essential to utility survival. The regulator cannot ignore their demands.

Public ire: The regulatory ideal of pure objectivity, pure merit, pure facts, and pure logic does not exist. Our discussion of purposefulness pointed out that the public interest has many components—health, safety, economic survival, environment, long-term interests, short-term interests—many of which conflict with each other. Regulators must maximize the totality of these interests at reasonable cost. Then regulators must defend their decisions before a public whose irritability exceeds its expertise. The possibility of public ire thus induces responsible decisions and clear explanations.

Because these four pressures are unavoidable, literal independence is unachievable. It is unachievable because the regulator is only one of many actors. Courts overturn, legislatures change their laws (e.g., replacing "just and reasonable" with "rates shall be fixed for five years"), lenders lower bond ratings (e.g., because a commission disallows imprudent costs), large customers self-generate (a response to high rates, but resulting in higher rates for the customers left behind). Literal independence is unachievable because the regulator must anticipate these actions.

Literal independence is undesirable. No regulator should be independent of the forces that make democracy work: legislative mandates, professional accountability, judicial review, administrative procedures, ethical obligations, engineering principles, economic principles, financial realities. A regulator who acts in ignorance of others' reactions becomes a passenger in someone else's airplane.

2. *Effective independence:* Literal independence is undesirable because some constraining pressures induce accountability to the public. Effective independence means independence from forces that reduce accountability, forces that attack the purpose of regulation.

What forces, then, block the alignment of private behavior with public interest? At minimum, a regulator must be independent of financial or employment inducements (although

professional ambition does not undermine independence if that ambition is connected to public interest purposes). But there is more. A regulator's decisionmaking should be independent of arguments that are unverifiable (e.g., "An authorized return on equity below 14% will cripple us"); or legally irrelevant (e.g., "We need this merger to remain competitive"). Regulators also must be independent of adjectives, adverbs, and other phrases aimed more at emotions than intellect (e.g., "chilling effect," "rate shock," "rate relief").

Independence is assisted, paradoxically, by attentiveness to the forces that undermine independence. The maxim of Machiavelli's imitators—"Keep your friends close and your enemies closer"—applies here. Attentiveness does not mean selling out; it means studying and monitoring the parties' motivations so as to spot and exploit opportunities to align those motivations with the regulatory purpose.

Independence does not mean independence from one's own pre-existing views. Independent regulators have active minds. They have hunches. A hunch is not a bias. A bias is an inability or unwillingness to examine facts and reason objectively. A hunch is a tentative conclusion, based on education, observation, and experience. No one wants a regulatory bench who says, "My mind is a complete blank." The independent regulatory mind is not blank; it is full of experiences, prior readings, stray facts diligently and casually acquired. These experiences, readings, and facts produce hunches. Hunches are unavoidable and useful—as long as the regulator establishes a systematic, objective method for testing them, on the record.

II. Evidence of Effective Regulation: Do Successful Regulators "Balance" and "Preside," or Do They Demand Performance and Lead?

A. Commissions are not courts; regulators are not judges

1. Animal, vegetable, or mineral: What is a regulatory commission?

Newcomers to regulation are not newcomers to government. They understand "executive branch," "legislative branch," "judicial branch." But they wonder, "What exactly are we?" The tendency is to emulate the familiar. An attractive option is the judicial branch. Judges sit on benches, await the parties' disputes, use adversarial processes, find facts, then apply law to those facts.

But to view the commission as a court—to "preside"—undermines regulatory effectiveness by creating undue dependency on private parties.

2. How do commissions differ from courts? A commission's purpose derives from its origins. In the United States, a state legislature receives lawmaking powers from the state constitution. The legislature then creates a commission and delegates to it specified powers. Those powers are some substantive slice of the legislature's own lawmaking powers. That delegation of authority consists of commands coupled with standards—verbs coupled with adjectives and objects: set just and reasonable rates, ensure reliable service, allow mergers if consistent with the public interest. Common to these commands and standards is a single legislative purpose: Within a defined substantive space, make policy for the public interest.

Courts and commissions do have commonalities. Both make decisions that bind parties. Both base decisions on evidentiary records created through adversarial truth-testing. Both exercise powers bounded by legislative line-drawing.

But the differences are larger: Courts do not seek problems to solve; they wait for parties' complaints. Contrast a commission, whose public interest mandate means it literally looks for trouble. Courts are confined to violations of law, but commissions are compelled to advance the public welfare. Even the narrowest of commission decisions—say, addressing a special contract between a utility and its industrial customer—affects a public interest larger than the parties. Will the low contract price shift costs to other customers or weaken the utility's finances? Will the lucky buyer's competitors seek the same treatment? To what effect?

Court decisions can have policymaking attributes. A class action suit under the civil rights or securities laws, an antitrust suit against a Microsoft or an AT&T, can set policy for a generation. But consider this difference: In courts, the judge's power to act is confined to the issues stated by parties. In commissions, the complaint is stimulation but not limitation. The commission can add issues, combine it with other cases, invite or require the appearance of other parties, convert a two-party complaint into a multi-party rulemaking—all as the public interest demands.

So what is a regulatory body—animal, vegetable, or mineral? A commission does look like all three branches: like a legislature when promulgating rules and standards; like an executive agency when investigating and enforcing; like a court when ruling on complaints. But utility commissions are not "like" anything; they are what they are: units of government created to carry out powers delegated to the legislature by the Constitution, then re-delegated by the legislature to the commission. They make policy for the public.

3. How does "acting like a judge" undermine a regulator's effectiveness?

Notwithstanding these differences between court and commission, I know many regulators who prefer to preside (like judges) rather than lead (like commissioners). This is a problem, for several reasons.

A regulator-acting-as-judge assumes that the parties, their interests, and their arguments constitute the full intellectual universe requiring regulatory attention. This assumption is built on five premises, each one wrong:

1. that the scatter plot of private interests will display some pattern from which to determine the public interest;
2. that the public interest is synonymous with the satisfaction of private interests;
3. that the private interests' strategic evidentiary submissions will produce information sufficient to discern the public interest;

4. that the opportunity for access equals the reality of access; i.e., that all possible private interests have hearing room resources sufficient to get the commission's ear; and
5. that through the "*sturm und drang*" of private interest opposition, the "truth" will emerge.

By accepting any of these five premises, a commission undermines its effectiveness in five ways:

1. by inducing intellectual passivity—making the proceedings and the record party-centric rather than public-centric ("What are the parties seeking?" instead of "How do I advance the public interest?");
2. by responding to the parties' short-term needs instead of the public's long-term interest;
3. by depriving the regulator of objective education (because the regulator "learns the issues" from parties' arguments rather than objective sources);
4. by distorting the regulator's time management (because as the parties load the record with conversation among themselves—testimony, cross-examination and briefs four ways (direct, reply, answering and cross-answering)—procedural law compels the regulator to peruse every page, leaving her insufficient time and mental space to read and think on her own); and
5. by substituting private settlements for public interest solutions. (Regulation, unlike marital dissolutions or fender benders, requires policymaking, not dispute resolution.)

B. The regulatory mission: Do we "balance" private interests, or do we align them with the public interest?

A newly appointed assistant to a newly elected commissioner, both new to utility regulation, told me she's asked her commission staff, "What is our mission?" The answer she received: "We balance the interests of customers and investors." This notion of regulation-as-private-interest-balancing, so deeply embedded in regulatory conversation, practice, and psyche, has at least five problems: *ambiguity, nearsightedness, presumption of conflict, passivity, and legal looseness.*

1. Ambiguity: "We balance the interests of consumers and investors." Which consumers—large or small? Today's or tomorrow's? Our state's, our region's, or our nation's? Which interests? Short-term or long-term? The interest in low rates or the interest in a viable supplier? Which investors? Buy-and-hold shareholders, pension funds, hedge funds, short sellers, current owners, or future owners—which shareholders? What about bondholders? Which interests—this year's profits or next decade's viability?

What balance? "Balance" implies equivalence—the precise midpoint between two interests of equal weight. Really? Are the customer-investor weightings exactly equal? Can these weightings diverge from equivalence, provided the variations "balance" over some longer period on time? What on earth do we mean by "balance"?

2. *Nearsightedness:* If utility service were merely a commercial transaction, between sole supplier and captive customer, then "balancing the interests of customers and investors" would be a logical mission (provided we resolved the dozen ambiguities discussed above). But utility service is more than a commercial transaction. It is the infrastructure supporting our economy—schools, hospitals, streetlights, manufacturing. It is a means of preserving life and the quality of life (think water shortage, electricity outage, no phone service, no streetlights, no movies). It is the 1,000-year detritus of today's consumption decisions: nuclear waste and carbon emissions from electricity generation, chemical residue from telephone pole treatment, gas pipeline leaks. The regulatory lens must be both wide-angle and long-distance. "Balancing the interests of consumers and shareholders" doesn't cut it.

3. *Presumption of conflict:* A balance presumes opposites. (Picture the "scale of justice.") The presumption is wrong. If you look at legitimate aims—viable suppliers, satisfied customers, no waste, no free lunch, reasonable prices, reasonable returns—customer interests and shareholder interests are not only consistent; they are mutually reinforcing. High-quality performance and efficient consumption benefit everyone: customers, shareholder, bondholder, employees, the environment, the nation's infrastructure.

So why this apparent need for "balance"? Because there is opposition among interests. But that opposition arises often not from legitimate aims, but from illegitimate ones: the cost-causer seeking to shift costs, the shareholder asking for excess returns. What has been regulation's response? I would like to see more regulators expose illegitimacy. Then, this assumption of opposites—which produces a preoccupation with "balance"—would self-correct. But many regulatory fora do the reverse. Rather than reject illegitimate aims, regulators often expect it, accept it, and embed it into the very core of regulatory procedure: Each party positions itself at the poles, aggrieved and relief-seeking, testimonially swearing at the other's effrontery. Then comes the wheel-dealing in private, the "settlement" (with boilerplate forbidding commission amendment), and the "approval" stamped by a boxed-in commission. So the presumption of conflict, embodied in the "balancing" mission, embedded in regulatory procedure, leads to compromises of principle rather than principled compromises. The midpoint of two private interests is still a private interest.

4. *Passivity:* A commission that balances private interests presides rather than leads. Outcomes are defined by the parties' desires, not the public's needs. The forum ends up serving the parties when the parties should be serving the forum.

5. *Legal looseness:* Regulatory proceedings are legal proceedings, bounded by statutes and constitutional law. Those legal sources do not deal in "stakeholders" and their "interests"; they create "rights" and "obligations." So the regulatory responsibility is not to balance "interests," but first to define the rights and obligations, and then to honor the rights and

enforce the obligations. A mission of "balancing the interests of customers and investors" diverts the commission from its legal obligations.²

C. **Decisional defaults: Does regulation have them backwards?**

I recommend to you the book *Nudge*, by Richard H. Thaler and Cass R. Sunstein (Yale University Press 2008). Its contribution to regulation is potentially profound.

In a section entitled "Defaults: Padding the Path of Least Resistance" (pp.83-91) the authors make four assertions:

"[I]nertia, status quo bias, and the 'yeah, whatever' heuristic are pervasive."

"All these forces imply that if, for a given choice, there is a default option—an option that will obtain if the chooser does nothing—then we can expect a large number of people to end up with that option, whether or not it is good for them."

"Defaults are ubiquitous and powerful. They are also unavoidable in the sense that for any node of a choice architecture system, there must be an associated rule that determines what happens to the decision maker if she does nothing."

"Of course, usually the answer is that if I do nothing, nothing changes; whatever is happening continues to happen. But not always."

Their illustration is organ donation. Germany and Austria have different defaults. Germany's is "opt in": a citizen's consent to donate her organ must be explicit. Austria's is "opt out": the law presumes her consent unless she declines explicitly. In these two adjacent nations, what portion of the population consents? Germany, 12 percent; Austria, 99 percent. Difference in lives saved? Thousands.

In utility regulation, what happens when a regulatory choice could make a difference, but no choice occurs? Do our defaults make sense? Let's look at four examples: energy efficiency, rate structure, commission staffing, and statutory authority.

1. Energy efficiency: Consumers under-invest in energy efficiency. They over-value upfront costs and under-value long-term benefits; they require too short a payback period; they will passively pay 18% interest on a credit card balance but miss opportunities to earn high returns by investing in home improvements that cut energy costs. Inertia is powerful—and it makes consumers worse off.

² Caveat: The occasional statute does contain a balancing-type phrase in its Preamble. In that limited context, my legal argument has less force. But even there, the interests requiring balance are the rights and obligations created by statute (which the commission must define), not the general political interests advanced by parties.

How do our public policies address this problem? For most energy-efficiency policies, the default—the "choice" if the consumer makes no choice—is to do nothing, i.e., to continue inefficiency, to be worse off. True, programs are available. But to trigger their benefits, the consumer must act: find, hire, and pay an energy auditor; choose among multiple thermostats, hot water heater covers, insulation types, window replacements; do the advanced math necessary to learn that paying now produces benefits later; find a bank and fill out loan papers; write a big check. Who on earth does any of these things when there is soccer to play and SpongeBob to watch? Opt-in is our default; as an energy-efficiency policy, it fails.

Why not switch it, making the default "opt-out"? Unless you say otherwise, a commission-vetted, independent auditor will visit your home, determine the cost-effective investments, procure the contractors and the financing, and arrange matters so that the stream of savings exceeds the stream of costs, leaving your wallet untouched but your residence's efficiency increased. Why is the default backwards?

2. Rate structure: Embedded cost rates do not send accurate price signals; time-of-use rates do. Accurate price signals produce efficient behavior, conserving resources for all citizens. Some states do have optional time-of-use rates, but inertia remains powerful. If the embedded cost rate is the wrong rate and the time-of-use rate the right rate, which is the better default? Why not make the better rate—the time-of-use rate—the default rate, so that those who want to waste energy through overconsumption have to opt out?

3. Commission staffing: How do we staff our state commissions? In most U.S. jurisdictions, the default staff structure consists of positions designed 20 to 30 years ago, when markets and transactions were simpler. When new issue challenges arise, the default is shaped by civil service rules and budget limits: We tend to shift people to new areas without sufficient education, rather than bring in new people expert in the new challenges. Which is the better default: a static, reactive structure, or anticipatory analysis? Should we not have an annual review where we ask "What are the new challenges? What skill sets will best meet those challenges? Should we retrain our existing people or must we find new people?" Hiring procedures should be as flexible as industry change requires. The default is backwards: Although industry change is certain, staff structure is largely fixed.

4. Commission statutory authority: Competitive businesses and mission-driven nonprofit organizations assess their opportunities continuously: They restructure their priorities, staffing, and resources to be at their best. The default practice is to align decisions with demands—through alertness, assessment, adjustment, and re-invention.

A commission's statutory authority needs the same constant attention. Legislatures and commissions, working together, must identify industry structures to encourage, standards of excellence to establish, economic risks to manage, innovations to induce.

But that's not our default. In many U.S. jurisdictions, the default is a century-old statute, changed episodically—when some political urgency moves a legislature to amend it. And the amendment usually adds responsibilities without resources. These episodic interventions rarely produce a coherent whole.

A better default would be a legislative requirement that every two years, commission and legislature produce a joint charter and plan. These documents would describe the challenges faced by each regulated industry, then assess the fit: between industry structure and industry performance, between commission responsibility and commission authority, and between commission obligations and commission staffing. Accompanying the document would be a draft of the statutory change reflecting all these needs.

If the goal is to adjust commission authority continuously to ensure public interest achievement, is there a better default?

D. Conclusion: Commission effectiveness—is it measurable?

Regulatory commissions are realizing that the legacy practices of processing retail utility filings and intervening in federal cases are too reactive. Commissions are concluding that effective regulation requires more purposefulness, more decisiveness, more independence, more leadership. How might we measure our progress?

Here are some thoughts on metrics, arranged by three major goals:

Goal #1: Clarify the commission's regulatory purposes: Metrics must reflect purpose. Regulation's purpose is to establish performance standards for utilities, then to enforce those standards so that utility behavior aligns with public interest. Setting standards requires multiple value judgments.

Let's start by looking inward: Has the commission made the necessary value judgments? Two examples: (1) What is the appropriate performance standard—average, superior, state-of-the-art, better-than-the-neighbor? (2) Are we confronting and resolving the vectors in tension, such as economic efficiency vs. affordability; economic development vs. environmental sensitivity, speedy decisions vs. participatory procedures? These unavoidable conflicts call for courage in the form of decisiveness. To be everything to everyone is to embrace indecision.

Another metric: Does everyone within the commission understand, absorb, and embrace the commission's value judgments? Ask yourself: If I asked each of my commission's employees (California's commission has 800) to state our regulatory purpose, our performance standards, our tension resolvers, would I get consistent answers?

Assume your commission has clear purposes, shared by all staff. Now look outward. Does the utility's performance track the commission's priorities? Does each utility company have a clear plan, accessible to the public and acceptable to the commission, to pursue and achieve the public interest? Would that utility's employees all answer the purpose question consistently? Or does the utility have a business strategy at odds with the public's needs? Then—Does each utility company carry out its public interest responsibilities plan innovatively and cost-effectively? Does the utility's internal and external culture reflect the commission's priorities? If the answers are yes, yes, and yes, then it is likely that the standard metrics (e.g., rates, quality, responsiveness) will be satisfactory.

Goal #2: Identify the regulatory challenges: Metric: Has your commission identified the main challenges and assigned resources to them?

The newest gas and electric challenges include climate change, energy efficiency, the integration of renewable energy, rate design, and regional power supply planning. And there are the traditional challenges:

market structure (do we want competition or monopolies—and for which products and services, which customer groups, which geographic territories?);

corporate structure (do we want leveraged buyouts, conglomerates, and non-integrated asset collections; or do we want local companies focused on providing essential services?);

infrastructure sufficiency (will we pay for our own wear and tear, or will we bequeath those costs to our offspring?);

rate design (is it time to remove the average-cost mask, exposing the true hourly cost of consumption?);

technological advances (who should fund the demonstration projects that produce both dry holes and breakthroughs?); and

workforce replacement and modernization (where do we find the next generation of pole-planters, tree-trimmers, and substation-designers?).

Have we done the homework necessary to meet these challenges?

Goal #3: Shape the regulatory infrastructure to meet the challenges: Regulatory excellence requires a regulatory infrastructure. There are five parts.

Authority to act: Pre-historic regulatory statutes need systematic modernization, not piecemeal revision. Enacted a century ago, then layered with the latest urgencies and opportunities, our statutes have gaps, redundancies, and asymmetries that weaken regulatory authority.

Metric: Do we have the authority we need to produce the performance we need? Do legislators look to the commission first?

Information necessary to act: Information reaches regulators unevenly. If they ask, if they have time to ask, if they think to ask, if someone chooses to supply it, if the information supplied is truthful and evenhanded.

Metric: Do we have the information, and information-gathering processes and resources, necessary to make good decisions? Do the utilities have duty to

inform? Does the commission learn of its options sufficiently ahead of a required decision to make decisions carefully? Do they fulfill that duty timely and objectively? Is there trust?

Expertise necessary to act: Traditional commission expertises are silo-based: accountants, economists, engineers, lawyers; electric, gas, telecomm, water; rate cases, mergers, service quality investigations. These expertises remain essential, but there is a risk of hammers seeing only nails.

Metric: Do our commissioners and staff have skills in multi-disciplinary thinking and multi-year strategizing?

Decisionmaking procedures leading to action: Many legacy procedures emphasize the reactive—awaiting utility filings at the state level, intervening as supplicants in federal venues. Reactivity risks prioritization-by-parties. Utilities initiate proceedings to advance business objectives. The sum of these entrepreneurial efforts does not equal public interest policy. Reactivity makes regulators captive.

Marshall McLuhan offers an analogy. If "medium is the message" (*Understanding Media: The Extensions of Man* (1964)), then procedure is the policy. The context (e.g., cinema, television, comic book, traditional book) defines the intensity of a person's participation. The procedure (adjudication, investigation, rulemaking, cross examination, multi-party panels, informal discussions, "collaboratives," commission-directed submissions) defines the level of commission alertness—and the quality of its leadership.

Metric: Policymaking is both proactive and reactive. Are we getting the mix right? Do the present procedures and workload allow the commission to lead, or only react? Do our proceedings focus on the commission's priorities or the stakeholder's priorities? Are we disposing of dockets or producing performance?

Continuous re-evaluation: Effective regulation is continuously self-critical: It examines and re-examines its infrastructure to ensure the best fit of purposes, authorities, information, expertises, and procedures to the challenges at hand.

Metric: Have we defined regulatory excellence? Are there re-evaluation criteria and procedures, a process for making mid-term corrections? When a commission approves a merger based on specified expectations of benefits, does a later commission assess the results?

III. Questions and Recommendations

A. Purposefulness

The regulator coming to work without her own purpose finds her day filled with other people's purposes. Ask yourself these questions:

1. Do you have a definition of public interest? Is it consistent with that of your fellow commissioners?
2. Have you identified the private interests appearing before you?
3. Do you understand—analytically, not judgmentally—how those private interests might diverge from the public interest, now or in the future?
4. Have you signaled to those interests your insistence on the alignment of their behavior with the public interest?
5. Have you designed your regulatory mechanisms to achieve alignment and no more than that? (Unnecessary regulation is just as troublesome as insufficient regulation.)

B. Decisiveness

Require private requests to address public interest questions by establishing advance expectations in all substantive areas. Examples:

1. For rate increase filings, require the utility to demonstrate consistency with optimal practices in all major areas of its business.
2. For rate decrease filings, require the consumer advocate to propose programs by which consumers will use service efficiently.
3. For merger applications, require that the utilities are already using optimal practices and achieving economies of scale and scope available to them separately, that the merger's purpose and result is improved efficiency and service quality, and that the merger will not reduce competitors' access to "bottleneck facilities."

C. Independence

1. Have you identified the forces that undermine independence, in the abstract and in your own commission context?
2. Can you tell when a party's behavior crosses the line between advocacy of policy and manipulation of emotions?
3. Do you have at the ready verbal signals that will move the party away from pecuniary presentation and back to the public interest purpose?

D. Skepticism

A regulator cannot ignore private interests. The law forbids it; so does practical politics. So how can regulators use private interests—rather than the other way around?

Start with skepticism. Private interest always claims the mantle of the public interest. A developer of wind farms, a builder of nuclear power plants—both promise "clean" and "green"; but their real interest is profit from wind and nuclear construction. The industrial customer criticizes energy-efficiency investments as impractical; but its private interest is to keep rates low. Notice how these private interests de-emphasize public interests: Does the wind developer discuss transmission cost? Does the nuclear developer mention her federal loan guarantees, her statutory limit on accident liability, and her absence of answers on waste disposal?

* * *

The personal attributes of effective regulators—purposefulness, decisiveness, and independence—are, with effort and commitment, within any person's grasp. And the prerequisite for effective regulation—leadership in the form of standards for excellence, established and enforced by appointees and professional staff—is similarly attainable. What remains unclear is whether our constituents—the populace and its elected representatives—understand, appreciate, and absorb our mission deeply enough to support it with political and financial resources sufficient to sustain the tough decisions ahead.