Interconnection Animus: Do Regulatory Procedures Create a "Tragedy of the Commons"? Can Regulators Defer Gratification In Favor of the Big Picture?[1]

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> *Picture a pasture open to all....As a rational being, each herdsman seeks to maximize his gain. Explicitly or implicitly, more or less consciously, he asks, "What is the utility to me of adding one more animal to my herd?" ... [T]he rational herdsman concludes that the only sensible course for him to pursue is to add another animal to his herd. And another; and another. ... But this is the conclusion reached by each and every rational herdsman sharing a commons. Therein is the tragedy. Each man is locked into a system that compels him to increase his herd without limit --in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all.*

Garret Hardin, "The Tragedy of the Commons," *Science* (Dec. 13, 1968), available at http://www.garretthardinsociety.org/articles/art_tragedy_of_the_commons.html.

No one disputes the benefits of interconnectedness: accessible air travel, job mobility, telecommuting, economies from inter-regional trade. Yet regulatory efforts to increase electrical interconnectedness draw opposition, seemingly reflexive, always intense. Embedded in regulatory practice and culture, this behavior is not cost-free; public benefits are delayed and diminished. Can we make adjustments, or is opposition inevitable?

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Procedural Narrowness Yields Zero-Sum Relationships

Consider the battle over new, extra high voltage electric transmission facilities. In the Virginia-to-Ohio region served by PJM, FERC allocated their costs on a postage stamp basis (all users pays the same rate regardless of location or benefit). Challenged in the Seventh Circuit by Ohio, Illinois and other midwestern interests, FERC lost. The Court found insufficient evidentiary support and inconsistent FERC reasoning.

The case is but one of many cost allocation battles, state against state, producer against consumer, utility against independent, east against west. Despite the national benefits of new infrastructure, controversy persists. Two reasons are statutory and cultural. Regulatory statutes -- in this case the Federal Power Act -- always grant opportunities to litigate: New facilities require new costs; new costs require rate filings; rate filings attract proponents and opponents. Our litigation culture adds the sharp edges: Victory-seeking clients hire victory-promising lawyers; these party-pairs join the battle if litigation cost is below the value of winning multiplied by the probability of winning.

One more ingredient makes conflict inevitable: the narrowness of the typical proceeding. A 500 kV transmission facility is, inarguably, a "big project." But for a nation with 300 million citizens, who rely on electricity for everything from incubators to funeral homes, a single transmission facility is a small contributor to life's daily costs. Yet that facility gets its own proceeding, in which participants then focus on winning benefits, and avoiding costs, associated with that single facility. Procedural narrowness is therefore the key ingredient in the recipe for a zero-sum culture. By isolating each proposal from its benefits context, our procedures promise a showdown between win-seekers and loss-avoiders.

Facility-Specific, Party-Centric Litigation Produces a Procedural "Tragedy of the Commons"

Once a proposal reaches the cost allocation stage, its prudence is presumed. Prudence means that over a time horizon sufficiently long, or over a geographic territory sufficiently wide, the benefit-cost ratio is sufficiently positive to justify the investment relative to alternatives. The only question remaining should be, "How do we allocate the net benefits so that no one is worse off and everyone is better off?"

In proposal-specific litigation-land, that optimistic approach is a rarity. Narrow proceedings mean that even if the proposal is part of a net-benefits package, a party has a right to oppose it if for that project and that party, the benefit-cost ratio is negative.

This right to a hearing, project-by-project, is the source of much waste and distraction. There is an expectation that every proposal must have a positive outcome for every party; that a proposal is "bad" if it makes anyone worse off. How logical is it, how useful, to slice-and-dice regulatory decisions into a series of win-lose polarities? No clear-thinking citizen (i.e., one uninfected with regulatory experience) would insist that every public policy benefit him personally. Otherwise, we would --

-- cease funding for multiple sclerosis because not everyone contracts it;

-- eliminate the local crossing guard because not everyone crosses there;

-- eliminate the Air and Space Museum because not everyone goes there;

-- eliminate every program for which the cost-bearers differ from the benefit-receivers.

Oddball examples? They do not differ logically from oppositional responses to cost allocation proposals for utility infrastructure. These oppositions, each one rational individually, draw out regulatory proceedings, delay benefits, add costs, and kill projects. Under our regulatory procedures, the sum of individually rational litigation decisions yields a societally irrational result.

Welcome to regulation's "tragedy of the commons", where the commons is not Garrett Hardin's pasture, but the "right to a hearing" for every cost-causing project. We slice proposals so narrowly that someone always has reason -- and a right -- to oppose. The sum of all these individual rights, vigorously and expensively exercised, creates policy gridlock, Hadley v. McCoy animus ("you won last time so I need to beat you this time"), and lost opportunities.

Hardin points out that "the commons, if justifiable at all, is justifiable only under conditions of low-population density. As the human population has increased, the commons has had to be abandoned in one aspect after another." This reasoning applies to regulatory procedure. When administrative litigation was simple -- buyer and seller arguing over rate levels -- there was sufficient aural and temporal space to air all concerns. That simplicity is gone. A typical transmission case has over a dozen parties, arguing about total cost, allocated cost, need, alternatives, rate design, intergenerational equity, environmental effects and more. As with Hardin's pasture, the problem grows geometrically, because (a) there are multiple cases simultaneously and (b) every party's "right to be heard" begets a counter-right in that party's opponents. These factors shrink the supply of problem-solving resources: time, money and goodwill. The result is Hardin's tragedy of the commons.

So regulators call for "consensus" and "cooperation." This reliance on voluntary restraint, on what Hardin calls "conscience," produces a Darwinian result: the victorious are the holdouts – the ones who resist consensus and cooperation. As Hardin concludes, "Conscience is self-eliminating."

Solution: Broaden Proceedings' Scope So That Benefits Exceed Costs

To save our regulatory commons, we must break out of zero-sumsmanship. We need proceedings whose substantive scope ensures that total benefits exceed total costs.

A transmission system benefits not only the generation and loads it connects, but also the regional economy it supports. But "just and reasonable" ratemaking does not count that broader benefit. Ratemaking merely identifies a revenue requirement and the rate levels necessary to produce it. There is no mention of employment growth, industrial location attractiveness, or environmental values, even though the right transmission proposal can enhance all three. It is this singular focus on revenue requirement and rate levels that produces zero sum thinking. As any

attendee of RTO "settlement" discussions will testify, calls for "consensus" do not work well in a zero sum context.

Ratemaking's confines need not condemn us to endless cost allocation disputes. The key is to broaden the decisional context. There is usually some combination of transmission proposals, covering broader geographic areas or long time horizons, for which total benefit exceeds total cost. By replacing zero-sum proceedings with positive benefits proceedings, the parties can fight over benefits rather than cost. The result: More cooperation, more speed, more results.

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I have focused so far on procedure, as cause and as solution. But I see a deeper problem: a need for more public spiritedness, more deferred gratification, more generosity.

Another Source of the Problem: Contrasts in Community Commitment

Beneath the friendships and trust gained from residence in this state regulatory community, the subsurface has plenty of growling, teeth baring, and logic suppression. Examples:

1. Why do coal states insist on a right to low rates, when those low rates stimulate electricity consumption that imposes pollution costs on other states?

2. Why do the beneficiaries of hydroelectricity insist that the benefits are "theirs," when this low-cost power owes more to nature, geographic serendipity, federal taxpayers, and 1930s laborers than to any efforts or innovations from the residents of those states?

3. Why do states that see wind power as in-state economic development work so hard to have other states fund the transmission investment?

4. Why do states whose air quality benefits from wind power expect other states to incur the associated aesthetic and transmission costs?

5. Why do so many urban power plants end up near low-income neighborhoods?

6. FERC Order No. 719 requires each regional transmission organization to allow "aggregators of retail customers" (ARCs) to bid demand response into the RTO's organized market—unless the state prohibits the retail customer's participation. But a state that prohibits participation causes the region to forgo a leftward shift in the demand curve—a fancy way of saying that if one state blocks efficient demand response, the region's prices stay higher than necessary. Why is this behavior considered "OK" as a matter of "state prerogative"? (Separate question: Why would a national regulator, with a statutory obligation to advance benefits for all consumers, invite and accommodate state policies that reduce benefits for consumers? That's a topic for future discussion.)

Contrast these examples of states that offer their wealth to others:

1. The states that cause their ratepayers to pay extra to attract renewable energy or increase energy efficiency, even though the benefits of supplier diversity, emissions reduction, and demand reduction will produce lower costs and prices for non-residents.

2. The states that subsidize education for the next generation of power engineers, lines workers, and pipe hangers so that the nation's lights stay on, even though some of these students will take their skills to other states.

3. The states that are generous with low-income assistance, according dignity to our poorer citizens, making the entire nation more civilized.

4. The group of western states working to integrate information on population patterns, resource richness, environmental vulnerability, and political cost tolerance into a regional electricity solution that recognizes the commonality of risk and opportunity.

Causes of Intra-Regional Tension

Why do we have more examples of opposition than of cooperation? The problem arises in part from a combination of incrementalism and a political expectation of "no losers." In regulation, incrementalism is inevitable. We make many decisions case by case: this asset, that cost allocation, this transmission adder, that rate increase. In Major League Baseball's 162-game season, every game is win-or-lose (the league's standings even have a column labeled "W-L"). Similarly, every regulatory decision gets strip-searched for negative attributes. While every state wants to "collaborate" and "compromise," no one wants to lose, not even once. Yet long-term benefits require short-term hits. So by salami-slicing our decisionmaking, we distort vision and depreciate value. A "no losers" test produces real loss.

The problem also comes from confusion over words and actions. Consider the phrase "states' rights." A focus on "rights" creates a mindset of entitlement, leading to worry about winning. There is no such thing as "states' rights." Individuals have rights; states have powers. (See the U.S. Constitution, Tenth Amendment: "The *powers* not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people" (emphasis added).) In regulation, the relevant powers are the powers to regulate industry performance.

With powers and performance in mind, consider now the difference between state-as-stakeholder (i.e., when it advances its residents' interests over non-residents' interests) and state-as-regulator (i.e., when it focuses on improving industry performance). If we focus less on stakes and more on performance, we focus less on loss and more on benefit.

Solution: Defer Gratification, Think Bigger

States want deference from federal agencies. Which group of states is more deserving of deference: the cost-shifters and baby-splitters, who emphasize the internal and the short-term; or the planners and pie-expanders, who emphasize the external and the long-term? Would states

deserve—and gain—more credibility with federal regulators if they were seen— and acted—less like states protecting their consumers and more as co-regulators seeking to solve a national problem?

A article in *The New Yorker* (J. Lehrer, "DON'T! The Secret of Self-Control," May 18, 2009) described longitudinal studies conducted on four-year-olds in the 1960s. Researchers gave the children a choice: one marshmallow immediately versus two marshmallows fifteen minutes later. The children who managed to defer gratification had, on reaching high school, better grades and SAT scores; and, decades later, better body mass indices, better careers, better lives. While attributing the inter-child differences in part to "wiring," the researchers did not give up on the immediate gratifiers. There are ways to "re-wire" children—to teach techniques that strengthen the will-muscles. (You had a better chance of surviving the fifteen-minute wait if you simply turned away from the marshmallows or covered your eyes. Other techniques included "kicking the desk, or tug[ging] on their pigtails, or strok[ing] the marshmallow as if it were a tiny stuffed animal.")

Similarly, constituencies that learn to defer gratification live better lives—as do their successors. What has this to do with regulators? Regulators can teach "re-wiring." Regulators are the issue experts. While regulation is political (its decisions assign obligations, benefits, and costs), it is one step removed from politics. Its practices and procedures emphasize fact-finding, principles, and consistency over grab bags, power struggles, and happenstance. (Not to mention desk kicking, pigtail tugging, and marshmallow stroking.) Regulators have the institutional credibility to help citizens grasp the need for deferred gratification. That is why election-year governors who pressure their commissions to "get rates low" have it wrong, while the New England governor who told his commission chairman "Leave the politics to me; you focus on the long term" had it right.