

# **Advice to Presidents and Governors on Appointing Excellent Regulators**

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December 2016

Your many duties include appointing and confirming economic regulators. In the utility sector, they are responsible for inducing high-quality performance by providers of electric, gas, water, and telecommunications service. Their decisions will affect millions of consumers; billions of investor dollars; the local, regional, and national economies; and our air, land, and water. Here are nine thoughts on producing top-notch results.

## **1. Appointments rooted in principle**

“Regulation” is not a political whipping boy, something to campaign against. Nor is it a unidimensional spectrum on which “more” is better than “less.” Serious regulators do not debate oversimplifications like “command and control” versus “light-handed” regulation. (The regulatory legend Peter Bradford once noted, “I’ve heard of light-headed regulation, light-fingered regulation, and red-handed regulation; I know little of light-handed regulation.”) The purpose of regulation performance—aligning utilities’ behavior with the public’s needs. Principled regulators ask five questions: (1) What outcomes do we seek? (2) What behaviors, engaged in by whom, impede those outcomes? (3) What behaviors, engaged in by whom, achieve those outcomes? (4) To prevent the negatives and promote the positives, what actions must regulators take?

## **2. A multi-dimensional job**

Utility regulation used to be straightforward. Utilities built infrastructure, sold products and services and proposed rate increases. Commissions approved projects and set rates. Their central aim was to protect customers from monopoly abuse—imprudent investments, inefficient operations, and undue discrimination against choiceless customers—while setting rates that gave investors a fair shot at a reasonable return.

Today’s regulators do much more: They make markets, design programs, administer investment funds, incubate renewable-energy industries, disseminate broadband, promote energy efficiency, protect critical infrastructure, and resolve stakeholder differences.

With all these demands, what does it take to excel at regulation? On a personal level, what must regulators be, and what must they do, to be effective? Next are some thoughts on attributes, experience, vision, ideological baggage, and political skill—along with an alert about asymmetry.

### **3. Personal attributes**

An effective regulator is purposeful, decisive, and independent. A purposeful regulator defines the public interest by articulating a vision (see #5 below). A decisive regulator acts to align utilities' and consumers' private behavior with that vision. An independent regulator accepts the pressures of public-interest politics (the need to make tradeoffs among meritorious but conflicting goals) but avoids the distortions of private-interest politics (the pressures from narrow forces seeking benefits for themselves). Recognizing that commissions are not courts and regulators are not judges, she not only presides; she leads.

She rejects the rhetorical bipolarity of “markets versus regulation” because she understands, per Alfred Kahn, that her “central, continuing responsibility” is “finding the best possible mix of inevitably imperfect regulation and inevitably imperfect competition.” She prefers facts and logic over adjectives and adverbs.

### **4. Professional experience**

Regulation is an eighty-miles-an-hour bus. The driver needs to know how the bus runs and where it should go. Aim for appointees with deep regulatory experience. Promoting a staff person gives a double punch, boosting agency morale while ensuring experience. Add someone who has worked in a regulated industry: not a talker but a doer—someone who planned, financed, built, or operated infrastructure, or who connected with customers. You'll take a hit for the “revolving door,” but you'll gain someone who knows how it feels to be regulated.

### **5. Vision**

A vision is more than a two-sentence mission statement. It is purpose depicted. The regulator with vision can describe the optimal industry structure (in which motivations, behavior, and performance all align with the public interest), its microeconomic features (the product array, customers' experience, sellers' profitability); and its macroeconomic features (the industry's overall performance, its contribution to the state and regional economies, its environmental effects). An effective regulator tests that vision against present facts, makes adjustments, and then designs and sequences the regulatory steps to produce it.

### **6. Ideological baggage**

Avoid false dichotomies. There is no Republican or Democratic way to regulate. Federal versus state, markets versus regulation, urban versus rural, generation versus efficiency, incumbent versus newcomer, publicly owned versus investor-owned, publicly traded versus

closely held: All these “versuses” lead to zerosumsmanship, usually boiling down to “mine versus yours.” The best ideas come not from ideology, hope, or promises of “good faith”; they come from facts, logic, and extrapolation from experience.

## **7. Political skill**

Twenty-five years ago, the politics of regulation were easy to follow: Investors wanted solid returns; customers wanted reasonable rates. Positions were predictable; the debate was over dollars. Today, the interests have multiplied in numbers and diversity. The investment community is no longer just shareholders and bondholders; we have private equity, hedge funds, short sellers, holding companies from Scotland, England, Australia, Germany, and France. The consumer community is also splintered; the simple threesome of residential, commercial, and industrial has given way to a United Nations of irrigation farmers, computer manufacturers, military bases, casinos, gold mines, and ski resorts. Each technology has its own interest, from wind turbine manufacturers to smart-grid installers. There are environmentalists, labor unions, privacy advocates, and terrorism consultants.

Many of these newcomers are new to regulation's purpose. Some view commissions as supermarkets—places to go to shopping. Others seek protection—from high prices and complicated choices.

Dealing with this diversity requires political skill. The choice is between channeling these perspectives toward a long-term vision of industry structure and performance or producing a series of “compromises” that produce only short-term peace.

## **8. Resource asymmetry**

With rare exceptions, utility executives know more than their regulators. This asymmetry invades every relevant knowledge category: costs (including opportunities for cost reductions); operations (e.g., the capability, availability, and vulnerability of physical plants); customers (consumption patterns, product preferences, payment histories); market value and financing opportunities; utility staff capabilities; and technological potential.

Addressing this asymmetry is key to regulation's credibility. To induce the utility to provide excellent service at reasonable cost, the regulator must establish standards, then compensate the utility to the extent that it meets those standards. To do so credibly and effectively, the regulator literally needs to know what he's doing. His expertise must match the utility's. The under-resourced, under-informed commission risks (a) setting performance standards too low or rates too high, causing captive ratepayers to overpay for subpar service; or (b) setting performance standards too high or rates too low, weakening the company and losing investors' trust. Regulation's credibility is undermined by asymmetry.

To be independent, regulators need the staff resources that independence requires: staff whose credentials—and pay—match the utilities'. Ratepayers already pay for the utility's personnel; they won't mind paying for objective staff who can judge utility performance. Allowing commissions to finance their operations through the same rates that pay for utility personnel is the most direct solution to asymmetry.

## **9. The Value of Muslims and Mexican-Americans**

Sorry, Mr. President-Elect, couldn't resist. You uncorked a bottle of venom, then poured glasses wherever you went. Every regulatory statute prohibits undue discrimination. Consider appointing to FERC someone who knows how it feels.