# "Regulatory Capture" II — What Are the Warning Signs?

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This essay describes capture's warning signs. Within each of five categories are conditions or practices that contribute to, reflect, or perpetuate regulatory capture.

## Vision and Priorities

1. The commission's leaders don't ask the big questions: What products best serve the public? What performance standards must utilities meet to deliver those products? What price levels are necessary, and sufficient, to support those standards? What market structures will yield these products, performance, and prices? Within those market structures, what corporate structures will induce the utility's executives, managers, and professionals to produce those results?

2. The commission's resources are over-allocated to processing parties' petitions, and under-allocated to pursuing the commission's priorities. (This is not necessarily the commission's fault. When legislative deadlines combine with legislative under-funding, a commission's workload often is dominated by what others want rather than by what the public needs. See the next point.)

3. Statutory deadlines are asymmetrical: On deadline day, no action on a utility's request means auto-approval; no action on a customer's complaint means auto-rejection.

4. The commission lacks a program of continuous self-improvement: a program that has for each department, department head, and employee a specific plan for professional advancement; a program whose resources and momentum are not compromised by the commission's other work load.

5. The commission does not regularly recommend legislative changes to strengthen its ability to improve industry performance.

## Hearings and Procedures

6. In commission proceedings, the parties emphasize positions over perspectives. They assert their interests rather than offer their expertise.

7. The commission invites and rewards this practice by structuring proceedings around parties' requests. Hearing orders (the initial orders stating the issues to be decided) merely restate the parties' requests, rather than articulate a public interest purpose. The commission becomes a commercial-interest arbitrator rather than a policy leader.

8. In the hearing room, the parties ask each other hours of questions aimed at their own interests. The commissioners mostly observe, on the premise that oppositional sparks reveal a public interest path.

9. The parties treat the commission staff as a mediator for short-term settlements rather than as a transmitter of the commission's vision. (A real likelihood if there is no vision; see #1 above). The commission accepts these settlements instead of directing its staff to pursue its vision.

## Professionals and Professionalism

10. The "revolving door" is a one-way door: More commission staff take utility jobs than utility staff take commission jobs. This tendency signals neither corruption nor conflict of interest; it is rather the natural economic result of failing to pay good people what they're worth.

11. Similarly: Top professional-school graduates prefer the regulated over the regulator, even though a career on the public sector side has no match in intellectual engagement and public service opportunity.

12. Regulatory leaders cement the salary differential by discounting the need for credentials. We require licenses for pedicurists but not for rate case witnesses; we award "certificates" for conference attendance but not for subject matter mastery. Utilities, in contrast, require advanced credentials for plant operators, fiscal officials, executive officers—anyone whose hand or pen touches operations, finance, or management.

13. The difference in credentialing reinforces, unremarkably, the difference in salaries; leading, unremarkably, to a difference in motivation and morale; leading, unremarkably, to a difference in tenure for the talented. They spend their formative years learning on the taxpayer dime, then move to the regulated sector. No one with the power to fix the problem notices or reacts.

## Politicians: Support or Undermine?

14. The governor influences the commission non-transparently, "requesting" outcomes on behalf of interest groups. The commission consents, rather than reminding the governor, transparently, that her influence over sitting commissioners is no greater than any other citizen.

15. When the commission makes the tough calls (e.g., utility service cannot be below-cost-but-high-quality, shareholder investment cannot be low-risk-but-high-profit), politicians join the protests rather than signal support.

16. The legislature diminishes the commission's stature by passing laws urged by interest groups without clearing them with the commission.

## "Bigger is Better"

17. To support its proposals for mergers and corporate restructuring, the utility cites its "need to position itself competitively." The commission adopts the argument, viewing its regulatory duty as supporting the utility's competitive interests. The irony of, and market distortion resulting from, using government orders to serve a competitive interest, goes unnoticed. (There is a difference between (a) keeping a well-performing utility monopoly financially capable of providing its obligatory service, and (b) becoming a volunteer in the utility's competitive campaigns. When that difference disappears, when "bigger is better" becomes the guide for decisions, the utility's goals become the commission's. That's capture.)

18. While supporting the utility's expansion, the commission protects the utility from contraction. While citing "competition" as a basis for approving utility proposals, the commission undermines competition by resisting competitors' proposals—proposals to perform functions currently assigned to the utility. The reason to resist—as argued by the utility and adopted by the commission—is that reducing a utility's role will weaken its ability to perform. (This approach confuses total profits with return. A utility whose obligatory, exclusive role shrinks will see lower total profits; but its return on equity, its coverage ratios, and its other financial metrics can remain strong.)

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The warning signs of capture are not the actions of utilities, but the actions and inactions of regulators. This makes the term "regulatory capture" both imprecise and inaccurate. The "captured" commission's cage is not locked and guarded by its enemies; its door is opened and closed by the commission itself.