

As the Resource Gap Grows, What Are a Commission's Duties?

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Several years back I wrote two essays on “Regulatory Resources: Does the Differential Make a Difference?” I argued that (a) a utility–regulator differential undermines the regulatory mission by leading to regulator–utility deference: “The risk is that performance standards, and the pace of innovation, are established by the regulated and accepted by the regulator—the opposite of what the public interest requires.”

The problem is getting worse. My recent expert-witness duties amounted to a final exam on frontier issues: an \$80 million “incentive” proposal authorizing supra-normal returns; a multi-state merger combining two holding companies, three utilities, and a host of trading and marketing affiliates that had recently escaped bankruptcy; a rate case addressing the “return on equity” effects of riders and pre-approvals; and a “formula rate” proposal under a statute mandating billions in new utility spending.

Common to these cases is their exposure of regulation's soft underbelly: a growing gap between political demands and regulatory resources. We can solve the problem if we (1) recognize first that regulatory workloads are new and growing, that there are consequences for quality; and (2) articulate the obligations of legislators, commissions, utilities, and ratepayers.

Workloads: New and Growing

A time traveler from even five years ago would be struck by the diversity and immensity of regulators' responsibilities: designing new performance standards, to reflect climate change concerns and customer-empowering technologies; predicting cost uncertainties associated with environmental upgrades, infrastructure modernization, and terrorist protection; reconciling utilities' eminent-domain requests with landowners' disgruntlement; deciding how to allocate the risk of variances between predicted and actual costs; monitoring billion-dollar construction projects to ensure that those variances are kept to a minimum; overseeing renewable-power procurement; evaluating wholesale-market competitiveness to enable build-versus-buy decisions; monitoring immature markets at retail to ensure that new entrants face no barriers erected by incumbents; educating consumers so that the billions in “smart grid” investments have a commensurate value in terms of customer conservation; and positioning commissions to distinguish mergers that advance the public interest from those aimed only at acquiring and aggrandizing.

These efforts arise from obligations imposed by law, yet legislatures rarely accompany new tasks with new funds.

Consequences for Quality

The resource shortage reflects both an absolute gap (between the commission's duties and its resources) and a relative gap (between the commission's resources and the utility's resources). Why the relative gap? We fund a commission by asking: "What are legislators willing to allocate from a limited taxpayer-funded fisc?" The commission's needs compete with every other budgetary demand. For the utility, the question is different: "What are your reasonable needs?" This question is constitutionally commanded; a utility is entitled to recover from ratepayers the reasonable amount of dollars necessary to educate the commission on the utility's expenses and capital requirements. There is no competition from other resources. The two questions produce two different answers. Hence the relative gap.

Compounding the resource gap is an information gap. This relative gap undermines the regulatory purpose. Compared to a commission, the utility has greater knowledge of its costs and cost-saving opportunities. Absent comparable access to and mastery of this utility information, the commission cannot credibly determine whether the utility's costs reflect cost-effectiveness. (Adding to the information gap is the expertise gap, since to judge the utility's performance credibly one must oneself be an expert in that performance.)

Legislators' Obligation

If the purpose of regulation is performance, regulators need the resources to assess performance. The legislative obligation is simple: Pay for what you propose. A commission is not a repository of unlimited expertise, staffed and poised to administer any new program and solve any new problem. It needs resources that match its obligations. To impose new duties without budgeting new staff, to claim credit for greening utilities while "limiting the growth of government," is misleadership, because it misleads. Worse, it infantilizes the electorate, leading them to expect public improvements without paying for them.

Commissions' Obligation

The commission's obligation is also simple: Speak up. Not every legislator understands the labor intensity of utility regulation. Regulation involves a long series of mental verbs: identifying questions, inviting ideas, organizing expertise, processing participation, deliberating options, drafting possibilities, publishing decisions, defending in court, monitoring compliance, enforcing against violators. All this takes time. Legislatures need to know.

The second commission obligation is also simple: Align the utility's interest with the public's. A utility proposal must satisfy the public interest. A proposal cannot satisfy the public interest if compliance is uncertain or if harm could go undetected. This logic train means a commission can, and must, condition its approvals on availability of staff to ensure compliance and detect and prevent harm. This approach makes an applicant the commission's ally in aligning resources with demands.

Utilities' Obligation

A utility cannot meet its burden of proof if its commission has not mastered the evidence. If the commission commits to this principle, if it commits to disapproving proposals that its resources are insufficient to evaluate, things get easier.

The utility's need for approvals matches up with the commission's needs for resources. The utility then has several options. It can use its political clout—much of which derives from the government's grant of a century-long monopoly—to press for commission resources. Or it can skip the legislative process by volunteering to collect through rates the resources the commission needs. No one is asking the utility to pay from its pocket. Shareholders have no obligation—other than through normal income taxes—to fund their regulators. Refusing the voluntary role, while insisting on cost recovery for its own regulatory costs would strike any objective person as inconsistent and indefensible.

Ratepayers' Obligation

Ratepayers (or taxpayers) do need to pay for regulatory resources. But there is resistance, appearing in several forms. One is, “The utility got this statute passed; the shareholders should pay for the necessary staff,” a view that seems to tax the utility for exercising its First Amendment right. I also hear “Our commission is the utility's doormat; why fund it?”—a statement whose downward spiral of illogic needs no explanation. Then there's the general “we need to reduce government spending” canard, a viewpoint whose disconnect from benefit–cost reality is disassembled by Prof. Robert Frank in his 2011 book *The Darwin Economy* (showing, among many other examples, that failing to fix roads now, costs more later).

This ratepayer–taxpayer resistance can be removed if those who know better—legislators, regulators, utilities, and ratepayer representatives—share that better knowledge.