Commission Positioning: Using "Vision" to Avoid "Too Big to Fail"

Scott Hempling
June 2011

Uncertainty is everywhere: our economy, industry structures, our utilities' business strategies, technology's effect on customers, our commissions' budgets, and especially the role of regulation. Uncertainty has regulators asking, "How do we position our commissions?" The question recognizes that others—utilities, new entrants, large customers—are positioning themselves. The commission that fails to position itself risks becoming passenger rather than pilot.

Start with "Vision"

Prior essays identified the key attributes of effective regulators as purposefulness, education, independence, and decisiveness. A prerequisite for purposefulness is vision. (Thanks to a sharp southeastern regulator for that insight.) Vision is not an abstraction, an inspiration, or an emotion; vision is a mental picture of what things should look like and how things should work, within one's regulated industries and within one's regulating agencies.

Vision is a set of preferences informed by experience, observation, and logic. It is striving's successful result. A regulator's vision depicts five things: (a) standards for utility performance; (b) the industry structures most likely to produce that performance (i.e., Alfred Kahn's "best possible mix of inevitably imperfect regulation and inevitably imperfect competition"); (c) the specific regulatory inducements -- and only those inducements -- necessary to that performance; (d) the personnel and practices within the commission necessary to design and apply those inducements; and, finally, (e) utilities consistently meeting the regulator's high standards.

Vision has less tangible elements, too. We know that private political tensions can block public-interest progress. (See the essays "Politics: How Do Regulators Respond?" Parts I and II.) Regulators wishing to counteract this tendency envision an internal utility culture that mirrors the commission's standards, a culture that treats the commission as an ally for excellence. The regulator also pictures commission-legislative relations that produce joint decisionmaking, rather than legislative overrides sought by those dissatisfied with commission outcomes. (See "It's April—Do You Know Where Your Legislatures Are?" and "More on Legislative–Regulatory Relations: Layers, Protections and Cost-Effectiveness.")

Positioning Questions

With a vision in place, the positioning commission asks, about each regulated industry, six questions: (a) What are the likely trends in products, services, providers, technology, and customer needs? (b) Which trends should we encourage and discourage? (c) Where will private

behavior conflict with the public interest? (d) What regulatory efforts are necessary to align that private behavior with the public interest? (e) Within the commission, what skill sets are necessary to support those efforts -- to set standards and judge performance -- and what education and recruitment will attract, retain, and build those skill sets? (f) What investigations and proceedings will best get the facts and insights necessary to answer all these questions?

Positioning Steps

As the answers arrive, a commission can start positioning. First, a reminder of what we are trying to accomplish:

Regulation's purpose is performance. Regulation establishes standards and assigns consequences. Standards need to be proposed, imposed, absorbed, and exceeded: proposed by independent experts, imposed by the regulator, absorbed into the utility's culture, and exceeded by the utility's leaders and employees. The key is to find, for each performance area, the industry's best-performing utility, then replicate its practices here. Performance reviews should be continuous, not only conducted post-failure. Continuous review creates a culture of urgency inside the utility, felt and reflected by all utility employees, from executives to managers to lineworkers (and back again: As the West Virginia Commission's investigation of layoffs is now revealing, sometimes the workers set standards for the executives), to satisfy the standards established by regulation. (So when a CEO assures citizens that the company will improve its performance while his hearing-room lawyers are busy badgering witnesses who critique that performance—a situation playing out in my home state—that is urgency uncommunicated.)

Commission positioning then means building an infrastructure able to create vision, set and enforce standards, and self-critique. The ingredients are:

Staff skills: Diverse skill sets that match the diverse standards that measure performance.

Staff pay: A pay scale sufficient to attract to the commission the professional equals of the utility managers whose performance the staff must judge.

Staff quantity: Baseload staff sufficient in quantity to allow the commission both to react and to pro-act, and access to top consultants for the unusual demands.

Leadership: Commission leadership expert in regulation, undistracted by other career goals, politically secure enough to assign consequences, all exemplifying the purposefulness, education, decisiveness, and independence of effective regulators.

Legal authority: The boundaries of the regulator's authority must match the terrain covered by the utility's activities. The authority must include the power to assign consequences for all adverse effects of those activities.

Accountability: The commission must be accountable, legally and politically, to all those with responsibility for, or affected by, the commission's decisions: the legislature, the consumers, the utility, the financial community, and the courts.

Cost responsibility: There are two types. Expenditure responsibility focuses on cost-effectiveness: Over the long run, are customers receiving value for their money? Causation responsibility is pay-as-you-go: Each cohort—temporal and geographic—pays for the costs it causes. Exceptions should be minor, transparently justified, and temporary.

Essential to Positioning: Having Alternatives

Positioning requires alternatives, because reality never fits plans. Consider our dependence on the incumbent. Regulation's credibility depends on its ability to assign consequences for poor performance. But if the poor performer is poor financially—or will be made poor by the consequences—regulation loses its clout. In the early 1990s a Midwestern commission found its utility a billion dollars imprudent. Rather than see the utility fail, the commission allowed the imprudent dollars in rates—labeling them "stabilization rates." I recall asking the commission's utility director, "John, how could you allow imprudent dollars in rates?" He responded, "Sometimes you have to put aside your principles and do what's right." In other words, he had no alternatives.

For regulated markets that are potentially competitive, ensuring alternatives means removing historic entry barriers, along with the incumbent's unearned advantages, while preventing the incumbent from creating new entry barriers. (For an application of this concept to "smart grid" markets, see Professors Johann Kranz's and Arnold Picot's paper.) But where economies of scale require a monopoly, alternatives are absent. How then can commissions preserve their power to assign consequences? The logical answer is to avoid "too big to fail" situations—to avoid approving a utility investment so large that an imprudence penalty would kill the company. Our near future will bring proposed investments in nuclear, smart grid, coal plant repowering, pipeline replacement, and long-term renewables purchases. When examining those offerings, keeping "too big to fail" avoidance in mind is commission positioning.