

TRANSPARENCY IN REGULATED INDUSTRIES: ELEMENTS AND IMPORTANCE

Ashley C. Brown
Harvard Electricity Policy Group
Draft 5/20/96

If there is one single concept that is absolutely critical to the successful implementation and conducting of a regulatory process, it is transparency. The process, the reasoning, the mathematics, the logic, the transactions, the administration, and the mechanics of regulation must be absolutely transparent to all if the system is to inspire confidence. We use "transparency" to mean that all stages and elements of the work of the Commission are to be accessible for public display as well as for understanding. The Commission should be like a machine with all details, units and work plainly in view. The same should be the case for all transactions which occur in the electricity market. Without the confidence that comes from transparency, investors will not risk their capital, consumers will not tolerate adverse rate changes, politicians will not refrain from tampering with the process, and restructuring will be but an empty shell. Transparency is the glue that holds the regulatory compact together. So, what is this glue made of? What is transparency, and why is it so important?

The importance of transparency and its link to confidence in the system is that transparent regulation conducts business in the full light of day, in full view of anyone who cares to watch. While the intricacies of regulation can be quite arcane and complex, the manner in which the work is done is simple and plain. The integrity of the decision makers, their reasoning, the facts and arguments that they consider, the process by which decisions are made, and the rules by which all must abide are clear, are well known, are verifiable, and are manifestly resistant to unethical, unlawful, or unfair tampering. Of at least equal importance is the existence of transparency in markets that are subject to regulation. The transparency of transactions that occur within the regulated scope of activity serves as a further guarantee that the process has led to results that are straightforward and honest from a business perspective. If there are problems in the transactions that are occurring, the transparency of the market and the institutions that do business in that market makes it likely that either the market will correct itself, or the problems will be apparent so that regulators will be signaled, either on their own initiative or through the urging and complaints of those who feel aggrieved by the problems, that they need to intervene to fix the problem.

While there is no single factor that defines transparency in regulation, it is useful to examine six aspects of it that are critical. None of these aspects standing alone can guarantee transparency, but the absence of it in any one of the six areas can deprive the entire process of its transparency.

The six aspects are as follows:

1. The integrity of the decision makers;
2. The integrity and logic of the reasoning process behind the decisions;
3. The comprehensiveness and breadth of the facts and arguments that were taken into consideration in making a decision;
4. The integrity of the decision making process itself;

5. The clarity and verifiability of the rules that governed the decision making process and the decisions themselves.
6. The clarity and verifiability of the transactions that occur within the regulated market.

It is useful to explore each of these areas individually.

1. INTEGRITY OF THE DECISION MAKERS

The integrity of the decision makers is, of course, absolutely mandatory. They must not only be incorruptible, but must refrain from any type of activity or involvement which might even give the appearance of impropriety. Some of the rules in this area are clear. Bribes of any kind, or even small favors that give the appearance of special favors must be absolutely prohibited and violators subject to at least removal from office if not criminal prosecution. There are, however, a number of more subtle rules that the Commission itself can adopt that will strengthen the perception of honest decision makers. Such rules include requiring the public disclosure by Commissioners and critical staff members of all of their major financial interests to make it clear that they hold no financial interests that are either in conflict, or even appear to be in conflict with their official duties. A flat prohibition on the ownership of any financial interest of any kind in any business subject to the jurisdiction of the Commission is also warranted.

A requirement that a Commissioner or critical staff member recuse himself/herself from any involvement in a case where he or she does have an actual or apparent conflict of interest is also warranted. In some regulatory bodies, a member of the Commission may be removed from voting on a particular matter where a majority of his/her colleagues have concerns, based upon a demonstrated and publicly stated actual or apparent conflict of interest or improper conduct of some kind. Such removal can occur, however, only on the public demonstration of a cause for such an action. Limitations on a Commissioner or key staff person that prohibit their employment by a jurisdictional company or working on matters pending before the Commission for some period of time after that person has left his/her regulatory position is another restriction that closes off certain temptations that might appear to influence a decision maker (such restrictions are known as "revolving door" rules). A prohibition of *ex parte* communications, or, at a minimum, a rigidly enforced requirement that such contacts be subject to full disclosure, will go far to assure even the most skeptical of observers that the decisions made are not the result of "cozy, quiet little arrangements among friends."

In addition to limitations on the conduct of decision makers there are appropriate protections that can be built in to shield regulators from improper influences. Regulators serve fixed terms and cannot be removed from office without a demonstration of sufficient cause for doing so; sufficient cause arising only from demonstrated malfeasance or non-performance of duty. Mere disagreement with a Commissioner's position on a matter, no matter how unpopular that position is, does not constitute grounds for removal. The salary and benefits of Commissioners can be set out specifically at the time a person is appointed to the position and changes from that can be prohibited during the term of office in order to preclude the possibility of punishing or rewarding a commissioner for a decision that he or she made in good faith performance of duty.

In summary there are a variety of institutional mechanisms that can be put in place to either regulate the conduct of decision makers or to protect them from improper manipulations or temptations. It goes without having to say so, of course, that the first and most important protection is the appointment of high minded, dedicated, public servants to the Commission. The personal integrity and personal commitment to integrity of the decision maker is of paramount importance.

2. INTEGRITY AND LOGIC OF THE REASONING PROCESS

An essential component of the integrity and transparency of the regulatory process is its intellectual foundation. It is that basis in logic and reason that precludes both arbitrariness and too much politicization of the process. Indeed, it is also an insulation against corruption. While there are many policy and other decisions on which reasonable people could very well disagree, and, indeed, the Commission may well make decisions that Commissioners themselves might, in hindsight, come to regard as mistakes, the decision must be at least justifiable on intellectual, policy, and factual grounds. In short, transparency of the process does not necessarily demand that the correct result is always reached. Human beings may well make errors or reasonable judgements with which other people may disagree. It does, however, demand intellectual rigor, well reasoned decision making, and coherent policy. Such a standard requires intelligence, honesty, diligence, and perhaps even courage on the part of the regulators. Further, transparency demands that those qualities must be demonstrated.

The demonstration of intellectual rigor and honesty is not easily accomplished, particularly in areas where there are advocates on all sides with very different points of view. It can only be accomplished by a disciplined and consistent effort over time to explain the rationale for each substantive decision taken. That rationale should almost invariably include the policy objectives sought or being pursued, an explanation of how the measures being taken will contribute to those policy objectives, and such other considerations as went into the decision. When one of the Commissioners disagrees with the majority on a decision that is taken, that Commissioner should issue a separate, dissenting opinion setting forth a full explanation for his/her disagreement. Similarly, when a Commissioner agrees with the outcome but does so for different reasons than those set forth in the opinion of the majority, he/she should write a separate, concurring opinion setting forth the reasons for the agreement and disagreement.

The importance of issuing separate opinions is to stimulate debate on the subject being discussed, for the dissenting or concurring Commissioner to set out a record which might be used by the Commission, a Court, or even another policy maker in the future to change policy direction, to simply protest a decision, or perhaps some other rationale. The issuance of such opinions, however, serves two vital institutional interests. The first is that the ability of any one of the Commissioners to speak out helps to keep all of the Commissioners intellectually honest, rigorous in thought, and serious in purpose. Secondly, and of equal importance, separate opinions, particularly ones that are well reasoned, provide very clear indications of thoughtful debate and careful analysis that can go far in presenting a decision making process that is intellectually honest, rigorously analytical, well reasoned, and utterly transparent. Ironically, even poorly reasoned opinions can serve the cause of transparency because the reasoning stands naked and unmasked before all.

At the Federal Energy Regulatory Commission as well as a number of state commissions in the United States, it is common to have what are known as "Sunshine Laws". These laws prohibit any discussion of matters pending before a Commission by Commissioners (unless it is only a minority of the Commissioners in those states that have 5 or 7 commissioners; for a three member commission such as the NERC, such a law would make it impossible for any commissioner to informally talk with a colleague about anything related to a matter pending before the Commission) outside of an official, publicly announced meeting of the Commission. The idea is that all relevant discussion should take place in the "sunshine" (i.e. in public). While these laws are designed to accomplish an even greater measure of transparency, many observers believe that they are counterproductive in that the public discussions are less frank and open than they should be, indeed, are often quite sterile, that the real decision making authority is effectively transferred from the Commissioners to the staff who are able to communicate among themselves, and that the quality of and accountability for decision making is thereby reduced. Transparency, while of paramount importance, may have to be balanced against the need for colleagues to talk frankly and quietly among themselves in deciding the serious matters before them. In achieving that balance, however, one should never lose sight of the critical importance of transparency.

The critical element of the reasoning and integrity implicit in the regulatory process is that no substantive opinion is rendered without full explanation, that Commissioners clearly reveal the thought process by which they arrived at their decision(s) and opinion(s). All parties have a right to know the reasoning process. Even if some people may disagree with the reasoning and/or the conclusion, the publication of an explanation for every decision will add immeasurably to the transparency of the process, and thereby render disagreement matters of substance and not a matter of how fair or honest the process itself was.

3. EVIDENCE CONSIDERED

As important as the exposition of the reasoning of the decision makers is, it alone does not achieve transparency. The context of the discussion and debate that preceded the decision is of at least equal importance in achieving transparency. It does little for the credibility of the Commission to render a perfectly reasoned decision based on facts that are hidden from view. Consumers angry about a price increase, are not going to feel less aggrieved because the Commission had secret information, not available for anyone to scrutinize, upon which it based a decision to raise prices. Similarly, no one is likely to risk their capital in a regulated market where the regulators make decisions based upon information which they are unwilling to share. Indeed, transparency demands that not only the decision and the reasoning behind it be publicly exposed, but that all of the evidence, be it fact, opinion, or argument, that was presented to the decision makers in an effort to persuade them be similarly unveiled on the public record.

There is little way to completely expose the entire basis upon which opinions are formed. Everyone is the product of a personal background which colors their world view and that is likely incapable of exposition. On the other hand, those facts and arguments that were presented on a particular matter and which shaped a decision maker's view of a particular set of circumstances are

capable of exposition. Accordingly, it makes sense to make a formal record of all of the information that was provided to the Commission on a particular matter.

There are two elements critical to the transparency of that record. The first is that all of the information that was submitted on the matter is included in the record, including the transcript of any formal proceedings that occurred. The second is that all of the information is open and available to anyone who wishes to see it. Indeed, there should be a presumption that all of the records in possession of the Commission are public records open to anyone. Transparency requires that there be a presumption that all documents in possession of the Commission are public documents open and available to anyone who wishes to see them. While it is reasonable that the Commission retain authority to deem a document "confidential," that authority should be used sparingly, and only upon a very clear demonstration of the need for confidentiality by a party who is seeking such a designation for a document. As a matter of practice, it is probably not wise for the Commission to designate a document as confidential on its own unless it is an internal personnel document, an early draft of a proposed action or decision by the Commission that is not yet ready for release, a security matter, or matters that are related to litigation in which the Commission is involved, such as a matter pending in the courts.

The simple principle that should be followed if transparency is to be achieved is that both the reasoning and the information upon which that reasoning is based should be public and open to public exposition. In the absence of compelling circumstances, no information should be withheld from public view.

4. DECISION MAKING PROCESS

In the effort to achieve transparency, there can be no substitute for making certain that all parties having an interest in the outcome of a particular matter are afforded a full opportunity to provide meaningful input into the decision making process. The credibility of the Commission and of the regulatory process in general would be ill served if decisions were taken without public notice that they were being contemplated, without the opportunity for the diverse affected interests to express their views and offer their evidence in some meaningful way in the process.

For there to be transparency key elements of the process should include:

1. the public notice that a particular matter is under consideration at the Commission (indeed, all applications, formal complaints, commission initiatives, and whatever else is undertaken by the NERC should be the subject of publication at the time an action or application is initiated at the Commission);
2. the provision for ample opportunity for anyone, either a formal participant in the process or perhaps just a residential consumer with an opinion, who wishes to provide the Commission with input on a particular matter to do so;
3. the maintenance of a formal, publicly available, record of all arguments and evidence

provided to the Commission on a particular matter which constitutes the entirety of the information upon which the Commission will make its decision;

4. ample provision for the opportunity for a person or entity interested or materially affected by the outcome of such a proceeding to not only offer all of the relevant arguments and evidence which it believes the Commission needs to consider before taking its decision, but also to examine, test, and respond to all of the opinions and evidence offered to the Commission by other parties, many of whom have quite diverse and possibly adverse interests to advance.

The key concept is that anyone with any interest in knowing the totality of what the Commission has before it in a pending case will have access to that information, and no one participating in a particular matter will be precluded from knowing precisely what information the Commission has before it on which to base its decision.

In establishing the process, the Commission will want to make certain that it accomplishes three very important goals:

1. Making certain that the process is truly transparent in that the entire process of initiating a case for consideration and letting it be known that the matter is undergoing a decision making process at the Commission, gathering information, examining and considering that information, the reasoning process for coming to a conclusion, and the decision itself;

2. Assuring that everyone and anyone who wishes to participate or provide input on a particular matter has ample opportunity to do so at whatever level a party wishes to do so, ranging from full participation to the simple act of merely offering an opinion;

3. Assuring that the Commission gathers all of the relevant information necessary on a particular matter, that that information is tested in some meaningful way in order to distinguish what is reliable and what is not, what is of value and what is not, and making whatever other judgements need to be made about information in order to enable the Commission to make a well informed, well reasoned decision.

5. CLEAR AND VERIFIABLE RULES

Transparency would be impossible to attain in the absence of clear, fully articulated, publicly known, and consistently applied rules and policies regarding the criteria to be used in making various types of decision, the public policy objectives the Commission is pursuing in making various types of decisions, the expectations and obligations of licensees, and the process by which decisions will be taken. Anyone having business before the Commission, regardless of whether that party is a licensee or just a simple consumer, is entitled to know how the Commission will conduct its business. The inability to know that information would render meaningful participation before the Commission virtually impossible, thereby putting the confidence of both capital investors and consumers at considerable risk. It is, therefore, of great importance that the Commission use consistent and

predictable terms and conditions on licenses applied with little or no discrimination (if there are deviations from the norm, the basis for each such deviation should be well documented), that the Commission adopt and publish rules which, among other things, set forth:

1. the precise nature of the procedures to be followed in making decisions ;
2. the standards (including explanation of the burden of proof) that the Commission will apply in evaluating the performance of, or complaints against, licensees (e.g. quality of service for utilities or anti-competitive behavior for generating companies);
3. the public policy goals that the Commission is pursuing;
4. a statement of the rights and obligations of consumers;
5. the terms and conditions governing access to the records of the Commission (the rules should be quite liberal, but the smooth operation of the Commission might require such reasonable limits access only during regular business hours, reasonable charges for copying expenses, prohibition on the defacing or alteration of documents, etc.);
6. such other matters which may be necessary for the Commission to conduct its business in an open, transparent, and publicly accessible fashion.

While part of the value of adopting and publishing rules and letting policy objectives be known is to attain stability and predictability in the process, the status quo need not endure forever. Changes are likely to be necessary or beneficial from time to time. Accordingly, the process for making changes in the rules should also be set forth, and that process should be open and accessible for anyone to participate. The principles that should be honored consistently are complete openness on what is contemplated in terms of the subject matter under consideration, public notice that matters are pending, and ample, meaningful opportunity to participate. Stability and predictability in honoring those principles even when contemplating changes in previously adopted rules should be sufficient to maintain public confidence in the regulatory process even in the midst of change.

6. FINANCIAL TRANSPARENCY

As important as transparency is in how the Commission conducts its business, it alone, is not sufficient to assure the transparency of the entire regulatory process. To achieve the desired level of transparency, the financial and other transactions that occur within the scope of the Commission's jurisdiction should also be transparent. The workings of the regulated market, the financial records of monopoly licensees, the power sales of the generating companies, annual reports of licensees, and perhaps other financial records should be accessible as public records at the Commission. In order for those records to be easily understood and meaningful, the Commission will need to adopt reporting requirements and accounting standards with which licensees will need to comply as part of their license conditions. The Commission will need to further require, as part of its license conditions, that licensees comply with all reasonable information or data requests from the Commission. The

Commission may well want to issue periodic reports on the operations of the market, reports that are replete with market information.

The critical factors are that the market be open, that financial data be available and accessible, that consumers and investors alike have access to systematic and meaningful information on the market, and that regulators have the information that they require in order to maintain their requisite level of oversight. Such transparency will not only go far to providing assurance to both investors, but will, if consistently demanded and enforced, also provide the side benefit of exposing shortfalls in revenues or non-cash transaction.

The importance of financial transparency cannot be overstated. Indeed, the transparency in the regulatory process is designed to build confidence and credibility in the system of regulation. The ultimate proof of whether such confidence is merited or deserved is derived from the actual operation of the market itself. It is financial transparency that will provide the ultimate evidence of whether the system is working as it is envisioned to do so, and whether the public interest is being well served.