

HARVARD UNIVERSITY
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GOVERNMENT



Harvard Electricity Policy Group

Center for Business and Government
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HARVARD ELECTRICITY POLICY GROUP SEMINAR

**Forum on Regulatory Decision Making: Is the Process
Too Rigid? Can It Respond to the Dynamics of A
Competitive Market? An Array of Perspectives**

**Mark Hopkins Hotel, San Francisco, California
April 15th, 1994**

MEETING SUMMARY

In previous sessions, the HEPG has discussed the issue of conflicts, gaps, and overlaps between federal and state regulation of electricity, specifically with regard to: a) issues of transmission pricing, siting planning and access, b.) the potential usefulness of RTGs in addressing these issues; and c.) "who owns the problem" of stranded assets allocation.

A further topic -- potential reform of the process by which regulators make policy in the context of "sunshine" laws and rules governing ex parte communications -- emerged as a result of discussions at these sessions. At the request of several key groups involved in these discussions, this HEPG seminar was organized to explore in more depth the regulatory decision-making process and ways in which it might be adapted to deal with a changed electricity industry.

The seminar began with a critique of the current system from the decision-maker's perspective, followed by comments from two federal judges on the likely response of the courts to process reform. A panel of practitioners provided different viewpoints as to the environment in which utilities and other parties approach the regulatory process, and the session finished up with the observations of two professors of administrative law and a general discussion.

Regulators: Critique of current regulatory process and alternative models

There are differing views as to whether regulatory bodies are capable of dealing with a more competitive marketplace. It could be argued that competition and regulation have nothing to do with one another, and that the problems of responding to a more competitive marketplace may require changes, not only to the regulations themselves, but also to the process of regulatory decision-making. This forum explored that question.

Papers: *Sunshine May Cloud Good Decision Making, The Overjudicialization of Regulatory Decisionmaking*, and three papers from the California Public Utilities Commission¹

First Regulator

Prior to the enactment of sunshine laws, the proceedings of many commissions were of a more quasi-legislative than a quasi-judicial nature, and commissioners were in full control of the process. During a proceeding at my commission, the hearing examiner communicated freely with the commissioners. Commissioners could ask questions of staff with specific technical expertise, even if the staff had been witnesses in a proceeding (Although the utilities didn't like this practice, it was necessary because we didn't have enough staff to have more than one person who was an expert on any particular subject.) Commissioners wandered in and out of each other's offices all the time -they could try out ideas on each other without worrying about making each other look foolish in public. They could talk to any citizen with a concern who could afford the fare to the state capitol.

The only (self-imposed) "sunshine" rule was that no votes could be taken in these sessions. There were, of course, few surprises, because by the time you've argued a case for several hours with your colleagues, you know pretty much where everyone stands. The only *ex pane* rules we had were: 1.) never talk to anyone in the utility's rate department while the utility was in a rate proceeding; and 2.) try not to talk to the lawyers about any case they were dealing with. That was it. You talked to utility executives, to consumer groups – anyone who had an interest.

Sunshine laws and *ex parse* laws took this control away from commissioners. In some cases control was shifted to the staff, who weren't subject to the rules and could communicate with each other all they liked. In some cases control was shifted to parties in proceedings, who could control the record, even when the general public might have had an interest. But commissioners were

¹ Papers and outlines handed out for this seminar are listed at the end of this summary.

stranded – collegiality, education of new commissioners, the trust that grows from familiarity with your colleagues and their approach to issues -- all this was sacrificed. Once I wrote a memo to my colleagues, saying "Since we seem to have to talk about these things in public meetings, here are some issues I'd like to discuss at our next meeting." When we got to the meeting, one of my fellow commissioners said, "I'm sorry, I didn't read your memo, because as I understand the law, it counts as an *ex parte* communication."

When I got to the FERC I found the same state of affairs. I couldn't open my mail. I could only talk to one of my colleagues at once. I was told to pick my assistants with care, because they would be voting in my name more often than I would. We have created a circumstance where we have delegated deliberations. We have delegated decision-making. At the FERC, it's the assistants who sit around a table (at what they calla "pre-agenda" meeting) and develop policy, divide up the work – who basically get to do what the commissioners used to do.

Sunshine laws and *ex parte* laws have narrowed the focus of the work commissions do and forced commissions into an undo emphasis on the adjudicatory side of their activities. They have required commissioners to pay more attention to the parties before them, and devote less attention to the indirect consequences of their actions. This has tended to isolate commissioners from the outside world and makes them bad policymakers.

As I look back over my career, the routine work of the commission was almost never the important work. We deregulated surface transport. We've restructured the telecommunications industry and the gas industry. None of these fit an adjudicatory role. All of these called on commissioners to understand a wide range of technical issues, and decide where best to use their authority to make changes to produce an efficient and equitable economic system. There is no one else in this society who can play this role.

Second Regulator

I am, to my great surprise, coming to the end of my term on the commission, and I hope that the individual who will succeed me has a more productive experience than I have had. This is a sad commentary, but public life today seems to be predicated upon the assumption that, when a vacancy occurs on commission, the Governor of the state sets out to find the worst candidate in the state to fill the position. The state Senate then mindlessly confirms that individual, and then belatedly we try to do whatever we can to neutralize the ability of this corrupt and incompetent person to fulfill the duties of the position he has just been asked to discharge.

The distrust, the lack of collegiality, the distance between myself and my colleagues, the service on a committee that doesn't meet, is terribly corrosive. The term, "to place something in commission", originates from 14th century England, and was until recently understood as an attempt to weaken the authority of an executive by making a decision subject to be discharged by a committee. At some point, there is no meaningful authority left.

There are three problems at my commission. Dispute resolution is too long and too complicated. If you can't find the magic words in the record, you cannot make a decision. We're currently working on finding alternatives to the present process.

Ex parte contacts are another problem. In 1912, a little town in my state passed an ordinance to deal with the new horseless carriages zipping through town. It stated that, "When coming to an intersection in a self-propelled contrivance, the occupants of all four vehicles shall stop, and none shall proceed until the other has commenced." When I first met my new colleagues on the commission, I suggested that we go across the street and grab a sandwich -- it was thereupon pointed out to me that, on my very first day on the commission, I had suggested that we violate the law.

As President of the commission, I cannot confer with my colleagues as a judge would about

how workloads are maturing and the status of assignments that have been made. Consequently, the commission has little capacity to make judgments about how it will utilize its resources -- one commissioner can make demands on staff that may be critically needed elsewhere. I would like the ability to meet with my colleagues to plan workload.

This process of decision-making by a body of five persons without consultation is irrational. It alarmed the general counsel of my agency that I would walk in front of a committee of state legislators and bluntly, brazenly tell them how decisions are made in the state. But it's seedy to hide the truth. A government that operates under circumstances that it doesn't wish to fully lay out in public is dysfunctional from the get-go, and I don't think an assumption that the public prefers the illusion of accountability to true accountability is very useful. The legitimacy of government and of authority is very much an issue in my state right now, and I don't think the status quo has a legitimacy that meets the public's expectations.

So I'm here for some fresh ideas. I was told in the legislature earlier this week that this group, bringing together as it does so many individuals with such broad-ranging backgrounds, from within and without the state, from within and without consumer groups and industry groups, would be of great help to the legislature in providing direction to them as they try to move forward on these issues. We have heard it posited that the role that regulatory commissions are asked to play is unique, and that current practices are inhibiting the fulfillment of that role. Others here might disagree, and say that their role is not unique, and that the process is just about right the way it is. Whatever the answer, these are basic premises which it is very important to test at this point in the history of regulation of this industry.

Third Regulator

We're here around this table to figure out how to allow regulators the ability to create regulatory change where it is needed – change of an unprecedented nature that is going to be required to address changes that have taken place in this industry. One of the first things I did when I became a commissioner was to champion the cause of getting the commission an exemption to the state's open meetings statute. We needed this exemption so that the three members of the commission could go into a room together and discuss what we were going to do about these issues, the outcome of which are vital to the state. We got an exemption to the Administrative Procedures Act, which allowed us to talk to the experts on the staff, even though they might have been witnesses, to talk about technical aspects of issues.

Why do we need to be able to talk to each other? The issues we are asked to decide are extremely complex, and require deliberation among colleagues, the benefit of collective wisdom, and all the expertise we can muster. But these days you've got down-sizing, you've got right-sizing, you've got reduced budgets and reduced staff, and you simply don't have the luxury of shaping policy through intermediaries, and through double and triple hearsay.

I'd like to pose a question to those of you who are not regulators. If you had to go back to your office today, and found that there was a new office policy that you had to go through a member of your staff or some other assistant in order to work with your colleagues, how difficult would it be to accomplish your objectives? If you enable people to talk to one another, you still have dissent, you still have the ability to think independently, but you also get the benefits that people usually get from talking issues over with one another.

A commission cannot act outside of its order. Any order of ours is appealable and gets us right into the judicial system. The retail wheeling issue is a good example of how this system works.

It is a complex issue, and one about which feelings run high. How do you discuss this issue? Being ultimately answerable to the checks and balances of the court system ensures that we have someone who is going to review the propriety of our order, and whether the commission has made errors of procedure or of law, but we are still able to move forward on our business.

One of the benefits of having the exemption is that intervenors in cases must put their best case forward, because there is no assurance that whatever they agree to with staff will carry the day. The commissioners will be deciding the issue themselves -- they will be debating it -- they will be looking at the facts, and not a "He said", "She said" kind of arrangement.

Another benefit is time and speed. We have case management. In my state, we have moved to a zero docket backlog for the first time since the inception of the commission. We have gone from cases that historically ran 2 to 3 years to cases that run 9 to 12 months -- we have eliminated the incentive to drag a case along.

Another benefit is that, given a commission with the ability to deliberate in private, Wall Street no longer speculates about the outcomes of commission decisions.

Another important benefit of the open meetings exemption is that you do a better job of accounting for different opinions on the staff. Any commission has "company" people who concentrate on what utilities are doing, as well as what I'll call "tree-huggers" for lack of a better term, and people with other points of view. Leadership coming from the chair or member of the commission ensures that you have the breadth of these positions represented, and don't have conflicts among the staff as to what should or shouldn't be part of the record. This is a much more honest way of proceeding.

Finally, any citizen can walk into a hearing room at the end of a proceeding and say, "I would like to make a statement", and not be cross-examined, or have to be represented by an attorney.

Fourth Regulator

The strange nature of the way we do business was driven home to me fairly early in my experience as a commissioner. The commission had an open docket on low income payment plans. The governor, in appointing me, had asked me to go out and talk to consumer groups and make them feel like they have access to the commission. So I did – I went out and met with folks (although not with parties in the case) to hear what their concerns were, and one day I discovered that a small gas company in the state had filed a complaint against me accusing me of having improper contacts with customers. I got a call from a reporter, saying "What do you have to say about this?", and I said, "Well, I've been accused of being in the consumer's hip pocket, and that's absolutely right, I am." And that was pretty much the end of that. But what's interesting is that, you would expect, as my Governor did, that part of my job would be to go out and be available to the public, and listen to their concerns, and suddenly there I was, accused of violating my responsibilities.

Historically, the bulk of work that commissions have done has been quasi-legislative in nature. Economic regulation by commissions, be it of railroads, electric utilities, or whatever, developed in this country out of concern that legislatures were not ideal bodies for dealing with the complexities of ratemaking or other aspects of regulating these industries, and therefore we should create specialized bodies to take over these functions from the legislature. There are cases which are adjudicative in nature, such as consumer complaints or boundary disputes between utilities, but the bulk of what regulators do is quasi-legislative in nature, like rulemaking or ratemaking.

It is interesting that restrictions on commissions cover both quasi-judicial and quasi-legislative functions, without regard to whether or not the restrictions match the process at hand. In judicial proceedings, the input is very narrowly controlled, and the decision-maker is largely precluded from bringing in extraneous information. *Ex parte* communications are verboten. You could lose your

license if you violate that. But in exchange for the narrow information, the impact of the decision tends to also be fairly narrow – you decide a dispute between two parties, and that's where it ends. All the parties that are affected directly by the decision are sitting at the table. Indeed, you have to demonstrate an interest in the outcome of the proceeding before you can intervene. There is no prospective impact unless the case has some precedential value, and the decision-maker is expected to be neutral.

Now, contrast this with legislative decision-making. Legislators are expected to get wide input – as much as they can – before making a decision, because their decision is going to have a wide impact, and will affect parties whether or not they're at the table. It's no defense to say, "I don't have to pay that bill because I wasn't there when they set the rates." You pay it whether you participated or not – it's prospective in nature. Due process doesn't play much of a role in legislative bodies.

Regulators have been provided with a job that is fundamentally prospective in nature, but the process by which decisions are made is essentially adjudicatory. One morning, I read a story in the paper that two communities near where I lived were thinking about merging. I walked into the office, where we were hearing a case in which these communities were asking to turn a toll call into a local call, and found out that the hearing examiner had decided there was no "community of interest" between these two towns. I said, "Wait a minute, how about this story in the paper? How can we possibly say there's no community of interest when they're discussing a merger?" She said, "You can't consider that, Commissioner - It's not in the record." From her perspective, the work of the commission was best served if the commissioners were less informed on the subject than the average citizen who read the newspaper that morning.

Lawyers are trained in process, and that's what they practise -- whether it's appropriate or not.

Judicial review of commission decisions has reinforced this tendency by concentrating on questions of procedural discipline.

Commissions these days are being called upon to make some very fundamental policy decisions regarding the electricity industry. I'd like to throw out for discussion a suggestion about an alternative way of making these decisions more coherently. A company when filing, say, a rate case, which as discussed above has impacts beyond the parties present, identifies those questions which it feels are policy issues. All parties after discovery have the opportunity to identify policy issues, and the commission goes into "legislative mode" on these issues -- engaging in fact-finding, observing *ex parte* rules to the extent that they disclose all of their contacts, and free to consider the input of experts, public hearings, etc, and free to communicate with each other on these issues. At the conclusion of these proceedings, the commission issues its opinion, at which point the parties can then meet and settle the case consistent with those policy pronouncements, or choose to have hearing before the commission (in its "Judicial Mode") on residual matters, with the understanding that for purposes of the hearing they have to follow the policies just set. (Commissions need to be wary of settlements reached outside of clear policy guidelines. Nine times out of ten, the "parties in the room" will agree to stick it to those who aren't present.) Judicial review of this process would focus on whether the essential elements of fairness and due process had been followed.

[A participant agreed with the notion that input from the public was important. In the seventies, none of the utilities or regulators thought there was any demand elasticity for electricity at all – the only people who were testifying that there was were some outside parties, mostly from the environmental movement, who turned out to be right. Occasionally someone walks in off the street with a good idea.]

Response from the Bench: How will the Courts view process reform?

First Judge

The present system of utility regulation is based on the well-known concept of "trust no one", which has become a more dominant theme generally in American government. But if you're not going to trust people that you've placed in positions of public responsibility, you're not going to be able to counteract the lack of trust by splitting up staff into advocacy staff and advisory staff, or by passing extreme sunshine laws. The previous expositions we've heard here have adequately described the consequences of these policies to the transaction of public business.

Fairness, as perceived by lawyers, by industry, by ratepayers, and so forth, is the dominant value that is considered when creating commissions. How these organizations are set up to make policy is of secondary interest. And if fairness is the dominant theme, we look to the courts as the forum for mediation. The courts, of course, work on the adversarial model, where the judge plays an essentially passive role, and is not there as a proponent of any sort of forward-looking policy. In the courts there are also no permanent sets of interest groups, as there are before regulatory commissions, where there are different types of consumers, environmental organizations, utilities, etc., all of which have an ongoing advocacy job.

How does the role of a utility commission change as we go through the transition to more competition in another regulated industry? Competition in the infrastructure industries like electric power tends to drive rates toward cost. The economists among you would say that's good. But the process also tends to provide greater benefits for the customer classes that are big and have alternative supply sources, particularly industry. It does not benefit so much, if at all, small residential or commercial customers who have no options for their power supply and more inelastic

demand. That makes economic sense, but in some quarters, it might be considered a violation of the principles of equity, however they are defined. Regulatory institutions are traditionally defenders of equity. They've developed more of an interest in efficiency in recent years, but they haven't lost their interest in equity, and properly so — at the very least, this follows from the method of their appointment or election to office.

When I was a state commissioner back in the seventies, we had to deal with a situation of rapidly growing demand. In this situation, largely out of concern for conservation of resources, we felt that marginal cost ratemaking, which was presumably an effective way of allocating resources, particularly fuels, had a lot to recommend it. We were the first commission in the country to come out in favor of marginal cost ratemaking, but the idea never received a great deal of support. If you really pinned people down, they were against it on equity grounds. They didn't think it was fair that, if you turned on your washing machine during the air conditioning peak, you had to pay a hundred times as much as someone who turned on their washing machine at one o'clock in the morning. This has been one of the great problems of introducing these ideas in the regulatory arena. Traditionally (and this is going back a long way), ratemaking meant protecting the residential class. The captive users. There were a lot of them, and they all voted, which is one of the main reasons why we had commissions to begin with. This was equity in the view of the commissioners, and generally also in the view of the courts.

This definition of equity is going to be more difficult to maintain in a more competitive regime. The forces of competition are moving against what has been considered an equitable result. Right now in the telecommunications industry we have what is called universal service, which means that everyone is entitled to some kind of service -- it might be that they'll run the wires to your house or it might be fiber optics. Whatever it is, everyone's entitled to it, and at an "affordable price". But

there you go – how do you square that with a competitive system, where the companies are fighting over the big urban customer, and no one is fighting for the business of the farmhouse out in the middle of nowhere. What is equity in this scheme of things? It is still whatever the regulators say it is -- and the courts are going to be even more equity-minded and less efficiency-minded than most regulators.

Second Judge

We've heard a sort of "cri de coeur" from regulators this morning. They're telling us, "Help! Someone appoints me to this job, and then they don't let me do it." My first reaction is a technical one. As I understand the federal system under the Administrative Procedures Act, they have an exception to *ex parte* rules in the case of common carrier ratemaking. I ask my class, "What's that exception doing there? Is it logical? You don't let the commissioners talk to staff normally, but on rates it's ok?" The answer eventually seeps through -- they don't understand the rates. It's too complicated. They've got to talk to somebody to figure it out. With respect to sunshine laws that some states have adopted, it sounds as if it's been pushed to an extreme in some instances.

Of course the judges in a panel have to communicate. We communicate in writing, and if all those writings had to be made public, I don't think we could do our job. Someone writes a sentence in an opinion and someone else doesn't understand it, and language has to be put together so that the idea can be communicated correctly. That kind of informal communication is necessary to a court. And it's equally necessary that it be private. My instinct is that we have seen a problem and we applied overkill. Send in the tanks to rescue Patty Hearst. This is a common problem in law, that goes beyond what the regulators described this morning. I don't think you advocate getting rid of sunshine laws – rather you advocate the notion that the law should have some definition of a

meeting in it, so that the definition isn't so broad that it prevents you from having lunch with someone. The strongest case for an exemption, as was pointed out earlier, is that when the commission is carrying out a planning or managerial role, rather than a traditional adjudicative role.

What will happen if you don't get the statutes changed? The pessimistic side suggests that the world will collapse, electricity will be a nightmare, and maybe it will start running all over the ceiling again, like James Thurber's grandmother thought it would. The optimistic side is the same kind of thing I tell myself when all the judges get together and say, "Why aren't we getting our cost of living increases, and the entire federal judicial system is about to go down the drain, and OH MY GOD THIS IS TERRIBLE." The country will survive. We might not get a better judicial system, but it's not the end of the world. One of the regulators earlier was saying that lack of communication means all the power goes to the chairman. All right, so on a five-person commission you've got four jobs that don't mean much and one that does. There are models of running electricity regulation with only one person. All right, so power flows out of the commission. Who does it flow to? Well, you say on one hand the staff -- but they work for the commission. You're looking right now at ways of taking planning problems and turning them over to ad hoc groups made up of relevant interests. If their plans are well worked out you will approve them when they are presented to you, which makes the commission's job less meaningful, but achieves acceptable results.

The problems that commissions dealing with the electricity industry are facing are primarily managerial. Somebody's going to have to plan a transmission system, so we don't lose the efficiencies of central dispatch. There are technical solutions to this problem, and the managerial and planning problem is to bring about those technical solutions. Someone will also have to build that transmission, and this is a planning and negotiation problem. A third big problem is the stranded asset problem. That is a problem that has no technical solution. That's a political problem,

and it requires negotiation among lots of groups. This is not something that adjudicators are very good at. So your choices are: 1.) change the present system, get the exemption; 2.) come up with a way around the present system, work out the problem elsewhere, and present it to the commission for approval.

My final point, as I listen to this discussion, is that there doesn't seem to be a special problem as far as the government is concerned. I just finished writing something about toxic wastes and the regulation of chemicals, and if you think *you* have a problem, try that one. Trying to introduce rationality into that kind of system is very difficult. Why? Because we're living in a time when people don't trust the government very much. The regulators here all said, "Trust me. Trust me." I trust you, because I know you, but there are people out there who don't know you and may not trust you, and they produce a system which is filled with checks and balances and absolutely does try to freeze any action. That's the world we live in. If you show people an organizational chart of the government, and say, "Do you trust this institution? Do you trust that one?", the answer is "No, no, no..." all the way down. You know what group gets the thumbs up? The Army. That gives me hope. Because the Army did what it's supposed to do in Iraq. It showed that if you don't micromanage your tank movement — if you let General Schwarzkopf handle that one the way he thinks best — if you stick to the public decision, which is, let's go to Iraq, let's not go to Iraq, and then do the job you decide on, you get some additional public trust. Translating that into the electricity world, it seems to me that it's also possible to build a degree of public trust by showing them that you can give them electricity at a price that isn't too terrible, and you do this job the best way you can, by taking the lead in planning, so you get lower prices, etc.

Take this problem that people call the "stranded assets" problem. The problem goes like this: It would be possible to reorganize the industry and lower rates quite a bit except for the fact that

you have to pay something for the stranded assets. My impression is that nobody expects to get 100% — maybe they'd *like* 100%, but what they're worried about is that they'll get nothing. If that's so, then maybe you could get the lawyers to use their negotiating skills to produce some solutions, so that prices begin to fall. The average person would think that's the miracle of the century and the politicians would fall over themselves trying to take credit. If that began to happen even a little bit, it would produce a lot of public trust. [A participant pointed out that this was the advice that Colbert gave Louis XV, and we know what happened to him.]

Panel of Practitioners,

First Practitioner (Telecommunications Company Counsel)

One thing that has changed for the telecommunications industry is that, where the traditional rate case situation, with witnesses, cross-examination, etc., didn't make a whole lot of sense at the time, it makes even less sense now. So one of the vital issues for electricity regulation is, given all the restrictions outlined this morning, how are you going to make the policies you need to make? It maybe that you can't resolve the tension between competition and regulation, and that commissions, ten years or so from now, will simply become the commercial utility courts of the nation, where parties, be they consumer interests or providers of services, take their disputes, and the commission acts in a purely adjudicative fashion and steps away from policy-setting, from rules of entry, and rules of competition. The question is, who is going to make the other decisions?

Another option is to take a look at the way the caseload is handled. Does it make sense in the current environment, as opposed to the environment in 1915 when they set up the commission, to have all commissioners rule on all disputes that comes before the commission? Does a full commission really need to decide on minor complaint cases? Do all commissioners need to approve all contracts? Would it be possible for a commission to separate its jurisdiction, like municipal and superior courts, so that the commissioners are freed up a little to devote their attention to policy matters?

Second Practitioner (Utility Attorney)

It has been asserted by several speakers that the process doesn't work, the process has failed. What is the purpose of the process we're talking about? Under state statutes, the purpose of the process is to set rates that are just and reasonable. Rates that allow utilities to recover prudently

incurred costs. That provide a fair return. Can it be said that the process has failed to produce such rates? That utility investors have become obscenely rich? That customers have been raped by outrageously high electricity rates? The process is not the problem.

What is the problem? All of the speakers have asserted that the regulatory process is largely legislative in nature. I would like to suggest that most of the cases which come before a state commission do not call for legislative policymaking. Most rate cases turn on issues that are fact-sensitive, and rate cases are not good places to make policy. One of the regulators said that the routine work of commissions was not their important work -- that the restructuring of various industries over the past few decades was the important work. Not only do I disagree with this, I don't even concede that the restructuring of these industries is the proper work of commissions. This problem began with Mr. Justice Douglas in the *Colton case*, when the court decided that things which should never have been regulated in the first place, like the wellhead price of natural gas, should be regulated. Regulation is primarily a substitute for competition. I've never read the statute that said that it was the job of regulators to encourage competition.

What is the role of policy? A common objection to the adjudicative process in utility regulation is that the players aren't all equal in their ability to make themselves heard. Is policy simply the sum of equal amounts of interest by all parties? I think that it is not, and that participation in proportion to the importance a party places on an issue should be considered by regulators more.

When I retire, and need never again appear before a regulatory commission, I'm going to write an article called "The Myth of Regulatory Expertise". Few commissioners are serious students of regulation. I was on a panel once on the social role and implications of regulatory rule-making, where I took the position that commissioners ought to implement the statutes which created their

commissions and carry out those functions, and a commissioner on the panel laughed and said, "Son, I don't know how it is where you practice, but in my state, when the Governor says "Jump", I say "How high?". In most states, the regulatory process is highly politicized. Earlier, one of the judges said, "I trust you because I know you." I say, "I know you, and I don't trust you."

The problem is not that the process is over-judicialized. It isn't judicialized enough. I want commissioners held to the facts of the record before them. When I represent a client with a real interest, I do not want commissioners who were appointed for political reasons to say, "Don't bother me with the facts, I'm here to make policy." The judicial process is a bulwark of defense against uninformed commissions and biased staff. My cure is more of a judicial approach, and for the courts not to defer to regulatory expertise but to insist on evidence of record that supports the conclusions, or even to engage in *de novo* review.

Third Practitioner (Attorney to Large Industrial Customers)

I worked for the California Public Utilities Commission during a time when there was a lot of interaction between the commissioners. One would suspect that, with so much discussion between offices, not much would happen at the public session, and that no one would see what the deliberative process really was. In fact it worked very much in the reverse. The commissioners communicated so much prior to a conference that they had a much clearer understanding of the issues and of the opinions of the other decision-makers, and they wished so much to respond to them in public that conferences took twice as long as they do today. The public actually got a much better feel for what went into making a particular decision.

The single biggest problem facing many commissions is the sheer volume of decisions that it faces. The California commission issued approximately 1400 decisions in the past year -- this volume

is simply overwhelming. The previous speaker asserted that commissions were created to constrain monopolistic behavior -- that's absolutely the reason the California commission was created in 1911, but eighty years later, you've got companies that are clearly not monopolies, like some of the surface transportation companies, and the legislature, by and large, has never gone back and changed the statutes to allow for changes in these industries, leaving it to the commissions to make the policy judgments to handle this themselves.

First and foremost, the role of administrative law judges and hearing officers needs to be clarified. Often they get too close to the process, and achieve almost a proprietary interest in the final order, so that it becomes very difficult for decision-makers coming in at the end to make any changes. There have been proposals in California to give back more control to the decision-maker by involving them earlier, or changing the way they handle case load. Last year, about 900 of the 1400 decisions appeared on the commission's consent docket. Would a rational application of sunshine statutes require that the commission discuss each and every one of these orders? Conversely, can we assume that no discussion at all has occurred with regard to those 900 decisions? Some relaxation that would permit the commission to act more quickly -- to review or discuss groups of decisions, or some other method, would achieve better results.

But if we go to a streamlined model, we have to have some means of retaining the rights of an aggrieved party to come back and get a quick resolution of a dispute. Today, the person really left out of the loop is a complainant before the commission, because the commission has to crank out decisions within ninety days. There has to be some way for a party, be it a competitor or a consumer group, to obtain relief from the commission. Alternative dispute resolution models are being discussed, and they are potentially a good option. Any options that offer a legitimate way of moving the process along faster are good, because it's in no one's interest to drag out a proceeding.

Fourth Practitioner (Consumer Counsel)

It disturbs me to hear so many calls for the elimination of due process protections. When I was a hearing officer, I advised the commissioners that the most important thing they could do was to protect the integrity of the process, so that parties involved would be confident that they were trying to come up with fair decisions. They may not win all the time, but if the losing party thinks that at least they got a fair hearing, they'll be more likely to accept the commission's work.

As a consumer advocate, it is even more important to me that the public think the process is fair. I hear people supporting a notion that commissions should balance everyone's interests -that's not what they're charged with. They're there to assure just and reasonable rates, and it's important that the public perceive that this is what they're doing. But we all know that the public right now does not have a lot of faith in the political process or in government in general. There have been scandals at commissions in recent years. In the seventies a commissioner in Missouri had to resign because he was accepting favors from the telephone company. In Minnesota a few years back, a case had to be completely re-litigated because the commissioners, while they were deliberating, were negotiating job offers with one of the telephone companies. Recently the chair of the Florida commission resigned because of allegations of improper behavior. There are currently allegations of bribery in Oklahoma. This sort of event does not give the consuming public a great deal of faith in the agency, and if we eliminate due process, we don't have much left. Discovery is also very important in utility regulation, even in rule-making proceedings, because you generally have one side – the utility – which is in control of the information. Other parties need all the tools they can get to help level the playing field.

I also disagree that commissioners never get to discuss policy. They spend a great deal of their time attending fora like this, for instance. But commissioners need to realize that, while it

might be easier to sit down and make a deal with all the people around a table, they need to look at the record and come up with a sound decision based on the record. I don't think judicial review provides a great deal of protection, either, because you can base a decision on one tiny piece of information in the record and still be within the bounds of "arbitrary and capricious".

The degree to which discussion between commissioners is constrained by sunshine laws has been overstated here today. In Missouri, the commissioners have a daily meeting to discuss pending cases.² If there's a big case before them, the subject is posted on the agenda, they discuss it, and the meeting is open to the public. I have never seen their decision-making constrained because it's open to the public. Most of the issues discussed are so esoteric that the press doesn't understand what's going on. The commissioners hold business meetings to manage caseload, discuss appropriate procedure, etc. [In response to a question about how the Missouri commission got parties to address a particular issue, the speaker said that they issue a procedural order, saying, in effect, "When you file your testimony, address this issue."] If letters are written in, they're simply filed, and copies are sent to all parties in the case.

[A participant noted that there are times when evidence that came out of public hearings was far more useful to the commission than anything that the parties put in evidence, and it made him wonder what the commission was missing in those cases that didn't involve public participation.]

² The Missouri Commission states that it meets approximately once a week for the purpose described by the speaker. -- Ed.

Fitch Practitioner (Utility General Counsel)

Having heard the comments of the counsel who represents utilities just now, it is interesting to note that there may not be an identity of interest between the utility itself and the counsel who represents the utility. That may mean inside or outside counsel -- I'm not going to explore that distinction. But I disagree with several things he said.

He said that the adjudicatory process is a protection from politics -- that may be the intent, but it is not the result. I don't know of a single commission where a political or legislative consideration hasn't somehow entered into its decision-making. There is a political impact, whether you like it or not, and it is unrealistic to assume that you can try to take the politics out of utility regulation.

The second thing I disagree with is that state commissions are bodies that are narrowly convened, and their only purpose is to set just and reasonable rates. That may be true in some states, but *should* it be true? Because the underlying question I have from listening to the discussion today is, who is making energy policy in this country? Congress obviously does some. But do we really *want* Congress to set energy policy? Would they be able to? I think not. If we expect Congress to make every single energy policy decision, we're going to paralyze the country. The same thing goes for state legislators, only more so. Energy policy is very complex -- it gets more complex all the time, and Congress has delegated two sets of regulatory experts to make the decisions that lead to policy for the good of the country. They are legislative, and not solely adjudicatory, in nature.

Now some of our regulators, particularly at the state level, are probably not as expert as we'd like to see. The answer is not to take decisions out of their hands, but to educate them. Clearly, we need a much better educational system for anyone involved in the process, whether it's an

adjudicatory or a policy-making process. Some time ago, in Texas, someone made a comment that a mere housewife could not serve on the regulatory commission, and of course the next thing the governor did was turn around and appoint a mere housewife to the commission. This engendered quite a bit of debate about what level of expertise you need to serve on a commission.

Energy is important. It's a sector that has great implications for the future of the country, and I don't think we should be embarrassed to say that people in this area should be educated about how to do the job they're doing. Education builds trust, because you know that people know what they're doing. But you need to educate more than commissioners. The people around the table here should view themselves as the Machiavellis of the energy business. We need to find Princes to send out into communities, to law schools (where there is currently very little emphasis on regulatory process), and to the courts, to educate people about what's wrong with the system and how to fix it. The more you educate, the more you build trust, the more trust you have, the more communication there is, and this is a process we should start here.

The Indiana commission, by court order, does not have the ability to issue declaratory orders -- it only has the ability to issue decisions based on facts of record. So it has less authority than a normal adjudicatory body would have, and the result is that the citizens of Indiana get rulemaking by statute. The legislators get together and try to get the ratemaking process right, what the exact way of handling a specific issue should be, etc. This is all done by people with no expertise in this area, and in the context of last-minute bargaining over a bill, which gets you funny results sometimes, when someone sticks in language at the last minute, after all the deals have been cut. So you have rulemaking by statute, and, on the other end, regulators who don't understand anything beyond the issue of the day, and no one understands how it all fits together. This is not a good situation for anyone, and I would much rather go back to the broad concept of allowing regulators to make

decisions that are in the public interest, based on the facts of the case, and not on a statute that was written for another set of facts and events in the past.

Another problem in Indiana is that, because of *ex parte* rules, we have no ability to settle a case quickly. We had a merger case, where there was a great deal of controversy over whether the commission had the ability to designate staff to talk to the utility. With no one to talk to, it was a real question whether there was any possibility of settling the case. This is not the case everywhere. At the FERC, almost every case is settled. In Indiana, on the other hand, almost every single issue is litigated. Normally, in other states, the company files its testimony, opposing parties file their case, you have a chance for rebuttal and you go to hearing. In Indiana, we file our case after 4-6 months of discovery. The other party drafts its testimony. Several months later, *they* go on the stand, and we go through the same thing with rebuttal, etc. -- it's a three-part process. In each of these hearings, all the commissioners must be present. On top of it all, we had a recent court decision that any party that did not intervene in the commission proceedings can take it to the courts, and start the whole process from scratch again. There is also very little deference to the "arbitrary and capricious" standard, so the courts are more than likely to look at any case *de novo*.

The Academic Perspective

Papers and Outlines: *Unruly Judicial Review of Rulemaking, Regulatory Decisionmaking Reform, and California Underground Regulations*

First Professor

The remarks of one of the practitioners earlier imply a serious misunderstanding of what is happening in the electricity industry today. Yes, it *can* be said that consumers have been raped by high electricity rates. Electricity rates, on average, are about 20% higher than they would be if the industry were governed by market forces. That certainly fits my definition of being raped. Now, it is certainly the case that that is not reflected in high monopoly rents earned by providers. That is because we have managed to come up with a combination of institutions, substantive regulatory methodologies, and procedural regulatory methodologies that are so completely out of synch with the technology and the economics of the industry, that we have created a lose-lose-lose environment in which no one gets any rents out of it. It's all in the form of massive inefficiencies. The only rents I can identify are those of my students, as they go out in the practice of law, who get very rich cross-examining expert witnesses in ways that, when I read the transcripts, mystify me as to what they're talking about.

Now, this practitioner also misstated the holding of *Hope Natural Gas*. The holding in *Hope Natural Gas* is that, "We, the justices of the Supreme Court, do not care what methodology you use. Any methodology that produces results that you can convince us are acceptable or good, we will label just and reasonable." Since *Hope Natural Gas*, there have, of course, been about 1,200 cases applying the just and reasonable standard, and over the last decade the vast bulk of those have involved completely different methods of regulation, particularly in the natural gas industry, where

the courts increasingly say, "Well, if you can convince us that what you have done is restructured the industry in such a way as to allow market forces to become effective and to determine prices, then we will call those rates just and reasonable as well." It's certainly true that the particular methodology that was applied and upheld in *Hope Natural Gas* was the traditional historical cost-of-service method. To give you an idea of what I think about the future of that method, when I put together my latest book of teaching materials, a case book on economic regulation, I had to figure out what I was going to do with cost of service regulation. I'm interested in teaching materials that will teach students how to practice law in this area in the future, not in the past. I need to cover this in some way – where do I cover it? -- I put it in the chapter entitled "Historical Evolution" because I have every reason to believe that none of my present students, except perhaps some of the third years, will be involved in implementing that archaic methodology.

The process of utility regulation is a legislative process. And the Supreme Court first said that in 1892, and it has said it at least a dozen times since then, most recently in *Barrasch v. Duquesne Light* just three terms ago. As such, it is a process that requires a tremendous amount of data, from a wide variety of sources. It is also a process that requires data of particular types, and this goes to a related point in both the federal Administrative Procedures Act, and in great many judicial opinions: rate-making is a species of rule-making. Rule-making and rate-making are dominated by disputes over policy and over issues of legislative fact; they're not dominated by issues of classic adjudicatory fact. The kinds of factual issues that our legal system was designed to resolve are questions like, who struck the first blow in a nineteenth century tavern brawl, and was he baited by a prior name-calling by the other party to the brawl? When it comes to a case based on that sort of very specific, historic fact, our legal system still may have problems resolving them, but we haven't been able to come up with a better system than the one that we have been using for centuries.

When it comes to the kinds of gathering data relevant to the kinds of legislative facts that increasingly dominate the rate-making process, the judicial method of gathering facts will appeal only to people who are trained as trial lawyers. And even they, the few that I've seen who have made the transition into managing a multi-billion dollar enterprise, have quickly discovered that oral evidentiary hearings in cross-examination of employees are not the most efficient way to gather the relevant data. Now when I say legislative facts, what I'm talking about are facts that are broad, that are not specific to individuals or to individual firms, but that are broadly applicable to large numbers of people, related to generalizable phenomena, and in a high proportion of cases are looking forward instead of looking backward.

In the new world of utility rate-making – we're seeing this already in the natural gas industry, and we will see it increasingly in the electricity industry – there are not going to be fixed rates. There are not going to be situations where "Here's the rate, and it will remain in effect until the next rate case, and here's the relationship among rates that will remain in effect until the next rate case." That is totally inconsistent with the way in which a competitive market functions, and it's incompatible with the kind of very dynamic, volatile market that will exist in this industry in, I believe, no more than five years. Instead, the rate-making will consist of devising formulas, trying to figure out what formula will produce the best result. And those formulas will in turn be based upon predictions of relationships, broad relationships and effects on the incentives of both the providers of electricity and of consumers of electricity. If any jurisdiction continues to use the backward-looking historical fact, cost-of-service approach to any extent, it will cost the economy of the state that uses that methodology a great deal. Once you accept that rate-making is rule-making, and that's been broadly accepted for forty years, then it becomes increasingly clear that the procedures that historically have been used in many jurisdictions make no sense at all. There is no

need, except in very rare cases, for an oral evidentiary hearing. I just got through reading 3,000 pages of cross-examination of the experts who are opposing me in a case that's to be tried before a jury, and I underlined everything important in red, and three of the 3,000 pages that had underlining on them.

There is also certainly no need for limits on ex-parte communications, and indeed limits on ex-parte communications are extraordinarily counterproductive in circumstances of that type. You have to be able to try to assemble the relevant data from a wide variety of sources, the vast majority of which are not accessible through any sort of formal hearing record, or even for that matter, through a formal notice and comment decision-making procedure.

To support these points, I refer you to a large number of decisions of the District of Columbia circuit over the last ten or fifteen years, beginning with one of my real favorites, former Chief Judge Pat Wald's opinion in *Sierra Club v. Costle*³. Many of you may have read it because it has fifty some odd pages of discussion of EPA's implementation of Section 111 of the Clean Air Act, the section that deals with SO₂ emissions. But the more important part of the opinion, for this discussion, is a 12-page discussion of ex-parte contacts in rule-making. It's just an outstanding explication of the subject. Basically she says, not only are ex-parte contacts not prohibited, but that ex-parte contacts are absolutely essential in order to allow an agency to perform the functions that are assigned agencies in the rule-making context.

There have also been a great many decisions in the D.C. circuit over the last six or seven years, in particular, in which the D.C. circuit has consistently upheld the FERC's decisions declining to authorize or require an oral evidentiary hearing. The FERC's use of oral evidentiary hearings has plummeted tremendously over the last couple of decades, really beginning with the Supreme

³ *Sierra Club v. Costle*, 657 F 2nd 298 (1978) pp.400-410

Court's decision in *Florida East Coast*, in which in 1972 the court held that the term "hearing" need not mean oral evidentiary hearing, but in the rate-making context certainly could be satisfied by submission of paper. Since then, the level of oral evidentiary hearings used in regulatory proceedings by all federal agencies has fallen way off, and that's certainly true at the FERC. Over the last six or seven years, FERC has denied hearings in a great many cases in which it previously would have routinely allowed hearings, and on every one of those occasions, when the issue was then raised in a reviewing court, the court usually in no more than two or three sentences, said, "Of course you're not required to have an oral evidentiary hearing. Whatever paper proceedings you provided are not only adequate, but almost certainly superior to the oral evidentiary hearing as a basis for obtaining the kind of data relevant to the kinds of decisions you're now making." A particularly good example of that is the DC circuit's opinion in the *Iroquois Gas case*, entitled "Louisiana Independent Producers and Royalty Owner's Association", in which the claim was that FERC had not conducted a sufficient hearing in the proceeding and the response of the panel of the DC circuit was, "We're mystified as to why they conducted any oral evidence hearing. There seems to be nothing in this case that is appropriate for an oral evidentiary hearing. We're not going to tell them that they violated the law by voluntarily providing one, but we are going to start by saying we're mystified as to why in the world they did it."

The procedural issue also leads us right to the whole issue of communication among colleagues, and communication among others within agencies in the decision-making process. Are we better off with single-manager agencies, or are we better off with collegial decision-making bodies? I'm not sure I know the answer to that question. But I do think there is the potential for a collegial body to make higher quality decisions measured by a number of criteria, if the decisionmaking process is allowed to evolve in a healthy manner. I think the potential for better decisions

to be made by a collegial decision-making body than by a single individual can be illustrated in part by the description we had this morning of the present composition of the Michigan Public Service Commission. In a sense that strikes me as an ideal composition of a three-member body charged with that responsibility. We've got people of widely different educational backgrounds. People who have widely different life experiences, who come from very different communities. As a result they are likely at least initially to begin with a greater ability to empathize with some important constituencies within a state than with others. But once placed around the table together, and told, "You must come to agreement on how to deal with this cluster of issues that affects all of the constituencies that you represent, and that involves all of the areas and expertise that you have from your prior education and your prior professional experience, plus a lot more that you haven't yet been exposed to", I think the collegial decision making process can produce a much higher quality decision. They will be forced to engage one another in discussion. Discussion that at times may not be entirely polite. Where they are sharing very different views and perceptions of even what the public interest is, and are attempting to educate one another as to the very different entering points of view that they and the constituency with which they empathize carry initially into the decisionmaking process.

A collegial decision-making process is potentially the source of strength and higher quality decisions only if it takes place through a communication process that includes what I call the three C's – it's got to be Candid, Critical, and Continuous. The views that are expressed cannot be always the most polite of views. Sometimes they need to be, "You're really full of it. You really don't understand what this is all about, either because you don't sufficiently empathize with this constituency that I tend to identify with more than you do, or because you have a misunderstanding about how alternative sets of rules might work and the kinds of results that are likely to be obtained

through application of alternative sets of rules." If that process goes on in that candid manner, in a manner that is frequently quite confrontational, and it continues on a regular basis, it probably will produce better quality decisions both in term of the merits and the ultimate effect on the economy of the state. That's what we're talking about – managing a very large portion of the economy of a state, and the likely public acceptance of the results of the decision-making process.

Actually I think that there's an even better decision-making process that state utility commissions and federal regulatory agencies can use. It's what my frequent co-author, Ken Davis, refers to as "institutional decision-making". Under this model, the decision is not a function only of the sharing of the often contentious views of the three or five commissioners of the agency, but a sharing of those views along with the views of the staff members who have expertise in various areas that are relevant to the commission's decision-making. What method of decision-making are you going to use to take on the most important issue in the electricity industry today -- how we're going to handle transmission? If I were a commissioner, I'd need to know a whole lot about the relationship among thermal limits, reactive power, phase shifters, parallel flows, and network interactions. And I'd better have some engineers on hand and available to discuss those with me. And I want those discussions to take place with all of my colleagues at the same time, because if we conduct them separately, we're going to come out of those discussions with very different understandings of what the basic technological and engineering concepts and constraints are. Then I'd want to be able to turn to the economists and say, "Ok, you just heard our discussion about all of these engineering constraints. What does that tell you about the cost of transmission in various circumstances? Are congestion costs likely to be a large factor or a small factor in all of this? Is out of merit dispatch of generating stations likely to be a significant component of the cost of transmission of electricity in various circumstances? Is the cost of transmission likely to vary from

one time period to another as load conditions vary around the loop?" All of these discussions need to take place. And they need to take place with the commissioners and the experts in each field communicating with each other, able to ask each other questions, and not once but in an iterative process, where we go through this for probably a year or more, several times a week before we get very far.

This process also can't be very sensitive to how each of us appears in the discussions. I've attended enough open meetings to know what open meetings are like. They are the absolute opposite of candid, critical, and continuous. They are contrived, they are pre-scripted, and they take place in accordance with an elaborate set of rules, usually unspoken. Not only do you never ask a commissioner a question that might embarrass the commissioner (and, given the complexity of these issues, not even the smartest commissioner is going to be able to answer much. That's another advantage of the institutional decision-making process – you can wind up with an institution that collectively has a lot more knowledge than any individual member), but you also eliminate a lot of other questions on the basis that asking the question might embarrass *you*. After all, you are supposed to be the expert on this end, so you're scared to death to ask a question like, what is a phase shifter anyway? To at least some important members of the community that question makes you seem like a total idiot, but it's a very important question to ask, and I would not want to bet on the results of a quiz of the present utility regulators in the United States. Multiple choice. What is a phase shifter? Certainly I wouldn't want to bet on the results of the same quiz administered to my colleagues at the Federal Energy Bar Association, who may feel at some point that they're competent to cross examine as to the ways in which phase shifters operate without knowing what the hell a phase shifter is.

This process of institutional decision-making can produce very high quality decisions --

probably as high quality as any institutional structure is capable of producing given the extraordinary difficulty of trying to understand all of the complicated things that are going on in this area and trying to come up with a set of rules applicable to this industry that are likely to produce reasonably socially beneficial results. But that in turn means that the commissioners and their staff have to be given the freedom to engage in candid, critical, and continuous discussions. I recognize that there are crooks among us. No question about it. There's what, 300 PUC commissioners in the United States at present. In any group of 300 in the United States, I guarantee you there are some crooks. I hope that those that now exist are caught, incarcerated for ten years, and may they bum in hell, and maybe some fraction of them will be. A few also will get away with it. But frankly, they are still a small minority, I think they always will be a small minority. And I've got enough faith in the rest of you that I would personally be glad to repose that degree of trust in you, with the realistic expectation that *as a quid quo pro I would* get electricity rates roughly 20 percent lower than the ones that I now have to pay.

Second Professor

I have recently been serving on a committee which is charged with making procedural recommendations to the California PUC as to how the commission ought to conduct its regulatory agenda in this era of transition in the industry.

Several of the members of the committee would agree with what has been said several times already today – that the commission has been trapped in a culture of cross-examination and trials. My goal is to move the commission away from the idea that it needs-to settle everything through a

trial. The remark made here earlier, that there is a difference between what utilities want and what utility lawyers want, was very acute. Cross-examination is familiar to lawyers, so they naturally feel that it is the best way to get at the truth. But it isn't a good way to make policy, or to get at what my colleague called questions of legislative fact.

If your law firm is trying to decide whether it should close its St. Louis office, that's an economic decision. A tough one, and people within the firm will differ sharply on the answer. You'll have people who will talk about the strength of the St. Louis market, people who will talk about the cost of real estate, etc. Are you going to have a trial, and have the exponents of different views cross-examine your experts? Of course not. Instead the decision-makers will listen to arguments from various people, they'll study written analysis, they'll ask the experts questions, and they'll make their decision. No one besides lawyers thinks that cross-examination is the best way to make economic decisions, and we need very badly to get away from this method in areas of economic regulation. I don't think that individualized ratemaking, to the extent that it still exists, should be free of due process constraints. But what due process requires is not what is required in a criminal trial. It does not require cross-examination to determine economic facts.

What we've recommended to the commission is greater use of rulemaking to settle policy questions. For some reason, rulemaking has fallen out of use at the commission in recent years. Why? It's a matter of culture and habit. Perhaps it's because the administrative law judges are more comfortable conducting trials than they are running rulemaking hearings. Perhaps it's because the commission would like to hide policy determinations from political scrutiny by burying them in 400 page adjudicatory decisions. Whatever the reason, they don't use rule-making, and they should. Every agency of the federal government is required to have in place a mechanism for negotiated rulemaking, and this should be true at the state level, too. We have proposed that the legislature

tell the PUC that "We have a strong preference that you resolve questions of policy through informal rulemaking." Not a mandate – no danger of reversal by the court if they *don't* do it. But a strong legislative push to change this habit. This can be done through guidelines, manuals, bulletins, policy statements – there are a variety of means. Spelling out these things in advance will be of enormous assistance to the industry and to the commissioners and other decisionmakers.

There's nothing wrong with admitting that this process is political. Policy questions are inherently political – they're tough choices, and they've been deliberately delegated to commissions to make. They might as well make them candidly, in ways that are visible, rather than hiding them by pretending it's a purely judicial decision.

What are the appropriate due process constraints for this type of proceeding? Our committee recommended a new idea, called the conference hearing. This idea came from the Model State Administrative Procedure Act of 1981, and has been adopted in various forms in maybe half a dozen states. All adjudicatory protections and procedures still apply -- if you have *ex parte*, that still applies. But instead of cross-examination, you have experts submitting their views in writing. The administrative law judge can ask experts to explain their methodologies. You can make oral arguments. But you don't actually have a trial over issues of policy. We believe the legislature should make it clear that the PUC is authorized to conduct hearings like this.

Use of alternative dispute resolution is another recommendation of ours. Negotiated rulemaking is a great way to do rulemaking. Negotiated adjudication is also great. The California PUC has gone a long way by adopting a set of rules for ADR. The obligations of the commission exceed by a factor of 100 the time and resources available, so it makes sense to create a legitimate dispute resolution mechanism and delegate as much as possible to it.

Finally, a few words about what I call "Regulation of the Regulators" – matters like *ex parte*

rules, separation of functions, etc. Although I agree completely with some of the things said here today about how sunshine laws like California's Bagley-Keane Act interfere with the ability of commissioners to do their job, I don't think you're going to get exceptions to the Act for the PUC in California. Politically it's a nonstarter. Ask the legislature to let the dirty bureaucrats hold secret meetings? Forget it. The reality is that you have to live with open meetings for the foreseeable future. ADR will help, simply by getting some decisions out of the commission. But I think commissions instead should concentrate on creating a culture where they can meet effectively in public. Tell their staff and each other it's ok to have uninhibited discussion in public meetings, if that's the way it has to be. It's not ideal, but if the alternative is that you never meet, it's the only choice you have. Perhaps it will help build trust.

General Discussion

[This summary of the discussion following the presentations above is a consolidation of comments on related topics, and doesn't necessarily represent any particular order of the actual discussion.]

Comments on regulators and policymaking

- The federal government is relying on state commissions to resolve many of the policy issues facing the electricity industry today. This is clearly what Congress had in mind when it passed the Energy Policy Act of 1992, although there are many issues active today that were not anticipated at the time. The role of the federal government, on one level, is to help states grapple with these issues locally. If we are going to deal effectively with greenhouse gases, for instance, it will be through the actions of individual utilities and commissions.
- There is an additional need to discuss the communication among regulators in different jurisdictions, particularly in a time of change in the industry, so that different jurisdictions do not pursue different paths in ways that end up being counterproductive.
- A decision has somehow been reached in this country that competition is the greater good. An enormously important consequence of that decision is, "How do we handle transmission?". We are contemplating a world in which there will be many power suppliers and limited transmission capacity.
- Should meter readers get \$12 an hour or \$17 an hour? How do we integrate the use of the transmission grid for neighborhood transactions with its use for large-scale regional power transfers? These two questions are very different -- the first may not be as intellectually

interesting as the second, but its answer is very important to some people. Should public utility commissioners be the ones to answer both kinds of questions?

- There are three kinds of activities carried out by most commissions. Routine disputes, which make up a great deal of a typical docket, but *which* are not difficult to decide, could be handled adequately via alternative dispute resolution or some other means, to streamline the system without abrogating the integrity of the process. The second activity, traditional rate-setting, works pretty well with the judicial procedures we've worked out over the years, and it enjoys a fair amount of confidence. The third activity, which one of the judges referred to as management and planning functions, does not work very well under a judicial model. So maybe this is a role we should think about transferring to Regional Transmission Groups (RTGs), that aren't bound by the constraints of current procedural laws. The question then becomes, what is the appropriate procedure?
- There are two crises in utility regulation today. The first is an inability to deal with complex problems because of inadequate jurisdictional boundaries. The second is a feeling of dissatisfaction with the decision-making process and its inability to legitimize itself. How do you solve these problems? The enhancement of public participation has not improved either the credibility or the results of this process.
- Is the job of a commission to protect the consuming public or to defend the overall public interest? The answer to this question will suggest very different actions by a commission in terms of policy-making.

Comments on process reform and public confidence

- Why is it that judges are so willing these days to interfere in the processes of public service commissions? Why is it that the Illinois Commerce Commission is consistently reversed, when the Property Tax Appeal Board and the Industrial Commission is not? To answer these questions, you have to look at what you're trying to get out of the regulatory process and whether that's what you're actually able to get out of it. Customers want good service at a fair price. The utility wants decisions that allow it to operate in a commercially rational manner. The reason why everyone is so willing to impose restraints on the system is that neither the customers or the utilities are getting what they expect out of it. Until you find ways to address this root problem, you are not going to find it easy to free yourselves of these restraints.
- We have heard a great deal today about how to create an efficient process for making decisions. What we haven't talked about much is how the public perceives the process. There is something to be said for oral presentations – for the ability to look the decision-maker in the eye and know that he or she is listening to you. With paper transactions, you never know if anyone read it, let alone the commissioner. It makes the lawyers and their clients feel better to stand up and tell the commission what's on their minds. You obviously have to balance this against managing the workload. But perhaps a town meeting approach to transmission pricing, with everyone talking to each other, would be an alternative you could try. That's a tough issue, and mere process isn't going to get us home on that one.
- I didn't hear anyone say, "Let's get rid of due process", but our colleague the consumer

counsel did. I think we're using different notions of what constitutes due process. To some people, streamlining or changing the existing cultural milieu at a commission, means that due process as they understand it is being threatened. This is a major political problem, and to make these changes you're going to have to figure out what to do about it. Trials are deeply institutionalized in every regulatory body. This comes from the proprietary interests of trial attorneys who represent interests before the commission, and sometimes of hearing examiners and trial staffs of commissions. You heard one of them this morning, who is anxious to exclude people, because it's his trial and he doesn't want interlopers. The commission's legal staff frequently has a similar proprietary interest in process. The concept of fairness is laced with all these cultural judgments about what constitutes transparency. We've ferry-rigged a system based on these perceptual objectives.

The whole question of professionalism is double-edged. On one hand, it's desirable to have regulators who are trained and knowledgeable. On the other hand, the public might have more faith in a housewife from El Paso than a Harvard-educated lawyer, considering where their career paths are going, etc. It's a difficult balance to strike.

- The ability of commissions to make wider use of rule-making is constrained in some states which still have legislative veto of proposed actions. In some states, orders of the commission are appealable to courts of first action, which tend to engage in *de novo* review of those orders, as opposed to courts of appeal, which tend to limit review to questions of law and procedure. Some commissions are reviewable only in the state's Supreme Court. These differences in standard of review may lead to different rule-making practices by commissions.

- There is a difference between fact evidence and opinion evidence. Trials and hearings traditionally deal with both, and whether evidence is one or the other doesn't matter so much as the context in which the evidence is heard. That you pay a meter reader \$12.17/hour is a matter of fact. Whether you think that's a prudent amount to pass through is a matter of opinion. But commissions should hear both of those things in the context of a record, rather than a utility coming to a commissioner and saying, "\$12.17 is way too much -- I can get you all the meter readers you want for \$8.00", and a union representative coming and saying "\$12.17 is terrific", the decision, what rate is prudent, shouldn't be made based on that kind of interaction. Issues should be decided based on a public, disciplined, record.
- Does public participation contribute to public trust? In and of itself, the answer must be yes. But when you add in all the other factors that are important to the public — i.e. are rates going up? — the job of a commission to maintain public trust becomes much more complicated. The interesting question that has been touched on today is, does public participation sometimes make matters *worse*? If it were to somehow prevent the agency from lowering rates, you could make a case for this. This is an important question, especially with environmental and other risk issues, like toxic waste.

Questions to presenters-

Question to a regulator: Having heard the discussion this morning, *why don't* you go ahead and separate the policy issues out of any adjudicatory hearing and go to a rulemaking? Don't even call it a notice and comment hearing. Say it's an informational device to inform the commission prior to formulating a policy bulletin.

Answer: We have come to recognize that we are not adequately taking advantage of rulemaking as a way of discharging the public business. I have no difficulty with the notion that we will use rulemaking in the future. There are moves in the legislature right now that are clearly designed to limit the commission to trial-type hearings, but I hope they won't pass. We have made progress on alternative dispute resolution. What I really want for my successor is a greater opportunity for commissioners to communicate among each other in setting the agenda for the commission. A recent study done by a professor of regulatory economics at Ohio State suggests that the great majority of regulators have come to the conclusion that they accomplished less on behalf of the public because of these restraints than they would if these restraints were released.

Commissioners need to become much more personally invested in the work that the commission carries out – we have been forced into a reactive mode, and I want that force removed. I am prepared to go to the legislature and say, "Enact this 3-year sunshine limitation. ~~K~~ at the end of three years, the public has not seen that the Commission has become more efficient, the backlog of cases has been reduced, and the Commission has put its scarce resources to better uses, then don't renew it." I believe that there is a decent chance that the legislature would accept that proposal.

Question: The "conference hearing" mentioned earlier -- is that in conjunction with rulemaking? **Answer:** We're recommending that, in a particular rate case, for instance, dealing with company's cost of services, that the commission have the option to use a conference model, which eliminates cross-examination, but not discovery. This remains a proceeding on the record, with the appropriate protections for the public. *Ex parte* limits would also be in force. There was not a unanimity of views on the committee about this issue, but there was general support for less formal proceedings and making greater use of rule-making. There were several members of the committee

that were concerned about the fairness issue -- whether there were strong enough safeguards. For example, greater use of rule-making has an impact on *ex parte* rules. *Ex parte* rules area balance between giving commissioners access to information and informing participants in the proceedings as to what information the commissioners have. Essentially, if we're going to relax procedural protection in order to have a more open and efficient process, we have to be willing to rework those procedures that will be relied on more.

Handouts for 4/15/94 Harvard Electricity Policy Group Special Seminar

Forum on Regulatory Decision Making: Is the Process Too Rigid? Can it Respond to the Dynamics of a Competitive Market?

Some of the materials listed below were prepared specifically for the seminar. Please do not cite any materials marked "Draft".

- Asimow, Michael *California Underground Regulations*, 44 Administrative Law Review 43 (1992).
- Brown, Ashley C. *The Ovejudicialization of Regulatory Decisionmaking*, Natural Resources and Environment, Fall 1990.
- Brown, Ashley C. *Sunshine May Cloud Good Decision Making*, Forum for Applied Research and Public Policy, Summer 1992.
- California Public Utilities Commission *Decisionmaking at the California Public Utilities Commission: Alternatives to Litigation* A Discussion Paper for the Workshops on Alternatives to Litigation, January 1993.
- California Public Utilities Commission *Decisionmaking at the California Public Utilities Commission: Alternatives to Litigation* Second Discussion Paper, August 1993.
- California Public Utilities Commission *Alternatives to Litigation Program: A Progress Report*, October 12, 1993.
- Jones, Douglas *Sunshine Laws and Public Utility Commissions. Partly Sunny Preferable?* NRRI Quarterly Bulletin 15:1.
- Pierce, Richard J., Jr. *Regulatory Decisionmaking Reform*, Draft outline.
- Pierce, Richard J., Jr. *Unruly Judicial Review of Rulemaking*, *Natural Resources and Environment*. Vol. 5 No. 2 (Fall 1990).
- *Sierra Club v. Costle* 657 F 2nd 298 (1978) pp 400-410
- Stalon, Charles *Regulating In Pursuit of Efficient and Just Prices* Draft outline, April 15, 1994.