



Bureau of  
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National  
Association of  
Regulatory  
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Commissioners

# Successful Interactions Between Regulators and Regulated

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# Why Regulate Public Utilities?

## Why Regulate Public Utilities?

- Because they provide essential, vital services requiring resilience and fair prices.
- Because they are **monopolies**. Only one set of wires, gas pipes, water and sewer connections into homes and businesses.
- **The basic social contract:** Utility has a monopoly and has a guaranteed, steady income in return for oversight, monitoring and regulation for the public good.



# Why Regulate Public Utilities?

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## Why Regulate Public Utilities?

- The **regulator** provides fair, consistent rules for the utility to operate within.
- The **utility** has limited financial risk and provides essential services to public at just and reasonable rates.
- The regulator must be independent, informed and able to perform oversight. The utility is responsible for its own financing, management and staffing to provide utility services.



# Roles of the Regulator



- **Judge:** Render legal decisions in court-like settings:
  - Rate cases – how much a utility may charge utility services;
  - Disputes between utilities and customers – payment of bills and overcharges;
  - Violations such as gas pipeline safety infractions.
- **Crisis manager:** Assessment of service performance.
- **Inspector and monitor:** Checking compliance with safety and marketing rules.
- **Policy maker:** involvement in questions such as sources of power (fossil fuel vs. renewable); the appropriate level of investment in resilience; the overall cost of utility services.



## Interactions Between Regulators and Public Utilities

- The interaction depends on what role the regulator is playing.
- Interactions between regulators and the utilities range from formal to informal, antagonistic to friendly, from controversial to routine.
- The **regulators' objective**: Complete, accurate and useful information to set the rules that will guide and incent utilities.
- The **utilities' objective**: To satisfy the regulator, minimize effort to produce information and avoid provision of information that works against their interests.
- **Effective interaction**: Alignment of the objectives or limiting the ability of the regulator or utility to thwart each other's objectives.



## The Relationship Between Regulator and Public Utility

- Regulator decisions are based on law, evidence, staff evaluation and what the regulator determines to be fair and reasonable.
- **Not a relationship of equals.** Regulator decisions profoundly affect the utility, much like a judge decides a civil or criminal case.
- A utility may be pleased or upset. Friendship and enmity have no place in the relationship. The relationship requires distance, not knowing what the next decision may be.
- The demeanor must be professional and command respect. A utility should perceive a victory as earned on the merits, not granted by friendship or as a favor. A loss should also be based on the merits, not on animosity or personal antagonism.



## What Determines a Decision? What Affects the Outcome?

- A decision should be **based on the law, the evidence, what a regulator determines to be fair and reasonable** and an understanding of the probable outcome.
- Reality is often complicated. No regulators are attorneys, financial experts, engineers and public policy experts in electricity, gas, water, telecommunications and other fields.
- All regulators need to draw upon others, including colleagues, staff and the experts who submit briefs or appear at hearings.



## What Determines a Decision? What Affects the Outcome?

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- A good outcome – one the regulator feels good about months and years afterwards. Characteristics:
  1. The starting point is a competent team the regulator trusts. They should be candid, professional and ready to perform the work required for an excellent decision.
  2. A clear understanding of the law. Ask questions. Put it in your own language and hear back that you have it right.
  3. Agreement on the facts. What is the evidence? Identify and seek to eliminate or reduce ambiguity.





## What Determines a Decision? What Affects the Outcome?

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4. The most difficult part: **Deciding what is fair and reasonable.**  
A private, personal determination. Decided and then weighed against alternatives: What if various changes were made?
5. Once the decision is drafted, the commissioner should ask what the consequences of the decision are likely to be. Are they appropriate? Will the regulator still believe the decision is the right one if the projected consequences become real?



## A Rate Case

- **The law** provides that capitalized expenses (such as plant and assets) that are used and useful may be in the rate base.
- Necessary and reasonable expenses must be allowed.
- **The Constitution:** A utility has the right to attempt to earn a profit.
- **The financial calculations** (depreciation, taxes, evaluation of appropriate expenses, salaries and benefits, capital expenditures) require exhaustive research and assessment.
- **Consumers and often legislators want no rate increase at all** – even if evidence demonstrates that one is required. Common arguments include the high cost of living, the burdens of the times, and the utility executives are too highly compensated.



## A Rate Case

*(cont'd)*

- The allowed rate of return should reflect the cost of capital in a non-competitive environment – corresponding to the risk of the investment. There is little guidance for the regulator.
- **The challenge is hard: determining which expenses are necessary and which can be reduced without hurting quality of service.**
- Which capital improvements are necessary to sustain or increase the infrastructure quality and which are not?
- A successful interaction is one in which the utility sees that work was done professionally, the used and useful costs were permitted and the cuts – although painful in places – can be tolerated.



## A Rate Case

*(cont'd)*

- **For the regulator**, the successful interaction results in the utility having enough capital to sustain a healthy operation and enough expense allowance to perform essential work.
- There should be enough tightening of expenses **to remind the utility** that they are a monopoly with limited risk and are there to serve the public.
- **For both, the outcome should be respect and the perception of fairness.**



# Performance in a Storm





## Regulator as Public Crisis Manager (Performance in a Storm)

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- There **needs to be agreement on the challenges a storm presents**: damage done, transportation required and personnel disruptions.
- The company should present facts reviewed and assessed by regulatory staff.
- Regulator questions: Were preparations appropriate, assessments of priority problems addressed and services restored effectively? Were there shortcomings? Any penalties appropriate?
- **For the regulator, success is clear direction for future storm performance.** The utility must understand regulator expectation of above-and-beyond restoration efforts. The regulator must decide what was inadequate and needs improvement.



## Regulator as Public Crisis Manager (Performance in a Storm)

*(cont'd)*

- **If penalties are to be imposed** they should be seen as fair, while there is appropriate incentive to improve and perform better next time.
- The regulator should **resist the temptation to apply 20/20 hindsight** to the situation or to get caught up in expressions of frustration and the politics of the situation.





## Regulator as Inspector: Cooperation and Penalties

- **For the utility, a successful outcome is understanding and acknowledgement of any inadequate safety management, recognition that the regulator is serious about enforcement, and agreement regarding appropriate remediation.**
- The utility should understand what needs to be done in the future and have both positive motivation and incentives to correct the problem and avoid further fines.
- **For both, the outcome should be respect and the perception of fairness.**





## Regulator as Inspector: Cooperation and Penalties

- **The presence of the regulator in inspection needs to be routine, expected and professional.**
- **The inspectors need to be fully qualified, patient and principled.** They are neither friend nor enemy of the utility. They are there to protect the public.
- When a utility makes a mistake, provides inadequate or unsafe service or risks injury to workers or the public, there often needs to be a penalty.
- In the case of a gas pipeline fault, lives may be endangered. The same can happen with an unsafe electric connection or a broken water main.



## Regulator as Inspector: Cooperation and Penalties





## Regulator as Inspector: Cooperation and Penalties

- **The first step is thorough investigation.** Was the mistake self-reported or discovered by the police, a customer or the regulator?
- Has this kind of incident happened in the past? **Were remedial steps prescribed put into effect?** Was required training actually carried out? How confident is the regulator that this behavior will not recur, and how serious is the utility about making correction?
- **For the regulator, a successful outcome results in greater safety and improved performance.** A fine is a penalty but more importantly a warning that processes and behavior need to change. There must be consistent application of the rules even when not a bad outcome, no injuries or damage.



## A Case of Resilience (Performance in a Storm)

- **For the public utility a successful outcome is a fair verdict.**  
In the uncertainty of a storm, did the regulator understand what preparations were necessary and the expenses required?
- Were positive efforts to restore service recognized and minor shortcomings related to emergency performance understood?
- For both, the outcome should be enhanced mutual respect and the perception of fairness.



## Alignment vs. Limited Contact

- **Regulator and utility want safe, reliable, low-cost service.** Both want high consumer satisfaction and responsive service.
- Regulators should **foster cooperation**. Teamwork leads to more productive interactions than hostility and litigated processes.
- The **regulator controls goals and objectives** but allows the utility to help decide how they are achieved. Most conflict comes from disagreement about goals: How reliable, responsive or safe should service be? How to achieve goals is less controversial.
- **Cooperation** requires **trust**. Regulators tend to mistrust utilities – expect them to withhold or distort information. Utilities often expect regulators to rule harshly, require unnecessary information and misunderstand information provided.



## Alignment vs. Limited Contact

- **Regulators need to seek opportunities to cooperate and be well trained in aspects of the industries they regulate.**
- When cooperation is not possible or does not work, the regulator still must have complete, accurate and useful information. Other sources to draw upon include third parties and technology, e.g. meters.
- Examples: Connecticut requirement for **third-party verifiers** to validate authorizations to switch suppliers. ISO-NE has its own electronic access to the meters that measure electricity generated and flowing to the wholesale electric market.



## Summary

- Successful interactions between regulators and utilities reflect the varied challenges both face and must be sustained with fresh decisions appropriate to each interaction.
- **The regulator wants to have a healthy, reasonably prosperous utility that invests wisely, covers reasonable expenses and provides safe, reliable service at the lowest possible cost.** That requires a wide range of assessments, approvals, disapprovals, incentives and penalties.
- The regulated entity wants to work with a regulator who is competent, not biased, open to understanding the reality of new situations and fair in enabling the utility to do its work.



## Summary

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**These key principles characterize some perspectives shared by the regulator and the regulated utility:**

- 1. Cooperation and regular communication** as a standard business practice – not as a power contest or effort to gain advantage.
- 2. Candor from the utility.** What really is the situation and what is a consequently reasonable request of the regulator?
- 3. The ability of the regulator to have an open mind,** recognizing when the utility is right and reasonable and judging when it is wrong or asking for too much.





## Summary

*(cont'd)*

4. **Utility presentation of accurate, understandable information.**
5. The ability of the **regulator to be disciplined and perform the hard work required** to understand the information provided.
6. Perhaps surprisingly, the ability of the regulator **to accept the loneliness of being a regulator.** Decisions often please no one, and praise is rare. Criticism and anger are often directed at regulators. Gratification comes not from public praise or accolades but from the **quiet satisfaction of doing what the regulator believes is right.**
7. **Essential: conduct that builds mutual respect.**