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Digest of a Performance Audit of Public Utility Regulation in Utah

The development of partial competition in the telecommunications, electric power and natural gas industries is requiring the state to reevaluate its approach to public utility regulation. The current organizational structure and regulatory practices were designed to support the regulation of monopoly providers in which the focus was on setting utility rates and making sure services were adequate and reliable. The development of competition will bring significant changes to some segments of the utility industries that will require corresponding changes in the way the state regulates those industries. The process of addressing these changes will require the participation of both the Legislature and state regulatory staff.

Historically, the public utility industries have operated as government regulated monopolies. In exchange for the right to be the exclusive provider for a service region, utility providers agreed to submit to government regulation. In addition to monitoring service quality, a primary task of regulators has been to examine the prudence of utility expenditures and establish rates that allowed a utility provider the opportunity to earn a fair return on investment. B Because disputes over utility rates are generally resolved through trial-like proceedings, the state has adopted an organizational structure designed to facilitate the judicial role of the Public Service Commission. In order to protect the commissioners from unfair influence or "*ex-parte*" communication with those who argue cases before them, state policy makers decided that the technical staff could not work directly for the commission. A separate agency, the Division of Public Utilities, houses the regulatory staff who actually monitor utility activities and advocate actions before the commission. Commissioners have a small staff of advisors to help them interpret the information presented during proceedings and to help them write orders and establish rules. Both the commission and division represent the broad public interest. A third agency, the Committee of Consumer Services, has a small staff who represent the interests of the residential and small business consumers during commission proceedings.

Changes in utility industries are leading to changes in their regulation. In 1995, the Utah Legislature passed a telecommunications reform act that has paved the way for the restructuring of that industry. The Legislators may soon consider similar reforms for the electric power industry and perhaps some day for natural gas industry. For their part, state regulatory staffs are using more informal procedures to address the policy issues associated with a partially competitive, partially monopolistic marketplace. Although the state will need to continue to rely on traditional regulatory tools to regulate those segments of the market that remain uncompetitive, regulators are now placing an increased emphasis on the development of the new rules, policies and procedures to govern competitive segments of the marketplace.

This report discusses the challenges of regulating industries that are partially competitive and partially monopolistic. Our work included a review of how other states are responding to similar challenges. In many ways, Utah's regulators are making similar changes as other states.

However, Utah's favorable conditions of relatively low utility rates and financially healthy providers make changes less urgent here than in some states. The following summarizes the major conclusions in this report:

Quasi-legislative Techniques can be Used to Resolve Policy Issues. As competition develops in the public utility industries, state utility regulators are devoting an increasing amount of their time to developing the new rules, policies and procedures for the future marketplace. Historically, most states relied on adjudicative proceedings to resolve many issues. Increasingly, however, states are relying on "quasi-legislative" techniques to make decisions that have industry-wide applicability. Although Utah has been using many of the informal policy-setting procedures, there are a number of forces that are encouraging the commission to resolve industry-wide policy issues during adjudicative proceedings. We feel state regulators' use of quasi-legislative procedures to address industry-wide policy issues is appropriate and encourage utilities, consumer interests, potential new competitors, and the Legislature to support this process.

Legislature Should Provide Broad Guidance. It is the Legislature that decides whether to reform state regulation of an industry and establishes the objectives of the reform process. In telecommunications, the Legislature has already provided important guidance by approving the Utah Telecommunications Reform Act of 1995. Legislators may soon need to provide similar guidance on possible reform of the electric power industry. Based on our observations of other states, we provide legislators with a number of specific suggestions for how they can provide regulators with the broad guidance they need. These include: (1) providing legislation containing broad language on competitive expectations or offering specific "guiding principles" for restructuring efforts, (2) setting deadlines for achieving certain milestones in the reform process, (3) outlining a process that regulators should use as they develop market forms, and (4) creating a legislative committee that can act as a focal point for legislative consideration of utility issues. However, while the Legislature should offer broad guidance, we feel that legislators should rely on the technical expertise of state regulatory staff for detailed decision-making.

Organizational Structure Should be Examined. Legislators asked us to review the roles of the commission, division, and committee and to determine if the three agencies can be consolidated. One option is to consolidate the commission and the division, as they are in most other states. While consolidation should be considered, there are advantages in keeping the organizational separation. Moreover, the fact that utility regulators are engaged in a difficult market reform process may make this a poor time for a major organizational change. As an alternative to taking immediate action, we feel legislators should consider initiating a strategic planning process to evaluate possible organizational changes in the context of a broad reform of public utility regulation in Utah, including future statutory, policy, and staffing needs. In addition, we feel the Legislature should clarify the organizational independence of the Committee of Consumer Services.

Chapter I
Introduction

With historic changes taking place in the public utility industries, the state's approach to utility regulation needs to be reviewed. The current organizational structure and traditional practices were developed in an environment of monopoly regulation in which rate setting was the primary tool used to achieve regulatory objectives such as low rates, adequate and reliable services and financially healthy utilities. However, competition is now developing in some parts of the state's telecommunications and electric power industries and the traditional methods of government regulation will be emphasized less while regulators will need to focus more on other regulatory issues. For example, the introduction of competition in some segments of the public utility industries raises many difficult policy issues that are currently being addressed by state regulators. The availability, quality and cost of future utility services will depend on how successfully these policy challenges are resolved.

Although there remains much uncertainty over future industry conditions, this report discusses some legislative and regulatory actions that may help the state continue to respond to anticipated changes. Chapter II identifies a number of regulatory tools that Utah and other states are using to establish the new policies needed for a competitive marketplace. These procedures should be increasingly relied upon in addition to the adjudicative procedures currently used to establish rate orders. Because the Legislature plays an important role in the market reform process, Chapter III suggests a number of ways that the Legislature can offer broad guidance to regulators as they develop new policies for utility regulation in Utah. Finally, in Chapter IV we suggest that possible changes in the organizational structure ought to be addressed as part of a larger strategic planning process. Before discussing these issues, we provide introductory information about Utah's current regulatory practices and the challenges facing state policymakers because of changing utility industries.

Current Organizational Structure and Practices Evolved to Regulate Monopoly Utilities

Governments have long regulated public utilities because they have been natural monopolies. The nature of the utility industry has made regulated monopolies a more efficient means of providing services than a competitive marketplace. Thus governments, acting in the public interest, have allowed utility monopolies to operate while being subject to state regulation. Utah's existing regulatory structure and practices have evolved to meet the historical need to review the prudence of monopoly provider actions and to set utility consumer payment rates. In Utah, the Public Service Commission has traditionally monitored utilities and established rates through an adjudicative process in a court-like setting. Because of technological advances, however, the nature of the utility industry is changing and regulatory practices are changing as well.

Public Utility Monopolies Must be Regulated

Historically, the nature of public utilities led to regulation, rather than competition, controlling the industries. A 1967 Utah Supreme Court decision explained the potential that:

> *duplication of facilities would be so wasteful and impractical that the law provides for the granting of monopolistic franchises, as a consequence of which such utilities are deemed to submit to regulation by a public authority, which in a measure, substitutes for the controls usually imposed upon business by free competition.*

Monopolies cannot exist without government control because consumers would have little or no ability to affect the availability, quality or cost of the service received. Since statehood in 1896, Utah's constitution has prohibited monopolies *"except as otherwise provided by statute."* Utah law empowers the Public Service Commission to grant monopoly franchises subject to ongoing control by state regulators.

The granting of a monopoly franchise to a private utility company with the agreement that the company will comply with regulatory orders is known as the "regulatory compact." The utility agrees to provide services of an acceptable quality to consumers in the franchise area and the state agrees to allow consumer payment rates that reimburse all necessary utility costs plus provide the utilities the opportunity to earn a fair return on investment. To determine allowable customer payment rates, regulators must evaluate the prudence of utility investments and evaluate its expenses so that only reasonable costs are allowed to be recovered in utility consumers' service rates. For their part, utility monopolies have been shielded from competition, but risk not being able to recoup investments that are judged unreasonable by regulators.

For the most part, disputes about the necessity of utility expenditures, and thus about the payment rates that are charged to consumers, have been settled in adjudicative hearings. The adversarial approach inherent in these adjudicative hearings is appropriate because the interests of the utility for higher payment rates and consumers for lower payment rates are clearly drawn. In addition, the facts in dispute generally concern past events that are effectively addressed through an evidentiary procedure including sworn testimony with cross-examination. A 1980 Utah Supreme Court decision provides a good explanation of the evidentiary process used to set utility consumer payment rates:

> *The first prerequisite of a rate order is that it be preceded by a hearing and findings. At such a hearing the legislature intended there be evidence adduced which could reasonably be calculated to resolve the issue presented for determination, which in this case is a rate increase. The findings required by statute... must be made in accordance with the evidence so presented. If there be no substantial evidence to support an essential finding, that finding cannot stand; and a rate order predicated upon it must fall... A state regulatory commission, whose powers have been invoked to fix a reasonable rate, is entitled to know and before it can act advisedly must be informed of*

all relevant facts. Otherwise, the hands of the regulatory body could be tied in such fashion it could not effectively determine whether a proposed rate was justified... there must be substantial evidence to support the essential findings in a rate order.

In addition to clarifying the evidentiary requirements of a Public Service Commission order which sets consumer payment rates, the Supreme Court decision affirmed the appropriateness of the adversarial process to settle rate disputes. Furthermore, in this same court decision, the Supreme Court recognized the right of the Division of Public Utilities staff to participate as an advocate by challenging a commission order. By doing so, the court contributed to the subsequent separation of most of the commission's former staff from under their administrative control. This separation, which was enacted in 1983, was considered necessary to prevent the staff from speaking "off the record" with commissioners while at the same time acting as advocates in the commission's adjudicative proceedings. Concern over the potential for such communication, known as "*ex-parte"* communication (i.e., communication in the interest of one party), was lessened by the separation of the division and the commission.

Utah's Regulatory Structure Was Designed to Support Rate-setting

In Utah, three largely independent state entities participate in enforcing the state's regulatory compact with telecommunications, electric power, natural gas, and water companies. These three entities are the Public Service Commission, the Division of Public Utilities and the Committee of Consumer Services.

The Public Service Commission (the commission) is the independent state agency charged with the responsibility of providing the public utilities the opportunity to earn a fair return on investment, and assuring that utility consumers have safe, reliable and adequate utility services at a reasonable price. The three-person commission has a staff of 13 people, including economists, technicians, and office clerical staff, who assist it in evaluating information and conducting proceedings. The commission is given rule making and adjudicative powers to fulfill its duties. The commission exercises its rule making power in proceedings where public input is received and general regulatory requirements, including industry-wide policies, are formally established as rules. The commission exercises its adjudicative power when establishing rates or settling disputes between parties within the framework of existing laws and rules. During adjudicative proceedings, the commission acts as a panel of judges in a trial-like setting where witnesses provide sworn testimony and are subject to cross-examination. Following such hearings, the commission staff helps it evaluate the information presented during the proceeding and prepare an order based on the evidentiary record.

The Division of Public Utilities (the division), housed in the Department of Commerce, is a separate state agency of about 35 staff people including auditors, economists, and engineers who carry out a wide range of administrative tasks required by the statute and by the commission. Historically, the division's primary responsibility has been to monitor all aspects of utility

service, which includes the provision of safe, adequate and reliable services. The division also monitors utility companies' earnings and advises the commission when rates need to be either increased or decreased. Finally, the division may investigate other aspects of utility service at the request of the commission, monitor compliance with commission decisions and state utility regulations, and make recommendations to the commission on regulatory policy. The division participates in commission hearings as an independent party and has the right to appeal commission decisions to the Utah Supreme Court. Like the commission, the division's objective is to balance the needs of consumers to have low utility rates against the need for utility companies to be given the opportunity to earn a fair return on investment.

Lastly, the Committee of Consumer Services (the committee) is a six-member council of consumer advocates, appointed by the Governor. Unlike the commission and division, each of whom consider both utility and consumer needs and represent the broad public interest, the committee only represents the interests of residential consumers, small business consumers and agricultural farmers who use pump irrigation and rely on utilities and water. The committee is supported by a governor-appointed administrative secretary and eight staff members. Staff helps the committee protect utility consumers by conducting research and preparing analysis of utility earnings. Like the division, the committee may participate in utility proceedings before the commission or the Utah Supreme Court.

The above structure and use of a judicial model have been appropriate for reviewing the prudence of utility expenditures because adjudicative proceedings are an effective way to review the factual evidence surrounding a utility's necessary costs. But, technology is changing the condition of public utilities, and subsequently, the role of regulators.

Technological Advances are Eroding the Traditional Regulatory Compact

The development of new technologies is bringing some change to the traditional regulatory compact between the state and public utilities. New technological developments in telecommunications and electric power generation are making it possible for consumers in some settings to effectively bypass an established utility's service system to obtain service from an alternative source. Thus, parts of the industries are changing from being natural monopolies that must be regulated to industries where competition can play an increasing role. In response, utility regulators are expected to rely more on free market forces rather than rate-of-return regulation to control utility industries.

In the telecommunications industry, developments in microwave technologies, for example, may make it possible for new rival telephone companies to install low frequency microwave systems that will serve an entire community without having to install lines to every home. In addition, someday homeowners with access to cable TV may be able to purchase a modem that will transmit high volume signals such as Internet, video, data transmission, as well as their voice signals at a much higher bandwidth than has been possible over the traditional copper wire that is

now used for telephone lines.

In the electric power industry, the development of small gas-fired electric turbines has made it possible for industrial consumers to construct their own mini power plants and effectively leave the existing monopoly system. In addition, changes in the federal law allowed independent power producers to begin selling power on a wholesale market. As a result of these changes, large industrial electric customers are examining the feasibility of leaving government regulated systems to generate their own power or to purchase power on the open market at unregulated prices.

In the natural gas industry, consumers are also asking the government to require the gas companies to provide open access to their transmission systems so consumers can purchase natural gas on the national market and transport it over the existing transmission system.

As these and other technologies are further developed, the state will no longer be able to guarantee the exclusive franchise status that public monopolies have enjoyed for decades. This means that many of the rules, policies and procedures that have governed public utility regulation for decades will become increasingly outdated. The state is now crafting a new regulatory compact and an entirely new set of market rules and policies to govern a partially competitive and partially monopolistic marketplace. This new regulatory framework should allow consumers to benefit from the improved service and reduced costs that competition is expected to bring, while maintaining consumer safeguards that have been enjoyed in the past.

The challenge of crafting a new regulatory framework will require the combined effort of both the state Legislature and the state's three regulatory entities. This report offers a number of suggestions, based on the experience of other states, for how the Legislature and the regulators might proceed. The Legislature's role is to provide broad guidance and then the regulators formulate the specific rules, policies and procedures to achieve that Legislature's broad objectives. In telecommunications, the Legislature has already provided broad guidance through the Telecommunications Reform Act of 1995. As competition develops in electric power, we anticipate that the Legislature will need to offer similar guidance for the electric utility industry, as well. Because the Legislature has neither the time nor the staff to resolve the specific technical details required to address the specific market reform issues, that job has been delegated to the state's Public Service Commission. With assistance from the Division of Public Utilities, the commission is now formulating the specific rules, policies and procedures needed to implement the Legislature's broad goals and objectives. Finally, it is the responsibility of the Legislature to monitor the progress of the Public Service Commission in accomplishing the reform process.

Audit Scope and Objectives

Legislators asked us to evaluate the process of public utility regulation in Utah and to determine if it is appropriate in view of the competitive changes occurring in the utility industries. Our audit included a review of the practices and procedures used by state regulators, as well as an analysis of the existing organizational structure. Many of the findings presented in this report were obtained by comparing Utah's approach to regulation with the practices used in other states who are also currently involved with utility deregulation and restructuring. Specifically, this audit report addresses the following questions:

1. Are current regulatory practices and procedures used by the Public Service Commission adequate for meeting the expected conditions of utility competition in the future?

2. Are there means by which the Legislature can offer broad guidance to the Public Service Commission amid the current utility regulatory changes?

3. Do changes need to be made in the organizational structure of the regulatory entities in light of the changing role of regulators?

Chapter II
Quasi-legislative Techniques can be Used to Resolve Policy Issues

As the nation's public utility industries continue to undergo rapid change, an increasing amount of state public utility commissions' work will focus on drafting the new rules, policies, and procedures associated with a competitive public utilities industry. In response to this shift away from rate-making and prudence review, many public utility commissions are placing less emphasis on adjudicative proceedings and are relying more on informal proceedings that are better suited for policy formulation. In Utah, regulators are formulating the new rules that will govern Utah's partly competitive, partly monopolistic marketplace. As in other states, Utah's utility regulators are beginning to use informal and consensus-building techniques in developing these new market rules. Although they sometimes find it difficult to move away from the formal adjudicative setting that regulators and interest groups are familiar with, we recommend that Utah's regulators continue to rely on more informal proceedings when addressing industry-wide policy issues.

The informal techniques are referred to as "quasi-legislative" techniques because they are the kinds of procedures that are commonly used by a legislative interim study committee or a task force. Quasi-legislative techniques include the use of working groups, staff research reports, informal public hearings and other techniques designed to help policy makers examine the issues, receive public input, and build consensus around a new rule, policy or procedure. The quasi-legislative techniques are most commonly used as a means to develop new policies that may be formally adopted as a commission rule, or perhaps legislatively enacted, as was the case with Utah's telecommunications reform policy. We believe that the commission's success in resolving the complex market reform issues it faces will partly depend on the increased use of quasi-legislative techniques to address policy issues.

States Are Increasing Their Use of Quasi-legislative Techniques

Nationwide, there has been a shift toward using quasi-legislative techniques to develop generic rules and away from using trial-type hearings to issue specific orders. Historically, state public utility commissions have used adjudicative proceedings because they were generally deciding issues involving a single utility company, for example when they set utility rates. Although they will continue to do some rate-making and monitoring of individual companies, commissions in Utah and many other states are increasingly faced with industry-wide policy issues associated with the changing public utility industries. Policies that apply industry wide can be formally established as a commission rule, through a commission rule making process, or in law by the legislature. Regulators have found that the use of quasi-legislative techniques

provides an effective means to analyze and discuss alternatives before policies are formally adopted as rules or placed in law.

Adjudication and Rule Making Meet Different Needs

Some issues are appropriately resolved through adjudication while other issues are best resolved through rule making. **Utah Code** establishes the procedures that are to be used and provides guidelines for when each process is most appropriate.

Adjudicative proceedings are generally used to establish rates or resolve disputes by examining the factual information and by applying existing laws and rules. In public utility regulation, rate setting has been effectively accomplished in trial-like settings. Adjudicative proceedings are described in the state's **Administrative Procedures Act**, which applies to *"all state agency actions that determine the legal rights, duties, privileges, immunities or other legal interests of one or more identifiable persons..."* Because adjudicative proceedings are used to apply existing laws and rules to individuals or to resolve disputes between adversarial parties, the use of trial-like procedures helps protect the due process rights of the parties. Following an adjudicative proceeding, the commission issues an order, which applies to the specific company involved in the hearing, based on the factual evidence presented. Because adjudicative proceedings resemble a trial, commissions are said to be acting in a "quasi-judicial" manner when conducting adjudicative proceedings.

Rule making proceedings, on the other hand, are more legislative than judicial in nature. Rules may be established that apply throughout a regulated industry, not just to a single entity or individual. According to the Administrative Rule Making Act (*ARA*), a "rule" is *"...required by state or federal statutes or other applicable law; ...has the effect of law; [and] ...implements or interprets a state or federal legal mandate..."* The ARA defines "policy" as a statement that *"...broadly proscribes a future course of action, guidelines, principles or procedures..."* Since the trend toward market competition in public utilities involves many new policy considerations and potentially many utility companies, rule making proceedings provide an appropriate means to establish statewide policies. Because rules apply broadly, rule making requires a public process to make sure that everyone affected by a proposed rule has an opportunity to provide input. Instead of basing decisions on the historical evidence, rule making requires agencies to view a public policy issue in a prospective manner, consider the alternatives, and then establish a course of action that will best achieve the state's broad goals and objectives. For this reason, rule making can be accomplished using more informal techniques than are used in judicial procedures. In fact, a Public Service Commission rule states:

> *Hearings conducted in connection with rule making shall be informal, subject to requirements of decorum and order. Absent a finding of good cause to proceed otherwise, testimony and statements shall be unsworn, and there shall be no opportunity for participants to cross-examine...*

When public utility commissions use legislative-like procedures to formulate and build consensus around industry-wide policies, in anticipation of a rule making proceeding, they are said to be acting "quasi-legislatively." Although Utah, like other states, has begun to use these techniques, they remain under pressure to continue to use adjudicative proceedings to address the industry-wide policy issues associated with market reform.

In the Past, State Commissions Have Emphasized Trial-Type Hearings

Until recently, most state public utility commissions (PUCs) have emphasized their role as "judges" (a "quasi-judicial" role) and have relied on trial-type hearings to address rate cases and even some policy decisions. Specifically in Utah, the Public Service Commission has been recognized as a commission with a judicial emphasis. For example, one former commissioner told us that he felt his role as commissioner was mainly one of being a "judge" and that the commission's authority was exercised through formal orders that had to be based on the judicial record. While national utility experts recognize that the judicial role is appropriate for rate-making, they feel there is an increasing policy-making role will require new techniques.

A 1988 study by Robert Burns of the National Regulatory Research Institute titled **Administrative Procedures for Pro-active Regulation** reported that state public utility commissions at the time were not normally using rule making proceedings to make major industry-wide policy decisions. The reason, the report said, is that most state commissions had developed a long tradition of using trial type proceedings to resolve most regulatory matters. Specifically, the report states,

> *Since 1887, most state and federal regulatory commissions have been modeled after the Interstate Commerce Commission. Rates were set by state and federal commissions in adjudicatory (trial-type) proceedings. The basic elements of a trial-type proceeding as used for rate setting typically include the filing of a rate request (including a minimum or standard filing requirement), discovery, sometimes a pre-hearing conference, oral or written direct testimony, cross-examination, oral or written rebuttal testimony, possibly an administrative law judge's opinion, and the commission decision or order.* ***For most state commissions this procedure still remains the principal means of policy decision-making*** (emphasis added).

Although Burns recognizes the importance of trial-type procedures for rate setting, he suggests that trial-type proceedings are not the most effective means of resolving industry-wide policy issues:

> *Trial-type procedures are often appropriate, they are well suited for procedures in which the principal purpose is to determine facts. This is certainly so in the ordinary rate case, where major prospective policy issues are not typically*

considered. However, trial-type proceedings are ill suited for considering prospective policies.

According to Burns, the problem with using adjudicative proceedings when addressing industry-wide policy issues is that the trial-like format does not allow policy makers to examine the wide range of options available to them. He said:

The problem today is that many of the issues that face state [public utility] commissions are basic, industry-wide policy issues that implicitly or explicitly require the commission to make economic and financial decisions about future events and conditions and to engage in regulatory planning or policy making based on their conclusions... because the commission must limit its decision in a trial-type procedure to the record as presented by the parties, certain innovated ideas and solutions might not be brought to the commission's attention... This may not lead to the best resolution of the issues.

As recently as 1994, Jonathan Raab, a utility consultant in consensus-based policy techniques, also observed that public utility commissions *"still tend to set industry-wide policy by precedent through adjudicatory proceedings."* In his book, **Using Consensus Building to Improve Utility Regulation**, Raab suggested that one reason state public utility commissions are reluctant to use quasi-legislative techniques is *"procedural inertia at state PUCs... that until, recently has been exclusively focused on adjudicatory proceedings."* However, Raab also predicts that *"rule making will begin consuming an increasing proportion of PUCs' dockets... as PUCs recognize the virtues of trying to resolve inherently subjective public policy disputes through rule making rather than adjudication."*

Utility regulators nationwide are beginning to recognize that commissions will need to shift their focus away from traditional trial-type proceedings and toward other techniques that will help them address the issues associated with market competition. For example, at the 1995 annual conference of the National Association of Regulatory Utility Commissioners, state public utility commissioners were told they would need to *be "less judicial and more prone to seek consensus positions."* Among other topics, commissioners at the conference discussed the *"de-judicialization of PUC activities"* and their *"becoming more quasi-legislative and less quasi-judicial."*

Quasi-legislative Techniques Are Appropriate to Address Policy Matters

The state's rule making act provides the minimum procedures agencies are required to use in order to establish rules. However, resolving the complex policy issues associated with market competition has required a process that goes far beyond the typical rule making proceeding. In other words, much of the policy formulation needs to take place prior to any rule making proceeding. The process of reforming the telephone, electric power and natural gas industries

will be difficult because, depending on the policies the commission adopts, there may be fundamental changes in the way these basic services are provided. Because the effects will be so widely felt, the process of developing new market policies needs to be an open public debate rather than an adjudicated one in which only the formal interveners participate in the proceeding. Finally, because the stakes are high for both the providers and the major consumers of utility services, a special effort must be made to foster consensus around a proposed policy or rule. Overall, because the reform process needs to be more of a public policy debate rather than a trial-like proceeding, an increasing number of other states' regulators are viewing their public utility commissions not as a "quasi-judicial" panel of judges but as a policy-making, "quasi-legislative" body that facilitates a public policy investigation or debate. The following are some of the quasi-legislative techniques that are being used to conduct this policy investigation process.

1. **Staff Research and Analysis.** Research by expert staff or consultants can be an effective means of defining the public policy issue to be discussed. Some issues can be highly technical and complex and staff research reports can be used to educate the commission, law-makers and the public about the economic conditions and policy concerns. The reports also serve as a useful mechanism for initiating a public discussion about the public policy issues and the alternative strategies that might be pursued.

2. **Working Groups.** Working groups comprised of representatives from a wide range of interest groups can be a useful tool for resolving complex policy issues. One reason is that the utilities, industry and consumer advocates themselves can often formulate a better set of rules and policies than the commission would be able to on its own. In addition, a working group can sometimes help the participants reach a consensus around a new rule or policy. The result of a working group's effort often results in a formal report recommending specific rules, policies or procedures that would then be taken up as a proposed rule by the commission.

3. **Facilitators.** A facilitator can be used to initiate the free-flow of creative policy ideas in a much more conducive setting than an adjudicative hearing. This is particularly helpful if participants are reluctant to participate when the commissioners are present. Although the commissioners should participate indirectly by setting some of the parameters around the negotiations, the details of the process can be given to a facilitator.

4. **Guiding Principles.** Quasi-legislative proceedings often begin by requiring participants to agree on the guiding principles or objectives of their efforts in the policy setting process. In some cases, the Legislature formulates the guiding principles. But, the commissioners or working groups themselves can develop the principles to guide restructuring efforts, as well.

5. **Non-adversarial Hearings.** Under a quasi-legislative model, hearings are less adversarial and staff take the role of advisors rather than advocates. Rather than engage in a

courtroom-like trial, some commissions conduct their hearings using an informal process similar to those used by a legislative committee. Those wishing to make comments are invited to come before the commission and make a presentation on an issue.

The presentation may or may not be on-the-record, but there is no cross examination, and no pre-filed testimony, both of which are more typical of judicial hearings.

6. **Public Outreach.** In an effort to make the rule making effort a public process, commissions should make a special effort to help the public understand the changes that are occurring within public utility industries. This may require the use of public hearings throughout the state in which the commission describes the problems they are trying to address and the proposed solutions that they are considering. The public outreach process should help the commissioners evaluate the potential effect of their proposed rules and policies on citizens.

Other States Use of Quasi-legislative Techniques

Increasingly, regulators are recognizing that the traditional adjudicated hearings are not the best way to address industry-wide policy matters. Some states have decided that the use of quasi-

legislative techniques is a more effective way to address policy issues associated with market competition. They reserve judicial proceedings for issues that require an examination of the factual evidence and for instances where rules and guidelines are already well established. For example, the California Public Utilities Commission said,

> *Through rule making proceedings, the Commission will put new emphasis on quasi-legislative processes rather than litigation. These rule makings will be efficient, provide easy access for all stakeholders and a forum for addressing regulatory issues in a structured but open manner. This openness will help increase public confidence in the Commission's decision-making process and make the Commission accountable to stakeholders* (**Vision 2000 — A report on Our Progress Toward Change**).

In addition, to California, other states that are emphasizing the use of quasi-legislative techniques include Washington, Arizona, Colorado, New Hampshire, and Massachusetts. The following, describes the approach New Hampshire used to address electric power restructuring and the approach used by Colorado to address the industry-wide policy issues associated with telecommunications reform.

New Hampshire's Non-adjudicated Electric Restructuring

The New Hampshire Public Utilities Commission is currently engaged in a rule making process for electric utility restructuring. That state provides a good example of a commission that used non-adjudicated hearings as a large part of the process. The commission chose to use non-adjudicative procedures because they felt they would allow a quicker and more efficient approach to resolving extremely difficult policy issues, as opposed to an adjudicated hearing. George McCluskey, the Director of New Hampshire's newly formed Energy Restructuring Division, told us that they are trying to do the energy restructuring process as efficiently as possible. From the past they learned that the adjudicative procedure *"just never ends; that's why we chose not to use it."* The New Hampshire Legislature, he said, has given them a deadline for putting out a restructuring plan. McCluskey said that one problem with adjudicative hearings is that the parties tend to go on and on about tangential issues. He said the commission decided they *"don't want to be side-tracked"* by adjudicated hearings because of the legislative deadline to issue a final restructuring plan no later than February 28, 1997. Of course, this does not mean that informal proceedings do not take a long time and sometimes allow participants to become side tracked on issues. But the New Hampshire staff feel that they have better control over the proceeding and can focus more on the critical issues at hand without becoming sidetracked by legal maneuvering that is common during adjudicative proceedings.

The rule making process began after the commission conducted several "roundtable" meetings to explore the complex issues surrounding competition, retail wheeling and industry

restructuring and the policy options that the state might pursue. In other words, New Hampshire used informal techniques to prepare for rule making in electric power restructuring. In the roundtable meetings, participants included legislators, state department heads, the electric utility representatives, small power producers, advocates of conservation, and representatives of business, industrial and residential consumers. The roundtable meetings resulted in a report that identified the issues that needed to be addressed as the state developed its reform strategy. The one recommendation of the report was that the state Legislature draft a set of principles to guide the restructuring process.

The Legislature passed a bill directing the commission to begin a "generic proceeding" to develop a statewide electric utility restructuring plan no later than February 28, 1997. The legislation declared a broad statement showing intent to move to electric power competition and then provided a set of guiding principles the commission was to follow. They also allowed the commission to impose an interim stranded cost charge.

The New Hampshire Public Utilities Commission is currently engaged in several rounds of verbal and written testimony, as well as technical sessions regarding their initial restructuring plan. In addition, the commission is conducting a pilot program *"to examine the implications of retail competition in the electric utility industry."* The pilot program is open to a limited number of consumers in all classes, in all areas of the state. It is anticipated that by February 28, 1997, the commission will present its final restructuring plan to the Legislature along with any proposed changes to the statute that may be needed.

Colorado's Process For Telecommunications Reform

Colorado used quasi-legislative techniques to reform its telecommunications industry. The reform process was overseen by an interim committee of the Legislature, but the majority of the policy work was performed by a working group that encompassed the telecommunications' parties. An advisory committee to the Legislature was created to review, advise and make recommendations to the legislative interim committee. The advisory committee consisted of six legislators, the Governor, and one representative each from the following: the large local telephone company, a small local telephone company, a long-distance provider and consumers. The advisory committee received their "advice" from an eighteen member working group, which was the actual focus of the reform process. It included representatives of telephone providers, consumers, the governor's office, legislative staff, commission staff and other interested parties. All meetings of the working group were open to the public and any groups interested in providing information to the working group were encouraged to do so.

The working group addressed six issues associated with telephone reform, including:

1. Interconnection/unbundling
2. Number portability

3. Resale of local services
4. Universal service
5. Emergency “911” service and
6. Certification of new entrants

The working group was divided into subgroups, one to focus on each of the subject areas. A facilitator was assigned to each group. They met several times each week, from July 1995 until December 1995, to review the issues and draft proposed rules. During October and November of 1995, the full working group assembled to review the proposals by individual subgroups.

By December 1995 the working group produced their final report that contained reform policies for three of the six areas: (1) number portability, (2) Emergency “911" service, and (3) certification rules. The working group was able to reach a consensus on only some aspects of the remaining issues: interconnection/unbundling, resale of local services, and universal service. However, even for these partially-resolved issues, the process did succeed in identifying and clarifying the options the state could pursue. Each of these remaining issues, except the pricing of interconnection and resale, were eventually decided by the commission itself. In order to prevent the resale issue from delaying the reform process, the commission established interim resale rates until the commission could hold an adjudicative proceeding to resolve that issue.

Once the working group submitted the proposed rules to the interim committee, the advisory committee and the Colorado Public Utilities Commission, the commission then began a rule making proceeding. As part of the proceeding, the proposed rules were submitted to the public and the commission began to hold statewide hearings to which the public was invited to hear a presentation regarding the proposed reforms and to provide the commission with their input.

We have observed that in recent years, Utah has also begun to use some of the same techniques used by these other states although they remain under some pressure to continue to address industry wide policy issues during adjudicative proceedings. Utah’s success in the use of these informal policy setting techniques will depend on the support of all those with an interest in resolving the tough reform issues associated with a competitive public utility marketplace.

Utah Should Continue to Use Quasi-Legislative Techniques

Like many other states, Utah’s public utility regulators have begun to use quasi-legislative techniques to address public policy issues. Like other states, the Utah Public Service Commission has for many years emphasized adjudicative procedures. However, the commission and its staff are recognizing the advantages of resolving industry wide policy issues through quasi-legislative techniques. For example, the commission has sponsored an investigation into electric restructuring that has featured well-attended monthly technical conferences. Similarly, the Division of Public Utilities has conducted a number of informal technical conferences to

resolve some of the issues associated with telecommunications reform. However, we also observed a few instances in which industry-wide policy issues were still being addressed through formal adjudicative proceedings. We believe that the commission will only be able to increase its use of quasi-legislative techniques if it receives support from the Legislature, existing utility providers, potential new service providers, and consumer advocates.

Commission Is Using Quasi-Legislative Techniques

In recent years the commission has shown an increased reliance on rule making procedures and some of the quasi-legislative techniques described in this chapter. For example, many of the issues associated with telecommunications reform have been addressed through the use of quasi-legislative techniques. The telecommunications reform process was initiated after the commission and division staff conducted a series of technical conferences to which a wide range of interest groups were invited. The division staff then produced a report titled **An Assessment of Alternative Forms of Regulation** that identified ways to introduce competition into the telecommunications industry. The division is continuing to address many of these issues in informal technical conferences with the various interest groups. Some of the issues that have been addressed through quasi-legislative techniques include universal service, number portability, and extended area service.

A good example of the staff research that often has been performed in conjunction with a policy setting proceeding is the research recently conducted by two division staff people. In a recent report, they addressed a very difficult policy issue concerning the method of determining the cost of the local telecommunications network. In fact, the division staff received nationwide recognition for their efforts when the National Regulatory Research Institute published the report in the Fall 1996 quarterly journal. Many other states, as well as the Federal Communications Commission, are interested in the innovative policy analysis these staff members have developed. This kind of policy analysis is often the first step in a quasi-legislative process and is an important first step toward resolving a complex policy issue.

Another example of a quasi-legislative process is the commission's monthly technical conferences to investigate the possibility of allowing competitive sale of electric power generation in Utah. These meetings have included a wide range of interest groups from throughout the state. At one meeting a facilitator from out of state was invited to guide the discussion. In addition, the participants put together a list of "guiding principles" that might be used to evaluate any reform proposals. The commission has also created a number of work groups to address specific issues associated with electric restructuring. The issues being addressed through working groups include economic issues, stranded costs, legal ramifications, reliability issues and retail wheeling.

Pressures Still Exist to Resolve Policy Issues During Adjudicative Proceedings

Although Utah has been using many of the informal policy setting procedures described in this chapter, there still have been occasions when the commission has addressed industry-wide policy issues during an adjudicative proceeding. The reason, in our view, is that there are a number of forces that are encouraging the resolution of industry-wide policy issues during adjudicative proceedings.

Some Market Reform Issues Are Addressed During Adjudicative Proceedings. In recent years, the commission has been charged with the task of establishing an entirely new regulatory framework for regulating telecommunications industry. While many issues have been addressed through informal proceedings, many of the issues legislators are most concerned about were addressed during adjudicative proceedings. For example, the commission needs to find a way to make sure that high quality, affordable services are provided to all residents of the state but at the same time remove all subsidies from the existing pricing structure. In addition, there are concerns about how the state is going to make sure that the quality of the existing telephone system is maintained even as the incumbent phone company is required to resell service from that system and at the same time face obsolescence due to the introduction of competing systems. In connection with this issue, the Legislature has requested that the commission consider as a policy option a new method of depreciation. To address these and other issues associated with the reform of the telecommunications industry, the commission needs to make some very difficult policy choices. These are policy decisions because there may be many different ways to achieve the same Legislative policy objectives. There is no right or wrong answer, no established set of rules that tell the commission how to resolve these problems. It requires state officials to consider the broad goals and objectives of the legislature and to explore many different alternative strategies.

We observed that some of these fundamental market reform issues are being addressed during adjudicative proceedings — during a US West rate case in 1995, a US West depreciation case in 1995 and during the combined interconnection docket and rule making proceeding in 1996. Again, Utah was not the only state to address these issues during an adjudicative process. However, we believe that a better process would have been to formulate the new rules and policies through quasi-legislative process and then formally adopt them through a non-adjudicated rulemaking proceeding.

Organizational Structure Supports Adjudication. One reason the commission may find it easier to address policy issues during an adjudicative proceeding is that the organizational structure of public utility regulation in Utah is designed to facilitate the commission's judicial role. This issue is discussed in more detail in Chapter IV. The commission is created as a separate decision-making body and it has long been their practice to regulate through orders and formal decisions made at the conclusion of a trial-like process. In fact, historically, the only policy issues or rule making the commission has done, have had a fairly narrow application to just one utility company and therefore they could be addressed during a regular rate case. It has only been during the past few years that industry-wide policy issues that affect many different entities have been an important consideration of utility regulators. As a result, the commission

does not have the same long history of formulating industry-wide policy as they do with rate making.

Participants Want to Address Market Reforms Through Adjudications. Another reason the commission sometimes resolves market reform issues through adjudication is in response to the interest groups that prefer to use adjudicative proceeding. For example, representatives from one of Utah's utilities told us that they prefer that the commission resolve most disputes, even policy issues, through an adjudicated proceeding because it allows them to put their case on the record up against the evidence of other participants. They like to have the entire policy setting debate "on the record" because it makes it easier for them to decide if they want to appeal the commission's decision in court.

Representatives of Utah's consumer interests have also expressed concern about informal proceedings. For example one of the state's leading consumer advocates expressed concern that informal proceedings would allow powerful interest groups to influence the decision-making process. Instead, this advocate prefers to resolve industry-wide market reform issues through adjudicated proceedings because it offers the consumer representatives their "day in court." In addition, this advocate points out that the trial like process requires the commissioners to base their decisions on the factual information presented during the trial and prevents commissioners from making deals during closed door discussions with powerful interest groups.

Commission Also has Many Reasons for Adjudication. The commission and their staff also provided us with a number of reasons why they felt it was better to address the industry-wide reform issues during adjudicative proceedings. For example, they said that the participants tend to be more forthcoming when they are placed on the witness stand. In addition, the cross examination gives the commissioners a chance to see if the issues will hold up under scrutiny. Commissioners and their staff have expressed concern that during quasi-legislative proceedings, no one is held to what they say and there is no one reviewing the record to see if the arguments for any given proposal are accurate. They said that when participants are required to take the stand and give formal testimony, they provide better and more accurate information than they do when they are in an informal meeting.

Another reason for using adjudication was that the commissioners felt that it was better to consider the new market rules, policies and procedures during the same proceeding in which they would be applied. They said this allows them to make better decisions because they can consider the proposed rules, policies and procedures in the context of the problem that they were trying to solve.

Commissioners also said that it is more efficient to address the market reform issues during an adjudicative proceeding because many of the participants intend to file a court appeal of the commission's decision. Since some participants plan to appeal the commission's decisions whether or not its adjudicated or done through rule making, commissioners contend that it is more efficient if they conduct the adjudicated proceeding so that participants do not have to go

through an extra appeal to the district court.

Participants Need to Support the Commission's Efforts to Formulate Rules Through Quasi-legislative Techniques. While it may be difficult for those who have been involved in a judicial form of regulation for many years to adopt a new way of resolving disputes, we found that the commission and division have significantly increased their reliance on quasi-legislative techniques in recent years and anticipate that they will continue to do so when addressing industry-wide policy issues. Regulators from other states that rely heavily on quasi-legislative techniques have told us that the participants eventually come to prefer the informal process over adjudication. The participants eventually learn that the result is usually a better, more technically sound set of rules and policies when compared to those the commission would produce through an adjudicated proceeding. Although there may be concerns about due process and the fairness provided during informal proceedings, we believe that if the process is conducted in an open, public forum, and if it follows the steps described in this chapter, that it will ultimately produce better public policy and produce more consensus around the issues than could be achieved through trial-type hearings. To achieve this, however, will require that utilities, consumer interests, potential new competitors, the commission, and the Legislature all support this process.

Recommendations:

1. We recommend that the Public Service Commission and Division of Public Utilities continue to use quasi-legislative techniques when formulating industry-wide policies, procedures and rules.

2. We recommend that the use of adjudicative proceedings be reserved for rate making and when addressing other issues that cannot be resolved through quasi-legislative techniques.

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Chapter III
Legislature Should Provide Broad Guidance

The Legislature and the state's public utility regulators each play important roles in the process of reforming Utah's public utility industries. The Legislature decides whether to reform state regulation of an industry and establishes the objectives of the reform process. In telecommunications, the Legislature has already provided that guidance by approving the Utah Telecommunications Reform Act of 1995. Legislators may soon consider whether or not similar reforms in the electric power industry would be beneficial. Following the broad guidance from the Legislature, it is then the role of the Public Service Commission and the Division of Public Utilities to craft the specific market reforms necessary to accomplish the legislative objectives. In Chapter II, we recommended that regulators continue to use quasi-legislative techniques when developing industry-wide policies. In this chapter we discuss some methods the Legislature can use to direct the reform process by providing broad guidance and oversight to the state's utility regulators.

The Legislature's role is important because the success of the market reform process depends largely on the Legislature providing clear guidance on how the state should proceed. For example, regulators are currently evaluating the possible effects of relying more on competition to control the delivery of electricity to Utah consumers. If market forces are to replace some regulatory controls in the electric power industry, the Legislature will need to identify the broad goals and objectives of the reform process for that industry as it did for the telecommunications industry. But the Legislature's involvement does not end with the passage of the initial reform legislation. There needs to be an ongoing interaction between state regulators and the Legislature throughout the reform process as legislators are asked to consider statutory changes to implement specific reforms proposed by regulators. Meanwhile, the regulators are investigating competitive aspects of electric power generation to see if such partial-deregulation would bring wide-spread benefits to Utah.

Legislative Guidance is Important

State regulators receive legislative guidance from existing legislation and through more informal means such as committee meetings. The state constitution and recent telecommunication's statute direct regulators to rely on market competition whenever possible. However, if regulators move too quickly toward competition, consumers and utilities risk losing the existing benefits of regulation. Utah currently enjoys relatively low utility rates and has financially healthy utilities. Therefore, legislators may want to direct regulators to continue to proceed cautiously toward competition so they can thoroughly investigate the possible effect of relaxing regulatory controls. In fact, regulators have begun making a thorough investigation of electric power restructuring to see whether competitive electric power generation would benefit

all Utah consumers, and whether or not it would be in the best interest of the state to pursue deregulation in electric power generation. By thoroughly investigating the issues before enacting such changes, Utah regulators are first able to observe other states' movements toward competition as part of their investigation. Yet still, some parties such as the large industrial electric power users, maintain that Utah needs to move quickly to electric competition, and risks delaying the benefits of such competition if it does not act with some degree of urgency.

Legislators Have Guided Regulators Toward Reliance on Market Forces

The Utah Legislature has taken steps to communicate its intentions to move to utility competition whenever possible. For example, the **Utah Constitution** was recently amended to show the state's increasing reliance on free market competition in business practices:

> *It is the policy of the state of Utah that a free market system shall govern trade and commerce in this state to promote the dispersion of economic and political power and the general welfare of all the people... Except as otherwise provided by statute, it is also prohibited for any person to monopolize, attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of trade or commerce* (**Utah Constitution**, Article XII, Section 20).

This importance of relying on market forces was recently specified to include the telecommunications industry in the Utah Telecommunications Act of 1995. In this act the Legislature declared that it was the policy of the state to:

> *...encourage the development of competition as a means of providing wider customer choices for public telecommunications services throughout the state; ...enhance the general welfare and encourage the growth of the economy of the state through increased competition in the telecommunications industry...* (**Utah Code** 54-8b-1.1(3) & (9)).

While no recent legislation has addressed competition in electric power, two legislative interim committees heard presentations on the subject during the 1996 interim. Legislation may be considered during the 1997 General Session that would call for competitive practices in electric power generation. However, during the interim committee discussions, differing opinions were expressed about how rapidly the state should move toward electric power competition. For example at the Business, Labor and Economic Development Committee, a representative of industrial power users argued that the state should move quickly toward competition because it forces prices down and improves service for everybody. However, consumer interests expressed concern that moving too fast could result in higher cost or less reliable electric service.

Current System has Served Utah Well

Utah now has relatively low-cost utility services and financially healthy major utility providers. As a result Utah does not have the urgent need to aggressively pursue competition in an effort to reduce utility prices as some other states have done.

Utah consumers benefit from relatively low-cost telecommunications, electric power and natural gas services. Utah's basic business telephone rates are the lowest of the 14 states where US West provides service; its basic residential telephone rates are the second lowest. Likewise, Utah's electricity rates are substantially low, compared to the rest of the nation and surrounding states. Nation-wide, Utah has the eighth lowest weighted-average commercial and residential rates. When compared with surrounding states' average, Utah has lower rates in all three consumer categories: industrial, commercial and residential. Lastly, Utah's residential natural gas rates are below the average of its surrounding states. Utah's rate of 44 cents per therm is second lowest; only Wyoming has a lower rate of 37 cents per therm among surrounding states. This information is summarized in Figure I.

Figure I
Utah's Utility Rates Compared to Surrounding States

	Basic Telephone* (dollar cost per one line)		Electric Power† (cents per kilowatt hour)			Natural Gas‡ (cents per therm)
	Business	Residential	Industrial	Commercial	Residential	Residential
Utah	$27.73	$11.18	3.8¢	5.8¢	7.0¢	44.0¢
Regional Average	35.95	14.21	4.6	6.5	7.3	54.0

Notes:

** Average telephone rates including extended area service as of September 1995. The telecommunications "region" consists of the 14 states served by US West Communications: Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming.*

† Average rates for 1994. For this analysis, the electric power "region" consists of the six states that surround Utah: Arizona, Colorado, Idaho, Nevada, New Mexico, and Wyoming.

‡ Average residential gas rates for winter 1994-95. For this analysis, the natural gas "region" consists of the six states that surround Utah: Arizona, Colorado, Idaho, Nevada, New Mexico, and Wyoming.

In addition to having low utility rates, the state utility consumers are also being served by financially healthy utility companies. We reviewed reports from such financial analysts as Standard & Poor's, Salomon Brothers and Smith Barney, who indicate that Utah's major utility providers—US West, Utah Power and Mountain Fuel—are financially sound. These three regulated utilities, responsible for telecommunications, electric power and natural gas provision, all have good bond ratings that allow them to raise capital at reasonable interest rates. Industry analysts also consider the overall quality of the regulatory commissions to be about "average" when compared to other state regulatory agencies.

State is Making Progress Toward Greater Reliance on Competition

Even though deregulation must be approached cautiously, the state is making progress toward competition in both the telecommunications and electric power industries. The purpose of moving toward greater competition is to use market forces to improve the quality and availability of utility services and to lower their cost. But, if the state moves too quickly away from current regulatory controls it could lose the benefits it now enjoys. While there are different opinions about whether they are moving fast enough or too fast, regulators are making progress toward relying more on market forces to control the utility industries.

Telecommunications Reform is Progressing. Regulators are moving forward with telecommunications reform, but the process can be lengthy for a number of reasons. For example, regulators must assure that consumer safeguards are in place before new telephone providers are allowed to enter the market. As a recent **Salt Lake Tribune** article pointed out, "*fourteen companies have applied... to carve out a piece of US West's local or intrastate long-distance business in Utah. As yet, none has crossed every hurdle needed to market itself as a local telephone provider along the Wasatch Front.*" In other words, the new entrants must be able to show that they will provide reliable service before they enter the market. So, although legislators have communicated state policy to move to competition, the regulators must still assure that effective competition is in place before the state moves from monopoly services. Another reason the process is lengthy is because of problems with the technological feasibility of competitive providers being able to connect to the incumbent's existing network of telephone lines. The process is somewhat stalled now, because there is a question whether the incumbent's network has the capacity to take on the competitors connecting switches.

While telecommunications reform may not be moving as quickly as some expect it could, it is important to recognize the magnitude of the change. The process of reforming an entire industry requires regulators to carefully consider the effect that each new rule and policy will have on the public. Regulators also must balance the needs of the different interest groups that may be affected by the regulatory changes they are considering. Because the process is taking considerable time, US West has suggested that the May 1997 deadline for establishing rates may need to be postponed. Even so, Utah regulators recently finished an analysis of competitive rates, and appear to be making progress on other issues as well.

Electric Restructuring is Being Studied. Unlike telecommunications, the Legislature has not enacted an electric power reform act. However, state regulators are studying the possible use of market forces to control the electric power industry. State regulators have generally taken a cautious approach because they want to ensure that the public will benefit from competition before they consider enacting widespread reform. Regulators are now holding monthly technical conferences at which interested parties are able to discuss electric restructuring issues. In fact, the commission has formed several study committees where the regulators and various parties involved in public utilities are studying several aspects of electric power restructuring. Some of these study groups will present feasibility studies as early as January 1995. Another of the groups is looking into a pilot project in electric power competition. While progress is being made, there are different opinions on how quickly the reform process ought to move.

Some interested participants, such as representatives of municipal power providers believe that the state does not need to pursue electric power restructuring as quickly as other states because Utah enjoys low utility rates and is served by utilities that are financially healthy. Two of the states that have progressed far in introducing competition into their electric power industries, California and New Hampshire, each have high rates and have moved quickly in an effort to lower rates. It can be argued, therefore, that since Utah currently has low electric power rates, it has the luxury of more carefully considering its approach to market reform than other states that are burdened by high utility rates.

On the other hand, representatives of large industrial power users argue that the state only postpones the benefits of market reform by not proceeding more quickly. These large electricity consumers are anxious to move ahead with competition immediately because Utah could lose its competitive advantage if it does move ahead with electric restructuring issues. Another low cost state, Wisconsin, faced the same issue:

> *Some commentators regarded low rates as a reason to proceed very carefully with regulatory changes. Their view was 'if it's not broken, don't fix it.' Other commentators saw this as a head-in-the-sand approach, and asserted that Wisconsin would lose these advantages unless it moves promptly into the new competitive age.*

Large industrial users also argue that Utah cannot shield itself from the changes that are going on in the electric power industry because the Utah market is part of a larger regional power system that is experiencing fundamental changes. Utah should pursue a market-based system because competition, they believe, will force utilities to operate more efficiently, and provide better services than can be provided by a system regulated by the government.

In conclusion, state regulators are making progress toward competition in both telecommunications and electric power. The telecommunications reform process has benefitted from broad legislative guidance and by the Legislature adopting the Telecommunications Act of 1995,

which was authored by state regulators. The study of whether or not the state will move to competition in electric power generation is in the early stages and will need additional legislative guidance. In addition to statutory guidance, good communication between the Legislature and regulators will be important to guide the restructuring of both industries. The following section discusses some of the methods the Legislature may use to continue providing effective guidance and oversight to utility regulators.

Legislature has Many Tools to Provide Broad Guidance

In our study of other states' utility reforms, we reviewed a number of techniques that state legislatures have used to provide guidance and oversight of the market reform process. In addition to providing direction and oversight, communication between the Legislature and regulators is important during the deregulation efforts. The techniques described in this section may help the Legislature offer broad guidance on emerging competitive issues and provide continuing oversight of state regulators. Based on the broad guidance provided, state regulators should be able to continue making progress implementing market reforms.

The remainder of this chapter illustrates four tools to be considered by the Legislature as they offer guidance to regulators. These tools include: (1) providing policy guidance that ranges from broad language on competitive expectations to offering specific "guiding principles" for restructuring efforts in the three utility areas, (2) setting deadlines for reporting findings about reform, (3) outlining procedural requirements to be used by regulators as they investigate competitive forms, and (4) identifying a focal point for legislative consideration of utility issues.

Legislature Could Clarify the Objectives of Market Reform

Even though we believe that the telecommunications reforms enacted by regulators are consistent with the intent of the Telecommunications Reform Act, at some point legislators will need to be involved with portions of the reform which lead to further legislation. For example, legislation concerning the universal service of telephone provision will be introduced in the 1997 general session. In addition, the Legislature will need to provide broad guidance regarding the state's position on electric power reform. First, the Legislature can provide a broad policy statement in legislation or a joint resolution. Second, the Legislature can specifically list what has been termed as "guiding principles" that clearly identify the specific objectives of the reform process.

Legislature Can Offer Broad Guidance. As mentioned, some electric utility interests, such as large industrial power users, have expressed concern that the commission is moving too slowly in bringing competition to Utah's electric power industry. If the Legislature believes that the commission is not moving ahead as aggressively as it needs to in electric power restructuring, they

should reiterate the state's policy, as stated in the constitution, that the free market system is to be relied on whenever possible. The Legislature could encourage the commission to actively pursue, as its goal, the development of competitive markets within the industries it regulates. This is essentially the message communicated by the New Hampshire Legislature when it issued its broad intent to move to electric power competition. In May 1996, their restructuring bill read:

> *A transition to competitive markets for electricity is consistent with the directives of part II, article 83 of the New Hampshire Constitution which reads in part: "Free and fair competition in the trades and industries is an inherent and essential right of the people and should be protected against all monopolies and conspiracies which tend to hinder or destroy it." Competitive markets should provide electricity suppliers with incentives to operate efficiently and cleanly, open markets for new and improved technologies, provide electricity buyers and sellers with appropriate price signals, and improve public confidence in the electric utility industry.*

Beyond this, there are means by which the Legislature could more specifically guide the process.

Legislature Could Enumerate More Specific "Guiding Principles." A step beyond offering broad intent has been used in other states where legislatures specifically list expectations of utility industry reform. For example, the Legislature may wish to preserve some of the more desirable aspects of monopoly regulation, such as system reliability, which would be included on such a list. They could also communicate prerequisites to competition, such as an expectation that competition will benefit *all* consumers. As a precursor to the Telecommunications Reform Act of 1995, the Division of Public Utilities prepared a comprehensive policy document on telecommunications reform. In this document, the division suggested principles that should guide the reform process. These "guiding principles" were enacted as part of Utah's Telecommunications Reform Act. Concerning electric power competition, the Legislature could require a similar list of principles.

The New Hampshire Legislature created a good example of a guiding principles list for electric restructuring. Their Legislature actually listed out their "interdependent policy principles" mentioned in the broad policy statement. These included:

1. Continued system reliability
2. Customer choice in electric power providers
3. Regulation and unbundling of services and rates
4. Open access to transmission and distribution facilities
5. Universal service
6. Benefits for all consumers
7. Full and fair competition
8. Environmental improvement
9. Reliance on renewable energy resources

10. Energy efficiency
11. Near-term rate relief
12. Recovery of stranded costs (investments) of existing electric utilities
13. Reliance on region-wide power pooling, (i.e., regionalism)
14. Urgent use of administrative processes ("...New Hampshire should move *deliberately* to replace traditional planning mechanisms with a market driven choice as the means of supplying resource needs.") and
15. Use of an expeditious timetable

The Utah Legislature could establish a similar list of guiding principles for electric power restructuring to guide state regulators. With this type of broad direction, experienced state regulators can develop the specific policies required to meet legislative objectives.

Legislature Could Establish a Time Line for Change

In order to encourage progress toward market reform in the telecommunications and electric power industries, some state legislatures have established deadlines for achieving certain milestones in the reform process. For example, by establishing deadlines and by prescribing the specific tasks to be completed by each date, the Colorado Legislature was able to make sure the reforms required for a competitive telecommunications market were in place in just over a year. In their Telecommunications Reform Act, passed in May 1995, the Colorado Legislature declared that *"Local exchange telecommunications markets [in Colorado] shall be open to competition... on or before July 1, 1996."* The bill also required that the difficult policy issues associated with competition be addressed initially by working groups and that they complete a report containing their recommendations to the commission *"on or before January 1, 1996*" when it was to begin its formal rule making process.

An advantage of establishing time expectations is that it enables utility companies and others to plan accordingly. Thus, Colorado's approach allowed the new telephone providers with some confidence that if they began to install new equipment, lay the transmission lines, and prepare to offer service, that they would be able to put that equipment into service at a certain date. Although the Utah Telecommunications Reform Act included specific deadlines, most of those did not relate to the entry of market competition, but instead had to do with the deregulation of US West. Unlike the Colorado law, Utah's reform act did not provide new telephone providers with that time schedule or a process for enacting the market reforms and allowing the introduction of new competitors. Establishing a time line identifying when important reform milestones should be achieved can be a useful tool to keep the process moving.

In contrast, a potential disadvantage of establishing deadlines is that if they are not realistic, they may lead to poor decisions. Deregulating some aspects of the utility industries is a major undertaking that needs to be conducted in a thoughtful manner. Legislators and regulators need to agree on a process and make sure the necessary resources are available to complete that process. It does little good to set a deadline if regulators cannot complete important tasks in the time

allowed. As a result, the state could end up with market reforms that are in place quickly but do not accomplish state objectives. If sufficient resources are not put in place to accomplish the goals and if the time deadlines are not based on a well planned reform process, then the time lines may be counter productive.

Legislature Could Specify Procedural Requirements

The Legislature could require that certain procedures be followed that would not only enhance the reform processes, but better assure that deadlines can be attained. For example, the Legislative Executive Committee has expressed a concern that the process of restructuring the telephone industry has not progressed as quickly as they intended even though specific deadlines have been established. This suggests that deadlines alone may not be sufficient to ensure that progress is made. Furthermore, deadlines and policy guidance do not assure public involvement. Legislative directives to use more public hearings and to continually rely on quasi-legislative techniques, such as working groups and consensus hearings, could provide more such assurance.

Legislature Could Require More Public Hearings. Because utility competition will bring unprecedented changes, it is important that the Legislature involve the public as much as possible. For example, there may be significant costs and benefits of telecommunications reform. It is widely believed that competition will generally bring better services, lower costs and a wide range of choices to the consumer. However, the requirement to eliminate subsidies among certain customer classes could result in a significant increase in rates for residential consumers. It would be inappropriate for government to adopt a reform package that dramatically increased residential rates without some public input.

The California and Colorado legislatures, for example, felt so strongly about public involvement in the market reform process that they required their public utility commissions to hold many public hearings throughout the state. The California Legislature required their Public Utilities Commission (CPUC) to hold public hearings in sixteen cities throughout the state prior to the CPUC's final decision on electric power restructuring. The CPUC enhanced this public participation by providing coverage of public hearings over cable television. The public was also encouraged to submit written comments, or even respond to the process over the Internet. Like the CPUC, the Colorado Public Utilities Commission held fourteen public meetings throughout the state as part of its telecommunications deregulation effort. At each

hearing, commission staff provided audiences with a brief description of the changes that were being proposed in the telecommunications industry and then the public was invited to comment about the potential effects of the proposal.

Legislature Could Mandate Increased Reliance on Quasi-Legislative Procedures. Some states have not only established deadlines for completing the market reform process but have also

established the process through which regulators would resolve the issues associated with market reform. Utah regulators, as mentioned in Chapter II, have been using these techniques in telecommunications reform and in the electric restructuring investigation.

For example, the Colorado Legislature required the market reform issues associated with telecommunications reform be resolved by a Telecommunications Working Group consisting of regulators, consumers and various telecommunications utility representatives. The Colorado Legislature said the *"members of the working group... shall meet and attempt to reach consensus on proposed rules to be submitted to the commission for consideration and adoption as appropriate..."* for implementing competition in local exchange telecommunications markets. The Legislation also required the commission to give broad "deference" to the recommendations of the working group. Members of some of the working group sub-committees told us that although the process was time-consuming, they were able to formulate consensus conclusions. In addition, the California PUC was asked to rely less on litigious proceedings, as well, although the directive in that state came from the Governor. Similarly, legislators could recommend the Utah Public Service Commission continue to rely on consensus-building techniques such as working groups if they prefer those procedures be used. Utah regulators are accustomed to such procedures as they have been using working groups in both telecommunications and electric power issues. The Legislature could direct them to continue with such procedures prior to resorting to adjudicative procedures.

Legislature Could Identify a Focal Point for Utility Regulatory Issues

As mentioned, the Legislature plays an important role in providing broad guidance and direction. Yet there is no focal point for providing that guidance. While we recognize the existence of an Information Technology (IT) Commission for dealing with telecommunications reform issues, that commission's work encompasses many issues associated with information technology and is not focused primarily on the market reforms needed for the telecommunications industry. Further, the IT Commission is not a legislative committee. As for electric power issues, several presentations on electric restructuring have been made to different legislative interim committees, such as the Business, Labor, and Economic Development Interim Committee. But, there is still no single legislative forum that has been designated to address these regulatory issues.

The Legislature has clearly established which committees have oversight responsibility for other significant public policy areas. A similar relationship could be established for all utility regulatory issues. For example, the Director of the Department of Natural Resources knows he must answer to standing and interim committees for energy, natural resources and agriculture. Legislators may want to identify which committee or create a special task force or interim committee that is responsible for utility regulation. Other states have statutorily created such oversight committees or special legislative task force groups for telecommunications and electric power reform. However, the lasting solution would be to formulate a standing utility regulatory

committee. Our office recently learned that House leadership is proposing a new "Public Utilities and Technology" standing committee as part of a larger committee restructuring. Naturally, we support the proposal.

Colorado's telecommunications deregulation process, discussed in Chapter II, provides a good example of how a legislature can oversee the reform process. The Colorado Legislature created an Interim Committee on Telecommunications Policy, consisting of five senators and four representatives, which recommends telecommunications policy to their Legislature. At the same time, the Legislature created a public utilities working group that actually developed the new policies for competitive telecommunications to then be considered by the interim committee and Legislature. In another example discussed in Chapter II, the New Hampshire Legislature authorized HB 1393 that formed an oversight committee for electric restructuring, consisting of seven representatives and seven senators. This oversight committee was created, among other things, to assure that New Hampshire's Public Utilities Commission would incorporate specific legislative policies into the electric restructuring package. In our opinion, committees such as these could be formed in Utah.

In addition to guiding the process of market reform, Legislative oversight may also be needed for any reforms in the regulatory structure itself. In Chapter IV we indicate that the Public Service Commission may need to conduct an internal strategic planning process to determine new roles, a new structure, and statutory revisions needed in light of the changes going on in the industries they regulate. As they conduct this internal reform process they will need some mechanism to formally communicate their findings to the Legislature. This could be a standing committee or sub-committee.

Recommendations:

1. We recommend that the Legislature continue to offer broad guidance in the reform of the electric power and telecommunications industries and that they continue to rely on the Public Service Commission and Division of Public Utilities for detailed decision-making and technical expertise.

2. When the Legislature needs to provide guidance to regulators, we recommend they use some of the tools used by other state legislatures. Specifically, Legislators can:

    - state (or restate) the Legislature's broad intentions for utility competition or enumerate "guiding principles" specific for reforming each utility area,
    - establish a time line for change,
    - specify procedural requirements such as requiring an increased use of public hearings and a greater reliance on working groups for policy formation, and
    - create a legislative committee to oversee utility regulation and related issues.

Chapter IV
Organizational Structure Should Be Examined

Legislators have asked us to determine if the current organizational structure of public utility regulation in Utah is meeting today's needs and whether the structure will be able to meet future needs. Specifically, legislators asked us to review the roles of the commission, division, and committee and to determine if the three agencies can be consolidated. One option that is available is to consolidate the commission and the division, as they are in most other states. However, there are advantages in keeping the organizational separation that now exists. While consolidation could be considered, the fact that utility regulators are engaged in a difficult market reform process may make this a poor time for a major organizational change. In addition to addressing the consolidation of the division and commission, legislators should also consider clarifying the organizational status of the committee. Although most states have an independent consumer advocate that functions as a separate agency, it is unclear whether the committee is an independent agency or a part of the division.

As an alternative to taking immediate action, we feel legislators should consider initiating a strategic planning process to evaluate possible organizational changes in the context of a broad reform of public utility regulation in Utah. As mentioned in Chapter I, the development of competition in the public utility industries may require states to reexamine the regulatory compact with utilities and the state may need to make fundamental changes to its approach to regulation. In addition to reevaluating the organizational structure, the state may need to reexamine the statute, the regulatory policies and procedures, and the duties, qualifications and number of staff. Because each of these issues affect one another, legislators might require that the organizational issues be addressed as part of a broader reexamination of public utility regulation rather than addressing the organizational issue by itself.

Current Organizational Structure Facilitates Judicial Role

Before legislators decide whether to consolidate the state's regulatory agencies, they should consider the reasons why the state adopted the regulatory model that it did. During the early 1980s, the state reorganized public utility regulation in a way that protects the commission's judicial role. Prior to 1983 the commission and the division were both part of the same department. However, the consolidated structure led to concerns about the division having unfair influence with commissioners during adjudicative proceedings. A fundamental concept of judicial proceedings is that *ex-parte* communication must be avoided; it is unfair for an advocate of one position to have access to a judge that advocates of other positions are denied. However, in a consolidated structure staff act as both advisors to the commission outside of

judicial proceedings and as advocates before the commission during judicial proceedings. The concern caused by a consolidated structure was expressed by the Utah Supreme Court in 1980:

> *To hold that the Public Service Commission should not only decide between those conflicting interests in its judicial capacity, but also should represent the state in protecting public rights, would make the commission both judge and advocate at the same time. Such a concept violates our sense of fair play and due process which we believe administrative agencies acting in a quasi-judicial capacity should ever observe.*

So, in order to protect the commission's impartiality in its role as a judge, the state has separated the decision makers from the technical staff. The commission acts as a panel of judges and the division and the committee participate as advocates along with utilities and other interests during commission proceedings. Consistent with this judicial structure, the Legislature created three separate regulatory agencies that performed the following roles:

1. The **Public Service Commission** is an independent state agency, consisting of three commissioners and 12 staff members, including administrative law judges. Their statutory responsibility is contained in **Utah Code** 54-4-1:

   > *The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and to supervise all of the business of every such public utility in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction;*

   Consistent with its role as a judicial body, the commission has a relatively small staff who help evaluate the information presented to the commission by other parties. After commissioners and their staff consider the information presented to them, they issue formal written orders that guide the operation and regulation of the utility industries. Although the commission is vested with broad supervisory and regulatory powers, it is not equipped with either the staff or the resources to actually carry out the day-to-day work of regulating the state's public utility industries. This is the role of the division.

2. The **Division of Public Utilities** was created by statute in 1983 as a division of the Department of Commerce. The division consists of approximately 35 staff people and a director. Under Utah law, the division is granted broad authority and responsibilities to monitor all terms and conditions of utility service such as rates, safety, adequacy and reliability. Their statutorily defined objectives are contained in **Utah Code** 54-4a-6(4):

   (a) Maintain the financial integrity of public utilities by assuring a sufficient and fair rate of return;
   (b) promote the efficient management and operation of public utilities;

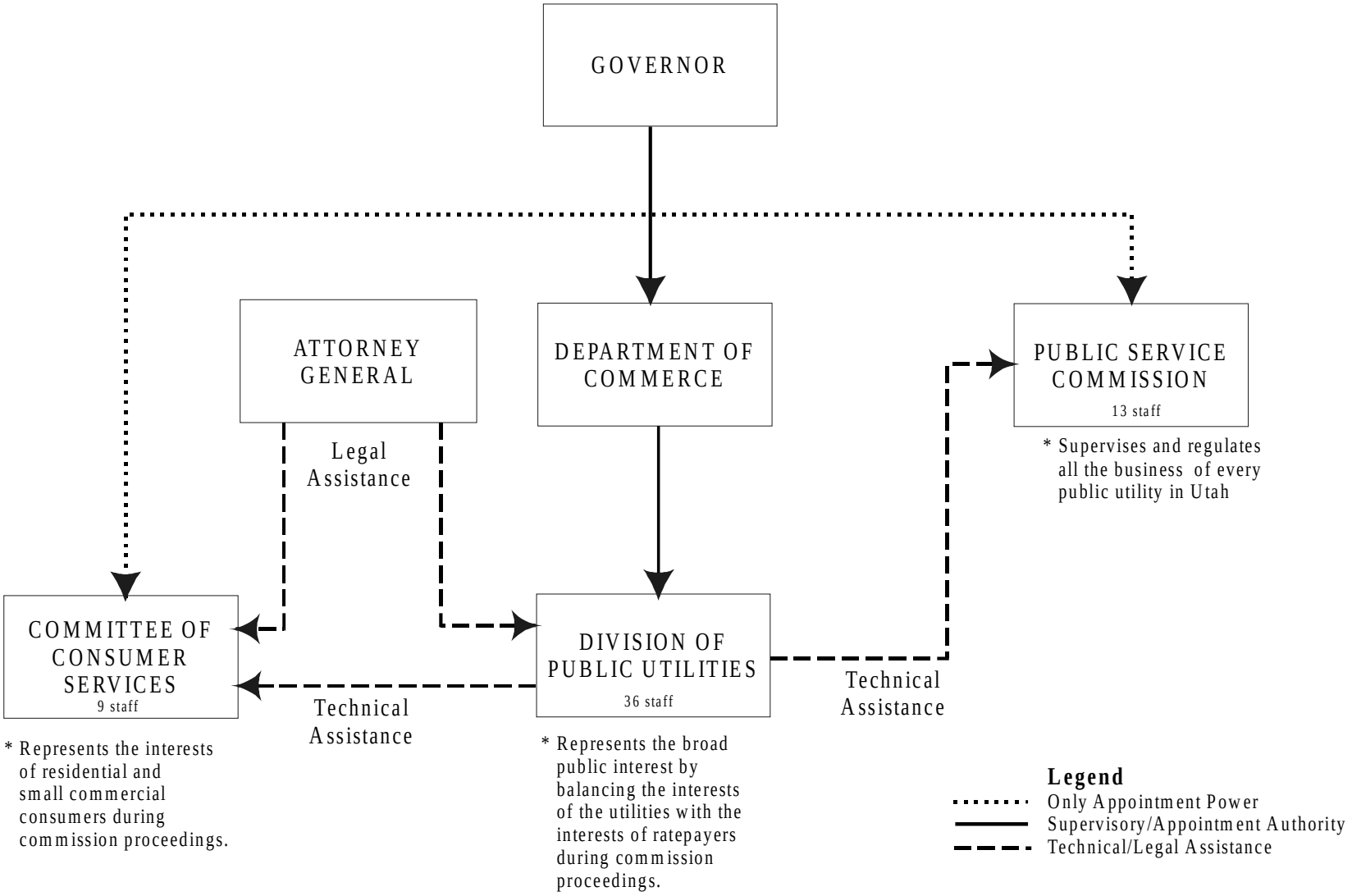
(c) protect the long-range interest of consumers in obtaining continued quality and adequate levels of service at the lowest cost consistent with the other provisions of Subsection (4)
(d) provide for fair apportionment of the total cost of service among customer categories and individual customers and prevent undue discrimination in rate relationships;
(e) promote stability in rate levels for customers and revenue requirements for utilities from year to year; and
(f) protect against wasteful use of public utility services.

While the commission has broad authority to "*supervise all of the business of every ...public utility in this state*" it is the division's staff of accountants, engineers, and economists that actually carry out and enforce the orders of the commission and that monitor the activities of the public utilities in the state. In one respect, the two agencies perform separate functions but share the common objective of protecting the public interest. The analogy has been made that the commission is the "judiciary" and the division are the "police." The commission can request the division to complete studies as necessary. On the other hand, the division can petition the commission for action on items that need attention.

3. The **Committee of Consumer Services** was created by statute in 1977 to protect the interests of the residential and small commercial consumers during the commission's proceedings. Although the committee is statutorily part of the Division of Public Utilities, it functions as an independent agency. The committee has eight staff members and an executive secretary. Oversight is provided by a 6-member citizen committee. By representing small consumers, the committee helps bring balance to commission proceedings. The division is required to protect the broad public interest by balancing the needs of the utilities and the industrial and residential consumers. The utilities and large industrial consumers are well represented and are effective are advocating their positions. It is the role of the Committee of Consumer Services to provide balance to the discussion by providing independent representation for small consumer interests.

   The relationship among the three regulatory agencies can be summarized in Figure II.

Figure II
STRUCTURE OF UTAH'S UTILITY REGULATORY ENTITIES



Even though the organizational structure is designed to facilitate the commission's judicial role, this has not prevented staff from performing their non-judicial functions. As mentioned in Chapter II, the amount of policy setting being performed by state regulators has increased. For example, staff from the division, commission and committee have worked together on research projects associated with electric power reform. The following describes both the arguments for maintaining a formal separation between division and commission and for consolidating the agencies.

There are Arguments for the Current Structure and for Consolidation

We discussed the issues surrounding the organization of utility regulation with many individuals who are knowledgeable in public utility matters in Utah and in other states. The following information provides their arguments for continuing Utah's existing organizational structure as well as their arguments for consolidating the division and commission. However, some suggested that the organizational structure of state regulators is not as important as the state's overall regulatory philosophy. In our view, Legislators can best resolve the issue surrounding organizational structure by deciding which of the commission's roles should receive the greatest emphasis. If Legislators are still concerned about ex parte communication and about protecting the commission's judicial role and *ex-parte* considerations are still a primary concern, then the state should continue with the existing structure. If, on the other hand, Legislators would like the commission to emphasize its policy-making role, then it may not be necessary to continue to separate the commissioners from the technical staff.

Arguments for the Current Organizational Structure

There are several arguments for maintaining the current organizational structure. First, since the commission and division are separate entities, it helps to reduce the concern about *ex-parte* communication. Second, the structure gives the division the independence to advocate positions without the potential of being influenced by the commission. Third, the separation of the Division of Public Utilities provides them with the ability to appeal commission decisions. Fourth, having an independent division provides the Governor a direct voice in utility issues.

When evaluating the advantages of various organizational models it is important to recognize that the state has prospered under the current regulatory structure. As mentioned in Chapter III, Utah consumers enjoy relatively low utility rates while its utilities are all financially healthy. In light of this, legislators might decide it is best not to disrupt a regulatory system that is meeting the needs of both consumers and the utilities.

Separate Structure Lessens the Concern About *Ex-parte* Communication. One of the arguments for keeping the division staff separate from the commission is that it helps avoid the problems of *ex-parte* communication. As mentioned, this is one of the reasons why the

Legislature separated the two agencies in 1983. Even though previous studies of public utility regulation in Utah recommended consolidating the division and the commission, that recommendation was never implemented because legislators and utilities were concerned about inappropriate staff influence on the decision-making process. Most recently, in 1987, utilities were opposed to rolling the division back into the commission. Through discussions with utility representatives and consumer advocates, we determined that the *ex-parte* problem is still a prime concern. Even with the existing protections, utilities and consumer advocates are concerned about the degree to which the commission is influenced by division staff and by outside interest groups.

Separate Structure Helps Division Provide Objective Information. By being separate, the division staff believe they can provide the commission with better information because it allows them to take a more independent view than they could if they were directly supervised by the commission. Some division staff are concerned that if they were part of the commission, they would be influenced by the commissioners to take a specific course of action. Division staff report that colleagues from other states who operate in a consolidated structure have told them direct commission oversight causes problems. Reportedly, there are times when staff in other states have been unable to pursue specific consumer protections and develop unbiased analysis of utility issues because it was not consistent with the expectations of their states' commissioners.

Division Staff has the Right to Appeal Commission Decisions. As an independent agency, the division is also able to appeal commission decisions to the Supreme Court. The division considers their right to appeal an important "check and balance" in the system. This has been manifest over the past fifteen years in the way the division has successfully challenged a few commission decisions and has recovered several million dollars for consumers.

Division can Carry out the Governor's Policies. Another argument for staying with the current organizational structure is that it allows the division to carry out the policies of the Governor. As an agency within the Department of Commerce, the division is responsible for carrying out the policies of the Governor's appointees. This responsibility, the division staff say, makes them more responsive to the needs of the public than they would be if they were part of the commission. In addition, the division staff not only represent the Governor's policies before the commission but also advocate those views to the Legislature. For example, during the 1996 legislative session, presumably with the support of the department director and the Governor, division staff made presentations to Legislative committees and lobbied against a bill that they believed was not in the public interest. The division staff feel that their independent status allowed them to provide information to legislators that they would not have been able to provide if they worked directly for the commission.

Arguments for a Consolidated Structure

We have heard several arguments for a consolidated organizational structure where the division becomes part of the commission. First, providing direct oversight of technical staff might allow the commission to become more pro-active in addressing changing utility conditions. Second, the commission would have more direct access to a large staff (the division) and could establish a plan for action and see that steps are taken to carry out that plan. Third, a combined structure would provide a focal point for accountability.

A consolidated structure could be beneficial in the future as competition grows and policy issues become more important. At a recent national regulatory conference, state commissioners recognized the changing need for regulatory staff to assist them in their decision-making role. The conference report concluded *"that as competition grows, the need for an advisory staff role grows and the need for an advocacy staff decreases."* If the need for advocacy staff decreases, then the importance of have organizational protection against *ex-parte* communication lessens as well.

Consolidated Structure may Allow the Commission to be More Pro-active. One role the commission may fulfill is to develop plans of action and see that steps are taken to carry out those plans. However, one criticism we heard from outside observers is that the commission tends to be reactive and to respond to others, rather than initiate action themselves. Some utility industry representatives who do business in Utah and other states told us that other commissions tend to provide more direction and guidance of the regulatory process than Utah's commission does. If commissioners did have broader supervisory responsibility over the technical staff, then they would be better equipped to chart a course, lay out a plan of action and see that the required resources are devoted to carrying out that plan. Because it has few staff, the Public Service Commission generally acts as a deliberative body that reviews information brought to them by others, including the division, and makes decisions.

Combined Staff may Give the Commission More Ready Access to the Technical Staff. One of the roles of the division staff is to make sure that the commissioners have the best data possible before making decisions. However, the current organizational structure addresses the *ex-parte* concern by establishing an organizational barrier to communication. In 1986, one former commissioner recommended eliminating the division and dividing the staff between the commission and the committee because *"the best information does not get to the commission"* with the separated structure. A report by the National Regulatory Research Institute (NRRI) observed that:

> *The problem with such a bifurcated staff approach for solving separation of functions concerns is that, for states with ex-parte communication rules, the commissioner or administrative law judges are isolated from the staff that has the most expertise on the issue.*

A consolidated structure would provide commissioners a greater opportunity to meet informally with division staff and discuss the policy options. How they might accomplish this while still conforming with ex-parte rules is discussed later in this chapter.

Combined Structure Would Provide Focal Point for Accountability. Because the commission and the division share the same objective of promoting the broad public interest, accountability is diffused. Although the commission is the decision-making body that establishes regulatory requirements through rules and orders, it does not have adequate staff to investigate issues or monitor compliance. Similarly, although the division has the technical staff to analyze and recommend policies to serve the public interest, it has no rule making authority. Because the organizational structure is designed to facilitate the commission's role as judge, the commission is limited in its ability to make sure the state's policies are carried out. As mentioned at the beginning of this chapter, it is the division that actually provides most of the administrative oversight of the state's regulatory process. With a consolidated regulatory structure, the Legislature and the Governor could fix accountability for carrying out the state's public utility policy solely with the commission.

Either Structure Can Be Effective

While there are good arguments both for retaining the independence of the commission and the division and for consolidating them, either structure can be effective. As discussed in Chapter III, the state has achieved low utility rates and healthy utilities with the existing structure. On the other hand, some other states have achieved similar conditions with a consolidated structure. While each structure has advantages, either may accomplish all the necessary regulatory functions. For example, *ex-parte* concerns can be accommodated in a consolidated structure and commissioner access to technical staff can be accomplished in a separated structure.

Other states that have a combined structure deal with *ex-parte* communication in a variety of ways. Several of these alternatives are suggested by the NRRI. One alternative is to require the advocacy staff and advisory staff to observe *ex-parte* rules only when they are engaged in formal adjudicative proceedings. Most state's that have a single regulatory agency address the *ex-parte* problem in this manner. NRRI suggests that: "*staff who are party in a case can be identified by memorandum, effectively creating a Chinese Wall that should prevent ex-parte communication problems from arising."* This they suggested "*may minimize the need to create two separate staffs and may minimize the degree to which commissioners are isolated from knowledgeable staff. . . ."* Yet NRRI also acknowledged that such a process would not be considered as *" 'clean' as it should be because staff communicate with each other and there is likely to be some leakage between staff who put on a case and the remaining staff."*

As steps can be taken to address *ex-parte* concerns in a consolidated structure, likewise steps can be taken to facilitate commissioner interaction with division staff in a separated structure. One potential shortcoming of the divided organizational structure is that the division staff are not

able to fully support the commissioners. Although they share many of the same broad goals and objectives, the division staff are accountable to the division director, not the commission, and are there to perform the work he directs them to perform. However, the commission can ask the division to perform specific research or provide answers to technical questions. In fact, the commission and division and utilities frequently hold technical conferences to help commissioners and staff better understand certain issues. Recently, division management became aware that some commissioners felt they did not have access to the division staff and have already implemented corrective action. They began what they call "brown bag" luncheons, where they meet with the commissioners; they also prepare monthly briefings.

Organizational Structure Depends On Future Regulatory Roles

In our opinion, the effectiveness of the organizational structure depends on what are the future roles of the commission and the technical regulatory staff. Since utility industries are in the midst of fundamental changes and there remains considerable uncertainty about future regulatory needs, we feel the Legislature should consider possible changes in the context of a broad strategic planning process.

In our view, the best way for Legislators to decide what kind of organizational structure is best for Utah is to decide what the primary role and mission of the commission should be. As they have in the past, the commission will continue to act both as a judicial and policy-making body. The organizational structure that best supports the commissions decision-making duties depends, in part, on how frequently it uses adjudicative, quasi-legislative and other techniques. Even if legislators decide that a different organizational structure is best for Utah, they should consider whether it is currently the right time to make a change.

There are good reasons why legislators might choose to put off making any changes to the organizational structure. The state is still in the process of reforming the telecommunications and electric power industries. It is not yet clear what role regulators will need to perform when the market restructuring process is completed. In addition, it may be counterproductive to reorganize the state's public utility agencies at a time when staff are being required to resolve some very complex market reform issues. For these reasons, legislators may want to postpone making any organizational changes until the state has time to conduct a strategic planning process to determine the long term role and function of the commission. That is the option described at the end of this chapter. Before we consider that option, however, we address the importance of maintaining the independence of the Committee of Consumer Services.

Legislature May Wish to Strengthen the Committee of Consumer Services

The Legislature should consider strengthening the Committee of Consumer Services. The committee performs an important role of representing the interests of residential and small commercial consumers. With emerging utility competition, it is likely that the need for a strong consumer advocate will increase, particularly if the Legislature chooses to combine the division with the commission. In our view, the committee needs to be independent if it is to function effectively. However, the statute that establishes the committee is relatively unclear concerning the independent status of the committee. Although it has functioned as an independent agency since it was created, there is some doubt as to whether the committee staff should answer to the director of the Division of Public Utilities, since the statute places the committee within the division. For this reason, the Legislature may need to clarify the statute and consider ways to strengthen the independence of the committee.

Role of the Consumer Advocate May Become More Significant

The need for a strong consumer advocate is likely to continue as the state develops a competitive marketplace. The committee was created in 1977 to represent the interests of residential and small commercial consumers. In a 1984 audit titled **A Sunset Audit of the Committee of Consumer Services**, the Legislative Auditor General concluded that the committee *"serves an important public purpose and should be reauthorized."* We still believe that the committee performs an important role in representing the interests of consumers, especially in light of pending utility competition. For example, problems that rarely occurred during monopoly regulation, such as unfair trade practices, unfair advertising, and anti-competitive activities, could become serious problems as the market grows increasingly competitive.

The need for a strong Committee of Consumer Services will also increase if the Division of Public Utilities is combined with the Public Service Commission. One earlier study concluded that the division, if consolidated with the commission, should no longer be able to appeal decisions to the supreme court. Currently, both the division and committee have the right to appeal commission decisions before the Utah Supreme Court. In fact several appeals made by the division, and the committee, or both, have succeeded in overturning commission decisions and have save ratepayers tens of millions of dollars. For this reason, we believe that it is important that those representing the consumers' interests have the ability to appeal commission decisions. As it stands, the utilities and the industrial consumers are well represented during commission hearings and have the ability to appeal commission decisions to the Supreme Court; so, if the division and commission are consolidated, it will be important that at least one entity, the Committee of Consumer Services perhaps, continue to have the ability to appeal commission decisions.

Legislators May Wish to Clarify the Independent Status of the Committee

Because it is important that consumers be well represented, legislators should consider ways that they might preserve the independent status of the committee. Specifically, we would like to reiterate some of the recommendations made in our 1984 audit report to the Legislature because they are still pertinent today. In 1984, and today, there is confusion over who oversees the committee. The administration of the Department of Commerce is concerned that the statute places the Committee of Consumer Services *"within the Division of Public Utilities,"* which implies that the committee staff should be accountable to the division head and department head. However, the statute also indicates that the executive secretary of the six member committee shall be *"appointed by the governor with the concurrence of the Committee..."* and that he or she will *"carry out the policies and directives of the committee..."* This suggests that it is the committee, not the division director, that has management oversight of the committee.

The statute also does not clearly state whether the committee is to have any support staff beyond the executive secretary, only that it *"may request the Division of Public Utilities to review accounting, procedures and expenditures..."* This suggests that the division is to provide the technical support for the committee. However, this has not been the case. For years the Legislature has recognized the need for an independent committee staff and has included funding for those staff in the committee's budget each year.

A final consideration deals with the organizational placement of the Committee of Consumer Services. Just as we did in 1984, we encourage the Legislature to reconsider the organizational placement of the committee. If the division is consolidated with the commission, then the committee could remain as an independent division in the Department of Commerce. The advantage of being in the same proximity of the division and commission staff is that the committee can share in the cost of technical resources such as library materials. On the other hand, we found, as we did in 1984, that most states have their consumer advocate agency located in the Attorney General's Office. The committee could be located there or, as in many other states, it could be positioned as an independent agency that answers directly to the Governor. We recommend that the issue concerning the organizational status of the committee, as well as the issue of consolidating the division and commission, be taken up during a strategic planning process which will be described below. If legislators choose not to initiate a strategic planning process, we would still encourage them to address the organizational status of the committee.

Legislators Should Initiate Strategic Planning

Rather than acting now, the Legislature could delay changing the organizational structure until state regulators have had a chance to thoroughly investigate future regulatory needs. As discussed throughout this report, after years of regulating monopoly utilities, the state is now beginning to rely more on market forces to control the utility industries. While the transition to a more competitive environment will require an increased emphasis on policy development, it is less clear what the role and mission of regulators will be after competition has developed more fully. For this reason, legislators may want to rely on a strategic planning process to evaluate future regulatory needs in light of the changing role of public utility regulation. Such a process

would require that organizational issues be considered in the context of a wide range of other reforms that would be made to the state's approach to regulation. The Public Service Commission could lead a strategic planning effort or responsibility could be given to another group such as a legislative or Governor's task force.

Fundamental Change May Be Needed in the Future

There is widespread agreement that the changes taking place in the utility industries today are so dramatic and fundamental that the very foundation on which utility regulation is based may need to be reevaluated. For example, a recent study by the NRRI concluded:

> *The change required of commission's today is not the familiar gradual evolution in response to incremental changes in the external environment. The change required today is in response to a fairly radical reshaping of the environment and, as a result, requires fundamental changes in the missions and operations of public utility commissions.*

The NRRI article proceeds to warn regulatory commissions that if they do not make fundamental changes in the way they conduct business that they will be viewed as an obstacle to progress and have change imposed on them from outside.

This is the lesson that the California Public Service Commission had to learn very quickly when it came under fire from certain legislators because the commission had pursued electric power deregulation without consulting the Legislature. Led by two commissioners who had prior experience in corporate retooling, the commission responded by conducting a thorough reexamination of "*what a more effective commission should look like in the year 2000.*" The commission strategic planning process included workshops with representatives from the Legislature, consumer and business advocates, industry, regulated utilities, labor unions, residential and commission staff. The result, was a plan that identified steps the commission is now taking to better serve its "customers," to hold staff more accountable to the commission, and to hold the commission more accountable to the Legislature. Most importantly, the plan lays out a strategy for regulating an increasingly competitive marketplace. The plan also identified several changes that are being made to the responsibilities of individual staff members and the organizational structure of the commission.

It may be more difficult to justify changing Utah's regulatory structure and practices in Utah because, unlike other states, utility rates are low and consumers are not as concerned about making changes to the state's approach to public utility regulation. Still, as utility industries change, agencies need to change as well. If possible, it is best if the change is initiated by the regulatory staff themselves because they have the greatest expertise to resolve these challenges. However, if regulatory agencies are reluctant to adapt to the changing conditions around them, then the process of change may need to be initiated by the Legislature or Governor's office. Regardless as to whether the regulators or the Legislature initiates the reform process, we believe

that a comprehensive evaluation of future regulatory roles, missions, and practices could help identify the future duties and qualifications of the staff. Such a process could logically precede a legislative decision on the appropriate organizational structure.

Future Regulatory Needs are Unclear

Because there is considerable uncertainty over future industry conditions, the long term regulatory needs remain unclear. In a fully competitive environment, government regulation would not be needed, although monitoring such things as advertising claims and service quality would still be important. However, full and effective competition is not in the foreseeable future. Regulatory needs are clearly changing, but exactly what those needs will be will depend on the extent to which market competition develops in the public utility industries.

The utility industries and government regulators are now in a transition period between monopoly regulation and partial competition. The focus of regulation is moving away from the review of the prudence of a utility's expenditures in order to set consumer payment rates. Instead, during this transition phase, the commission will need to place a greater emphasis on the complex policy issues associated with the introduction of market competition. The earlier recommendations in this report address some of the ways to facilitate a regulatory reorientation from adjudication to policy making.

Following a transition period, the regulatory activities may be very different from what they have been in the past. The importance of different activities will depend on how widely competition develops. Therefore, one of the most critical regulatory tasks in the future may be to determine the extent of competition in any given region so that regulators can decide whether traditional regulatory controls should be lifted. For the reasons discussed in Chapter I, regulatory control must continue where true competition does not develop. Another important future regulatory activity may be to monitor and eliminate any anti-competitive behavior so that utility providers and consumers are protected. In addition, regulators may need to develop ways to measure the quality of service provided by utilities and disseminate that information to consumers.

The number and type of regulatory staff that will be needed in the future will largely depend on how the nature of public utility regulation changes. For example, because reviewing a provider's costs is not necessary if competition exists, fewer accounting professionals may be needed by the regulatory agencies in the future. Similarly, the changing emphasis from adjudication to policy making could decrease the number of legal staff required. In addition, the need to evaluate market conditions and review possible anti-competitive behavior may increase the need for economists. However, there currently remains so much uncertainty about future conditions that other factors suggest eventual needs may require more accountants and lawyers but fewer economists.

In light of the uncertainty about eventual regulatory activities and staffing needs, the

Legislature may choose to defer organizational restructuring pending a strategic planning process. In additions to evaluating future needs, a broad-based review of the utility regulator's mission, activities and needs, a study could help identify needed statutory changes.

Strategic Planning Process Could Evaluate Future Needs

Since the Public Service Commission is charged with overseeing public utility regulation in Utah, it could oversee a strategic planning effort to evaluate the future roles of the regulators and their staffing needs. A strategic planning process would require broad representation from a wide range of interest groups. This is the approach that the California Public Utilities Commission used very effectively. Another option would be to assign responsibility to a special task force such as the one created by the Governor to address the issues associated with Job Training programs several years ago. Such a task force should also include representatives from a wide range of stakeholder interests, including the consumers, industry, legislators and the utilities. In either case, the Legislature should establish the scope of the reform process, designate a time line for the completion of the process and designate a legislative committee to which a report would be made. Such a report should specifically address the future regulatory structure and resource needs as well as identifying possible statutory changes.

Although there are a number of different strategic planning processes that could be used, we recommend that the commission consider the strategic planning process authored by Douglas N. Jones in the Fall 1995 issue of the **NRRI Quarterly Bulletin**. Jones recommended a three-step process in which strategic planners would identify *"(1) the changing missions and roles of the regulatory commission, (2) the strategies for achieving them, and (3) the implementation requirements that operationalize the strategies."* During this three step process, participants might strive to accomplish the following:

1. Formulate a vision of success for public utility regulation in the future. For example,
   - What is the new role and mission of public utility regulation in Utah?
   - Who are the "customers" of public utility regulation; what are their needs and expectations?
   - What indicators can be used to measure success?

2. Identify and address strategic issues, including the fundamental policy choices facing an organization. For example:

   - Does the *ex-parte* concern remain so important that the Division of Public Utilities must remain independent from the Public Service Commission?
   - What can be done to improve the independence of the Committee of Consumer Services?
   - Which agency should be responsible for monitoring market competition, antitrust activities, and anti-competitive business practices?

3. Develop a plan to accomplish the vision of success. For example:
    - What new rules, tasks, and procedures will be needed to accomplish the vision of success?
    - What staff competencies will be needed to accomplish the mission? More economists, fewer accountants or more engineers and fewer attorneys?
    - What changes in the statute will be needed?
    - What agency structure will help staff function most effectively while maintaining accountability to the Legislature?

A planning process that evaluates these issues and includes a broad representation of interested parties could help build consensus for the changes needed and advise the Legislature about the best organizational structure for the future. While the Legislature could make organizational changes immediately, an advantage of deferring legislative action until after a strategic planning process is that it would allow the state to consider the organizational issues in the context of the broad range of issues that will affect public utility regulation in the future.

Recommendations:

1. We recommend that the Legislature initiate a strategic planning process to evaluate future regulatory roles, organization, activities, and resource needs that will be better suited to a more competitive marketplace. The Legislature could require the commission to oversee the strategic planning process or conduct the process itself.

2. If the Legislature chooses not to initiate a strategic planning process, we recommend that they still clarify the organizational status of the Committee of Consumer Service in the statute by providing them with more organizational independence.

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Agency Response