BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Review of the Missouri Public Service Commission's Standard of Conduct Rules and Conflicts of Interest Policies	)))	**Case No. AO-2008-0192**

NOTICE REGARDING SCOTT HEMPLING'S PRESENTATION AT THE ROUNDTABLE DISCUSSION HELD ON JANUARY 7, 2008

Issue Date: January 9, 2007

On December 13, 2007, the Chairman of the Missouri Public Service Commission, the Honorable Jeff Davis, opened a workshop docket and set a Roundtable Discussion to consider potential enhancement of the Commission's Standard of Conduct Rules and Conflicts of Interest policies. That Roundtable was held on January 7, 2008. At the Roundtable, Mr. Scott Hempling, the Executive Director of the National Regulatory Research Institute made a presentation and provided a handout summarizing his presentation. A copy of Mr. Hempling's presentation materials are attached to this notice.

BY THE COMMISSION

Colleen M. Dale
Secretary

Dated at Jefferson City, Missouri,
on this 9th day of January, 2008.
Stearley, Regulatory Law Judge

Before the
Missouri Public Service Commission

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Comments of Scott Hempling, Esq.
Executive Director
National Regulatory Research Institute[1]

Introduction

I am Scott Hempling, Executive Director of the National Regulatory Research Institute. NRRI is an independent, nonprofit corporation funded primarily through voluntary dues contributed by state public service commissions. Its mission is to provide the research services state utility commissions need to make regulatory decisions of the highest possible quality.

Chairman Davis has asked me to initiate today's discussion. A few caveats first. My thoughts are my own, not NRRI's nor or any state commission's. I acknowledge having a history with the Missouri Commission, for whom I was outside counsel for federal electricity matters from about 1992 to 2006. I've discussed some of my thoughts with Chairman Davis, but neither he nor any other Missouri Commissioner has confined, guided or influenced my comments. As you will see, I allocate responsibility for the present difficulties on an equal opportunity basis.

I have no specific knowledge of the pending merger. I have not reviewed any of the filings, other than those involving the motion to dismiss the merger application. My thoughts today are informed by your procedural debate, but they are not specific to Missouri or to mergers.

I have been on all sides of the decisionmaking process: litigant, commission advisor, brief-writer and opinion-writer. So I have had to live, often uncomfortably, with all manner of procedural practices. I wish to focus this morning on how we can modify these practices to help regulators do their jobs the best they can. I will ask three questions:

1. What procedural principles best serve regulation's purposes?

2. Can informality co-exist with objectivity?

3. Is there a trust problem here?

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[1] 301-502-0968; shempling@nrri.org.

I. What Procedural Principles Best Serve Regulation's Purposes?

Economic regulation seeks to align private behavior with the public interest. For today's regulators, the public interest is becoming difficult to discern: New interest groups, accelerated technological change, higher customer expectations, lower investor patience, and growing instability in corporate and market structures, are combining to blur regulatory vision.

Enlarging the problem is the uncertain stature of state commissions. Underfunded and understaffed relative to their responsibilities, they also face a common political dichotomy: citizens support regulation when it protects, but reject regulation when it obstructs.

To preserve its political effectiveness, regulation cannot ignore these pressures. But to preserve its professionalism, regulation cannot succumb to them. Otherwise regulation becomes mere conflict resolution rather than public interest promotion. For the public interest to prevail, regulators have to gather facts, and create opportunities for objective analysis.

So, what procedures best carry out these purposes? I have two main thoughts.

A. Shift the focus from the parties' interests to the regulatory interest

The present debate seems focused on parties' behavior: What does the law permit and prohibit parties to say and do? Who said what to whom, when and under what circumstances? Rules on party behavior, like rules in athletic contests, are indispensable because they define boundaries and thus build trust in the outcomes.

Unlike athletic contests, however, regulation is not a forum in which private interests get an opportunity to win; it is a forum in which government officials carry out their obligation to align private behavior with public interest.

I suggest, therefore, that we focus more on what regulators need to do their duty.

1. Regulators need full information and objective analysis. Regulators, like all people, gather and absorb information in different ways: Some by listening, some by talking, some by writing, some by reading, some by all of the above. Some learn by causing opposing views to confront each other publicly; others learn by sitting in a room quietly, meeting with one person at a time. Some like to hear from the parties first, then study objective materials. Others prefer to study objective materials first; thus educated, they then turn to the parties. The regulator needs to find the right person to talk to, at the right time. The right person is not necessarily party's designated witness.

2. Regulators are forced to learn on the job. They are rarely as well educated, in terms of utility regulation, as the professionals coming to meet them. That differential creates opportunities for exploitation. A party who takes advantage of that differential -- by telling only half the story, by omitting contrary arguments, by shading the facts, by oversimplification-through-powerpoint -- contributes to the degradation of the forum and the process. She is being

penny wise and pound foolish. In the long run no one benefits from a forum that makes decisions based on self-interest arguments.

B. Find the right mix of formality and informality

Benefits of informality: The author Russell Baker wrote: "An educated person is one who has learned that information almost always turns out to be at best incomplete and very often false, misleading, fictitious, mendacious - just dead wrong." The key to becoming educated is to ask the uneducated question. The great explorers, from Galileo to Edison to Watson and Crick, made their discoveries by asking ignorant questions. So do inexperienced regulators. But they'd rather ask their ignorant questions in private.

Risks of informality include unequal access, arising from and exacerbating asymmetry of resources; secret deals; incomplete information; subjective information; misleading information.

Benefits of formality include clarity of the evidentiary rules, boundaries on what goes into the record, discipline of cross examination, higher level of expertise, public trust.

Problems with formality: In a strictly formal setting, the parties have great influence over what the commissioners hear, how they hear it, when they hear it, from whom they hear it. Putting on a case for a private client is stagecraft -- an exercise in persuasion that easily becomes manipulation.

You might say, "But the adversarial system produces truth." That maxim, with origins in the judicial context, is overstated in the regulatory context. In regulation the purpose is not to choose between private party positions, but to advance the public interest. Regulators are not judges; they are policymakers. Sometimes they use adjudication as a procedure to make policy but they make policy for all residents. In an adversarial focus, the focus is on the adversaries. In regulation, the focus must be on the public.

II. Can Informality Co-Exist with Objectivity?

Underlying the legal prohibitions against ex parte contacts and prejudgment is a goal of objectivity. Are there ways to preserve objectivity while allowing informality?

A. Informal, pre-filing conversations -- if handled carefully -- serve useful purposes.

In informal conversations, questions get asked; precision is sought. Here are six simple suggestions to preserve the positives while diminishing the negatives.

1. The purpose should not be to read tea leaves. The Commissioners are barred from expressing an opinion; so seeking an opinion is an invitation to violate the integrity of the process. A party committed to the integrity of the process will not invite a Commissioner to violate it.

2. The purpose should be two-fold: to pay the courtesy of advance notice, and to see what questions or concerns a Commission might have. Why the courtesy of advance notice? So the Commissioners can begin their preparation. They can seek objective reading material, assign assistants to draft briefing papers, determine the necessary staffing, start the process of retaining consultants.

Eliciting Commissioner questions and concerns allows parties to focus their submissions on the public interest. Provided a Commissioner makes clear she has no fixed position, where is the prejudgment or impropriety with a Commissioner making the following statements?

a. "Assertions of merger benefits that go beyond three years make me uneasy because it becomes hard to predict what a utility's cost structure would have been absent the merger."

b. "The last time Witness X appeared on the stand, he lost some credibility with me because he testified that absent a 13% ROE, the company would be crippled; yet one week later the company settled on a 11.8% ROE and the company seems to be doing fine."

c. "If you file a merger application, I hope you will provide evidence on whether the return on the customer's dollar, in terms of cost reductions flowing from the acquisition premium cost you expect customers to pay for, at least matches the return the company could earn on alternative investments of comparable risk."

d. "The way you describe your proposal, it seems to me you are asking the ratepayers to take definite risks in return for receiving indefinite benefits. There seems to be an asymmetry here but I am not sure. I hope your application and testimony and briefs will address this issue with precision."

e. "Put on whatever witness you want, but I find it difficult to credit testimony from CEOs when they speak in platitudes."

f. "I'd like to see more witnesses at lower levels in the hierarchy -- the ones who actually make the utility run."

3. Commissioners should ask questions but express no final opinions. Probing questions should not be confused with negative conclusions. When two retail monopolies propose to merge, it is reasonable to probe.

4. If the party uses written materials, they should become public within 24 hours.

5. The Commissioner should place notice of the meeting on the public record.

6. Others should have opportunities to discuss the same issues with the same Commissioners.

Implementation of these six ideas seems to be to remove any basis for taint, while preserving the flexibility necessary for clearheaded information-gathering.

B. There is a tendency to confuse unequal access with improper access

Indisputable fact: The major utilities have more regulatory affairs resources than do the intervenors.

A Commission can say to the utility: I want to talk to your load forecasting person to understand the methodologies used to predict industrial load for 2010. The utility can make this person available in 24 hours at no incremental cost (the base costs being covered by rates). The consumer advocate cannot make comparable resources available to the Commission.

This asymmetry of access creates opportunities to take advantage. Even a straight, objective presentation creates an advantage: a bond, a reputation for responsiveness, a dependency. That is why people seek face time with Commissioners. The people not present, those with fewer access resources, lack those opportunities and advantages. This asymmetry of access is exacerbated by irony: irony that the asymmetry is funded in part by ratepayers because regulatory relations is a cost of doing business recoverable in rates.

But: unequal access is not improper access. The solution is not to limit access, but to expand it by creating comparable resource bases for the customer side. I see no reason why regulated utilities would not support legislation which grants to the OPC a level of ratepayer-funded regulatory resources bearing some reasonable relation to the utilities' ratepayer-funded resources. That is not the present case. Why not?

C. A few words on prejudgment

We should take care to distinguish bias from hunch. A bias is an inability or unwillingness to examine all facts and reason objectively. A hunch is tentative conclusion, based on education and experience, that a particular set of propositions is more likely to be true than false; and that if true, requires a particular outcome. No one wants a bench saying "my mind is a complete blank." The regulatory mind is not blank; it is full of experiences, prior readings, stray facts both diligently and casually acquired and evaluated. Those stray facts lead to hunches. Hunches are unavoidable and they are useful -- as long as the regulator establishes a

systematic, objective method for testing them. And the expression of a hunch, in public or private, is not prejudgment. Expressing a hunch gets a reaction; and commissioners can learn from the reaction. Let's avoid dampening the thought process in the name of unachieavable procedural purity.

D. A few words on appearance of impartiality

The law is clear: the mere fact of a meeting, not ex parte, does not signal partiality. Nor does a flurry of post-meeting emails from the non-Commissioner attendees, about how positive the meeting was.

It is human nature to deceive oneself about a meeting's outcome. I've lost track of the number of lawyers, including me, who left their oral arguments thinking they'd won because the bench was friendlier to their side.

It would help if meeting participants characterized their meetings more cautiously. Rather than saying things like "the Commissioner reacted positively," try this: "He asked a lot of questions. More questions than I expected; more questions than I wanted, but good questions. We'd better get to work on the answers."

III. Is There a Trust Problem Here?

The parties have framed their dispute in the language of procedural law. But I wonder if the underlying problem is one of trust. Consider three examples:[2]

1. If one employee says the meeting's purpose was merely courtesy and education, while his boss says its purpose was to gauge the Commissioners' reactions before he signed a multibillion contract, trust diminishes.

2. If a party seeks Commissioner disqualifications, through a motion that (i) ascribes to the Commissioners no act other than attending a lawful meeting, (ii) asserts "appearance of impropriety" on the sole basis that a non-Commissioner participant later characterized the Commissioners' views as favorable, (iii) cites no case supporting the argument that a lawful meeting becomes unlawful solely because a non-Commissioner participant writes hearsay about a Commissioner's position, and (iv) offers no independent evidence of Commissioner prejudgment, trust diminishes.

[2] These are hypothetical examples only. Any resemblance to the real world is completely coincidental.

3. When after 20 years of continuous merger proposals, there remains in the regulatory community no clear principles on how to measure, compare and allocate merger costs and benefits, trust diminishes.

Distrust breeds rigidity, but regulation requires flexibility. I hope you can find your way to restoring trust. We have a ways to go. I wonder if one place to start is to focus on our common goal – high quality regulation.

I've personally worked with and known hundreds of Commissioners, in this state and in about 30 others. Commissioners are, mostly, diligent, unbiased, committed to good faith practices and behaviors. They are also, mostly, inexperienced at regulation, and painfully aware of their inexperience. Their mistakes -- especially procedural ones -- are often mistakes of inexperience.

What is the regulatory community doing to solve this problem? The disparity in resources, pay scale, and professional preparation is indisputable. Do the stakeholders approach the Legislature and argue, as allies, for the resources needed by the Commission and the Public Counsel? Do they work cooperatively to fashion a state-specific curriculum for new regulators? Or do they behave as if the status quo -- well-meaning, but under-educated regulators, dependent on pre-filing meetings for education -- is a good thing? Do we understand regulation as a comprehensive, coherent system designed to ensure accountability to the public? Or do we view it as a process we game for temporary advantage? Is your debate here really about administrative procedure, or is it about your commitment to high-quality utility regulation?

Conclusion

In an appeal of a Federal Power Commission decision, the U.S. Court of Appeals for Second Circuit wrote:

> "... [T]he Commission has claimed to be the representative of the public interest. This role does not permit it to act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection at the hands of the Commission."

Scenic Hudson Preservation Conference v. FPC, 354 F.2d 608, 620 (2d Cir. 1965), *cert. denied sub nom.*, *Consolidated Edison Co. v. Scenic Hudson Preservation Conference*, 384 U.S. 941 (1966).

If we can design administrative procedures that recognize that the Commission's powers are broader than declaring winners and losers, we have a shot at giving the public the "active and affirmative protection" it deserves.

Thank you for the opportunity to speak today.