
AN ENERGY REGULATORS' PUBLIC INTEREST TOOLKIT

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INTRODUCTION

We expect our regulators to support the public interest, however what do we mean by 'the public interest' and how can we know that regulatory proceedings result in decisions that support it?

Scott Hempling's *Preside or Lead? The Attributes and Actions of Effective Regulators* (2013) states that a purposeful regulator should ask themselves:

Do I have a definition of "public interest"? Have I made my definition transparent by articulating it to my fellow commissioners and the parties who appear before my commission? Is my definition consistent with my fellow commissioners' definition? If not, have I worked out the differences?

Similar questions were top of mind in 2010 when the New Zealand Electricity Authority (Authority) was established with a statutory objective to "promote competition in, reliable supply by, and the efficient operation of, the New Zealand electricity industry for the long-term benefit of consumers."

In response, the Authority published its Foundation Documents which included an explanation of the legal principles and procedures underpinning good consultation, a clear and precise explanation of how the Authority interprets the objective specified for it in the *Electricity Industry Act 2010*, and a set of principles the Authority would follow when a quantitative cost-benefit assessment is inconclusive about which regulatory decision was best.

Concerns were raised at the time that publishing and consulting on these Foundation Documents could create a 'rod for our own back' by reducing regulatory flexibility in decision making. However, it was considered that this level of 'profound transparency' was needed to build public trust in the new regulator and deliver lower costs and better reliability of supply for consumers (by improving investor confidence).

The purpose of this paper is to translate key elements from the Authority's Foundation Documents into a Public Interest Toolkit (Toolkit) for regulators looking

to develop their own public interest definition and approach.

This Toolkit does not provide answers to regulatory issues under consideration. Instead, it is designed to act as an aid to assist regulators identify the questions to ask when evaluating utility proposals.

PUBLIC INTEREST TOOLKIT

The Toolkit is comprised of the following four checklists:

- I. Regulatory Proposal Checklist - provides a logical roadmap to ensure the regulator (and not the utility) frames the application review process;
- II. Public Interest Checklist - assists regulators in first defining the public interest (what is in and out of scope etc.) and then evaluating options against the public interest definition;
- III. Consultation Checklist - ensures that utilities have 'done their homework' prior to filing their application; and
- IV. Efficient Regulation Checklist – supports the Public Interest Checklist by giving guidance on efficient regulation.

I. Regulatory Proposal Checklist

The Regulatory Proposal Checklist provides a logical roadmap to ensure the regulator (and not the utility) drives the application review process. Specifically:

The decisive regulator asks not, "What decision do these parties want?" but rather, "What decisions does the public interest require?"

The utility's legal right to seek a benefit is not a right to frame the case. The alert Commission will reframe the utility's request as a public interest question ... Reframing means the public interest dog wags the utility's tail, not the other way around. (Hempling 2013)

The Authority was alert to this reframing issue in 2010 and addressed it by developing a template for staff that

I. Regulatory Proposal Checklist

1. Background	Provide a history of previous experience on this matter and any external requirements
2. Problem definition	Provide a clear statement of the issue or problem being addressed. The problem definition should be supported by evidence and the Public Interest Checklist
3. Options	Include a range of viable options to address the problem definition
4. Options assessment	Include enough information to be able to evaluate each option against the Public Interest Checklist
5. Assumptions	State any assumptions made in the analysis
6. Consultation	Demonstrate that appropriate consultation has been undertaken (see Consultation Checklist), and that issues raised have been considered
7. Conclusions	Conclusions should be clear, logical and based on the information and evidence available. Any key trade-offs made should be highlighted, and the report should support these trade-offs as reasonably reflecting customer preferences (current and future)

For example, consider a request by a utility to make an investment. The Regulatory Proposal Checklist encourages the regulator to step back from the details of the utility's proposal and ask "Do you need it?" and "Can you get it cheaper (or better) somewhere else?" A utility's request for a rate increase can become a Commission investigation into the utility's performance and a rate design change proposal an investigation of whether the existing design is economically inefficient.

A regulator's enabling legislation may place limits on the scope of the regulatory review undertaken or inquiries initiated. However, to the extent possible, this Checklist encourages the regulator (and not the utility or interveners) to frame the regulatory review in a way that is focused on supporting outcomes in the public interest.

required any proposal for market changes to start with a clear articulation of the problem to be solved rather than the proposed solution. The Regulatory Proposal Checklist was based on this template.

The key steps of the Regulatory Proposal Checklist are:

- Identify the problem, ensure that it is supported by evidence and it is within the regulator's mandate to address;
- Identify and evaluate options to address the problem against the Public Interest Checklist; and
- Ensure the utility has 'done their research' by evaluating their consultation approach against the Consultation Checklist.

II. Public Interest Checklist

The Public Interest Checklist assists regulators in first defining the public interest (what is in and out of scope etc.) and then evaluating options against the public interest definition.

The newly created Authority determined that clarification of its statutory objective to "promote competition in, reliable supply by, and the efficient operation of, the New Zealand electricity industry for the long-term benefit of consumers" would assist its Board in making consistent decisions and would also assist staff and advisory groups in developing market design and other proposals for the Board's consideration.

It therefore published and consulted upon its *Interpretation of the Authority's Statutory Objective*.

II. Public Interest Checklist

<i>Within the scope of an Economic Regulator</i>	
1. Lawful	Is the option compliant with relevant regulation / legislation?
2. Fairness	Prices should be designed to avoid undue discrimination. Rate shock should be mitigated to the extent possible.
3. Economic Efficiency	Does the option promote: <ul style="list-style-type: none"> • Efficient consumer consumption and investment decisions • Efficient utility operational and investment decisions • Efficient regulation (see <i>Efficient Regulation Checklist</i>) • Innovation - consideration of longer-term impacts
4. Reliability	How does the proposal affect short term and long-term reliability (including the utility's need to access financing)?
5. Safety	How does the proposal affect public safety?
6. Customer satisfaction	Will the proposal enhance or detract from customer satisfaction?
<i>Government policy direction may be required</i>	
7. Environment	Will the proposal support emission reduction goals, and are there any local environmental impacts which should be considered?
8. Social	How does the proposal affect low income and vulnerable consumers, indigenous communities, rural communities?
9. Economic Development	To what extent could the proposal affect regional job growth/taxes?

This document set out the Authority's interpretation of its statutory objective consistent with its legislative mandate and took into account the role and functions of sister regulatory agencies, the outcomes of a Ministerial review and other Government policy settings.

As the Authority's *Interpretation of the Authority's Statutory Objective* is specific to the Authority, a broader Public Interest Checklist has been developed which is informed by regulatory considerations described in Hempling (2013) and Bonbright (1988).

The Public Interest Checklist supports the Regulatory Proposal Checklist in (i) determining whether a 'problem definition' is within the mandate of the regulator to address; and (ii) providing a public

interest definition against which options can be evaluated.

The Public Interest Checklist is split between items that are traditionally considered within the scope of an economic regulator (lawful, fairness, economic efficiency, reliability, safety and customer satisfaction) and items where government policy direction may be required (environment, social and economic development).

The Public Interest Checklist is designed as a starting point for regulators interested in articulating or clarifying their public interest statutory objective. It is not intended to be a 'one size fits all' description of the public interest, but to instead be a starting point for debate and discussion.

The following four items are discussed in additional detail below: regulatory scope, low price vs. economic efficiency, 'whole of market' focus and fairness.

Regulatory Scope

A public interest purpose does not invite regulators to solve all public interest problems. (Hempling 2013) A regulator's enabling legislation can place limits on the type of public interest problem it is empowered to address.

As different regulators may have a different legislative mandate, the Public Interest Checklist separates items that are traditionally considered within the scope of an economic regulator from those where government policy direction may be required (environment, social and economic development).

For example, in its *Interpretation of the Authority's Statutory Objective*, the Authority determined that

pan-industry externalities such as carbon emissions were outside of its mandate to consider. Addressing fuel poverty was also not part of the Authority's mandate. Other regulators may be different.

The Public Interest Checklist is therefore intended to initiate a discussion of the extent to which broader public interest considerations can be addressed by the regulator.

Low Price vs. Economic Efficiency

The regulator's job is to get prices right: not low, not high, just right. (Hempling 2013).

The Public Interest Checklist therefore does not include 'low prices' or 'fairness to the utility' as a deliverable, but instead emphasises economic efficiency as a means of (all else being equal) putting downward pressure on prices over the long term. This includes consideration of the utility's ability to finance its operations.

Economic efficiency is not regulations only goal, but it is a good starting point as reducing inefficiency means we can make someone better off without making anyone worse off - and who's against that? (Hempling 2013)

Whole of Market Focus

The 'economic efficiency' criteria includes assessing whether the option under consideration supports:

1. efficient customer decisions;
2. efficient utility decisions;
3. efficient regulation (refer Efficient Regulation Checklist); and
4. innovation.

The first step is required for regulators who focus on encouraging both the efficient supply and efficient use of electricity (rather than just the supply side of the market). For example, whether an electric vehicle (EV) rate encourages off-peak charging or a utility's energy efficiency program effectively discourages energy waste.

The Authority interpreted its statutory objective as applying to both buyers and sellers in the markets for electricity and electricity-related services. Not all regulators may have this 'whole of market' focus.

Jurisdictions whose efficiency definition stops at the customer's meter - without consideration of whether

the customer is wasting energy or making suboptimal fuel choices – could see higher costs for customers for the services they receive (heat, light, transportation, etc.) compared to jurisdictions that have a 'whole of market' focus.

Fairness

While the Public Interest Checklist includes fairness as a consideration, it is fairly narrow in scope. Fairness is defined as avoiding undue discrimination and rate shock.

The reason for this is the very subjective nature of the term fairness – for example, in a discussion of whether utility fixed charges should be increased relative to variable charges, everyone can have a different opinion about what is fair, and they can all be right.

The fairness definition is therefore focused on undue discrimination and rate shock.

Bonbright explains that undue discrimination occurs where prices seriously distort relative use of a service. For example, where a discounted rate does not recover the utility's short-run incremental costs (or long-run incremental costs where the rate is expected to persist for the indefinite future) or gives a customer an unfair competitive advantage over another. Also, not charging more for on peak service could be considered discriminatory when nearing full capacity. (Bonbright 1988)

The Public Interest Checklist fairness criteria also includes consideration of rate shock to address Bonbright's principle of "stability and predictability of the rates themselves, with a minimum of unexpected changes seriously adverse to ratepayers and with a sense of historical continuity ('the best tax is an old tax')." (Bonbright 1988)

What constitutes rate shock is a flexible standard that can vary by regulator. Mechanisms to address it could include avoiding making changes unless there is a demonstrable efficiency benefit and phasing in rate design changes. This criteria does not include affordability considerations which are captured under 'Social' in the Public Interest Checklist.

In summary, the Public Interest Checklist is intended to be a starting point for discussion - interpretation of the public interest will likely vary by regulator.

III. Consultation Checklist

The Consultation Checklist ensures that utilities have 'done their homework' prior to filing their application.

have to pay for the investment in their rates) can help ensure the application is robust prior to being submitted to the regulator.

III. Consultation Checklist

1.	There are no universal requirements as to the form of consultation, and any type of interaction (whether oral or written) that allows adequate expression and consideration of views will be sufficient.
2.	Consultation must be allowed sufficient time, and genuine effort must be made.
3.	Consultation involves the statement of a proposal not yet finally decided on, listening to what others have to say, considering their responses, and then deciding what to do.
4.	For consultation to be meaningful, the utility must make available sufficient information to enable parties who are consulted to be adequately informed to make "intelligent and useful" responses.
5.	The word "consultation" does not require agreement (although it does require more than mere telling or presenting). Industry stakeholders may have widely divergent views and the issues may have been unresolved for many years. The utility may be required to break deadlocks by making decisions in relation to those matters.
6.	"Consultation" cannot be equated with "negotiation". Negotiation implies a process that has as its objective arriving at agreement (although in consultation the tendency is, at least, to seek consensus).
7.	The utility must approach the matter with an open mind, and must be prepared to change or even start a process afresh.

Consultation is important to better understand the problem, identify alternative options to address the problem and to evaluate them against public interest objectives. Consultation should therefore be early in the process and with whoever can help – this could include affected parties, customer groups, industry groups, government, subject matter experts, etc.

For example, a utility grid investment proposal could benefit from early consultation with subject matter experts and industry groups who could assist the utility in identifying alternatives (such as distributed energy resources) and ensuring cost estimates of those alternatives are up to date. Consultation with all affected parties (including those who will ultimately

While the regulator's own proceedings can also be useful in obtaining stakeholder input, the formal nature of regulatory proceedings can be less conducive to open dialogue. In addition, the utility may be less inclined to change their position once their application is filed.

The Consultation Checklist is therefore intended to provide a useful guide to regulators to assess the quality of a utility's consultation prior to submitting an application.

The Consultation Checklist is derived from consultation principles included in the Authority's *Consultation Charter*. These principles were based on the principles of consultation specified by New Zealand Court of Appeal 1993 (Wellington International Airport) decision:

"Consultation must allow sufficient time, and a genuine effort must be made. It is a reality not a charade. The concept is grasped most clearly by an approach in principle. To "consult" is not merely to tell or present. Nor, at the other extreme is it to agree.

Consultation does not necessarily involve negotiation toward an agreement, although the latter not uncommonly can follow, as the tendency in consultation is to seek at least consensus. Consultation is an intermediate situation involving meaningful discussion. Despite its somewhat impromptu nature I cannot improve on the attempt at description, which I made in *West Coast United Council v Prebble*, at p 405:

'Consultation involves the statement of a proposal not yet fully decided upon, listening to what others have to say, considering their

responses and then deciding what will be done.'

Implicit in the concept is a requirement that the party consulted will be (or will be made) adequately informed so as to be able to make intelligent and useful responses. It is also implicit that the party obliged to consult, while quite entitled to have a working plan already in mind, must keep its mind open and be ready to change and even start afresh. Beyond that, there are no universal requirements as to form. Any manner of oral or written interchange which allows adequate expression and consideration of views will suffice. Nor is there any universal requirement as to duration. In some situations adequate consultation could take place in one telephone call. In other contexts it might require years of formal meetings."

The Consultation Checklist is not intended to assess the adequacy of consultation where there is a legal requirement to consult - for example where there is duty to consult and, if appropriate, to accommodate the concerns of Indigenous Peoples. In those cases, a separate assessment would be required.

IV. Efficient Regulation Checklist

In striving to support the public interest, regulation itself can be a market barrier. The purpose of the Efficient Regulation Checklist is therefore to describe the attributes of regulation that best support efficiency and innovation. These include:

- Preference for specifying the outcomes desired, rather than what utilities must do and how they must do it;
- Preference for options that have larger pro-competition effects, because greater competition is likely to promote long-term economic efficiency and innovation; and

- Preference for options that are initially small-scale, and flexible, scalable and relatively easily reversible.

The efficient regulation principles were developed by Carl Hansen as part of the Authority's Consultation Charter to assist in evaluating regulatory options.

The Authority undertakes quantitative cost-benefits assessments of regulatory options. In principle, the most efficient option is the one with the largest present value of net economic benefits.

However, quantitative cost-benefit assessments can be inconclusive or infeasible, often leading regulators to undertake qualitative assessments. In these circumstances, these efficient regulation principles are used to evaluate options against these attributes.

In essence, this Efficient Regulation Checklist supports regulatory decisions that promote innovation, as on-going innovation is the key driver of higher living standards for consumers over the long-term.

IV. Efficient Regulation Checklist

1. Preference for Non-prescriptive Options	Where appropriate, preference for options that specify the outcomes required of industry participants rather than prescribe what they must do and how they must do it.
2. Preference for Greater Competition	Preference for options that have larger pro-competition effects, because greater competition is likely to promote long-term economic efficiency and innovation.
3. Preference for Market Solutions	Preference for options that directly address the source of any market failure.
4. Preference for Flexibility to Allow Innovation	Preference for options that provide industry participants with greater freedom and lower costs to adapt to requirements as they see fit, unless more restrictive options are justified.
5. Preference for Minimizing Regulatory Burden	Preference for ensuring no unnecessary regulatory burden is imposed on participants.
6. Preference for Small-Scale 'Trial and Error'	Preference for options that are initially small-scale, and flexible, scalable and relatively easily reversible.

EXAMPLE USE OF THE TOOLKIT

How would the Toolkit be used in practice? This section describes how the Toolkit may be used in the review of four illustrative applications:

Long-Term Resource Plan

A long-term resource plan is a roadmap that large utilities use to plan out acquisitions over five, 10 or 20 years. While resource plans tend to follow the outline of the Regulatory Proposal Checklist anyway, other Checklists may be useful.

For example, a resource plan typically starts with a description of the objectives against which different portfolio options will be evaluated – the Public Interest Checklist could be useful in developing those objectives.

The Consultation Checklist could be used to encourage utilities to consult with knowledgeable parties prior to submitting the application so that information included is up to date and reliable.

The Efficient Regulation Checklist could assist the regulator in reviewing portfolios, for example by encouraging a discussion on competitive market development.

Rate Design Application

Rate design proposals may start with the proposed solution (such as higher fixed charges) rather than a clear articulation of the problem. The Regulatory Proposal Checklist could be useful in ensuring that the regulatory review starts with a problem definition.

The Public Interest Checklist could also be useful in ensuring that the ‘problem’ to be addressed can be supported by evidence. For example, that the existing rate is unduly discriminatory or is resulting in inefficient consumer consumption or investment decisions.

The Alberta Energy and Utilities Board 1996 Nova Gas Transmission Decision nicely articulates this ‘problem definition first’ approach:

Before making a change in toll design, the Board would need to be satisfied, on the basis of clear and convincing evidence, that greater efficiencies or cost savings would accrue to the benefit of shippers overall.

The Board would also need to be satisfied that the magnitude of the changes to affected parties are acceptable and that benefits in the broad public interest would result. The Board would also look for transitional measures designed to manage such changes.

Revenue Requirement Application

In a revenue requirement application the utility requests approval of its operating budget for one or more years. The Public Interest Checklist can be used to look at these applications from the perspective of desired outcomes rather than a relying on a line by line review of the budget request.

For example, assessment against the reliability criteria could include considering whether reliability targets appropriately reflect customers willingness to pay and whether cybersecurity risks have been appropriately addressed. Review of the economic efficiency criteria could include assessing whether the utility has considered alternative ways to reduce costs (such as cloud computing) and whether the existing regulatory framework could be discouraging utilities from being proactive in this regard. Assessment against the customer service criteria could include considering whether charitable initiatives undertaken by the utility are generally supported by its customers.

The Toolkit can be particularly useful for regulators considering moving from cost-based regulation to performance-based regulation (PBR).

The Consultation Checklist could also be used to encourage the utility to engage with its customers to identify key priorities and trade-offs.

Capital Investment Application (EV charging stations)

For investment proposals, the Regulatory Proposal Checklist could be useful in ensuring that the utility provides a clear definition of the ‘problem’ and that other options (including demand side options) have been considered.

The Public Interest Checklist could be useful in ensuring that the ‘problem’ is clearly articulated. For example, a problem definition for a utility’s request to invest in EV charging stations would not be ‘not enough charging stations’ as that does not map to the Public Interest Checklist. Instead, a problem definition that does map to the Public Interest Checklist could be

‘suboptimal consumer investment in EVs resulting in suboptimal sales of electricity.’

Once the problem is clearly articulated, alternative options to address the problem can be considered. Options to address this problem could include utility investment in EV charging stations (to address the range anxiety issue). However, options could also include increased customer awareness in EVs, partnerships with dealerships, discounted EV rates, etc.

In addition, the Efficient Regulation Checklist could prompt the regulator to consider whether providing a subsidy for the charging station (instead of ownership) would have a larger pro-competition effect, and whether existing regulatory mechanisms (e.g. linking utility earnings to asset investments rather than desired outcomes) align the objectives of the utility with those of its customers.

These options may not have been considered if the regulator was only focused on the utility’s solution.

In summary, the Toolkit is not intended to constrain a regulator’s thinking. Instead, it is intended to help the regulator frame the regulatory review in a way that is focused on supporting outcomes in the public interest.

CONCLUSION

The decisive regulator makes decisions required by the public interest, when the public interest requires it, regardless of discomfort felt, using a logical method and an active approach. (Hempling 2013)

It is hoped that this Public Interest Toolkit, based on the Foundation Documents published and consulted on by the New Zealand Electricity Authority a decade ago, can assist regulators looking to develop their own public interest definition and then shape regulation to align private behaviour with it.

DISCLAIMER

This paper does not represent the views or opinions of the British Columbia Utilities Commission (BCUC), nor does it express, or intend to express, any opinion on pending or future matters before the BCUC. The analysis and information contained within this paper were compiled personally by the

author, and not in a professional capacity as an employee of the BCUC.

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BIOGRAPHY

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