



## **Should the Governor Appoint PRC Commissioners?**

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### **Policy Brief**

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#### **Executive Summary and Discussion of Findings**

Voters in November will decide whether to change the Public Regulation Commission (PRC) from an elected five-member commission to an appointed three-member commission. Voting in the affirmative would also create a nominating committee with the responsibility to compile a list of candidates submitted to the Governor who would appoint members from the list, with the consent of the state Senate, to serve on the PRC. No more than two commissioners could be members of the same political party. Commissioners would serve six-year terms and be limited to two terms, as they are presently.

Voters in eleven states, including New Mexico, elect their commissioners. The current system has been in place since 1996 when voters approved a constitutional amendment to create the PRC as a five-member commission, with members elected from districts.

The Amendment, which will be on the ballot this November for a vote, received bipartisan support in both chambers. The Governor also supports the Amendment.

New Mexico has prior experience with shifting from a statewide “commission” model to a more centralized model under the Governor. In 2003 then Gov. Bill Richardson pushed for (and received) an amendment to New Mexico’s Constitution which removed a vast majority of power from the Public Education Commission (PEC) and created instead the Public Education Department (PED) with the Secretary of Education being appointed by the governor. Today the PEC’s duties involve approving and regulating New Mexico’s charter schools (<https://files.eric.ed.gov/fulltext/ED514487.pdf>).

The author of this brief takes a careful look at regulatory commissions across the nation within the context of the vote New Mexicans will be asked to take this November on a Constitutional amendment that replaces the current elected PRC with a Governor-appointed PRC.

While it was not a “slam dunk,” the finding of this brief is that a three-member PRC appointed by the Governor, with input from the nominating committee, would be best for New Mexico. The perception by many observers is that the elected PRC has been a failed experiment that has ill-served New Mexicans for almost 25 years.

Below are five major reasons for supporting an appointed, three-member PRC:

1. **There is no good rationale for a state with a low population to have five commissioners.** The plurality of state utility regulators in the U.S. have three commissioners. The nominating committee – assuming it functions like it should and not be overly political – should screen out bad candidates and submit only qualified
2. Sadly for New Mexicans, **too often in the past elected PRC commissioners were unqualified and ill-suited for the job.** The public should expect that an appointed PRC would be less political and more competent in understanding the issues brought before it to serve the public good. While arguing for an appointed commission is not unequivocally preferable in all situations, the sorry history of an elected commission in New Mexico makes a strong case for an appointed PRC.
3. An elected regime precludes many qualified people with the right skills, temperament and expertise, because they lack political connections or the willingness to run a political campaign. It then follows that **a smaller pool of qualified people would run for office than the pool available to the Governor.**
4. Having worked for state utility commissions around the country for over 28 years, I have observed that **appointed commissioners are more competent, professional and knowledgeable**, of course with some exceptions. Elected commissions tend to attract and reward politically savvy people, while appointed commissions appeal to more professionally able people. The politically savvy people might give the public more what it wants, assuming (a big if) the voting process accurately reflects the preferences of the citizenry.
5. From talking with several people who worked for and interacted with the PRC, **the predecessor appointed public utility commission was better respected, more professional and, overall, operated more effectively.** There has been also widespread criticism of the elected commissioners’ qualifications to make decisions on highly technically issues. This has caused the Legislature to increasingly mandate PRC actions, as the public and stakeholders mistrust the PRC from making sensible decisions.

### **The Core Issues**

There are three basic questions to ask when examining what selection method is preferable from the perspective of the public good:

1. How would the selection method affect the chances that commissioners will act out of self-interest and other reasons external to the public interest?

2. What incentives do they face under each selection method?
3. What capabilities do they have to make good decisions on highly technical issues?

The interaction between democracy and special interests is crucial for understanding the different outcomes from elected and appointed commissions. Specifically, the degree of regulatory capture by special interests is likely to vary across regimes that elect and appoint commissioners. Each selection method is prone to regulatory capture. The results of elections may better reflect the preferences of special interests than of the general public. Governors' appointments may depend on the pressures placed by special interests for favors in return for political support.

A basic difference between appointed and elected commissions is their constituency. An elected commission has to appeal to the majority of voters. It seems likely that a candidate for commissioner who is sympathetic to utilities or appears to be amenable to rate increases has a small chance of being elected. An appointed commissioner has to receive the support of the governor, who may demand loyalty to her or to her political party, an endorsement by special interests, or the absence of opposition by powerful interests. For appointed commissioners, an insulating layer lies between them and the citizenry – namely, the governor for nomination and the legislature for consent.

### **Factors favoring an elected commission**

Advocates of an elected commission contend that the people should decide the selection of commissioners. After all, a participatory democracy allows the people directly affected by a commission's decisions to have a say in who should serve. Why should a governor make this choice, especially if she chooses on the basis of party loyalty or pressure from special interests?

Some critics of appointed commissioners contend that they unduly favor utilities and other interest groups, jeopardizing consumer interests. Regulatory capture favors utilities because of diffused costs and concentrated benefits. Some observers argue that this favoritism is more likely under an appointment method.

To wit, because regulated industries typically are better organized than the consumers of their products or services, a commissioner might maximize his political support by serving the interests of the regulated industry instead of consumer interests. Pluralist commentators on this regulatory dilemma have suggested that subjecting commissioners to greater public accountability would reduce the incentives for such behavior. They contend that since specialized political interests have less influence over the elective process than over appointments, commissioners should be elected rather than appointed.

When many people (e.g., voters) participate in a decision-making process, aggregation of information occurs, which can reflect better the wishes of the populace than when the decision is made by only one person (e.g., the governor). This favors an elected commission.

Under an appointed regime, when voters decide on who they prefer for governor, they consider the positions of the candidates on a host of issues, where utility regulation typically has low standing. The governor thus has much discretion in appointing commissioners that may not reflect the preference of the general population. Instead, the selection hinges more on the pressure placed by special interests that supported the governor in her election.

### **Factors favoring an appointed commission**

The conventional wisdom holds that appointed commissioners are superior to elected commissioners because appointed commissioners are less susceptible to political pressure. The presumption is that voters are too unsophisticated to assess the candidates for commissioners.

This perception is not self-evident: under a appointed-commission regime, there is no guarantee that the governor will select commissioners on the basis of their knowledge of the principles and legal underpinning of utility regulation, and other qualities (e.g., judicial-type temperament) for a good commissioner. Cronyism often occurs, appeasing a political party or specific interest groups. But, arguably, what may be more common is the tendency for a governor to appoint competent professionals who will not embarrass them.

Supporters of an appointed commission question whether voters are capable of selecting qualified people to be commissioners. The average voter probably knows little about judging the competence of candidates to serve as commissioners, let alone knowing much about the PRC and its duties.

One can segregate voters into two groups with respect to regulatory matters. One group is stakeholders in the regulated firms. These could include investors and utility workers and managers, who want higher profits and hence prefer higher prices. Moreover, since their livelihoods depend upon it, getting those prices is critical to them. The second group has no financial stake in the regulated industry and would almost always prefer low prices. Getting those prices, however, is less consequential to them. Narrow interests could thus overwhelm the public or broader interest in the voting.

Not surprisingly, there is usually a low turnout for commission elections in the different states. People tend to vote along party lines or have the endorsement of a political party, rather than on the basis of a candidate's qualifications. At least from New Mexico's past, bad (e.g., unethical, unqualified) commissioners seem to come more under the elected regime. The inference here is that the voting process has produced commissioners of poor quality. Of course, whether the Governor's appointments, over the same period, would have selected better commissioners lacks a definitive answer.

Unconstrained political democracy would seem then to have serious deficiencies. The special-interest effect and rent-seeking – namely, special interests trying to win political favors at the expense of the general public – are particularly stark realities of the political world. Political officials have a strong incentive to deliver concentrated benefits to well-organized interest groups at the expense of the vast majority of voters. The average voters have little incentive to invest the time and effort needed to inform themselves on many issues because they know that

their vote won't affect the outcome. In contrast, organized interest groups like utilities and environmentalists often feel strongly about policies that serve their interests; they are therefore willing to provide supportive politicians with campaign contributions and other political resources.

What this says is that elected political officials are not beyond advancing special interests, acquiring political resources from them, and then using the resources to solicit the support of the largely uninformed electorate. This will be true even if the positions taken by the special interests are antithetical to the public interest. The empirical evidence for different contexts is highly consistent with this prediction and is probably germane for utility regulation.

We cannot ignore the possibility of democratic failure. It is conceivable to have the voters elect bad commissioners because of (1) their ignorance of what constitutes a good commissioner and what the PRC does and (2) well-organized interest groups unduly influencing election results. Voters tend to rely on party identity rather than a candidate's qualifications. Interest groups could have undue influence; the vast majority of the public would have little incentive to understand the issues or even to vote; agenda-setters would ensure that their own preferences prevailed; and special interests would spend vast resources on seeking favors from the commissioners they supported in the election.

Politicians can easily fool rationally ignorant voters, which argues for an appointed commission. Since an individual vote is unlikely to turn an election, and that even then electing a certain candidate would have uncertain consequences, for most voters it is not worth spending time and effort to become well informed about the candidates. Perhaps the greatest obstacle to selecting qualified elected commissioners lies not with special interests and their unbridled lobbying, but the popular misconceptions, irrational beliefs, and personal biases held by ordinary voters.

We know that voting by the general citizenry may fail to select the best person to serve the public good or even the person that best reflects the preference of the majority of the citizenry. Utility regulation demands that commissioners have a minimal understanding of technical issues and the operations of the industries they regulate – preferably at the start of their tenure – to make good decisions. After all, the issues commissioners confront are highly complex and demand at least a basic knowledge of engineering, technology, economics, and more. It is more likely that the governor in conjunction with a nominating committee would choose people who possess this expertise than the general electorate is.

Based on the history in New Mexico, few would contest that voters have chosen people who lack the qualifications for a good commissioner. One can ask how well-informed and rational they are in voting for an obscure position that requires (1) minimal knowledge of the basic principles and legal underpinning of utility regulation and (2) judicial-type temperament that politicians generally lack. How much understanding do voters have of the issues brought before the PRC and what qualities make for a “qualified” commissioner? My guess is probably very little. That is no indictment on the typical voter, who sees little benefit from one candidate over another and really is unable to visualize what those benefits would be. Instead, voters often rely on party endorsements, newspaper editorials and the general positions of the candidates.

## **Qualified commissioners under each selection method**

The ultimate question for this paper is whether the odds are better that the Governor of New Mexico would select qualified people than the voting public. What is the incentive of the Governor to appoint qualified commissioners compared to the incentive of voters to elect them? It is conceivable to think that the Governor would return the favor to interest groups who support her by selecting someone that they recommend. We have also seen over time an increasing number of appointed commissioners around the country who were former elected officials and represent special interests. This shows that governors do not always select someone who has the minimum qualifications. A hidden cost of appointment systems is that they can serve “patronage” purposes.

The reality is that some commissioners are more sympathetic to industry and others to consumers. Major reasons for this are ideology, past associations with the industry or consumer groups, or future career concerns. Both selection regimes have these qualities, which can lead to imbalanced decisions.

### **Some Empirical Evidence**

There is conflicting empirical evidence on the effect of the commissioner selection method on electricity rates. Studies typically start off by assuming that commissioners are more pro-consumer if they are directly elected. Applying advanced statistical techniques, some studies have shown that electricity rates are lower in elected states, after controlling for other factors like costs and demand. Other studies do not. The fact, for example, that electricity rates are, on average, lower in elected states may be attributed to lower distribution and generation costs, rather than because of the commissioner selection method.

A different view is that elected commissions may be unwilling to redistribute wealth from utility stockholders to customers even if they had the discretion to do so. One reason is utility influence in elections. State statutes and judicial interpretations of those statutes may also confront the elected commissions with constraints and incentive structures similar to those faced by their appointed counterparts. There is some evidence that it may not matter much to the average utility customer whether a state has elected or appointed commissioners.

In past years, elected commissions around the country had the reputation for being less favorable for utilities and their investors than appointed ones: the general assessment of investment analysts was that elected PUCs are more unpredictable, less likely to pass through cost changes into prices, lower utilities’ bond ratings, allow lower rates of return on equity, and make it more difficult for utilities to earn their allowed return. But that may be changing: of the eight states rated "Above Average" by a 2016 analysis of the Regulatory Research Associates on the state-by-state investment climate three have elected commissions; of the eight states rated "Below Average," only one has an elected commission.

There is some empirical evidence that an elected commission may cause utility rates to rise in the long run if investors perceive an unfavorable regulatory climate; in New Mexico this is evident in past PRC unpredictable and often arbitrary decisions that tend to increase the required returns

of utilities to attract new investments. The reason is that one would expect the cost of capital to be higher in those states with an unfavorable regulatory climate. To the extent that an elected PRC allows a return lower than the cost of capital, utilities would invest less in capital projects that could benefit their customers and the State in the long-run.

### **Features of a Good Commission**

Like their colleagues in other states, the PRC has an obligation to ensure (1) the availability and reliability of utility services, and (2) that the rates and conditions for those services are fair, just, and reasonable for all utility customers. The presumption is that in the absence of regulation utilities would exploit their monopoly power at the expense of their customers. The relevant question here is whether an appointed or elected commission would better advance those goals.

#### **Balanced and evidence-based decisions**

Evaluating the different selection method requires knowing what constitutes good utility regulation. Most observers agree that regulation should advance the public interest and not unduly serve special interests. While defining the public interest is a matter of subjective interpretation, through the decades commissions have simplified it to two major features: (1) utility customers should have highly reliable service and pay “just and reasonable” rates for service, and (2) a prudent utility should earn a return on equity that allows it to be financially viable but not “highly” profitable.

This involves, among other things, decisions that reflect fairness for all involved parties in the regulatory process and commitment to the public interest. Specifically, good regulation weighs legitimate interests and makes decisions based on facts. Commissioners’ decisions should not unduly favor any single interest group. They should be supported by law and evidentiary record.

Well-informed decisions derives from staff and other parties delivering evidence that allows commissioners to evaluate the positions of various stakeholders and to balance those interests. A fundamental criterion for the method of commissioner selection is therefore the likelihood of choosing commissioners who balance the interests of different stakeholders and is technically competent in understanding the legal and economic implications of their decisions.

Balancing the interests implies that no one stakeholder “captures” commissioners; but with commissioners having much discretion and their decisions highly valued by stakeholders, individual stakeholders will devote substantial resources and time to sway commissioners to their agenda and interests.

The biggest challenge for commissioners is to make decisions on behalf of the public interest, notwithstanding the decisions’ unpopularity and political resistance, even decisions at odds with expressed public preferences. Independence is essential for allowing a commission to protect the general public in the face of strong economic and political pressures. It refers to the willingness of commissioners to follow the law rather than the interests of political parties and special interests.

Good regulation therefore avoids excessive politicization, which weakens regulation as an institution and instrument of public policy. Politically expedient decisions tend to undermine the commission's commitment to promoting the long-term interest of the state; of course, commissions cannot totally remove themselves from politics, as their decisions touch the well-being of diverse groups, including the various classes of consumers, utilities, and other stakeholders.

Election laws permit corporations and other special-interest groups to influence elections through donations in support of specific candidates. Given the state of campaign finance law, all methods of selecting utility regulators are subject, either directly or indirectly, to influence by special interests.

## **Independence**

Jeopardy of a commission's independence can originate from different sources: utilities, the executive branch of state government, the state legislature, special interest groups, the federal government, and the judicial branch. One example is the governor selecting people who agree with her agenda for promoting certain forms of energy (e.g., coal, clean energy) that may conflict with the welfare of utility customers. One can argue that her selections will be beholden to her and in the process lose their independence in acting on behalf of the public interest.

Independence has its limits, however, because of state statutes and commissioners being held responsible to the public for its actions. Good government requires that a commission is held accountable when it decides on cases that affect the general public. Whether an elected or appointed commission would do a better job in achieving accountability is not clear: what is the political cost under each regime of a commission that betrays the public interest by placating special interests?

## **Common problems of utility commissions**

Good commissioners consider the longer-term consequences of their actions, especially on utility customers, rather than trying to appease the immediate demands of stakeholders. It is unclear which selection method better meets this criterion: while elected commissioners care about the next election, many appointed commissioners would like to serve another term. Either way, myopic decision-making becomes more than a remote possibility.

Economic theory identifies different factors for the gap between ideal and actual outcomes. The major ones include information failure, the institutional reality, and the government's incentive to serve its self-interest and appease special interests rather than the public good. There is evidence that utility regulation is not immune from these factors. We see, for example, special interests lobbying legislatures, governors and commissions for favors that advance their agenda at the expense of the general public.

The three scourges of utility regulation are ideology, ignorance and inertia. Acting on political beliefs, inadequate information, and past conditions that no longer exist is a recipe for poor regulation. It ensures that commissions will be unable to advance the public interest. Ideology

threatens balanced judgment, which has been the hallmark of good regulation for many decades. Political pressures from both governors and state legislatures have become more intense in recent years, including in New Mexico. Within the commissions themselves, emphasis on special-interest demands has escalated to squeeze out public interest goals. Whether an elected or appointed commission is guilty of these “sins” requires further study.

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