

Information Disclosure and Policy Influence

By Sanford V. Berg

Director, Public Utility Research Center
University of Florida

ABSTRACT

This overview of information disclosure issues outlines problems regulatory agencies confront in the acquisition, management, and dissemination of information. Since regulators depend so heavily on firms for data, there is considerable interaction. Regular contact can lead to the agency identifying with the interests of the industry. Information asymmetry and dependence relationships may lead to concerns over the regulator being captured by the regulated industry. Procedures and strategies must be developed for dealing with the reality or perception of *industry capture*, including the role of transparency, sunshine rules, and ethical codes. Alternatively, regulators may identify excessively with particular consumer groups, either because of their economic or political power. Thus, industrial or residential customers might obtain prices that are below cost because of their political clout. In addition, *political capture* can stem from the influence of powerful government ministries. Regulators that are intended to operate at arm's length from the political process remain susceptible to pressure from this source. Agencies must establish the bounds of permissible influence. Effective agencies establish procedures that promote accountability, credibility, and legitimacy. First, independence must be reconciled with accountability. Second, reversals or inconsistency can undermine a regulator's credibility and hence effectiveness. But in some circumstances there may be trade-offs with other goals and values. Finally, for a regulator's decisions to be widely accepted and respected, it is not enough that they be strictly in accordance with law. Various stakeholder groups must be provided an opportunity to present their concerns regarding the regulatory decisions. Legitimacy in this broader sense can be cultivated through a number of strategies related to acquiring, managing, and disseminating information.

Dr. Sanford V. Berg
Director, Public Utility Research Center
University of Florida
Warrington College of Business Administration
P.O. Box 117142 (205 Matherly Hall)
Gainesville, FL 32606

Phone (352) 392-6148
Fax (352) 392-7796
E-mail: berg@dale.cba.ufl.edu

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This overview of information disclosure issues outlines problems regulatory agencies confront in the acquisition, management, and dissemination of information. Since regulators depend so heavily on firms for data, there is considerable interaction. Regular contact can lead to the agency identifying with the interests of the industry. Information asymmetry and dependence relationships may lead to concerns over the regulator being captured by the regulated industry or other stakeholders.

Procedures and strategies must be developed for dealing with the reality or perception of *industry capture*, including the role of transparency, sunshine rules, and ethical codes. Alternatively, regulators may identify excessively with particular consumer groups, either because of their economic or political power. Thus, industrial or residential customers might obtain prices that are below cost because of their political clout. In addition, *political capture* can stem from the influence of powerful government ministries. Regulators that are intended to operate at arm's length from the political process remain susceptible to pressure from this source. For example, for regional development purposes (or as political pay-offs), the Ministry of Energy might press for cross-subsidies (or fuel use requirements) benefiting particular parts of a country. Agencies must establish the bounds of permissible influence. Effective agencies establish procedures that promote accountability, credibility, and legitimacy.

Issues associated with managing the regulatory process deserve a significant amount of attention. Here, we focus on a narrow set of problems that government agencies need to consider—those associated with information disclosure. Since information asymmetries are recognized as a central reason for the shift from command and control to incentive-based regulation, it must be acknowledged from the start that the agency will never have the same set of information as a regulated firm. Regulators will not know the firm's capabilities, expectations regarding future input prices, technological opportunities, current and forecast demand patterns, and potential new services. The firm can be required to submit studies, but it seems realistic to assume that information voluntarily provided by firms will not be comprehensive. In particular, historical accounting and consumption data are not necessarily useful guides as to the likely evolution of cost structures and demand patterns.

Recent acquisitions of utilities in the UK have led to regulators being “surprised” by items appearing on published income statements. Such problems have resulted in the re-opening of rate reviews. Executives are not necessarily being devious when they reveal only partial information; rather, the provision of information alerts potential entrants to potential opportunities. We do not require unregulated corporations to reveal their strategies and related supporting documentation. So why should things be different for a regulated firm which might be producing in some unregulated markets or anticipating further deregulation in its own core

markets? One response is that laws may require particular types of reports. Alternatively, regulators may solicit cost data to make yardstick comparisons. The resulting "League Tables" help regulators and consumers gauge whether the firm is giving adequate attention to cost-containment. However, regulators might be tempted to engage in excessive information requests when they do not really know what they are looking for.

We should distinguish three characteristics of information: it can be confidential, inadequate, and/or uncertain. Confidentiality becomes a contentious problem in some situations. Incumbent firms will view as proprietary their plans, customer records, and internal benchmarking studies. Wirick, Lawton, and Burns (1996) put the case succinctly: "Unfortunately, most of the information commissions will need is the same information that utilities and their competitors are most likely to consider confidential or proprietary. In many cases, the utility has a legitimate concern that competitors might use the evidentiary process to discover information that harms the utility's position."(p. vi) Procedural due process (via open public records laws) and confidentiality can come into conflict. Issuing protective orders and only releasing aggregated information are two ways to limit the potential misuse of information.

Inadequate (or limited) information raises a different set of issues. As has been noted, information asymmetries are at the core of the regulators' problem. As Van den Berg (1997) writes in the context of UK water regulation, ". . . the water companies' control over information affords them opportunities to manipulate the information they make available to the regulator." (p. 103) She also argues that any monopoly over information increases the risk of regulatory capture. Decisions based on partial information will differ from those based on complete information. However, sophisticated use of incentive regulation can reduce the information rents available to firms. Finally, there are the problems associated with forecasts or forward-looking data. Such information is uncertain. Even when firms attempt to follow accounting rules, errors and mis-categorizations arise. Thus, both historical and forecast data may be flawed. Woodward (1998, p. 208) notes that the validity of information should be determined by the regulator, where the extent of testing the evidence depends on the standard of proof provided for in the legislation.

Wirick, Lawton, and Burns (1996) argue that the primary purpose of a regulatory audit is to reduce information risk: "Information risk, in a regulatory context, is the risk that a commission might make a wrong decision because of reliance on faulty information. In the future, if the decision-making role of [commissioners] is minimized, their need for information and concern with information risk will also be minimized." (p. iv) However, they still emphasize four factors influencing the level of information risk: "the magnitude of the decisions based on the information, the verifiability of the information, the materiality of the information, and the relationship between the commission and the information source."

How regulators deal with information disclosure issues has a significant impact on the legitimacy and credibility of the process. Excessive influence on policy from those controlling information can be a problem, so procedures to handle conflicts of interest need to be developed. In addition, the press is an important institution influencing the way the public perceives how the regulatory process is operating, so its role as a disseminator (and filter) of information needs to be considered.

The Regulator as Information Manager

The Executive Director of the Florida Public Service Commission, Mary Bane (1997), observes that regulators need systematic ways of managing the flow of information for three major reasons. First, there can be a massive volume of data which must be evaluated and analyzed. A danger is that analysts review piles of printouts—without having the right information. Volumes of accounting data are no substitute for good analysis. Furthermore, data requests can absorb significant corporate resources, even if standardized formats are established.

Second, information must be dealt with in a timely and structured way since unnecessary delays have potentially adverse impacts on firms and/or customers. Regulatory lag can provide good incentives for cost containment. But if schedules are established and then broken, all parties stand to lose. Third, stakeholders must be aware of the schedule for processing the case and provided an opportunity for participation. Information systems can help a regulatory body avoid the appearance of a chaotic and arbitrary system.

What characterizes an appropriate management system? Bane (1997) lists the following internal management tools:

- (1) Written procedures which define staff tasks and responsibilities and inform stakeholders of the regulatory process being used.
- (2) Calendar scheduling of all regulatory processes to ensure timely and fair processing of utility requests. Having one agency calendar avoids conflicting dates and provides information to stakeholders.
- (3) Case Management System for consolidating and tracking all information (filings, supporting analyses, transcripts, orders, etc.)
- (4) System for identifying and communicating with all stakeholders interested in a particular case (public notices and written statements justifying final decisions).
- (5) Historical record of regulatory decisions providing background information which can improve the continuity (and predictability) of decisions.

Note that the five types of information procedures are designed for a process where quasi-judicial hearings play an important role. Federal and state regulatory commissions in the U.S. have been characterized as being resource-intensive. The capability for processing information may create pressure to request *more* information. So commissions must determine at the onset, what level of resources makes sense, and the extent to which *less data* might result in *more information*. Nevertheless, Bane's observations provide a rationale for paying careful attention to how information is filed and available to interested parties.

One antidote to excessive information requests is an emphasis on content. Continuing education programs allow staff to sharpen their analytical skills and stay abreast of new technological and economic developments. Such programs enable staff to focus on what really matters—so that the process does not become a highly choreographed exercise that emphasizes form over substance. A highly trained and competent staff is a regulatory agency's most important resource. Skilled staff are in a position to see the big picture, determine which cases really matter, and prioritize the caseload accordingly. Both in-house and external training are important components of continuing education.

Knowledge and Power: Obtaining Information

Before data are requested from a company, the availability of current, readily available information should be examined and used to the extent possible to reduce regulatory costs and burdens that may be passed on to the ultimate ratepayer.

In a presentation at the *PURC/World Bank International Training Course on Utility Regulation and Strategy*, Beth Salack (1997) emphasized that information requested from a company should, reflect the goals of the regulatory body. Depending upon the form of regulation (price cap vs. cost of service), the data requirements change. For example, while earnings information is necessary in a rate base regulation climate, quarterly earnings information is not as imperative in a price cap climate. However, whatever the form of regulation, the statutory requirements and limitations may not be ignored.

Salack argued that data submitted to the regulatory body should be verified through an independent audit process that can be performed by external auditors working at the direction of the regulatory body or internal auditors from the regulatory body. An audit does not have to be performed every time data are submitted, but the possibility of an audit fosters the filing of correct information. She also makes a distinction between management (or performance) audits and financial audits. While each is a valuable tool in its own right, a combination of the two types of audits may often be the most effective approach. Such studies can be on an individual (historical) company basis or a cross sectional basis (facilitating comparisons).

Measurement guidelines can be used as a tool to determine when action should be taken by the regulatory body. The final decision of a regulatory body will be based, in part, upon subjective judgement; however, analytical tools and benchmarks can be used to help evaluate the "normalcy" of the company data presented to determine whether the data are reasonable, given the specific circumstances of the company.

We are familiar with the phrase, "Knowledge is power." In the context of complex negotiations, information can be a valuable asset from the standpoint of strategic bargaining. For example, regulators might like to know the weights various stakeholders place on specific outcomes. Regulators need to understand how to use information. In his sessions in the *PURC/World Bank Training Course*, David Lax (1997) identified a number of issues related to information disclosure. Strategic planning involves information-gathering to identify interests and priorities of various stakeholders. Such knowledge helps regulators identify potential allies and adversaries. A decision will prompt reactions. Thus, an important element in strategic planning

is the creation of a natural coalition—identifying other parties with common interests or positions. At the same time, regulators must be prepared to deal with adverse coalitions. A preemptive appeal to a shared objective may discourage an adverse party from late coalition formation. All stakeholders will attempt to shape key assumptions of regulators and to act opportunistically. Anticipating such strategies helps regulators retain their independence from the contending parties. Openness in decision-making makes it easier to establish credible commitments, since no one is excluded from the process. Broad participation reduces the likelihood that special interest groups will be successful in changing the outcome (Stiglitz, 1998, p. 15)

Managing Regulatory Discretion: Avoiding Conflicts of Interest

For the credibility and legitimacy of the regulatory process, stakeholders must have confidence that situations will be handled in an ethical manner. In another PURC/World Bank session, Klaus Tilmes and Daniel W. Fessler (1997) developed some principles for managing regulatory discretion. As a World Bank project manager and President of the California Public Utilities Commission (1991-1996), respectively, their observations are based on substantial practical experience. They define conflict of interest as a "situation in which a person, such as a public official, an employee, or a professional, has a private or personal interest sufficient to appear to influence the objective exercise of his or her official duties."

Tilmes and Fessler emphasize three key components of this definition. First, there must exist a private or personal interest, financial or otherwise. Second, this interest also conflicts with an official duty. Third, the conflict of interest interferes with objective, professional judgement. The following are typical examples of conflicts of interest:

1. Self-dealing
2. Accepting benefits
3. Influence-peddling
4. Use of employer's property for private advantage
5. Use of confidential information
6. Outside employment
7. Post-employment

Tilmes and Fessler present two tests to determine whether or not you are involved in a conflict of interest: First, consider if other individuals (e.g. an employer, colleague, or clients) would trust your judgement if they knew about your situation? For example, assume that the situation is described in the local newspapers or television. Are you comfortable? Sunshine is the great purifier. The second test is whether you have a personal interest in a situation. If so, recess yourself from any part of the decision-making. Since the legitimacy of the regulatory process depends on public confidence in the trustworthiness of public officials, agencies must institute procedures to ensure that conflicts of interest do not arise.

The Media as a Filter and Source of Information

The observations regarding the press suggest that newspapers and television have a significant role in disseminating information about the regulatory process. In the PURC/World Bank Training Course, Peter Ward and Teresa Erickson (1997) identify ways agencies can work with the media to ensure that complex issues do not get drowned out by half-minute sound bites. They underscore five points:

1. Know your communications goals. Decide on these as a team. Before each meeting with the press, consider how what you have to say fits with your goals. Your goals become the position statements for your answers.
2. Make journalists your allies. An informed public is an important part of the regulatory process. Helping journalists accurately report your activities accomplishes both your goals and theirs. Forming good relations with the press also means that they will be more willing to listen to your side of the story when "bad news" threatens to appear.
3. Know the journalists' audience, and speak to their concerns. When speaking with a journalist, remember you are really addressing their audience. Talk about their concerns, using examples and analogies that they can understand.
4. The media thrives on emotion. When emotion is high, the ability to reason is low. Blame and bad news are easiest to sell. In advance of a press briefing, think of the negative emotional angles a journalist might raise, and be prepared to explain how the alternatives would produce worse disadvantages.
5. Understand the goals of the other stakeholders. The media often reduces complex situations to winners and losers, villains and victims. If it appears you have neglected one group or show bias towards another, expect the media to play up the conflict. Show that you understand the goals of each stakeholder, and have dealt with each one fairly.

In a way, these are very common sense observations. Yet, often regulatory agencies violate best practice, damaging credibility with the investment community, reducing legitimacy in the eyes of the consuming public, and ultimately, reducing efficiency in infrastructure industries—through reduced investment.

As Baron (1996, p.76) has described it: "Information is essential for democracy, and the news media is a principal source of information to citizens. Along with this role comes the responsibility to uncover, report, and interpret news and to present it under standards of fairness, accuracy, and balance. The news media is, in principle, not to create news or to conduct trials to determine right and wrong; and drawing conclusions and advocating positions is supposed to be confined to the editorial page." He notes that the media can abuse its position. However, as Thomas Jefferson wrote, "Were it left to me to decide whether we should have a government without newspapers or newspapers without a government, I should not hesitate to prefer the latter."

Conclusions: the Political Economy of Information and Influence

A key task facing regulators is how to develop sound procedures for handling information, so that agency general oversight procedures let the economy take advantage of the innovative capabilities of market processes. The procedures should limit regulatory discretion so that potential benefits are neither dissipated through corporate gaming of the system nor lost through political opportunism. The former wastes resources and the latter breaks the commitments necessary for capital intensive infrastructure industries to prosper.

I proposed three “Laws” of Political Economy in a 1995 presentation in Australia (Berg, 1996):

- (1) *No new law [or regulation] is promoted on the basis that it benefits the powerful.* Laws and decisions are presented in terms of promoting the public interest, increasing fairness, and/or enhancing opportunity. The lack of quantifiable targets associated with the “public interest” makes it difficult to halt a program that is actually ineffective. Without a clear test (or information standards) regarding success or failure of a program, it is likely to continue for an unreasonable period of time.
- (2) *The powerful are seldom worse off after a new law has passed.* This point is tautological, since if a group is harmed by legislation and was unable to block passage, then the group lacks power. Still, the corollary to the Second Law is that laws (and regulatory decisions) ought to focus on enhancing efficiency. Otherwise, the law tends to involve a zero-sum game in which the powerful do not lose. In such a situation, there are just re-distributions among the other groups. Such relatively random sets of transfers are unlikely to be categorized as “in the public interest” or as enhancing fairness.
- (3) *Policy-makers who concentrate on laws and regulations that promote efficiency also promote the potential achievement of other social objectives.* The Third Law supports specialization and an appropriate division of labor among government agencies. Improvements in efficiency expand the production possibility frontier—making more output available for those who are not powerful, without harming those who are powerful. Programs that create wealth make it easier for society to address other concerns, including the distribution of wealth across individuals, social groups, industries, and regions.

My views are unchanged. There is increased evidence that those damaged by legislation and regulations take protective (and pre-emptive) measures or delay outcomes. When public and private special interests attempt to manipulate the political process, valuable resources are allocated away from productive to unproductive rent-seeking activity. The cumulative impacts of such activity can be very harmful to society.

Moving from Laws of Political Economy back to the unique role information plays in the regulatory process, we note that many issues remain. How are quality of service and customer-satisfaction to be evaluated? How detailed need the financial information be for evaluating profitability? What indicators are appropriate for determining when market power is no longer a threat? How can the reasonableness of affiliate transactions be determined? What is the appropriate cost-sharing between regulated and unregulated divisions of a utility? Should

executive compensation levels come under the purview of regulators? Many of these issues are politically sensitive: the illustrative list suggests that information issues will not soon disappear.

What can we conclude? It is clear that to be sustainable, the regulatory process must be accountable, credible, and legitimate in the eyes of stakeholders.

Accountability: Regulators remain accountable to different authorities for different dimensions of their performance. Independence must be reconciled with accountability. Various groups constrain regulatory decision-making: the courts prevent agencies from over-stepping their legal authority; budget authorities provide oversight to determine appropriate use of public resources; the criminal law establishes punishments for corruption. Most systems also provide a mechanism for removing regulators in certain circumstances. It is important that agencies develop internal procedures which support (and are consistent with) these external laws and institutions.

Credibility: Reversals or inconsistency can undermine a regulator's credibility and hence effectiveness. But in some circumstances regulators will need to balance competing goals and values. So long as the public record provides clear evidence regarding the facts associated with the issues at hand, the judgement calls of regulators will at least be based on information that others can examine and verify. Without such openness in the process, stakeholders supporting alternative policies will have a case for questioning regulatory decisions.

Legitimacy: For a regulator's decisions to be widely accepted and respected, it is not enough that they are strictly in accordance with law. Various stakeholder groups must be provided an opportunity to present their concerns regarding the implementation of alternative regulatory decisions. Legitimacy in this broader sense can be cultivated through a number of strategies related to acquiring, managing, and disseminating information.

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