Negotiation and Mediation Issues in Regulation

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Having a few definitions in place helps us understand why there has been a shift in emphasis from regulation to negotiation for some areas of dispute.

?? Litigation: A process of contesting an issue in an adversarial lawsuit—which can be settled by a judicial trial.

?? Regulation: A process whereby activities are controlled or directed according to a rule or principle.

?? Adjudication: A process of hearing and deciding a case based on the application of previously determined rules to conduct.

?? Stipulation: A process whereby an essential part of an agreement is specified.

?? Arbitration: A process whereby a person selected to the a judge makes a decision about a case involving contending parties who agree to abide by the decision.

?? Negotiation: A process of discussion designed to reach an agreement: “a means of advancing the full set of your interests by jointly decided action” (Lax, 1997)

?? Mediation: A process in which one party assists in settling differences among contending parties.

These terms are defined so that the different approaches can be distinguished more sharply. These techniques of conflict resolution are all part of the regulatory tool-kit. It is important to understand the strengths and limitations of each, and to see where the techniques might be best applied.

In the United States, regulatory commissions have tended to adopt a judicial approach to addressing issues. The process resembled court cases in which key stakeholders presented their sides of the argument, and the regulators made some final decision based on the facts in the record and on the law. They traditionally served in a quasi-judicial capacity. That is,
commissions would listen to the arguments of various participants—particularly the firms and customer groups. Regulatory agencies were established to implement policies established in the law (regarding obligations to serve, entry conditions, and prices which provided firms with the opportunity to earn a fair rate of return. Thus, agencies did not engage in arbitration—contending parties did not enter the process as “voluntary” participants. Regulators listened to the arguments and made decisions that might be appealed to the courts. If the laws were followed, commission decisions would go into effect.

However, as in the cases of legal trials, there was generally an attempt to limit the scope of the issues to be addressed. In the traditional regulatory setting, regulators presided over pre-hearing processes. In these meetings, there would be negotiations among the various parties. Participants were encouraged to agree to sets of facts, so that later hearings could address the truly controversial issues (like allowed rates of return). Stipulations by the parties allowed the process to spend more time on the issues that could not be resolved in advance.

**Streamlining Regulation**

Today, much attention is being given to streamlining the regulatory process or exercising the regulatory mandate with a “Light Hand”. The traditional highly choreographed hearing process in the United States had the advantage of being transparent: stakeholders had the opportunity to have their views heard, as lawyers guided incumbent firms, intervenors, and other interested parties through the process. “Due process” was emphasized in this legalistic setting. Some observers charged that style all too often replaced substance as the emphasis of regulation. Others saw the legalistic orientation as facilitating openness, ensuring that all the relevant facts were made available to regulators. Thus, both the process and the outcomes (as reflected in ultimate industrial performance) were important.

Regulators served as mediators who balanced the interests of investors and consumers. As additional issues were raised in the regulatory process, other stakeholders appeared. For example, environmental groups concerned about plant siting or energy conservation brought witnesses to hearings. In some states, collaborative processes emerged which attempted to bring participants together to narrow the range of issues. Direct negotiation among participants replaced the quasi-judicial orientation of the process, although government agencies might ratify (or in some cases, reject) the resulting agreements.

**Collaborative Activities**

Former California Commissioner, Daniel Fessler, describes such “All Party Settlements” as substitutes for trial type hearings (Fessler, 1997). Regulators make a bargain with stakeholders in a contested proceeding that the Commission will adopt a settlement if:

?? It commands the unanimous sponsorship of all parties; and

?? The Commission is satisfied that there is sufficient broad representation of affected interests so that the “public interest” is reflected in the settlement negotiations; and
?? No provision of the settlement agreement offends a statute, Commission rule, or prior Commission decision; and

?? The settlement is accompanied by a sufficient factual record to enable the Commission to oversee its faithful implementation.

Such a settlement process avoided some of the procedural tangles that can arise in a more formal hearing process.

In some cases, regulators served as mediators, as they tried to identify win-win options for participants. Playing the role of “honest broker” is quite different from that of being a judge, but dispute resolution sometimes called for such a role. Certainly, issues of fairness and openness are important, but streamlining the process was viewed as having the potential for improving decision-making—and benefiting all parties. Telecommunications interconnection pricing, power pool governance and regulation, appropriate levels of demand side management, and the treatment of stranded costs are the types of issues that might be addressed using such venues.

Pressures for Alternative Dispute Resolution (ADR)

Given the complexity of the issues associated with partial deregulation and industry restructuring, regulators continue to explore alternative mechanisms in various jurisdictions. In particular, Alternative Dispute Resolution (ADR) refers to substitutes for litigation as way of establishing rules or outcomes. ADR procedures can promote timely decisions, reduce contention, and save resources.

In a FPSC study, Butler, Pugh, and Cutting (1996) argue that the movement toward competition in portions of infrastructure industries is one impetus for changing regulatory procedures:

   Exceptional customer service is at least in part due to the ability of the utility to resolve disputes with suppliers/competitors and customers quickly. If the disputes are not resolved promptly, this could create an obstacle to the completion of transactions. One possible fallout could be an increase in the business failures of new market entrants. In the new era of regulation, it will be critical for disputes to be resolved expeditiously.

Stimulating greater responsiveness to customer needs and providing greater incentives for cost containment are the two driving motivations behind replacing regulation with competition. So Alternative Dispute Resolution (ADR) procedures are likely to become more important in the future. The essential tool-kit of regulators is going to include skills in negotiation and mediation—so that experts with specialized knowledge can be brought into discussions early in the process. Timely intervention allows the process to deal with non-issues that might be thrown up as roadblocks by some parties. More important, it allows complicated addresses to be addressed in a relatively non-adversarial setting. The interests of the parties may differ, but the resolution of technical issues can sometimes open up the possibility of win-win negotiations.

Application to Power Pool Governance and Regulation
Barker, Tenenbaum and Woolf (1997) identify twenty-six basic market design issues for new style power pools. The various market participants (generators, power marketers, transmission grid operators, distribution systems, and final customers) all have stakes in the arrangements that affect the delivery and financial settlements associated with this market. They distinguish between governance and regulation.

Governance is the process by which decisions get made, implemented and enforced—it is internal to the pools. In contrast, regulation is how governments review and change the decisions of pools—it is external to pools.” (p. v)

In their description of decision-making models, they note the problems associated with alternative governance mechanisms—since these involve different voting schemes, different approaches for representing stakeholder interests, and a variety of enforcement mechanisms. They note that backstops (or appeal procedures) for pool governance are inevitable.

Given the technical nature of disputes, a specialized board can have both the expertise and flexibility necessary to reach decisions in a timely manner. Barker, Tenenbaum, and Woolf conclude that a two-tier approach to governance is probably preferable to pure collective self-governance. Thus, an independent board can make a binding decision in the event of non-consensus or unreasonable delays. Such a board combines flexibility with expertise (and a detailed knowledge of the grid). It ought to have the power to ensure that disputes are not “bottled up” in a committee. The sector regulator serves as a point for the appeal of decisions by the technical board, should the need arise.

The types of issues raised by power pool governance and system operations affect the financial opportunities available to market participants as well as the economic efficiency of electricity sector. The traditional hearing process is not well designed to address (and resolve) the technical issues that are raised in the context of complex transactions in this market. Stalon (1997) underscores these concerns in his overview of the North American system (with its regional reliability councils and the evolution to Independent System Operators (ISOs). New approaches to conflict-resolution come to the forefront of debates over industry restructuring.

Application to Telecommunications

Access to bottleneck facilities is at the core of telecommunications issues. Proper access structure and rates, compensation arrangements, discounts based on quality of service, and other issues present a complex set of issues for regulators. The U.S. Telecommunications Act of 1996 specifies that state commissions approve all interconnection agreements. Commission arbitration is required if negotiation fails after 135 days. Davis and Zearfoss (1996, p. 1) identify several critical areas for procedural decisions related to commission involvement:

?? Who may participate in the process and at what stage,

?? How to select an arbitrator and how to determine appropriate commissioner and staff roles;
Whether to consolidate proceedings (facilitating negotiations across issues) or keep them individual; and

How open to make the discovery process (including the confidentiality of support documentation).

The transition to greater competition often involves new types of regulation rather than less regulation during the evolution to new industry structures. Issues include funding universal service, maintaining network interoperability, ensuring service quality, developing number portability, continuing supplier of last resort obligations, determining the appropriate extent of unbundling, designing efficient prices for network components, and limiting the exercise of residual market power. In some jurisdictions, as in New Zealand, these issues have been left to competition authorities to decide. In others, regulators serve as mediators in the development of complex contracts in vertical markets.

As with energy, the disputes have been very controversial. Similar to other infrastructure sectors, the issues have multiple facets, so that their resolutions lend themselves to negotiated settlements. Butler, Pugh and Cutting (1996, p. 23) argue, “Negotiation is a viable option when the parties to a dispute are independently motivated to reach a consensus. For example, in some instances, a timely resolution may be more valuable to the parties than a more favorable outcome that takes longer to become final.” Mediation may be a substitute for negotiations if a stalemate arises. Under a litigation model, if winner-takes-all, the resulting arrangements may be neither fair nor efficient.

**Concluding Observations**

International bodies can also play a role in the dispute resolution process. Well-designed concession contracts or licenses will include specific procedures for arbitration and adjudication— to reduce the uncertainties and lags associated with disagreements. Addressing such issues in advance reduces risks to investors and lowers the cost of capital.

Industry participants are more fully aware of their own interests (valuations placed on different outcomes), so regulators must establish incentives for stakeholders to reach agreements that advance mutual interests. Regulators must be able to “see through” the negotiation process to identify likely outcomes. However, they lack information on many key cost and demand components of the issues at hand. Furthermore, technologies are changing, so regulators must take care not to create unnecessary rigidities in the system.

In addition, regulatory objectives may differ from those of participants, so the regulatory agency must decide whether to be a player or a mediator. The problem with being an active player is that the agency opens itself up to criticism regarding its own impartiality. Nevertheless, some key interests may be neglected in negotiated agreements—such as those of small customers who are unable to organize. Such omissions must be rectified if the legitimacy of the process is to be sustained over time.
Even when it acts as a mediator, a regulatory agency’s priorities will influence the process. It must assess potential negotiation developments (understanding the interests of all parties). In addition, regulators must promote problem-solving in such a way that the information possessed by others is incorporated in the development of a solution. As Lax (1997) emphasized,

The essence of effective negotiation involves productively managing the tension between cooperative moves to create value and competitive moves to claim it.

How does a regulatory agency create value? One way is to help the system economize on transaction costs. In the process, regulators should avoid getting in the way of win-win opportunities. In the end, a regulatory agency’s key interest for segments where there is market power is in achieving beneficial outcomes. Such outcomes sustain the credibility of the system for investors, contribute to the legitimacy of the system for consumers, and promote efficiency in the economy as a whole. These goals are best achieved by providing incentives for monopoly providers to minimize costs, seek innovations, and select price configurations that provide the opportunity for them to recover their costs of service and that encourage efficient consumer choices. Its other task is to ensure that the benefits of competition flow to those who successfully commercialize new services and introduce new production processes and to the consumers who desire those services.

Thus, the quasi-judicial role of regulators is being supplemented by the provision of mediation services. As mediators, regulators can assist in the development of inter-firm arrangements that promote efficiency and innovation in complex infrastructure industries.

References


