

**TESTIMONY OF RANDOLPH J. MAY
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BEFORE

**GOVERNOR ROBERT L. EHRLICH'S
PUBLIC HEARING ON ELECTRIC RATE LEGISLATION
JUNE 20, 2006
ANNAPOLIS, MARYLAND**

Thank you for allowing me to testify today at this important public hearing. I am Randolph J. May, President of The Free State Foundation, a non-profit, non-partisan educational foundation. The Free State Foundation is a market-oriented think tank that promotes economically sound regulation and rule of law principles.

The ultimate concern in S. B. 1, and any matter relating to the regulation of utilities or other businesses, ought to be promoting overall consumer welfare. The welfare of consumers is impacted by the substance of a regulatory regime, say, the rules governing the calculation of a reasonable return on investment. And consumer welfare is also impacted by the soundness of the government processes employed to decide matters of public importance, and, more broadly, by whether government structures put in place for bodies such as the Public Service Commission are consistent with fundamental principles of sound governance.

Primarily, I want to speak to this second issue—the PSC’s structure—as it relates to SB 1’s provision to dismiss the current contingent of PSC commissioners and replace them with a new chairman and commissioners selected from a short list compiled by Senate and House legislative leaders. Before doing that, however, it is worth emphasizing that a reduction in retail rates does not necessarily enhance consumer welfare in the longer term. Unless utilities are allowed to earn a reasonable return, investment in new plant and equipment and innovation in seeking better ways to provide service will suffer. In this regard, the deregulation plan devised by the legislature six years ago appears fundamentally flawed in capping the utilities’ retail rates for so long, even as their wholesale energy costs escalated rapidly.

Now, with respect to my main point, I believe the provision dismissing the PSC chairman and commissioners is unwise. As far as I can determine, an action like this is virtually unprecedented. That is not surprising because it sends a signal that if the legislature is dissatisfied with any particular PSC action, it may simply dismiss the PSC commissioners and find a new group more to its liking. This precedent will create an environment in which utilities will conclude that regulatory decisions will be made not based on sound economic ratemaking principles, but rather with an eye to the political passions of the moment. In this environment, incentives to invest and innovate for the longer term will be diminished.

Recall the brouhaha that occurred when PSC Chairman Kenneth Schisler terminated five top staff PSC employees two years ago. There was a loud outcry, led by many in the legislature, that the firing of these top staffers compromised the PSC's independence. I believe that there is nothing untoward about the dismissal of senior staff in policymaking positions. When a new chairman, duly appointed by the governor and confirmed by the Senate, takes office he should be able to install a senior staff team that reflects his philosophical perspectives.

It is indeed ironic that the legislative leaders who decried the firing of PSC staffers as compromising the "independence" of the PSC now want replace all of the PSC commissioners. The SB 1 proposal seems to me to be a much greater threat to the agency's so-called independence than Chairman Schisler's action.

My own view, which is based on fundamental principles of sound governance derived from an understanding of our tripartite state and federal constitutional systems, is that the PSC is not, and indeed should not be, as many maintain, a truly "independent" agency. Maryland's PSC was founded on the Progressive-era ideal that regulation is a scientific enterprise that should be accomplished purely by experts in specialized administrative agencies. The notion was that the PSC would be immune from political interference by the elected branches of government. The ideal never matched the reality. And, in any event, some measure of political accountability to the elected branches for PSC decisions that establish policies—as opposed to those decisions adjudicating individual cases—is a positive thing. I don't think it comports with our notions of democratic accountability for there to be a so-called "headless fourth branch" of government entirely immune from influence by elected officials.

While the legislature's plan to replace the commissioners *en masse* with, in effect, its own picks in one sense is consistent with increased political accountability, it subverts the usual way we divide functions and disperse government powers. In our system, the legislature makes the laws and the chief executive, within the confines of the legislative mandates, is responsible for implementing them. And, typically, in our system of separated powers, the governor has broad discretion to choose the officials in his administration who will implement the laws. SB 1 upsets the checks and balances that help ensure, through an appropriate separation of powers, that one branch of government—here the legislature—does not unduly weaken another branch, here the Chief Executive. Effective government depends on each branch maintaining the wherewithal and the means to carry out its constitutional responsibilities in a vigorous manner.

If the legislature wishes to increase the PSC's political accountability, a better way would be, in connection with a broader, more dispassionate review of PSC reform, to change the law to make clear that the governor may remove a commissioner even over pure policy differences if the governor deems such action advisable. Under current law, commissioners may be removed only for "incompetence or misconduct." It is this type of tenure-protection provision that is generally viewed as giving the PSC its

“independence”. Another reform in this direction would be to allow the governor to designate one of the sitting commissioners the agency’s chair whenever he chooses. Changing these provisions would make the governor more accountable for the PSC’s policymaking actions, something some governors might not like. Nevertheless, the elected Chief Executive ultimately ought to be responsible for the policymaking actions of executive branch agencies. [Note that the Public Service Law specifies in Section 2-101 that the PSC is “an independent unit in the Executive Branch of State government,” highlighting its confused and confusing status.]

In sum, it is unfortunate that Maryland’s consumers face significant rate increases. Nevertheless, any rate relief plan should ensure that consumer welfare is not harmed in the longer term by continuing to cap rates at artificially low levels or imposing an unduly long transitional adjustment period.

By the same token, it is important that consumer welfare not be harmed by adopting a provision that signals the whole PSC will be sacked if the legislature is dissatisfied with a particular action or actions. This course will encourage the view that the legal regime and regulatory environment are unstable and unpredictable and not conducive to fostering long-term investment and innovation.

Reform of the PSC warrants serious consideration. But it is far more consistent with accepted notions of a government of separated and diffused powers—one in which no branch aggrandizes its own power at the expense of the power of a co-equal branch—for the PSC to be reformed in a way that increases the governor’s appointment and removal authority over the agency’s commissioners, and, therefore, the governor’s accountability for the agency’s policymaking actions. Because SB 1’s approach is in the opposite direction, it should be rejected.

Thank you again for this opportunity to testify.