Approved: April 9, 1997
Date

MINUTES OF THE SENATE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Pat Ranson at 1:30 p.m. on March 11, 1997 in Room 531-N of the Capitol.

All members were present except:
Sen. Hensley was excused

Committee staff present: Lynne Holt, Legislative Research Department
Fred Carman, Revisor of Statutes
Jeanne Eudaley, Committee Secretary

Conferees appearing before the committee:
William Steinmeier, Attorney and Regulatory Consultant

Others attending: See attached list

Sen. Ranson introduced pages from her district, who are assisting the committee today. She asked the committee to read the Minutes of the Meeting of February 18 (Attachment 1); after reading them, Sen. Morris made a motion the Minutes be approved, and it was seconded by Sen. Jones; and the Minutes were approved.

Sen. Ranson then made several announcements, one of which is the Wolf Creek Tour on Monday, next weeks' agenda and several news articles, which have been circulated to the members.

Sen. Ranson then introduced William Steinmeier, who gave a presentation on Stranded Costs in Electric Industry Restructuring (Attachment 2). Committee members questioned Mr. Steinmeier regarding retail wheeling, the market place, and concern for the bondholder losing assets. Mr. Steinmeier pointed out the problem with recovering costs, most of which are long-term generating costs which should not result in an increase of rates. However, he admitted, the potential for higher overall rates exist. He continued by stating public funding mechanisms should be utilized to compensate the utility for stranded costs.

Mr. Steinmeier discussed reasons to recover stranded costs on Page 7 and 8 and described the typical utility shareholder, as follows: "Typical electric utility shareholder is a woman of retirement age, with some college education, who has owned 500 shares of one utility for more than five years." Pages 9 and 10 cite legal reasons to recover stranded costs and methods he recommends for recovery, which include entrance and exit fees as well as access charges. Mr. Steinmeier discussed the treatment of stranded costs in other industries on Page 12 and conclusions on Page 19.

Sen. Ranson questioned Mr. Steinmeier regarding pilot programs, and he discussed several small programs, and stated the full-scale pilot programs he is aware of do provide for stranded costs, such as the one in Pennsylvania. Sen. Morris questioned Mr. Steinmeier regarding retail wheeling, and he was skeptical and stated it warrants a fundamental change in the structure which has existed. He stated his concerns that small customers will benefit from it and that he has questions that the public will be able to receive maximum benefits from retail wheeling. He went on to explain the pitfalls when only one class of customers can benefit from it. He lectured on the reliability aspect and keeping the load and demand in balance. He cautioned that policymakers should use caution and look ahead to see what the end result will be and stated that he has faith they will do the right thing.

Meeting adjourned at 2:30.

Next meeting will be March 12.

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: March 11, 1997

NAME	REPRESENTING
Bill Steinmeier	
E. A. Lehman	Western Resources
J. C. Long	UtiliCorp United, Inc.
Don't Miles	KEC
Roger Franzke	KGC
Larry Holloway	KCC
LewJene Schneider	KS Livestock Assoc
Kevin Shelton	PVD / DOR
Raney Gilliland	KLRD
Julie Hein	Hein & Weir
David Dittemore	KCC
B Banks	Jonathan Small
Heather Randall	Whitney Damron, PA

Attach. 1

Approved: March 11, 1997
Date

MINUTES OF THE SENATE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Pat Ranson at 1:30 p.m. on February 18, 1997 in Room 313-S of the Capitol.

All members were present

Committee staff present: Lynne Holt, Legislative Research Department
Fred Carman, Revisor of Statutes
Jeanne Eudaley, Committee Secretary

Conferees appearing before the committee:
Maria Seidler, Coalition for Competitive Energy
Dennis McLaughlin, Aurora Natural Gas
Emery Biro, Anadarko Petroleum Corp.
Mari Ramsey, Williams Field Services
Pierce Norton, Gen. Mgr. Of Operations, KN Energy
Russell Bishop, Vice-Pres., Govt. Affairs, PanEnergy Field Services

Others attending: See attached list

Chairperson Ranson called the meeting to order and announced the agenda for the remainder of the week, with KCC Chairman, Tim McKee, appearing tomorrow. She announced continuation of the hearing on **SB 148- relating to natural; gas gathering systems; providing for regulation of certain entities; certain natural gas public utilities and common carriers.** The following appeared in opposition to the bill:

Maria Seidler, Coalition for Competitive Energy (Attachment 1);
Dennis McLaughlin, Aurora Natural Gas, (Attachment 2);
Emery Biro, Anadarko Petroleum Corp., (Attachment 3);
Mari Ramsey, Williams Field Services, (Attachment 4)
Pierce Norton, General Mgr. Of Operations, KN Energy, (Attachment 5);
Russell Bishop, Vice-Pres., Govt. Relations, PanEnergy Field Services, Inc. (Attachment 6);
Steve Rome, S.W. Kansas Irrigation Association, (Attachment 7)

Sen. Ranson announced a letter and Resolution from the Southwest Kansas Irrigation Association (Attachment 7) was distributed to committee members.

Committee members questioned opponents regarding the Oklahoma law, the Task Force Minority Reports, which were referred to by opponents, and the complaint concept provision. Sen. Ranson also questioned opponents regarding publishing rates.

Sen. Ranson announced the committee will continue the hearing tomorrow in Room 519-S.

Meeting adjourned at 2:35.

Next meeting will be February 19, 1997.

Senate Utilities
3-11-97
Att. 1

Attach-2

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Presentation to the

KANSAS SENATE UTILITIES COMMITTEE

Senator Pat Ranson, Chairman

Stranded Costs in Electric Industry Restructuring

William D. Steinmeier
Attorney and Regulatory Consultant
Former Chairman, Missouri Public Service Commission (1984-1992)
Former President, National Association of Regulatory Utility Commissioners (NARUC)

Topeka, Kansas
Tuesday, March 11, 1997

Senate Utilities
3-11-97
Att. 2

OUTLINE OF PRESENTATION:

I. Definition of Stranded Costs

   A. Cause of Stranding: Government-Mandated Changes

   B. From Whence These Costs Came

   C. Categories of Stranded Costs

   D. Magnitude of Potential Stranded Costs in Electric Power Industry --

II. Policy Reasons for Full Recovery of Stranded Costs

III. Legal Reasons for Full Recovery of Stranded Costs

IV. Possible Stranded Cost Recovery Methods

V. Treatment of Stranded Costs in Other Industries
   A. Telecommunications
   B. Natural Gas

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

   A. Federal Energy Regulatory Commission (FERC)

   B. California Public Utilities Commission (PUC) and Legislature

   C. Massachusetts Department of Public Utilities (DPU)

   D. Rhode Island Legislation (1996)

   E.&F. Accelerated Depreciation in Various States

I. Definition of Stranded Costs

A. Stranded or Strandable Because of Government-Mandated Changes in Electric Industry Market and Regulatory Structures

B. From Whence These Costs Came

1. The "Regulatory Compact" Under Traditional Regulation

2. Costs Already Incurred Pursuant to Utility's Legally-imposed "Obligation to Serve" All Customers

3. Costs are Already Included in Just and Reasonable Rates of Utility

I. C. Categories of Stranded Costs

1. Investments (Eg., Nuclear Power Plants)

2. Liabilities (Eg., Purchased-power and Fuel Contracts; Nuclear Decommissioning Costs)

3. Regulatory Assets (Eg., Expenses Deferred by Regulators to Keep Current Electric Rates Lower)

4. Social Costs (Eg., Rate Cross-Subsidies; Renewables Set-Asides and Research; Low-Income Programs)

I. D. Magnitude of Potential Stranded Costs in Electric Power Industry --

1. $135-$300 Billion Aggregate (Moody's)

2. More Than Value of Book Equity for Some Utilities

3. Equal to Half of Book Equity for 50% of Investor-Owned Utilities

4. Serious Implications for Financial Viability and Reliability

II. Policy Reasons for Full Recovery of Stranded Costs

A. Necessary for Full, Fair and Economically Efficient Competition

1. Incumbents can't run race with leg weights

2. Baumol, Joskow & Kahn monograph[1] --

***"Considerations of equity and efficiency alike demand that policymakers face up to the need to give utility companies the opportunity to recover these potentially stranded costs in any transition to competition."* (p.37). Without doing so, *"there will otherwise be no assurance that the most efficient supplier will prevail."* (p.4).**

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1 William Baumol, Paul Joskow and Alfred Kahn, The Challenge for Federal and State Regulators: Transition from Regulation to Efficient Competition in Electric Power (Edison Electric Institute, 1995).

II. Policy Reasons for Full Recovery of Stranded Costs

B. Necessary for Fairness to Utility Shareowners

1. **Costs at Issue Were Incurred Under Traditional Regulation -- Limited Upward Earnings Potential, Limited Risk**

2. **Risk of Government-Mandated Change Was Not Compensated for in Regulated Rate of Return**

3. **<u>The Economic Report of the President</u> (Feb. 1996):**

"[R]ecovery should be allowed for legitimate stranded costs. The equity reason for doing so is clear, but there is also a strong efficiency reason for honoring regulators' promises. Credible government is key to a successful market economy, because it is so important for encouraging long-term investments. Although policy reforms inevitably impose losses on some holders of existing assets, good policy tries to mitigate such losses for investments made based on earlier rules . . . ." (At 187).

II. Policy Reasons for Full Recovery of Stranded Costs

B. Necessary for Fairness to Utility Shareowners (continued)

4. Utility Shareowners are Real People

- 68% of Common Equity of Electric Utilities is Owned by *Individual Shareholders.*

- Typical Electric Utility Shareholder is a Woman of Retirement Age, with some College Education, Who has Owned 500 shares of one Utility for More than Five Years.

- *Institutional Investors* also include many Mutual and Pension Funds in Which Millions of Ordinary Citizens Have a Stake.

- Customer-Members of Rural Electric Cooperatives Have an Equity-Like Interest in their Coops.

- The "Real People" who Own Electric Utilities are NOT Wealthy Patricians to Whom Most of Us Cannot Relate.

III. Legal Reasons for Full Recovery of Stranded Costs

A. Constitutional Principle: Government Cannot "Take" Private Property Without Just Compensation (5th and 14th Amendments).

B. Res Judicata and Collateral Estoppel -- Recoverability of Potential Stranded Costs Has Already Been Determined by Regulators.

C. Duquesne Light & Power Co. v. Barasch, 488 U.S. 299 (1989) -- Switching Ratemaking Methods to Require Investors to Bear Risks of Bad Investments but Denying Them Benefit of Good Investments "would raise serious constitutional questions." (at 315).

IV. Possible Stranded Cost Recovery Methods

A. Accelerated Depreciation and Amortization of Strandable Assets

B. Exit Fees Imposed on Departing Customers

C. Entrance Fees Imposed on New Competitors (New York "Competitive Equalization Fee")

D. Access Charges ("Competitive Transition Charge") for Access to Retail Distribution Network

E. Public Funding Through Taxing Mechanisms

F. The Passage of Time Before Implementing Retail Competition

V. Treatment of Stranded Costs in Other Industries

A. Telecommunications

1. Process of Introducing Competition In Progress Since 1956, and in Major Fashion Since 1984, So Time Has Helped Deal With the Issue.

2. Process Is Not Over Yet -- Direct Local Competition Under Federal Telecommunications Act of 1996 Is Raising Stranded Cost Concerns.

3. State and Federal Policies Since 1984 Have Helped Meet Stranded Cost Concerns During Incremental Competitive Growth.

4. Impetus for "Takings" Lawsuit Reduced by Revenue Growth from New Services.

5. No Telecom Counterpart to Nuclear Power Plants.

V. Treatment of Stranded Costs in Other Industries

B. Natural Gas

1. **FERC was Ordered by Federal Courts to Provide for Stranded Cost Recovery as Pipelines were Opened to Competitive Access.**

2. **FERC Learned from its Mistakes in Natural Gas when Addressing Electric Stranded Costs, and Said So:**

"We learned from our experience with natural gas that as both a legal and a policy matter, we cannot ignore these costs." (FERC Order No. 888, April 24, 1996, at 453).

3. **No Natural Gas Counterpart to Nuclear Power Plants.**

4. **Stranded Cost Impacts were Dispersed Among Pipelines and their Shareowners, Producers and their Shareowners, LDCs and their Shareowners, Reducing Impetus for "Takings" Lawsuit.**

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

A. Federal Energy Regulatory Commission (FERC)

1. Learned From Natural Gas Experience.

2. Acknowledged that Government Action Created Stranded Costs:

"We will not ignore the effects of recent significant statutory and regulatory changes on the past investment decisions of utilities." (FERC Order No. 888, April 24, 1996, at 452).

3. Recognized Necessity of Stranded Cost Recovery for Successful Transition to a Competitive Market. *(Order 888, p. 454).*

4. Confirmed Implications of Stranded Costs for Reliability and Access to Capital Markets. *(Order 888, p. 514).*

5. Directly Assigned Wholesale Stranded Costs to Departing Customers Through Exit Fee or Transmission Surcharge. *(Order 888, p. 477).*

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

B. California Public Utilities Commission (PUC) and Legislature

1. **PUC Order (Dec. 1995) Acknowledged Need to Account for:**

"Longstanding regulatory policies, past Commission decisions, and ongoing regulatory effects . . . ." (At p. 119).

2. **Emphasized:**

"that maintaining the financial integrity of the utilities is an important goal of this proceeding . . . . If the utilities were required to write off the entire amount of above-market levels of investments, they could face a financial disruption that might lead to lower system reliability and inefficient operation." (At 119-120).

3. **Created "Competitive Transition Charge" (CTC) to be Paid by Each Customer to Recover Stranded Costs. Legislature Authorized CTC in AB 1890 (1996).**

VI. B.

4. California PUC Order (Dec. 1995) also Recognized that Transition Costs:

"are already embedded in utility rates today"

and that their recovery through the CTC:

"should neither create a new ratepayer cost nor result in a higher revenue requirement." (At 113).

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

C. Massachusetts Department of Public Utilities (DPU) Restructuring Order of August, 1995

1. Said that:

"[R]esponsible policy must provide electric utilities a reasonable opportunity to recover net, non-mitigable stranded costs during the transition period." (At p. ii).

2. Acknowledged accelerated nuclear depreciation as an appropriate devise for mitigation of potential stranded costs.

3. Expressed some preference for an access charge as the primary vehicle for stranded cost recovery.

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

D. Rhode Island Legislation (1996)

1. Establishes Access Charge (Transition Charge)

2. Per kwh basis (2.8 cents per kwh initially, then set by Commission)

VI. Treatment of Electric Stranded Costs in Other Jurisdictions

E. Accelerated Depreciation

1. California

2. Florida

3. Pennsylvania

4. Ohio

5. Connecticut

F. Use of Earnings Above a Certain Level to Accelerate Depreciation or Amortization:

1. Alabama

2. Georgia

3. Texas

4. New Jersey

CONCLUSIONS:

- **If public policy makers determine that retail electricity competition is in the public interest, stranded cost recovery must be provided during the transition.**

- ***"Considerations of equity and efficiency alike demand that policymakers face up to the need to give utility companies the opportunity to recover these potentially stranded costs in any transition to competition." Baumol, Joskow and Kahn, 1995.***

- **Clear considerations of law likewise require stranded cost recovery.**

- **A number of methods for stranded cost recovery are available to policy makers, both in advance of restructuring (such as accelerated depreciation) and after restructuring (such as Competitive Transition Charges).**

- **God grant us wisdom.**