

Approved: Feb. 16, 1998
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 5, 1998 in Room 531-N of the Capitol.

All members were present except:
Sen. Hensley was excused

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

Conferees appearing before the committee:
David Dittmore, Director of Utilities, Corporation Commission
Larry Holloway, Chief of Electric Operations, Corporation Commission
Walker Hendrix, Consumer Counsel, Citizens' Utility Ratepayer Board (CURB)

Others attending: See attached list

Sen. Ranson called the committee's attention to a cartoon relating to deregulation which has been distributed to members.

Sen. Ranson announced the committee will hear a briefing on electric rate making, which is a precursor to consideration of the unbundling phase of deregulation. She introduced David Dittmore, who outlined powers and Rules of Practice and Procedure of the Corporation Commission (contained in the booklet entitled, "Overview of KCC Rate Regulation of Electric Utilities" - available from the Kansas Corporation Commission), as well as outlining rate case procedural requirements and appeal of Commission Orders. He also discussed determination of revenue requirements (the total the utility is allowed to collect), which include rate base, revenues, expenses and capital structure and rate of return. He also explained the revenue requirement calculation, and stated that coops use difference calculations to arrive at rates.

Sen. Barone asked for clarification, and stated the Corporation Commission staff proposes and recommends to the three commissioners, who make up the Corporation Commission, and they act as judge and jury and make the final decision. Mr. Dittmore also pointed out that if, after staff recommendations the commissioners are unable to make a decision on a rate matter, the case proceeds to a contested hearing. Sen. Steffes commented on the right return on equity and stated it is one of the most contentious areas and includes additional revenue shareholders should receive. Mr. Dittmore responded that the rate of return varies, but is somewhere between 10 and 11 1/4 %. Sen. Clark asked specific questions regarding a utility in his district which has made application to be deregulated and asked advice for the ratepayer and how the ratepayers are to respond and have input into the process in order to present a case. Mr. Dittmore recalled some history connected with Sunflower Electric Power Cooperative's debt restructuring in the late 1980's, which involved resetting rates and contingencies.

Sen. Ranson then introduced Larry Holloway, who continued explaining the electric rate making process and began with rate design (contained in the booklet entitled, "Overview of KCC Rate Regulation of Electric Utilities" - available from the Kansas Corporation Commission). Rate design includes class allocations, development of rates, customer classes, special contracts and customer aggregation. He gave examples and pointed out differences between customer classes and also summarized the KGE KPL electric rate case.

Sen. Ranson then introduced Walker Hendrix, who presented additional information on rates (Attachment 1). He stated that CURB represents the residential customer, which includes representation in court cases. He stated that costs are a big issue; that rates are based on cost or the value of service and that they are complex and difficult for the lay person to understand.

Meeting adjourned at 2:30
Next meeting will be February 9, 1998

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: Feb. 5, 1998

NAME	REPRESENTING
Harrie Ann Brown	Kans. Govt Consulting
Amy A. Campbell	Midwest Energy
Don & Miles	KCC
Dick Carter	Enron
Ernie Lehman	Western Resources
David Martin	Ks City Power & Light
Jim Durke	WESTERN RESOURCES
Charles Dwyer	DoB
Gal Williams	KCC
Larry Holloway	KCC
Dave Dittmore	KCC
Glenda Cater	KCC
WALKER HENDRIX	ChRB
Ron Cates	McGill's Asso.



Attach. 1

BILL GRAVES
FRANK WEIMER
A.W. DIRKS
GENE MERRY
RALPH SOELTER
FRANCIS THORNE
WALKER HENDRIX

GOVERNOR
CHAIRMAN
MEMBER
MEMBER
MEMBER
MEMBER
CONSUMER COUNSEL

Citizens' Utility Ratepayer Board

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SENATE UTILITIES COMMITTEE A DISCUSSION ON RATES

By Walker Hendrix
February 5, 1998

The establishment of a rate structure poses complex issues for regulatory commissioners. The actual formulation of rates is different than determining the amount of money the utility needs to collect. In establishing the revenue requirement (or the authorized amount a utility can collect), the Commission determines the amount of utility investment minus depreciation, a rate of return on which the investors are compensated and the expenses of rendering service. For the most part, the revenue requirement is based on historical costs and its determination in Kansas is retrospective. The revenue requirement does not factor into consideration the social costs associated with uninternalized natural resource, environmental and pollution costs.

Because the subject is so complex, you will find even regulatory commissioners who shy away from becoming too involved in the establishment of rates. The Commission normally focuses on whether the rates will yield the return that the utility is authorized to earn. The subject becomes more complex when the utility is capable of earning its return under alternative rate structures. The questions associated with rate structures can have significant impacts on the marketing of services, the time of consumption and who pays. For example, discounts can be provided for greater patterns of consumption, rates can be set so that higher charges are assessed against residential customers than industrial customers and rates can be set so that higher charges

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occur during the greatest demand for service. Rates can also be set to enable a customer to be interrupted during peak demand periods. Concepts like universal service can be implemented to allow customers in rural areas to experience rates which are equal to or lower than their counterparts in urban areas. Issues of fairness, predictability and stability also come into play.

The subject of rate structures is complex for several reasons. First, there is a mass of technical information that must be gathered. This information is greatly affected by the technology of metering which is used and the design and administration of rates for the different types of utility enterprises. Second, the subject is clouded by the lack of demand and cost information which is available to regulators. Third, the subject is also adversely affected by the numerous conflicting standards of fairness and functional efficiency in the choice of rates

Most authorities believe the best rate structures are ones that provide an adequate amount of revenue to be collected, costs to be attributed to service and practical attributes such as simplicity, understandability and certainty. Stated another way, rates should permit the attraction of capital, consumer rationing and fairness to ratepayers.

Based on this criteria, most utility experts advocate that rates should have some relationship to costs. Although this is an admirable goal, it is expensive and difficult to make specific cost determinations. Most often, individual costs will not add up to meet the overall revenue requirement of the utility. Many costs are joint and common and require allocation to permit specific assignment to customer classes. As a result, some practical deviation from costs is necessary to assure that rates are able to fulfill all the functions they are designed to meet. For example, every customer has an individual cost of service which is different from another customer. This makes it impractical to determine costs on an individual customer basis (unless

the customer is unique). Consequently, rate classifications are set up to permit the determination of costs on a broader level. Despite the deviation from costs, most analysts believe that cost as a starting point is the single most important factor in determining rates.

As noted, rate structures can take several forms. You may have a declining block rate structure which rewards you with discounts for successive amounts of consumption. You may note that your rate can change if you achieve certain amounts of use. Rates differ depending on the classification in which you find your use, e.g., residential, small commercial, commercial, industrial and street lighting. Rates often distinguish between the charges which are imposed to cover fixed costs and charges which are designed to cover the variable costs. Your demand charges usually include the fixed costs of the utility, i.e., the plant, wires and administrative costs. Your commodity charges include variable costs such as fuel, transportation, or the commodity itself. Often, times customer costs are broken out to reflect metering and individual distribution expenses.

Rates can also vary depending on the quality of service. If your business has back up energy sources, it may elect to buy utility services in such a way as the utility can curtail service during peak periods of consumption. This pattern of use is called interruptible. Service may vary with respect to voltage or the delivery point.

With the advent of competition, alternative providers have insisted on the use of marginal or incremental costs to determine prices. This form of pricing is typically used in the private sector and permits services to be priced in an economically efficient manner. In this fashion, rates can be designed using short term marginal costs or long term incremental costs. Essentially, you are looking to price services either on the basis of producing one more unit from

existing facilities (short-run) or in anticipation of new plant being constructed to produce the additional unit (long-term). Obviously, economists spend considerable time trying deduce what the proper definition is for examining forward looking costs and go to great lengths to explain their rationale for adopting one definition over another. Nonetheless, most economists contend that prices which reflect economic efficiency are superior to ones that don't.

The practical problem confronted by regulators and utilities which use forwarding looking costs is that it is almost impossible to get forwarding looking economically efficient prices to add up to the historical revenues that need to be collected by the utility to meet the revenue requirement. As such, to place incremental prices into effect requires some deviation or "second best" approach. Consequently, to recover all costs, rates must be set proportional to the forward looking costs or based on elasticities of demand.

Costs historically have been allocated using fully distributed cost of service approaches. This process includes dividing the historical revenues between utility functions and allocating costs to particular customer classifications. The problem with this approach is that costs tend to contain subsidies between classes and economic efficiency is neglected, leaving the possibility that the utility is being compensated for stranded investment. This is why most competitors want the use of prospective pricing and most utilities want be compensated for all their costs.

Discrimination is a key component in every rate structure. To assure fairness, customers in similar categories must be charged the same rates. Otherwise, you would have a system which does not correctly establish a price that recognizes the opportunity of the purchase. Although discrimination is practiced routinely in the establishment of a rate structure, it is only undue discrimination which is unlawful. The most noteworthy situation is large industrial customers

purchasing services at discounted prices under special contracts that are off tariff. The rationale for this practice is somewhat simple, although verification is a definite problem. A large industrial customer may have the resources to bypass the utility by building its own facilities, especially with the technological breakthroughs in co-generation. The utility wants to maintain the service of this customer, because the customer usually consumes large amounts of product and services at a consistent volume over time. As such, the utility charges the customer a rate based on the avoided cost of building a bypass facility. This way the ~~utility~~^{customer} gets the economic benefits of building its own facility and remains a customer of the utility. The utility prices the service or product at a price which allows for some contribution to the utilities fixed costs. Regulators generally approve these transactions, realizing that if the customer does not stay, it will cost the remaining customers more than the discount of inducing them to stay. Therefore, there are numerous situations where large industrial customers have rates that are established by contract and are not unlawfully discriminatory.

In conclusion, I would say that this subject can be made as simple or as complex as you desire. Rates are an important legislative process. Many components go into making a rate. Because of the number of elements to be considered, it should not be surprising that a rate structure can result in a very contentious hearing.