Approved 1-11-01:

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The meeting was called to order by Chairperson Stan Clark at 9:30 a.m. on January 9, 2001 in Room 231-N of the Capitol.

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All members were present except: All present

Committee staff present: Emalene Correll, Legislative Research
Raney Gilliland, Legislative Research
Bruce Kinzie, Revisor of Statutes
Lisa Montgomery, Revisor of Statutes
Ann McMorris, Secretary

Conferees appearing before the committee:
John Wine, Chair, Kansas Corporation Commission
Cynthia Claus, Commissioner, KCC
Brian J . Moline, Commissioner, KCC

Others attending: See attached guest list

Chair Clark noted there are five new members on the Utilities Committee. He introduced the staff from Legislative Research and the Revisor of Statutes office and the secretary who would be assisting the committee. He noted the primary focus of the committee would be on oil, gas and electricity and that there will be a learning curve as each committee has a glossary of terms to get familiar with. Each member received a copy of the Review of the Kansas Underground Utility Damage Prevention Act booklet prepared by the Kansas Corporation Commission in response to House Resolution 6011.

Pete Loux of Wichita, former KCC commissioner, was introduced.

Kansas Corporation Commission commissioners, John Wine, Brian Moline and Cynthia Claus appeared before the committee. A brief resume of each was handed out. (Attachment 1)

John Wine, KCC Chair, reviewed the purpose of the KCC and the various functions and issues they handle.. He discussed the Oregon task force study (Attachment 2) and compared the way various issues discussed in that study are handled in Kansas

Commissioner Claus reviewed her background and noted she had not prepared any specific comments on the work of the KCC and handed the mike to Commissioner Brian Moline. Commissioner Moline presented the history of the KCC from its start in the 1800s and commented on the regulation of services and rates. His written comments are attached. (Attachment 3).

The Chair opened the floor for questions. Several members questioned about state run generation plants, the Pennsylvania & California electric deregulation, rules on mergers, and the situation in surrounding states and how their actions affect Kansas.

The next meeting of the Senate Utilities Committee will be January 10, 2001 at 9:30 a.m.

Adjournment.

Respectfully submitted
Ann McMorris, Secretary

Attachments - 3

SENATE UTILITIES COMMITTEE GUEST LIST

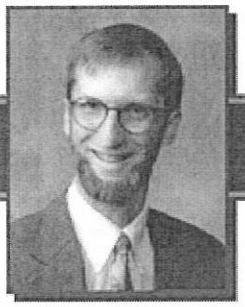
DATE: JANUARY 9 2001

NAME	REPRESENTING
Mike Ohrt	Penegar Smith
Amy Campbell	Midwest Energy
Bill Sneed	PNM
Andy Schaw	Kearney Law Office
Bob Alderson	Greeley Gas Company
Jack Glaves	Duke P-N + Kinder Morgan
Katrina Hull	AP
Pete Loux	Self
Ken Peterson	KPC
Dick Brewster	bp
Julie Hein	Hein + Weir
Stan Kram	Western Resources, Inc.
J.C. Long	UtiliCorp United
Denny Koch	SW Bell
Ina Sage	Self
Tom Day	KCC
Jeff Wagaman	KCC
Joe White	KCC
Ron Gaches	CBBA

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: January 9, 2001

NAME	REPRESENTING
Cynthia Claus	KCC
Brian Malin	KCC
John Wine	KCC
George Barbee	ENRON
JOHN C. BOTTENBERG	WESTERN RES.
Dave Hoffman	W.R.
Wayne Kitchen	W.R.
Jon K. Miles	KEC
Cynthia Smith	KCPL
Patrick J. Hurley	KCPL
Mike Taylor	City of Wichita
Lane Ann Rover	KS Govt Consulting
JIM BARTLING	GREELEY GAS CO



JOHN WINE, CHAIR

John Wine was first appointed to the Kansas Corporation Commission on March 15, 1996 by Governor Bill Graves. On March 14, 2000, Mr. Wine was reappointed by Governor Graves to a second term. He was elected Chair by the three-member Commission on September 10, 1997.

Before joining the Commission, Mr. Wine served as Kansas Securities Commissioner from January 1995 to March 1996. Prior to that, he served a 14-year tenure in the office of the Secretary of State. He served as General Counsel, Assistant Secretary of State, Legal Counsel and Deputy Assistant Secretary of State. Mr. Wine has also been a Disaster Loan Counsel with the U.S. Small Business Administration, and practiced law in the private sector.

Mr. Wine earned his Bachelor of Arts with Highest Honors in Political Science from Friends University in Wichita in 1975, and his Juris Doctorate from the University of Kansas School of Law in 1978. He is co-author of *Kansas Business Law: A Practical Guide to Laws and Regulations*.

Mr. Wine is a native of Wichita. He and his wife, Sue, have three children and are residents of Topeka. He has served on the boards of many charitable organizations and state commissions.

Chair Wine is serving a four-year term, which expires March 15, 2004.

March 2000

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URL:http://www.kcc.state.ks.us/commissioner/wine.htm
Revised Friday, 06-Oct-2000 15:47:24 CDT

Senate Utilities Committee
January 9, 2001
Attachment 1-1

CYNTHIA CLAUS, COMMISSIONER

Cynthia Jensen Claus was first appointed to the Kansas Corporation Commission on August 29, 1997, by Governor Bill Graves. On December 8, 1999, Ms. Claus was reappointed by Governor Graves to a second term.

Prior to joining the Commission, from 1979 to 1995, Ms. Claus was employed as an attorney with ARCO Pipe Line Company, a common carrier oil pipeline company, in its Independence, Kansas and Houston, Texas offices, serving as corporate counsel for ARCO Pipe Line from 1989 to 1995. Prior to her employment with ARCO, Ms. Claus practiced law in Independence, Kansas and Kansas City, Missouri. She has also served as municipal judge for Independence and Cherryvale.

Ms. Claus currently serves on the Telecommunications Committee of the National Association of Regulatory Utility Commissioners. She also serves as Governor Graves' official representative to the Interstate Oil and Gas Compact Commission, where she is a member of the Legal and Regulatory Affairs Committee.

Ms. Claus grew up and attended public schools in Johnson County, Kansas. She earned an undergraduate degree from the University of Kansas and a Juris Doctorate from the University of Kansas School of Law where she was elected to Order of the Coif. Ms. Claus and her husband, Bob Claus, live in Topeka, Kansas. They have two adult children.

Commissioner Claus is serving a four-year term, which expires March 15, 2003.

December 2000

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Brian J. Moline, Commissioner

Brian J. Moline was appointed to the Kansas Corporation Commission on December 16, 1998, by Governor Bill Graves.

Mr. Moline served as General Counsel to the KCC from 1979 - 1985 and from 1991 - 1995. He has also been General Counsel to the Kansas Insurance Commissioner and the National Association of Insurance Commissioners. Throughout his career, he has alternated between state government service and Kansas Legal Services, the statewide public interest law firm he co-founded in 1978. At various times, he has been Executive Director for both the Wichita and Topeka programs.

Mr. Moline holds a Bachelor of Arts from Wichita State University, a Juris Doctor from Washburn University, and a Masters in Public Administration from the University of Kansas. He is the author of Regulation in Transition, a monograph of the KCC and has published numerous articles and book reviews. He is on the Board of Editors of the Journal of the Kansas Bar Association and has served as Chairman of the Ethics and Grievance Committee of the Topeka Bar Association and on the Board of Trustees. In 1993, he received the Topeka Bar Pro Bono award for continued commitment to legal services for the indigent and received the Distinguished Service Award of the Kansas Bar Association in 1994. He is an Adjunct Professor at Kansas University and Washburn Law School.

For additional biographical information on Commissioner Moline, see *Who's Who in American Law*, 1998 edition.

Mr. Moline and his wife Kathie have four grown children and reside in Topeka.

Commissioner Moline is serving a four-year term, which expires March 15, 2002.

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URL:http://www.kcc.state.ks.us/commissioner/moline.htm
Revised Monday, 08-Jan-2001 14:54:44 CST

I-3

REPORT TO THE OREGON STATE LEGISLATURE

FROM THE HB 3615 INTERIM TASK FORCE

INTRODUCTION

The 1999 Oregon Legislature enacted HB 3615, which made changes affecting the Oregon Public Utility Commission (PUC).[1] The bill also directed the Governor to appoint an interim task force to "...study the structure of the Public Utility Commission and determine whether changes to the structure of the commission are necessary or advisable." In June 2000, the Governor appointed nine task force members.[2] In his charge to the Task Force, the Governor posed several broad questions addressing the structure of the commission, the role of the PUC staff, and the PUC's processes.[3] The Task Force identified additional questions.[4]

Beginning in August 2000, the Task Force gathered information from the PUC, conducted a survey of other states' regulatory utility commissions, solicited written comments, and heard public testimony.[5] On November 16, the Task Force circulated a draft report for comments from the PUC and other interested parties, all of whom discussed these comments at a public hearing. Following that final public hearing, the Task Force produced this final report. Our conclusions are summarized below.

From the outset, the Task Force has confronted the question of how broad its inquiry should be. At the very first meeting, one member thought the inquiry should even question the PUC's very existence. Concluding that any organization's mission drives its structure, the Task Force began by digging into the PUC's role in regulating industries (principally telecommunications, natural gas, and electric power) that are undergoing significant competitive changes.[6]

After our inquiry into the PUC's role, the Task Force narrowed its focus to structural issues that seem to be working and structural issues that clearly need improvement. In general, we concluded that the PUC is doing a good job in a difficult environment where no parties can predict the regulatory changes that technology and the market will bring. For those issues that need improvement, the Task Force inquiry has spurred the PUC to begin the documentation of its existing internal processes and staff guidelines. That documentation alone will have made the Task Force's work worth the effort.

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[1] 1999 Oregon Laws, Chapter 1102, amending ORS 756.014 and 756.036

[2] Duncan Wyse, Chair, Mary Ann Hutton, Vice Chair, Senator Gene Derfler, Leonard Girard, John Glascock, Chip Greening, Myron Katz, Bruce Samson, John Stephens.

[3] Appendix I.

[4] Appendix II.

[5] A list of those submitting comments and a summary of the comments are included in Appendix III and IV.

[6] Appendix V contains a paper entitled "A Short Course in Public Utility Regulation," prepared by former PUC Commissioner, PSU Economics Professor, and Task Force member Myron (Mike) Katz.

SUMMARY OF CONCLUSIONS

The PUC has a complex role in a dynamic regulatory environment.

Until recently, all aspects of telephone, electric, and natural gas services were thought to be "natural monopolies," and were subject to very close PUC economic regulation. The PUC's current mission identifies a dual role of (1) ensuring safe and reliable utility services for consumers at just and reasonable rates, while (2) fostering the use of competition to achieve the same objectives.[7]

While competition has substantially changed the regulatory environment, some aspects of the regulated industries' businesses will remain monopolies for the foreseeable future and will therefore require continuing PUC scrutiny.

Some regulated companies have contended that the advent of competition in their industry should lead immediately to a lifting of PUC regulation. While it is true that competition is developing very quickly in some telecommunications services, new competitors have made very small inroads, and only then in business markets. Very few residential customers have a realistic and cost-competitive alternative to their current local exchange telephone companies.

Most electric and gas customers will continue to face monopoly distribution service for the foreseeable future. While these customers may in the future have some supply options from different competitors, they will remain connected to the electric or gas distribution systems by one wire or pipe until technology provides additional options. Hence it will be necessary for the PUC to continue to exercise economic regulation over these monopoly services.

The PUC should continue to develop alternative regulatory processes for both the monopoly services of regulated companies as well as those regulated business segments evolving toward competition.

The Oregon PUC has developed some alternative forms of regulation. We encourage the PUC to continue to develop new regulatory processes that will enable regulated companies to better serve their customers, whether in regulated or competitive segments of their businesses.

The PUC should concentrate on the development of appropriate policies and procedures that will minimize the "lag" between evolving competition and regulation.

It is an irony of the current dynamic regulatory environment that, with the coming of competition to some regulated business segments, the PUC's work has become more time-consuming and complex—not less. When all aspects of the regulated industries' businesses were monopolies, all parties understood the rules of the regulation game. Once the pieces of these businesses began evolving toward competition, the PUC has had to invent new rules and procedures on the fly. Failure to timely develop new policies and procedures to recognize competitive advances may lead to a regulatory "lag" and slow down the ability of partially regulated companies to serve their customers in newly competitive markets. On the other hand, premature deregulation, without the appropriate institutional arrangements and market mechanisms, could disrupt both regulated and competitive markets, causing substantial harm to customers.

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[7] For this report's purposes, the Task Force has defined a competitive market as one in which a purchaser has the ability to choose differentiated services from multiple suppliers.

The PUC should ensure that decision-making processes are actually and apparently fair to all parties.

The Task Force concluded that, in general, the PUC's current structure works well, but we found that both regulated companies and customer groups do not perceive the PUC's decision-making processes as entirely fair. We were surprised to find that the Commission had not put into its administrative rules the internal policies and procedures it has been using to govern its processes and give guidance to its staff. We therefore strongly recommend that, for contested cases, the PUC document, in administrative rules, these long-standing internal policies and procedures. In response to the Task Force's findings, the PUC has undertaken to document those internal policies and procedures. We recommend that, as part of that documentation, the PUC adopt certain policies with regard to its decision meetings in contested cases to ensure actual and apparent fairness to all parties. We also recommend that the Commissioners play a more visible role in contested cases.

The PUC should develop clear guidelines for its staff in the conduct of the Commission's contested case proceedings.

Of all the issues considered by the Task Force, the role of the staff generated the most heated exchanges and diverse opinions. If we never issued a report, our inquiry has brought to light the need to clarify the role of the PUC staff, especially in contested cases. We found that most interested parties agreed that the staff is competent and has provided professional and rigorous analysis of cases presented by regulated companies. The PUC characterizes this approach as "balanced," while some regulated companies feel the staff plays an advocacy role for consumers, a position vigorously denied by customer groups. The Task Force has eschewed labeling the staff's role in favor of recommending that the staff follow the appropriate statutes, rules, and policies that bear on any particular proceeding.

I. THE ROLE OF THE PUC IN AN EVOLVING REGULATORY ENVIRONMENT

Overview of Public Utility Regulation

Why do we regulate public utilities in the first place? Unlike most other businesses, public utilities are subject to economic regulation. Economic regulation is government command and control over entry and exit, service and business decisions, and prices. The purpose of economic regulation in a market economy is to protect consumers from the lack of competition, because public utilities, or at least certain pieces of their business, are natural monopolies where it is more efficient to have a single seller rather than multiple vendors.

At one time, the entire business was regulated. It is now increasingly recognized that many parts of a utility's operations can be "unbundled" with some elements open to competition and deregulated while natural-monopoly components remain subject to traditional economic regulation.

Since the purpose of economic regulation is to protect consumers from the lack of competition, it follows that the proper objective of utility regulators is to simulate competition. In return for protection from competition and the guaranteed opportunity to recover costs and earn a reasonable return, utilities must, among other things, submit to rate regulation.

Setting rates is the most important function performed by utility regulators. There are three steps involved: establishing a utility's revenue requirement (the amount required to recover costs including a return of investments, plus a return on investments), determining the rate spread (how the revenue requirement is apportioned among each customer class), and determining the rate structure for each class of consumer.

The most serious problem associated with traditional "cost-of-service" regulation is that it fails to provide incentives for improvement in performance, innovation and efficiency. Increased profits associated with improved utility performance can trigger a rate case with higher profits erased, although this occurs infrequently, only in cases of persistent and unreasonably high earnings. On the other hand, utilities get to keep cost savings until rates are reset, which can be quite a spell. Alternative forms of regulation (AFOR) are being adopted in Oregon for energy and telecom utilities to address this issue by providing performance incentives.

U.S. Supreme Court cases (most notably FPC v. Hope Natural Gas Co. (1944)) have determined that "ratemaking 'involves a balancing of the investor and consumer interests,' which does not 'insure that the business shall produce net revenues.' From the company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. That return . . . should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

There is no single correct rate of return. Return on equity must simply be sufficient to continue to attract capital to ensure confidence in the utility's financial integrity.

In early 1999, the Oregon PUC declared that "competition is the best facilitator of innovation, affordability, and new investment" and that "the marketplace is the best vehicle to allocate resources and stimulate investment." Most mainstream economists would agree. History suggests that sooner or later, the forces of superior logic prevail. If that is true, it is likely that where competition in utility services is possible, it will emerge.

The Evolution from Full Regulation to Partial Competition

The PUC's mission has evolved over the last few years as competition has begun to play a greater role in some segments of regulated industries. For many decades policymakers assumed that certain services (e.g., telephone, electricity, natural gas) were best delivered by natural monopolies, and that government regulators could provide protection from the lack of competition. While most of the PUC's statutory authority derives from that long-held assumption, the Oregon statutes do give the PUC sufficient flexibility to meet the demands of the dynamic regulatory environment.

For example, the PUC is required to "...represent the customers of any public utility or telecommunications utility and the public generally in all controversies respecting rates, valuations, service and all matters of which the commission has jurisdiction." The Commission must use its powers to "...protect such customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates."[8] Other long-standing statutes prohibit unjust discrimination or preference.[9] In recent years, new

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[8] ORS 756.040(1), 757.020, 759.035

[9] ORS 757.310 and 757.325

statutory directives have been added related to specific industries. These include provisions relating to competitive services in the telecommunications industry[10], electric industry[11], and natural gas industry.[12]

Today, with the unbundling of some traditionally regulated services, many policymakers believe that substantial portions of these regulated industries could be delivered in a competitive, deregulated market. However, given the existence of incumbent service providers with substantial market power, how are Oregon policymakers to unravel years of regulatory policies and procedures in a way that opens up appropriate portions of these markets to competition without creating unregulated monopolies or disrupting consumer expectations of service quality and price stability?

The Commission has described this delicate balancing act in its mission:[13]

> Ensure that safe and reliable utility services are provided to consumers at just and reasonable rates while fostering the use of competitive markets to achieve these objectives.

On the assumption that the mission should drive the structure, the Task Force cannot overemphasize the complexity of the PUC's mission. Each of the regulated industries are evolving toward competition at divergent speeds. Within each industry, market segments are evolving in dissimilar ways, including the types of services offered to different classes of customers (business, residential, urban, or rural). While it is nearly impossible to forecast future developments, some examples of issues raised by newly competitive industries and market segments give a flavor of the complexity of the PUC's present job:

- Incumbent telecommunications utilities with land lines connecting network facilities with customers compete with nearly unregulated wireless providers. The incumbents must also compete with other facilities-based providers and with unregulated resellers which co-locate their equipment in the incumbent's central office. Despite these disadvantages, the incumbents still retain the vast majority of the business market and virtually all of the residential market. On the other hand, this growing competition, characterized by frequent new service offerings, means the PUC handles few contested telecommunications rate cases. Instead, the PUC must sort out disputes among the incumbent and new competitors who purchase unbundled services from the incumbents.

- Regulation of the natural gas industry provides a clear demonstration of the complexity and unpredictability of managing the transition from traditional economic regulation to some mix of economic regulation, partial regulation, and fully competitive markets. For several years, industrial gas users have been able to purchase gas supplies and to utilize capacity on interstate gas transmission facilities. Yet nearly all gas customers, whether residential or industrial, continue to rely on the distribution pipe provided by the local gas distributor for gas delivery. Gas distributors have now used the competitive supply

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[10] ORS 759.015 and 759.425(1)

[11] ORS 757.646 (SB 1149 enacted in 1999)

[12] ORS 757.516

[13] The Commission is empowered by statute to organize its operations. ORS 756.036

market to devise ways of managing their supplies for captive customers, including expanding storage facilities, purchasing additional transmission capacity, and utilizing financial risk management techniques. The manner in which the distributors use these options varies from one to another. Yet the PUC must keep track of all these activities to ensure that captive customers get reliable and cost competitive service.

- The 1999 Oregon Legislature took a first step down the road to electricity competition with SB 1149. The PUC is now implementing that legislative mandate through a rulemaking proceeding. After full implementation, Oregon electricity customers should be able to choose several differentiated services from multiple suppliers, either as part of an aggregated group or as individual businesses or consumers. Nevertheless, although electric customers may be able to choose among alternative suppliers or from a utility-provided portfolio, most customers will still have to use the local electric distributor's wires for delivery of the power.

The Task Force concluded that the evolution from full regulation to partial competition in some market segments will take much longer and will be more challenging than many people expected. Moreover, neither the PUC, nor the Legislature, nor this Task Force can predict what the endpoint will look like, since technology and product innovation will continue to change the regulatory and competition landscape in each of the regulated industries. We can expect new service choices from both the current monopoly suppliers and new competitors. We will likely find a mix of fully competitive services from multiple suppliers, some monopoly utility services, and some hybrid service offerings. We certainly expect the state of competition to diverge widely among the currently regulated industries (telecommunications, electricity, and natural gas).

Given this very complex and lengthy evolutionary process, Oregon policymakers must be sure the PUC is capable of managing this transition. Ironically, this critical role could place more, not fewer, demands on the PUC. Contested cases, such as utility rate filings, which once were the bread and butter of regulation, now comprise only ten percent of the Commission's and 30% of the staff's workload. For example, because of the multi-state nature of the major regulated companies, the PUC has increased its participation in regional and national proceedings and oversight groups to ensure regulatory consistency across state borders. In order to keep pace with competitive developments, the PUC and its staff must stay abreast of technology and market developments across the country. Only through these activities can the PUC effectively develop and implement the policies and processes necessary to meet the demands of the evolution toward more competitive markets.

Conclusions on the PUC's Continuing Regulatory Role

For most consumers of services provided by regulated companies, competition still does not exist. In the absence of competition, the PUC must continue to exercise its traditional regulatory role over the provision of monopoly services. In this very dynamic environment the PUC will be continuously challenged to revisit its regulatory policies and processes to ensure they both encourage innovation and competition and protect consumers' interests.

- The PUC should maintain an economic regulatory role for those service segments in which there is little or no competition.

- The PUC should provide incentives to encourage innovation and greater efficiency in the provision of monopoly services, and continue to explore the use of, alternative forms of

regulation, including alternative dispute resolution, consistent with the protection of consumer interests.

- The PUC should continuously examine its regulatory policies and processes to ensure their responsiveness to the needs of the faster-paced, more competitive market segments of the regulated industries. In particular, the PUC should continue to recognize the significant differences in the pace of competition among its jurisdictional industries.
- The PUC should continue to use collaborative processes, such as workshops and informal information-gathering inquiries both to stay informed on developing competition and other policy issues, and to involve the affected public in its proceedings.
- The PUC must ensure that captive customers of regulated monopoly service providers are not subsidizing those companies' unregulated businesses or their affiliated interests.
- The PUC should ensure that customers of regulated companies have the information necessary to make informed choices in the evolving business segments of regulated companies and their emerging competitors.

II. COMMISSION PROCESSES – ENSURING TRANSPARENCY AND FAIRNESS

The Task Force addressed a number of broad questions concerning the PUC's structure, processes and procedures. The Task Force considered major structural and statutory issues such as the number of commissioners, appointment of the chair, and application of the Open Meetings Law. The Task Force looked at the role of the commissioners, the Administrative Law Judges (ALJs), the PUC staff, and the Assistant Attorney General (AAG). The Task Force also examined aspects of the PUC's internal processes and policies that affect the public's interaction with the agency.

The Task Force examined what works well at the PUC and what could benefit from changes. The Task Force received significant public comment on specific aspects of the PUC's processes and procedures. The Task Force also received a great deal of input from the PUC on these topics in formal comments, numerous documents produced during the Task Force's inquiry, and in discussions with the commissioners and staff in all of the Task Force's meetings.

The Task Force concludes that the current overall structure of the PUC is working well. Although the Task Force considered sound arguments for some structural changes, the Task Force concludes that fundamental structural changes are not needed.[14]

However, the Task Force has identified a number of concerns involving the PUC's processes and the role of the PUC staff, which were reflected in public testimony. The Task Force does not find that the current processes and policies have resulted in unfair treatment. However, after extensive discussion and consideration, the Task Force concludes that a number of changes should be made to improve the transparency, perception of fairness, and confidence level in the decision-making processes at the PUC. Furthermore, the Task Force believes the PUC should continue its effort, started during the Task Force's inquiry, to collect together and codify its internal operating policies and guidelines. Many of the following recommendations specifically apply to contested case proceedings, but the thrust of the Task Force's recommendations could be applied in other types of proceedings as well.

A. Interactive Involvement of Commissioners

Issue: The commissioners are not sufficiently involved in a visible and interactive way throughout proceedings. This lack of participation gives parties no guidance on the issues most important to the commissioners until the PUC issues a final order at the end of a case. This process reduces parties' confidence level in PUC processes and gives at least the perception that the PUC staff and PUC staff Assistant Attorneys General (AAG) have undue influence in the process.

Recommendations: The commissioners should be involved in a more visible and interactive way throughout proceedings to both improve the PUC's decision-making processes and increase the parties' perceptions of fairness. The Task Force recognizes that the PUC currently utilizes some of the methods below in some cases and that not all of these tools may be appropriate in all cases. However, the Task Force encourages the PUC to utilize the following methods whenever practicable to increase the commissioners' early and interactive involvement in proceedings. The Task Force recognizes that some of these recommendations may lengthen proceedings. The Task Force assumes that the decision whether to use one or more of these tools, and its impact on the schedule for a case, would be decided with the input of all parties to the proceeding in a prehearing conference or during the pendancy of the case.

1. To the extent practicable, one or more commissioners should attend hearings on substantive matters and participate as appropriate by asking questions of parties, rather than relying entirely on ALJs and reading portions of the record.

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[14] See discussion in Section ____.

2. Particularly if commissioners have not attended the hearings, short oral presentations following the submission of testimony should be provided in which parties may summarize their case before the commissioners. In noticing the hearing, the commissioners should identify any particular issues on which they want the parties to focus their presentations. (Oral arguments upon briefing may also be appropriate, particularly on significant policy or legal issues.) The commissioners should actively question the presenters in oral presentations and arguments.

3. Commissioners should make a point to identify specific issues of concern to them during proceedings so that parties may respond with testimony and recommendations addressing the commissioners' concerns.

4. Commissioners should utilize "bench requests" or technical conferences during contested hearings to gather information from all parties, not just the PUC staff, in order to make the decision-making process more transparent and increase parties' confidence in the fairness of the process. Current communication technologies should be utilized to make this process prompt and efficient.

5. Where practicable, but especially in complex cases, the ALJ or commissioners should issue a proposed order to allow parties to comment prior to the issuance of a final order.

6. A mechanism should be utilized for the commissioners to decide some issues in a case on an expedited basis (e.g., summary disposition) while other disputed issues go forward.

7. The PUC should continue to develop and utilize settlement and other alternative dispute resolution processes.

B. Separation of Staff's Dual Role; Application of Ex Parte Rules

Issue: There is the perception among stakeholders and parties that the contested proceedings process is unfair because there is inadequate distinction between staff that presents testimony and staff that advises the commissioners. This is true even though the Assistant Attorney General, who is counsel to the commissioners, has the legal responsibility to ensure that "ex parte" rules are not violated. The Task Force does not believe, and has not been furnished with any information that demonstrates or implies that there has been any improper behavior by any commissioner, ALJ, AAG, or staff member.

The staff has not been subject to any formal "ex parte" rules, although they are expected top follow internal PUC policies concerning "ex parte" contact. During the course of the Task Force's review, the PUC incorporated these policies into a draft document, "Internal Operating Policy Guidelines" dated November 6, 2000, (see Appendix VI). However, even assuming these current internal policies are codified, the Task Force remains concerned whether the staff involved in promoting a position in a case should also be called upon to provide technical or policy input to the ALJ or Commissioners in the same case. These advisory communications occur throughout a contested case and in the decision meeting, and are "off the record" in that other parties are not privy to the communications."

This gives the perception that staff may have undue influence over the commissioners, and that other parties may be disadvantaged, or not in an equal position to have their views considered. With limited resources to deal with highly complex contested cases, the question is, how can the ALJ and the commissioners obtain adequate technical advice while assuring the parties that staff does not have undue influence in the decision-making process, or use its advisory role to tilt the decision in the case toward its own recommendations?

Recommendations: Even if the PUC staff is able to perform the dual role of "party" and "advisor" without disadvantaging other parties, the Task Force is concerned with whether and how it should perform this dual role. The Task Force understands the PUC's concerns in having limited staff resources yet needing technical assistance and advice during a case and in the final decision-making process. However, the Task Force believes it is of paramount importance to the integrity and confidence of the decision-making process to draw a brighter line between the staff involved in promoting its side of a case and the staff assisting the Commission in deciding the case.

1. In contested case proceedings, staff members who participate as witnesses, staff members who participate in the development or review of witnesses' testimony and provide substantive direction on the positions advocated by those witnesses, staff members who actively participate in settlement discussions representing the staff's position, the staff case manager, and the AAGs representing the staff in the case, should be treated as "party staff".

   a. The "party staff" should be subject to all the same *ex parte* rules applying to other parties in PUC proceedings;

   b. The "party staff" should not be called upon to provide policy analysis or recommendations to the ALJs or the commissioners in that case, other than on the record in the same manner as other parties or in a meeting made open to the public; and

   c. The "party staff" should not attend the commissioners' decision meeting(s) for that case, unless that portion of the meeting in which the party staff participates is made open to the public.

2. If the ALJ or commissioners need technical assistance[15] in a contested case that cannot be provided by a staff member who is not part of the "party staff", the information should be gathered, including utilizing electronic means, where appropriate:

   a. Through a bench request sent to all parties and allowing all parties to respond;

   b. Through a technical conference (including by conference call) with all parties given the opportunity to participate;

   c. Through a request to the "party staff" member, with the request and response provided in writing and served on all parties in a timely manner and included in the record; or

   d. Through other means that provides notice and a copy of any response to all parties.

3. Due to the reality of staffing and budget constraints, the Task Force is not recommending that a separate "advisory" staff be created and be protected from *ex parte* contact, including contact with the "party staff" in a case. However, the

[15] The Task Force assumes that "technical assistance" does not include the simple identification or location of facts in the record.

staff that advises the ALJ and commission should not act as a "go-between" to relay information from "party staff" in a way that would circumvent the intent of Recommendations 1 and 2, above.

4. The PUC should adopt detailed administrative rules to effect the recommendations in 1, 2 and 3, above. Additional internal policies not adopted as rules should at least be adopted as written guidelines.

5. A case manager should be assigned and publicly announced at the outset of all proceedings, regardless of type. The identification of a single case manager would afford oversight and coordination of staff positions and strategy and give other parties a central contact point for concerns that may arise throughout a proceeding. The case manager's duties and authority should include the responsibility to review the staff's overall case and individual testimony and exhibits to be sure that the recommendations are consistent with the staff's proper role. To the extent materials do not meet such standards, the case manager will be responsible for achieving the changes needed to bring the materials within the standard applicable to staff presentations.

C. Contested Case Decision Meetings

Issue: The Open Meetings Law does not apply to the PUC's deliberations on contested cases, which includes rate cases and other major proceedings.[16] This general statutory exemption applies to other state agencies' contested case deliberations as well. However, the PUC's proceedings are different than most other state agency administrative proceedings, such as an OLCC prosecution, water rights determination, or professional license application. The PUC's proceedings can involve highly technical engineering data, complex financial determinations, and broad policy issues affecting entire industries and nearly all citizens in the state. After lengthy and costly proceedings to build a record on complex cases, the PUC's ultimate deliberations and decisions are made in closed "decision meetings". The decision meetings include only the commissioners, the ALJ, an AAG, and selected members of the PUC staff, but not other parties or the public. The PUC's internal policies limit the participation of the staff in these meetings, but exceptions are made and the policies are not set out in rules.[17] Significant public policy is-

[16] ORS 192.690(1)

[17] The PUC's "Draft Internal Operating Policy Guidelines" of November 6, 2000 provides in part, "The Commission recognizes that Staff participation in evidentiary proceedings may create a perception that a Staff witness attending a decision meeting would attempt to persuade Commissioners to adopt a position that the witness had recommended. Consequently, the Commission limits Staff access to the decision making process. In addition, it is the Commission's expectation that any Staff participants in decision meetings refrain from advocacy. Neither ALJs nor Utility Program Staff should attempt to persuade Commissioners to adopt a par-

sues may be decided in these cases. This decision-making process lacks transparency and gives rise to questions of fairness. The perception is exacerbated in light of the current dual role of the staff and the exemption from *ex parte* rules applying to the staff and AAGs.

The Task Force believes there is a strong argument for making the PUC's decision meetings on contested cases subject to the Open Meetings Law, at least for proceedings that involve significant issues of public policy. In such cases, the PUC's determinations are different from the typical state agency contested cases. It is not clear why these types of major policy determinations should be made in a closed meeting where parties and the public at large cannot observe the PUC's deliberations. Opening the decision meetings also would help alleviate some of the concerns created by the PUC staff serving a dual role as both a party to the case and an advisor to the ALJ and commissioners in deciding the case.

Recommendation: PUC decision meetings in contested cases do not need to be made subject to the Open Meetings Law or be opened to attendance by all parties in order to ensure a fair decision-making process, but opening the meetings would improve the transparency and perception of fairness of that decision-making process. However, the concerns that cause support for open decision meetings should be alleviated if not eliminated if the PUC effectively and consistently implements the recommendations in Section II. B. and C. These would improve current procedures by increasing the interactive participation of the commissioners, make staff acting as parties strictly subject to *ex parte* rules, and provide for greater separation in the staff's role as a party and an advisor to the Commission in contested case proceedings. It would also ensure the "party staff" will not be participate in decision meetings unless that portion of the meeting is made open to the public. However, the Task Force urges the Commission to consider making all portions of its decision meetings open to the public, especially on cases involving significant issues of public policy.[18]

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ticular position. Their responsibilities in decision meetings are to analyze, advise, and recommend. ***It is Commission policy that, as a general rule, a Staff member who appeared as a witness in a particular proceeding shall not attend Commission meetings where the issues in the case are being decided. If a technical question arises at a decision meeting that can only be answered by a Staff witness, the staff member may attend for the limited purpose of explaining the technical matter. In no case should the staff witness advocate a position. Any such instance would be an ex-parte contact and would require disclosure. This restriction applies to particular individuals, rather than the entire Staff. So, for example, if a Staff member were actively promoting a particular position in a formal utility proceeding, that person should not participate in the deliberation and drafting of the final agency order, although it would be permissible for the person's supervisor to do so. Allowing the supervisor to participate ensures the commission, under the current staff structure, that it will have adequate policy and technical advice in the making of its decision. However, the requirement that the staff person not promote a particular position is still applicable."

[18] For any portion of a contested case decision meeting that is made open to the public, the Task Force assumes that the official record of the case will have been closed prior to the meeting and the proceedings in the open meeting will not be part of the record; that parties and members of the public (other than staff) will observe but not participate in the discussion and that the commissioners may go into executive session, not open to the public, with ALJs, AAGs representing the commission (but not party staff) to address legal issues).

D. CLEAR PROCEDURES

Issue: Aspects of the PUC's procedures and internal policies are not clear to the public and the parties in proceedings. Also, it is sometimes not clear at the outset and during a proceeding whether a matter is being considered under procedures applying to contested cases, rulemakings, or some other procedures. This may be a growing problem as more unusual and hybrid matters come before the PUC as a result of increased competition.

Recommendation: The PUC should be required to codify its internal policies and procedures in administrative rules. The PUC should be required to identify at the outset of each proceeding, and at any time the nature of the proceeding changes, the type of proceeding being undertaken and the specific rules and procedures that apply to that proceeding.

F. OUTSIDE INFLUENCE

Issue: There were serious concerns that changes adopted by the 1999 Legislature in HB 3615 could unduly politicize the PUC processes and influence the commissioners' independence. In response to these concerns, the Governor issued Executive Order No. EO-00-06.[19] The Executive Order sets out important protections, including the application of *ex parte* rules involving contacts from the governor's staff, executive or legislative branch members.

Recommendation: The concepts of the Governor's Executive Order Number EO-00-06 should be adopted in statute and/or reflected in state agency rules, as appropriate to ensure that undue political influence is not exerted over PUC decision-making processes.

G. OPEN MEETINGS LAW (NON-CONTESTED CASES)

Issue: The Open Meetings Law hampers the PUC commissioners' ability to engage in private discussions with one other (except in contested cases, for which there is an exemption from the Open Meetings Law.) Only two commissioners of the three-member

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[19] Executive Order EO-00-06 is attached as Appendix iv.

commission constitute a quorum. When a discussion between commissioners constitutes a deliberation toward a decision that requires a quorum (which is interpreted broadly), it requires giving 24-hours advance notice as a public meeting.[20]

Recommendation: There should be no change in the application of the Open Meetings Law concerning non-contested cases. The guidelines under which the PUC currently operates are indeed awkward but do not represent a barrier to the efficient conduct of business. Furthermore, the Open Meetings Law and its application to the PUC represents the further realization of the 1986 Ballot Measure's intent to provide transparency for the PUC and its decision making processes.[21]

G. Appeals

Issue: Parties aggrieved by PUC orders or actions must pursue a suit against the PUC in a county circuit court.[22] From the circuit court, appeals are taken to the Court of Appeals. The actions of most other state agencies are appealed directly to the Court of Appeals. This extra step in the PUC appeal process is costly, time consuming, and unnecessary. It subjects a specialized area of law to a lower court of general jurisdiction that may be unversed in utility law.

Recommendation: Appeals of PUC orders should go directly to the Court of Appeals.

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[20] ORS 192.630(1)

[21] 1986, Oregon Voters Pamphlet, Ballot Measure 4

[22] ORS 756.580 to 756.610

III. STRUCTURE OF COMMISSION AND THE ROLE OF STAFF

The Task Force considered the following questions:

- What is the appropriate number Commissioners and what should be their terms of office? Should Commissioners be full time? How should the chair be appointed?
- What is the most appropriate organizational structure of the PUC staff, in particular the staff that works on utility matters, for carrying out the agency's statutory, administrative and policy functions and for responding and adapting to increasing competition in the industries the PUC regulates?
- What specifically should be the role of the staff that works on utility matters?
- How should the staff balance its roles as consumer advocates and neutral analysts?
- How should commission policy be reflected in positions that staff takes in proceedings?
- Should commissioners have separate staffs of their own or continue to rely on staff support from within the agency? What level of involvement is appropriate for commissioners throughout a docketed proceeding?
- What should be the relationship between the agency (staff and commission) and the Attorney General's office?
- What is the role of the Administrative Law Judge and should ALJs be housed within the Commission?

The current structure of the Commission can be traced to the 1986 general election, where Oregon voters, by a vote of 724,577 to 297,973, replaced its unique one-person Public Utility Commissioner with a 3-member PUC. The new law provided that the three commissioners designate the chairperson (for a 2-year term). All three commissioners were otherwise equal. Under this new form, the Commissioners chose to delegate administrative and management responsibilities to an executive director selected by them and serving at their pleasure.

The 1999 Oregon Legislature modified Commissioner roles by enacting HB 3615. The new law provides that the chairperson be designated by, and serve at the pleasure of, the Governor. Under the new statute, the chairperson serves as administrative head of the agency. With the consent of one or more other commissioners, the chairperson may hire and fire PUC employees, prescribe their duties, and fix their compensation. HB 3615 gives the chairperson sole authority

to prescribe all PUC internal policies and procedures, employees conduct, and assignment and performance of the PUC's business.

The statutes pertaining to the PUC have always provided the Commission broad authority regarding how to organize its business. The Commission has complete authority to organize its staff and its work as it sees fit and to delegate to staff all its duties except making decisions. As with all Executive Department agencies, the PUC's budget must be approved by the Governor before being submitted to the legislature.

Currently, the Commission organizes its 120 person staff primarily around the two primary industry groups it regulates: energy utilities and telecommunications utilities. In addition, the Commission also has an Economic Research and Financial Analysis Division and an Operations Division. The Commission and its staff's primary functions across all utilities are as follows:

1. Advocacy to "represent customers in controversies" before the commission.
2. Adjudicate to decide controversies.
3. Police/Investigate to ensure utilities are obeying the law.
4. Regulate/Supervise utilities in various ways requested by statute.
5. Legislate/Rulemaking to carry out its legal mandates and adopt rules of process.

Unlike some states, Oregon has not chosen to divide its staff between advocacy and advisory functions. Instead, it has chosen to organize by areas of expertise, with staff expected to assume multiple roles as it applies it specialized expertise.

The Task Force realizes that there are tradeoffs in whatever organization structure that is chosen. The current structure enables a relatively small staff to specialize and provides a structure that is adaptable to changing conditions and a variety of decision-making processes

At the same time, the current structure does raise considerable concern about the role of staff in contested proceedings. The Task Force received many comments from both utility and consumer participants expressing similar, interrelated concerns. Because there is no bright line between staff involved in case advocacy and staff directly advising Commissioners, the Task Force concludes that, whether or not current staff roles and practices result in fair decisions, they create a very legitimate concern over the perception of fairness. The Task Force concluded that the PUC's role procedures and policies certainly should be clarified and where appropriate codified in administrative rules. Moreover, the Task Force finds that several interrelated changes in processes should be made. It should be noted that the Task Force's recommendations are directed at the PUC's regulatory model and decision-making processes, and the perceptions and potential for problems the current process presents, not the actions of the PUC or staff in any particular case.

These structural issues are discussed below.

A. Three-Member Commission

Issue: The current three-member Commission structure may be insufficient and awkward. Unlike larger boards and commissions, any two commissioners constitute a quorum for purposes of the Open Meetings Law, which places constraints on private discussions between commissioners. With the advent of increasing competition and complexity in the areas the PUC regulates, the three-member commission may be limited in its ability to respond to and foster competitive changes. In addition, in Legislative hearings, questions were raised as to whether Commissioner could serve on a part time, voluntary basis similar to many other state Boards and Commissions.

Recommendation: The current three-member commission should be retained. The current structure is working well. Expanding the commission could contribute to polarity and politicization. The majority of other states do not have five-member commissions, particularly those of the size of Oregon. The Task Force's other recommendations concerning the commission, such as those in Section II (A) and (B), address the primary concerns related to the commission structure and do not necessitate expansion of the commission.

The Task Force also strongly advise against part time Commissions. As discussed earlier, the PUC plays a critical role in overseeing industries that are critical to the health of Oregon. The work is complex and deserves full-time paid Commissioners.

B. Appointment of the Commission Chair

Issue: HB 3565 provides the Governor the authority to appoint the Commission chair, who now serves at the Governor's pleasure. This provides clearer accountability to the Governor for agency administration. On the other hand, this may give undue weight to the Chair and undue influence by the Governor in what a quasi-judicial, independent agency.

Recommendation: The Task Force is divided on the whether or not the Governor should appoint the Chair.

The legislative history of HB 3615 is instructive. The original version of HB 3615 proposed to expand the PUC from a 3-member full-time paid commission to a 5-member volunteer "lay" commission. In addition, it proposed to transfer the PUC staff to the Department of Commerce and Business Services (or to the Department of Economic Development as in proposed amendments). The final version of HB 3615 was a hybrid. First, it authorized the Governor to appoint a chairperson with increased authority but it retained the 3-member full-time Commission. And, of course, it established this task force to study the structure of the PUC.

Testimony indicated that the Governor's office wanted more state agencies to report directly to the Governor but to leave unchanged the commissioners' regulatory decision making. It is a central principle of public administration that executive agency officials who are

not elected should be accountable, answerable and responsible to the elected chief executive officer. The argument is not vacuous.

On the other hand, the PUC is a quasi-judicial agency. As such it should be independent and shielded from political interference, particularly in resolving contested cases, and in policy and rulemaking. Moreover, it is a matter of some importance that in PUC proceedings each commissioner should have an equal voice and that no commissioner wield improper power over any other commissioner.

It is noted that in some states, chairpersons of regulatory commissions do have sole administrative authority – hiring and firing staff, setting salaries, assigning office space and staff assistance to other commissioners, developing budgets, and controlling the entire management of the agency. Although each commissioner may have a putative equal vote in contested case decision making and in policy matters, a willful chairperson may exercise inappropriate influence by being able to reward those commissioners who are compliant and penalize those who are defiant.

Two mutually exclusive alternatives suggest themselves:

First, the provision of HB 3615 whereby (1) the Governor, rather than the commissioners, appoints the PUC chairperson, and (2) that chairperson becomes the chief administrative officer of the PUC should remain on the statute books and be exercised although it has not as yet been.

Alternatively, the Legislature should amend HB 3615 to reinstate the provisions of the 1986 law referred by the Legislature and adopted by the voters. Because the relevant provision of HB 3615 has never been invoked, the chairperson would continue as at present to be designated by the commissioners and all commissioners would continue to be co-equals. As far as the agency's chief administrative officer is concerned, that officer should either be designated by the commissioners as at present or, if it is deemed more appropriate, the Governor can designate that official with some provision of accountability to the commissioners as well.

C. Role of Staff; Representation of Consumer Perspective

Issue: It is not clear to some whether the PUC staff represents a "pro-consumer" point of view or a more "analytical, balanced" point of view in advancing positions at the PUC. There is also difference of opinion over what role the staff is supposed to represent under current law or should represent, as evidenced by conflicting comments from the PUC, staff, and stakeholders. The PUC's statutory duties are broad (e.g.: to "represent" and "protect" customers and the public from "unjust and unreasonable exactions and practices" and obtain "adequate service at fair and reasonable rates," and "substantial justice between customers and utilities.") In documents provided to the Task Force, the PUC described the staff's role as an "advocate" in contested proceedings, uniquely acting as "neutral analysts" and helping the commission to fulfill its statutory obligations by

acting as "neutral analysts".[23] In additional draft documents provided to the Task Force in November, the PUC further defined the staff's obligation to "balance" the various interests and not to act as an "advocate".[24] It appears to be up to the individual staff members and their supervisors to decide how to interpret this role and approach the issues in any given case. This lack of clarity creates concerns for both utility and consumer interests, since there are not clear expectations as to what position the staff will represent in any given case or issue. Moreover, unless the PUC staff clearly and consistently functions as a consumer advocate rather than taking a neutral or balanced view, there is no publicly-funded entity solely representing the interests of consumers in PUC proceedings in Oregon at the same level that utility interests are represented.

Recommendations: While differences over whether staff positions go "too far" or "not far enough" are to be expected, the Task Force concludes there is a genuine concern over the lack of clear definition of the staff's role. Furthermore, if the staff's role is defined as being a "neutral analyst", then some other entity should be funded to present a decidedly pro-consumer point of view to counter-balance the utility's case in contested proceedings.

The perspective that the PUC staff is expected to take in proceedings should be clarified and be consistent with the statutory mandates imposed on the Commission. This is especially critical in contested case proceedings, so other parties can have a better expectation as to what perspective the staff is representing. The Task Force recommends the following role for staff in contested cases.

The role and responsibility of PUC Staff witnesses in contested case proceedings is to advocate positions on issues that, in the opinion of the PUC Staff, are consistent with federal and state constitutional constraints, statutes, administrative rules, and orders governing the Commission, and to support those positions with substantial evidence.

The principal Oregon statutes PUC Staff should observe are as follows:

- The Commission shall represent the customers and the public in all controversies and all matters within the Commission's jurisdiction.

  (ORS 756.040)

- The Commission shall protect customers and the public from unjust and unreasonable exactions and practices.

  (ORS 756.040)

- The Commission shall obtain for customers and the public adequate service at fair and reasonable rates.

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[23] Report to the HB3615 Task Force, Structure of the Oregon Public Utility Commission, and PUC "Answers to the Questions for the HB 3615 PUC Task Force

[24] Draft Internal Operating and Policy Guidelines, November 6, 2000, and Contested Case Management by the Utility Program.

(ORS.756.040)

- The laws administered by the Commission shall be liberally construed in the interests of (1) the public welfare, (2) the efficient use of facilities, and (3) substantial justice between customers and utilities.

  (ORS 756.062)

Staff is also responsible for proposing new approaches or options on issues for Commission consideration consistent with these responsibilities.

Given the role of the PUC staff in Oregon, and given the resources available to regulated utilities, a program of broad intervener funding should be created to ensure that essential resources are available to those who advocate on behalf of consumer interests in PUC proceedings. The intervener funding program should be designed, funded and administered in a way that is fair, effective and cost-efficient in achieving results for all classes of customers.

For example, these are the kinds of provisions that might be considered.

- Funding could be available when the PUC determines that the intervener would or did make a contribution to the outcome of the case;
- Funding could be limited to the intervener's out-of-pocket expenses in presenting the case;
- Funding could be "charged to" the classes of customers that benefited from the intervener's participation.

D. Fulfilling Staffing Needs

Issue: The PUC has experienced some difficulty in attracting high-quality staff with expertise on utility issues to replace experienced staff lost due to retirement or promotion. The PUC has difficulty filling some positions due to a limited applicant pool with the unique skills required, and competition for those applicants from the private sector. The PUC reported that positions also tend to attract second-career applicants who may be expected to stay at the PUC for a shorter term.

Recommendation: The PUC has identified logical steps it can take to address this problem, which should continue to be pursued. These include review of salary levels, training existing staff for new responsibilities, utilizing its website for recruitment, and better emphasizing the benefits of state employment in job announcements. The Task Force also concluded that the long-term retention of staff in some positions may not be

as important in the future as it may have been in the past. Fresh thinking "outside the box" may be a distinct advantage in promoting the innovation the PUC will need to keep its regulatory models relevant to a changing marketplace. The PUC should seek authority to utilize consultants, contractors, special masters, etc., on a short-term basis, as needed, for special projects or particular cases in order to secure the needed expertise and new perspectives on regulatory issues. To the extent the PUC does not have the funding required to hire such assistance, the PUC should consider asking the utility(ies) involved in the project or case to make funds available for such purposes.

E. ROLE OF THE ALJS

Issue: Questions have been raised whether the ALJs should remain within the PUC and what the extent of their role should be. Currently, ALJs are responsible for conducting fair hearings and making independent recommendations to aid the commissioners in deciding a case. ALJs submit draft orders to the commission reflecting the ALJ's proposed resolution of the case. Although the ALJ's draft orders are expected to be legally sufficient, the commissioners also have an AAG providing legal advice to the commission concerning the order. The ALJ sometimes works with PUC staff "technical advisors" on complex cases and currently may call upon a staff member who is a case participant for assistance. This practice raises questions addressed in Sections II (C) and III (B) as well.

Recommendations:

1. The ALJs should not be separated from the PUC due to the high level of expertise and specialization required, and the value that experience adds to the decision-making process.

2. ALJs, as well as special masters, should be treated the same as commissioners for purposes of *ex parte* contacts.

CONCLUSION

The Task Force reviewed many aspects of the PUC, ranging from its overall statutory charge to its internal policies. The Task Force considered voluminous thoughtful input received from the PUC commissioners, PUC staff, consumer interest groups, regulated utilities, other service providers, and the public.

The Task Force finds that, overall, the PUC is functioning well and adapting to a changing regulatory environment. The Task Force analyzes areas of specific concern and makes recommendations that the Task Force believes are necessary to improve the PUC's regulatory model and decision-making processes. These recommendations do not represent drastic or fundamental changes to the PUC.

The Task Force concludes that the PUC continues to be needed, even with the advent of greater competition in utility services. The PUC will have new challenges to protect consumer interests while helping to foster the transition from a regulatory environment to a more competitive environment. Certainly, the PUC's role and regulatory models will need to evolve as greater competition is introduced into the utility industry. However, the Task Force believes the PUC will have a continuing role to play, albeit a different one, even if major elements of utility services are ultimately provided in a competitive market.

APPENDICES

i. Governors Charge to the Commission

ii. Task Force Request for Comments

iii. List of those submitting comments

iv. Summary of written comments

v. A Short Course in Public Utility Regulation

vi. Internal Operating Policy Guidelines

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Testimony of Brian J. Moline, Commissioner
Kansas Corporation Commission
January 9, 2001

Public utilities have existed, in one form or another, for over three hundred years. The English common law courts soon noticed that certain business enterprises–ferries, highways, toll bridges, stagecoaches–had an important effect on the public welfare. It became gradually apparent that the public interest demanded that these enterprises be obliged to serve all who applied for service, without preference and at reasonable rates. The term of art that was used was and is "affected with a public interest".

In America, the first public enterprise recognized as affected with a public interest and subject to regulation was the railroad. The railroads were termed "common carriers" and it was early established that states had the right to regulate them.

In 1877, in the landmark case of *Munn* v. *Illinois*, this notion of common carriage was extended to include grain elevators owned by Munn. The United States Supreme Court found that this particular business stood at the gateway of commerce and "took toll of all who passed"; therefore, the court reasoned, the grain elevator business was really a part of the carriage of goods in commerce and, as such, properly subject to regulation as a public utility. *Munn* was the first of a chain of U.S. Supreme Court cases that greatly extended the theory of common carriage.

As the cases developed, the courts began to pay less attention to the carriage or transportation aspects and more attention to the public interest characteristics of the enterprises. Financial services such as banking, insurance, certain health and environmental enterprises and firms delivering public utilities all fell under the rubric "affected with a public interest". Gradually, a two tier legal test began to develop to determine public utility status. First, the courts look for a special interest, inquiring what the consequence to the public would be if the particular enterprise went unregulated; second, the courts examine whether competition is present and effective as a regulatory force in the industry.

It was also determined quite early that certain utilities–such as gas, electric and water–are natural monopolies. This natural monopoly status is based upon a presumption that huge capital outlays were necessary to engage in these types of enterprises. It was believed competition in such industries would be ruinous and counterproductive. In order to induce investors to provide the capital needed to furnish these important public services, it was deemed necessary to grant exclusive franchises so that the economics of the industry would operate.

Public utilities, traditionally, are natural monopolies which are granted exclusive service areas, allowed to charge fair and reasonable rates, and allowed to impose reasonable conditions as to the terms under which services will be rendered. In return, the utilities must provide safe, adequate service to all who seek it in the service areas at fair and reasonable rates and without preference or discrimination. The duty of enforcing this delicate balance sometimes called the

Senate Utilities Committee
January 9, 2001
Attachment 3-1

"regulatory bargain" falls upon the regulatory agencies.

The Kansas Commission was one of the first state regulatory bodies in the nation: a three member Board of Railroad Commissioners was established by the Kansas Legislature in March, 1883. Most of its early activities were confined to rates and services of common carriers. In fact, the first case on record was filed by an individual on April 19, 1883, in the form of a complaint against a railroad alleging overcharges for transportation of freight which in turn produced discrimination in favor of one particular city over another.

The Railroad Commission had power and authority to regulate all steam-operated railroads, express companies, sleeping car companies and inter-company electric lines. The members were appointed by the Executive Council. Membership in the early Railroad Commissions was so prestigious that a United States Senator from Texas left the Senate to seek election to the Texas Railroad Commission.

When the populists controlled Kansas government (1892-1900), they were convinced the existing regulatory mechanism was ineffective and created a "Court of Visitation". This appointed agency attempted to combine regulatory techniques with judicial authority. The commissioners were called judges and could exercise judicial power such as contempt and confiscation of property. However, the scheme violated the constitutional doctrine of separation of powers and was declared unconstitutional by the Kansas Supreme Court and a three member Railroad Commission was restored.

As telephone service and electric energy became a part of daily life, the Legislature created a three member Public Utilities Commission in 1911 to replace the Railroad Commission. The new Commission also regulated telegraph and telephone companies, pipeline companies, water, light, heat, all power companies (except those municipally owned), mutual telephone companies and public utilities and common carriers situated and operated wholly or principally within any city. The members of this Commission were appointed.

For a brief period in 1920, the Legislature flirted with a rather curious institution called the Kansas Court of Industrial Relations. The Court of Industrial Relations combined traditional regulatory tasks with authority to arbitrate wages, hours, and other industry-labor disputes; however, there were procedural and conceptual difficulties with the idea, and after nine months experience, the Legislature abolished it and restored the Public Utilities Commission.

A successor agency was created by the 1925 Legislature: an appointed five-member Public Service Commission. Eight years later, the present regulatory body, the State Corporation Commission, was established with its jurisdiction extended to include the regulation of motor carriers. In 1933, Governor Alf Landon wanted intrastate sale of securities regulated because of the Finney bond scandal. He recommended regulation of securities be added to the Public Service Commission and the name changed to Corporation Commission to reflect the expanded jurisdiction. Gas conservation and supervision of plugging of abandoned wells to protect fresh and usable water from pollution by oil field practices were later added to Commission jurisdiction. In the late 1970s, mined land reclamation was also put under the aegis of the

Commission. In 1982, the Securities Division was severed from the Commission and made a separate regulatory agency and mined land reclamation was later transferred to the Department of Health and Environment. In 1991, the legislature removed most cooperative electric utilities from KCC regulation.

Although Kansas has had a Railroad Commission, Court of Visitation, Public Utilities Commission, Court of Industrial Relations, Public Service Commission and Corporation Commission, only one regulatory agency has been in existence at a given time.

The Kansas Corporation Commission is, like most regulatory agencies, something of a hybrid in state government. Because they combine legislative, judicial and executive powers, promulgate rules and regulations having the force of law, "adapt" the rules of evidence, administrative agencies have been a traditional source of frustration to practitioners, academics, legislators and judges.

The administrative process emerged primarily because the logical government alternatives, the legislative and judicial processes, had historically proven unwilling or unable to provide the desired degree of regulation on those private businesses "affected with a public interest". Legislative bodies soon discovered they function best when determining broad outlines and general direction of major policy. Large legislative bodies, however, are ill suited for handling masses of detail or for sifting through the often conflicting ideas of economists, engineers, accountants and other experts essential to fair and effective regulation. Gradually, legislatures developed the custom of legislating only the main outlines of programs and leaving to administrative agencies the task of working out subsidiary policies. This system facilitated not merely the promulgation of law through rules and regulations but also the correlation of rule making with such other necessary activities as adjudication, investigating, prosecuting and supervising.

Neither was the judicial branch suited to handle the type of business regulation an industrial society required. Courts are constrained by the evidence and witnesses the parties chose to present to them. Clearly courts could not investigate, supervise, fix rates, grant or deny licenses or perform any of the myriad regulatory tasks without an organization of accountants, engineers, rate specialists, economists and assorted other disciplines.

The Kansas Corporation Commission, then, exercises legislative authority delegated to it by the legislature but does so in a quasi-judicial fashion while being located in the executive branch of government.

The organic law that delegates legislative rate-making authority to the State Corporation Commission is found in chapter 66 of the *Kansas Statutes Annotated*. The regulatory power exercised by the Commission falls into three broad categories.

Licensing

Prior to doing business in this state, all public utilities and common carriers must be licensed and obtain a certificate from the Commission. The utility or common carrier must demonstrate that

the public convenience will be promoted by the transaction of such business. The statute was enacted to avoid unnecessary duplication and competition, and judicial decisions indicate that the public convenience should be the primary criteria

Rate Making
Every public utility and common carrier under the Commission's jurisdiction is mandated to establish just and reasonable rates, and every unjust, unreasonable, discriminatory or unduly preferential rate is prohibited. The utilities and common carriers must publish and file with the Commission copies of all rates, rules, regulations and contracts. Kansas law confines the utilities or common carriers to charging rates on file.

Supervision over Business Practices
The Commission has been authorized to supervise certain business practices of the utilities and common carriers. A public utility can be required to furnish accounts, reports and other information detailing such items as depreciation, salaries, legal expenses, taxes, and rentals. The Commission has the authority to examine and inspect all accounts, books, papers, records, property, and memoranda of utilities and carriers.

The state's objective with respect to regulation of public utilities and common carriers is the same as all the other state and federal regulatory bodies–to see that the public interest is served by the rendering of sufficient, non-discriminatory service at such prices as will be fair, equitable and reasonable to the customer, yet allow the enterprise such a return on investment as will be adequate. This same standard applies to the regulation of common carriers to the extent that regulation of motor and rail carriers still exists after federal deregulation and the Staggers Rail Act. In regard to the regulation of the production of oil and gas and the protection of fresh and usable water, the state objective is to conserve these precious natural resources and to protect correlative rights.

In a society committed to the general principle of free competition, the economic justification for rate regulation in certain industries has always been framed in terms of the exceptional conditions prevailing in those particular businesses. Public utilities as a class tend to exercise enormous economic power which tends to be concentrated in relatively few hands and can often lend itself to abuse. Utilities, as a group, are either enterprises that move toward monopoly or those whose highest efficiencies may be reached under monopolistic operation for a variety of reasons: such as the huge investment in plant required in proportion to current income, the operation of that plant largely at joint cost, and the consequent necessity of a large and steady volume of traffic to maintain the investment. These circumstances, under traditional regulatory theory, render complete competitive duplication of facilities improbable or impossible. If a duplicate exits, the facility is wasteful and uneconomical. New competitors are slow to enter, and old ones slow to leave an industry in which participation involves such a large economic commitment. Monopoly, once secured, tends to perpetuate itself. On the other hand, competition, if it exists at all, offers only the alternatives of combination or destructive price cutting designed to maintain volume at any cost. The historic experience with railroads and other utilities suggests the likelihood of instability and waste, high rates, ruthless price cutting, inadequate service, and price discrimination. These dangers often follow from periods of

unrestrained competition.

This traditional concept of regulation has been under critical examination for at least three decades. This examination began at the most logical and weakest assumption–the notion of limiting market entry to eliminate duplication of services. In a society generally committed to the concept of free, private, competitive enterprise, artificial barriers to entry are naturally suspect and often invalid. Also, regulatory activity that prohibits or controls price increases in goods and services during periods of substantial general price inflation can often lead to shortages in the delivery of those goods and services. Today many economists and some policy makers hold the view that economic regulation of business enterprises actually can have a negative and counterproductive result on the industry without commensurate benefits, particularly in a time of rapid technological change.

Economic regulation has usually rested on two dominant theoretical underpinnings. First, where competition is non-existent or ineffective, regulation must replace competition in the form of rate or price determination. When true competition emerges in these industries, obviously the need for price regulation recedes and may ultimately become non-existent. Many believe the proper role for regulation where true competition has entered is three-fold: (1) to monitor and encourage competition, ensuring a level playing field and controlling predatory pricing; (2) to ensure that all vestiges of artificial monopoly are ultimately dismantled; (3) allow the marketplace to set prices and quality of service while monitoring for abuses of market domination and ensuring access to service.

The second underpinning, however, is the one that is most troublesome–the concept that the public interest requires relatively equal access to services affected with a public interest which often translates to the notion that revenues from highly traveled routes or densely populated areas can and should be used to subsidize access in more sparsely populated areas.

A case can certainly be made that rural America and particularly rural Kansas has developed and prospered in no small part because of this aspect of traditional regulatory theory. Many observers have expressed concern that an inevitable consequence of deregulatory policy will be higher prices, limited access and lower quality of service to thin markets in rural areas.

On the other hand, some economic theorists and policy makers argue that this aspect of regulatory policy is actually destructive. By disguising the true costs of service, regulation promotes economic distortions and sends misleading price signals that are ultimately counterproductive. Under this theory, the long term public interest is best served by allowing market forces to work unrestrained regardless of sporadic and scattered negative consequences.

One hallmark of the last several decades has been the dramatic and often sudden economic changes that have drastically affected many of those industries we have traditionally thought of as public utilities. The areas of transportation, telecommunications, electricity, and natural gas are at various stages in moving from positions of total natural monopoly to at least a mixture of natural monopoly and competition. In some instances, particularly telecommunications, they could well move completely away from being populated by natural monopoly suppliers to a

totally competitive marketplace.

If there is one economic lesson we have all learned, it is that change, whether driven by economics, technology, or customer demand, is inexorable and unstoppable. To ignore change can be dangerous; to be unwilling to accept change can be potentially disastrous. It goes without saying that regulators and legislative policy makers can no more ignore competitive intrusions in a traditionally monopolistic industry than the industries themselves can. The presence of real and effective competitive factors can promote efficiencies and opportunities beneficial not only to the companies but to the consuming public. In that instance, it is the function of regulators to monitor developments and allow competition to flourish while maintaining vigilance that the competition is real and not illusory.

The presence of competition in those businesses historically affected with the public interest substantially changes the landscape. Once competition enters a traditional monopoly industry, the firms in that industry will experience an increase in business risks. That increase arises from the existing possibility that the firm may experience loss of business to competitors that they did not have to consider previously. Faced with an increase in business risks, the companies will attempt to adjust themselves to absorb competitive losses of revenues without experiencing impairment to their financial well being. Competition drives firms to profit maximization. Profit maximization can force avoidance of thin or less profitable markets. It is this potential consequence that most concerns policy makers of both urban and rural orientation.

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Until recently, the existing legal framework and regulatory traditions of most state agencies have remained essentially unchanged since their creation, but it should also be recognized that in many respects, regulators were mirror images of the businesses they regulated. Insulated from competition, guaranteed an opportunity to earn a profit, holding a monopoly on a basic necessity of life, many utilities became complacent and resistant to change. Today the electric, gas and telecommunications industry face a host of significant economic, technological, political and philosophical issues. Virtually all firms, to one degree or another, have developed operational, product market diversity and structural strategies to deal with the new environment.

Just as the utility industry was jolted from complacency by sudden and dramatic change, so regulators were jolted from their sedate and largely routinized existence. The same challenges that face this industry also face its regulators. Like the industries they attempt to regulate, regulators are in a transitional phase where long cherished assumptions and procedures must be tested, adapted and discarded if necessary. Some states are further along than others in adjusting regulatory techniques and procedures to new technical and economic realities.

A classic example of the evolution of a monopoly industry into the twilight between monopoly and true competition is the intra-state telecommunications business and the struggle virtually all states are experiencing in implementing the Federal Telecommunications Act which is designed to stimulate competition while retaining the traditional regulatory goal of providing affordable telephone service to all consumers regardless of costs. This effort illustrates the delicate balance of sometimes competing values involved in the process.

The cost of serving rural areas was subsidized for many years in artificially high access charges to long distance. It has been clear state and federal legislative policy for at least a decade to remove such implicit subsidies to aid in creating a genuine telecommunication free marketplace. To do so without some sort of safety net, however, would increase the cost of telecommunications to rural areas alarmingly. Thus, the Universal Service Fund was created to, among other things, make implicit subsidization explicit. Since the fund is financed by assessments on local service, the policy has also had the consequence of shifting the subsidor from those who use a lot of long distance service to those who do not.

Another example of competing, even conflicting, values is the trade off between price predictability and price fluctuation which is as current as today's headlines. California's electric deregulation plan, developed in close consultation with the state's two largest investor owned utilities, took effect on March 18, 1998. Under the scheme, utilities were required to sell at least half of their generating plants to unregulated third parties. New entrants were encouraged and allowed to compete with the traditional providers for retail customers. The price the state's power generators could charge utilities was capped at 75¢ a kilowatt hour, a price so high (as compared with an average delivered price in Kansas of 6.2¢ per kilowatt hour) that few thought the cap was anything more than a theoretical ceiling.

Even though the new competitive environment was expected to bring down electricity prices, the plan froze consumer rates until 2002 to afford the utilities an opportunity to recoup their so-called "stranded costs" - past investment in power plants under the old "regulatory bargain". Rates were frozen at what then seemed like high levels and, of course, allowed the gains from competition to be retained by the utilities to reduce their accumulated debt.

For the first 18 months the plan worked beautifully from the utilities' standpoint. The two major investor-owned utilities were able to buy low-cost wholesale electricity from generators and traders with enough margin to reduce accumulated debt.

But beginning last summer, for a variety of reasons, the new competitive environment came apart. The result for the utilities is their worst nightmare: an ever widening gap between the price they pay for electricity in an unregulated, open market and the price they can re-sell to customers because of the frozen rates, a gap that now exceeds 18 billion dollars. The consequence for retail customers: little or no benefits for the first 18 months of competition and the specter of huge rate increases (26%) to avoid utility bankruptcy and a total meltdown of electric service in the Golden state.

To summarize, I would state that there has always been a larger societal reason for the monopoly status of public utilities. The whole point of governmentally guaranteed monopoly in the public utility area was to remove competitive risk and replace it with an essentially cost plus return formula. In return, the public utility submitted itself to political decision making that tolerated, even encouraged, certain economic inefficiencies in return for the larger societal object: A regulatory imposed safety net that guaranteed access to those goods and services was deemed essential for survival at reasonable costs. As indicated earlier, technology cannot long be constrained or denied. Similarly, neither can economic realities be ignored for very long.

Competitive factors into the formerly monopolistic areas are inevitable and inexorable. Competitive factors, however, put new risk elements into a precariously balanced equation.