Approved: May 1, 2003 Carl Dean Holmes
Date

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 9:08 a.m. on March 11, 2003 in Room 526-S of the Capitol.

All members were present except: Representative Jerry Williams

Committee staff present: Mary Galligan, Legislative Research
Dennis Hodgins, Legislative Research
Mary Torrence, Revisor of Statutes
Jo Cook, Administrative Assistant

Conferees appearing before the committee:
Brian Moline, Kansas Corporation Commission

Others attending: See attached listing.

Chairman Holmes welcomed Brian Moline, Kansas Corporation Commission Commissioner, to the committee. Commissioner Moline briefed the committee on the basics of rate making as a legislative function (Attachment 1). Commissioner Moline stated that public utilities are natural monopolies that are granted exclusive service areas, allowed to charge fair and reasonable rates, and are allowed to impose reasonable conditions as to the terms under which their services will be rendered. Commissioner Moline told the committee that Kansas was one of the first state regulatory bodies in the nation and provided a brief history on the various stages. He then explained the various functions of the State Corporation Commission along with outlining the characteristics of the quasi-judicial process. Commissioner Moline shared with the committee his top ten lessons learned in his twenty years at the Corporation Commission. He did note that the top ten had turned into his top eleven. He concluded his remarks by stating that the Commission, like her sister state commissions, has been slowly, sometimes painfully, evolving into a modern regulatory entity.

Commissioner Moline responded to questions from the committee.

The meeting adjourned at 10:08 a.m.

The next meeting will be Thursday, March 13, 2003 at 9:00 a.m.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: March 11, 2003

NAME	REPRESENTING
Tom Day	KCC
J C Long	Aquila Inc.
David Springe	Curb
Steve Miller	Sunflower
Anne Spiess	KTIA
Wauneta Browne	AT&T
Brian J Nelson	KCC
Nelson Krueger	EVEREST Connections
Mark Schreiber	Westar Energy
Steve Johnson	Kansas Gas Service
Bob Sayers	SBC
Susan Mahoney	SBC
ALAN COBB	KCCT
Margie Petty	KCC
Susan Duffy	KCC
Robert E Lichtwardt	KIOGA
James Ludwig	Westar Energy
Brent Hoppock	KS Dairy Assn
Jack Glaves	Duke-KMP-A
Judy Allen	SITA

Testimony of
Brian J. Moline, Commissioner
Kansas Corporation Commission

Before the House Utilities Committee
March 11, 2003

Economic regulation of economic activity, in a society generally committed to free enterprise, has always been based on several assumptions:

(1) certain enterprises are affected with a public interest and the distribution and price of these services require public oversight

(2) that certain enterprises require huge capitol outlay and duplicative facilities would be wasteful and ruinous. In order to induce investors to provide the capital outlay necessary to enter the field, it was necessary to grant exclusive franchises for the economics to operate

This "natural monopoly" theory has been under attack from free market theorists in recent years and traditional monopolies have been deregulated to one degree or another in recent years with mixed results. Regulatory methods and techniques have been criticized as having imposed considerable cost on public utility operations with little in the way of compensating benefits.

English common law courts soon noticed that certain business enterprises 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.

As the cases developed, the courts began to pay less attention to the carriage or transportation aspects and more attention to the public interest aspects of those enterprises. Gradually, a two-tier 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 regulatory force in the industry.

Public utilities, then, are natural monopolies that 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 falls upon the regulatory agencies.

Regulation has also been attacked, especially by our good friends the economists, as being "political" and, therefore, by definition ill considered and shallow if not evil. There is a political dimension to regulation – not in the partisan, R & D sense....but in

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ATTACHMENT 1

the decisional sense. V.O. Key, the political scientist once defined politics as who gets what, when and why. Ratemaking is a classic political function in this sense and involves balancing diverse factors including geography, consumer class equity, generational equity, competitive pressures, investment climate, environmental concerns, economic development and other variables.

To be sure, regulatory decisions are more constrained than, say legislative and city council proceedings. For one thing, regulatory decision-making is a quasi-judicial process and, in the end, is a unique and sometimes confusing blend of law, politics, economics, accounting, engineering and public policy.

One of the Great Myths of Modern America, underlying both the original decision to create economic regulation and the more recent decision to de-regulate…is that business organizations embrace competition and cannot wait to begin mixing it up and engage in price wars to the benefit of consumers. It has been my experience that business organizations hate competition and will go to almost any length to dominate markets and maximize profit…how else to explain the inevitable rush to merge with, acquire or drive out of business any entity that remotely threatens market share that so characterizes business activity today.

A number of economists have written about the pros and cons of economic regulation. Arthur Okun-Equality v Efficiency – the Great Tradeoff – neatly capsulizes the conundrum. Much of the politics, and hence, controversy of regulatory decisions lies in trying to determine the proper balance between these two enduring, often conflicting, societal values – Equality and Efficiency.

Efficiency, in the economic sense, lies when resources are being put to their most productive use. In the economic sense, efficiency is achieved when resources and services are commanding the highest price that supply and demand will generate without "political" interference in the transaction. Unfortunately, pure economic efficiency often results in harsh and politically unacceptable results.

Equality, in this context, encompasses the notion of government rules and regulations to moderate the more harsh outcomes of unrestricted efficiency in terms of price, availability, distribution and quality of service. However, wholly political decisions can result in economic distortions, in some cases, unforeseen and even counterproductive distortions. What is required, of course, is balance…sometimes exquisite balance…of all the variables.

Complicating things even further has been the internationalization of finance and capital flight. Utility investment traditionally provided a limited but virtually guaranteed return that provided a secure if unglamorous investment. For a variety of reasons, investors are becoming more and more reluctant to invest in fixed return at jut the time when capital is needed to upgrade aging transmission facilities and necessary additional generating capacity – higher return, of course, means higher consumer prices – hence, the conundrum.

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The Kansas Corporation Commission (KCC) is, like most regulatory agencies, something of a hybrid. They seem to combine legislative, judicial and executive powers and have been a traditional source of frustration to practitioners, academics, legislators and judges.

The administrative process emerged primarily because the logical governmental alternatives, the legislative and judicial processes, had historically proven unable or unwilling to provide the desired degree of regulation on those private businesses infected with a public interest. Legislatures particularly ill-suited for handling masses of detail or for sifting the often conflicting ideas presented by scientists or other professional advisors. 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.

Neither was the judicial branch particularly well suited to handle the type of business regulation an industrial society required. 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.

When Congress approached the difficult task of establishing a federal regulatory commission in 1887, it had before it the diversified experience of more than twenty states, which were experimenting with similar commissions. Fourteen states had created an advisory commission having no ratemaking or disciplinary power as opposed to "strong" commission, an agency having legal authority to fix rates and enforce orders. Ten states created "strong" commissions with actual rate making power – Kansas…originated in the Middle West, where population patterns had led to serious overdevelopment of the railroad system. Railroad lines penetrated into areas that could not possibly support them and collapse seemed inevitable. To relieve these financial pressures, railroads resorted to cutthroat rates where competition existed and exorbitant rates where it did not.

Resentment of the farmer-shippers gave birth….unique grass roots political movement…correction….railroad abuses to which the farmer fell victim.

Kansas 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. Members were elected by popular vote. 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 – Court of Visitation – Populist domination.

As telephone serve 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…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. Members 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.

Successor created by 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, intrastate sale of speculative securities, and oil proration. Gas conservation and supervision of plugging of abandoned wells…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.

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.

Organic law…chapter 66…regulatory power….falls into three board 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…must demonstrate that the public convenience will be promoted….enacted to avoid unnecessary duplication and competition.

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.

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Supervision over Business Practices

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.

State's objective.....the same as all the other state 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.

In the exercise of its rate setting function, Commission exercises legislative authority but does so in a quasi-judicial fashion. Ratemaking is very similar to lawmaking but some major differences:

(1) only 3 of us.
(2) not up or down, yes or no votes – must be reasoned decisions based on the evidence.
(3) decision has to be made in open meeting – commissioners cannot discuss case among each other.

Characteristics of Quasi-judicial Process

- All witnesses are expert witnesses in the various specialties and disciplines
- All testimony is written and pre-filed. Hearings are almost completely cross-examination – rules of evidence
- By statute, all rate cases must be decided no later than 240 days
- Multiple parties – used to be just company and staff...now routine to have many parties – CURB, Industrials, Cities (rate design issues)
- Public hearings
- Ex parte communication

At the conclusion of the hearing, the Commission allows time as a rule for simultaneous filing of post-hearing briefs and often for simultaneous filing of reply briefs. Then each commissioner must begin the process of reviewing the pre-filed testimony, transcript and briefs to decide the issues.

KOMA requires that no two commissioners can discuss any facet of the case outside the Open and Publicized meeting requirements of KOMA. Major and controversial cases are discussed in a scheduled and publicized Administrative meeting. Minor cases are often decided on a notational voting basis. Advisory staff will meet with each commissioner independently to determine their thoughts

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on the issues and, on that basis, draft and circulate a consensus Order. Any commissioner, of course, can and often does request a meeting if the draft order does not meet with their approval. Properly done, the AG has approved notational voting as consistent with KOMA.

The final Order, often many pages, is drafted initially by Advisory Staff but usually extensively edited by commissioners before release.

Because of the technical nature of Commission Orders, KAPA requires parties to file a Motion for Reconsideration prior to filing for judicial review. This is to allow the Commission an opportunity both to correct any minor errors in the Order and to allow parties to refine appeal points. Parties may not raise on appeal any alleged error they have not request reconsideration.

Lesson learned in 20 years at KCC

(1) Hindsight is always perfect but must be avoided. The nature of regulation is to review business decisions years after they are made. It requires exquisite balance to review decisions, particularly those that turned out wrong not in light of what is known now but what was known then.

(2) Be respectful of the political process.

(3) Don't be too respectful of the political process. There are reasons regulation is isolated from the normal political processes. Legislative demands are often made on inadequate or incomplete information – don't over react.

(4) Have an agenda – consult it regularly – routine work invariably proliferates and crowds out creativity and vision. Try to stick to the Agenda – however late.

(5) Make necessary decisions – often no decision is worse than a bad decision that can at least be appealed.

(6) Be a good listener – problem with lawyers.

(7) Communicate – with everyone – while ex parte considerations inhibit communication during a case there is plenty of opportunity outside ex parte confines – keep communication lines open with everybody.

(8) Recognize the importance of the media – remember that most of the elected officials and all of the public will form their impressions from media accounts.

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(9) Remember – first thing you learn in law school – there is no right answer…there is only the best answer you can determine within the constraints of the proceeding and the information you have access to.

(10) Legislature gave you great discretion – use it – but use it wisely.

(11) In the end, so much of what I do as a commissioner really depends on value judgments…remember the Equality v Efficiency debate…there are so many gray areas that each commissioner has to find their own particular balance of pragmatism and idealism (just like you) in the hope that, collectively, the right decision will be made.

CONCLUSION

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, the regulators were mirror images o 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 gradually became complacent and collectively resistant to load management, customer relations, and other symbols of change.

Beginning in the late sixties, a series of events sent shock waves through the gas, electric, and telecommunications industries. The emergence of OPEC, steady annual inflation reaching double digits, rapid technological breakthroughs in power generation, transmission and distribution all combined to ensure that the utility business would never be quite the same again.

Many companies began to develop operational, product market diversification and structural strategies to deal with the new environment. Today, the industry faces a host of significant economic, technological, political, and philosophical issues. The conflicting requirements imposed by the utilities' constituent publics, such as ratepayer demands for inexpensive energy and investor demands for adequate rates of return, are becoming increasingly difficult to rationalize and manage.

Just as the utility industry was jolted from complacency by the events of the sixties and seventies, so the regulators were jolted from their sedate and largely routinized existence. The same challenges that face the industry also face the regulators. Like the industries they attempt to regulate, regulators are in a transitional phase in which long cherished assumptions and shibboleths must be tested, adapted, and discarded if necessary.

The Kansas Corporation Commission, like her sister state commissions, has been slowly, sometimes painfully, evolving into a modern regulatory entity. As recently as twenty years ago, Commission staff had little technical and

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professional expertise; the legal staff worked part time, and there was no organized research and development. Over the past twenty years, many improvements have been made: attorney positions are full time with no outside practice allowed; professional staff expertise in engineering, accounting, economics, and rate specialists have been added; and a research and planning arm has been created and is functioning well.

I have attempted to illustrate how the state Corporation Commission is organized and how regulatory decisions are reached. The commissioners are required by law to provide the regulated enterprise with rates sufficient to earn a fair and reasonable return. The quasi-judicial process by which decisions are reached places clear and reasonable limits on the discretion of the commissioners: they cannot be arbitrary and capricious; they must listen to the evidence before them and judge the credibility of the witnesses; and they must review voluminous compilations of data and exhibits and collectively reach a fair decision based on substantial and competent evidence.

Within these limitations, however, the regulatory scheme grants wide discretion to the commissioners to determine where the public interest lies in public utility matters, and this determination of the public interest is heavily influenced by the backgrounds, experiences, and personal values of the individuals who are appointed to the Commission.