BEFORE THE SENATE COMMITTEE ON UTILITIES

Presentation Of The Kansas Corporation Commission On SB 360

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Mr. Chairman and members of the Committee, thank you for the opportunity to speak on SB 360. The KCC is opposed to this bill for numerous reasons. It would allow gas and electric utilities to propose a rate increase without going through a rate case to determine their overall earnings levels. The surcharge allowed by the bill would reflect the revenue requirements associated only with an increase in investment from one chosen year to the next.

Such a surcharge would represent "single issue ratemaking," which is generally considered unreasonable. The determination of reasonable utility rates requires a review of the total costs of providing services and not just the amount of investment or rate base. Isolating only increases in rate base doesn't allow for potential offsetting changes in operating expenses, rate of return, revenues or other components of cost of service. Consequently, "single issue ratemaking" may result in over-earnings by the utility through unreasonably high rates.

It may be argued that this bill is needed so that utilities can recover significant increases in investment without the delay of a rate case. However, even disregarding the single issue ratemaking concerns and assuming that a rate increase is truly warranted, this bill would be bad policy.

First, there are some beneficial aspects to the "lag" inherent in the regulatory process. One longstanding criticism of rate of return regulation is that it tends to create an incentive for utilities to over-invest in facilities in order to increase the amount of rate base on which a return is earned. "Regulatory lag" may help to counter that incentive and encourage efficient and prudent investments and operations. In general terms, the regulatory process provides some incentives to monopoly utilities similar to those in a competitive marketplace. Because a competitive business doesn't have assurance if or when its increased investments will be recovered in increased prices, it has incentives to invest and operate efficiently and increase prices only as necessary. This bill would give utilities some assurance of recovering investments costs through increased rates from their monopoly customers and consequently diminish their

incentive to act prudently and efficiently.

Second, we read this bill as providing the Commission with discretion to allow the surcharges for increased investment rather than mandating such surcharges. In contrast to the existing subsection (f) of K.S.A 66-117, dealing with surcharges for increases in ad valorem taxes, there is no language in the proposed new subsection (g) that requires the KCC to approve the new investment surcharge when certain conditions are met. Since the Commission already has the discretion to allow such a surcharge, this bill is unnecessary. For the reasons I have mentioned, the Commission does not generally favor addressing increases in a single cost component outside of a general rate case. However, there are existing mechanisms by which utilities can address perceived inadequate recovery of costs in extraordinary circumstance.

For a significant increase in investment, the costs that a utility will not recover until the next rate case are the annual depreciation expense, the return (or carrying costs) on the additional rate base and any increase in associated taxes. If the utility believes that those are significant costs that would not otherwise be recovered, it can request an accounting order that allows it to accumulate those costs for potential recovery in the next rate case. In addition, it could request approval for a surcharge to begin recovery of costs before the conclusion of a rate case. The Commission approved of such an accounting order and a temporary surcharge for KPL in 1991 in connection with a major gas service line replacement project. Although the Commission denied the company's request for a continuing surcharge, it did depart from standard ratemaking practices in allowing recovery of the major investment. The point is that the Commission already has discretion to address special circumstances involving significant increases in utility investments.

If the bill is considered despite concerns about single issue ratemaking and if the bill is intended to mandate KCC allowance of investment surcharges, we would point out several areas where the bill should be improved or clarified. I would emphasize, however, that we are opposed to this bill even if these improvements were made.

1. If the company invokes this bill to institute a surcharge for increased investment, the Commission should have the ability thereafter to require rate reductions to reflect net decrease in rate base in subsequent years.
2. The Commission should have the ability to determine whether the new investment is

"used and required to be used" pursuant to K.S.A.66-128. Although this bill does not appear to conflict with that statutory responsibility, some might attempt to argue that this specific bill overrides that general statute.

3. Under Subsection (g)(3), the costs recoverable under the surcharge include "revenue related taxes." To be fair, the calculation of the surcharge should also include the effects of any additional revenues.
4. The "annual earning monitoring report" referenced in (g)(4)&(5) is apparently intended as a red flag mechanism to reveal when a company might be earning more than .75% above the return established in the latest effective rates. However, the bill does not specify that the earnings report should be calculated using the same adjustments, methods and principles as adopted in the last rate case. Therefore, the earnings report has little usefulness. I should also note that determining the return used in establishing current rates may be problematic since many rate cases are settled without establishing a return.
5. Under (g)(5), there is no guidance for what occurs if the earnings report does show earnings above the .75% level and the company files a statement on why the rates are not unreasonable or in violation of law. As noted above, this bill departs from the standard practice of determining reasonableness of rates in comprehensive rate case. Consequently, it is unknown what reasonableness standard should apply. The .75% figure should simply be a limit on any surcharge.
6. Also, with regard to the earning report, the last sentence of (g)(4) requires some adjustment to "reflect allocations among customer classes." We can't determine the purpose or effect of that sentence.
7. Subsection (g)(6) is apparently intended as a safeguard in requiring a rate case after the fifth anniversary of a surcharge. However, that rate case would relate only to the investment surcharge and thus does not consider revenues, operating expenses, rate of return or other components of cost of service. To provide a meaningful safeguard against utility abuse of this bill and unwarranted rate increases, the rate case should be a comprehensive rate case and the surcharges should be subject to refund based on the results of the rate case. (I should note that even a comprehensive rate case would not be

precise in determining whether the surcharges were reasonable for the entire five year period unless it examined the costs of service throughout the entire five years.)

Again, thank you for the opportunity to comment on this bill. I will be glad to answer any questions that the Committee may have.