Overview of the Role and Jurisdiction of the KCC

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Kansas Corporation Commission

Structure and Organization

- The Commission consists of three members appointed by the Governor to overlapping four-year terms. Current Commissioners are Dwight D. Keen, Susan K. Duffy, and Andrew J. French. No more than two members may be of the same political party.
- The Commission has five main divisions: Administration, Conservation, Utilities, Transportation, and Energy.

Division Overview

- **<u>Administration Division</u>:** Includes the Office of the Commission and various supporting functions. These are 1) litigation; 2) general counsel; 3) public affairs and consumer protection; 4) human resources; 5) information technology; 6) docket management; and 7) fiscal management and support services.

- **<u>Conservation Division</u>:** Regulates oil and natural gas production. The Conservation Division's main office is located in Wichita with District Offices in Chanute, Dodge City, Hays and Wichita. Its mission is to protect correlative rights and environmental resources with effective regulatory oversight.

Division Overview – *Continued*

- **Energy Division:** Mission s to promote energy conservation and efficiency in Kansas and to serve as a clearinghouse for information on alternative energy and other energy topics. In support of this mission, the Energy Division administers programs, promotes public education through outreach activities, coordinates government and private sector activities, and provides objective and up-to-date information on energy-related topics. It is also authorized to accept federal funds on behalf of the State of Kansas. The authority of the Kansas Corporation Commission is derived from K.S.A. 74-601 to 74-631.

- **Transportation Division:** Mission is to ensure appropriate and effective regulatory oversight of motor carriers with the goal of protecting the public interest and promoting safety through comprehensive planning, licensing, education, and inspection. This includes licensing, auditing, inspections, and other administrative procedures that promote efficient motor carrier operations, while balancing the public interest and safety, and minimizing the administrative burden to the extent possible.

Division Overview *– Continued*

- **Utilities Division:** Mission is to establish and regulate rates for public utilities, including electricity, natural gas, liquid pipeline, and telecommunications. The Division also houses the pipeline safety program, and administers the Kansas Universal Service Fund (KUSF) through a third party administrator pursuant to K.S.A. 66-2008-2010.

- **What is Not Regulated**: The KCC does not regulate most electric cooperatives, water cooperatives, municipalities, wireless telephones, long distance service, cable companies, or the Internet.

Utilities Division Overview

Kansas
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Organization of the Utilities Division

There are four sections within the Utilities Division. The sections are:

- Accounting & Financial Analysis (current staff size -12);
- Economics & Rates (current staff size – 2);
- Energy Operations & Safety (current staff size – 12);
- Telecommunications (current staff size – 5).

Utilities Division Workload

- Utilities Division works on approximately 600 to 700 dockets a year
- Participate in numerous Southwest Power Pool work groups and task forces
- Provide Commissioners with informal information and advice, written memos, report and recommendations, pre-filed and live testimony
- Assists legal and advisory in drafting pleadings, orders, etc.
- Provides technical support for informal complaints to the Commission's Public Affairs and Consumer Protection Division
- Ensures compliance with natural gas pipeline, One Call, and electric safety requirements
- Provide assistance to governor's office, legislature, and other entities
- Participate in or attend various meetings, conferences, workshops, etc. (SPP, NARUC, FERC, FCC, PHMSA, NAPSR)

Accounting & Finance Section Responsibilities

- Rate Cases
  - Revenue Requirement
  - Class Cost of Service
  - Tariffs
- Mergers and Acquisitions / Financial Transactions
- Financial Investigations / General Investigations
- Southwest Power Pool work group
- Integrated Resource Program Review
- Hedging and Gas Purchasing Programs
- Review of Surcharges / Automatic Adjustment Clauses
- Annual Reports / Annual Reviews
- Kansas Universal Service Fund Audits

Economics and Rates Section Responsibilities

- Weather Normalization: Eliminate weather effects on revenue
- Benefit Cost Analysis: Measure economic value
- Load Forecasting: Forecast utility customer energy usage
- Integrated Resource Program Review
- Rate Cases: Rate design

Energy Operations Section Responsibilities

- Transmission Line Siting
- Southwest Power Pool work group
- Wire stringing applications
- Certificate work
  - Certificated territory exchanges,
  - Transmission Rights Only certficates,
  - Certification of new utilities
  - GIS mapping
- Generation Survey (comparing load against generation)
- Emergency Management Planning
- Cyber Security

Pipeline Safety Responsibilities

- Compliance Oversight for Intrastate Natural Gas Pipelines.
  - 120 Operators; 37,600 miles of pipelines.
  - Construction, Operations and Maintenance Emergency Response.
  - Incident Investigation.
  - Customer complaints & inquiries.

- Compliance Oversight for Underground Utility Damage Prevention.
  - 1,200 utility operators (pipeline, electric, telecommunications).
  - 17,000 professional excavators.
  - 685,000 excavation requests per year.

Telecommunications Section Responsibilities

- Universal Service / Kansas Universal Service Fund
- General Investigations
- Interconnection Agreements / Arbitrations
- Carrier Disputes
- Certificates of Convenience
- Eligible Telecommunications Carriers
- Complaints
- Tariff Filings
- Annual Reports
- Video Service Authorizations

Current Major Issues

- Peer comparisons of electric rates in Kansas – Significant improvement from 2018 to 2021
- High Natural Gas Prices
  - Major factor in driving rate increases across the country
  - Electric utilities with a heavy weighting of natural gas generation have seen large rate increases
- Generation Resource Adequacy
  - Reserve margins are getting tighter due increasing variable supply (renewable resources), retirements of dispatchable generation (coal, gas, and nuclear) and extreme weather events
  - Southwest Power Pool has increased reserve margin requirements from 12% to 15% and moved to a performance based accreditation methodology for all types of generation
  - KCC will be holding a series of work study sessions to gain additional insight into generation resource issues
- Inflation and Supply Chain Issues
  - Current inflationary pressures increase the costs for capital and O&M during a construction cycle
  - Increased capital, labor, and O&M costs drive more frequent rate cases
  - Supply chain shortages also increase the prices of utility input costs and can slow the pace of construction

Current Major Issues

- Continuing need for construction cycle
  - Continuing transition to renewable generation (Wind, Solar) also creates need for resources to address variability such as Natural Gas and Energy Storage;
  - Transmission – both new to support additional renewable generation and replacement of aging facilities;
  - Distribution System –replacement of aging facilities and need to develop more resilient and hardened grid;
  - Integration of new energy storage for transmission services;
  - Aging natural gas infrastructure
- Combination of Utilities Division retirements, private sector retirements, and lagging salaries are leading to retention concerns.
  - It takes approximately 24-36 months to train new employees.
  - Difficult to recruit.
  - New hires can be difficult to retain.

Jurisdictional Utilities

- Electric
  - Evergy
  - Liberty/Empire
  - Southern Pioneer
- Natural Gas
  - Atmos Energy
  - Black Hills
  - Kansas Gas Service
  - Amarillo Natural Gas
  - American Energies Gas Service
  - City of Eskridge
  - Texas, Kansas, Oklahoma Gas
- Water
  - Barton Hills Water District
  - Green Acres Mobil Home Park
  - Suburban Water Company
  - Towns Riverview

Jurisdiction

- Jurisdiction for Utilities Division is primarily found in Chapter 66 statutes.
- For a broad overview of jurisdictional and legal authority, see provided attachment from Staff's December, 2018, Rate Study of Kansas City Power & Light and Westar Energy for the years 2008 to 2018, pages 9-17.

Questions?

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Kansas Corporation Commission

I. The Regulatory Compact

A. The Utility-Regulator Relationship

In the broadest context, the regulatory compact is a summary of the intent of the legal framework that establishes the relationship between a public utility and a regulatory body. This legal framework includes all of the statutory provisions, case law, rules and regulations, and Commission policies under which a utility is regulated.

SNL Financial and Regulatory Research Associates (SNL and RRA) have provided a concise and accurate description of the regulatory compact as follows:[1]

> The regulatory compact is an agreement codified by statute and case law that is unique to the utility space and calls for: the utility to provide safe, reliable and reasonably priced service; the commission to provide the utility with a reasonable opportunity to recover its costs and earn a return similar to that of other investments that have similar risk characteristics; the customer to pay the approved rates; and, the investor to supply the capital necessary to maintain or expand the utility system.[2]

SNL and RRA further explained the rational underlying the regulatory compact as follows:

> The utility sector is unlike any other sector of the economy. In a competitive industry, customers have numerous purchasing options. In the automotive or consumer products industry, customers can select from the product offerings of many different providers, and product quality and price have considerable influence on consumer purchasing decisions. If a seller's prices are too high or the quality of the product does not meet the customer's standards, the customer can select the wares offered by another seller. Prices in competitive industries are set by supply and demand in the marketplace.
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> Utilities, on the other hand, cannot simply set up shop wherever they choose. Utilities are natural monopolies because their capital costs are enormous. Monopolies, by definition, also have high barriers to entry. However, a company with monopoly power cannot be allowed to operate without oversight. If they could, the price of the company's product could be exorbitant. Hence, the state utility commissions were created to regulate the rates charged by the utilities and together

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[1] SNL and RRA are two leading utility research and analysis firms that combined in 2005. Combined, SNL/RRA provide subscription-based expert analysis through commentary, articles, and research papers on various news events as well as critical regulatory issues to investment banks, investors, utilities, and government agencies.

[2] RRA Regulatory Focus, The rate case process: a conduit to enlightenment, p.1. (July 3, 2018). (RRA, The rate case process).

> with the utilities themselves, investors and customers, comprise [the regulatory compact].[3]

B. Management Discretion

The need for a utility's management to use its discretion to make important business decisions is a critical component of understanding the relationship between a utility and its economic regulator. In Kansas, a utility is charged with a critically important responsibility to provide efficient and sufficient service at just and reasonable rates. It is therefore important that a utility's management is free to make business decisions as to how to meet its statutorily charged responsibility, while still being held accountable for its decisions by its economic regulator. This relationship has been defined as follows:

> It is, at best, an oversimplification that a just and reasonable rate is a question of sound business judgement. Regulatory agencies have only limited authority to interfere with discretionary power of utility management over legitimately internal affairs of a company subject to economic regulation. An agency is not a "super board of directors" for the regulated company.[4]
>
> Regulatory agencies do not have the responsibility to manage any company; their function is solely to regulate their activities in accordance with statutory standards and regulatory policy. An agency, therefore, does not order a company to acquire specific resources, but it may order that the company consider specific standards in formulating an integrated resource plan and that it submit such plan for commission review.[5]

While the definition and regulatory theory described above may seem to indicate that utility management is free to make its business decisions with little recourse, utility management is also keenly aware that its economic regulator will review its decisions after the fact and can disallow costs incurred by the utility. However, any cost disallowance by an economic regulator must be based on evidence, case specific facts, statutory guidelines, or prior precedent. For example, the *Process of Ratemaking* states the following:

> An agency will not defer to the utility's knowledge of the market, such as the market for gas supplies. "General knowledge and experience in the gas industry is insufficient, without more, to demonstrate the reasonableness of a utility's gas purchasing decision-making," whether the utility deals with affiliated or unaffiliated companies.[6]

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[3] RRA, The rate case process, p. 1.
[4] Leonard Saul Goodman, *The Process of Ratemaking*, p. 132. Internal cites omitted. (Public Utility Reports, Inc., 1998). (Goodman, *The Process of Ratemaking*).
[5] Goodman, *The Process of Ratemaking,* pp. 134. Internal cites omitted.
[6] Goodman, *The Process of Ratemaking,* pp. 134. Internal cites omitted.

In other words, a utility's management cannot rely solely on its business judgement as the singular source of evidence that its decision will result in a just and reasonable rate. Rather, the utility's management must provide sufficient evidence through its documentation and analysis that the business decision will result in a just and reasonable rate.

C. Reasonable Management Presumed

K.S.A. 66-101b requires a utility to provide "efficient" service. In doing so, reasonable management is presumed on the part of the utility unless specific findings of inefficient management can be documented. *The Process of Ratemaking* states:

> Unless there is direct evidence of mismanagement, regulatory agencies will presume that management has properly performed its duties. The presumption can be overturned with evidence of extravagance or of needless expenditures of money, waste, or enormous salaries. Actual cost may far exceed present value of the properties used and useful in the public service; or the company may simply have been unwisely built, in localities where there is insufficient business. In the absence of any satisfactory showing along one of these or similar lines, the company's evidence, that over a reasonable period earnings above operating expenses have been insufficient to pay capital charges on money invested in the enterprise, will sustain a finding that forced rate reductions are unjust and unreasonable.[7] [Internal cites omitted.]

However, a utility does have the burden to provide documentation through reports or other information that demonstrate its efficient operations.

The legal framework that encompasses the statutory provisions, case law, rules and regulations, and policies for Kansas' utilities in a rate setting context is addressed in more detail in the next section of this study.

II. Statutory Provisions, Case Law, and Policy Decisions

There are a large number of Kansas statutes, relevant case law, rules and regulations, and Commission precedential and policy decisions that encompass the legal framework under which the Commission's jurisdictional electric utilities are regulated. This study will not summarize or define each one. Rather, this section will attempt to reference and explain the most relevant statutes, case law, and Commission policies that affect the manner in which the Commission is legally required to establish rates.

[7] Goodman, *The Process of Ratemaking,* p. 840.

A. Statutory Provisions

As noted in the discussion of the Regulatory Compact above, "The regulatory compact is an agreement codified by statute and case law that is unique to the utility space *and calls for the utility to provide safe, reliable and reasonably priced service; the commission to provide the utility with a reasonable opportunity to recover its costs and earn a return similar to that of other investments that have similar risk characteristics; the customer to pay the approved rates; and, the investor to supply the capital necessary to maintain or expand the utility system.*" [Emphasis added.] Another way to state the Regulatory Compact's requirement to provide "safe, reliable and reasonably priced service" is to say that a Kansas utility is required to provide "efficient and sufficient service" and to establish "just and reasonable rates". In Kansas, the utility is mandated to provide efficient and sufficient service and establish just and reasonable rates and the Commission is mandated to require such per K.S.A. 66-101b, which states:

> **66-101b. Electric public utilities; efficient and sufficient service; just and reasonable rates.** *Every electric public utility governed by this act shall be required to furnish reasonably efficient and sufficient service* and facilities for the use of any and all products or services rendered, furnished, supplied or produced by such electric public utility, *to establish just and reasonable rates*, charges and exactions and to make just and reasonable rules, classifications and regulations. Every unjust or unreasonably discriminatory or unduly preferential rule, regulation, classification, rate, charge or exaction is prohibited and is unlawful and void. *The commission shall have the power*, after notice and hearing in accordance with the provisions of the Kansas administrative procedure act, *to require all electric public utilities governed by this act to establish and maintain just and reasonable rates when the same are reasonably necessary in order to maintain reasonably sufficient and efficient service from such electric public utilities*. [Emphasis added.]

In establishing just and reasonable rates, the courts have mandated the Commission consider certain interests. These include the following:

> The Kansas Supreme Court mandates the Commission consider and balance *the interests of the utility's investors vs. the ratepayers, the present ratepayers vs. the future ratepayers, and the public interest*. "[C]ases in this area clearly indicate that the goal should be a rate fixed within the zone of reasonableness after the application of a balancing test in which *the interests of all concerned parties are considered*." [Emphasis added] [8]
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> "The KCC is required to *balance* the public need for adequate, efficient, and reasonable service with the public utility's need for sufficient revenue to meet the cost of furnishing service and to earn a reasonable profit." [15-115 Order at ¶ 71, citing Danisco Ingredients USA, Inc. v. Kansas City Power & Light Co., 267 Kan.

[8] Order Approving Stipulation and Agreement, Docket No. 15-WSEE-115-RTS (September 24, 2015) (15-115 Order) at ¶ 71 citing Kansas Gas and Elec. Co. v. State Corp. Com 'n, 239 Kan. 488 (1986).

> 760, 773 (1999)]. [Emphasis added].

There is also a constitutional basis for the just and reasonable standard. If the Commission were to set rates that specifically favor customers over investors by ignoring legitimate utility costs and investments, then the Commission will most likely have violated the Takings Clause of the Fifth Amendment as well as the Due Process Clause of the Fourteenth Amendment. The *Process of Ratemaking* describes this issue as follows:

> The Fifth Amendment provides that, "No person shall…be deprived of…property, without due process of law; nor shall private property be taken for public uses without just compensation." The Fourteenth Amendment provides that "No State …shall deprive any person of…property, without due process of law…"
>
> A just and reasonable rate is a constitutional rate, but, as we shall see, a rate need not pass every just and reasonable test, which indeed may vary from state to state, to pass muster as a constitutional rate.
>
> The judiciary at first attempted to formulate their own threshold test for a constitutionally approved rate of a regulated company. The experiment was eventually abandoned in deference to the emerging just and reasonable standard already applicable to those companies.[9]

i. Balancing of Interests

As noted previously, the Commission is charged with a balancing test in which the interests of all concerned parties are considered when setting rates. However, achieving a balanced approach to setting rates does not mean that the Commission must always adopt the midpoint of a particular issue in dispute when setting rates. The appropriate approach is described in the *Process of Ratemaking* as follows:

> An agency that is satisfied that opposing views are both well supported in the record may adopt the midpoint between the parties' positions as a reasonable resolution of the matter. A reviewing court well may be satisfied that the agency reached its decision by exercising a judgement to "split the difference" between opposing views.[10]
>
> There is a limit to an agency's resolving issues by striking a middle ground between opposing views. An exercise of discretion and judgement does not necessarily produce only a middle ground position between opposing views. An agency may indeed need to reject outright positions outrageously stated or unfounded in logic or the evidence. In such cases, it should substitute reasoned analysis of the issues, even when there are a seeming multitude of issues to be resolved.[11]

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[9] Goodman, *The Process of Ratemaking,* p. 24
[10] Goodman, *The Process of Ratemaking,* p. 128
[11] Goodman, *The Process of Ratemaking,* p. 128.

> …[If] an agency constantly assumes that it will attain a proper balance between opposing interests by striking a middle ground, it will merely encourage the parties before it to stake out outrageous positions. Each party will but reasonably assume than it will fare much better in such "balance," if it asks for far more that it should reasonably expect to obtain, and "on balance" still receives more than it might otherwise obtain by more discrete evidence.[12]
>
> The proper balance of interests may require, not the automatic acceptance of a middle ground, but rather, a) a full understanding and analysis of each party's position; and b) if necessary to reach a fair result, the full acceptance of a party's position on a given issue.[13]

In order to reach a balanced decision, the Commission typically accepts (or adopts) one party's position on a given issue after hearing all sides and weighing the evidence. The Commission rarely "splits the difference" and, when it does, it is generally because equal evidentiary weight can be given the opposing parties positions. Staff also notes that it is our role to balance the interests of the ratepayer with the interest of the shareholder in addressing every case before the Commission. Staff's role is required because all parties[14] to a rate case, or any other type of case, are advocating for their specific interests and are therefore not attempting to balance the interests of the ratepayer and the shareholder. Staff's role is unique to the rate setting process and requires a careful and diligent approach in developing positions that strike an appropriate balance.

ii. Public Interest Standard

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B. Case Law

The term "case law" refers to law that comes from previous decisions made by courts in previous cases. Case law provides a common contextual background for certain legal concepts, and how they are applied in certain types of cases.

Statutory laws are created by legislative bodies, such as the Kansas Legislature. While statutory laws provide rules and guidelines, it is impossible for any legislative body to anticipate all situations and legal issues. The court system is charged with interpreting the law when it is unclear or in dispute as to a case-specific issue. The courts decide cases based on the applicable law, precedent, and the fact-specific circumstances of the case at hand. These court decisions become a precedent for future cases with similar facts.

Case law is also specific to the jurisdiction in which the decision is made. Generally, case law from a different jurisdiction, such as a different state, it is not enforceable in Kansas. However,

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[12] Goodman, *The Process of Ratemaking,* p. 129.
[13] Goodman, *The Process of Ratemaking,* p. 129.
[14] "Parties" are discussed in more detail in Section IV., but generally consist of the utility and intervening parties such as industrial customers.

if there is no precedent in Kansas, the relevant case law from another state may be used as persuasive authority in Kansas.

Because of the complexity of the issues that arise in utility matters, Staff researches case law from other states in order to gain an insight into the rationale used to decide certain issues. Of course, case law from Kansas generally requires Staff to follow the guidelines stemming from the court's decision in a case.

C. Commission Precedential Orders and Policy Decisions

The Commission designates precedential orders as such. The Commission's website lists its precedential orders and states the following:

> Precedential orders may bind parties, establish policies, or interpret statutes or regulations in a way that applies against a person or company that was not a party to the original order. The KCC cannot treat an order as precedential unless the agency designates the order as precedential and makes the order available to the public…

On the other hand, policy decisions generally are guidelines established by the Commission through an order for a certain issue or issues. While Commission policies may not be binding on parties in the same manner as a precedential order, any party that wishes to take an approach contrary to a Commission policy will have to make a compelling argument that the facts and circumstances specific to their issue(s) warrant a different approach.

The rationale behind establishing Commission precedent and policy has been described as follows:

> The administrative agencies, like the courts, cite and rely on their prior decisions to maintain consistency and fairness in their administration of their enabling statutes. Decisions from other jurisdictions can be instructive and useful; statutory and decisional law from other jurisdictions provide "persuasive authority by analogy."[15]
>
> Precedent is relevant on the basis of the broader legal principal that "the starting point" for just and reasonable rates is any long-standing business practice that has arisen with respect to such rates. "A change cannot be made without either a reasoned explanation or a finding that such a practice is unjust and unreasonable."[16]
>
> The binding effect of precedent is also manifest in the principle that all similarly situated regulated utilities should be treated alike. An agency will attempt to apply

[15] Goodman, *The Process of Ratemaking*, pp. 129-130. Internal cites omitted.
[16] Goodman, *The Process of Ratemaking*, p. 130. Internal cites omitted.

its cost terms and definitions uniformly to the various utilities that are subject to its rules, whether or not the rules and practices are formally codified.[17]

There are limits on an agency's resting on precedent. It cannot rely on precedent to the exclusion of the evidence on the record before it for decision. An agency's failure to base its findings on the evidence of record is reversible error on appeal to the courts.[18]

The courts are not concerned with the consistency or inconsistency of agency decisions, as such, but they will require agencies to explain their departures from current precedent. The judicial role here is less to enforce consistency than to require each agency decision to contain a rational basis before it will pass judicial scrutiny. Its primary role is to require regulatory even-handedness in the agency's dealing with the company and its customers.[19]

D. Basics of Ratemaking

A. Just and Reasonable Rates

As noted previously, in establishing just and reasonable rates, the Commission has used Kansas Supreme Court case law and has described its mandate as follows:

> The Kansas Supreme Court mandates the Commission consider and balance *the interests of the utility's investors vs. the ratepayers, the present ratepayers vs. the future ratepayers, and the public interest*. "[C]ases in this area clearly indicate that the goal should be a rate fixed within the zone of reasonableness after the application of a balancing test in which *the interests of all concerned parties are considered*." [Order Approving Stipulation and Agreement, Docket No. 15-WSEE-115-RTS (September 24, 2015) (15-115 Order) at ¶ 71 citing Kansas Gas and Elec. Co. v. State Corp. Com 'n, 239 Kan. 488 (1986)]. [Emphasis added.]

In order to meet the Kanas Supreme Court's mandate and follow the Commission's statutory obligations, the KCC follows a quasi-judicial process in determining a revenue requirement and the resulting rate design. This section discusses the rate case process as well as the pertinent aspects of determining the revenue requirement and rate design. Much of this section also relies on the RRA Topical Special Report *The Rate Case Process: A Conduit to Enlightenment* (RRA Special Report) for the narrative describing the ratemaking process because RRA has done an excellent job of distilling a complex discussion into a clear and concise narrative.

[17] Goodman, *The Process of Ratemaking*, p. 130. Internal cites omitted.
[18] Goodman, *The Process of Ratemaking,* p. 131. Internal cites omitted.
[19] Goodman, *The Process of Ratemaking,* p. 132. Internal cites omitted.