

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Received
on

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by
State Corporation Commission
of Kansas

In the Matter of the General Investigation into)
the Class Cost of Service and Rate Design) Docket No. 13-GIMX-606-GIV
Methods Used to Establish Gas and Electric)
Utility Rates.)

COMMENTS OF THE CITIZENS' UTILITY RATEPAYER BOARD

COMES NOW, the Citizens' Utility Ratepayer Board (CURB) and files its Comments in response to questions posed by the Kansas Corporation Commission (Commission) in its April 10, 2013 Order Opening Docket in the above captioned matter. In support of said Comments, CURB states the following:

1. On April 4, 2013, the Staff of the Kansas Corporation Commission (Staff) filed a request to open a general investigation into Class Cost of Service (CCOS) and Rate Design policies available for use in the general establishment of utility rates by the Commission. Staff's request included a Report and Recommendation that sets forth, in a fairly cursory fashion, certain perceived shortcomings of the orthodox rate design methodologies currently used in the rate setting process. The alleged shortcomings of orthodox rate design methodologies include: (a) pricing that is based on CCOS is not first best (first best being marginal cost pricing) because it is based on historical average costs; (b) pricing that is based on CCOS does not reflect future costs of new generation; (c) the orthodox methodology is a highly complex and technical modeling exercise with ambiguous results; and (d) compiling the orthodox CCOS studies can be expensive.

2. Staff's Report and Recommendation then sets forth basic criteria for alternative cost allocation and rate design methodology that might reduce the discretionary choices of cost allocators. According to Staff the basic criteria should: (a) establish an articulable standard for judging whether a cost allocation and rate design meets the statutory standards (i.e., that the proposed rates are not "*unjust, unreasonable, unreasonably inefficient or insufficient, unduly preferential, unjustly discriminatory*") while being theoretically defensible; (b) be simple and transparent; and (c) be cost effective.

3. Staff's report and recommendation then sets forth four alternatives or options that could be considered to address the concerns with the current methodologies (the status quo). These include: (a) adopting marginal cost pricing (with some subset of common cost allocation based on Ramsey pricing); (b) setting price floors and ceilings, limiting increases, and allowing price flexibility within these bounds; (c) using the comparative prices of other similar utilities; and (d) using a price cap mechanism with set limits on annual price or revenue increases but that does not regulate profit.

4. On April 10, 2013, in response to Staff's request, the Commission issued its Order Opening Docket and Appointing Prehearing Officer. In its Order, the Commission requests that interested parties submit responses to the following questions raised by Staff in its Report and Recommendation: (a) Is a Commission inquiry into cost allocation and rate design methodologies appropriate or necessary?; and (b) if so, what procedure should the Commission adopt to address these issues?

5. On April, 26, 2013, the Commission issued its Order granting CURB's petition to intervene in this matter.

Is a Commission inquiry into cost allocation and rate design

methodologies appropriate or necessary?

6. Since the Commission appears to have questions or concerns about existing CCOS and rate design methodologies, and appears to express an interest in alternatives to the use of existing CCOS and rate design methodologies, the logical conclusion is that a Commission inquiry is appropriate.

7. However, CURB does not think it is appropriate to start this inquiry from the position that existing cost allocation and rate design methodologies are necessarily flawed or in need of change, as seems to be suggested in the Staff Report and Recommendation. CURB disagrees with the characterization of the orthodox CCOS methodologies as overly difficult to understand and use, or that the results of orthodox methodologies are somehow inadequate to the task of fairly allocating common costs among utility customers. On the contrary, these orthodox CCOS methodologies are widely accepted and used in the utility industry across most states. What may be useful from a Commission perspective is a discussion around the policy implications and allocation impacts of the various orthodox methodologies to help guide a decision about which methodology the Commission may prefer.

8. CURB is also concerned that the proposed alternatives suggested in the Staff Report and Recommendation are impractical and/or not legally supportable. While marginal cost pricing is interesting from an academic standpoint, developing the infrastructure necessary to be able to meter and charge marginal prices would likely be prohibitive. Further, the existing rate

structure would have to be reworked to institute marginal pricing, which would be confusing to customers and thus violate Staff's simple, transparent and cost effective criteria for alternative methodologies. Staff Chief Economist Dr. Robert Glass has written a fairly extensive critique of several of the alternative CCOS methodologies now being proposed in Staff's Report and Recommendation. Generally speaking, he found the proposed alternatives unworkable. Dr. Glass concludes:

“Every mechanical method for developing rate design is flawed. Marginal cost pricing, while efficient, does not allow the utility to fully recover its costs. On the other hand, second best pricing (Ramsey Pricing) allows full recovery of costs but has proven difficult to implement, has failed to perform as expected in real world setting, and violates cost causation. FDC pricing is not as economically efficient as Ramsey pricing, at least in relatively simple models. However, FDC pricing is subsidy free in contrast to Ramsey pricing. CCOS, a specific form of FDC pricing, is the best of the group because it is based on cost causation—a principle endorsed by the Kansas courts—and has been widely accepted in the electric industry.”¹

9. Similarly, setting prices based on the prices a neighboring utility may charge, or setting price caps and allowing price increases based on criteria other than a utility's underlying costs will likely violate cost causation principles and may not stand up to legal scrutiny. At a minimum, these price cap type proposals would likely need statutory authorizations.

10. The Staff Report and Recommendation appears to suggest that cost allocation and rate design should be more mechanical. CURB disagrees. Rather, CCOS results should be viewed as merely a starting point or a guidepost, to be combined with other Commission policy concerns, like equity, rate shock, gradualism and transparency. Again, Dr Glass concludes:

¹ See p. 21 of Exhibit 1, attached to the Direct Testimony of Dr. Robert H. Glass, KCC Docket No 12-KCPE-764-RTS: (<http://estar.kcc.ks.gov/estar/ViewFile.aspx/20120822141631.pdf?Id=ab34efb1-0d3e-4202-955d-0b9848d8fe95>)

“Because there is no mechanically accepted method to generate rates and because many other factors besides economic efficiency and subsidy free allocation influence rate design, rate design by its very nature is a subjective balancing of many different and changing objectives. In this balancing act, rate design practitioners generally agree that CCOS is just a starting point and a guide, not the means to a mechanical rate design.”²

Attempts to mechanize cost allocation and rate design will have the effect of limiting the Commission’s flexibility and discretion. Ultimately, the Commission is charged with protecting the public interest, which may not in every instance equate to achieving pure economic efficiency. While the current Commission may prefer less discretion, past Commissions have general strived to maintain broad flexibility in the rate setting process.

11. Finally, CURB notes that the discussion in the Staff Report and Recommendation is framed around “cost allocation and rate design”. The Commission should view these as two distinct topics of inquiry. Cost allocation, by whatever methodology, merely determines the amount of revenue to be collected from each class of customers. Rate design determines the rate structure that is used within each class to collect the allocated revenue. Rate design has its own distinct set of policy considerations that are different than those being discussed around CCOS methodologies. CURB suggests that the Commission set aside rate design, and the structure of the rates to be charged, as its own discussion topic.

² Id.

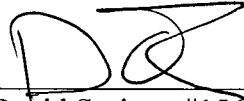
What procedure should the Commission adopt to address these issues?

12. CURB recommends the Commission begin with informal round table discussions to address CCOS and rate design issues. An informal open dialog between the Commissioners, Commission Staff and interested parties would provide a common understanding of the policy objectives of the Commission and provide a common understanding of technical challenges with each proposal, both orthodox and alternative. CURB suggests three roundtable discussions. The first roundtable should be devoted to the technical and policy challenges of the “orthodox” CCOS methodologies, with a focus on how differing allocation methods and modeling assumptions change the cost impact on each class of utility customers. The second roundtable should explore the four alternatives to the orthodox CCOS methodologies suggested by Staff, with a focus on the practical application of each alternative and an examination of whether each meets the basic criteria for alternative cost allocation and rate design methodologies set forth by Staff. Finally, CURB suggests a third roundtable focused solely on rate design, with a focus on policy objectives and rate structures to achieve those objectives.

13. After the informal discussions, the Commission can evaluate whether moving forward to a more formal evidentiary type proceeding will be necessary. The Commission could proceed through a comment process or through an examination of testimony and witnesses. If formal proceedings are necessary, the informal roundtables should help the Commission to narrow the line of inquiry to something practical and manageable. A more narrowly tailored inquiry into select topics will reduce the cost burden on all parties to the proceeding.

WHEREFORE, CURB respectfully submits the above comments for the consideration of
the Commission.

Respectfully submitted,



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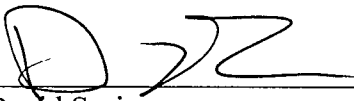
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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

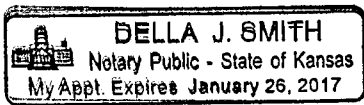
I, David Springe, of lawful age, being first duly sworn upon his oath states:

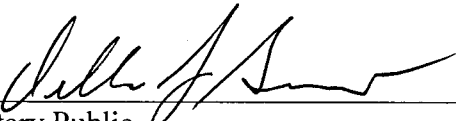
That he is an attorney for the above named petitioner; that he has read the above and foregoing Intervention, and, upon information and belief, states that the matters therein appearing are true and correct.



David Springe

SUBSCRIBED AND SWORN to before me this 21st day of June, 2013.





Notary Public

My Commission expires: 01-26-2017.

CERTIFICATE OF SERVICE

13-GIMX-606-GIV

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 21st day of June, 2013, to the following parties who have waived receipt of follow-up hard copies:

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