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Comments of Mark Sievers, Chairman
Kansas Corporation Commission

Before the
Senate Utilities Committee
January 10, 2012

Thank you for the opportunity to talk with you about the Kansas Corporation Commission. I look forward to working with you to craft solutions to the issues that confront Kansas.

Let me start with a quick overview.

I'm Mark Sievers, I am deeply honored to be the current chairman of the Commission. The other Commissioners include Ward Loyd and Thomas Wright. I've been in the job since May.

At a high level, the Commission regulates public utilities, commercial motor vehicles, oil and gas and serves as the state's energy office.

By statute the Commission exists to ensure safe and reliable service at just and reasonable rates, and to balance the public interest. But not all of the divisions within the Commission are focused on regulating rates – in fact, most of the agency's employees and work efforts have nothing to do with rates. So how do they conceptually come together in the same agency? At a high level, the Commission engages in activities to correct for market imperfections in two general respects:

First, the Commission's regulatory authority over some industries is focused preventing the exercise of market power from providers who have a government-granted monopoly. This includes traditional, privately-owned utilities – electric power, natural gas, water and telecommunications. This includes setting returns and rates. The Commission does not generally engage in rate and profit regulation with firms where the exercise of market power is not a threat – and that includes cooperatives and municipal utilities where consumers elect their utilities' management, and most telecommunications firms that operate in markets where consumers have lots of choices.

In a very real sense, in this role, the Commission is a substitute for the market and seeks to emulate the rates, terms and conditions that would have prevailed in a competitive market.

In the second area, the Commission's regulatory activities are focused on minimizing harm from market imperfections in otherwise competitive industries. This includes regulation of commercial motor vehicles, oil and gas production, pipeline safety and the energy division. In each of these areas, but for some Commission involvement, market incentives would produce undesirable results. For example, safety regulation and environmental standards are typically thought of as mechanisms to incent or mandate activities that would not otherwise occur but for some sort of regulation. Vehicle inspections, limits on drivers' work times, minimum driver qualifications, set back requirements for oil and gas wells fall into this category.

The Commission's Energy division is a little different than the other divisions of the KCC that oversee specific industries, but has a consistent economic regulatory purpose. Fundamentally, the Energy division is a program manager that administers a range of alternative energy and energy efficiency grants and programs. Alternative energy creates economic development opportunities for Kansas and, to the extent it is successful, energy efficiency reduces demand for energy from electric generating facilities. In my framework, the Energy division engages in activities that would not be observed in the marketplace and so it is an activity of the KCC that falls into the second category.

In addition to the high-level economic regulatory mission, the Commission is a quasi-judicial agency that hears and decides cases in all these areas. It is a miniature court system. People file a host of legal documents with the Commission – motions, applications, pleadings, etc. The Commissioners sit as judges, hear evidence, make decisions and issue orders. In this sense, the Commission's work flow is very much akin to a court – pleadings are filed, discovery happens, testimony is heard, trials are held and orders are issued.

I've given you all a table titled Kansas Corporation Commission Snapshot that attempts to summarize the Commission's work activities in each of these major areas. In total, the Commission has a headcount of 218.5 FTEs. It is a fee funded and federal funded agency that has a budget of about $20 million. About 2/3ds of that budget is for salaries.

At the highest level, more than 5,000 filings are made each year with the Commission. Around 1,300 separate dockets are opened each year. The Commission issues about 2,000 orders annually – that's about 7 or 8 each working day. Almost all of that paper flows across each Commissioner's desk.

A lot of the item counts listed in the Snapshot are routine matters, so when I started this job, I asked for an analysis of activities and work efforts in major cases, defined as anything that took more than two weeks of staff time to complete. What I learned was that in a typical year, in just the utilities division, there will be about 22 major proceedings that consume about 20,000 hours of professional staff time and 8,700 hours of legal time. In a typical year, the KCC will also make more than 20 filings with the FERC and the FCC and at any one time a couple decisions are appealed and pending before the Kansas appellate courts.

Participating in and complying with this quasi-judicial, quasi-legislative regulatory process is expensive – it typically involves many lawyers, consultants, expert witnesses and the like. Based on my review of past rate cases filed with the Commission, somewhere between 1 and 7 percent of past revenue requirement awards are rate case expenses – that's a crude measure of the cost of the 5,000 filings and 2,000 orders that flow through the Commission. It is a cost that's borne by Kansas consumers in the form of higher rates and investors in the form higher costs and thus of lower returns on investments made in Kansas regulated entities. Minimizing that regulatory cost by pursuing operational efficiencies is an important management mission of the Commission.

That's why the Commission has taken steps to improve the managerial structure of the agency to one where the Commissioners function like a board of directors and day-to-day management of the agency is vested in the Executive Director who functions like CEO. I've given you an organization chart that summarizes the current structure. This is still a work in progress and there are lots of opportunities for improvement. My management style is to provide direction but then delegate and rely on the expertise of the professional managers who actually do the substantive work to identify and implement process improvements. I hope to update you as this progresses and I know that Patti Petersen-Klein our Executive Director, would also be happy to brief you.

In addition to traditional regulatory, rate making proceedings, a very large proportion of Staff activity is spent doing on-site inspections, audits and responding to inquiries from the public. The Conservation division inspects a wide range of drilling activities, and that might include physically going to a well site and observing a mechanical integrity test and enforcing rules and regulations governing drilling, well construction, well spacing and well operations. In a typical year, the Conservation division will make more than 5,300 well inspections and process more than 4,500 well permits. The Pipeline Safety group in the Utilities' division employs inspectors who physically inspect natural gas pipelines throughout the state. In a typical year, the Pipeline Safety group will spend about 700 person-days making on-site safety inspections. When incidents happen, we typically open a docket to investigate the cause of the incident and take appropriate enforcement action. The Transportation division, together with the Highway Patrol and others, conducts inspections of a wide range of motor vehicles and audits their personnel and operational records. In a typical year, more than 37,000 driver inspections and 25,000 vehicle inspections are made. The Public Affairs and Consumer Protection group literally answers the phone at the Commission and handles around 3,000 complaints and comments from the public each year.

In addition, the Commission's regulatory authority is often where unfunded government mandates get turned into the rates paid by consumers and returns realized by investors. Let me give you two examples.

Kansans spend more than $6 billion a year on electric service. Last year, the Commission approved a retrofit of the LaCygne power plant to comply with the EPA's Regional Haze rule designed to protect air quality in wilderness areas and national parks outside of Kansas. The price tag was $1.23 billion that will be paid by Kansans. That's essentially a $1.23 billion unfunded federal mandate. We're also now embroiled in another EPA matter – the Cross State Air Pollution Rule -- that burdens Kansas with the cost of a federal clean air mandate. Both raise the cost and price of service. The Commission does not and cannot pass on the wisdom of such programs, that determination was made by Congress and the EPA. But the Commission is the point at which those determinations are translated into rates and returns.

There are also state mandated programs. For example, Kansans spend about $1 billion a year on telephone service making calls within the state of Kansas. The Kansas Universal Service Fund is a $62 million state fund to fund a variety of programs the legislature has concluded are desirable. The Commission's role is not to pass on the wisdom of those programs, but to ensure that the funds for such programs are fairly collected from providers, efficiently administered and used as directed by law. Like federal mandates, these programs raise the cost and price of service and the Commission is the point at which that legislative mandate becomes reflected in Kansans' rates and returns.

Finally, I've given you all a one-page summary of how I classify the major issues confronting the Commission that I would be happy to discuss as you might be interested.

I would observe that it has been surprising to me that most of the major substantive issues confronting the agency have a significant environmental nexus that is largely driven by forces outside of our control and generally beyond our influence. For example, EPA rules to comply with the Cross State Air Pollution Rule, the Regional Haze Rule, and the closure of the nuclear waste repository at Yucca Mountain all impose significant costs on Kansans.

With that, I'd be delighted to answer any questions.

Top KCC Issues

Environmental Challenges	1. ***Coal***. EPA emissions regulations (CSAPR) threaten system reliability (Westar, BPU, Sunflower) in Kansas and dramatically increase infrastructure costs (KCP&L's LaCygne $1.23 billion, Westar's ECRRs); environmental compliance raises revenues due to investment in capital intensive retrofits but does not enhance service levels and discourages investment in energy efficiency. Westar, BPU and Sunflower are projecting rolling blackouts starting in April 2012 under the proposed EPA CSAPR rules (currently stayed) if implemented as planned by the EPA. 2. ***Nuclear***. Closure of Yucca Mountain creates uncertainty surrounding costs of nuclear waste disposal. 3. ***Oil***. Mississippian oil play, horizontal drilling & hydrofracturing create significant potential for economic growth, but note: (1) full potential is, as yet, unknown; (2) how environmental concerns (disposal of well cuttings, fracking, water use) are handled will drive development (compare North Dakota (allows drilling) & New York (bans drilling)); and, (3) boom-town issues are potentially challenging for local governments. Recently, EPA has shown interest in fracking. 4. ***Gas***. Regulatory gap for underground gas storage safety (federal law proposed by Senator Roberts to close the gap). Aging gas pipeline infrastructure in weak economic environment. Increased environmental restrictions on coal add make gas-generation more attractive. 5. ***Renewables***. Kansas wind development & export depends on: (1) transmission collaboration between quasi-governmental, independent RTOs (*e.g.*, KETA, SPP v MISO); and, (2) who pays for the costs (common carrier model (ITC, Prairie Wind) v. private carrier model (Clean Line, BP)). Drives economic development in rural Kansas. 6. ***Energy Efficiency***. Rate-base rate-of-return regulation discourages investments in energy efficiency or alternatives that do not involve capital investment in infrastructure. Poor take rate for Efficiency Kansas loan program; reallocation of ARRA funds to jobs-intensive programs at Commerce & Regents.
Telecommunications Challenges	1. ***Federal USF/ICC Reform***. Because of make-whole statutes, 6% KUSF assessment could balloon to make up losses in federal support for rural telcos disadvantaging Kansas in attracting telecom intensive investment and jobs (*e.g.*, call centers). Audit of KUSF administrator underway. 2. ***Wireless Substitution for Landline***. 60% of KS telecom spending is for wireless phones. Who pays for stranded/idle landline plant as consumers migrate away from traditional phones?
Agency Management Challenges	1. ***Transition to BOD Structure***. Executive Director serving as CEO, Commissioners as policy setting BOD, judicial body rather than day-to-day agency managers. 2. ***Job Scope & Structure***. Transition to a performance metrics driven, cross-trained organization w/strong, accountable managers consistent with work load. 3. ***Legalistic (Expensive) Paper Intensive Work Processes.*** 5,000 annual filings, 1,300 dockets and 2,000 orders probably adds between 1-7% to cost of service. 4. ***Internal Controls & Compliance.*** Creating formal compliance & tracking processes/controls to ensure compliance with Commission orders, legislative directives, etc. Reviewing agency emergency management plan.

KANSAS CORPORATION COMMISSION SNAPSHOT – JANUARY 2012

INDUSTRY	KCC'S PRINCIPAL RESPONSIBILITIES	2011 ANNUAL ACTIVITY VOLUMES
Conservation (Oil & Gas) • 46,000 Oil wells (40.4M bbls/yr) • 25,200 Gas wells (333 Bcf/yr) 2,389 active licensees 9,245 inactive licensees	1. Develops and enforces operational rules regarding drilling. 2. Plug abandoned wells and, if possible, assign financial responsibility. 3. Develop and enforce rules related to (a) underground gas storage (b) CO_2 sequestration and (c) compressed air energy storage 4. Investigate and direct oil and gas production spill clean-ups 5. Manage contamination cases	***1,150 filings annually*** (motions, testimony, orders, applications, etc) 354 new dockets (142 open) 147 new penalty, show cause, well plugging orders w/fines 117 new horizontal well applications (2011 total) 45 Exception requests (*e.g.*, 10 year TA requirement) 4,579 drilling permits filed 5,324 oil & gas inspections performed 10,873 environmental permit applications processed 2,179 hours spent responding to complaints; 889 spills reported 29,347 reports processed on injection/disposal wells 21 licenses denied based on past compliance issues 229 financial assurance mechanisms audited 365 abandoned wells plugged (FY 2011, 352 in Chanute area, avg cost $4,500/well); 5,500 abandoned wells in inventory
Electric Power **KS total revenues ≈ $6B** Westar 34% KCP&L 11% Empire 0.4% Sunflower 4% Midwest 3% MKEC 3%	1. Regulate market entry & exit in distribution and transmission (but not generation) 2. Set rates, returns on IOU offerings 3. Regulate transmission line siting 4. Review decommissioning cost projections for Wolf Creek 5. Participate in Southwest Power Pool (SPP) (affects transmission costs allocated to and from KS, facilitates sale of KS wind energy, economic dispatch minimizes electric costs) KS avg rate ≈ $96 (residential bill) US avg rate ≈ $124 (30% higher than KS)	***1,200 filings annually*** (motions, testimony, orders, applications, etc) 112 new dockets (35 open) 53 certificate applications, area exchanges, cease service 32 tariffs, rate filings, energy cost adjustments/riders 9 FERC filings (electric & gas)

Kansas Corporation Commission Snapshot – January 2012

<table>
<tr><th>Industry</th><th>KCC's Principal Responsibilities</th><th>2011 Annual Activity Volumes</th></tr>
<tr><td>Gas, Pipelines, Pipeline Safety

Major local distributors
KGS (74%), Black Hills (14%), Atmos (9%), Midwest (7%);
588 communities;
900k customers
193 BcF gas annually
$1.3 B plant investment

11 non-profits & co-ops
58 municipalities
15 master meters
38 transmission lines
6 gathering lines</td><td>1. Regulate market entry & exit
2. Set rates, returns on IOU gas systems
3. Oversee pipeline safety for all systems
• 24,300 miles of distribution, transmission, and gathering pipelines
• 90% of pipeline is distribution pipe serving 939,000 consumers

KS avg rate ≈ $92 (residential bill)
US avg rate ≈ $119 (30% higher than KS)</td><td><u>200 filings annually</u> (motions, testimony, orders, applications, etc)

31 new dockets (8 open)

700 person-days of on-site field inspections/year</td></tr>
<tr><td>Telecommunications

KS total revenues ≈ $1 B
• Rural LECs 3%
• AT&T & CenturyLink 18%
• Wireless 59%
• VoIP 2%
• IXCs 16%

Broadband access in KS is virtually universal -- 93% of KS households have access to broadband (3-6Mb down, >200Kb up) (figures <u>exclude</u> satellite and cellular broadband)</td><td>1. Administer KUSF assessment-subsidy
• About $62M; 6.18% assessment; Recipients:
o 37 rural LECs ($25.5M, 105k lines)
o AT&T & CenturyLink ($19.2M, 46k lines eligible for KUSF)
o 9 other carriers ($9.5M)
o KRSI & TAP ($1.6M)
o Lifeline ($3M; 31k lines)
o Kan-Ed ($6M)
o Audit expenses ($456k)
• Federal USF support is ≈ $185M
2. Oversee market entry/exit
3. Tariff repository
4. Handle interconnection disputes

KS avg rate = $29 (residential local bill)
US avg rate = $34 (17% higher than KS)</td><td><u>1,550 filings annually</u> (motions, testimony, orders, applications, etc)

476 new dockets (83 open)
318 new tariff/contract filings
26 new interconnection agreements
56 new certificate cases (name change, new entrant, abandonment)
25 new individual KUSF cases (audits, applications)
4 new general investigations (all KUSF related)
7 formal complaints (1 KUSF, 5 interconnection, 1 consumer)
Audit of KUSF administrator (GVNW) underway</td></tr>
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KANSAS CORPORATION COMMISSION SNAPSHOT – JANUARY 2012

Transportation 8,361 motor carriers registered in KS or under federal UCR	1. Licensing, inspection and auditing to enforce compliance with motor carrier safety regulations 2. Vehicle/Driver inspections and civil assessment program in partnership with KHP 3. Training for motor carrier operators to understand and comply with commercial motor carrier rules and regulations	***1,158 filings annually*** (motions, testimony, orders, applications, etc) 388 compliance reviews/audits of motor carriers; top 5 violations identified: 1)5,913 maintenance violations; 2) 5,509 records of duty violations (driving time restrictions); 3) 1,468 driver qualification violations; 4) 234 substance/alcohol testing violations; and 5) 200 rules of the road violations. 140 carriers assessed civil fines 156 educational seminars, classes; 1,410 attendees 30 complaints received and processed 37,537 KS driver inspections (2,209 placed out of service (5.9%)) 25,198 KS vehicle inspections (3,814 placed out of service (15%)) 2,509 Hazardous materials inspections (50 placed out of service (2%))
Energy Division	1. Administers energy efficiency programs and grant funding 2. Promotes public education through outreach programs 3. Provide program management for alternative energy and energy efficiency	• ARRA Grants (must be spent by 4/12) • State Energy Program Grant ($38.2M) • Efficiency Kansas loan program (seeking private financier) • Energy Efficiency Block Grant ($9.6M, must be spent by9/12) • Facility Conservation Improvement Program (provides facility improvements and allows access to favorable financing) (to date -- 43M sq/ft; $259M in financing; $19M energy savings)

Public Affairs & Consumer Protection	1. Handles inquiries and complaints from the public
	2. Responds to media inquiries
	3. Handles open records requests
	4. Manages public hearings in major cases
		2,332 complaints/inquiries; 757 comments
		  • 38% of complaints are about rates & charges
		  • 27% of complaints are about service quality/issues
		• 896 Electric complaints ($4,053 consumer savings)
		• 545 Gas complaints ($22,156 consumer savings)
		• 598 Telecommunications complaints ($20,040 consumer savings)
		• 393 Other complaints/comments