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**BEFORE THE SENATE UTILITIES COMMITTEE
PRESENTATION OF THE
KANSAS CORPORATION COMMISSION
March 2, 2005
HB 2084**

Thank you, Chairman and members of the Committee. I am Larry Holloway, Chief of Energy Operations for the Kansas Corporation Commission. I appreciate the opportunity to be here today to testify for the Commission on HB 2084.

This bill allows electric and natural gas public utilities to recover an amount greater than the amount they spend for certain energy efficiency and conservation program investments that benefit individual commercial customers from all of the utility's ratepayers. Additionally, this bill requires the Commission to allow an electric and natural gas utility to recover certain energy efficiency and conservation investments that benefit individual residential customers from all of their utility customers.

The Commission opposes this bill. The premise of allowing a regulated utility to recover more than its investment is a violation of sound regulatory policy and an incentive to make unwise investments in a fashion that could drastically increase utility rates. Furthermore, requiring only an energy audit to justify a regulated utility's energy efficiency or conservation investment can cause all of the utility's ratepayers to subsidize an investment that only benefits an individual ratepayer.

Section 1(c) of this bill requires the Commission to allow 110% recovery of certain electric and natural gas utility investments for commercial customers. This is a fundamental violation of good utility ratemaking policy. The premise of utility regulation is to replicate

Adam Smith's "invisible hand" of competition for an industry that is a natural monopoly, such as electric and natural gas service. The concept of allowing a utility to recover more than its initial investment is a violation of this basic premise.

Obviously the intent of this legislation is not to entice electric or natural gas utilities to make investments that their commercial customers would already make for themselves; nonetheless this could be the outcome of such increased return on investment. Suppose, for example, that a commercial customer had an energy audit and found that it would save money by investing in new heating and air conditioning equipment. Later the commercial customer finds out that the utility is also interested in such investments. The customer contacts the utility; the utility pays the customer for his investment, marks up the investment by 110% and passes the cost through to all of the utility's ratepayers. The investment already made sense for the Commercial customer, and would have been made without the incentive, nonetheless all of the utility's customers ended up paying for the investment. Just as public policy should not provide a tax credit for more than 100% of an investment, or for an investment that already made sense and would have been made anyway, no regulatory policy should allow recovery of more than the initial investment. Such a policy would cause unneeded investments or provide an unnecessary incentive for investments that would have been made anyway.

In addition to such unintended consequences, the bill's *intended* policy goal -- increasing energy conservation and efficiency -- is already well served in current law. Currently K.S.A. 66-117(e) allows the Commission to award a ½ % to 2 % greater return on conservation and energy efficiency investments:

66-117(e) Upon a showing by a public utility before the state corporation commission at a public hearing and a finding by the commission that such utility has invested in projects or systems that can be reasonably expected (1) to produce energy from a renewable resource other than nuclear for the use of its customers, **(2) to cause the conservation of energy used by its customers, or (3) to bring about the more efficient use of energy by its customers, the commission may allow a return on such investment equal to an increment of from 1/2% to 2% plus an amount equal to the rate of return fixed for the utility's other investment in property found by the commission to be used or required to be used in its services to the public.** The commission may also allow such higher rate of

return on investments by a public utility in experimental projects, such as load management devices, which it determines after public hearing to be reasonably designed to cause more efficient utilization of energy and in energy conservation programs or measures which it determines after public hearing provides a reduction in energy usage by its customers in a cost-effective manner. (emphasis added)

The proposed legislation allows the Commission no discretion in evaluating the reasonableness of any investments made in energy efficiency or conservation for residential or commercial customers. It only requires that these customers have an energy audit. There may well be investments identified by an energy audit that are reasonable and cost effective. In fact some of these investments may even save money for all of the utility's ratepayers. This bill does not allow the Commission discretion in determining either of these factors. The only criterion is that the investment is identified by an energy audit. Suppose an energy audit determines that a \$5,000 investment in a new heating and air conditioning system would save a particular commercial customer \$3 a year on energy costs. Such a utility investment could be made under this statute and the Commission would be required to charge all of the utility's ratepayers \$5,500, even though no other customer benefited from the investment, the investment had a real cost of only \$5,000, and even though the commercial customer who received the new heating and air conditioner system only saves \$3 a year on his utility bill.

The incentive in section 1 (c) for commercial customers mandated by this legislation undermines the legislative policy direction aimed at ensuring reasonable rates for consumers of electricity and natural gas in the following major areas:

- The Commission is required to “ ... establish and maintain just and reasonable rates ... to maintain sufficient and efficient service...” (K.S.A. 66-101b for electric utilities and 66-1,202 for natural gas utilities).
- The Commission “shall determine the reasonable value of all or whatever fraction or percentage of the... property is used and required to be used in its services to the public...” (K.S.A. 66-128).
- “The state corporation commission, in determining the reasonable value of property, ... shall have the power to evaluate the efficiency or prudence of

acquisition, construction or operating practices of that utility. ...” (K.S.A. 66-128c).

Section 1(a) of this bill has been amended to remove an increased return on investment for residential customers. However, not only does the Commission still have concerns regarding this section of the bill, the Commission believes that this bill actually could unintentionally remove some incentives that exist currently.

This section of the bill, like section 1(c), requires that the Commission allow recovery from all utility ratepayers of any investment the utility makes that has been identified by an energy audit. As in the previous example, this would require the Commission to make all ratepayers pay for investments that might have very little benefit for specific utility customers. There are many appropriate tests for determining the economic benefits of utility funded energy efficiency and conservation programs, however an energy audit is not one of them. For example, some states, such as Vermont, have required utility ratepayers to fund conservation investments that save energy and also provide societal benefits, such as reductions in greenhouse gas emissions or other forms of pollution, by assigning a societal “cost” to these emissions. In this type of calculation, the concept is that society receives some quantifiable benefit, and this is used to justify the cost to ratepayers for the investment. On the other end of the spectrum, most state utility commissions use a “ratepayer impact test” to justify energy efficiency and conservation investments. Simply put, this test verifies that the utility’s investment provides a net benefit through lower rates to all customers. An example in this type of investment may be such things as controllers that cycle air conditioners and keep the utility company from building additional power plants. The Commission knows of no state that has taken the position that all customers should bear the costs of energy efficiency or conservation investments solely because they are identified in an individual customer’s energy audit.

The Commission is also concerned that the amended language in section 1(a) of the bill may have the unintended consequence of removing the Commission's current authority under K.S.A. 66-117(e) (discussed above) to allow an electric or natural gas utility to recover ½ to 2% above the utility's authorized rate of return for reasonable investments in energy efficiency or conservation. While it is unlikely that this was the intent of the amended language, the fact that this statute would be enacted after the existing language in K.S.A. 66-117(e) could be used to argue that the Commission would no longer be allowed to grant the existing incentive for the types of investments envisioned by section 1(a), or 1(b) of this bill.

While section 1(b) of the bill is somewhat unique, and at least does not have the concerns of socializing investments identified by and energy audit to all utility customers, the Commission believes it is unnecessary. While several electric utilities experimented with token operated prepaid programs in the 1980s and early 1990s, no utility currently has such a program or has proposed such a program. Additionally, the Commission already has broad authority to approve any similar type of program should an electric or natural gas utility request it.

In conclusion, even as amended, the Commission believes this bill is unnecessary, potentially raises rates of all ratepayers, and may remove existing incentives for investments in energy efficiency and conservation.

For a discussion of established state demand side management programs see: [Who Should Deliver Ratepayer Funded Energy Efficiency; A Survey and Discussion Paper](#), pub. 2003 by the Regulatory Assistance Project, at:

<http://www.raponline.org/Pubs/RatePayerFundedEE/RatePayerFundedEEFull.pdf>

For a discussion of state policy options for energy efficiency see:

http://www.eere.energy.gov/state_energy/policy_options.cfm