



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN  
ATTORNEY GENERAL

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MAIN PHONE: (913) 296-2215  
CONSUMER PROTECTION: 296-3751  
ANTITRUST: 296-5299

ATTORNEY GENERAL OPINION NO. 84- 24

Honorable Stephen R. Cloud  
State Representative, Thirtieth District  
Room 175-W, State Capitol  
Topeka, Kansas 66612

Honorable Robert J. Vancrum  
State Representative, Twenty-Ninth District  
Room 115-S, State Capitol  
Topeka, Kansas 66612

Honorable Ron Fox  
State Representative, Twenty-First District  
Room 155-E, State Capitol  
Topeka, Kansas 66612

Re: Public Utilities--Powers of State Corporation  
Commission--Valuation of Utility Property by  
Commission

Synopsis: Section 2 of 1984 House Bill No. 2927 (as amended by House Committee of the Whole) would empower the State Corporation Commission to exclude from the rate base of a public utility all or a portion of costs of acquisition, construction or operating which were incurred (in whole or in part) due to a lack of efficiency or prudence, or costs incurred in the acquisition or construction of excess capacity. Such legislation, if enacted, could be enforced by the State Corporation Commission and the courts of this state. Cited herein: K.S.A. 66-128, 1984 House Bill No. 2927.

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Dear Representatives Cloud, Vancrum and Fox:

You request our opinion as to the validity of Section 2 of 1984 House Bill No. 2927 (as amended by House Committee of the Whole), a measure supported by each of you. Specifically, you pose the following questions:

"(1) May the Legislature permit the State Corporation Commission ('SCC') to exclude all or a portion of the costs of acquisition, construction or operating incurred due to a lack of efficiency or prudence (Sec. 2 of the Act)?

"(2) May the Legislature permit the SCC to exclude all or a portion of the costs of acquisition incurred to build excess capacity (Sec. 2 of the Act)?"

Section 2 of 1984 House Bill No. 2927 (as amended) provides as follows:

"The state corporation commission, in determining the reasonable value of property under K.S.A. 66-128, and amendments thereto, shall have the power to evaluate the efficiency or prudence of acquisition, construction or operating practices of that utility. In the event the state corporation commission determines that a portion of the costs of acquisition, construction or operating were incurred due in whole or in part to a lack of efficiency or prudence, or were incurred in the acquisition or construction of excess capacity, it shall have the power and authority to exclude all or a portion of those costs from such reasonable value as so determined.

"For the purpose of this act, 'excess capacity' means any capacity in excess of the amount used and required to be used to provide adequate and reliable service [to the public within the state of Kansas] as determined by the commission. The commission may in its discretion prohibit or reduce the return on costs which were incurred in constructing, maintaining or operating excess capacity."

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In regard to your first question, concerning exclusion from the rate base of costs incurred due to lack of efficiency or prudence, it should be noted that the State Corporation Commission (commonly known as the K.C.C.) has historically had the duty, pursuant to K.S.A. 66-128, to ascertain the reasonable value of all property of a public utility used or required to be used in services to the public, whenever the Commission deems the ascertainment of such value necessary to enable it to fix fair and reasonable rates. In the process of reviewing orders of the K.C.C. (previously the Public Service Commission) involving public utility rates, the Kansas Supreme Court has indicated that lack of efficiency or prudence is a legitimate consideration in determining whether property should be included in the rate base.

In State, ex rel. v. Telephone Co., 115 Kan. 236 (1924), a case wherein the rate base of a public utility was contested, the court, in the process of defining what constituted a "reasonable rate," stated as follows:

"In this attempt at a definition, it has been assumed that the telephone exchanges in controversy have been built where they were needed; that they have been properly constructed; that they were economically built; and that they have been well managed."  
115 Kan. at 251.

In Southwestern Bell Tel. Co. v. State Corporation Commission, 192 Kan. 39, 65 (1963), the court held that, in determining a rate base pursuant to K.S.A. 66-128, the K.C.C. "should receive and consider all evidence which has a relevant bearing on reasonable value of a company's property." Further, the court, in considering the propriety of including in the rate base the cost of a plant purchased by a public utility where the purchase price exceeded the original cost of the plant less depreciation, indicated that the K.C.C. could consider the prudence of the purchase. Specifically, the court stated as follows:

"Where the reasonableness of the purchase price is not questioned by the Commission, it should be included in the rate base as the original cost of the Company's property. It should be understood, however, that where there is a material difference between the cost to the

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seller and the purchase price paid, the Commission may consider the prudence of the purchase and govern its allowance accordingly." (Emphasis added.) 192 Kan. at 67.

Although we are unaware of any reported case wherein a Kansas court has ruled upon the authority of the K.C.C. to consider, in determining rate base, lack of prudence of a public utility in constructing a plant, the legislature may, in our judgment, resolve any uncertainty in this regard by expressly granting such authority to the K.C.C. Thus, in response to the first question set forth above, and in accordance with the pronouncements of the Kansas Supreme Court in the Telephone Co. case and the Southwestern Bell case, it is our opinion that the legislature may grant regulatory authority to the State Corporation Commission to exclude from the rate base of a public utility all or a portion of costs of acquisition, construction or operating which were incurred (in whole or in part) due to a lack of efficiency or prudence.

In regard to your second question, the Kansas Supreme Court has addressed, by way of dicta, the authority of the K.C.C. to exclude, from the rate base, a facility, or segment thereof, whose production is far in excess of present or near future needs. Specifically, in Kansas Gas & Electric Co. v. State Corporation Commission, 218 Kan. 670 (1976), the court reviewed an order of the K.C.C. which excluded a portion (1/3) of the reasonable value of a plant on the grounds that, due to mechanical problems, it was operating at a low percentage of capacity. The court held that the K.C.C. was not authorized, under K.S.A. 66-128, to exclude a percentage of the utility property since the Commission had found there to be significant use of the plant, and had failed to find specifically that the plant was not required to be used. However, the court qualified its holding as follows:

"This is not to say that a unit or segment of a facility that has become obsolete or whose production is far in excess of present or near future needs or for any valid reason, is not used or required to be used and can be set off or separated from a facility otherwise used, cannot be excluded from the rate base under the statute." (Emphasis added.)  
218 Kan. at 674.

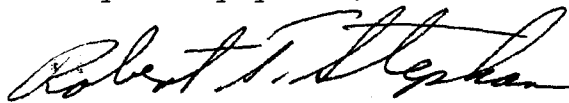
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In accordance with the above-quoted authority, it is our opinion that the legislature may grant regulatory authority to the State Corporation Commission to exclude from the rate base of a public utility all or a portion of costs of acquisition or construction which were incurred in the acquisition or construction of excess capacity.

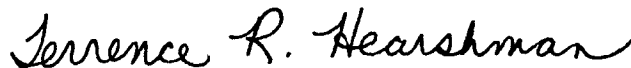
Finally, it is appropriate to note several recent decisions wherein state courts have indicated that excess capacity and managerial imprudence may be considered in determining rate base. In Park Towne v. Pennsylvania Public Utility Comm., 433 A.2d 610 (Pa. Cmwlth. 1981), the Commonwealth Court of Pennsylvania held that, where evidence supports findings of managerial imprudence or other wrongdoing, plant construction costs found to have been imprudent may be excluded from the rate base. The same court ruled that generating units found to represent excess generating capacity may be removed from the rate base. Philadelphia Elec. v. Pa. Util. Comm., 433 A.2d 620 (Pa. Cmwlth. 1981). Further, in Consumer's Counsel v. P.U.C., 423 N.E.2d 820 (Ohio Sup. Ct. 1981), the Ohio Supreme Court stated, by way of dicta, that if a utility imprudently completed a project that should have been abandoned, the Public Utilities Commission of Ohio was required to disallow inclusion of such costs in the rate base and disallow any claimed operating expenses related to the unnecessary project.

Although the above-cited decisions from other jurisdictions are not controlling in Kansas, they indicate that ratepayers need not bear costs associated with managerial imprudence and excess capacity. In our judgment, legislation conveying such authority could be enforced by the State Corporation Commission and the courts of this state.

Very truly yours,



ROBERT T. STEPHAN  
Attorney General of Kansas



Terrence R. Hearshman  
Assistant Attorney General

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