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February 16, 2004

The Honorable Stan Clark
Kansas State Senate
State Capitol, Room 449-N
300 SW 10th Avenue
Topeka, Kansas 66612

Re: Response to Questions on Senate Bill 310

Dear Senator Clark:

There have been questions and concerns expressed about the effect of Senate Bill 310 on telephone companies and specifically the KUSF audits that are taking place. The following clarifications hopefully address those questions and concerns.

With regard to affiliate transactions, this bill is simply intended to clarify the KCC's authority to promulgate rules and regulations regarding potential cross subsidies between regulated and unregulated affiliates. In light of recent significant Commission dockets involving Westar and Aquila, it appears that such rules and regulations are particularly timely. The Commission already has authority to prevent cross subsidies in the context of a rate case or other proceeding involving the determination of a utility's cost of service. There is no question that the KCC has the authority and obligation to ensure that a company's rates or its draw from the KUSF do not reflect costs associated with non-regulated activities. Otherwise, the company's customers would be paying for the costs of services they do not receive; or the contributors to the KUSF would be paying for services that the fund is not intended to support. This is especially egregious if the subsidized services are services that are subject to competition.

The Commission Staff is developing affiliate rules for two basic reasons. First, they are intended to spell out how affiliate transactions should be accounted for and how various costs should be allocated between regulated and unregulated activities. Although the Staff attempts to apply the

same accounting principles consistently in rate cases, the promulgation of rules will assist the companies in knowing what is expected. Of course, no rules can be detailed enough to cover all possible situations. Since telephone companies are already subject to the FCC affiliate rules, Staff does not intend to propose affiliate rules for telephone companies in the short term. In the event Staff believes affiliate rules are necessary, it is anticipated that such rules would either cover matters not addressed by the FCC rules or provide more specificity or guidance than the FCC rules.

The second reason to adopt rules is that not all potential abuses can be adequately addressed in the context of rate cases. If a company is improperly accounting for unregulated costs, that practice may have consequences concerning the company's financial picture that go beyond improper recovery of costs in regulated rates.

There were questions raised about the potential burden on small companies of preparing cost allocation manuals (CAMs). With regard to gas and electric companies, the Staff has not reached any conclusions on which companies should be required to prepare and submit a CAM. The FCC, in adopting its affiliate accounting rules for all ILECs in 1987, decided that all companies needed to comply with those rules because all had incentives to cross-subsidize their unregulated activities. The FCC also noted that compliance with the accounting rules should not be burdensome because the companies needed to allocate costs to justify their regulated service rates and for internal business management purposes. However, the FCC did not require the submission and approval of CAMs and annual independent audits by the smaller carriers. The KCC staff will also consider the potential burdens with regard to CAM requirements as it develops proposed rules.

Finally, a question was raised about whether price cap companies are subject to the FCC's affiliate rules. Price cap regulated telephone companies are subject to the rules. They fall within the definition of "telecommunications carrier" in the Federal Act and are required to separate regulated from non-regulated costs. Both the Federal Act and the rules prohibit the use of competitive services to subsidize non-competitive services. 47 C.F.R. 32.27 specifies accounting rules for transactions between affiliates. It includes all companies subject to the Uniform System of Accounts, which includes price cap regulated companies. (A copy of §32.27 is attached for your reference.)

If you have any additional questions, don't hesitate to contact me.

Sincerely,

/s/

Susan B. Cunningham

cc: Senate Utilities Committee Members