

**GOVERNMENT AGENCY PARTICIPATION  
IN THE REGULATORY PROCESS**

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## EXECUTIVE SUMMARY

This report provides NARUC member commissions with an independent view of the frequency, nature, and effects of government agency participation in the regulatory process. The report is directed toward commissioners and regulatory staff who are experiencing (or may experience) participation and influence of other governmental units in regulatory matters.

In the past decade government agencies (as large users of utility services) have become more visible participants in the regulatory process. In many cases this participation has taken the form of intervention before regulatory commissions. In the majority of these cases, formal testimony has been provided by the government agency. Issues associated with utility regulation have become increasingly divisive. Thus, it is not unanticipated that government agencies, as consumers of utility services, may perceive their interests as different from other consumers, particularly those of small users. Government agencies do not have the same characteristics and thus do not exhibit the same regulatory behavior as consumer advocates. Similarly, government agencies as nonprofit entities do not exhibit the same regulatory behavior as profit-driven industrial intervenors.

Thirty-two regulatory commissions responded to a NRRI survey on government agency intervention. The most cited intervenors were the Department of Defense and the General Services Administration. The majority of the respondents listed cities and counties as intervenors. Many commissions cited state administrative agencies as intervenors. The survey indicated that the primary area addressed by agency testimony was rate design; the revenue requirement was of second importance. Some of the respondents found minimal differences between agency intervenors and other intervenors. Most commissions stated that agency intervention, for the most part, provides valuable input in the regulatory process. The "problems" most associated with agency intervention are (1) the further prolongation of already lengthy proceedings, and (2) pursuit of rate design postures that seek to shift costs from large users to captive residential customers.

Fourteen cases were examined in which government agency testimony was provided. The impact of agency intervention varied substantially across the fourteen cases. Examination of the cases reconfirms several intuitive

judgements. First, agency testimony is more influential on issues in which the interests of large users do not conflict with the interests of small users than on issues in which the interests of small and large users conflict. Second, agency testimony involving extensive analysis is more effective than testimony unsupported by studies. Third, agency testimony is more influential when it is similar to testimony of other interested parties, especially commission staff. However, agency testimony is less influential when supported only by that of other large users. Fourth, government agency testimony can be self-defeating in those cases in which the focus of debate is shifted from the utility to other agency intervenors, (i.e., the primary opponent in the regulatory proceeding). In these cases, the testimony of agency intervenors has a high probability of being given little weight in the formulation of the decision.

Government agency participation in the regulatory process is not monolithic. The effectiveness of agency intervention appears to vary substantially across agencies as a function of staffing, resources, and intervention philosophy (or lack thereof). Some agencies have highly professional intervention programs and thus are more effective than agencies that lack resources and do not have an unambiguous intervention philosophy.

The most important factor in determining the effectiveness of agency intervention is the quality of testimony. In addition, testimony is more effective when the intervenor views issues from the perspective of the regulators rather than providing a general criticism of the positions of the public utility, absent any suggested alternatives.

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## FOREWORD

During the past decade, local, state and federal agencies have increasingly appeared before state and federal regulatory commissions, acting as intervenors in electric, natural gas, and telecommunications cases. We believe this to be a relatively new phenomenon in both frequency of occurrence and extent of participation. This report assesses the participation of government agencies (as consumers of utility services) in the regulatory process. We hope that you will find it of value.

Douglas N. Jones  
Director  
Columbus, Ohio  
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**CHAPTER ONE**  
**INTRODUCTION**

Problem Statement

In the past decade, state, local and federal government agencies (as large consumers of utility services) have become more visible participants in the regulatory process. In many cases, this participation has taken the form of intervention (as interested parties) before state and federal regulatory commissions. In the majority of these cases, formal testimony has been provided by the government agency. In a minority of cases, the participation has taken the form of seeking (or threatening to seek) alternative sources of supply to obtain more favorable rate treatment. Government agency participation in the regulatory process has varied widely in scope and nature across electricity, natural gas, and telecommunications cases.

While government agencies (e.g., cities, counties, state universities, state agencies, federal agencies) historically have had the legal right to intervene in the regulatory process and be party to state and federal regulatory proceedings, until the past several decades this type of participation, with few exceptions, was relatively infrequent and appeared to lack intensity.

Recently, there has emerged an increased emphasis on cost containment in government agencies, increased emphasis in the regulatory process on public utility efficiency, increasing competition in both telecommunications and energy markets, and an increased pace of technological change in certain public utility sectors. As a result of these changes, intragovernmental and intergovernmental relationships that historically had been passive have now more often become divisive. Government agencies are exhibiting behavior somewhat similar to large commercial and industrial customers. These government entities are exerting efforts to obtain preferential rate treatment and are examining alternative sources of supply, including self-supply.

A recent example of the more visible participation in the regulatory process was the proposed rule change by the General Services Administration

(GSA) in implementing "The Competition in Contracting Act of 1984" (as reported in Public Utilities Fortnightly, July 24, 1986). The 1984 legislation requires federal agencies to acquire supplies and services by a competition process; however, the legislation has been silent regarding utility services. The GSA proposed to apply the legislation to electricity, natural gas, water, and sewage services, thus exempting federal agencies from the obligation to buy services from the utility in the service area in which the agency is located. That is to say, federal agencies would be required to seek supplies at minimum cost. The GSA retreated from this rule change several months after its proposal (as reported in Public Utilities Fortnightly, November 13, 1986). If GSA had issued a final order incorporating the proposed rule change, one conjectures that the result would have been the solicitation of competitive bids for utility services, effectively resulting in more federal preemption of state regulation. This example clearly indicates that some agency intervention can increase state regulation while other agency intervention can decrease the scope of state regulation.

Another example of more active participation is the U.S. Navy proceeding with plans to build six cogeneration units to provide naval facilities with electricity and steam (as reported in Public Utilities Fortnightly, November 13, 1986). The generating facilities would substitute for electric service presently obtained from San Diego Gas and Electric Company (SDG&E). The Navy anticipates selling the excess power generated to SDG&E.

The Public Utility Regulatory Policies Act of 1978 (PURPA) specifically provided (in Sections 121 and 305) for Department of Energy (DOE) intervention in state regulatory proceedings, if in the judgment of DOE the commissions were not aggressively considering the ratemaking standards of PURPA. However, after a few intercessions in the early years of PURPA, DOE appears to have abandoned this avenue of intervention. It is difficult to determine whether this abandonment was due more to the harsh criticism by state regulators regarding this type of intervention or due more to DOE recognition that this intervention circumvented rather than strengthened state regulation.

Thus, it is appropriate that an examination of the changing relationships between government agencies as consumers of utility services,

regulatory commissions, and the providers of utility services be the focus of a research inquiry.

### Research Approach and Framework

This research report includes several elements.

One component is an examination of the frequency of government agencies (as consumers of utility services) appearing as intervenors before state and federal regulatory commissions in the past decade. These data are derived from a mail survey of regulatory commissions that was developed and conducted by NRRI.

A second and related component is an examination of the types of cases in which governmental agencies (as consumers of utility services) have intervened in the last decade. These data are also derived from the mail survey of regulatory commissions developed and conducted by NRRI.

A third and possibly the most important component is an analysis of several illustrative cases involving government agencies as intervenors in the regulatory process. These selected cases include both intergovernmental relationships (e.g., the Department of Defense intervening before a state regulatory commission) and intragovernmental relationships (e.g., a state administrative agency intervening before a state regulatory commission).

The third component also involves an examination of the regulatory posture of government agencies in rate and related cases relative to the posture of intervenors such as large industrial users, nongovernmental consumer advocates, governmental consumer advocates, as well as regulatory commission staff. One issue is whether government agencies (in their attempt to seek preferential rate treatment and least cost utility supplies) behave like industrial intervenors and thus have similar effects on captive or core market consumers. For example, a government agency separating itself from the existing utility network may cause "stranded investment," thus creating the issue of who should bear the costs of the excess capacity. The utility may incur substantial capital costs in order to serve the government entity. The success of the government entity in obtaining preferential rate treatment or bypassing the utility system results in a thinner customer base to absorb the residual costs. This scenario is derived from the case studies as well as discussions with persons providing

government agency testimony, government agency staff, and regulatory commission staff.

A fourth and final component is an appraisal of the regulatory and public policy problems created by the increasing participation of government agencies (as consumers of utility services) in the regulatory process. Issues here include whether the phenomenon of government agency participation is becoming a permanent part of the regulatory process (given the increased emphasis on cost containment), whether the government agency intervention is effective (and how it could be made more effective), and whether there have emerged any recent discernible trends in the frequency and nature of government agency testimony. This appraisal is derived from the case studies as well as from discussions with persons providing government agency testimony, government agency staff, and regulatory commission staff.

Issues associated with public utility regulation have become increasingly divisive. In addition to the traditional point that investor interests often conflict with those of consumers, we see interests of present consumers conflicting with those of future consumers; interests of commercial and industrial users conflicting with those of residential users; and the interests of nongovernmental consumer advocates (i.e., consumer groups or grassroots advocates) at times conflicting with those of governmental consumer advocates (i.e., consumer counsels, public advocates, or proxy advocates). Therefore, it is not unexpected that government agencies, as consumers of utility services, perceive their interests to be different from the interests of other consumers, particularly small users such as residential consumers.

In a broad sense, government agencies as intervenors in regulatory matters are a form of public representation, at least in contrast to industrial intervenors who conceptually represent the relatively narrow interests of managers and stockholders. However, government agencies do not directly represent the public as do governmental consumer advocates. In brief, government agencies as intervenors represent the public as taxpayers but do not necessarily represent the public as utility ratepayers. Government agencies may intervene to decrease their utility rates and thus potentially decrease taxes; governmental and nongovernmental consumer

advocates may intervene to obtain decreased residential rates at the sacrifice of increased tax levels.

In some cases, a conflict of interest can exist. For example, a municipality may intervene in a rate case allegedly representing both its taxpayers (as a large user) and its residents (as ratepayers). That is, a municipality representing itself (its taxpayers) as well as its residents may exact from the regulatory commission lower rates for itself at the cost of increased residential rates.

Conceptually, the posture of government agencies as intervenors will tend to vary with the regulatory issue (Gormley, 1983). One issue category is that labeled as high complexity and low consumer conflict, e.g., a rate of return or general rate increase. Consumer advocates will tend to oppose the increase. However, nongovernmental consumer advocates may lack the technical expertise to be effective intervenors. Industrial intervenors may oppose the increase but not vigorously, given their knowledge of financial markets. Government agencies will tend to oppose the increase. One conjectures that the posture of the government agency will be somewhat similar to both consumer advocates and industrial intervenors.

A second issue category is that of low complexity and high consumer conflict, e.g., lifeline rates. Nongovernmental consumer advocates will strongly advocate lifeline rates, however, governmental consumer advocates may be less enthusiastic, given their knowledge of the cross subsidization required to finance the lifeline rates. It may be that government agencies will oppose lifeline rates on the basis that they view themselves as a primary subsidizer of the lifeline concept. Industrial intervenors will also view themselves as a primary subsidizer of lifeline rates.

A third issue category is that of low complexity and low consumer conflict, e.g., late payment penalties. Both governmental and nongovernmental consumer advocates will tend to oppose these penalties. If they act purely out of self interest, government agencies may support late payment penalties as a way of keeping downward pressure on all rates. Industrial intervenors will pursue a strategy similar to that of government agencies. However, given a perception of minimal financial consequences, both agency and industrial intervenors may adopt a neutral position on late payment penalties for public relations reasons.

A final issue category is that of high complexity and high consumer conflict, e.g., rate structure redesign. Nongovernmental consumer advocates may lack the technical expertise to deal with issues of cost allocation, pricing methodologies, and rate structure reform. As a large user, government agencies will oppose rate redesign that increases the percentage of revenue requirements to be generated by the government agency as a large user of utility services. One anticipates that industrial intervenors will adopt a similar posture.

In brief, the government agencies do not have the same characteristics and thus do not exhibit the same regulatory behavior as governmental and nongovernmental consumer advocates. Similarly, government agencies (as nonprofit entities) do not have the same characteristics and thus do not exhibit the same regulatory behavior as industrial intervenors. However, since government agencies appear to have characteristics more similar to industrial intervenors (and other large users of utility services) than to consumer advocates, one anticipates a regulatory posture more similar to other large users than to small users of utility services. In any event, the posture of the government agency will likely vary with the particular regulatory proceeding and the issues involved.

#### Report Preview

This is a NRRI report that provides NARUC member commissions with an independent view of the magnitude, nature, and effects of government agency participation in the regulatory process. The report is aimed at commissioners and regulatory staff who may be concerned with the participation and influence of other government units in regulatory matters.

This report consists of three remaining chapters. Chapter 2 includes a summary and interpretation of the NRRI survey results. Chapter 3 includes an analysis and assessment of government agencies as intervenors in the regulatory process; selected examples of intergovernmental and intragovernmental intervention are examined. Chapter 4 incorporates some evaluation of government agency intervention.



**CHAPTER TWO**  
**NRRI SURVEY OF GOVERNMENT AGENCY INTERVENTION**

The NRRI Survey

The NRRI and the author in early 1987 developed an instrument that surveyed regulatory commissions regarding their experiences as to government agency intervention. The survey generated data on government agency participation in the regulatory process. The results of the survey are reported in this chapter. The survey instrument appears as Appendix A.

The survey requested information on several matters. First, the survey requested data on the frequency of intervention by government agencies before regulatory commissions. Second, information as to the specific government intervenors was asked for. Third, the types of testimony provided by the government intervenors were requested. Fourth, the survey sought information on the posture of government agency intervenors relative to that of parties such as investor-owned utilities, consumer advocates, and industrial customers. Finally, the survey asked for an assessment of regulatory problems as well as associated policy issues that may result from the participation in the regulatory process by government agencies.

It should be stressed that the survey and the subsequent examination of specific cases focuses on government agency intervention, as large users of utility services. The analysis in this report does not directly involve government agency participation in the regulatory process in which the intervention is on behalf of the general ratepayer, e.g., intervention by the Office of the Attorney General in a particular state or intervention by a governmental consumer advocate. Participation by such agencies is, of course, relatively common.

The Survey Results

Thirty-two commissions responded to the NRRI survey. The respondents were: Alabama, Arkansas, California, Delaware, District of Columbia, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Missouri, Montana, New Jersey, New

Mexico, New York, North Carolina, Ohio, South Dakota, Tennessee, Utah, Virgin Islands, Virginia, Washington, Wisconsin, and Wyoming.

The respondents were asked to estimate the number of cases in which government agencies intervened in the period 1975-1986. In some of these cases there was more than one agency intervenor. Kansas listed 46 cases; Missouri, 45 cases; North Carolina, 39 cases; District of Columbia, 31 cases; Florida, 30 cases; Maryland 25 cases; Washington, 20 cases; and Tennessee, 20 cases. New York, California, New Jersey, and Ohio cited frequent intervention by government agencies with the remaining respondents citing a lower incidence of intervention. The Virgin Islands reported no agency intervention.

The respondents were asked to list the agency intervenors. The most cited intervenor was the Department of Defense (19 commissions cited it as an intervenor distinct from the individual armed services) followed by the Air Force (8 commissions), General Services Administration (6), Federal Executive Agencies (4), Department of Energy (4), and the Department of the Navy (3). Counties were listed as intervenors by 14 commissions; cities and municipalities were listed as intervenors by 18 commissions. Intervention by a state administrative agency was cited in Alabama, California, Florida, Georgia, Kansas, Kentucky, Maine, Massachusetts, Missouri, Montana, Ohio, Utah, Washington, and Wisconsin.

Intervention by state commerce agencies was noted in Maryland, New York and Ohio; intervention by state energy boards was noted in California, District of Columbia, Kansas, New Jersey, New York, North Carolina, and Utah. Universities, colleges, and boards of regents were cited as intervenors in California, Florida, Kansas, Ohio, and Utah. Other agency intervenors cited were state departments of transportation, airport authorities, transit authorities, and special districts (e.g., municipal utility, school).

The respondents were requested to list the types of testimony and issues addressed by the agency intervenors. One topic addressed by the testimony was revenue requirements, i.e., cost of capital, capital structure, cost of service, cost disallowance, prudence of investment, rate base valuation, test year, and specific accounting issues. Another subject addressed by the testimony was rate design, i.e., cost allocation, rate increase timing, and the economic impact of the rate design. In addition,

testimony was reported on price elasticity of demand, quality of service, disconnection and deposit practices, and the financial impact of rate increases on the government agency and taxpayers.

The survey indicated that the primary area addressed by the testimony was rate design and that the secondary area was revenue requirement issues such as return on equity. The survey also indicated that federal agency intervenors are more likely to address revenue requirement issues than state and local agency intervenors.

The respondents were asked to compare the government agency intervenors with other intervenors. Nineteen respondents found little or no differences. One indicated that they were similar to other intervenors. Three respondents indicated that government agency intervenors were very similar to industrial intervenors (have mutual interests) and thus generally are on the opposite side of rate design issues from consumer advocates representing residential consumers.

More striking differences were noted in other responses. Two indicated that agency intervenors are more "single issue" oriented than other intervenors, i.e., they focus only on special interests associated with being a large user. Another indicated that because of the one issue orientation, the agency intervenors do not participate as regularly and as fully in the regulatory process as industrial intervenors. For example, while there may be in excess of 100 issues incorporated in a rate case, the agency intervenors usually address only a limited number of issues of special interest to them. One speculates that this narrow intervention approach to rate design and revenue requirement issues has both advantages and disadvantages. It has the advantage of the potential for emphasis, effort and resources being clearly focused. It has the disadvantage of providing the appearance of the agency being interested in its own narrow interests rather than in the interests of the general public.

Two respondents indicated that the federal agencies provide testimony on both revenue requirements (generally rate of return) and rate design. Other agency intervenors focus generally on matters of cost allocation and rate design. These respondents also indicated that cost of capital testimony by federal agencies generally recommends rates of return on equity below that of commission staff and very close to that of consumer advocates.

In brief, the survey results indicated that the posture of the government agency can resemble that of a consumer advocate or an industrial intervenor, depending upon its interest and the type of regulatory proceeding. For example, the federal agencies intervene as large consumers and thus their posture resembles generally that of a large industrial customer on rate design issues. In contrast, their rate of return testimony can resemble that of consumer advocates. Cities may provide testimony resembling that of consumer advocates if they appear as representatives of their citizens. In contrast, their testimony may approximate that of industrial or commercial customers if they appear as simply large users of utility services.

The respondents were asked to cite any regulatory or policy problems created by government agency intervention in the regulatory process. Twenty-five commissions stated that agency intervention created little or no problems. Several of these commissions stated that agency participation provides vital input to the regulatory process (it insures that the commission has a more complete record upon which to base its decision) and thus agency intervention should be encouraged.

The concerns regarding agency intervention which did emerge from the survey were several. First, government agencies are generally funded by tax revenues. The agencies tend to adopt positions with the singular objective of reducing agency costs; these positions may be in conflict with the interests of many small user-taxpayers. Second, an agency may be wasting taxpayer money by engaging in ineffective intervention. This raises the policy issue of whether the government agency should be accountable to the public regarding the effect on the regulatory outcome from the expenditure of intervention resources. Third, agency intervention, whether effective or ineffective, can further create prolonged hearings and additional case expenses that place a strain on commission resources. Fourth, agencies sometimes base positions on inadequate information, e.g., testimony is general in nature and lacking in state-specific data. Finally, intervention by local governments can be somewhat ambiguous as to the group the agency is representing. It is sometimes unclear whether the municipality is representing all consumers (residential and business) or itself as a large user of utility services. In some cases, the intervention is complicated by the municipality attempting to represent both itself and all municipal

consumers, even though (as mentioned earlier) there can be a conflict of interest.

All in all the survey indicated that the participation of government agencies is a generally accepted phenomenon by regulatory commissions. Agencies, for the most part, are viewed as providing valuable input to the regulatory process.

In the author's view there are no problems created by agency intervention which differ substantially from those created by other intervenors. The primary "problems" with agency intervention are the prolonged proceedings and the rate design postures that seek to shift costs from large users to captive residential customers. These and other "costs" must be weighed against the benefits of a more thorough regulatory process resulting in a better information base for regulators.

The survey is the basis for two additional observations. First, it was a surprise to find that a substantial amount of agency intervention is for "monitoring" purposes and does not involve formal testimony. Many government agencies participate in a rate proceeding only through cross-examination of utility and commission staff witnesses. There is a question as to whether this type of intervention involves an effective use of agency resources. Second, it was a surprise to find no discernible decrease in agency intervention in the most recent period covered. The author anticipated decreased intervention in the context of decreased inflation rates, relatively stable energy prices, and the trend toward deregulation.



**CHAPTER THREE**  
**GOVERNMENT AGENCY PARTICIPATION**  
**IN THE REGULATORY PROCESS**

In general, public utility rates must be just, reasonable, and nondiscriminatory. This suggests that regulators are bound to insure that rates are neither sufficiently high as to violate standards of fairness nor sufficiently low to be confiscatory. Thus, regulators have the opportunity to redistribute income between producers and consumers and/or between consumer classes as long as the boundaries of this "zone of reasonableness" are not violated (Russell and Shelton, 1974). This implies that intervenor testimony such as that provided by government agencies has a potential impact in determining the point at which rates fall in the "zone of reasonableness." In addition, as with other testimony, government agency testimony can increase the potential for internal cross subsidization across user classes and services.

A study of the regulatory decision-making process indicates that regulatory agencies consistently make use of information provided in regulatory hearings (Joskow, 1972). For example, allowed rates of return were shown to depend not only upon certain financial variables but also upon the size (and reasonableness) of the public utility company request, the presence (or absence) of supporting cost of capital testimony by the public utility, and the presence (or absence) of conflicting testimony by intervenors. The empirical evidence indicates that intervenor testimony does make a difference by depressing the return allowed below that requested by the utility. One is not surprised at this particular result since if intervenor testimony had no impact, then intervenors such as government agencies have been wasting substantial resources intervening in the regulatory process.

There is the issue of the motivation for intervention in utility rate matters. One can conjecture that an incentive for intervention is the increased importance of the combination of budget constraints and public resistance to tax increases. Another motivation is the agency strategy of consistent intervention enhancing the credibility of the agency in the regulatory process, thus insuring that the intervention has a long-run

impact. Still another motivation is increasing recognition of the magnitude of cost savings that occurs with either decreased utility rates or with utility rates not increasing as much as they would have without intervention. In sum, government agencies intervene because utility rate increases affect their operating budgets and thus affect the viability of their mission.

An analysis of agency intervention requires the distinction between rate level and rate structure. Rate level issues involve the determination of total revenue requirements for the public utility, i.e., the phase of traditional rate base regulation that incorporates the determination of average rates including rate of return. Rate structure issues involve the allocation of total revenue requirements to individual services and user classes. This phase of traditional rate base regulation incorporates cost allocation and rate design, i.e., the determination of prices for individual customer classes and services.

In the past, government agencies tended to intervene primarily in matters of rate design and cost allocation. This intervention has the objective of influencing the allocation of revenue requirements to customer classes. More recently, the intervention has been expanded to matters of revenue requirements (including rate of return). This intervention has the objective of influencing the magnitude of revenues to be allocated.

Regarding rate of return, government agencies commonly (along with other intervenors) have operated as part of a coalition opposing the public utility. Industrial users, consumer advocates, and government entities tend to view a rate of return increase (or an increase in overall revenue requirements) as an increased burden on all user classes. However, once total revenue requirements are ascertained, conflict emerges among the various intervenors (i.e., the coalition destructs). Not surprisingly, industrial users, consumer advocates, and government agencies then attempt to impose the increased revenue burden disproportionately on users other than themselves.

As clearly indicated by the testimony from various energy and telecommunications cases analyzed below, there are regulatory matters in which the government agency testimony is similar to positions taken by consumer advocates and by commission staffs. However, with the increasing competition in both energy and telecommunications markets, government



agencies as large users of these services may take substantially divergent positions from that of consumer advocates and regulatory staff. An example is the government agency threatening system bypass and correspondingly advocating pricing structures to prevent bypass.

The cases selected for analysis have a singular prerequisite, i.e., the government agency intervenor provided formal testimony in the regulatory process. As previously noted, government agencies intervene in some cases but do not provide formal testimony. In these particular cases it is quite difficult to ascertain and assess the specific position of the government agency on the relevant regulatory issues. Because of this, these kinds of cases were excluded from examination.

#### Rate of Return Intervention

The testimony provided by government agencies on rate of return is driven by agency concern about earnings levels and total revenue requirements. The testimony is motivated by the expectation that higher revenue requirements tend to translate into higher rates for all user groups and vice versa.

Rate of return testimony (including briefs) that were reviewed included that of the General Services Administration before the Maryland Public Service commission (Case No. 7973), the City of Los Angeles before the California Public Utilities Commission (Application No. 85-01-034), the Department of the Navy before the California Public Utilities Commission (Application No. 86-12-047), the Department of Defense (DOD) before the Arkansas Public Service Commission (Docket 84-165-U), the DOD before the Pennsylvania Public Utility Commission (Docket No. R-85-0220), and the DOD before the Indiana Public Service Commission (Cause No. 37837).

In the Pennsylvania case the DOD did not provide expert witness testimony but did file a brief. The utility (West Penn Power Company) recommended a return on equity of 16.0 percent; the PUC staff, 14.0 percent; the Office of Consumer Advocate, 12.57 percent; and the industrial intervenors, 13.75 percent. The DOD noted that determining the appropriate rate of return was the single most important issue in this case, given a major increment to the rate base of the utility. As a result, the DOD

argued for an allowed rate of return on equity not to exceed the recommendation of the PUC staff (14.0%).

In the Indiana case, the DOD again did not sponsor expert testimony but did file a brief. The utility (Indianapolis Power and Light Company) argued for a return on equity of 15.25 percent. The Office of the Utility Consumer Counselor, the City of Indianapolis, and the commission staff entered into a stipulation providing for a return of 15.25 percent. However, the DOD argued for a return on equity of 13.5 percent, which was the return recommended by the industrial intervenors. In the Pennsylvania case, the DOD return recommendation corresponded with that of the commission staff and consumer advocate. In this case, the DOD recommendation on rate of return was substantially below that of the commission staff and consumer advocate. In both cases, the DOD recommendation was similar to that of the industrial intervenors.

The DOD, GSA and the Federal Executive Agencies (FEA) intervened before the Federal Communications Commission (FCC) in Docket No. 84-800, a non-traditional rate of return proceeding involving several FCC proposals for determining rates of return in telecommunications markets. The FCC initially proposed to adopt the risk premium method for prescribing interstate rates of return on equity. The FEA objected to the rate of return methodology being restricted to one method. Instead, the FEA recommended that the cost of equity be estimated by various existing methods thus providing a large database from which the FCC could formulate its decision. Other intervenors similarly argued that there was no single method that was superior in estimating rate of return on equity.

In response, the FCC proposed a weighted state average rate of return (replacing the risk premium proposal). The FEA then argued that weighted state averages have little relevance in assessing a proper industry rate of return. The FEA recommended that the authorized overall interstate rate of return of 12.75 percent be reduced to 11.7 percent. Its recommendation was based on a simple average of currently effective rates of return prescribed by the various states.

The rate of return testimony provided by government agencies in individual rate cases generally produces cost of capital estimates slightly less than those of commission staff, substantially less than those of the utility, and comparable to those of consumer advocates. One source noted a

recent exception to this generalization in which the cost of capital estimate provided by the government agency fell between the estimates provided by the commission staff and the public utility. The agency estimate was higher than that of the commission staff in this instance. Rate of return testimony by industrial intervenors is too infrequent to provide a point of comparison.

Federal agencies account for virtually all of the rate of return testimony provided by government agencies. One source estimated that 20 percent of the federal resources devoted to participation in energy regulation matters are presently allocated to rate of return, 30 percent to accounting issues, and 50 percent to rate design. Another source noted that the allocation of federal resources devoted to participation in telecommunication regulation matters has been altered by AT&T divestiture. Prior to divestiture, it was estimated that 70 percent was allocated to rate of return and 30 percent to rate design. Since divestiture, it was estimated that the mix has been reversed to approximately 30 percent to rate of return and 70 percent to rate design. In telecommunications, once there is active participation in a rate case, one source indicated that the bulk of the resources is devoted to rate of return, as opposed to rate design. In energy, one source noted a recent change in strategy by federal agencies. This is that increasing emphasis is being placed on contract negotiations (e.g., entering into long-term supply contracts with utilities) and decreasing emphasis is being placed on traditional rate case intervention.

#### Energy Case Intervention

Ten energy regulation cases (nine involving electricity and one involving natural gas) were selected for examination.

1. New Mexico Public Service Commission (Case No. 1891). This case involved a proposal by the Public Service Company of New Mexico (PNM) to acquire Southern Union Company. This was a case of an electric utility proposing to acquire a natural gas utility.

The testimony provided by the Federal Executive Agencies (FEA) recommended approval of the acquisition under certain conditions, e.g., that PNM be precluded from engaging in natural gas production. By primarily being a transporter and distributor, it was argued that PNM would be a more

effective countervailing force to natural gas producers in New Mexico. The FEA testimony recommended that approval of the acquisition should not guarantee automatic inclusion of all Southern Union assets in the PNM rate base. Instead all inclusions should meet a strict used and useful standard.

The FEA testimony also recommended the rejection of a proposed two-year moratorium on gas rate filings coupled with a PNM proposal for retaining a percentage of cost savings resulting from purchase contract renegotiation. According to PNM, the purpose of the gas cost reduction program was to eliminate a forecasted revenue shortfall. The FEA testimony provided revenue estimates indicating that current rates would provide adequate revenues after acquisition and that traditional rate regulation would provide adequate incentives for gas cost reduction.

The PSC decision in this case was highly compatible with the FEA recommendations. The PSC agreed with FEA testimony that the benefits of the acquisition exceeded its costs. Also, the PSC agreed with the FEA that the acquisition be approved on the condition that PNM be precluded from engaging in natural gas production of any kind, without prior approval of the PSC. Finally, the PSC agreed with the FEA that the gas utility would be financially viable after acquisition under current rates being charged. The PSC concluded that the conservative revenue estimates provided by the FEA were persuasive. As a result, the PSC rejected the related proposals of a two-year moratorium on rate filings and the gas cost reduction incentive program (the latter was contingent on the rate filing moratorium). The PSC adopted the FEA recommendation on a refund plan to customers involving funds from an antitrust settlement.

In this case, there were no government agency intervenors other than the FEA. The Office of the Attorney General of New Mexico intervened on behalf of all utility consumers. On numerous issues, the FEA and the Office of the Attorney General were in agreement. There were numerous issues in which the interests of the large users did not conflict with the interests of small users, e.g., the assessment of the financial viability of the gas utility after acquisition under current rates. This was a case in which government agency testimony was influential in numerous aspects of the PSC decision and not in conflict with general consumer interests. One speculates that the FEA testimony was effective because it viewed issues

from the perspective of the commission rather than simply providing a general criticism of the utility position.

2. Illinois Commerce Commission (Docket No. 81-600). This case involved a rate increase request by Central Illinois Light Company (CILCO). Government agency testimony focused on two dimensions of the rate request, street lighting and time-of-day rates for large users.

Regarding street lighting, the City of Peoria (COP) argued that the proposed rates were not cost-based and did little to encourage the improvement of load factors. COP also questioned the cost estimates of CILCO and provided some adjustments to those cost estimates. COP testimony focused on its inability to curtail usage as well as its minimal contribution to system peak demand. COP estimated that its electricity costs would increase 100 percent as compared to the system average increase of 11 percent. COP recommended that the rates for street lighting be increased by no more than the system average rate of increase.

In 1981 CILCO had implemented time-of-day rates for large users. In its rate proposal CILCO assumed that, on average, large users would be able to shift 10 percent of their on-peak load to off-peak. The Springfield Sanitary District (SSD) provided testimony focusing on being a large user incapable of shifting load from peak to off-peak. SSD argued that given the nature of its demand, it would be difficult to achieve substantial improvements in load factors. Similar testimony was provided by Illinois Central College. Neither agency intervenor argued that the proposed rates were either non-cost based or discriminatory.

The commission decision in this case was not highly correlated with government agency testimony. In both street lighting and time-of-day rates, the primary influence was commission staff testimony. The staff recommended that the street lighting increase be limited to 50 percent of that proposed and that any larger increase be spread out over future rate cases. The Illinois Commerce Commission decision incorporated the staff proposal. The commission staff proposed certain modifications to the time-of-day rates proposed by CILCO; again, the commission decision incorporated these modifications. However, the Commission did agree with the government intervenors that the 10 percent load shift assumption was invalid.

In this case the Office of the Attorney General of Illinois intervened on behalf of all consumers; its testimony involved issues other than that of

street lighting and time-of-day rates for large users. But as noted, the primary influence on the commission decision was staff testimony; it is obvious that agency testimony had little impact. This case clearly supports the hypothesis that agency testimony involving extensive analysis (including cost calculations) is more effective, as opposed to testimony simply focusing, say, on being a large user and incapable of load shifting.

3. Maryland Public Service Commission (Case No. 7962). This case involved natural gas transportation policies and rates for local distribution companies (LDCs). The Department of Defense (DOD) in its testimony provided several recommendations. In the case of direct purchases by end-users, the DOD recommended that LDCs be required to provide transportation services at unbundled cost-of-service rates. However, the DOD did note that the cost-based rates respect the long-term interests of captive customers. The DOD recommended that LDCs be encouraged to make direct purchases and maintain a portfolio of supply contracts. The DOD testimony recommended in general that transportation charges include a customer element based on customer costs and a commodity element based on the variable costs of transportation.

In its decision the PSC ordered LDCs to provide both firm and interruptible transportation services for direct purchases by end-users, i.e., LDCs must provide transport services to all customers on a nondiscriminatory basis. The PSC decision referred to the DOD only as one of several intervenors (commission staff, industrial users, and Office of People's Counsel) providing similar testimony as to the benefits of mandatory transportation services.

The industrial intervenors and the DOD both argued for strict cost-of-service rates for transportation services, however, neither they nor the LDCs provided detailed cost data. As a result, the PSC ordered cost of service studies to determine transportation service rates.

In this case, on several major issues, government agency testimony was quite similar to that of other intervenors. One notable aspect of DOD testimony was its apparent concern for the interests of captive market customers.

4. Indiana Public Service Commission (Cause No. 37837). This case involved a rate hike request by Indianapolis Power and Light (IPL). The City of Indianapolis (COI) provided testimony on the design of large user

tariffs. COI criticized the IPL method for allocating demand costs to customer classes on the basis that the method did not reflect actual cost causation. COI provided cost data employing an alternative allocation method; the industrial intervenor provided a third cost of service study. COI criticized the IPL proposed rate design for large users, arguing that energy charges were being employed to recover fixed costs. COI recommended that the tailblock energy charges remain unchanged and the increased revenues from large users be recovered via other blocks in the large user tariff. In general COI argued that large users were subsidizing residential users.

The DOD filed a brief that was generally supportive of the IPL proposed rates for large users. However, similar to the consumer group intervenor and the Office of Utility Counselor, DOD focused on revenue requirement issues rather than on rate design issues.

In its decision, the PSC determined that the IPL method was the most appropriate basis (of the three cost of service studies) for determining cost allocations to customer classes. Regarding the COI proposal for loading the entire rate increase on either demand charges or the initial blocks in the large user tariff, the PSC rejected this recommendation and accepted the IPL proposed rate design. The PSC noted that no other intervenor supported COI; that the COI proposal would induce migration from this user class to the small commercial-industrial class; and that COI acknowledged in testimony that it had not even considered the migration problem.

In brief, this case is one in which an agency intervenor (COI) was largely ineffectual in the determination of large user rates.

5. New Jersey Board of Public Utilities (Docket No. ER8512-1163). This case involved the rates charges by the Public Service Electric and Gas Company (PS). The Department of Energy (DOE) provided testimony focusing on rates proposed for commercial and industrial classes. The testimony examined both interclass rate structures (cost allocation methods) and interclass rate design (user class tariffs). DOE rejected the PS rate design but generally found the PS class revenue allocation acceptable. In sum, DOE accepted the class revenue levels proposed by PS but argued that the proposed rate design for large users overemphasized revenue recovery by energy charges, particularly off-peak energy charges.

DOE testimony recommended increasing demand charges by a lesser percentage than on-peak and intermediate energy charges, and that off-peak energy charges make some contribution to fixed costs. In contrast PS proposed increasing demand charges more than energy charges, with off-peak energy charges remaining the same. DOE recommended an approximate 40/60 percent division of the revenue increase between demand and energy charges.

PS proposed a 60/40 percent split of the revenue increase between demand and energy charges for the large user rate schedules. Its proposal was based more on load management criteria than on cost of service data. The Division of Rate Counsel recommended a 0/100 percent split while the BPU staff recommended a 10/90 percent split (supported by cost analyses and proposed tariff design).

The BPU found that a 20/80 percent split of the revenue increase between demand and energy charges was appropriate for the large user tariffs. There was no mention of DOE testimony in the decision. One concludes that DOE testimony had minimal impact on the BPU decision relative to Rate Counsel and BPU staff testimony.

6. Maryland Public Service Commission (Case No. 7587). This was a rate case involving the Potomac Electric Power Company (PEPCO). Testimony was provided by a unique combination of a large agency user and a representative of typically small users, the Washington Metropolitan Area Transit Authority (WMATA) and the Office of People's Counsel (OPC).

WMATA/OPC testimony focused on class revenue requirements, particularly the allocation of costs to the rapid transit rate. The testimony concluded that the average and excess demand (AED) method employed by PEPCO was inappropriate for allocating generation costs and was biased against residential and rapid transit classes. WMATA/OPC recommended the use of the average demand and peak (ADP) method providing cost data employing the ADP method. WMATA/OPC also recommended a decrease of 19 percent in the present rapid transit rate relative to other classes to achieve parity in rates of return across classes. It also recommended that residential rates remain unchanged.

FEA testimony also focused on the distribution of revenue increases across classes, particularly the allocation to the general service (large user) class. The FEA recommended that the revenue increase be distributed not across the board (as proposed by PEPCO) and not to equalize class rates



of return (as proposed by WMATA/OPC), but be distributed so that class rates of return would be within 10 percent of the average rate of return. Interestingly, FEA also requested the creation of a rate class for the federal government.

Regarding costing methods, the PSC adopted the ADP method advocated by WMATA/OPC. The PSC decision noted that the ADP method (compared to AED) allocates more capacity costs to high load factor users (e.g., federal agencies) than to low load factor users (e.g., residential and rapid transit). Regarding class revenue allocation, the PSC rejected both the WMATA/OPC request for a further adjustment to the rapid transit rate relative to other rates and the GSA definition of the range of reasonableness for class rates of return. The PSC also rejected the FEA request for the creation of a new user class for the federal government. That proposal was opposed by both PEPCO and OPC. The PSC found no evidence that federal government usage had characteristics substantially different from other large users to warrant the creation of a new user class.

In brief, this rate case involved some issues (cost allocation method) in which the interests of a large agency user did not conflict with the interests of small users. In contrast, there were issues (class revenue allocation) in which the interests of a large agency user did conflict with the interests of small users.

7. New Mexico Public Service Commission (Case No. 1916). This was a rate case involving the Public Service Company of New Mexico (PNM). FEA testimony focused on revenue requirement issues and the PNM cost of service study. The FEA testimony recommended several adjustments to the revenue requirements proposed by PNM, e.g., a reduction in fuel expenses, a reduction in operating expenses, and a decrease in rate base.

The PSC ignored the FEA recommendation on fuel expenses; no other party supported the FEA on this issue. The PSC rejected the FEA recommendation on operating expenses; the industrial intervenor supported the FEA on this issue. The PSC accepted the FEA recommendation on rate base reduction; the FEA was supported on this issue by both the Office of the Attorney General of New Mexico and the PSC staff. Not surprisingly, it appears that agency testimony may be more influential in a commission decision if it is supported by other parties, particularly the commission staff.

8. Ohio Public Utilities Commission (Case No. 682-517-EL-AIR). This was a rate case involving the Dayton Power and Light Company (DPL). The FEA, among other things, objected to the inclusion of CWIP (for the Zimmer nuclear plant) in the rate base of DPL. The FEA recommended the exclusion of CWIP and the allowance of AFUDC.

The FEA position was the same as that of the PUC staff. The PUC in its decision excluded CWIP from the DPL rate base. A somewhat surprising aspect of this case is that the FEA and PUC staff was not joined by the Office of Consumers' Counsel on the CWIP issue.

9. Idaho Public Utilities Commission (Case No. U-1006-265). This was a rate case involving the Idaho Power Company (IP). The FEA provided testimony on revenue requirements and power costs.

The FEA testimony recommended a series of adjustments to revenue requirements including the reduction of required coal inventory in rate base, reduction in wages, reduction in depreciation, and a reduction in taxes. IP was a utility in which hydro accounted for the bulk of power generation. Thus, under favorable water conditions, a higher percentage of generation comes from hydro relative to thermal thus reducing power supply costs. The FEA recommended the use of a fuel adjustment mechanism to reflect changes in power supply costs due to changes in water conditions.

The PUC in its decision accepted the FEA recommendation on wages. This recommendation was supported by the PUC staff. The PUC accepted the FEA recommendation on coal inventories also supported by the PUC staff. The PUC rejected the FEA recommendation on depreciation, taxes, and the fuel adjustment clause for power supply costs. These latter recommendations were not supported by any other parties.

Again, a critical variable in the influence of agency testimony may be whether it is supported by other parties, perhaps especially the commission staff.

10. Illinois Commerce Commission (Docket Nos. 83-0537 and 84-0555). This was a rate case involving the Commonwealth Edison Company (CE). Government agency testimony involved class revenue responsibilities, street lighting, and transit rates.

The DOE criticized the CE method of distributing the revenue increase to customer classes; DOE testimony proposed an alternative method of revenue distribution which increased residential and street lighting rates more than

the CE proposal and increased large commercial/industrial rates less than the CE proposal. Both the CE and DOE proposals had residential, street lighting, and transit rates increasing by nearly double that of large commercial/industrial rates.

The City of Chicago (COC) and the Illinois Department of Transportation (IDOT) attacked the CE proposed increase in street lighting by arguing that street lighting is essentially off-peak. The Chicago Transit Authority (CTA) attacked the CE proposed increase in transit rates arguing that rapid transit provides substantial benefits to the metropolitan area and that the transit rate increase was not cost-based.

The CC in its decision did not acknowledge the DOE testimony on interclass revenue allocations. The CC rejected most of the recommendation offered by COC/IDOT regarding street lighting. The CC noted that most of the CTA arguments regarding transit rates were without merit and thus rejected them. The CC decision noted that CE was not the primary opponent of the intervenors in the area of revenue responsibility and rate design. The primary opponent was the other intervenors who favored alternative rate designs. It is obvious that the agency intervenors disagreed more with each other than with CE.

In summary, this is a case pitting government agency intervenors against each other, i.e., street lighting versus transit versus general large user rates. The CE proposals regarding rate design were generally adopted; the recommendations of the agency intervenors were rejected.

#### Telecommunications Case Intervention

Four telecommunications rate cases were selected for examination.

1. Maryland Public Service Commission (Case No. 7788). This was a case involving intrastate interexchange rates for AT&T Communications (AT&T). The DOD provided general testimony on pricing. The testimony focused on the effects of intrastate carrier access charges on MTS, WATS, and private line rates.

DOD argued that MTS, WATS, and private line rates (via carrier access charges) were providing subsidies to local exchange customers, thus creating the environment for system bypass. DOD recommended that the PSC conduct an in-depth examination to determine a cost basis for the access charges. DOD

also recommended that AT&T be provided greater flexibility in pricing (as requested by AT&T) and that TELPAK service be terminated at some specified future date.

Regarding access charges, the PSC rejected DOD testimony by noting that the issue of access charges, imposed by Chesapeake and Potomac Telephone Company (CP) on AT&T, was outside the scope of this particular case. Regarding present rates, the PSC noted that no party questioned current AT&T rates as being anticompetitive or discriminatory; instead, the testimony of DOD and others was directed toward whether the current rates were excessive. The PSC accepted the current rates as reasonable.

Regarding pricing flexibility, the PSC staff (as well as the Office of People's Counsel and CP) recommended moving gradually toward pricing flexibility. The PSC held that pricing flexibility would be implemented in future cases. Finally, the PSC adopted the DOD position of specifying a reasonable planning horizon for TELPAK service termination.

The DOD testimony had mixed results in influencing the PSC decision. It had substantial influence on the TELPAK issue, lesser influence on pricing flexibility, and little or no impact on access charges and current rates.

2. Maryland Public Service Commission (Case No. 7851). This was a case involving local exchange rates for Chesapeake and Potomac Telephone Company (CP).

The FEA provided both general and rate design testimony. The FEA noted that Centrex rates were excessive thus creating the potential for system bypass; examples of federal agencies replacing Centrex were cited. The FEA recommended that the Centrex access charge for large users not be increased. The FEA testimony also recommended that business message rates be reduced to the level of residential message rates with the revenue loss being absorbed by increased monthly residential rates. The FEA also urged that CP be allowed to offer bulk discounts for unit message charges. Finally, the FEA recommended that residential rates be increased by a greater amount and that business rates be increased by a lesser amount than that proposed by CP.

Regarding Centrex access charges, the PSC rejected the FEA recommendation of no increase. The industrial intervenors joined the FEA in advocating equal unit message charges for residential and business users. The PSC rejected this approach noting the potential for increased

residential charges. Regarding business and residential rates, the PSC followed the advice of PSC staff by not allowing either to increase as much as requested by CP. The FEA recommendation of a reallocation of the increase between business and residential was not addressed in the decision.

In addition to CP the PSC staff and the Office of People's Counsel presented comprehensive cost of service studies; the FEA did not. One conjectures that this might explain why the FEA recommendations were rejected in the PSC decision.

3. Indiana Public Service Commission (Cause No. 38059). This case involved a proposal (local calling plan) by Indiana Bell Telephone Company (IB) to change the flat rates for basic local service to a rate structure having access charge and usage charge components. The same usage charge would apply to both residential and business.

The FEA opposed the implementation of the proposal involving mandatory local measured service; the FEA testimony was supported by similar testimony from industrial intervenors. The FEA objections were primarily oriented toward the lack of cost-based charges. It was estimated that the IB proposal would increase business message rates 25 percent above current levels. The FEA argued that the increase in rates would lead to local exchange bypass.

The PSC in its decision adopted the IB local calling plan proposal with some modifications. For example, the proposal involved time-of-day pricing. Despite the objections of several intervenors including the Office of the Utility Counselor (OUC), the PSC adopted, for the most part, the IB statewide system of peak and off-peak hours. Regarding the IB proposal of maximums on bills for local usage, given the objections of the OUC, the PSC rejected these maximums as inefficient.

The FEA testimony was largely rejected in the PSC decision. The consumer advocate's (OUC) participation appears to have influenced the decision substantially more than the PSC staff and intervenors such as the FEA.

4. Minnesota Public Utilities Commission (MPUC Docket No. P-421/CI-85-352). This case involved a system of intrastate access charges proposed by Northwestern Bell Telephone Company (NWB).

The DOD provided general testimony oriented toward access charge levels and their potential effect on MTS and WATS charges as well as the

implications for system bypass. The DOD recommended cost-based tariffs for each service, i.e., set access charges at the incremental costs users impose on the local exchange carrier. The DOD testimony did not distinguish between switched interLATA access charges and end-user access charges.

The Minnesota Department of Administration (DOA) provided more specific testimony. The NWB proposal on end-user charges involved the flowing through of revenues to decrease carrier access charges. The DOA recommended that the PUC insure that the end-user revenues be used to reduce MTS and WATS rates charges by the interexchange carriers.

The PUC accepted the NWB proposal for interLATA switched access charges with a minimum of modifications. The FEA testimony was generally rejected in the PUC decision. The PUC rejected the NWB proposal for end-user charges on local customers. This rejection appeared to be heavily influenced by the testimony of the Department of Public Safety. The PUC acknowledged the DOA testimony by noting that future rate cases would focus on the implications of decreased carrier access charges on toll rates.

In summary, this case involves one state agency intervenor (DOA) influencing the regulatory outcome substantially more than a national agency intervenor (DOD).

#### An Overview of Outcomes

Fourteen cases were examined in which government agency testimony was provided. The influence of agency intervention (as large users of utility services) varied substantially across the fourteen cases. However, several generalizations regarding the effectiveness of agency testimony can perhaps be made.

First, government agency testimony is more influential on issues in which the interests of large users do not directly conflict with the interests of small users than on issues in which the interests of small and large users do conflict. In other words, government agency intervention is more effective when supported by testimony of intervenors such as consumer advocates. Second, as with other participants, government agency testimony involving extensive analysis (e.g., cost of service studies) is more effective than testimony unsupported by analysis. Not surprisingly, agency testimony unsupported by analysis has a higher probability of being rejected

in the regulatory outcome. Third, government agency testimony is more influential when it is similar to testimony of other interested parties (e.g., regulatory commission staff). It is less effective when supported only by other large users such as industrial intervenors. Fourth, government agency testimony can be self-defeating in those rare cases in which one agency intervenor confronts other agency intervenors. When the public utility is replaced by other government agency intervenors as the primary opponent in the regulatory process, the testimony of agency intervenors has a high probability of offsetting each other, thus greatly diminishing their roles in shaping the regulatory outcome.





**CHAPTER FOUR**  
**SUMMARY AND CONCLUSIONS**

There is evidence of federal agency participation in utility regulation cases as early as 1940. However, the practice of government agencies (as large consumers of utility services) contesting before state and federal regulatory commissions has increased substantially in both its extent and frequency in the past two decades. In many cases, the participation has taken the form of intervention (as interested parties) before a regulatory commission and has often involved the provision of formal testimony.

This report consisted of several elements. One was an examination of the frequency of government agency intervention and the types of cases in which agencies have intervened. A second element was an analysis of several cases involving government agencies as intervenors. A final element is an overall appraisal of government agency intervention. This final component implicitly involves an examination of two divergent views. On the one hand, some argue that regulatory commissions in their orders generally give little weight to testimony provided by government agency intervenors. This line of reasoning flows from the perception that agency intervenors make little pretense of acting in the public interest, engage in very limited intervention, and adopt postures in their testimony no different from other large users of utility services. This narrow approach could be explained either by a lack of resources, lack of professional staff, or by the absence of an unambiguous intervention philosophy. Others argue, on the other hand, that testimony provided by government agency intervenors has had a substantial influence on regulatory outcomes, particularly over the long-run. This line of reasoning flows from the perceptions that bypass of the present supplier of utility services is not an idle threat and that agency intervention is clearly focussed and is frequently supported by extensive analyses.

An Appraisal of Agency Intervention

Numerous persons in the field of public utility regulation were questioned as to the overall effectiveness of agency intervention. These

sources represent a cross-section of regulatory staff, government agency personnel, and consultants providing agency testimony. The sources characterized agency intervention as ranging from ineffective to modestly effective.

One conclusion that clearly emerges from the questioning of persons closely associated with agency intervention is that government agency participation in the regulatory process is not monolithic or homogeneous. This applies particularly to intervention by federal agencies. For example, the NRRI survey noted that some agency participation is for "monitoring" purposes and does not incorporate any formal testimony. This limited intervention (in some cases involving, at most, cross-examination of utility and commission staff witnesses) was cited by several sources as seriously constraining the effectiveness of agency intervention. In addition, where testimony is provided, some agencies merely prefile written testimony, request specific hearing dates for its witnesses (in many cases, not in the normal hearing sequence), and have the witnesses appear. The agencies may not conduct any major cross-examination, file any analyses or studies supporting their positions, or provide specific alternatives to the proposals of the utilities. Several sources noted that this type of participation is rarely productive and can alienate commissions and commission staffs. The latter depend upon the development of a thorough record and a clear understanding of the positions of each participant in the case.

In contrast, other agencies participate actively in rate cases (e.g., counsel and witnesses attend a majority of the hearings) and engage in extensive cross-examination of the testimony provided by the utility, commission staff, and other intervenors. The testimony of these agencies is typically supported by in-depth analyses and generally provides specific alternatives to utility proposals. These agencies routinely file briefs when permitted by the regulatory process. One source cited an example of an agency which requires its expert witnesses - subsequent to the issuance of the commission order - to prepare an analysis of the effectiveness of the agency's intervention.

In brief, the effectiveness of agency intervention can vary substantially across agencies; this variance is a function of staffing, resources, intervention philosophy (or lack thereof), etc. Some agencies

appear to have highly organized and professional intervention programs and thus are more effective than agencies that lack resources, lack experienced staff, and have an ambiguous intervention philosophy. In addition, there are differences in the quality of intervention across utility services, depending upon their importance to the particular agency. That is, electricity, natural gas, and telecommunications cases are not necessarily handled with the same degree of thoroughness by a particular agency. Thus, one can not easily generalize regarding the effectiveness of agency intervention, particularly at the federal level.

A potential source of federal agency ineffectiveness, according to some, is fragmentation in the procurement of services. For example, at the Department of Defense (DOD), local telephone services are the responsibility of individual military bases or defense agencies. For the civilian agencies, most services are procured through the General Services Administration (GSA). Despite some coordination among agencies, this fragmentation limits attempts at constructing an appropriate database to be used in testimony and perhaps precludes the presentation of a consistent regulatory posture. This fragmentation extends to representation responsibility before regulatory commissions. As several sources noted, the responsibility for representation does not necessarily lie with the procurement group that is most likely to be harmed by ineffective representation. Moreover, any benefits from effective participation flow to the procurement agency rather than to the representing group. The procurement and representation fragmentation appears to have created a system in which agencies are not necessarily accountable for their performance and are unlikely to properly be rewarded for their efforts.

As to representation, the GSA has primary responsibility for representation and ultimate authority to designate intervenors. However, the GSA generally surrenders this authority whenever an agency has the funds, willingness to intervene, and a dominant interest in the case. As a result, there has emerged an informal but somewhat rigid assignment of intervenors. For example, specific states can be labeled as "Air Force," "Navy," and "Department of Energy." Increased centralization, according to one source, would result in quicker responses to regulatory schedules and thus more effective intervention.

As one would hope, a factor consistently cited as a contributor to the effectiveness of testimony was the quality of testimony. Legitimate testimony supported by extensive analysis enhances the credibility of the agency position, while testimony unsupported by analysis has the opposite effect. Several sources noted that agency testimony is more effective when the intervenor views issues from the perspective of the needs of the regulatory commission, i.e., the intervenor focuses on providing important input to the commission. Several sources noted that effectiveness is enhanced when the agency posture coincides, rather than conflicts, with the positions of other interested parties in the regulatory proceeding. Another source indicated that effectiveness is hampered by the providing of general, rather than case-specific testimony, i.e., some agency testimony does not seem to vary from case-to-case.

A possible constraint on the effectiveness of federal intervention is the absence of a database that provides composite bills to agencies in each regulatory jurisdiction. There is an absence of usable information on utility expenditures by agency or by government facility. One conjectures that the fragmentation in the procurement of utility services has precluded attempts at constructing a usable database. Agency intervention would be substantially enhanced if a utility expenditure database was constructed. What is needed is a reporting system incorporating data such as expenditures by utility service, government installation, and agency for each utility service area. This type of information would be of value in agency decisions regarding the nature and extent of intervention in particular rate cases.

Similar to the survey respondents, the majority of the sources interviewed indicated no substantial recent decrease in the frequency of government agency testimony. One might have expected a decrease in agency intervention as a result of declining inflation rates, relatively stable energy prices, and the trend toward deregulation in both telecommunications and energy. In fact most sources indicated that they believe agency intervention to be a permanent rather than a transitory element in the regulatory process.

Government agencies could be expected to be different from industrial intervenors in behavior and motivation. For example, government agencies are not viewed as profit maximizers, as are private firms. Therefore, one

anticipates differences in intervention behavior. Further, the objectives of government agencies and industrial intervenors are different. The motivations of agencies include budgetary constraints, known public resistance to tax increases, and the magnitude of cost savings from utility rates either decreasing or not increasing as much as they would have without agency intervention. Government agencies thus are driven by a combination of public interest goals and budget limitations. Of course, the absence of a profit motive also applies to governmental consumer advocates, nongovernmental consumer advocates, and commission staff. In contrast, industrial intervenors are primarily driven by the profit motive. Firms in the private sector adopt public interest goals only if that is perceived to be good public relations in a particular instance.

The survey, examination of case studies, and questioning of sources, then, reveal that government agencies do not exhibit intervention behavior identical to industrial intervenors. Interestingly, several sources concluded that industrial intervenor testimony is more effective than agency testimony, with the same quantity of input. For example, in some cases, the industrial intervenors coordinate their activities with the public utility. The regulatory commission may be more apt to accept industrial user input than agency input, based on fear of loss of that industry (government agencies may be perceived as generally immobile). In this context, several sources noted that captive customers in monopoly markets have more to fear from industrial intervenors than from agency intervenors. That is, industrial intervenors tend to have a narrow focus on rate design while agency intervenors have a broader focus on both rate design and revenue requirements. Thus, agency interests, as compared to the interests of industrial users, may conflict less with the interests of the captive consumers. This may not be due to the ineffectiveness of agency intervention but rather due to some agencies striving to balance the interests of a large user (and protection of public funds) with the interests of the public as taxpayers and ratepayers.

### Conclusions

Historically, federal agencies have tended to refrain from interference in the operation of lower levels of government, unless intervention was

ascertained to be absolutely necessary. However, regarding intervention in the utility regulation process, this general aversion to lower level intervention appears to no longer apply. The survey, examination of case studies, and questioning of numerous sources clearly indicate significant intervention in the state regulatory process by federal agencies (as large users of utility services).

The intervention by a federal agency (or by a state department of administration) in the state regulatory process raises questions regarding political and economic leverage. One conjectures that there are opportunities for some agencies to exert undue leverage on the regulatory outcome. This potential for political leverage (with price discrimination and cross subsidization the results) distinguishes some agency intervenors from industrial intervenors. However, certain industrial firms can exert unusual economic leverage where they are monopsonistic (or oligopsonistic) buyers.

Participation by government agencies is generally accepted by regulatory commissions. Agencies, for the most part, provide valuable input to the regulatory process. The concerns by regulators with agency intervention appear to be the already prolonged proceedings and the rate design postures that seek to shift costs from agencies to captive residential customers. Of course, further extending the lengthened regulatory process must be balanced against the input provided by government agencies which strengthens the case record.

Happily, the most important factor in determining the effectiveness of agency intervention is the quality of testimony. Testimony supported by in-depth analysis is more effective than either general testimony or testimony unsupported by analysis. Testimony is more effective when the intervenor submits its own analysis (and accounting adjustments) and recommends a specific revenue requirement level, rather than merely providing a general criticism of the utility position. In cases in which emphasis has been clearly focussed (and resources have been adequate), agency intervention has generally been effective. In cases in which involvement has been less thorough (e.g., prefiled testimony with insufficient analysis) agency intervention has generally not been persuasive.

One motivation for agency participation in the regulatory process appears to be the perception of government as a ratepayer who is passive and

has "deep pockets." An aggressive intervention program can be designed to change that perception. In this context, agency intervention affects the public interest by protecting the fiscal health of the government agency. This incentive is not expected to diminish in the future. Another motivation for agency participation is the perception that regulators are relatively insensitive to interests not directly represented in regulatory proceedings. For example, in the past decade, agencies have become more visible in their intervention so as to insure equitable rate treatment and preclude commissions from implicitly levying costs on customer groups not actively engaged in intervention. This motivation, too, will not likely disappear but could intensify with the current societal attitude of wanting government to act "more like a business."





**APPENDIX A**  
**NRRI SURVEY INSTRUMENT**

This appendix contains the survey instrument for the NRRI survey of regulatory commissions on government agency intervention.

**NRRI SURVEY ON GOVERNMENT AGENCIES  
AS PARTICIPANTS IN THE REGULATORY PROCESS**

The primary focus of this research inquiry is to examine since 1975 the changing relationships among government agencies as consumers of utility services, regulatory commissions, and utility companies, (i.e., electric, natural gas, telecommunications and water). In the past decade state, local and federal government entities have increasingly become intervenors before state and federal regulatory commissions. This current inquiry is intended to shed light on the frequency, occasions, and nature of that participation.

It would be very helpful and greatly appreciated if you would complete and return the following four survey questions by June 1, 1987 to Dr. Patrick C. Mann, Institute Associate, c/o NRRI, 1080 Carmack Road, Columbus, Ohio, 43210. Please provide the name (and telephone number) of a contact person from whom, if necessary, further information can be obtained on this subject.

Question 1:

During the period of 1975-1986, on how many occasions have government agencies (whether local, state or federal agencies) intervened in cases before the state regulatory commission?

Who were the government agency intervenors in each case?

Question 2:

What types of testimony have been provided by these governmental agencies (e.g., rate design, cost allocation, profitability)?

Question 3:

Are there significant differences in the posture of government agency intervenors in rate or other cases as compared to investor-owned utilities, public advocates, and industrial customers?

Question 4:

What regulatory and/or public policy problems, if any, are created because of the increased participation in the regulatory process by government agencies-local, state, or federal?

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#### C. Resource Persons

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