



Committee Report, Vol. 16, No. 4

**Public Service Commission's Office of the
Public Advocate: An Examination of
Statutory Compliance and the Efficiency and
Effectiveness of the Current Contract**

Legislative Audit Office

April 2010

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April 2010

Prepared by
Stephanie Meese
Dana McNeil

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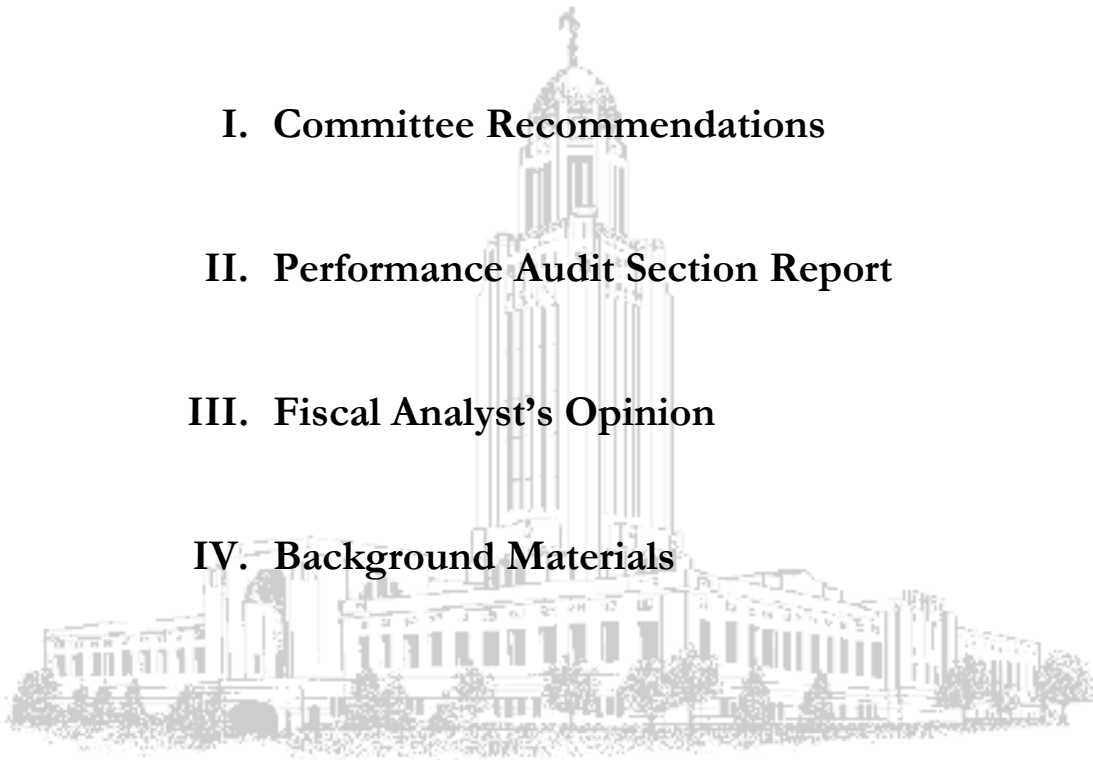


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Audit Summary

By law, the Natural Gas Regulation division of the Public Service Commission (PSC) must create the office of the Public Advocate, for the purpose of representing consumer interests in PSC proceedings. Rather than assigning the position of Public Advocate to a designated state employee within a separate division of the PSC, the agency has engaged the services of an outside law firm with one of the attorneys of this firm acting as the Public Advocate.

By statute, the costs of the program are paid by the regulated utilities and passed on to customers in the form of a surcharge on natural gas bills. The amount spent on legal services by the program has ranged from \$51,000 in FY2004-05 to \$630,000 in FY2007-2008. In the last fiscal year, FY2008-09, roughly \$390,000 was spent on legal services. These figures raised questions as to whether this contractual arrangement was compliant with the statutory requirements governing this office and whether there could be cost savings if this function was handled in-house by a state employee rather than outsourced.

The audit staff found that the PSC's decision to outsource the public advocate was not prohibited by law and was therefore compliant with the relevant statutes. We also found that outsourcing the duties of the position was more cost effective and efficient than hiring a state employee.

The following are the Performance Audit Committee's specific recommendations for this report.

SECTION I: Public Service Commission's Statutory Compliance with Public Advocate Position Requirements

Finding: We believe the PSC's decision to outsource the public advocate position complies with the statute.

Finding: We believe the current location of the public advocate office reflects a reasonable interpretation of the statute.

Recommendation: None.

Finding: The PSC is noncompliant with the statutory requirement that it promulgate rules and regulations specific to the location of the public advocate office.

Discussion: The PSC provided us with their draft rules and regulations which address this matter and stated that this draft will likely be released in March in order to incorporate any possible changes necessitated by the SourceGas ruling, due in late February.ⁱ

Recommendation: The PSC should promulgate the relevant regulations immediately.

SECTION II: Efficiency and Effectiveness of Current Public Advocate Contract

Finding: The PSC's decision to outsource the public advocate position is more efficient and effective than hiring an in-house public advocate.

Finding: The PSC's annual expenditure for the public advocate's services has never exceeded what the Legislature authorized it to spend.

Recommendation: None.

ⁱ Email from Mike Hybl, January 28, 2010.



II. Performance Audit Section Report

Legislative Audit Office Report

Public Service Commission's Office of the Public Advocate: An Examination of Statutory Compliance and the Efficiency and Effectiveness of the Current Contract

April 2010

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Stephanie Meese
Dana McNeil

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INTRODUCTION

Nebraska law requires the Natural Gas Regulation division of the Public Service Commission (PSC) to create the office of the public advocate, for the purpose of representing consumer interests in PSC proceedings. The PSC did this by outsourcing the position to a local law firm. The Auditor of Public Accounts questioned whether contracting to fill this position complied with statutory requirements and referred this matter to the Legislative Performance Audit Committee (Committee).

In January 2010, the Committee directed the Legislative Audit Office (Office) to conduct a performance audit of the public advocate position, focusing on statutory requirements for the PSC in creating and overseeing this position. Specifically, the Committee directed the Office to answer the following questions:

- 1) Does the PSC's contract for legal services meet the duties of the public advocate, laid out in §§ 66-1830 - 66-1835?
 - More specifically, do these statutes allow/prohibit the use of a contracted attorney for the public advocate position?
- 2) Efficiency and Effectiveness of Current Public Advocate Contract:
 - From the perspective of the PSC, what necessitates that the public advocate position be outsourced rather than filled with a state employee?
 - What are the advantages and disadvantages, including cost and overall effectiveness, of employing an in-house public advocate versus outsourcing the position?

Sections I and II of this report give an overview of the creation of the public advocate position and answer the specific questions posed for this audit. Section III contains our findings and recommendations.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The methodologies used are described briefly at the beginning of each section.

We appreciate the cooperation and assistance of the PSC during the audit.

SECTION I: Public Service Commission’s Statutory Compliance with Public Advocate Requirements

In this section, we give a brief overview of the history of the Public Service Commission’s (PSC’s) Office of the Public Advocate. We also report the results of our analysis of the PSC’s statutory compliance with the requirements for the position. Our evaluation is based on interviews with PSC staff, the attorney currently serving as the Public Advocate, our review of PSC administrative regulations, legislative history and relevant statutes, and information obtained from the PSC Web site.

Creation of the Office of the Public Advocate

In 2003, the Legislature passed LB 790, the State Natural Gas Regulation Act, which created the office of the public advocate as well as a Natural Gas Department within the PSC. Under the Act, the public advocate’s purpose is to represent ratepayers as a class in the litigation of rate cases filed by natural gas companies. The Act established the office as a “separate and independent division” within the PSC.¹

The public advocate, who must be an attorney with experience in consumer-related utility issues or the operation of utilities, is appointed to a four-year term by the executive director of the PSC and can only be removed for good cause.² If necessary to discharge his/her duties, the public advocate can hire or contract with additional staff—such as attorneys, legal assistants, experts, consultants, secretaries, and clerks—as provided in the public advocate’s budget, which must be approved by the PSC.³ The position is funded through an assessment process: the gas companies pay for the program but recoup the costs from the customers in the form of a surcharge on their gas bills.⁴

Public Advocate Powers

The public advocate’s function is to represent the interest of ratepayers in the litigation of rate cases filed by natural gas companies, and other related matters. A rate case begins when a natural gas company files a request for a rate increase with the Commission. The public advocate defends the public as a class against the rate increase, either by litigating the case before the Commission or reaching a settlement with the natural gas company.

By law, the public advocate is given a number of powers to use in fulfilling his/her function, including the ability to “investigate the legality and reasonableness of rates, charges, and practices of jurisdictional

utilities” and “represent and appear for ratepayers and the public in proceedings before the Commission and in any negotiations or other measures to resolve disputes that give rise to such proceeding.”⁵ Additionally, the public advocate is allowed by law to enter into stipulations with the other parties in a rate cases or other proceedings in order to potentially lower the cost of regulation as well as allow the Commission to make the best possible decision for all parties.⁶

The public advocate is statutorily barred from advocating on behalf of any single individual, organization or entity.⁷ Due to this prohibition, the public advocate cannot handle individual utility consumer complaints because the public advocate represents a class of clients.⁸

Agency Statutory Compliance

Rather than retain an in-house attorney to serve as the public advocate, the PSC has outsourced the position to a local law firm with one attorney appointed as the public advocate. The primary statutory compliance question in this audit is whether outsourcing this position complies with statutory requirements and legislative intent.

We found that there are no restrictions in statute regarding the use of a contracted attorney for the public advocate position. While the language used in this section of law—including “his or her powers” and “no person”—indicates that the Legislature envisioned an individual serving in this position, the language contains no clear statement about whether the position should be filled by a state employee.⁹ The statute could be read to suggest that the public advocate be a state employee as the office was created as a division “within the PSC;” however, the requirement that the individual holding the position serve a four-year term suggests that the position be filled by contract.

When statutory language can be interpreted in more than one way, we normally look to the legislative history to see if debate clarifies the Legislature’s intention. In this case, however, there is no legislative history, because the relevant language was added as a select file amendment with no discussion.

In the absence of a statutory requirement that the public advocate be a state employee, or legislative intent to that effect, we believe the PSC’s decision to outsource the position complies with the statute.

<p>FINDING: We believe the PSC’s decision to outsource the public advocate position complies with the statute.</p>

The statute also emphasizes that the office of the public advocate must be “separate and independent” and that no employees of the

public advocate be supervised or directed by the PSC.¹⁰ The law requires that the public advocate’s physical office be “at the same location as the commission” but be kept separate from the PSC’s other offices as provided by PSC rules and regulations.¹¹

The Public Advocate’s current office—that of the office of the law firm under contract—is located in the same city block as the PSC office. The PSC believes that this arrangement complies with the statutory requirements for the office; however it has not promulgated regulations addressing this issue as required.

We found the language requiring the office be “at the same location as the commission” somewhat vague. While it might be read strictly as requiring the office to be in the same office or building as the PSC, it might also be read less strictly to mean near by. We believe that when the requirements for the office are read together, they reflect the Legislature’s attempt to ensure that the public advocate’s office would be physically located near the PSC in order to be accessible but separate enough to ensure its independence from the PSC. Consequently, we believe that the current location of the public advocate office reflects a reasonable interpretation of the relevant statutory provisions.

FINDING: We believe the current location of the public advocate office reflects a reasonable interpretation of the statute.

FINDING: The PSC is noncompliant with the statutory requirement that it promulgate rules and regulations specific to the location of the public advocate office.

Notes

¹ Neb. Rev. Stat. § 66-1830(1).

² Neb. Rev. Stat. §§ 66-1830(2) and (3).

³ Neb. Rev. Stat. § 66-1832.

⁴ Neb. Rev. Stat. § 66-1832.

⁵ Neb. Rev. Stat. § 66-1831(1).

⁶ Neb. Rev. Stat. § 66-1831(3).

⁷ Neb. Rev. Stat. § 66-1831(2).

⁸ Neb. Rev. Stat. § 66-1830 and interview with Harding & Shultz, January 20, 2010.

⁹ Neb. Rev. Stat. § 66-1830(1) and (3).

¹⁰ Neb. Rev. Stat. §§ 66-1830(1) and 66-1832.

¹¹ Neb. Rev. Stat. § 66-1832.

SECTION II: Efficiency and Effectiveness of Current Public Advocate Contract

In this section, we discuss the Public Service Commission's (PSC's) rationale for outsourcing the duties of the public advocate. The scope statement for this audit also anticipated a discussion of both the advantages and disadvantages, including cost and overall effectiveness, of employing an in-house public advocate versus outsourcing the duties of the position. However, we were not able to identify any advantages to employing an in-house public advocate, which we discuss at the end of this section.

Our evaluation is based on interviews with the PSC Executive Director, the PSC Commissioners and the current Public Advocate, billing records and a cost comparison analysis prepared by the PSC, relevant statutes, and legislative history.

PSC Rationale for Outsourcing the Duties of the Public Advocate

After passage of the State Natural Gas Regulation Act (SNGRA), which created the Office of the Public Advocate, the PSC initially sought to fill the position in-house at a salary of approximately \$70,000 to \$75,000.¹ While the applicant pool was good, the PSC determined that none of the applicants had sufficient litigation and natural gas regulation experience to handle the highly complex rate disputes filed by the utilities. This was particularly significant because the first rate case had already been filed and there would be little or no time for training.²

Before issuing a Request for Proposal (RFP) for the position, the PSC consulted with former Senator David Landis, sponsor of LB 790, which became SNGRA. Senator Landis had no objection to outsourcing the position, as long as the ratepayers received quality representation and the public advocate remained insulated from the PSC.³

Several law firms responded to the RFP. The contract was awarded to Harding & Shultz, with Roger Cox designated as the Public Advocate.⁴ The PSC selected Harding & Shultz, in large part, because of the natural gas litigation experience and contacts within the utility regulation community, which Mr. Cox acquired working in the system that existed prior to the enactment of SNGRA.⁵

In addition to the need for considerable expertise, the PSC believes there are four other reasons to outsource the public advocate position: the downtime between rate cases; potential conflict of interest

issues; cost; and the possible inability to retain an in-house public advocate. Following is a discussion of each of those issues.

Downtime

As shown below, rate cases take seven to eight months to process from the utility’s initial filing to the issuance of the final order. Litigating rate cases is very time and resource intensive, but there are substantial periods of time between cases. As Table 2.1 shows, there were 28 months between the first two rate cases filed and 23 months between the third and fourth rates cases.

Table 2.1: Natural Gas Rate Cases					
<i>Utility Applicant</i>	<i>Date Application Filed</i>	<i>Date of Commission’s Final Order</i>	<i>Approximate Length of Case</i>	<i>Mode of Disposition</i>	<i>Approximate Time Between Cases</i>
Aquila	06/30/2003	01/21/2004	7 months	Settlement approved by Commission	
Kinder Morgan	06/02/2006	12/27/2006	7 months	Settlement approved by Commission	28 months
Aquila	11/15/2006	07/24/2007	8 months	Tried and final decision rendered by Commission	1 month overlap
SourceGas	07/02/2009	Final order expected approximately 02/23/2010	8 months	Tried and awaiting final decision by Commission	23 months
Black Hills Energy	12/01/2009	Hearing scheduled for 05/24/2010; final order expected on or before 08/10/2010		Pending	3 month overlap

Table created by the Legislative Audit Office, data compiled from table provided by Harding & Shultz, February 10, 2010.

In addition, the workload varies considerably even during a single case. Harding & Shultz’s billing records show a fluctuation of a low of 14 hours in a month spent on public advocate work to a high of 373 hours. (see *Appendix A*) By law, the public advocate’s duties are restricted to representing jurisdictional ratepayers in utility rate increase disputes and related matters, which would leave an in-house public advocate with significant periods of time with little to do.⁶ Consequently, under current law, the PSC believes that outsourcing is

the more efficient and effective way of dealing with these workload fluctuations.

Conflict of Interest Issues

The PSC is concerned that a statutory amendment to allow the public advocate to work in other areas regulated by the PSC could raise questions about a potential conflict of interest or the appearance of a conflict. Independence from other business of the PSC is of paramount importance to the public advocate's credibility in order to avoid all appearances of impropriety. Involving the public advocate in other PSC business could potentially conflict with the public advocate's duty to represent the natural gas ratepayers and would be a viable conflict of interest argument on behalf of the utilities.

One Commissioner also pointed out that the current funding for the public advocate position—which comes from utility fees—could not be used to pay the public advocate for other types of work. If the statute was amended to allow the public advocate to work in other areas—for example, telecommunications or transportation—the salary for the new duties would have to be paid from general funds.⁷

Cost

Additionally, the PSC calculated that it would be more expensive to hire an in-house public advocate, rather than outsourcing the position. From November 2004 through June 2009, \$1,196,059 has been paid to Harding & Shultz under its contract with the PSC.⁸ According to the PSC and the Public Advocate, the cumulative ratepayer savings from all concluded rate cases has been over \$41 million.⁹ (*See Appendix B*)

The term of the first public advocate contract began in November 2004 and was renewed in November 2008. Prior to this renewal, the PSC prepared an analysis which compared the costs of the current contract to the cost of hiring the public advocate in-house. (see Table 2.2) This analysis compared the cost of the current Natural Gas Department, which consists of the Natural Gas Director and one administrative assistant, to what the PSC has paid to Harding & Shultz for public advocate work.¹⁰ The PSC used the costs of the Natural Gas Department as a comparison since the public advocate office would likely need the same level of administrative support as well as other operating costs, including separate office space.¹¹ The analysis excluded consultant costs because this amount would remain the same regardless of whether the public advocate was in-house or outsourced.¹²

<i>Fiscal Year</i>	<i>In-House Public Advocate Expense - Estimate*</i>	<i>Public Advocate Expense - Actual</i>	<i>Consultants/Experts Expense - Actual**</i>	<i>Total for All Natural Gas Regulation Expenses</i>
2003-04	\$188,916	\$43,612	\$77,925	\$310,453
2004-05	\$130,949	\$51,145	\$0	\$185,094
2005-06	\$198,684	\$136,670	\$11,679	\$347,033
2006-07	\$245,703	\$267,332	\$121,474	\$634,509
2007-08	\$329,575	\$396,968	\$230,389	\$956,932
2008-09	\$287,470	\$300,332	\$87,601	\$675,403
Total:	\$1,381,297	\$1,196,059	\$529,068	\$3,109,424

Table created by the Legislative Audit Office; data compiled from cost break-down provided by PSC and totals confirmed against Legislative Fiscal Office numbers.

**Includes salaries of Natural Gas Director and administrative assistant as well as operational expenses, does not include costs of public advocate or consultants.*

***Consultant costs are listed separately as it would likely remain the same regardless of whether the public advocate was in-house or outsourced.*

This analysis, which the PSC updated through June 30, 2009, estimated that employing an in-house public advocate would have cost the ratepayers almost \$1.4 million or about \$200,000 more than the approximately \$1.2 million spent for the outsourced public advocate.

Moreover, the PSC's analysis does not include three items which the PSC believes would further inflate the cost of retaining an in-house public advocate. First, the costs would be higher, at least initially, because the individual would likely be inexperienced in utility rate case litigation and would need to consult with a natural gas litigation specialist. Second, it is unlikely that the PSC would be able to hire a qualified individual for the public advocate position at a comparable salary to that of the Natural Gas Director—currently approximately \$70,000 annually—due to the high level of legal and natural gas experience required to litigate rate cases. The PSC estimates it would require a salary of \$100,000 to \$150,000 to retain an in-house public advocate who could provide a similar level of representation to that of the utility companies. Utility companies litigating rate increase cases are represented by in-house attorneys, as well as outside law firms specializing in utility regulation law.¹³ As an example, in the most recent rate case, SourceGas was represented by three in-house attorneys as well as two attorneys from one of the state's larger law firms.¹⁴ The third and final item not included in the PSC's cost analysis is that the salaries of other PSC staff attorneys would likely need to be raised in order to preserve salary equity with the public advocate.¹⁵

Possible Inability to Retain an In-house Public Advocate

An additional disadvantage to employment of an in-house public advocate cited by the PSC is the incentive created by public salary constraints for this individual to leave for a higher paying position with a utility or a law firm specializing in natural gas law. This would be particularly problematical if the resignation occurred in the midst of a rate case, when the statutory time frame for resolution is 210 days.¹⁶ It would be very difficult, if not impossible, to both hire and train someone new, given the law's complexity.

Discussion

As stated at the beginning of this section, the scope statement for this audit anticipated that we would be able to identify a defensible argument for retaining the public advocate in-house or identify cost savings or other benefits to doing so. However, our research led us to conclude that outsourcing the position is the more efficient and effective choice.

FINDING: The PSC's decision to outsource the public advocate position is more efficient and effective than hiring an in-house public advocate.

To assess the validity of the PSC's reasons for outsourcing the position, we first contacted former Senator Landis, who confirmed his awareness and support of the PSC's decision to outsource the position.¹⁷ In addition, we found the PSC's arguments credible regarding the complexity of the responsibilities of the public advocate's job, the potential downtime, and the potential conflict of interest issues raised by assigning other duties to the public advocate.

We also agree with the PSC's analysis that hiring an in-house public advocate is unlikely to result in significant cost savings. In addition, we found that the PSC has not spent more on the public advocate than was originally envisioned. The LB 790 fiscal note estimated a combined cost for the newly created Natural Gas Department and the public advocate of \$844,452 for FY2003-04 and \$748,719 for FY2004-05.¹⁸ These amounts were expected to cover three positions—the Public Advocate, the Director of the Natural Gas Department, and an administrative assistant—as well as operating and contractual costs.¹⁹ (The fiscal note specifies that the PSC requested, and was given, the authority to spend up to \$500,000 in contractual services.) The PSC's actual expenditures were \$310,454 in FY2003-04 and \$185,094 in FY2004-05.

Table 2.3: PSC Natural Gas Department Actual Expenditures vs. Limitations		
<i>Fiscal Year</i>	<i>All Natural Gas Regulation Expenses</i>	<i>Operations Limitations Approved by Appropriations Committee*</i>
2003-04	\$310,453	\$844,452
2004-05	\$185,094	\$748,719
2005-06	\$347,033	\$1,087,203
2006-07	\$634,509	\$1,103,182
2007-08	\$956,932	\$1,147,036
2008-09	\$675,403	\$1,161,824

Table created by the Legislative Audit Office.

**Only those funds allocated for the operational costs of the Natural Gas Department and the public advocate.*

Furthermore, as shown in Table 2.3, the Legislature subsequently increased the operations limitations for the Natural Gas Department and the public advocate and the actual expenses have never exceeded those limitations.

FINDING: The PSC's annual expenditure for the public advocate's services has never exceeded what the Legislature authorized it to spend.

Notes

¹ Interview with Mike Hybl, PSC Executive Director, December 15, 2009.

² Interviews with Mike Hybl, December 15, 2009 and Commissioner Frank Landis, January 20, 2010.

³ Interviews with Mike Hybl, December 15, 2009, Commissioner Frank Landis, January 20, 2010, and telephone conversation with former Senator David Landis, January 22, 2010.

⁴ Interview with Commissioner Frank Landis, January 20, 2010.

⁵ Interviews with Mike Hybl, December 15, 2009, Harding & Shultz, January 14, 2010 and Commissioner Frank Landis, January 20, 2010. Under this system, each city council negotiated with the utilities for rate increases. Ratepayers were at a disadvantage due to the caliber of legal representation brought by the utilities and city council turnover, which disrupted the continuity of institutional knowledge acquired between lawsuits.

⁶ Neb. Rev. Stat. §§ 66-1830 and 66-1831.

⁷ Interview with Commissioner Gerald Vap, January 20, 2010.

⁸ An additional \$529,068 was spent on consultants and experts. Cost comparison analysis prepared by the PSC, 2008, updated through June 2009.

⁹ Interviews with Harding & Shultz, January 14, 2010 and Commissioner Gerald Vap, January 20, 2010. This figure includes the savings in two Aquila rate cases and one Kinder Morgan case. It does not include any savings that might be realized through the SourceGas rate case. Litigation of this proposed increase concluded in December 2009 and the Commissioners' decision is still pending.

¹⁰ The consultant costs are the actual costs incurred by Roger Cox for experts in the matters he has handled to date. This analysis was originally prepared prior to renewal of the contract but has been updated through June 30, 2009. Email from Mike Hybl, January 22, 2010.

¹¹ Neb. Rev. Stat. § 66-1832.

¹² Interviews with Mike Hybl, December 15, 2009, Harding & Shultz, January 14, 2010 and PSC Commissioners, January 20, 2010.

¹³ *Id.*

¹⁴ Email from Mike Hybl, January 28, 2010.

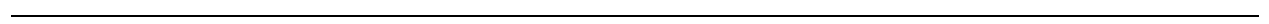
¹⁵ Interview with Commissioners Frank Landis and Gerald Vap, January 20, 2010.

¹⁶ Interview with Commissioner Tim Schram, January 20, 2010.

¹⁷ Telephone conversation with former Senator David Landis, January 22, 2010.

¹⁸ LB 790 fiscal note prepared by Scott Danigole, May 27, 2003.

¹⁹ *Id.* Due to the time lag between the bill's start up date and the date upon which cash receipts are expected to be received, \$100,000 was allocated from the general fund for the first four months of the program's operation in fiscal year 2003-04.



Section III: Findings and Recommendations

The following are the Legislative Audit Office's findings and recommendations for this report.

SECTION I: Public Service Commission's Statutory Compliance with Public Advocate Position Requirements

Finding: We believe the PSC's decision to outsource the public advocate position complies with the statute.

Finding: We believe the current location of the public advocate office reflects a reasonable interpretation of the statute.

Recommendation: None.

Finding: The PSC is noncompliant with the statutory requirement that it promulgate rules and regulations specific to the location of the public advocate office.

Discussion: The PSC provided us with their draft rules and regulations which address this matter and stated that this draft will likely be released in March in order to incorporate any possible changes necessitated by the SourceGas ruling, due in late February.¹

Recommendation: The PSC should promulgate the relevant regulations immediately.

SECTION II: Efficiency and Effectiveness of Current Public Advocate Contract

Finding: The PSC's decision to outsource the public advocate position is more efficient and effective than hiring an in-house public advocate.

Finding: The PSC's annual expenditure for the public advocate's services has never exceeded what the Legislature authorized it to spend.

Recommendation: None.

Notes

¹ Email from Mike Hybl, January 28, 2010.

Appendix A: Public Advocate Hours Billed

Total Hours Billed Per Month for Public Advocate Services by Harding & Shultz						
	2004-2005*	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
July		73	55	251	254	106
August		30	50	121	197	128
September		69	90	165	139	155
October		74	75	135	53	195
November	71	77	169	195	43	373
December	-	73	187	119	61	348
January	61	22	118	44	80	370
February	30	45	133	50	97	333**
March	30	70	116	78	106	
April	31	14	121	108	61	
May	64	15	91	169	31	
June	58	32	308	140	55	

Table created by the Legislative Audit Office; data compiled from Harding & Shultz billing records, provided February 10, 2010.

**Contract between PSC and Harding & Shultz was not entered into until November 2004.*

***As of February 10, 2010.*

Appendix B: Summary of Ratepayer Savings Effected by the Public Advocate in General Rate Cases (as of 1/15/2010)

As noted in Section II of the report, this appendix provides a document outlining ratepayers savings effected by the Public Advocate. The following is a copy of this document given to Legislative Audit Office staff by the Public Advocate on January 14, 2010.

SUMMARY OF RATEPAYER SAVINGS EFFECTED BY THE PUBLIC ADVOCATE IN GENERAL RATE CASES (AS OF 1/15/2010)

Pursuant to the State Natural Gas Regulation Act, Neb. Rev. Stat. §66-1801, *et seq.* ("the SNGRA"), the law firm of Harding & Shultz, P.C., L.L.O., has served as the Public Advocate since 2003 by appointment by the Executive Director of the Nebraska Public Service Commission and approval by the Commission. The terms of the engagement are subject to a written contract. Roger Cox and Jack Shultz are the two primary Harding & Shultz attorneys who perform Public Advocate services. However, other attorneys, legal assistants and other firm personnel also assist from time to time in providing such services.

This memorandum will summarize the amount of savings to jurisdictional ratepayers that have flowed from the work of the Public Advocate in the two prior Aquila rate cases (filed in 2003 and 2006, respectively) and the one prior Kinder Morgan rate case (filed in 2006).

All figures listed below are rounded to the nearest \$1,000.00 increment. Please note that the figures for savings to ratepayers are expressed initially in terms of reductions in annual revenue levels sought by jurisdictional utilities in their formal applications for rate increases and average monthly equivalents¹. The level of savings flowing from the Public Advocate's work in the specific rate cases discussed below that have been concluded are also expressed in cumulative figures, based upon application of such annualized savings figures to the number of full and fractional years that the specified revenue requirements levels were or have been in place. (For simplicity, durations of time during which rates have been in place are rounded to the nearest one-half month increment.)

In addition to the three prior general rate cases discussed herein that have been fully concluded, two other general rate case proceedings are currently pending before the Nebraska Public Service Commission. The first was filed by SourceGas Distribution LLC on July 2, 2009, designated as Commission Docket NG-0060 and the second was filed by Black Hills Energy on December 1, 2009, designated as Commission Docket NG-0061. The amount of any savings to jurisdictional ratepayers from the level of rate increase sought by SourceGas and Black Hills in those proceedings will not be known until the Commission decides those cases. Brief comments regarding the Docket NG-0060 proceedings are also included below. Due to the recent filing and the fact that the case is in a very preliminary stage no comments will be provided about the Black Hills case other than the application requests a \$12,000,000 revenue increase.

¹ For ease of computation, the savings figures set forth herein assume equal distribution of revenues in each month of the calendar year. Obviously, because a very substantial portion of natural gas usage is weather sensitive, the level of actual revenue attributable to cold weather months is typically greater than in warm weather months. To compute the exact amount of savings with complete accuracy would require a painstaking analysis of actual sales data (dollars billed and gas volumes delivered) from each utility, which is not readily available to the Public Advocate. However, because utility "revenue requirements" are typically stated in annual terms, using monthly averages of a utility's annual revenue requirements provides a reasonable proxy for estimating the level of savings to ratepayers that has flowed from the work of the Public Advocate.

First Aquila Rate Case

Aquila's first rate case filed on 6/30/2003 was a consolidation of three separate dockets (one docket for each of Aquila's three rate areas) – Dockets NG-0001, NG-0002 and NG-0003. The combined annual revenue increase sought by Aquila in those consolidated cases was \$9,896,000. The Public Advocate negotiated a settlement with Aquila that reduced the level of the annual revenue increase to \$6,172,000 – a savings to ratepayers of \$3,724,000 per year or \$310,333 per month. These savings effectively began on the date when Aquila implemented interim rates in Dockets NG-0001, NG-0002 and NG-0003 at the start of October of 2003 and continued until mid-February of 2007, when Aquila implemented interim rates in its second rate case, Commission Docket NG-0041, that replaced the rates that were approved in the first Aquila rate case. (By statute, interim rates can be placed into effect 90 days after Aquila filed its second rate case, Docket G-0041, on 11/15/2006.)

The cumulative level of savings to ratepayers from October of 2003 through mid-February of 2007, when Aquila implemented interim rates in Docket NG-0041 (a period of approximately 40.5 months) was approximately \$12,568,500.

Kinder Morgan Rate Case

Kinder Morgan's rate case, filed on 6/2/2006, sought an annual revenue increase of \$11,054,000 – Docket NG-0036. The Public Advocate negotiated a settlement with Kinder Morgan that reduced the level of the annual revenue increase to \$8,250,000 – a savings to ratepayers of \$2,804,000 per year or \$233,666 per month. These savings to ratepayers continued until 10/1/2009, when SourceGas' Distribution (Kinder Morgan's successor) implemented interim rates in the general rate case filed by SourceGas on 7/2/2009 at Commission Docket NG-0060.

The cumulative level of savings to ratepayers from 1/1/2007, when Kinder Morgan's final rates became effective, through 10/1/2009 (a period of 33 months) was approximately \$7,711,000 (and could actually be higher depending upon the ultimate outcome of other pending litigation discussed in the footnote that follows).²

² We have used the 1/1/2007 effective date for KM's final rates in order to present the most conservative savings figure. Because KM's rate case at Docket NG-0036 had the unusual feature of having interim rates that would produce only 70% of the full level of annual revenue increase requested by Kinder Morgan in its application, it did not seem appropriate to use the date when interim rates were implemented in Docket NG-0036 for purposes of the computation of savings.

However, please note that, the Commission's Order entered on 12/27/2006 in Docket NG-0036 provided that Kinder Morgan's final rates in that proceeding would "become effective" on 1/1/2007. Under the theory of Kinder Morgan, and SourceGas Distribution, LLC (which succeeded to ownership of Kinder Morgan's Nebraska utility assets in March of 2007), the utility claims it was permitted to charge the final rates for all bills rendered by the utility on or after 1/1/2007, even though such bills included charges for December 2006 gas deliveries. The issue of whether Kinder Morgan could lawfully do so is being litigated before the Nebraska Supreme Court as Case No. S-09-000600, which arises from Commission Docket FC-1327.

Second Aquila Rate Case

Aquila's second rate case, filed on 11/15/2006, sought an annual revenue increase of \$16,294,000 – Docket NG-0041. This case was fully litigated. Following a contested hearing, the Commission reduced Aquila's annual revenue increase to \$9,155,000 – a savings to ratepayers of \$7,139,000 per year or \$594,916 per month. These savings to ratepayers continue through the present time, as the overall annual revenue level of Black Hills Energy (Aquila's successor) remains at the level established in the Commission's 7/24/07 Order Granting Application in Part. The cumulative level of savings to ratepayers from mid-February of 2007 (when Aquila implemented interim rates) until mid-January of 2010 (a period of 35 months) is approximately \$20,822,060. This annualized level of savings to ratepayers will continue until 3/1/2010, when interim rates go into effect with respect to the general rate case recently filed by Aquila's successor, Black Hills Energy, at Docket NG-0061.

SourceGas Rate Case

On July 2, 2009, SourceGas Distribution, which succeeded to the Nebraska utility assets of Kinder Morgan, filed a general rate case, designated as Commission Docket NG-0060. In its Application in Docket NG-0060, SourceGas sought an annual revenue increase of \$9,322,476. The Public Advocate vigorously opposed SourceGas' rate increase request.

Both SourceGas and the Public Advocate engaged in extensive discovery and have completed and submitted all pre-filed written testimony and exhibits. The Commission conducted a four-day hearing in Docket NG-0060 from 12/14/2009 through 12/17/2009. SourceGas and the Public Advocate both submitted detailed written post-hearing briefs to the Commission on 1/8/2010. The Commission's consultants, GDS Associates, are scheduled to submit a written post-hearing report to the Commission on 1/19/2010 and a final order by the Commission is anticipated on or about 2/23/2010.

Cumulative Savings from Fully-Concluded Rate Cases

The cumulative savings for ratepayers achieved by the Public Advocate from October of 2003 through January 15, 2010 with respect to the two Aquila rate cases and the Kinder Morgan rate case discussed above total \$41,101,560. Hopefully, further significant savings will be obtained for SourceGas ratepayers in the SourceGas Rate Case that is pending at Commission Docket NG-0060.

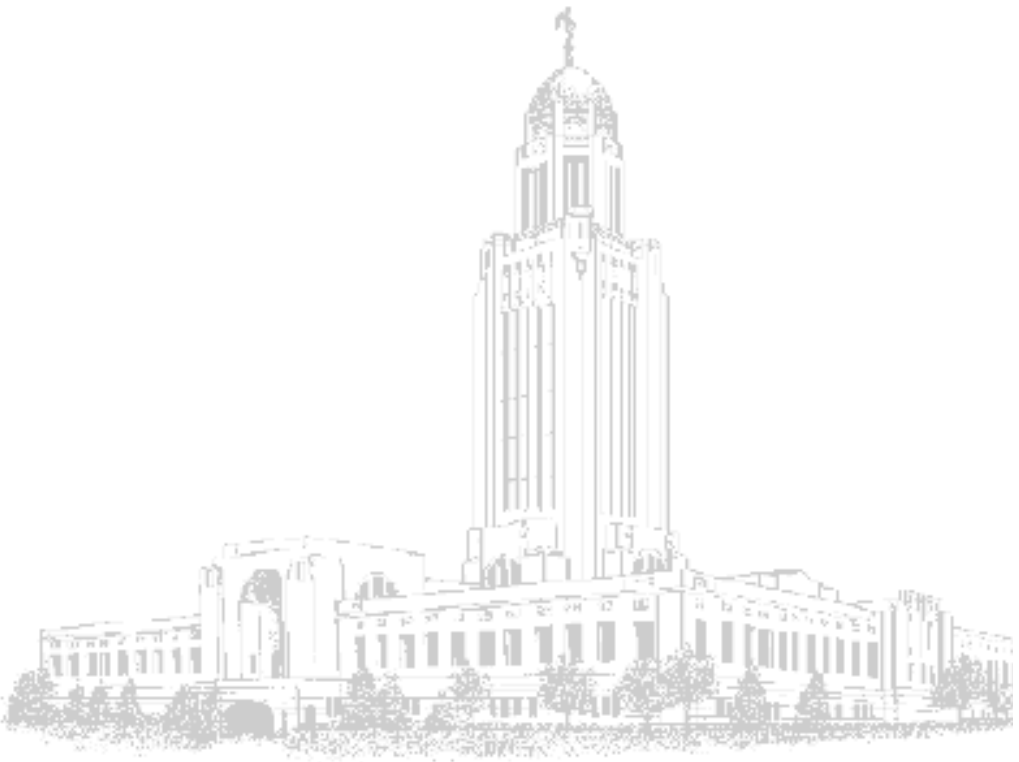
If Kinder Morgan's theory that it could charge its Docket NG-0036 final rates to customers for gas service rendered in December 2006 is ultimately upheld, the level of savings achieved to date for ratepayers in the Docket NG-0036 rate case proceeding would actually be higher than the cumulative total of \$7,711,000 noted above, as savings for the month of December 2006 would also need to be considered. On the other hand, if the PA would prevail on the pending appeal and if a determination is made of a level of overcollections from ratepayers within the range of the various figures that Kinder Morgan and SourceGas provided at various points of time during the course of the Docket FC-1327 litigation, additional savings to affected ratepayers by refund could also be achieved somewhere in the range of between \$414,502 and \$1,174,981, depending upon the level of overcollections that a court, or the Commission on remand, may determine to have occurred.

Other Comments

We understand and acknowledge that, due to the sheer magnitude of the tasks involved, rate case litigation involves a substantial level of expense for the services of the Public Advocate. However, the level of cost incurred for the services of the Public Advocate is relatively modest in comparison to the overall level of savings to ratepayers through the reductions in utility annual revenue levels that have been achieved through litigation and/or negotiation of the three fully-concluded rate cases discussed above. As noted above, the cumulative savings figure through January 15, 2010 of \$41,101,560 does **not** include any further savings that may will be obtained for SourceGas ratepayers in the SourceGas Rate Case pending at Commission Docket NG-0060 or the Black Hills case in NG-0061.

Several other observations are appropriate:

- An attorney employed as a staff attorney for the Public Service Commission and who is involved in providing advice to the Commission could not ethically also serve as the Public Advocate. The SNGRA provides that the Public Advocate is to be independent of the Commission.
- Our firm's background and experience enables us to provide both administrative Public Advocate services and litigation capability.
- Jurisdictional utilities typically have a number of different attorneys working on their rate cases and other matters.
- The SNGRA gives the Public Advocate authority to engage attorneys and consultants. Due both to the sheer volume of work that rate cases and other natural gas litigation matters before the Commission can present and the fact that the jurisdictional utilities typically have a cadre of attorneys and other utility employees involved in their litigation matters, we believe that if there were to be an individual in-house Public Advocate, he/she would need to engage an outside law firm or firms having extensive utility litigation experience and expertise in utility regulation and would thereby incur a significant level of fees and expenses to replicate the very type of expertise and capability our firm currently provides.
- Any Public Advocate, whether engaged on a contract basis or as an in-house Public Advocate, will have the need to engage outside rate consultants in rate cases and from time to time with regard to other matters (just as we have in the past) to provide strategic input on ratemaking and other utility-related matters and to provide necessary written and oral testimony in proceedings before the Commission. We have been very actively involved in these processes, but there is a certain level of work that must be done by consultants and a corresponding level of expense that must be incurred for the work of such consultants.
- Obviously, it is more difficult to quantify a specific dollar value to the benefits the Public Advocate's activities bring to non-rate case matters. However, we believe that our services in these matters have also provided valuable protection of the interests of jurisdictional ratepayers.



III. Fiscal Analyst's Opinion

State of Nebraska

LEGISLATIVE COUNCIL RECEIVED

FEB 19 2010

LEGISLATIVE AUDIT

PATRICK J. O'DONNELL
Clerk of the Legislature

CYNTHIA G. JOHNSON
Director of Research

JOANNE PEPPERL
Revisor of Statutes

MICHAEL CALVERT
Legislative Fiscal Analyst

MARSHALL LUX
Ombudsman

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Legislative Fiscal Office
PO Box 94604, State Capitol
Lincoln, NE 68509-4604

February 18, 2010


Martha Carter, Legislative Auditor
Legislative Audit and Research Office
P.O. Box 94945, State Capitol
Lincoln, NE 68509

Dear Martha,

The Legislative Fiscal Office has reviewed the draft report regarding the Public Service Commission's Public Advocate Office. It is the estimate of the Legislative Fiscal Office that the recommendations currently contained in the report can be carried out using the existing budgetary and staffing resources of the Public Service Commission.

If you have any questions, please contact me at 471 -0055.

Sincerely,


Scott Danigole, Program Analyst
Legislative Fiscal Office



IV. Background Materials

BACKGROUND MATERIALS

The “background materials” provided here are materials (in addition to the Office’s report) that were available to the Committee when it issued the findings and recommendations contained in Part I of this report. They include:

- the Office’s draft findings and recommendations (provided for context);
- the agency’s response to a draft of the Office’s report; and
- the Legislative Auditor’s summary of the agency’s response.

These are the Office's draft recommendations on which the Committee's final recommendations (in Part I) are based.

Section III: Findings and Recommendations

The following are the Legislative Audit Office's findings and recommendations for this report.

SECTION I: Public Service Commission's Statutory Compliance with Public Advocate Position Requirements

Finding: We believe the PSC's decision to outsource the public advocate position complies with the statute.

Finding: We believe the current location of the public advocate office reflects a reasonable interpretation of the statute.

Recommendation: None.

Finding: The PSC is noncompliant with the statutory requirement that it promulgate rules and regulations specific to the location of the public advocate office.

Discussion: The PSC provided us with their draft rules and regulations which address this matter and stated that this draft will likely be released in March in order to incorporate any possible changes necessitated by the SourceGas ruling, due in late February.¹

Recommendation: The PSC should promulgate the relevant regulations immediately.

SECTION II: Efficiency and Effectiveness of Current Public Advocate Contract

Finding: The PSC's decision to outsource the public advocate position is more efficient and effective than hiring an in-house public advocate.

Finding: The PSC's annual expenditure for the public advocate's services has never exceeded what the Legislature authorized it to spend.

Recommendation: None.

Notes

¹ Email from Mike Hybl, January 28, 2010.

Nebraska Public Service Commission

COMMISSIONERS:

ANNE C. BOYLE
ROD JOHNSON
FRANK E. LANDIS
TIM SCHRAM
GERALD L. VAP



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MAR 12 2010

NEBRASKA CONSUMER HOTLINE:
1-800-526-0017

EXECUTIVE DIRECTOR:

MICHAEL G. HYBL

LEGISLATIVE AUDIT

March 12, 2010

Ms. Martha Carter
Legislative Auditor
Legislative Audit Office
State Capitol, Room 1201
Post Office Box 94945
Lincoln, NE 68509-4945

Dear Ms. Carter:

The members of the Commission and I have thoroughly reviewed the draft report regarding the Office of the Public Advocate. The Commission fully accepts the conclusions reached by your office in the report. The Commission does currently have in process a rule-making and intends to fully address the issue you have identified regarding the location of the public advocate office.

The Commissioners have asked me to express their appreciation for the professionalism, courtesy and thoughtfulness that your staff displayed during the course of this review.

Should there be any additional information that you require to complete this review, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Mike Hybl".

Mike Hybl
Executive Director

MH:kjl

LEGISLATIVE AUDITOR'S SUMMARY OF AGENCY RESPONSE

This summary meets the statutory requirement that the Legislative Auditor “prepare a brief written summary of the response, including a description of any significant disagreements the agency has with the Section’s report or recommendations.”¹

On March 12, 2010, the Executive Director of the Nebraska Public Service Commission submitted the Commission’s response to a draft of the Performance Audit Section’s audit report. The director indicated that the Commission fully accepted the conclusions contained in the report and is in the process of developing regulations as recommended. There are no remaining areas of disagreement between the audit staff and the Commission.

¹ Neb. Rev. Stat. sec. 50-1210.

Performance Audit Committee Reports: 1994 to 2010

- Department of Health and Human Services: Statutory Compliance in Closing the Lincoln Regional Center Community Transition Program (November 2009)
- Department of Economic Development's Job Training Grant Program: Statutory Compliance (November 2009)
- The State Foster Care Review Board: Authority, Conflicts of Interest, and Management Practices (December 2008)
- Personal Services Contracts: An Examination of Compliance and Oversight (October 2008)
- The Nebraska Information Technology Commission: An Examination of Statutory Compliance and the Project Review Process (November 2007)
- The Nebraska Lottery's Implementation of LB 1039 (February 2007)
- The State Department of Education's Student-based Teacher-led Assessment and Reporting System (February 2007)
- The Lincoln Regional Center's Sex Offender Services Program (August 2006)
- The Public Employees Retirement Board and the Nebraska Public Employees Retirement Systems: An Examination of Compliance, PIONEER, and Management (August 2006)
- The Nebraska Medicaid Program's Collection of Improper Payments (May 2005)
- The Lincoln Regional Center's Billing Process (December 2004)
- Nebraska Board of Parole (September 2003)
- Nebraska Department of Environmental Quality: Administering the Livestock Waste Management Act (May 2003)
- HHSS Personal-Services Contracts (January 2003)
- Nebraska Habitat Fund (January 2002)
- State Board of Agriculture (State Fair Board) (December 2001)
- Nebraska Environmental Trust Board (October 2001)
- Nebraska Department of Roads: Use of Consultants for Preconstruction Engineering (June 2001)
- Department of Correctional Services, Inmate Welfare Fund (November 2000)
- Bureau of Animal Industry: An Evaluation of the State Veterinarian's Office (March 2000)
- Nebraska Ethanol Board (December 1999)
- State Foster Care Review Board: Compliance with Federal Case-Review Requirements (January 1999)
- Programs Designed to Increase The Number of Providers In Medically Underserved Areas of Nebraska (July 1998)
- Nebraska Department of Agriculture (June 1997)
- Board of Educational Lands and Funds (February 1997)
- Public Service Commission: History of Structure, Workload and Budget (April 1996)
- Public Employees Retirement Board and Nebraska Public Employees Retirement Systems: Review of Compliance-Control Procedures (March 1996)
- Leaking Underground Storage Tank Program (December 1995)
- School Weatherization Fund (September 1995)
- The Training Academy of the Nebraska State Patrol and the Nebraska Law Enforcement Training Center (September 1995)
- Nebraska Equal Opportunity Commission (January 1995)
- The Interstate Agricultural Grain Marketing Commission (February 1994)

