LEAGUE OF WOMEN VOTERS OF NEW MEXICO

STUDY OF THE NEW MEXICO PUBLIC REGULATION COMMISSION
(2011-2013)

Final Report
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Public Regulation Commission Study Committee

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REPORT TO THE NEW MEXICO LEAGUE OF WOMEN VOTERS BY THE PUBLIC REGULATION COMMISSION STUDY COMMITTEE

July 30, 2013

This is the Public Regulation Commission (PRC) study committee's final report to the New Mexico League of Women Voters on the state study approved in March 2011. It is the second report prepared by the PRC study committee. In January, 2013, a report was presented to the PRC commission which included detailed suggestions for improving PRC records and operations, as well as general recommendations based on the League's adopted positions.

This report is different; it begins with a recommendations section which focuses only on recommendations which require action by the legislature. This is followed by a brief history of regulation in New Mexico. The final section details the PRC's regulatory responsibilities in each of the industries it regulates; the purpose of this section is to show the broad range of knowledge required to be a good PRC commissioner, and the consequent importance of having a selection method that is likely to produce able commissioners. It may also be useful to those who are interested in knowing exactly what the PRC's powers are over the industries it regulates, and what the PRC's place is in the scheme of state and federal regulation.

During the time the PRC study committee did its work, the Insurance Division was part of the PRC, and regulation of insurance was studied in the same way as regulation of other industries. When the League position on the PRC was adopted in 2012 it was not yet known whether or not regulation of insurance would remain under the PRC. On July 1, 2013, the Insurance Division became a separate agency, the Office of the Superintendent of Insurance (OSI). However, its regulatory responsibilities were unchanged and are included in this report. The League position on the PRC was amended in 2013 to include the OSI.

Problems at the PRC and recommendations for solving them

There have been a number of attempts by the New Mexico legislature to improve the PRC. In this section we will make suggestions for dealing with four problems at the PRC whose solution requires either legislative action or at least assent: the way commissioners are selected, corruption, the way the PRC is funded, and inadequate representation of consumer interests.

1. Selection of Commissioners. Because the PRC has broad regulatory powers, it would be strengthened by having a broad range of expertise on the part of commissioners. During the time that committee members attended PRC open meetings in 2011 and 2012, we observed six commissioners in action (one of the five elected commissioners was forced to resign, and was replaced by an appointed commissioner). There were significant differences in how commissioners dealt with the cases brought to them. Commissioners with a strong background in regulation and/or knowledge of regulatory law were able to understand more easily the cases brought to them, were able to bring up relevant issues that had not been covered in staff investigations, and to correct staff errors. Those without backgrounds in law or regulation tried earnestly to bring their life experiences to bear on the cases brought to them;

while occasionally these experiences were useful, the gap in effectiveness between commissioners with and without relevant backgrounds was quite evident. On the basis of these observations, the committee decided that a major improvement to the PRC could be made by having more able commissioners. The question is, how should this be done?

New Mexico has already tried three different methods of selecting its regulators; see the history section of this report for more detail on each method. In one of the predecessors of the PRC, the State Corporation Commission (SCC), the three commissioners were elected in state-wide elections. In the other predecessor, the Public Utility Commission (PUC), the three commissioners were appointed by the Governor with the advice and consent of the Senate. The five members of the PRC, which took over the duties of both the SCC and the PUC beginning in 1999, are elected one each from five separate districts.

Qualification requirements for all SCC commissioners and PUC commissioners were minimal[1], and like its predecessors, PRC Commissioners were originally required to have no special qualifications for serving**.** That changed with legislation passed in 2013 which implemented a constitutional amendment that voters approved in 2012. In the future, anyone seeking to become a PRC Commissioner will be required to have either ten years of professional experience in an area regulated by the PRC or ten years of combined relevant education and professional experience.[2] Current Commissioners, some of whom could not meet these new requirements, are exempted from the law. The 2013 law also requires that all commissioners have ethics training and take 32 hours a year of continuing education.

The qualification requirements passed in 2013 will not necessarily solve problems that are inherent in having commissioners elected from five separate districts. While it is useful to have the different geographic areas of the state represented on the Commission, it is unlikely, if not impossible, that a Commission elected by districts will have the broad range of expertise that the Commission needs.

While the qualification requirements may weed out people with no relevant experience who get into office because they have political skills or connections, it cannot take into account qualities that are not captured by educational degrees and years of experience, qualities such as temperament, knowledge of and compliance with legal and ethical constraints, integrity, and knowledge of the operations of the Commission. The League has adopted a position intended to promote an evaluation process that can take into account such qualities:

[1] The requirement that applies to all elected officials is that they be U.S. citizens, legal residents of New Mexico for at least one year, and over 21. In addition, SCC commissioners were required not to be employed by any of the companies regulated by the SCC.

[2] SB0008, passed in 2013.

PRC candidates should be evaluated on the basis of qualifications by a broad-based nonpartisan process.

The League position stops short of suggesting how the final selection of candidates should be made—by election or some form of appointment. There is a widespread view among people familiar with the PRC that commissioners should be appointed rather than elected. An appointment process could balance the need for expertise in all the industries regulated by the PRC with the need for geographic diversity. However, changing from elected to appointed commissioners would require a constitutional amendment, which is unlikely to occur until the results of the qualification requirements passed in 2013 are known.

It remains to be seen how well the new qualification requirements will work. One possible problem is that in some districts the new requirements will disqualify all those interested in running for PRC seats. Another possibility is that there may be a problem in enforcing the new qualification requirements; the law provides only that a candidate submit to the Secretary of State a notarized affidavit stating that he or she meets the qualification requirements. However, the statute does not provide any specific guidance as to how the Secretary of State can or should evaluate these affidavits. The law does provide that any voter may challenge the candidacy of a person on the grounds that qualification requirements are not met. The challenge is made by filing a petition in district court. Many believe that it will ultimately be the court that determines whether PRC candidates are qualified. Finally, it remains to be seen whether the new qualification requirements will indeed result in the election of a more able and effective commission. It is possible that this will not be known until the commissioners elected in 2018 take office in 2019.[3]

If, due to these or other problems, the legislature decides to consider appointed rather than elected commissioners, a good example of how appointments could be made is provided by the process that South Carolina uses to select members of its Public Service Commission.

In South Carolina, a committee evaluates candidates for their Public Service Commission on the basis of six qualities—experience, temperament, knowledge of and compliance with legal and ethical constraints, aptitude for leadership and/or service on the Commission, integrity, and knowledge of the operations of the Commission. For each of these qualities, candidates are judged to be outstanding, appropriate, above average, or adequate, and are then given a numerical score between 0 and 100 based on the overall evaluation. The evaluation scores are made public, and the final selection from among the candidates is made by the legislature.

2. Corruption. The PRC has a great deal of power over the companies it regulates. Some of this power is exercised at the employee level rather than by the Commission. Consequently, there is an opportunity for both employees and Commissioners to exercise this power in unethical ways.

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[3] Three commissioners were elected in 2010, and two in 2012. All are allowed to run for a second term regardless of whether they meet the new qualification requirements. If all win a second term, no commissioners required to meet the new qualification requirements that became law in 2013 will take office until the three commissioners elected in 2018 take office in 2019.

The League PRC study committee concluded that the most effective way of combating corruption would be to have an inspector general at the PRC, one of whose functions would be to investigate possible corruption on his/her own initiative or in response to internal and external complaints. The League position states:

> **The PRC should have an inspector general charged with reviewing practices for handling incoming payments properly, conducting internal audits of other functions, and pursuing such other investigations as are deemed necessary.**

One form of corruption can occur when commissioners or staff members who exercise regulatory authority over an industry, or staff members who influence that authority, are induced to offer favorable treatment to the regulated companies by the implicit promise of a job in the industry when they leave the PRC. The League has adopted a position designed to delay such employment.

> **PRC Commissioners and advisory staff should be prohibited from working in a business regulated by the PRC for at least one year after they complete their tenure at the PRC.**

3. Changes needed in funding the PRC. Currently, the PRC receives nearly all its funding in the form of appropriations by the legislature from the general fund. The level of funding therefore depends as much on the general fund's expected revenue and expenditures as it does on how much money the PRC needs to perform the regulatory duties assigned to it by the legislature. Most other states fund their regulatory commissions from a separate fund derived from fees and/or assessments on the regulated industries. The New Mexico League has adopted the position that New Mexico fund the PRC in the same way:

The PRC should be funded by assessments on the industries that it regulates and those funds should be sequestered from the general fund. The legislature should approve a budget sufficient to enable the PRC to carry out its allotted duties successfully.

Under this method of funding, assessments would be set annually based on projected budgets approved by the legislature. The revenue from these assessments would be put into non-reverting funds, which means that revenue not expended would carry over to the following year and could be used either to reduce the assessments in that year or to increase reserves up to levels approved by the legislature; reserves would be available for infrastructure improvements, such as computer systems, or to meet unforeseen emergencies.

Three of the regulatory functions of the PRC and the OSI are currently funded by non-reverting funds. For these funds—the title insurance fund, the insurance fraud fund and the pipeline safety fee fund—fees are set annually based on the budget approved for the coming year's operations. For example, the unexpended fund balance in the pipeline safety fee fund at the end of 2012 was sufficient to cover the budget for this fund approved by the legislature for FY2013; therefore, no assessment was made to operators for FY2013.

Funding the PRC with assessments on regulated industries will allow the PRC's budget to be based on the actual cost of the regulation required by New Mexico statutes rather than being tied to tax revenues that rise and fall with the state of the economy.[4] Money not expended in the year should not be returned to the general fund because this would, in effect, retain the PRC's current position of competing with all other expenditures financed from the general fund.

Economic theory supports funding of regulatory agencies by the regulated industries in order to promote efficient allocation of spending by consumers. The regulated industries pass the cost of these regulatory assessments on to their customers. Including the cost of regulation in the price of those goods sends the proper price signal to consumers, who thus base their consumption on the true cost of providing the goods, of which the cost of regulation is one component. Having the PRC funded by regulated industries is the fair way to pay for regulation because it ensures that those who buy the goods are those who pay for regulating the industries that produce them. Most states[5] fund their regulatory commissions by separate funds, not part of the state general fund, derived from fees paid by and/or assessments on regulated industries.

New Mexico has flirted with industry funding of regulation in the past. Prior to the mid-1950's, statutes provided that fees assessed on telephone, telegraph, gas, water, electricity, and pipeline companies were to be used for regulation and no other purpose. However, in 1957 all these fees were swept into the general fund and since then most appropriations to regulatory agencies have been made by the legislature from the general fund.[6]

If the PRC is funded by assessments on regulated industries, it will be necessary to make some changes to the statutes that currently provide fees and assessments. Two types of changes are needed--changes to clarify which companies must pay the assessments and changes to provide for assessments that are commensurate with the regulatory oversight exercised by the PRC.

Clarification of which companies must pay assessments is needed in the telecommunications industry, in which landline companies pay Utility and Carrier Inspection Fees, but some wireless companies insist they are exempt and refuse to pay them.

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[4] In their study, "Funding the Costs of Public Utility Regulation", Larry Blank and Doug Gegax of the Center for Public Utilities at New Mexico State University advocate funding the PRC from assessments on utilities rather than from the state general fund in order to promote "an independent commission that operates in a stable and autonomous environment."

[5] Dr. Gegax's study, referred to in the previous footnote, found that in 42 states utility regulation is funded entirely from a separate public utility regulation fund.

[6] When the Public Service Commission was created in 1941, the statute establishing it provided that utilities (gas, water, steam, and electricity) pay 0.5% of gross receipts into the Public Utility Fund "for the purpose of defraying the salaries and other expenses of the Commission, and said monies shall be used for no other purpose." Inspection fees, set at .0025% of gross receipts, were first assessed on motor carriers and utilities (defined in the statute as telephone and telegraph companies) in 1951. The enacting statute provided that the fees were to be used to pay the expenses of the State Corporation Commission, and "no part shall revert to the general fund." Both laws were amended in 1957 to direct all receipts to the state general fund. The tax on telephone and telegraph companies is currently .00511% of gross receipts, and on motor carriers, .00256% of gross receipts. The tax on gas, water, steam, and electricity sales is currently 0.506% of gross receipts.

Provision of assessments commensurate with regulatory oversight is needed in the transportation industry. The Commission spends a good deal of time on the regulation of taxis, ambulances, and tow trucks, but these carriers pay only minimal regulatory fees that do not cover the cost of their regulation.[7]

4. Improving representation of consumer interests. The PRC is charged with balancing the interests of consumers, investors, and the public; this often means taking care of consumers and the public interest, since most regulated companies have staff or consultants paid to look after their interests at the PRC. The League's position is:

> **Consumer interests should have strong representation when the PRC is making policy decisions and setting rates.**

New Mexico, like many other states, places representation of consumer interests under the Attorney General (AG). The AG staff assigned to do this consists of two lawyers but no technical staff. Because its staff is small, the AG's office cannot represent consumer interests in all cases; it must choose the cases in which it intervenes. It was suggested to the PRC study committee that possible alternatives for locating the staff representing consumer interests, such as a separate state agency or a non-profit organization awarded a contract to do this job, should be considered. Wherever the consumer advocacy function is located, consumer interests could be represented more strongly if the size of the staff assigned to do this were increased. The League PRC study committee recommends that the consumer advocacy staff as well as the PRC itself be funded through assessments on regulated industries. Most states fund their consumer advocacy staff from the separate funds collected to fund their utility regulation commissions.[8]

History of Regulation in New Mexico

The New Mexico constitution adopted in 1913 set up a three-member State Corporation Commission (SCC), which was authorized to charter corporations and to regulate communication companies, at that time telephone and telegraph, and common carriers, with particular attention to railroads. The Commission also took over regulation of insurance in 1925. The three commissioners were elected in state-wide elections and served staggered six-year terms; the only required qualifications, in addition to those that applied to all elected officials,[9] were that they not be employed by the any of the companies regulated by the SCC.

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[7] The statute (63-7-20) requiring payment of regulatory fees by utilities and carriers specifies that the fee shall be paid by those companies subject to the jurisdiction of the Commission by virtue of the provisions of Article 11 of the New Mexico Constitution, which is interpreted not to apply to these companies.

[8] "Funding the Cost of Public Utility Regulation," Larry Blank and Doug Gegax, November 2010, states that 34 states fund a separate consumer advocacy function out of the separate funding source used to fund their utility regulation commissions.

[9] Required qualifications that applied to all were that they be U.S. citizens, legal residents of New Mexico for at least one year, and over 21.

When it was decided in 1941 that utilities needed to be regulated, the legislators decided not to assign this job to the State Corporation Commission. Instead, they set up an entirely separate agency, at first called the Public Service Commission, and later renamed the Public Utility Commission. Like the State Corporation Commission, it had three members who were required to have no special qualifications for serving. However, unlike the State Corporation Commission, these members were not elected by the public, but were appointed by the Governor with the advice and consent of the Senate to serve staggered six-year terms.

In 1947, due to changes in federal case law, New Mexico's regulation of insurance companies had to be changed. The State Corporation Commission recommended the creation of a three-member State Insurance Board. They also recommended that they themselves be the members of that Board, and that they each receive an extra $3,000 a year to compensate them for their additional duties, and so one more regulatory agency was added.

An attempt was made to combine all these regulatory agencies in 1955, but doing so required a constitutional amendment, which the voters turned down. No further attempt was made until the 1990's, when the Constitutional Revision Commission recommended that all these regulatory bodies be combined into one agency with a board appointed by the governor. However, this proposal was changed as the recommendation made its way through the legislature. The constitutional amendment that the legislature finally put before the voters abolished both Commissions and replaced them with a five-member Commission whose members were elected from five separate districts. Voters approved this amendment, and the first members of the Public Regulation Commission (PRC) were elected in November, 1998 and took office in January, 1999.

Since its origin in 1999, there have been a variety of problems at the PRC. Personal problems of several commissioners have made headlines. Some employees were reputed to use their positions to extort payments from regulated companies, and one was convicted of doing so and sent to prison. When decisions made by the Commission were appealed to the New Mexico Supreme Court, they were usually overturned. Operations at the Corporations Bureau[10] became so slow that Commissioners were forced to spend a good deal of time on requests by constituents for aid in getting their paperwork through the Bureau.

Some commissioners decided that the PRC had too broad a jurisdiction to be able to focus well on its responsibility for utility regulation, and cooperated with Think New Mexico, a politically active research group in Santa Fe, to develop ideas for improving the PRC.

The report produced by Think New Mexico in 2011 suggested that PRC commissioners needed to be more highly qualified, and also suggested moving a number of functions—the Corporations Bureau, the Transportation Division, and the Insurance Division—out of the PRC. Because some aspects of the PRC were specified in the New Mexico Constitution, most of these changes required constitutional amendments. Think New Mexico worked to get the 2012 legislature to propose three constitutional amendments, all of which the voters approved in November, 2012. Think New Mexico then worked with the 2013 legislature as it passed the

[10] The Corporations Bureau handles paperwork required for the establishment of corporations.

legislation required to implement the three amendments approved by the voters. Think New Mexico and the legislature also worked together to develop legislation that changed the regulation of transportation.

The four changes made in 2013 were:

1. PRC regulation of transportation was changed in ways that varied by type of carrier; changes were designed to affect ease of entry and regulation of rates.[11]

2. Anyone seeking to become a PRC Commissioner in the future will be required to have the education and/or experience specified in the 2013 law.[12] Current Commissioners, some of whom could not meet these new requirements, are exempted from the law.

3. The Corporations Bureau, formerly a part of the Administrative Services Division of the PRC, moved to the Office of the Secretary of State.[13]

4. The insurance division moved from the PRC on July 1, 2013[14] to become a stand-alone agency, the Office of the Superintendent of Insurance (OSI). This will have little effect on the deliberations of the Commission, but has significant budgetary implications for the PRC inasmuch as part of the funds allocated to the insurance division went to support legal and administrative staff outside the Insurance Division, and those funds were lost when the insurance division moved.

As a result of these changes, the PRC became smaller; it lost approximately 37% of its staff when the Insurance Division and the Corporations Bureau moved out of the PRC.

The PRC's Regulatory Responsibilities and Regulation of Insurance

This section discusses the regulatory responsibilities of the PRC and the Office of the Superintendent of Insurance (OSI) for four types of industries: (1) the natural monopoly

[11] HB0194, 2013 which required no constitutional amendment.

[12] SB0008, 2013, which implemented the constitutional changes specified in HJR11, 2012, requires commissioners to have at least ten years of professional experience or ten years of combined professional experience and higher education in specified areas. Current Commissioners are exempt from this requirement. In addition, all commissioners are required to have ethics training, and to have 32 hours of continuing education each year.

[13] HB0046, 2013, which implemented the constitutional changes specified in HJR 16, 2012.

[14] HB0045, 2013, which implemented the constitutional changes specified in HJR 17, 2012.

utilities—gas, electric, water and sewer; (2) telecommunications; (3) insurance[15], and (4) transportation.

One purpose of this section is to give the reader an idea of the range of knowledge required to enable a commissioner to make appropriate decisions, and the consequent importance of selecting intelligent and knowledgeable commissioners. Another purpose is to provide an overview of how much regulatory power the PRC has in each industry: the number of companies it regulates (in some industries not all companies are regulated by the PRC), what the regulatory powers of the PRC and OSI are, and what their place is in the scheme of state and federal regulation.

In order to illustrate the range of knowledge required, examples of cases brought to the Commission are given for each industry. To understand these cases, some knowledge of how cases are handled at the PRC is useful.[16] Cases are first assigned to a hearing examiner who conducts a hearing at which affected companies are represented by their staffs or lawyers. Consumers and small business may be represented by staff from the New Mexico Attorney General's (AG) office, as provided by law. However, because the AG staff assigned to this task consists of only two lawyers, they must choose their cases, and do not attend all such hearings. The PRC's legal and technical staff members offer testimony at the hearing; they are charged with balancing the interests of investors, consumers, and the public.

Based on the hearing, the hearing examiner prepares a recommended decision (RD) for the Commission. The RD is then sent to the Office of the General Counsel, which typically writes its own comment on the case and on the RD. Both these steps must be completed before the case is presented to the Commission.

The natural monopoly utilities. Because of the extensive infrastructure required to provide gas, electricity, water and sewer service, these industries are usually monopolies in the areas they are entitled to serve, and thus there are many similarities in the ways they are regulated. However, there are enough differences to warrant discussing each industry separately. Accordingly, the section for each industry includes a description of the structure and regulation of that industry, and how regulation is divided between the PRC, other state agencies, and the Federal government.

For each of these industries, the PRC issues a Certificate of Convenience and Necessity (CNN) that delineates a company's service area in some way, and in return for the monopoly power granted, the regulated company cedes to the PRC some control over its rates, its service, its ability to issue debt, and its transactions with affiliates. To illustrate the broad range of knowledge needed by PRC commissioners to regulate these industries, it is useful to look at the

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[15] Beginning July 1, 2013, the PRC was no longer responsible for regulating insurance. However, the regulatory responsibility of the state of New Mexico remains the same, and it is that responsibility that is described here.

[16] The steps described here are followed for complex cases. Simple cases, such as a consumer complaint, may be handled by the Consumer Relations Division and never reach the Commission.

issues raised in just one aspect of regulation—setting of rates. As will be seen, the factors to be considered in rate cases make it beneficial to have commissioners with expertise in a number of different areas.

Rate regulation in New Mexico varies by industry and size of company. For example, most rate increases for those small water companies that are regulated by the PRC go into effect automatically on a file-and-use basis without review by the Commission. But rate increases for gas and electric companies that are regulated by the PRC, and also for large water companies regulated by the PRC, require Commission approval. For these companies, requesting a rate increase involves considerable time and expense; hence, there are often several years between a company's petitions for a change in rates. If there is unexpected inflation or changes in commodity prices in the intervening years, the rates may turn out to be inadequate to cover expenses. Hence, what is called "regulatory lag" is a big concern for companies that apply to change their rates only once every few years.

The legislature has addressed this concern by authorizing future test years and adjustment clauses.

--Future test years: In rate cases, operating and maintenance costs are typically calculated for a test year and then adjusted for known significant changes from that year. In 2009 the legislature amended the statutes to allow utilities to use a future year as a test year, and to project estimated costs for that year. This change in the law meant that the commission was required to amend appropriate sections of the New Mexico Administrative Code. This process was finally initiated three years later in March, 2012, and the revised rule was finally adopted in November, 2012, followed by further revisions in January, 2013. Commissioners should be able to understand the accounting and regulatory issues involved in using a future test year well enough to choose among alternative proposals by affected parties.

--Adjustment clauses: These allow certain expenses to be passed through to ratepayers without going through a rate case. The expenses eligible for such treatment are those that are significant, volatile, and unpredictable; until recently, these expenses were limited by statute to fuel, gas, and purchased power. In 2011 the legislature added water purchased by water companies to this list.

--Rate design is another factor considered in rate cases. Utility rates are usually divided into a fixed service charge, considered payment for infrastructure, and a variable charge that varies with the amount used. Commissioners should understand the effect of different designs on the company's revenue. Utilities often charge different rates to different classes of customers; ideally, rates are designed so that one class does not subsidize another class, but this is a rule often broken in the interest of some social goal. Commissioners should be able to recognize cross-subsidization and have some basis for deciding when it is allowable.

Utilities are allowed to earn a return on the capital they have invested in infrastructure, provided the investment is deemed reasonable by the PRC. What is "reasonable" is, to some extent, a judgment call that knowledge of the industry will help a commissioner make. In addition, the commission decides the appropriate rate of return on investment, which is based on both market interest rates and factors affecting the cost of capital to a particular company. Some knowledge of relevant financial factors is useful to a commissioner.

Regulation of water and sewer utilities

Structure and regulation – In New Mexico there are approximately 650 community water systems[17], organized in a number of different ways. Most of them are run by governing boards elected by the ratepayers, including municipal water systems, water cooperatives, mutual domestic water consumers associations (MDWCAs), and water and sanitation districts. Some, such as water users associations, are organized like a private club that serves only its members. Only 27 of these companies are privately owned water companies. These 27[18], plus one water and sanitation district which has voluntarily elected to be subject to PRC regulation, are the only water companies regulated by the PRC.

These privately owned companies range in size from a company serving 21 customers[19] to one serving over 17,000. Most of them are locally owned, but six of the larger ones are owned by parent companies in other states and Canada.

Membership in the group of privately-owned water companies changes over time. Many small water systems are set up as a necessary part of developing a subdivision or trailer park, and when the development is complete, the owner/developer often has no further interest in running a water company. In some cases ownership is transferred to the ratepayers, who organize a cooperative or MDWCA to run it, whereupon it ceases to be regulated by the PRC. Sometimes a small system may be taken over by an adjacent municipal or county system as it extends its lines. There is an incentive for small privately-owned water systems to become municipal or member-owned systems because this gives them access to several government programs that offer financial assistance to such companies, but not to privately owned systems. This is important because the financing of needed maintenance is often a problem for water companies whose annual revenue is small. Eight of the privately owned companies in New Mexico had gross revenue of less than $100,000 in 2011.

Privately owned sewer utilities, of which there are nine, are also regulated by the PRC.

The PRC's regulatory powers and those of other agencies—In addition to the authority it has over the fully regulated water companies, the PRC has limited regulatory powers over some others. It can approve or disapprove rates and service regulations established by contracts between utilities and municipalities[20], it has the authority to determine reasonable cost[21] for water wholesalers, and it can settle some territorial disputes.

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[17] Community water systems are defined as those serving at least 25 year-round residents or at least 15 connections serving year-round residents.

[18] This number counts divisions owned by the same parent but serving different areas as separate companies; if companies with multiple divisions were counted only once, there would be 24 companies.

[19] The PRC web site lists a still smaller company serving 9 customers, but PRC staff is not sure whether it continues to exist or who is running it.

[20] NMSA 1978, 62-6-15. Contract rate with the municipality and utilities; how established.

[21] NMSA 1978, 62-6-4 B.

One of the ten water and sanitation districts in New Mexico has elected to come under the PRC's regulation, and the PRC has limited authority over one other—the Eldorado Water and Sanitation District; when its Board adjusts rates or fees, it is required to have a public hearing presided over by a hearing officer selected from a list provided by the PRC.

The PRC has no control over water rights, which are regulated by the New Mexico State Engineer, or water quality, which is regulated by the New Mexico Environment Department. The U.S. Environmental Protection Agency issues the National Pollution Discharge Elimination System (NPDES) permits that must be obtained by wastewater treatment plants that discharge waste directly to water systems.

Examples of Cases Brought to the Commission.

(1) There have been very few water rate cases brought to the Commission since 2005, when New Mexico statutes were changed to link the regulation of rate changes to the number of connections. The 2005 change provides that companies with fewer than 1500 connections (currently, 19 privately owned companies) may increase their rates up to 50% a year unless 10% of customers protest, and that companies having between 1500 and 5000 connections (currently, 7 privately owned companies), may increase rates up to 8% a year unless 10% of customers protest or the commission decides to review the increase[22]. This change in the law meant that, in the absence of protests, all but one of the regulated water companies could make annual rate changes within prescribed limits without a hearing before the commission.

The one large water company whose rate changes are still automatically subject to a hearing before the Commission, the Clovis division of Epcor Water New Mexico,[23] filed a rate case in 2011 which included a request for an adjustment clause permitting it to pass the cost of purchased water through to customers immediately. This adjustment clause was newly permitted by a law passed in 2011; the large water company is a major beneficiary of this change in the law because it gets its water from the Ogallala Aquifer, which is rapidly declining, and the company has seen its annual production decline in spite of more than doubling the number of its wells in the last 13 years. It thus faces the choice of drilling more deep wells or purchasing water.

This was the first request made to the Commission asking to use the purchased water adjustment clause, and the PRC had not yet made the changes to the New Mexico Administrative Code (NMAC) required to reflect the change in the law. The Commission discussed at length the effect of allowing the company to use this adjustment clause, repeatedly expressing concern about the possibility that purchased water would be used as a substitute for pumping the

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[22] NMSA 1978, 68-8-7.1 A and B.

[23] Epcor Water New Mexico (formerly New Mexico-American Water Company) has two divisions, one in Clovis and one in Edgewood. Epcor (USA) is headquartered in Arizona and wholly owned by its Canadia parent, Epcor.

company's own wells, with the possibly higher cost being automatically passed on the consumers. The Commission finally agreed to allow use of the adjustment clause, with the provision that only the cost of purchased water actually used by consumers could be passed on in rates; although this provision did not address the substitution problem, it gave some protection to consumers.

(2) A Certificate of Convenience and Necessity (CCN) issued by the PRC includes a description of the territory to be served, and the utility is obliged to serve all who request service in its territory. If a company wants to expand its territory, it must apply to expand its CCN. The following summary of a recent case illustrates how a decision about a CCN can involve a conflict between the PRC's authority and that of the State Engineer and local governments.

In 2008 the new owner that had purchased an existing water company petitioned to expand the territory specified in its CCN, intending to serve the new area by using the water rights it had acquired when it purchased the water company. Bernalillo County protested, arguing that the water rights requirement that the County imposed on developers should also limit the territory served by the water company. The Recommended Decision (RD) of the hearing examiner ruled against the County, but recommended rejecting the water company's request on the grounds that its water rights might be needed to serve lots still undeveloped in its current territory. The company took exception to being required to hold water rights indefinitely to serve possible future growth. When this case is finally brought before the Commission, its decision will have to deal with the County's claims, and also recognize the possible conflict between the company's obligation to serve in its territory and its ability to get additional water rights approved by the State Engineer.

This case[24] had not yet been heard by the Commission by the end of 2012 even though it had been opened in 2008 and the RD was made in July, 2010; it is an example of the problems caused by the PRC's lack of a comprehensive tracking method for assuring that cases are dealt with promptly. After inquiries were made by the League study group, there was a renewed flurry of activity in the case, leading to a bench request issued May 2, 2013 asking the company for data on rates, number of customers and any relevant changes in State Engineer rules.

(3) Many of the PRC's dealings with small water companies involve helping to solve the problems caused by poor management and inability to maintain the system properly. Such problems do not often make their way to the Commission, but they can use up a good deal of staff time. They are often initiated when customers complain to the PRC about poor service.

Some examples of service complaints that have gone to the Commission are one case in which customers complained about lack of pressure, and another in which the company failed to provide any water at all since its electricity had been cut off because it had not paid its electric bills.

When such complaints are made against small companies with limited revenue, the Commission may have no good options. Statutes allow it to force the company into receivership,

[24] Case 08-00177-UT, New Mexico Water Service Company

but the receiver may find it as difficult to finance upgrades as the owner did. It is unclear whether regulations permit the receiver to sell the company, and even if it is allowed, there may be no one who wants to buy it. Such cases, according to the testimony of one hearing examiner, are among the most difficult cases brought to the Commission.

Regulation of Electric Utilities

Structure and Regulation: The PRC regulates 18 rural electric cooperatives (RECs) and three investor-owned electric companies (IOUs): El Paso Electric, Public Service Company of New Mexico (PNM), and Southwestern Public Service Company. The PRC's jurisdiction does not extend to the three RECs headquartered outside New Mexico that serve a few customers in the state, nor to electric utilities owned by local governments such as those in Los Alamos, Farmington, Gallup, and Raton, nor to the Navajo Tribal Utility Authority.

The three IOUs provide most of the electricity delivered by regulated companies—94% in 2011—and serve most of the population—81% in 2011. However, the 18 rural electric cooperatives serve the largest area, providing electricity in 80% of the state.

All three of the IOUs own their own generation facilities and also purchase some power from other sources. Two of the RECs have both generation facilities and distribution lines. The remaining 16 are distribution cooperatives only; 12 get electricity from a Colorado generation cooperative, and the other 4 from an Oklahoma generation cooperative. The PRC has only limited jurisdiction over the wholesale rates charged by these two generation cooperatives.

In recognition of the fact that RECs members have direct control over rates through an elected board, New Mexico's statutes give the PRC less authority over rates charged by rural electric cooperatives than over rates charged by investor-owned firms. For example, while the commission may review rate changes filed by an IOU on its own initiative, it reviews rate changes by a rural electric cooperative only if the lesser of 25 members or one percent of members protest to the commission.

The PRC's regulatory powers and those of other agencies: Both the federal Environmental Protection Agency (EPA) and the New Mexico Environment Department (NMED) have regulatory authority over air and water quality, which may affect companies providing electricity in a substantial way. For example, the EPA recently mandated that PNM upgrade its San Juan Generating Station (SJGS) in order to meet EPA's regional haze reduction standards; PNM estimated their proposal would cost $750 million. The New Mexico Environment Department proposed an alternate compliance plan that would cost less, perhaps as little as $100 million. PNM did not agree to either proposal and the matter went to federal court. Although the PRC has no regulatory authority in such matters, two members of the commission proposed a third alternative—substituting natural gas for coal rather than cleaning up the coal-using generation facilities. If the alternative chosen results in increased costs of production, it will have an impact on PNM's rates.

The Federal Energy Regulatory Commission (FERC) has authority over interstate transmission and bulk wholesale electricity markets. FERC's recent efforts to encourage investment in transmission by reforming transmission planning and cost allocation have resulted in some shift of authority from state regulators to FERC and regional planning organizations. A recent FERC regulation, FERC Order 1000 (issued in 2011), requires transmission planning at the regional level to be done by regional planning organizations. These organizations are also responsible for allocating new transmission costs fairly to the companies that are their members, with FERC as a backup if the process does not produce a cost allocation method. Two regional planning organizations operate in New Mexico, WestConnect and Southwest Power Pool.

The regional planning organizations' authority to allocate transmission costs affects the PRC's traditional authority over cost recovery through retail electricity rates; it is unlikely that the PRC can deny an IOU's ability to recover, through retail rates, the transmission costs allocated to it by the regional planning organization to which it belongs. Under FERC 1000, the PRC has two ways to affect transmission cost allocation—through participation in regional transmission planning, and by commenting on proposed cost allocation plans filed with FERC. Both options require commissioners to become knowledgeable about transmission and cost allocation issues.

Types of cases brought to the commission. Rate cases occupy a large part of the utility division's staff time, but comprehensive rate cases appear before the commission very seldom. Typically, years elapse between an electric company's filings of comprehensive rate cases with the PRC. However, requests for various types of add-on rates are brought to the commission frequently in the interims between rate cases.

(1) "Riders" are one type of add-on rate. For example, in 2012 Jemez Mountain Electric Coop (JMEC) asked the Commission to approve a rider to cover the cost of an $11.2 million fee for right-of-way within pueblo boundaries that JMEC negotiated with Ohkay Owingeh Pueblo. This fee was to be paid over 25 years. At issue was not only the need to recover the cost of the fee through a rider, but also the question of how the cost should be divided between consumers inside and outside pueblo boundaries. Another critical issue was how the outcome of this case would affect JMEC's right-of-way negotiations with other tribal governments. JMEC's lines cross the territory of ten tribal entities, and it has discovered that it needs to negotiate new right-of-way agreements with most of them, as previous agreements had lapsed.

The PRC has no role in the negotiations with the tribal entities, but must approve the riders required to pay for the fees agreed upon. JMEC has negotiated agreements to pay $26.6 million to five tribal entities over periods ranging from 22 to 25 years, but the PRC has thus far approved only the rider required to pay the fee negotiated with Ohkay Owingeh Pueblo.[25] The PRC has scheduled mediation sessions to deal with the rate hikes proposed by JMEC in August and September, 2013. The Board of Trustees of JMEC has passed a resolution to request congressional assistance in acquiring tribal right-of-ways without creating financial hardship for its members.

(2) The PRC has spent a good deal of time on developing rules for renewable energy. Utilities are required to get a specified amount of their electricity from renewable energy, but a company can be excused from meeting its requirement if the cost it would incur exceeds the

[25] Story posted on the New Mexican website on July 20, 2013.

reasonable cost threshold (RCT). However, the RCT can be calculated in different ways. The Commission, after months of work, finally adopted a calculation method in a final order issued on December 18, 2012. At the end of December, the terms of the two commissioners who had been most instrumental in drafting this order expired.

The subsequent history of this order is curious. On January 17, 2013, a joint motion for a rehearing was filed by the PRC staff, the Public Service Company of New Mexico (PNM), the Attorney General, and the New Mexico Industrial Energy Consumers (NMIEC); the request was based on the need to revise the calculation of the RCT[26]. Such petitions must be granted or refused within 20 days, or they are considered to be denied, and on January 25, one of the newly elected commissioners was asked by staff members to sign a single-signature provisional order granting a rehearing, pending review by the entire Commission. This effectively scuttled the order that had just been approved in December. In March the motion for a rehearing was finally presented to the entire Commission, which voted to grant the motion, and scheduled a hearing for May 9. But before this date arrived, the Commission reconsidered, and on May 1 rescinded its order for a hearing and instead reinstated the rule originally approved in December, 2012. However, at this time, the PRC is still considering amendments to that rule.

Regulation of Natural Gas Utilities

Structure and Regulation Unlike the vertically integrated electricity industry, in which the same company often owns the entire infrastructure from generating facilities to the lines leading to the customer's meter, the natural gas industry is organized by function. There are five distinct steps involved in getting natural gas from the well to the ultimate consumer, and it is common for each step to be performed by a different company; that company may perform that same function in a number of different areas and states.

The first step is to drill a gas well and produce gas from it. The second is to carry the gas through gathering pipelines to a gas producer. In the third step, the producer cleans the gas to standards required for transmission pipelines. The fourth step is to carry the gas through transmission lines to a local distribution company, or alternatively, to store it for later use. In the final step, a local distribution company transports the gas through its distribution pipelines to the consumer.[27]

In New Mexico and several other states, another type of company, a gas marketer, may be involved in supplying gas to large consumers. New Mexico is an "open access" state, which means that any customer of a distribution company may contract to buy gas directly from a producer through a gas marketer; the gas is delivered by the local distribution company serving the customer's area, but the customer is billed by the gas marketer.

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[26] This was the second of two motions for a rehearing; the first was made by NMIEC on January 16, and was subsequently granted in part and denied in part.

[27] Recent estimates of pipeline mileage in New Mexico are: 312 miles of gas gathering lines, 6,798 miles of gas transmission lines, and 13,100 miles of gas distribution lines; the latter figure does not includes lines between the meter hookup and the consumer.

This horizontal organization of the industry has made it difficult to find a way to regulate the price that customers pay for natural gas. The history of federal-level price regulation and deregulation is fascinating; regulatory errors and unintended consequences from a succession of statutes and oversight agencies resulted first in nationwide shortages in the 1970s and then in oversupply in the early 1980s. Attempts to deal with these problems led to further unbundling of some functions and finally to price deregulation of most functions.

There follows a brief description of each of the functions required to get gas from a well to the consumer, the number of companies in New Mexico involved at each step, and whether or not price is regulated in New Mexico at each step.

Gas is produced in New Mexico from thousands of gas wells, which have numerous owners. Two major producing regions are the San Juan Basin in the northwest corner of the state, and the New Mexico portion of the Permian Basin in the southeast corner of the state. The price of gas at the wellhead is not regulated.

To get the gas to a processor, the well owner must contract with a company that operates gathering lines in the area of the well. Approximately two dozen companies operate gas gathering lines[28] in New Mexico, but in some areas there is only one gathering company, which may thus exercise monopoly power. The price charged by the gathering company for gas transportation is not regulated, nor are the other conditions it may impose[29].

The gas processor, after cleaning the gas to the standard required for pipeline transmission, either sells it or stores it for later sale. The price at which the gas is sold is not regulated; it is generally based on prices in the national market, which will be discussed later. The price of storage is regulated by the Federal Energy Regulatory Commission (FERC) if it is owned by interstate pipeline companies and used in their system, or if used in interstate commerce, but not otherwise.

Gas is transported from a gas processor to a local distribution company through a transmission line. In 1992, FERC ruled[30] that the company operating the transmission line may not own the gas it transports; it can only provide transportation service. The price of transportation on *interstate* transmission pipelines is regulated by FERC, which sets a maximum allowable transmission price on a pipeline-by-pipeline basis. There are four major operators of interstate pipelines in New Mexico,[31] and most interstate lines carry gas produced in New

[28] This is the number of companies who do gas gathering for others, not producers who operate lines just for themselves. Exhibit A, Brief of Amicus Curiae, Gas Processor Associations, PRC case No. 09-00424-UT.

[29] Examples of other conditions are whether the well owner may choose the processor to which the gas is transported, and whether the well owner must contract with the company operating the gathering line for meter installation or is allowed to contract with an independent meter installer.

[30] FERC Order No. 636; this order led to the emergence of gas marketers.

[31] These are El Paso Natural Gas Company, Southern Trails Pipeline Company, Transwestern Pipeline Company, and TransColorado Gas Transmission Company.

Mexico's major basins out of state The price of transportation on *intrastate* transmission lines in New Mexico is not regulated by law, but because nearly all of these lines are owned and operated by local distribution companies whose charges to customers are regulated by the PRC, the price that customers pay for transmission on intrastate lines effectively is regulated.

Prices charged by local distribution companies are regulated by the PRC only if they are investor owned utilities (IOUs). There are three IOUs in New Mexico—New Mexico Gas Company, Zia Natural Gas Company, and Raton Natural Gas Company. These three companies serve most of the natural gas users in New Mexico[32]. The PRC does not regulate the publicly owned utilities in Socorro, Las Cruces, Las Vegas, and Farmington, or the member-owned gas utility in Willard.

Prices charged by gas marketers are not regulated; they are decided by negotiations between the marketer and the customers it serves. A marketer's customers must be large enough to justify the negotiations with pipelines and/or processors that have to be made by the marketer. The web site of the New Mexico Natural Gas Company lists seven natural gas marketers serving customers in its service area.

Some areas of New Mexico do not have natural gas service. Consumers in these areas may use propane instead. The PRC has no authority over propane prices, but does regulate service.

As the above summary shows, the price for natural gas paid by most customers in New Mexico is regulated at only two points in the trip from wellhead to the ultimate user—the price charged for moving the gas through interstate transmission lines is regulated by the Federal Energy Regulatory Commission (FERC), and the price charged by investor-owned local distribution companies (LDCs) is regulated by the PRC. However, the PRC regulates only the portion of the customer's bill attributable to the LDC's distribution costs. The portion of the bill that covers payments to producers for natural gas and payment for transportation through transmission lines owned by other companies is not regulated; it is simply passed through to customers, and a typical natural gas bill consists mainly of this passed-through charge. Therefore, any discussion of the price of natural gas in New Mexico must consider the market in which the local distribution companies buy their gas.

Natural gas is a commodity traded in a national market, and most gas purchase contracts are tied to one of the price indexes set in the national market.[33] The gas market is highly volatile and has pronounced seasonal swings. Both producers and local gas distributors need to hedge

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[32] New Mexico Gas Company serves more than 500,000 customers in 23 counties and maintains about 12,000 miles of natural gas pipelines across the state with about 80 billion cubic feet of annual throughput. Zia Natural Gas Company serves 35,000 customers in Lea, Eddy, Lincoln, Doña Ana and Colfax counties. Raton Natural Gas Company, a privately-held IOU, serves 3300 customers, all within Raton's city limits.

[33] Commonly used indices are the New York Mercantile Exchange (NYMEX) price, which is based on the price at Henry Hub in Louisiana, and the Inside FERC prices, which are published by Platts for a number of hubs throughout the country.

against the risk of price swings, and a variety of financial instruments have been developed to enable them to do so.

Speculators help make the market by assuming risk in the hope of profiting from price changes. There are two interconnected natural gas markets—one for the physical commodity, and one for financial trading based on the commodity. It has been estimated that the value of trades in the financial market for natural gas, that is, trades made by people who have no intention of buying or selling the physical commodity, is at least 10 times as large as the value of physical trades. Trades in the financial market can affect the index prices on which many gas purchase contracts are based, and in this way can affect the price that local distribution companies pass on to their customers.

Although the nationwide market for natural gas is regulated both by the exchanges on which the gas is traded and by a federal agency, the Commodity Futures Trading Commission (CFTC), speculators have in the past succeeded in influencing the price indexes on which most gas prices are based[34], and thus the prices paid by most consumers. Federal regulations governing the gas markets have evolved over time to counter speculators' efforts to manipulate the market.

The PRC's regulatory powers and those of other agencies. A number of state and federal agencies in addition to those mentioned above regulate some aspect of the natural gas industry. This section describes how regulatory responsibilities not dealt with in the previous section are divided between the PRC and other agencies.

The permit required to drill a natural gas well is obtained from the Oil Conservation Division of the New Mexico Energy, Minerals and Natural Resources Department, unless the well is drilled on Federal lands or on lands where the mineral rights are owned by the Federal government, in which case the Bureau of Land Management issues permits.

Enforcement of pipeline safety regulations is divided between the PRC's Pipeline Safety Bureau, which inspects and enforces safety regulations on intrastate transmission and distribution pipelines, and the Office of Pipeline Safety in the U.S. Department of Transportation, which handles safety on interstate transmission pipelines. The PRC's Pipeline Safety Bureau inspects gathering lines only if they are regulated lines. Federal rules determine which lines are regulated and which are not, based on the number of buildings in the area and other factors.

Other federal agencies providing regulatory oversight include the Environmental Protection Agency, with jurisdiction over air and water quality, and the Bureau of Land Management and the Minerals Management Service in the Department of the Interior over gas production and transportation on federal lands.

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[34] See "Excessive Speculation in the Natural Gas Market" released by the staff of the Permanent Subcommittee on Investigation of the U.S. Senate in 2007.

Other state agencies involved include the New Mexico Human Services Department, which administers the Low Income Home Energy Assistance Program (LIHEAP). Customers qualify on the basis of income and household size; benefits include reduced rates and guaranteed gas supply throughout the winter.

Examples of cases brought to the Commission.

The fact that the PRC does not regulate price and service on gas gathering lines has not prevented people from bringing cases involving these matters to the PRC. In the two cases discussed below, the PRC, while not asserting authority to intervene, facilitated negotiations that helped resolve the problems.

In 1999 a group of gas well owners in the San Juan Basin brought a complaint[35] against one of the gathering line companies operating in the region, Enterprise Field Services, LLC, asserting that the rates charged for transportation services were unjust, unreasonable, and discriminatory. The complainants asked the PRC to assume jurisdictional power in the case and to hold a hearing to determine just and reasonable rates and to compel Enterprise to discontinue discriminatory rates, terms, and charges.

The PRC, while specifically not asserting jurisdictional authority in the case, asked Enterprise to respond. Enterprise responded that PRC lacked jurisdiction to consider the case, but agreed to enter into negotiations with the complainants. The case was finally settled in 2012 on the basis of renegotiated agreements, which led to the withdrawal of the complaint by all parties.

A more recent case arose in the same area in 2012. This affected 474 landowners in rural San Juan County who had been receiving raw (unprocessed) natural gas from "farmtaps" on gathering lines which crossed their land. These lines were owned by two gas gathering companies, Williams Four Corners and Enterprise Products, both of which both sold gas to New Mexico Gas Company (NMGC). All the people with farmtaps received their gas as customers of NMGC, which sold them gas under a contract used to serve customers from other companies' pipelines. If they had purchased gas directly from the gas gathering companies, these companies could arguably be labeled distribution companies, and thus be subject to the PRC's rules for distribution companies.

When, in 2012, first Williams and then Enterprise decided to stop selling gas to NMGC and to cease supplying the farmtaps, NMGC sent letters to the farmtap customers saying that NMGC could no longer supply them with gas, and offering them $5,000 which they could use to make other arrangements for getting gas. The Attorney General (AG) then asked the PRC not to let NMGC abandon these customers. Subsequently, NMGC, the AG, and the PRC utility staff drafted a stipulation under which 446 farmtap customers would be tied into existing New Mexico Gas Company distribution lines and 28 others located in more remote areas would be paid cash to assist them in converting to an alternative energy source. The cost to NMGC would be borne

[35] PRC case 09-00424-UT

by its other ratepayers through a rate rider increasing a typical residential bill by about $.08 each month.

When asked to approve this stipulation, the Commission instead ordered its staff to investigate how gas could be supplied to the customers who would be cut off, made Williams and Enterprise parties to the investigation, and also directed its staff to examine the obligations of Williams and Enterprise to serve these customers and consider whether both should be considered public utilities inasmuch as they were providing gas to some consumers.

The ensuing discussions between all parties resulted in an amended stipulation, under which, if approved by the Commission, NMGC would extend its lines to fewer customers—411 rather than 446—and make cash payments to more customers—63 rather than 28. Williams and Enterprise would both help pay expenses, and the cost to NMGC would be collected from other ratepayers through a rate rider increasing a typical residential bill by about $.04 each month.

As of this writing, NMGC had published notice of the amended stipulation in the Albuquerque Journal and one protest had been received.

Regulation of Telecommunications Companies

In the past three decades, the telecommunications industry has been transformed from a collection of monopolies to a largely competitive industry. Changes in regulation have been made to fit the new structure of the industry, and state and federal subsidies have been introduced to ease the transition and replace the implicit subsidies provided under the previous system. The result of these changes is a regulatory system more complex than that of any other utility regulated by the PRC; in order to provide appropriate regulation, a PRC commissioner should have a good deal of knowledge about the industry. The following brief description only touches on the kinds of knowledge required.

Before the 1980's, telephone companies were monopolies in the areas they served, as other utilities are today. All provided wireline service, that is, customers were linked by copper wires to a switch located in a local exchange. In New Mexico, exchanges in the larger towns were owned by AT&T, while exchanges in rural areas were owned by several small independent companies.

This system changed in 1984 when AT&T was broken up by a federal antitrust suit. The new AT&T retained only long distance service; its local exchanges throughout the United States were allocated to seven separate companies, called "baby bells". After the breakup, local exchange telephone service in New Mexico was provided by the baby bell U.S. West and by the 13 small independent companies that served rural areas.

The federal Telecommunications Act of 1996 promoted even more competition in the industry. It not only required incumbent telephone companies to allow competitors to interconnect to their lines, it also required them to sell their services at wholesale prices to competitors who wanted to resell them at retail prices, and to lease parts of their systems, for example, lines serving individual customers, to competitors.

Competition has been further aided by changes in technology. Traditional wireline telephone service now competes with wireless cell phones, transmission using voice over internet protocol (VoIP), and cable modem service, which offers access to the telephone system through television cables.

The structure of the telecommunications industry, that is, the mix of large and small companies and where they serve, is highly influenced by the availability of subsidies. When AT&T was broken up, the implicit subsidies that it provided (for example, low rates for local calling service were subsidized by high rates for long-distance service) were replaced with several explicit subsidy programs run by the Federal Communications Commission (FCC) and by states that elected to supplement the FCC subsidies. New Mexico has set up a State Rural Universal Service Fund, administered by the Commission, which provides support to rural telecommunications companies. These subsidies are especially important to small companies serving high-cost areas. In order to be eligible for most of these subsidies, a company must be certified as an eligible telecommunications carrier (ETC). ETC status is granted by the PRC.

The emphasis of these subsidies has changed over time and is projected to change further in the future. In November 2011 the FCC announced its intention to redirect most subsidies to a new program to make broadband service available to everyone, reducing existing subsidy programs. This change is expected to have a major impact on small carriers dependent on these subsidies, and they have protested to the FCC.

Currently, the main telecommunications service providers are divided into four groups for regulatory purposes.

ILECs—incumbent local exchange carriers—are companies who provided wireline services when the federal Telecommunications Act of 1996 was passed, and their successors.

CLECs—competitive local exchange carriers—are companies established after 1996 to provide local service to customers.

IXCs—interexchange carriers—transport messages between local exchanges and/or provide long-distance service directly to customers as an alternative to going through a local exchange.

Wireless carriers may be either CLECs or IXCs, but are regulated differently from other carriers in these groups.

ILECs—There are 18 ILECs in New Mexico, all of which provide wireline service. CenturyLink-Qwest has nearly 500,000 subscribers; Windstream has almost 70,000 subscribers. The other 16 are all much smaller. See table 1 below.

For all ILECs, the Commission is responsible for issuing a certificate of convenience and necessity, and for regulating wholesale rates (those charged to other telecommunications companies for resale), rates charged for allowing other carriers to connect to their system, and

Table 1: Local Exchange Carriers

Incumbent Local Exchange Carriers	Headquarters	Number NM Subscribers
1. Baca Valley Telephone Company	Des Moines, NM	538
2. Centurytel of the Southwest	Monroe, LA	4,114
3. Copper Valley Telephone Coop	Wilcox, AZ	3,017
4. Dell Valley Telephone Coop	Dell City, TX	492
5. EMNR Telephone Coop	Clovis, NM	9,465
6. La Jicarita Rural Telephone Coop	Mora, NM	1,813
7. Leaco Rural Telephone Coop	Lovinton, NM	1,607
8. Mescalero Apache Telecom	Mescalero, NM	1,237
9. Navajo Communications	St. Michaels, AZ	6,900
10. Panhandle Telephone Coop	Guymon, OK	20
11. Penasco Valley Telephone Coop	Artesia, NM	2,352
12. Roosevelt County Rural Telephone Coop	Portales, NM	1,526
13. Sacred Wind Communications	Yatahey, NM	2,191
14. Tularosa Basin Telephone Co.	Tularosa, NM	3,921
15. Valley Telephone Coop	Willcox, AZ	3,663
16. Western New Mexico Telephone Co.	Silver City, NM	6,095
17. Windstream Communications	Santa Fe, NM	69,588
18. Century Link – Qwest	Monroe, LA	493,128

intrastate access charges (for a discussion of access charges, see IXC discussion below) . However, the Commission's responsibility for retail rate regulation differs by size of carrier, as measured by the number of access lines, with the level of regulation increasing with the size of carrier.

For rural telecommunications companies, defined as those having fewer than 50,000 access lines, the Commission reviews residential rate changes only if at least 2.5% of customers protest. Changes in business rates and rates for special services such as call waiting go into effect as filed without review.

Mid-sized companies—Windstream is the only one—are regulated on a price cap basis, that is, rate increases may not exceed an indexed price cap which is reset annually according to rules specified by the Commission in the New Mexico Administrative Code[36]. The Commission also specifies NMAC rules governing service quality and consumer protection.

Large companies—CenturyLink (formerly Qwest) is the only one—are also regulated on a price cap basis, but regulation is done through an alternative form of regulation (AFOR) agreement which deals with rates, service quality, and build-out of facilities[37]. This agreement is renegotiated every three years. Currently, AFOR III is in effect (except for portions that have been vacated by the New Mexico Supreme Court) and AFOR IV is slated for consideration. CenturyLink has petitioned the Commission to declare that telecommunications services are subject to effective competition throughout New Mexico, and says that once such a determination is made, Century Link will request regulatory parity with its CLEC competitors.

CLECs—There are 120 CLECs registered in New Mexico, but only 42 are active[38]. They provide either wireline service (through their own facilities or facilities leased from an ILEC) or VoIP service.

For all CLECs, the Commission is responsible for issuing a certificate of convenience and necessity, and for regulating intrastate access charges (see IXC description below) . Rates are filed with the commission, and go into effect 10 days after they are filed unless the PRC staff protests[39] . Rates must comply with commission rules, which are designed to prevent companies from setting rates below the cost of providing service.

IXCs—There are 207 IXCs registered in New Mexico, but many are not active. To the extent that they handle interstate calls, they are regulated by the FCC; intrastate calls are regulated by the PRC. The PRC decided in 2000 that the intrastate long distance market is effectively competitive, and reduced its regulations accordingly.[40] Currently, IXC's are required to obtain a CCN from the PRC[41], are required to file an annual report, and must notify the PRC of changes in rates 10 days before they go into effect; unless PRC staff protests, the new rates go into effect as filed.

The rates charged by IXC's are paid by the end-use customers who use their services when they make a telephone call, though when long-distance service is bundled with other services, this charge may not be shown on telephone bills. In turn the IXC pays access fees, per

[36] Rules governing price ceilings appear in NMAC 17.11.23.8.

[37] Companies whose rates are regulated on a rate-of-return basis have an incentive to invest in new plant because they can earn a return on it; however, companies regulated on a price cap basis have a disincentive to invest in new plant because such investment may cut into their profits. Thus the AFOR also specifies required build-out of the system.

[38] "Active" is defined here to include only those carriers submitting an annual report at the end of 2011.

[39] NMAC 17.11.19.16.

[40] PRC cases 3246 and 3198.

[41] Their application must be reviewed by the PRC within 30 days, and if complete is accepted.

call per minute, to the carrier of the customer who makes the call, and to the carrier of the customer who receives the call.

Access fees are regulated differently for interstate calls and intrastate calls, and for rural and non-rural carriers. Beginning in 2006, New Mexico required intrastate access fees charged by ILECs and CLECs to be gradually reduced so that by the beginning of 2008 they were no higher than interstate access fees, which are set by the FCC. Access fees for wireless carriers are not regulated, and must be negotiated between the wireless carrier and IXCs.

Wireless Carriers—There are 11 wireless carriers in New Mexico. Wireless carriers are regulated by the FCC; the PRC's role is limited to granting ETC status and handling consumer complaints against wireless carriers.

The PRC's regulatory powers and those of other agencies. Before the breakup of AT&T, states regulated the rates charged by local exchanges, and the Federal Communications Commission (FCC) regulated long-distance rates. Changes in technology have required a re-alignment of regulatory responsibility. The general principle is that telephone service provided in the state is regulated by the state, service that crosses state lines is regulated by the FCC, and service that cannot be accurately separated into in-state and out-of-state is also regulated by the FCC. This simple principle has led to a very complex system of dual regulation; see box below.

Entry: Entry for both ILECs and CLECs is regulated by the PRC, but the FCC controls entry for wireless carriers, broadband service, and VoIP service.

Rates: ILEC and CLEC rates are regulated in part by the PRC and in part by the FCC, depending on whether the services charged for are allocated to interstate service or intrastate service. The FCC controls rates for wireless carriers, broadband service, and VoIP service.

Access Fees: For ILECs and CLECs, the FCC regulates access fees for interstate calls, and the PRC regulates access fees for intrastate calls.

Competition: The PRC determines whether there is effective competition in an area served by an ILEC or CLEC, thus making them eligible for reduced regulation.

ETC status: The PRC grants eligible telecommunication carrier (ETC) status to all carriers.

Consumer complaints: The PRC handles consumer complaints for all carriers.

Changes in the industry and changes in technology over the past decade have both tended to shift regulation from the PRC to the FCC as ILECs (regulated in part by the PRC) have lost subscribers, while the number of voice over internet subscribers and wireless subscribers (both regulated by the FCC) has grown. The number of ILEC wireline subscribers has declined sharply in the last decade, from just over one million[42] in 2001 to 595,000 in 2011. In the same

[42] Figures are reported to the FCC. Before June 2005, carriers with fewer than 10,000 subscribers did not report. Using data from the time series, we estimated the total number of ILEC subscribers in June, 2001 to be 1,014,000.

time period, the number of CLEC wireline subscribers has grown somewhat, and there has been a very sharp increase in CLEC VoIP subscribers[43]. In 2011, CLECs had 68,000 wireline subscribers and 103,000 voice-over-internet (VoIP) subscribers for a total of 171,000 CLEC subscribers. Wireless carriers in New Mexico had 1,662,000 subscriptions in 2011, more than double their 620,000 subscriptions in 2001.

Types of cases brought to the Commission.

As the industry has changed, so have the types of cases brought to the Commission. Half the cases brought currently[44] deal either with the state and federal subsidy programs or with complaints. There are two types of complaints—consumer complaints and interconnection complaints.

The consumer complaints often involve outrage over the hefty charges made for early termination of contracts for wireless or DSL service. The following case illustrates the uncertain line between PRC and FCC jurisdiction. A complaint[45] was filed against Qwest on account of a $199 early termination fee for DSL service. The complainer had terminated the service because he was charged more than the monthly rate he had been promised, and could not get Qwest to adjust the rate. Qwest's initial response was that the PRC did not have jurisdiction over the complaint because DSL was regulated by the FCC, and that the complainer should instead file a case in court under New Mexico's consumer protection laws. However, Qwest agreed to PRC mediation, which resulted in a refund of the $199.

The interconnection complaints involve disputes between ILECs like Qwest and the CLECs they are required to interconnect to their lines or to whom they are required to sell unbundled elements of their system. In one such case,[46] Qwest complained to the PRC that an Illinois-based CLEC, McLeod, which provided service to users by purchasing or leasing lines from Qwest, charged Qwest a "Wholesale Service Charge" whenever a customer decided to abandon McLeod and transfer to Qwest. This charge appeared on the last page of a 300-page tariff document filed with the PRC by McLeod and approved by the PRC. It was structured to apply only to Qwest, not to any other carrier to which a consumer might switch. Qwest argued that it was unjust, unreasonable, discriminatory, and anti-competitive. The PRC ordered McLeod to respond to the request, which it did a month later. PRC records show no further developments in this case for two years. Then the commission issued an order stating that due to the passage of time, issues in the case may be stale, and dismissal of the case may be warranted. It gave notice that the case would be closed unless either of the parties showed good cause to keep it open within 30 days. Neither company responded.[47]

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[43] Data comparable to the 2011 data are not available for 2001 for two reasons; there were so few CLECs that printing aggregate data would have violated company confidentiality, and before December 2008 VoIP data were not broken out, but were included in the totals reported to an unknown degree.

[44] This statement is based on cases brought to the Commission between August, 2011 and July 2012.

[45] Case 11-00096-UT.

[46] Case 09-00370-UT.

[47] Qwest and McLeod later settled this matter, among other disputes between them, on a nationwide basis. Shortly after the PRC's final order was issued, McLeod's holding company, PAETEC, was acquired by Windstream Communications.

The next example deals with an application for Eligible Telecommunications Carrier (ETC) status by T-Mobile, a wireless carrier, made in 2012. This was an unusual application, in that T-Mobile sought conditional ETC status for the purpose of participating in a Mobility Fund auction conducted by the Federal Communications Commission (FCC). The Mobility Fund was set up as part of the FCC's announced decision to redirect government subsidies to make broadband service more widely available; it provided up to $300 million in one-time support to speed development of mobile voice and broadband service in areas the FCC had determined are unserved by high-speed wireless networks. Companies that wanted to participate in the auction in order to serve those areas were required to have ETC status. Areas to be bid on were census tracts rather than the service areas of existing telecommunications carriers. T-Mobile sought ETC designation only in those areas for which it won the auction.

There were two interveners in this case, the New Mexico Exchange Carriers Group (NMECG) and Mescalero Apache Telecom, Inc. (MATI), and two issues that they brought up are discussed here.

One issue is how subsidizing T-Mobile's offering of wireless service in the areas served by other rural carriers would impact the financial condition of the existing carriers, and how the public interest would be affected by this impact. MATI argued that T-Mobile would be able to cherry-pick in the area served by MATI by bidding to serve only areas that it made business sense to serve, i.e., areas along highways or with dense populations. T-Mobile, unlike MATI, would not be required to serve MATI's entire service area, and would thus be able to provide service more cheaply than MATI in the low-cost areas it did serve, which meant that MATI would lose customers in those areas and would no longer be able to serve its remaining customers in its high-cost areas.

The Recommended Decision (RD) presented to the Commission by the hearing examiner noted that it did not seem to be in the public interest to allow T-Mobile to serve in MATI's service area, but that there was not enough evidence to determine how subsidizing T-Mobile's offering of wireless service in the areas served by other rural carriers would impact their financial condition. Nevertheless, the hearing examiner recommended, and the Commission approved, granting T-Mobile's request for conditional ETC status in all areas in which it won the auction except in areas served by MATI.[48]

Another issue that came up in this case was that T-Mobile had refused to pay the Utility and Carrier Inspection Fee (UCIF)[49] that all ILECs and CLECs are required to pay. NMEGC

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[48] T-Mobile subsequently won the auction for just one of the 22 areas in New Mexico which won support in the auction; the area they won is the southern part of Torrance County.

[49] NMSA 63-7-20 Utility and Carrier Inspection Fee, provides that, "Each utility and carrier doing business in this state which is subject to the control and jurisdiction of the commission by virtue of the provisions of Article 11 of the constitution of New Mexico with respect to its rates and service shall pay annually to the commission a fee in performance of its duties as now provided by law. … The fee for utilities shall not exceed five hundred eleven thousandths percent of its gross receipts from business transacted in New Mexico for the preceding calendar year. ... In the case of utilities or carriers engaged in interstate business, the fees shall be measured by the gross receipts of the utilities or carriers from

argued that this gave T-Mobile an unfair advantage over its ILEC and CLEC competitors, and urged the commission to make its ETC designation conditional on payment of the UCIF.

The legislation on the UCIF allows for several interpretations of legislative intent, and although this issue had come up before, and the PRC staff had recommended that a docket be opened to resolve it, the Commission had not yet done so. The RD in this case contained the requirement that, "A new docket shall be opened immediately to resolve the issue of the duty of wireless telecommunications carriers to pay the Utility and Carrier Inspection Fee under NMSA 1978, 63-7-20." The Commission approved this requirement when it accepted the RD in June, 2012, but as of May, 2013, the Commission had not yet opened this docket. This is another example of the need for a more effective docket tracking system at the PRC.

Regulation of Transportation

The carriers for which the PRC's Transportation Division has some regulatory responsibility include motor carriers, railroads, and pipelines. For instrastate railroads and some pipelines, the PRC performs safety inspections, but does not otherwise regulate them. In this section we will describe only regulation of motor carriers, a group that includes ambulances; various kinds of passenger transportation such as taxis, buses and van pools; movers of household goods; intrastate freight haulers, and towing services.

The aims of regulation, and the PRC's power to regulate, differ between different types of motor carriers, but some powers apply to all. Any motor carrier must obtain an operating authority from the PRC in the form of a certificate, a permit, or a warrant.[50] Carriers defined as tariffed carriers—the group includes ambulance services, household goods services, shuttle services, specialized passenger services, taxicab services, and towing services performing nonconsensual tows—must also have their rates approved by the PRC.

In regulating tariffed carriers, there is a need to balance several goals—allowing the business adequate revenue, ensuring that the public has reliable access to the service, and seeing that the public is not overcharged. Legislation passed in 2013[51] made significant changes in the methods used to balance these goals. While the different types of motor carrier services are affected in very different ways by the 2013 legislation, some generalizations can be made.

The 2013 legislation draws a distinction between "full-service" and "general service" transportation providers, and gives full service providers greater power to deny entry to potential competitors by preventing the PRC from certifying them. Full service providers consist of all

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intrastate business only … As used in this section, "utility" includes telephone companies and transmission companies … "

[50] Certificates are issued to ambulance companies, household goods carriers, shuttle services, taxicab services, and specialized passenger services. Permits are issued to carriers who transport passengers or household goods pursuant to a contract between the carrier and another person; for example, a company may contract with a permitted carrier to transport its employees between offices. Warrants are issued to charter services, commuter services, freight haulers, and towing services.

[51] House Bill 194, identical to Senate Bill 328.

ambulance services, scheduled shuttle services, and taxicab companies that offer centrally dispatched service 24 hours a day all days of the year. All other passenger services are general service providers, as are household goods carriers.

The 2013 legislation also distinguishes between a *protest* of an application to certify a new company, and an *objection* to the application. Only full service providers may *protest* an application to provide service in their territory. Any interested party may file an *objection* to the application, but the fact that only a protest requires the Commission to hold a public hearing, with its attendant additional expense for the applicant, is a change that tends to make it easier to start new taxicab companies and shuttle services.

The 2013 legislation provides some disincentive to protest or intervene in an application for a certificate or permit by requiring that a fee be paid to do so; the fee is the same as the fee for filing the application. This change also tends to make entry of new companies easier.

The 2013 legislation makes entry more difficult for new ambulance companies in the territory of existing companies. For taxicab and shuttle services, the effect on ease of entry will vary from case to case, as will be discussed below. For household goods carriers, entry of new companies is made much easier.

The 2013 legislation *allows* the Commission to establish voluntary statewide tariffs for any tariffed service carriers, and *requires* the Commission to establish maximum statewide rates for household goods carriers.

The 2013 legislation stiffens the penalties for providing transportation services not authorized by the Commission, or for charging predatory rates, by declaring both practices to be unfair and deceptive practices under the Unfair Practices Act, which allows either the Attorney General or any damaged party to bring action against the carrier regarding the service or rate.

Ambulances. There are approximately 86[52] companies offering motor carrier ambulance service[53] in New Mexico. The group includes for-profit entities, not-for-profit entities, and quasi-governmental entities connected to fire districts, municipalities, or counties, some of which receive subsidies from local governments. For all these entities, the PRC regulates safety through annual inspections and establishment of standards for vehicle design and required equipment.

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[52] An exact number cannot be determined because available estimates of the number differ. The PRC's eDocket file for ambulance companies shows 86 certified companies in May, 2013. The number of companies listed on the Transportation Division's listing of ambulance companies is 77. When the PRC staff initiated the latest increase in rates in February, 2008, their petition included the statement that "Upon information and belief, there are approximately 95 ambulance services certificated by the Commission…" The Recommended Decision of the hearing examiner issued in April 2009 noted that "The Commission has authorized ninety-eight companies to provide Ambulance Service in New Mexico."

[53] These numbers do not include companies offering air ambulance service, which are not regulated by the PRC.

The PRC also regulates charges for service through a statewide voluntary tariff[54]. Most of the companies have chosen to adopt the statewide rate schedule[55]; the others have chosen to file separate rate schedules to be approved by the PRC.

The legislative changes adopted in 2013 increase the difficulty of starting a new ambulance service in a territory already served by an existing ambulance service. The 2013 law provides that the Commission shall not grant an application to provide ambulance service in the territory of an existing provider if the existing provider either provides reasonably adequate service or is willing and able to provide such service and subsequently does so. The applicant for a new ambulance service has the burden of proving that the existing service is inadequate and that the proposed service will meet a public need. And because all motor carrier ambulance companies are classified as full service providers, if an existing company protests the application, the PRC is required to hold a public hearing on the application, which increases the expenses of the applicant.

Taxi service. There are 29 taxi companies certified to operate in New Mexico[56]. The 2013 legislation divides these companies into municipal taxi services, defined as those having a centrally dispatched service that operates 24 hours a day all days of the year, and general taxi services, which do not meet these requirements. By July 1, 2013, all certificates previously issued to taxi companies are required to be replaced with new certificates specifying whether the company is a municipal taxi service or a general taxi service. This requires the PRC staff to determine which companies meet the law's definition of a municipal taxi service.

Until it is known how many existing taxi companies qualify to be called municipal taxi services,[57] it is not possible to say whether the new law will increase or reduce the difficulty of starting a new taxi company.

The 2013 legislation increases the difficulty of starting a general taxi service in the territory of a municipal taxi service by providing that the Commission may not issue a certificate

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[54] In 1998 a voluntary statewide tariff was adopted by the State Corporation Commission, and it has been updated twice since; the last update was in June, 2009. New Mexico is one of only three states that regulate ambulance rates at the state level.

[55] Seventy of the 77 companies listed in the Transportation Division's listing of ambulance companies have adopted the current statewide rate schedule. The number appears to have increased sharply after the increase in the statewide tariff authorized in 2009; the recommended decision in that case states that only 33 of the 98 companies (33%) authorized by the PRC had adopted the statewide tariff in existence at that time, but currently 91% have adopted it.

[56] Lists of taxi companies available on the PRC web site differ in the companies included. The number shown here is the number of certified taxis in the eDocket file. The list provided in the Transportation Division's list of taxis includes only 17 companies.

[57] As of this writing, no municipal taxi certificates have been issued, but Transportation Division staff estimate that 5 or 6 taxi companies may be eligible for such certificates. There are also many unanswered questions on how to define what it means to be centrally dispatched and to operate 24 hours a day. For example, if an owner of a single cab claims that he sleeps with his telephone and answers calls at all hours, is his service centrally dispatched and available 24 hours a day?

to a general taxi service proposing to serve in the territory of a protesting full-service company. Any municipal taxi service is considered a full service company, and as such is entitled to protest the entry of a general taxi service into its territory. Previously, the law provided only that the service should be responsive to a public need, and that the Commission should consider the effect that issuance of the certificate would have on existing taxi services, with the proviso that diversion of revenue or traffic was not sufficient grounds for denying the certificate[58].

However, the 2013 legislation makes it easier for a general taxi service to start up in the territory of another general taxi service by removing the requirements that the applicant show that the service would be responsive to a public need, and that the Commission consider the effect on existing taxi services.

The aim of these changes appears to be to make it easier for new companies to enter the market while at the same time preventing the entry of companies seeking to take over the more profitable parts of the market, thus driving out of business the full service businesses which are obligated to serve all segments of the market.

Rates for taxi service must be approved by the Commission. The law provides that they should be nonpredatory and nondiscriminatory, and that the Commission shall authorize adequate revenue levels. There are currently no statewide tariffs; each company files its own. However, the 2013 legislation gives the Commission the power to establish statewide rates for voluntary and optional use.

Shuttle service. There are 18 shuttle services certified to operate in New Mexico. Legislation passed in 2013 divides these companies into scheduled shuttle service, defined as one that transports passengers to and from airports on the basis of a daily time schedule, and general shuttle service, which is one not required to operate on a set schedule. By July 1, 2013, all previously issued certificates are required to be replaced with new certificates specifying whether the company is a scheduled shuttle service or a general shuttle service.[59]

Whether the 2013 legislation will make it easier or more difficult to start a new shuttle service will depend on how many existing shuttle services are classified as full service companies, and how the Commission will interpret the new law. Since only an existing full service shuttle company is entitled to protest the entry of a new shuttle company in its territory, entry will be made easier in areas in which no full service shuttle services exist. In areas where there is an existing full service company, the new law requires that the Commission not certify a new entrant if that would have a reasonable potential to affect the provision of full-service shuttle service to the community; previously the law required the Commission to consider the effect on existing companies, without specifying exactly what effect would result in the denial of an application. Depending on whether the new law changes how the Commission actually

[58] These requirements were in addition to the requirements still in effect that the applicant be fit and able, and in compliance with safety and financial responsibility rules.

[59] As of this writing, no scheduled shuttle service certificates have been issued, but Transportation Division staff estimate that 3 shuttle companies may be eligible for such certificates.

decides such cases, prospective entrants may find it easier or more difficult to get a certificate to set up a new shuttle service.

Rates for shuttle service must be approved by the Commission. The law provides that they should be nonpredatory and nondiscriminatory, and that the Commission shall authorize adequate revenue levels. There are currently no statewide tariffs; each company files its own. However, the 2013 legislation gives the Commission the power to establish statewide rates for voluntary and optional use.

Household goods carriers. There are 46 intrastate household goods movers in New Mexico[60]. Of these, 42 are members of the Movers and Warehousemen's Association and have adopted the approved rates developed by the Association. The remaining four have had separate individual rate schedules approved by the Commission.

The 2013 legislative changes made significant changes in the way household goods movers are regulated. Starting a new moving company was made easier in three ways. (1) The Commission is no longer required to consider the effect of a new company on existing movers before issuing a certificate. (2) The Commission is no longer required to consider whether the application for a certificate will serve a public need. (3) While existing movers may *object* to the application, they may not *protest* it because only full-service carriers may protest an application, and household goods movers are not included in the full-service group defined in the new legislation. While the Commission must consider *objections* to an application, only *protests* require the Commission to have a public hearing. Furthermore, the legislation requires the Movers and Warehousemen's Association[61] to allow any mover to become a member of the organization.

The 2013 legislation shifted control of rates from the Movers and Warehousemen's Association to the PRC in several ways. (1) It directed the PRC to create a statewide tariff establishing maximum rates[62]. Previously, moving companies had the option of adopting the rates established by the Movers and Warehousemen's Association, or applying to the PRC for approval of separate rate schedule. (2) It provides that the Association must propose matters concerning statewide tariffs to the Commission. (3) It provides that when the new rules take effect on July 1, 2013, the tariffs established by the Association will become the tariffs of the individual companies that have adopted them. [63]

The involvement of the PRC in settlement of disputes between movers and shippers was increased. The legislation requires the PRC to establish a program to settle disputes, which may be used at the voluntary option of the shipper. Previously, the law provided that a mover could

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[60] The PRC web site lists 47, but one appears not to have provided required insurance information to the PRC and so is assumed not to be operating currently.

[61] HB 194, section 21, amending NMSA 65-2A-23. The bill refers to any motor carrier organization.

[62] HB 194, Section 3, amending NMSA 65-2A-4.

[63] HB 194, Section 33, enacting a new section of the Motor CarrierAct.

apply to the PRC to establish a program to settle disputes, but this provision had not yet resulted in the establishment of a dispute settlement program by the PRC.

Towing and Property Hauling Companies. The number of intrastate towing and/or property hauling companies changes frequently, but as of mid-2013 there were between 350 and 400 such companies in New Mexico; most of these are towing companies. The PRC's only entry requirement for these carriers is that they meet financial responsibility and safety requirements. Most companies meet their financial responsibility requirements by buying insurance. The PRC staff is assiduous in tracking whether or not insurance is current, and several times a year appear before the Commission to request revocation of the operating authority of companies whose insurance is not current.

The 2013 legislative changes did not make significant changes in the way towing companies are regulated, but starting a new towing company was made somewhat easier by removing the provision that a person may protest an application for a warrant on the grounds that the applicant cannot meet safety or financial responsibility requirements.

With the exception of companies that perform non-consensual tows (tows requested by law enforcement officers), the PRC does not regulate rates charged by these companies. Towing companies that perform non-consensual tows must have their rates approved by the PRC, and they are subject to other laws, enforced by the PRC, that aim to prevent the same company from appearing multiple times on the police list of companies that perform non-consensual tows.

When the police require that a vehicle be towed, they call a company from their list of towing companies in the area who perform non-consensual tows; they rotate through the list, calling the next company whose turn it is to be called. Non-consensual towing is profitable enough to provide an incentive for companies to maximize the number of times they appear on the list; for example, if a man owns one company, his wife another, and his son a third, and they all use the same facilities, they will appear on the list three times, and be called three times as often. Laws have been passed to try to prevent this; the initial effort prohibited common control of two companies having the same operating authority in the same territory. The 2013 legislation repeals the common control rule and simply prohibits a towing service that performs nonconsensual tows from using the same equipment and facilities as another carrier performing nonconsensual tows. The Transportation Division is currently working on rules to implement this change in the legislation.

The PRC's regulatory powers and those of other agencies The Federal Government began to deregulate railroads and motor carriers in 1976, and the effort was completed in 1995, when all remaining responsibilities for motor carrier regulation were transferred to the Department of Transportation and the Federal Highway Administration. At that time, the federal government also preempted state regulation of trucking, which meant that states could no longer regulate price and service in the freight hauling sector of the motor carrier industry. However, states were allowed to continue to regulate price and service for taxis, ambulances, some passenger carriers, and household goods carriers.

States and the Federal Government share responsibility for safety regulation of motor vehicles. Division of responsibility depends on whether the vehicle is an interstate or intrastate carrier, whether it is used for carrying passengers or freight, and its size or number of passengers carried. For interstate carriers, safety is regulated by the Federal Motor Carrier Safety Administration, an agency of the Department of Transportation. For intrastate carriers, safety is regulated by state agencies, either the PRC or the Motor Transit Division of the New Mexico Department of Public Safety (DPS), depending on the size of the vehicle and the number of passengers it carries (see chart below for details).

Table 2: Responsibility for regulation of safety by the PRC and Department of Public Safety (DPS)

Passenger carriers				Carriers of goods		
No. of passengers	Interstate	Intrastate		Weight, pounds	Interstate	Intrastate
<8	none	PRC		<10,000	none	PRC
8-15	DPS	PRC,DPS		10,000-26,000	DPS	PRC
>15	DPS	DPS		>26,000	DPS	DPS

For all intrastate carriers, the PRC is responsible for regulation of financial responsibility, which for most companies means making sure that appropriate insurance is carried. The DPS checks for proof of financial responsibility at check points.

Most states in the United States, including New Mexico, participate in the Unified Carrier Registration Agreement, which provides for collecting annual fees from interstate carriers to be used for highway safety purposes. Each carrier chooses a base state, and UCR fees go only to that state. Some states serve as nodes, collecting fees for surrounding states. New Mexico is a node state collecting UCR fees from carriers based in New Mexico, Arizona, and parts of Nevada, and the PRC is the agency responsible for collecting these fees. All such fees are remitted to the New Mexico general fund, from which they are dispersed to the appropriate base states.

Examples of cases brought to the Commission. The following two cases both concern towing companies in Espanola, where several towing companies are run by people in the same family and the fortunes of the towing companies are affected by family feuds and changes in the political fortunes of the towing company owners. Both cases involve three towing companies: Robert's Towing, owned by Robert John Seeds, a city councilor in Espanola; Seeds Towing, owned by his son, Robert L. Seeds; and Fairview Wrecker, owned by Laura Seeds, who lives with Robert John Seeds and has changed her last name to Seeds but is not his wife. All three companies were on the Espanola police department's rotation list and all operated out of the same yard and had the same telephone number.

In March, 2011[64] the staff of the PRC charged Seeds Towing with towing a 2004 Audi, refusing to allow the owner to reclaim personal possessions in the car, thwarting the owner's attempts to claim the car by having no staff in the office when he tried to do so, and illegally selling the car at an auction at which Mr. Seeds bought it himself for $756.37. The owner estimated the car's value at $13,000.

The Commission assessed a fine of $18,000 against Robert L. Seeds on January 12, 2012. On February 12, 2013, Robert L. Seeds appealed the Commission's decision to the New Mexico Supreme Court.

This case was settled by a stipulation signed in October, 2012, in which Robert L. Seeds agreed to pay a fine of $10,000, and to dismiss his appeal to the Supreme Court. He surrendered his towing warrant (having taken a job in Dubai, U.A.E.), and agreed to be permanently prohibited from applying for a towing warrant in New Mexico in the future. The agreement did not cover return of the 2004 Audi; the owner was pursuing remedies outside this case.

In October 2011, in a separate case[65] , the staff of the PRC brought to the Commission a number of charges against Seeds Towing, Robert's Towing, and Fairview Wrecker. Staff charged that the three companies operated under common control, which was not allowed by law, that they had performed tows while uninsured, and that they had overcharged in a cited instance. The overcharge occurred as the result of a tow made on April 22, 2011 when the police called Seeds Towing to tow a 1991 Ford truck; the truck was in fact towed by Roberts Towing Service. In subsequent investigations it was established that the Seeds had not allowed the owners to reclaim the truck, and had subsequently sold it.

In Robert John Seeds' testimony in this case, he suggested two theories about why the PRC had filed complaints against him for practices that he said were common among towing companies. One theory was that he had refused to lend then-PRC Commissioner Jerome Block any more money after he found out how Commissioner Block used the first $200 he lent him. He said that, "Since the refusal to give cash to the commissioner, I started receiving paperwork from the PRC Transportation Division regarding my son's business Seeds Towing…" The second theory was that, as an Espanola City Councilor, he had voted to fire the Espanola city manager, who was the brother of the PRC's Director of Transportation, Larry Lujan. He said, "Mr. Larry Lujan has taken this very personally. It was about the same time that the problems that eventually led to the vote to fire Larry Lujan's brother became known that the PRC investigations began. Larry Lujan decided that he would do whatever he could to cause me problems."

This case was settled by a stipulation in which Robert John Seeds agreed to pay $1,500 to the owner of the truck, and to pay a fine of $2,000. The stipulation states[66] that the PRC staff "is satisfied that Respondent Mr. Seeds only operates Robert's Towing and has taken steps to ensure his towing business is separated from Laura Seeds'. Robert L. Seeds has forfeited his warrant

[64] Case 11-00067-TREN

[65] Case 11-000382-TREN

[66] Uncontested Stipulation, Case No. 11-00382-TREN, page 4.

and Mr. Seeds is in compliance and has a separate phone number[67], a separate tax identification number, has a separate Form E on file[68], is listing separate vehicles, and has his own fenced off a separate *(sic)* tow yard from warrant holder Laura Seeds as per Staff's requirements."

Note that the motor carrier legislation passed in 2013 after these two cases were settled eliminates the "common control" test and replaces it with the requirement that companies performing non-consensual tows may not use the same equipment and facilities. The PRC staff will be responsible for ensuring that Roberts Towing Service and Fairview Wrecker Service meet this new requirement.

Regulation of Insurance

Structure of the industry In 2009 there were 1,356 insurance companies permitted to do business in New Mexico; 24 chartered in New Mexico, and the others licensed.[69] In 2009, insurance companies in New Mexico collected $9.46 billion in premiums, and paid $208 million in taxes and fees to the insurance department of the PRC. Of this, $7.7 million was used to pay the department's regulatory expenses; the balance was used for other state programs or turned over to the state general fund.

Insurance companies in New Mexico may sell more than one type of insurance, but there are a couple of limitations—(1) if a company sells life insurance, the only other kinds of insurance it can sell are annuities and health insurance, and (2) companies that sell title insurance are not allowed to sell any other type of insurance. As of 2009, the number of companies selling policies in the broad categories of life insurance, health insurance, title insurance, and property

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[67] During Robert John Seeds' testimony in case 11-00382-TREN, he was asked, "Do you have a specific telephone number that you use for Robert's Towing Service?" and answered "Yes". He was then asked, "Do any other wrecker services share this number with you?" and answered, "No. Fairview Wrecker Service and Seeds Towing did for decades until the PRC complained recently. Seeds Towing is out of business and Fairview Wrecker Service went to the trouble and expense of getting its own phone number."

[68] Insurance companies file Form E with the PRC to show they have issued insurance to a motor carrier. The League committee found that Robert Seeds Towing Service and Fairview Wrecker Service are insured under the same policy by the same company issued on the same date. However, the insurance company did file separate Form E documents with the PRC for each towing service.

[69] In order to sell insurance, a company is required to have a charter. Unlike banks, which can have either a state or a federal charter, insurance companies can be chartered only by states. Once chartered in one state, an insurance company is required to obtain a license from most other states in which it sells insurance. A few states have recently changed their laws to allow insurance purchases across state lines. The American Legislative Exchange Council (ALEC), an organization with an interest in relaxing regulation in a number of areas, has pushed to allow such purchases. Since 2010 three states have passed legislation which allows at least some purchases across state lines. These states (and the date such purchases were first allowed) are Wyoming (2010), Georgia (2011), and Maine (2011); the laws vary by state, and none offer across-the-board permission to buy insurance out of state. Bills allowing insurance purchases across state lines have been introduced in other states, but none have so far become law. Bills passed in Arizona and Oklahoma in 2011 were vetoed by their governors.

and casualty insurance were as follows: Life insurance – 496; Health insurance – 505; Title insurance—21; Property and casualty insurance—822.

Regulation of Insurance in the United States. In order to understand current regulation of insurance in New Mexico, it is essential to know the history of insurance regulation in the United States. Insurance regulation developed at the state rather than the national level for two reasons—initially most insurance companies were local, and until 1944 the courts ruled that insurance was not an item of interstate commerce, which meant that Congress did not have the power to regulate insurance.

However, in 1944 the Supreme Court ruled that insurance is an item of interstate commerce. This ruling raised questions about states' ability to regulate and tax insurance companies, and thus posed a problem for the many states that relied on revenue from these sources. It also posed a problem for the insurance industry because interstate commerce is subject to federal antitrust laws. Application of antitrust laws to insurance could interfere with the industry's business model, which involves sharing data and sharing rating systems. Rating systems assign risk to people and to property;[70] these risk assignments are among the factors used to determine premiums charged for insurance. To deal with these concerns, Congress passed the McCarran-Ferguson Act in 1945, which prohibited application of the federal antitrust and similar laws[71] to the business of insurance, provided that insurance is regulated by state law.

Since 1945, Congress has periodically taken an interest in the nature and quality of state regulation of insurance; bills have been introduced which would have transferred some of states' regulatory powers to the federal government. A major player in leading states' efforts to retain control of insurance regulation has been the National Association of Insurance Commissioners (NAIC, see box below). These efforts, while preserving state authority over most aspects of insurance regulation, have in fact transferred some regulatory functions from state regulatory agencies to the NAIC and its affiliated organizations.

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[70] Rating systems for people are based on characteristics such as age, gender, smoking or non-smoking, etc. Rating systems for property are based on location and other characteristics.

[71] Specifically, McCarran Ferguson provides that the Sherman Act, the Clayton Act, and the Federal Trade Commission Act apply to the business of insurance only "to the extent that such business is not regulated by state law." However, the exemption does not apply to agreements to boycott, coerce, or intimidate.

The National Association of Insurance Commissioners, its services and affiliates

The National Association of Insurance Commissioners (NAIC) is a private voluntary organization which began in 1871 as a cooperative association of state insurance regulators. Until 1968 its activities were supported by their own state staffs. In 1968 it set up a support and service office, which has grown into an organization with an annual budget (in 2011) of $75 million, organized as a Delaware corporation. In 2011, 76% of the funding for the NAIC came from insurance companies; 12% came from the member states.

The NAIC has fought to retain state control of insurance regulation and to protect it from proposed bills that would dilute state control, such as, for example, a federal charter for insurance companies. The NAIC has done this in two ways—by offering supporting services to state regulators that make regulation, and compliance with regulations, easier, and by addressing insurance companies' complaints about having to comply with 51 different sets of state statutes in ways that did not increase Federal oversight of insurance. The boldest of these initiatives was the development of the Interstate Insurance Product Regulation Compact.

The Interstate Insurance Product Regulation Compact created the Interstate Insurance Product Regulation Commission (IIPRC) - a public entity treated as an instrumentality of the Compacting Member States. States that sign the Interstate Insurance Product Regulation Compact agree to allow policies and rates for life insurance, annuities, long-term care insurance, and disability income insurance to be approved by the IIPRC rather than the state's insurance regulator, thus reducing the states' control of these types of insurance. New Mexico signed in 2009. As of July, 2011, 41 states had joined the IIPRC. The IIPRC thus participates directly in the states' regulation of insurance.

[For a more detailed history and list of other affiliated organizations, see Appendix B.]

Insurance regulation in New Mexico has changed over time as the aspects of the industry considered worthy of regulation have changed. For example, in 1925, when insurance regulation was turned over to the State Corporation Commission (SCC), insurance companies were prohibited by law from making contributions to political parties or aiding any candidate for political office. They were also prohibited from having more than one agent in any town for each kind of insurance sold. But premium rates were not regulated at all beyond the requirement that they had to be filed with the Superintendent of Insurance before use.

In response to passage of the McCarran-Ferguson Act, New Mexico created a State Insurance Board and, in 1947, passed an initial set of laws giving the Board control over insurance rates. Insurance companies were divided into four classes—(1) Life, Accident and Health (2) Casualty, Fidelity and Surety, (3) Fire and Marine, and (4) Title Guaranty. Rates for the first three groups were governed by very general provisions, but no provision was made for governing rates for Title Guaranty insurance, an oversight not remedied until 1985 after the Federal Trade Commission threatened New Mexico title insurers with charges of price fixing.

The initial rate regulations adopted in 1947 have since been changed in ways that vary by type of insurance, and so have the state's regulatory responsibilities. Currently, the regulation of insurance in New Mexico is handled mostly by the Office of the Superintendent of Insurance (OSI), the agency created when the Insurance Division separated from the PRC in July, 2013, but the federal government and the National Association of Insurance Commissioners (NAIC) also share in regulation. The remainder of this section describes the regulation of rates and policies, the regulation of solvency, and requirements for regulators to provide information to the public, pointing out the roles of the OSE, the federal government, and the NAIC in regulation.

Regulation of rates and policies: Rate and policy regulation in New Mexico varies sharply by type of insurance. The differences attest to the fact that markets differ for different types of insurance. No insurance company has the kind of monopoly power that a gas or electric utility has, but for some types of insurance the cost of entering an area is so high that existing companies enjoy a quasi-monopoly position. Consequently, some types of insurance are offered by few insurers and the market is dominated by several large companies. Furthermore, not all companies licensed in New Mexico actively sell insurance in the state, which means that the number of companies of each type given above overstate the actual competition in the New Mexico insurance market.

One reason for regulating premium rates in some markets is that insurance companies are allowed a degree of cooperation in rate setting that in any other industry would make them subject to antitrust lawsuits. This cooperation is permitted by law because the ability of insurance companies to offer lower rates is actually enhanced by allowing them to share data and share risk[72]. Companies are able to cooperate in setting rates by purchasing the services of firms that specialize in collecting data from many insurance companies and using them to calculate risk and to recommend rates or rate calculation formulas.

The following list shows how rates are regulated for each type of insurance.

<u>Life insurance, annuities, disability income insurance, and long-term care insurance</u>. (In 2009 approximately 28% of premiums collected in New Mexico came from these types of insurance.)

Companies selling these policies may choose to have their policies and rates approved either by the Insurance Product Regulation Commission (IIPRC), or the New Mexico Superintendent of Insurance; if they choose the latter, they are subject to New Mexico's regulatory requirement that rates should be disapproved "if the benefits provided therein are unreasonable in relation to the premium charged." This requirement does not apply directly to policies approved through the IIPRC.

<u>Health Insurance</u>. (In 2009 approximately 43% of premiums collected in New Mexico were health insurance premiums.)

The federal Patient Protection and Affordable Health Care Act (PPACA) gives the federal government a role in regulating a number of aspects of health insurance policies. State enforcement of federal regulations is voluntary, but the federal government has the power to

[72] The bigger the data base on which a company's risk assessments are based, the more competitive its prices can be, hence the need to share data on losses for particular types of insurance. Sharing risk also enhances competition. The more customers a company has, the less likely it is to be hit with claims very much larger than the average, and by sharing risk with other insurance companies, an insurance company effectively spreads its risk over a larger number of customers.

enforce these regulations if a state does not. Rate regulation remains under state control except in areas where the PPACA contains specific provisions on rates.

Since 1947, it has been a requirement in New Mexico that health insurance rates must be filed prior to use, and that the Superintendent of Insurance may disapprove the rates if he finds that the benefits offered are unreasonable in relation to the premium charged. In addition to this general rule, laws passed in 2010 and 2011 added more specific rules to be applied to health insurance rates; however, these laws do not apply to so-called "limited benefit" policies such as medicare supplement, vision, dental, or long-term care insurance.

The 2010 law[73] requires insurers to spend at least 85% of the premiums they receive on direct payment for health care, as opposed to administrative costs, with the exception that the Superintendent of Insurance may set a lower level, but not less than 75%, for individual (as opposed to group) policies.

The 2011 law,[74] among other provisions, contains one dealing with premium increases in insurance blocks that have been closed (i.e. policies that are no longer sold to new customers); the law requires companies, before increasing rates, to group these policies with like policies that are still being sold for the purpose of calculating costs and consequent permissible rate increases. This law was passed to forestall so-called "death spirals" (see box).

What is a death spiral? A death spiral can occur when an insurance company closes a particular block of insurance (i.e. no longer allows purchases by new customers). As existing policy owners grow older and their health care costs increase, the lack of new healthy customers results in an increase in premiums. Policy owners in that block face the choice of dropping coverage entirely or switching to a less expensive policy. If the insurance company allows the healthy policy owners to transfer to less expensive plans, but does not offer that option to those whose claims are likely to be high, costs in that block increase even more quickly, and finally become so high that almost no one can afford those policies; at this point, the policy is said to be in a death spiral. Allowing death spirals to occur provides an insurance company with a way of getting rid of its high-cost customers while not violating its promise that health insurance will continue to be renewable. The law passed in 2011 was intended to foil this tactic.

<u>Workers compensation insurance</u>. In 2007, New Mexico passed a law that requires all insurers that provide workers compensation insurance to base their premiums on the same rating system and advisory loss costs, with both measures to be developed by an advisory organization selected by the Superintendent of Insurance. The organization selected is the National Council on Compensation Insurance (NCCI, see box). The rating system assigns injury risks to each different type of employment; loss costs represent the projected losses (i.e., the ratio of compensation payments made to premiums received) for each employment classification.

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[73] HB12, passed in 2010, relating to health coverage.

[74] SB208, passed in 2011, became effective January 1, 2012.

What is the National Council on Compensation Insurance (NCCI)? The NCCI collects data and develops insurance rating systems used to calculate workers' compensation premiums in 35 states, including New Mexico. It is a not-for-profit bureau owned by its member insurers. It uses the information it collects to provide workers compensation insurance rate recommendations.

Premiums charged by each insurance company to a particular employer are based on the advisory loss cost for that industry, the wages paid by the insured company, the premium credit, if any, applicable to the insured employer, and the insurance company's own loss cost multiplier. The insurance company's own loss cost multiplier is determined by its expenses; it is the only factor in the rate calculation formula that varies from one insurance company to another. Insurance companies' loss cost multipliers are posted on the OSI website. Loss cost multipliers for companies offering workers' compensation insurance posted on the OSI web site in mid-2013 ranged from .805 to 2.229.

Title insurance. In 1985, rates for title insurance in New Mexico were placed under the direct control of the Superintendent of Insurance, with the requirement that all title insurance companies must offer insurance at the rates set by the Superintendent.[75] This law was passed at the request of the title insurance industry, which was being threatened by charges of price fixing filed by the Federal Trade Commission (FTC). The suit was dropped by the FTC after the law was passed.

This system was modified slightly in 2009[76] after a scathing report by Think New Mexico exposed this history and the consequences to consumers of this law.[77] The modification allows title insurers to offer lower rates, provided their proposed rates are approved by the superintendent of insurance.[78] The 2009 amendment to the title insurance law also added title insurance to the list of insurance types for which the superintendent of insurance was required to offer price information, including escrow, closing and settlement charges, to consumers. This information is now on the OSI website.

[75] Laws of 1985, Chapter 28.

[76] House Bill 488, introduced by Ben Lujan, became Laws 2009, Chapter 80.

[77] Copies of "The Secret Story Behind New Mexico's Title Insurance Law, How it Harms Working Families, and How We Can Fix It" may be downloaded from the Think New Mexico website by selecting the "Title Insurance Reform" publication.

[78] The proposal to lower rates must state in which county or counties the lower rates are to be offered, since in New Mexico title insurance must be purchased from an agent operating in the county in which the property is located. The law provides that before approving rates, the superintendent shall provide notice of the filed title insurance rates to all agents and underwriters doing business in that county or counties and may conduct a hearing. In determining whether to approve filed title insurance rates, the superintendent shall consider the interests and protection of consumers and independent title insurance agents and the potential impact on competition within the title insurance industry. This modification became effective in July, 2009; implementation also required changes in the New Mexico Administrative Code, which were adopted in December, 2010.

Other Property and Casualty Insurance. This category includes all other types of property and casualty insurance, e.g. property, marine and transportation, fire, homeowners, commercial, liability, vehicle, fidelity and surety, and malpractice insurance. Premium rates for personal insurance products, such as homeowners insurance, are regulated differently from rates for commercial insurance.

For personal insurance, rates must be filed before use, and the superintendent of insurance is required to provide price information on insurance to consumers as an aid to promoting a competitive market.

For commercial insurance, with some exceptions, insurance companies are not required to file rates in competitive markets. All markets are assumed to be competitive unless the Superintendent declares them to be non-competitive. In 2007, the Superintendent declared four markets to be noncompetitive—farmowners multiple peril, medical professional liability, credit, and mortgage guaranty. They remained in this status for three years—the law provides that the noncompetitive status expires after three years unless renewed—but were not renewed when they expired due to a hiring freeze and consequent shortage of staff at the PRC. This illustrates how lack of funding for regulation can defeat the intentions that drive changes in statutes.

Insurance Rates not Regulated. There are three types of insurance whose rates are not regulated under New Mexico's statutes—wet marine and transportation insurance, surplus lines insurance, and reinsurance. See Appendix C for a description of these insurance types.

Regulation of solvency. Insurance regulators, like bank regulators, need to ensure the solvency of the companies they regulate in order to protect the customers of insurance companies, who pay premiums over time for a benefit that may be received only years later. State regulators must either examine insurance companies or rely on the examinations conducted in other states.

In New Mexico, examinations are ordered by the office of the Superintendent of Insurance. Examinations are done by outside companies, who are selected by the office of the Superintendent of Insurance. There are two potential sources of fraud in this system—money or favorable consideration of certain claims can be extorted from insurance companies by threatening them with costly examinations, and examinations contracts can be awarded to favored companies.

Providing information to consumers. The jobs of regulators have changed over time. A recent addition to the job of insurance regulators is the provision of information to consumers to help them choose between insurance companies; the types of information offered vary by state.

For example, the Superintendent of Insurance is now required to offer price information on title insurance companies, including their escrow, closing and settlement charges, to consumers. This information is now on the website of the Office of the Superintendent of

Insurance[79]. The website also offers information on prices of homeowners and automobile insurance.

In 2011 the legislature passed a law[80] requiring the Superintendent of Insurance to post on its web site information on rate filings by health insurance companies. In spite of this legislation, as of July, 2013, only a small portion of the information required by this law had been put on the website; staff in the Office of the Superintendent of Insurance explained that there are a number of reasons for this, including difficulties with the electronic filing system operated by the NAIC, SERFF[81].

The actual filings by insurance companies, which would be the easiest source of the information required by law, are not available on the web site, partly because the staff believes that extracts from the filings provided in a standard format would be more useful to consumers. Regulatory agencies in other states have different opinions on what information should be provided to consumers; for example, the Insurance Division of the Oregon Department of Consumer and Business Services posts recent rate filings by insurance companies on its web site, and they are easy to find and access.

Types of Cases Brought to the Commission. (This deals with actions taken by the Commission and by the Insurance Division before July 1, 2013, when the Insurance Division became an independent agency not supervised by the PRC. However, the problem discussed in this section is one that could occur in the new Office of the Superintendent of Insurance.)

In 2005, the New Mexico Legislative Finance Committee (LFC) pointed out in a special report[82] that 87% of contracts to examine insurance companies since 2003 had been awarded to one person, Nestor Romero, that he had been paid over $10 million for work done between 2003 and 2005, and that the hourly fees charged by this contractor were approximately 3 times as high as rates suggested by the National Association of Insurance Commissioners. Competitive bidding for insurance examinations is not required by law as are other purchases by state government because examination expenses are paid by the insurance companies examined, not by the PRC.[83]

At its October 6, 2005 meeting, the Commission discussed this report, pointed out that Commissioners had previously expressed a desire for a more formal Request for Proposal process for choosing examiners, and asked Superintendent of Insurance Eric Serna for a timeline

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[79] Access is www.osi.state.nm.us.

[80] SB 208 passed in 2011.

[81] See Appendix B for a description of SERFF.

[82] The report, titled "Public Regulation Commission, Review of Management Practices of the Insurance Division", is summarized in the minutes of the New Mexico Legislative Finance Committee, October 3, 4 and 5, 2003.

[83] A curious example of spending by the Insurance Division at this time is provided by the order for examination of Lovelace Health System issued in 2006. The original order, signed Nov. 10, 2005 by Thomas Rushton, acting for Superintendent Eric Serna, capped the cost at $150,000. An amended order signed by Serna on Jan. 3, 2006 upped the cap to $300,000; there were no other changes in the order.

for an RFP.   Superintendent Serna replied that he was developing a team to develop a process and hoped to present a proposed draft of an RFP within 30 days.

In fact it took over a year, and a new Superintendent of Insurance, to develop a bidding process for examining insurance companies.[84]   The process developed was not one of issuing an RFP to which any qualified regulatory examination company could respond. Instead, the Insurance Division developed a list of six companies, and only these six are asked for bids when an examination is ordered; price is only one factor considered when awarding contracts. The six companies were selected by a committee; selection was based on materials requested from a number of nationwide firms that perform regulatory examinations. One of Nestor Romero's companies, Regulatory Consultants, is one of the six, and has won several examination contracts under this new system, but no longer receives the vast majority of examination contracts.

[84] The PRC Annual Report for 2006 notes that in the year to come (i.e., 2007), the Insurance Division planned to implement a formal Request for Proposal process for the Examinations Bureau "to enhance transparency".

Appendix A

League of Women Voters of New Mexico Position with respect to the Public Regulation Commission (PRC) and the entity regulating insurance (Adopted 2012; revised 2013)

1. PRC candidates should be evaluated on the basis of qualifications by a broad-based nonpartisan process.

2. Candidates for the PRC should have education and/or appropriate professional experience in a related field or in consumer advocacy. There should also be mandated, ongoing professional training after election.

3. The PRC should be funded by assessments on the industries that it regulates and those funds should be sequestered from the general fund.

4. The legislature should approve a budget sufficient to enable the PRC to carry out its allotted duties successfully.

5. Insurance and Utilities should be regulated by separate agencies.

6. The laws forbidding *ex parte* communications between Commissioners and those who are interested parties in cases before the PRC should be very strong, and penalties for violating the laws also should be strengthened.

7. The PRC should have an inspector general charged with reviewing practices for handling incoming payments properly, conducting internal audits of other functions, and pursuing such other investigations as are deemed necessary.

8. The PRC Commissioners and advisory staff should be prohibited from working in a business regulated by the PRC for at least 1 year after they complete their tenure at the PRC.

9. Consumer interests should have strong representation when the PRC is making policy decisions and setting rates.

Appendix B

The National Association of Insurance Commissioners, its services and affiliates

The National Association of Insurance Commissioners (NAIC) is a private voluntary organization whose members are the chief insurance regulators of the states, the District of Columbia, and the five U.S. territories. Its stated aim is to assist state insurance regulators; among its goals are the promotion of competitive markets and the support and improvement of state regulation of insurance. It has fought to retain state control of insurance regulation and to protect it from proposed bills that would dilute state control, such as, for example, a federal charter for insurance companies. The NAIC has done this in two ways.

One way has been to improve the quality of state regulation by offering supporting services that make regulation, and compliance with regulations, easier. For example, the NAIC has drafted a number of model laws applicable to specific types of insurance which states can adopt, allowing them to improve their regulatory statutes with very little staff effort.

Another way has been to address insurance companies' complaints about having to comply with 51 different sets of statutes in ways that did not increase Federal oversight of insurance. The boldest of these initiatives, the development of the Interstate Insurance Product Regulation Compact is discussed later.

History. The NAIC began in 1871 as a cooperative association of state insurance regulators, and until 1968 its activities were supported by their own state staffs. In 1968 a support and service office was set up to augment the regulators' own staffs. This office has now grown into an organization with an annual budget (in 2011) of $75 million, organized as a Delaware corporation. It has its central office is in Kansas City, an executive office in Washington D.C. and a Securities Valuation Office in New York City.

Funding. In 2011 76% of NAIC funding came from the insurance industry; the balance came mainly from the state members (12%), and fees paid to the NAIC by its affiliated organizations (9%).

Of the $57.4 million in revenue from the insurance industry that the NAIC budgeted for 2011, the biggest chunk was the $25.7 million in database filing fees. These fees are assessed on insurance companies on the basis of their premium base; for example, a company with $2 billion in premiums would pay a database filing fee of $45,096. Insurance companies use the database to file their quarterly and annual statements, thus avoiding the need to send copies to each state in which they do business.

Another chunk of the NAIC's revenue comes from fees for services. The service programs are:

System for Electronic Rate and Form Filing (SERFF) provides a standardized platform that insurance companies use to make required filings to the states;

Securities Valuation Office (SVO) provides ratings for securities and the debts of banks and corporations; expanded in 2009 to provide an alternative to existing rating organizations for mortgage-backed securities;

Online Premium Tax for Insurance (OPTins) was set up in 2008 to automate and simplify the payment of premium taxes that insurance companies make to states;

State Based Systems (SBS) provides web-based software that can be used by states to support regulatory functions such as processing license applications and renewals, handling consumer inquiries and complaints, and enforcement actions;

International Insurers Department (IID) processes applications and annual financial filings of insurance companies in foreign countries which are listed in the Quarterly Listing of Alien Insurers; some states require such a listing in order for these companies to conduct business in the state.

As can be seen from this list, much of the NAIC's business consists of providing services which help insurance companies by standardizing their transactions with 50 different sets of state regulations and helps state regulators by providing software that performs some of their regulatory functions. There are obvious economies in having one organization provide software for such functions rather than have them developed by 50 different state regulatory agencies. To an extent that varies by the service provided, the states have helped the NAIC's business by adopting statutes that require insurance companies to use these services; for example, SERFF is used in all 50 states, and 27 states (including New Mexico) require that it be used by insurance companies for filings.

<u>Affiliated Organizations</u>. In addition to providing services, the NAIC has sponsored two separate but affiliated organizations, the Interstate Insurance Product Regulation Commission (IIPRC), and the National Insurance Producer Registry (NIPR).

The Interstate Insurance Product Regulation Compact, which to date has been adopted by 41 Member States, created the Interstate Insurance Product Regulation Commission (IIPRC)—a public entity treated as an instrumentality of the Compacting Member States. The IIPRC participates directly in the states' regulation of insurance. States that sign the Interstate Insurance Product Regulation Compact agree to allow policies and rates for life insurance, annuities, long-term care insurance, and disability income insurance to be approved by the IIPRC rather than the state's insurance regulator. The first two states signed up in 2004, and in 2006; when 26 states had joined, the organization became operational. New Mexico signed up in 2009. As of July, 2011, 41 states have joined the IIPRC. Its 2011 budget projected revenue of $1.36 million from filing and registration fees paid by insurance companies and expenses of $1.69 million.

The National Insurance Producer Registry (NIPR) provides databases and software to aid states in licensing and regulating insurance agents and brokers. It was incorporated in 1996 as a non-profit affiliate of the NAIC. It is governed by a Board of Directors comprised of 13 members—seven state insurance regulators and six insurance industry representatives. In 2010, it had a budget of $17 million.

Laws that refer to the NAIC. The NAIC's services and model laws have been integrated into state and federal laws in a number of ways. Several examples follow.

Example 1. The Dodd-Frank Act specifies that a state may not prohibit a surplus lines broker from placing insurance with an insurer domiciled outside the United States that is "listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC."

Example 2. A rule of the Federal Health and Human Services Department used to implement the Patient Protection and Affordable Health Care Act (PPACA) provides that if a state does not have standards for a medical loss ratio in the individual health insurance market, the Center for Medicare and Medicaid Services (CMS) "will apply NAIC Model 134-1, 'Guidelines for Filing of Rates for Individual Health Insurance Forms.'"

Example 3. The PPACA requires health insurance companies to submit data on the proportion of premium revenues spent on clinical services and quality improvement, also known as the Medical Loss Ratio (MLR). The law also directs the National Association of Insurance Commissioners (NAIC) to establish definitions and methods for determining what services constitute clinical services and quality improvement and which must be counted non-claims costs.

Appendix C
Types of Insurance Rates Not Regulated in New Mexico

There are three types of insurance whose rates are not regulated under New Mexico's statutes—wet marine and transportation insurance, surplus lines insurance, and reinsurance.

Wet marine and transportation insurance includes only insurance that deals with boats or the import or export of goods. New Mexico, along with many other states, does not regulate rates for this type of insurance because it is generally determined case by case based on the nature of the risk assumed and the experience of the person calculating the rate. Not surprisingly, very little of this type of insurance is written in New Mexico.[85]

Surplus Lines Insurance is insurance that insurance companies licensed in New Mexico refuse to handle; following such refusal, surplus lines brokers may place this insurance with companies not licensed in New Mexico. Although little known, the market is not small; in 2009 approximately $100 million in surplus lines premiums were written in New Mexico. The focus of regulation of surplus lines insurance is on surplus lines brokers rather than the price of insurance.

Reinsurance is bought by an insurance company in order to place part of its risk outside the company. A New York Times article on recent investigations of reinsurance practices by New York State regulators was published on June 11, 2013. Summaries of the points made in the article appear below.

Conventional reinsurance deals are negotiated at arm's length by independent companies; both sides understand the risk and can agree on a fair price for covering it. The obligations drop off the original insurer's books because the reinsurer has picked them up. However, New York's investigators found that some life insurance groups were creating their own shell companies in other states or countries — outside the regulators' view — and saying that these so-called captives were selling them reinsurance. The value of policies reinsured through all affiliates, including captives, rose to $5.46 trillion in 2012 from $2.82 trillion in 2007. The chief problem with captive reinsurance is that the risk is not being transferred to an independent reinsurer. Also, the deal is not at arm's length. Because insurers, unlike banks, have no prepaid fund like the Federal Deposit Insurance Corporation to make customers whole in the event of a collapse, New York regulators feared that taxpayers might have to be called to the rescue.

Because New York has standing to investigate only life insurers based in that state, its regulators are calling for other states, or the federal government, to conduct similar investigations. The National Association of Insurance Commissioners has been examining the same type of transactions, but its members are sharply divided about their potential risk and what, if anything, to do about it.

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[85]Statistics for 2001 provided by A.M. Best show only $829,000 in premiums collected in that year. These are the latest data readily available.