

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Don Myers at 9:00 a.m. on March 5, 1998 in Room 514-S of the Capitol.

All members were present except:

Committee staff present: Lynne Holt, Legislative Research Department
Mary Ann Torrence, Revisor of Statutes
Mary Shaw, Committee Secretary

Conferees appearing before the committee: Don Schnacke, Kansas Independent Oil & Gas Assn.
Jamie Clover Adams, Governor's Office
Shirley Klenda Sicilian, Kansas Department of Revenue
Leslie Kaufman, Kansas Farm Bureau

Others attending: See attached list

Chairman Don Myers opened the meeting for discussion of the committee minutes from the meetings February 5 through February 18 which were distributed at an earlier meeting. The Chairman recognized Representative Burroughs who made a motion to accept the minutes as distributed. Representative Stone seconded the motion. Motion carried.

Hearing on SCR 1616 - Resolution urging Congress to provide gas producers relief from refunds ordered by FERC

The Chairman recognized Don Schnacke, Kansas Independent Oil & Gas Association, proponent, who spoke in support of **SCR 1616**. Mr. Schnacke noted in his testimony that the subject matter contained in the resolution is very important and should require immediate attention of the legislature. He mentioned that Governor Graves, Attorney General Stovall and the State Corporation Commission all weighed in on this issue and the entire Kansas Congressional delegation sponsored two bills aimed at getting relief on interest and penalties. (Attachment#1) Questions and discussion followed.

The Chairman recognized Jamie Clover Adams, Legislative Liaison, Office of the Governor, proponent, who spoke in support of **SCR 1616**. Ms. Adams noted in her testimony that FERC authorized inclusion of the Kansas taxes in the rates. The penalty is punishment for which no wrong was done and it is unreasonable to require producers to pay the penalty of interest in the sums that have to be refunded because the FERC orders were nullified. She also noted that all has been done at the state level that can be done and the ball is now in the Congressional delegation's court. (Attachment#2)

The Chairman announced that hearings were closed on **SCR 1616**.

The Chairman recognized Representative Sloan who made a motion to recommend **SCR 1616** favorable for passage to be placed on the Consent Calendar. The motion was seconded by Representative Alldritt. Motion carried.

Continued hearing on SB 436 - Establishment of Joint Committee on Taxation of Electric Public Utilities

The Chairman recognized Shirley Klenda Sicilian, Director of Policy & Research, Kansas Department of Revenue, who was requested to be present to answer questions from the Committee regarding revenue. Ms. Sicilian also provided additional information to the Committee regarding **SB 436**. (Attachment#3)

The Chairman recognized Leslie Kaufman, Assistant Director of Public Affairs Division of the Kansas Farm Bureau, proponent, who spoke in support of **SB 436**. Ms. Kaufman noted in her testimony that the Farm Bureau has a strong interest in the retail electric industry restructuring debate and should not be implemented

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES, Room 514-S Statehouse, at 9:00 a.m. on March 5, 1998.

unless the benefits from increased customer choice provide all consumers with the assurance of reliable service at an affordable price. Also, that rules and regulations promulgated as a result of legislation, including electric industry restructuring, should assure Kansas is not at a competitive disadvantage with any other state. (Attachment #4)

The Chairman announced that the hearings were closed on **SB 436**. Questions and discussion followed.

The Chairman recognized Representative Sloan who made a motion to accept the balloon amendment (Attachment #5) and excluding all of the references to natural gas in the balloon. The motion was seconded by Representative McKinney. Discussion followed. Representative Aurand requested that the call for the question be divided. The Chairman called for the question regarding the balloon to vote on the first part on Page 1, line 17, to strike "13 members as follows" and insert "the following members" and on Page 1, line 19, to add "and" after the word "taxation", and on Page 1, line 20, to strike the remainder of the sentence following the word "utilities" and insert ", or their designees, and all legislators who are members of the retail wheeling task force.". Motion carried. The Chairman called for the vote on the second part of the balloon regarding Page 1, on line 22, to strike after subsection (b) the first sentence "Within 30 days after the effective date of this act, the joint committee shall organize and elect a chairperson and vice-chairperson." and insert "The chairperson and vice-chairperson of the retail wheeling task force shall serve as chairperson and vice-chairperson, respectively, of the joint committee". Motion carried.

The Chairman recognized Representative Sloan who made a motion to delete the word "uniform" in line 5 and in line 6, to delete the words "and equal". The motion was seconded by Representative Johnson. Motion carried.

The Chairman recognized Representative Sloan who made a motion to replace "July 1" in line 11, Page 2, with "January 11". The motion was seconded by Representative Alldritt. Motion carried.

The Chairman recognized Representative Sloan who made a motion that the Committee recommend **SB 436** as amended favorable for passage. The motion was seconded by Representative Burroughs. Motion carried.

The Chairman asked Representative Sloan to carry the bill.

The meeting was adjourned at 10:00 a.m.

The next meeting is scheduled for March 10, 1998.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: March 5, 1998

NAME	REPRESENTING
Don Schnacke	KCOBR
Paul Slaves	Wuhu Oly + KAV
Leslie Kaufman	Ks Farm Bureau
Patrick Heesley	KCOB
Cody Denton	DOB
Don Ryan	2150321 Kaw Valley
Edgar Harder	
Agnes Harder	
Don Miles	KCC
Larry Holloway	KCC
DAVID BYBEE	KDOCH
JOHN J KULICK	HOCCHINSON KR
Joe Duk	KCK BPU
J.C. LONG	UtiliCorp United Inc.
Bruce Graham	KEPCo
Ernie Lehman	Western Resources
Dave Holtman	" "
Stacy Solder	Pete m. Liel + Assoc.



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Statement of Donald P. Schnacke
Before the House Utilities Committee
SCR 1616
March 5, 1998

The subject matter contained in SCR 1616 is very important and should require the immediate attention of the legislature.

Requiring the repayment of Kansas advalorem taxes, interest and penalties by Kansas natural gas producers by the Federal Energy Regulatory Commission is perhaps the most significant mis-carriage of justice that I have witnessed in my entire professional career.

Kansas producers were ordered to pass the Kansas advalorem tax through the rate base to consumers since 1974. Kansas producers and royalty owners did what was asked, relying on the federal agency involved - FERC. Later when FERC reversed itself, they ordered refunds of taxes and interest paid after 1988. On appeal the court pushed back the repayment to 1983 which added up to over \$500 million. The industry tried to appeal this order but the U.S. Supreme Court refused to accept the appeal.

Governor Graves, Attorney General Stovall, and the State Corporation Commission all weighed in on this issue. The entire Kansas Congressional delegation sponsored two bills aimed at getting relief on interest and penalties, which is about two-thirds the total.

Passage of this resolution will help when hearings are scheduled in the Congress - hopefully this month.

We will appreciate your prompt action in the passage of SCR 1616.

Donald P. Schnacke

DPS:sm

House Utilities
03-05-98
Attachment 1

STATE OF KANSAS

BILL GRAVES, Governor
State Capitol, 2nd Floor
Topeka, Kansas 66612-1590



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OFFICE OF THE GOVERNOR

MEMORANDUM

TO: House Utilities Committee

FROM: Jamie Clover Adams, Legislative Liaison *Jamie*

DATE: 4 March 1998

SUBJECT: Senate Concurrent Resolution 1616

Mr. Chairman and members of the committee, thank you for the opportunity to appear in support of Senate Concurrent Resolution 1616. The Administration has been actively following this issue for quite some time.

Governor Graves is extremely frustrated with the recent action of the Federal Regulatory Energy Commission (FERC) requiring Kansas producers to pay interest and penalties on taxes passed through to consumers from 1983-1988. What makes the situation worse is that FERC authorized the inclusion of the Kansas taxes in the rates. This penalty is punishment for which no wrong was done. It is unreasonable to require producers to pay the penalty of interest on the sums that have to be refunded because the FERC orders were nullified. He also finds it difficult to accept the proposition that those who invested in the exploration for and development of the natural resources of our state, for the benefit of Kansas citizens, would find themselves penalized because the form of taxation was different in Kansas than in other states.

We have done all that we can at the state level. The ball is now in the Congressional delegation's court. As the resolution points out, two bills have been introduced to absolve Kansas producers of the interest and penalties on the refunds owed. This resolution is very important because it provides another opportunity to show state government support for fair and equitable resolution on this issue for Kansas producers.

On behalf of the Governor, I urge favorable consideration of this resolution. Thank you for the opportunity to appear before you today. I would be happy to answer any questions you may have.

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Attachment 2

Shirley K. Sicilian, Director
Office of Policy & Research
Kansas Department of Revenue
915 SW Harrison St.
Topeka, KS 66612-1588



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Office of Policy & Research

TESTIMONY

TO: Chairman Don Myers
House Utilities Committee
FROM: Shirley Klenda Sicilian
Director of Policy & Research, Kansas Department of Revenue
RE: Senate bill 436 - Creating an Interim Task Force on Electricity Tax Issues
DATE: March 5, 1998

Chairman Myers and members of the House Utilities Committee, thank you for the opportunity to testify today regarding Senate Bill 436. My name is Shirley Sicilian and I am Director of the Office of Policy & Research at the Kansas Department of Revenue.

A move to competition in electric generation will create numerous tax issues. The issues are highly complex and their resolution will have significant implications for three sets of stakeholders: electricity generators; electricity consumers; and governments, both state and local. With careful consideration, the tax burden on Kansans may be minimized, and large unintended tax shifts may be avoided.

1. Electricity Generators - creating a level playing field.
A. Sales and use tax collection responsibilities for out-of-state generators.

Under current case-law, an electric generator located in Kansas and selling to a Kansas consumer has a clear responsibility to collect and remit state and local sales taxes. But retail wheeling will allow consumers to purchase directly from out-of-state generators. If an out-of-state generator does not itself transmit the power into Kansas, or otherwise engage in a sufficient level of business activity here, the out-of-state generator may not have "nexus" in Kansas, and the State may be constitutionally prohibited from requiring collection of state sales or use tax.

In many cases where there is not sufficient nexus for sales tax to apply, the Kansas compensating use tax would apply. (K.S.A. 79-3701 et seq). The state compensating use tax is imposed on the consumer for use of a product or service in Kansas in any case where the sale of that product or service would have been subject to sales tax, but for the fact that it did not take place in Kansas. The purpose of the use tax is to level the competitive playing field between in-state and out-of-state suppliers.

There are two reasons why the use tax may not lead to a perfectly level playing field. First, with the exception of motor vehicles and boats, there is no city or county use tax. Thus, to the extent local taxes are due on in-state sales, there may still be an advantage for out-of-state suppliers with insufficient nexus. Second, the experience with mail order companies is that not all consumers are aware they owe the use tax and therefore many perceive a price difference where there really isn't one. To the extent

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se nexus issues are similar across the states, the Kansas supplier may have the same advantage as other states that the out-of-state supplier has in Kansas.

B. Tax treatment of cooperative and municipal generators.

Some Rural Electric Cooperatives and municipal generators could have a tax advantage in competition with other generators to the extent they are not required to pay state income taxes. Municipal generators do not pay local property taxes.

C. Property tax changes.

Article 11, section 1 of the constitution requires public utility property to be assessed at 33% of market value. Other Commercial and Industrial property is assessed at 25%.

K.S.A. 79-5a01 defines a "public utility" as any company or persons which "control, manage or operate a business of ... (5) generating, conducting or distributing to, from, through or in this state electric power." Any firm which has a business of generating electric power, whether rate regulated or not, may arguably still fit the definition of "public utility" set out in the statute.

However, there may be an argument to the contrary. In two recent cases, the Kansas courts struggled with the issue of whether the company was "(3) transmitting to from or through the state a telephonic message." (K.S.A. 79-5a01). One case dealt with a pager company and the other a cellular company. In both cases the court ultimately found the company was not transmitting telephonic messages and therefore was not a public utility under 79-5a01. However, it is not perfectly clear from the cases the extent to which the courts took into account the fact that neither company was regulated, and how that might affect whether those companies would then come under the natural and ordinary meaning of the term "public utility" as that term is used in the constitution. (*First Page, Inc v. David C. Cunningham, et. al.*, 252 Kan. 593; *In re Appeal of Topeka SMSA Ltd., Partnership*, 260 Kan. 155).

If the courts were to find that unregulated electric generation companies cannot be considered "public utilities" for purposes of the property tax statutes, there would be two major changes. First, that electric generation property would no longer be state assessed - it would most likely be valued by the county appraiser on an asset by asset basis with real property set at market value and tangible personal property set in accordance with the constitutional formula. Second, the value would most likely be assessed at the C&I 25% rate, compared to the 33% public utility rate.

Both changes would significantly reduce property tax owed by electric generators. Some electric generators have argued such a reduction in property tax liability is important to reducing the overall tax burden on Kansas generators relative to their out-of-state competitors.

D. Consistent taxation of transmission and distribution.

Under current law, unbundled transmission and distribution could be considered a non-taxable service if provided by a third party, unrelated to the generator; but a taxable service if provided by the generator or its affiliate.

This situation arises because sales tax is computed on the "gross receipts from the sale or furnishing of electricity." "Gross receipts" is the "total selling price" which is defined as "the total cost to the consumerincluding freight and transportation charges." The department would consider transmission and distribution charge components to be part of the total selling price as "freight and transportation charges." Thus, unbundling a *bill* for services supplied by a single company would not, by itself, change sales tax treatment. However, if the services were *functionally* unbundled, i.e. supplied by different, unaffiliated, companies, there may be issues which need to be addressed. For example, delivery services

not subject to tax. If unbundled transmission or distribution charges were supplied by an unaffiliated third party, these charges may be considered "delivery services" and may not be subject to tax. Electricity generators who supply the full range of services may be at a competitive disadvantage compared to those who supply only the generation component.

2. Electricity Consumers - maintaining tax exemptions and avoiding tax shifts.

A. Clarification of sales tax exemptions.

Retail wheeling will allow consumers to purchase electricity from one firm and have it distributed/transmitted by another. K.S.A. 79-3603(c) imposes a tax on the "sale or furnishing of ... electricity which ... is not otherwise exempt under this act." K.S.A. 79-3606(w) exempts the "sales of ... electricity ... delivered through lines..." for agriculture, residential, oil production use and for use on property exempt from property tax. (emphasis added). If the intent of the electricity sales exemption statutes was to exempt both types of transactions, generation and transmission/distribution, it may be a good idea to make that clear at this time.

Likewise, 79-3606(n) exempts "tangible personal property consumed in production." K.S.A. 79-3602(m) defines "property which is consumed" to include electricity. If the intent was to exempt both the electricity and the distribution/transmission, it may be a good idea to clarify that at this time also.

B. Property tax shifts.

Any property tax change for electric generators has the potential to affect non-electric generation property tax payments if local jurisdictions raise the mill levy to make up for significant reductions in the electric generation property tax base.

3. The State - anticipating changes in tax revenue.

A. Effect of lack of nexus on sales and income tax receipts.

If out-of-state generators are not required to collect state use taxes, there could be a reduction in tax revenue to the state. Residential consumers are currently exempt from state sales and use tax anyway, but business consumers would need to be aware that they do owe use tax. Local governments have no authority to impose a use tax on electricity to make up for lost sales tax revenue. Likewise, lack of nexus for income tax would reduce state income tax revenues to the extent Kansas consumers are buying from out of state generators.

B. Effect of unbundling on sales tax receipts.

The current price of electricity includes cost recovery for generating plant which may in the future be deemed "stranded investment." Likewise, the cost of providing universal service is currently just another cost of doing business recovered in the electricity bill. As long as these costs continue to be recovered through the generators, they may be considered simply itemizations of input costs required to supply the underlying product, generated electricity, and may remain a part of the tax base. However, if these costs are not borne by the generation utility, so the alternative cost recovery method for these components is no longer associated with the taxable sale of electricity, there may be an issue as to whether the charges, on a stand-alone basis, remain subject to sales tax. Also, as mentioned above, the provision of unbundled transmission and distribution by a third party may be a non-taxable service and be removed from the sales tax base where provided on a stand-alone basis by an unaffiliated third party. These changes would impact the local, as well as the state, sales tax base.

C. Effect of possible property tax valuation changes on school mill levy.

If the valuation of generation property is reduced, the contribution these properties make to school finance will automatically decrease.



PUBLIC POLICY STATEMENT

HOUSE COMMITTEE ON UTILITIES

SB 436 as Amended – Establishing the Joint Committee on Taxation of the Electric Industry

March 5, 1998
Topeka, Kansas

Prepared by:
Leslie Kaufman, Assistant Director
Public Affairs Division

Chairman Myers and members of the Committee, thank you for the opportunity to share, on behalf of Farm Bureau members, our support for the amended version of SB 436. I am Leslie Kaufman. I serve as the Assistant Director of Public Affairs for Kansas Farm Bureau.

Farm Bureau has a strong interest in the retail electric industry restructuring debate. Retail electric restructuring should not be implemented unless the benefits from increased customer choice provide all consumers with the assurance of reliable service at an affordable price.

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It is essential to our members that energy regulation and retail electric restructuring be advantageous to all segments of the economy, including agriculture and rural consumers. Additionally, rules and regulations promulgated as a result of legislation, including electric industry restructuring, should assure Kansas is not at a competitive disadvantage with any other state.

Careful examination of the issues and impacts of retail electric restructuring, including taxation issues, is critical to assure these standards are met. As such, we support the creation of the joint committee on taxation of the electric industry to study the tax issues surrounding deregulation of the electric generation industry as detailed in SB436 as amended. We respectfully ask the Committee for their support as well.

Thank you.

Energy Regulation TU-5

Legislation regarding energy regulation or retail electric restructuring should result in fair competition. Competition should result in lower prices, better service, utility innovations and more choices. Energy regulation and retail electric restructuring should be advantageous to all segments of the economy including agriculture and rural consumers.

We support the Kansas Corporation Commission's role in monitoring service quality and equitable rate treatment for all segments of the energy industry falling under its jurisdiction, whether through statute, regulation or retail electric restructuring. Rate structures should facilitate an open market and allow a reasonable return on generation, transmission, and distribution investments.

Rules and regulations promulgated as a result of legislation, including electric industry restructuring, should assure Kansas is not at a competitive disadvantage with any other state. Retail electric restructuring should not be implemented unless the benefits from increased customer choice provide all consumers with the assurance of reliable service at an affordable price.

SENATE BILL No. 436

By Committee on Utilities

1-14

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Attachment 5

10 AN ACT establishing ~~the a~~ joint committee on taxation of public utilities
11 to study and make recommendations regarding taxation of deregulated
12 electric generation public utilities ~~the electricity industry.~~

and natural gas industries

14 *Be it enacted by the Legislature of the State of Kansas:*

15 Section 1. (a) There is hereby established the joint committee on
16 taxation of electric public utilities ~~the electricity industry.~~ The joint
17 committee shall consist of ~~13~~ members, as follows: The chairpersons, vice-
18 chairpersons and ranking minority members of the house and senate
19 standing committees on taxation and assessment and taxation of the house
20 and senate standing committees on utilities ~~and the chairperson of the~~
21 ~~retail wheeling task force.~~

the following members

and

, or their designees, and all legislators who are members of the retail wheeling task force

22 (b) ~~Within 30 days after the effective date of this act, the joint com-~~
23 ~~mittee shall organize and elect a chairperson and vice chairperson.~~ The
24 joint committee may meet at any time and at any place within the state
25 on call of the chairperson. Members of the joint committee shall receive
26 compensation, travel expenses and subsistence expenses or allowances as
27 provided in K.S.A. 75-3212, and amendments thereto, when attending
28 meetings of such committee. Amounts paid under authority of this section
29 shall be paid from appropriations for legislative expense and vouchers
30 therefor shall be prepared by the director of legislative administrative
31 services and approved by the chairperson or vice-chairperson of the leg-
32 islative coordinating council.

The chairperson and vice-chairperson of the retail wheeling task force shall serve as chairperson and vice-chairperson, respectively, of the joint committee

33 (c) The staff of the office of the revisor of statutes, the legislative
34 research department and the division of legislative administrative services
35 shall provide such assistance as may be requested by the joint committee
36 and authorized by the legislative coordinating council. The legislative di-
37 vision of post audit shall provide such assistance as may be requested by
38 the committee and authorized by the legislative post audit committee.
39 The department of revenue, the commission and all other state agencies
40 shall provide assistance to the joint committee as may be requested by
41 the committee.

42 (d) The joint committee shall study, investigate and analyze the ram-
43 ifications to the taxing systems of the state and its political subdivisions

5-2

1 arising from the deregulation of electric generation public utilities and
 2 the relative tax impacts upon and among electric generation public util-
 3 ities restructuring of the electricity industry and the relative tax
 4 impacts of restructuring on and among electricity providers, with
 5 the goal of recommending a uniform tax policy that allows all elec-
 6 tricity providers to be taxed on a fair and equal basis. The joint
 7 committee shall submit to the legislature on or before January 11, 1999,
 8 a final report of the committee's findings and recommendations. The
 9 committee may introduce such legislation as it deems necessary in the
 10 performance of its function.

and natural gas industries

and on and among natural gas providers

and all natural gas providers

11 (e) The joint committee is hereby abolished on and after July 1, 1999.
 12 Sec. 2. This act shall take effect and be in force from and after its
 13 publication in the Kansas register.