Kansas Gas Service
A Division of ONE Gas

OPPONENT TESTIMONY

Senate Bill 126

Janet Buchanan
Kansas Gas Service

Senate Committee on Utilities
January 28, 2020

Good afternoon Chairman Masterson and members of the committee. Thank you for the opportunity to present testimony, on behalf of Kansas Gas Service, in opposition to Senate Bill 126 as currently proposed. Kansas Gas Service is the state's largest regulated natural gas utility serving more than 635,000 residential, commercial and industrial customers in 341 communities across Kansas. My name is Janet Buchanan and I am Director of Rates and Regulatory Reporting.

Kansas Gas Service appreciates the opportunity to share its concerns raised by Senate Bill 126 and why it believes the proposed bill is unnecessary. Those concerns were enumerated in my testimony on March 20, 2019. A copy of that previous testimony is included as Exhibit I. While the testimony in Exhibit I addresses the existing language contained in Senate Bill 126, it is my understanding that amendments may be proposed by the Kansas Industrial Consumers Group ("KIC") to alleviate concerns raised by Kansas Gas Service and other conferees. KIC recently shared potential amendments to Senate Bill 126 and this testimony addresses those proposals. While Kansas Gas Service appreciates the efforts of KIC to address the concerns presented at the hearing last year, some have not been addressed and new issues were created. The KIC's anticipated amendments do:

- Potentially address normalization violation concerns from the original proposed language; and
- Provide symmetry for increases and decreases in tax rate.

However, the KIC's amendments do not address the following concerns:

- Imposition of a requirement to process and implement a change in rates at an unreasonable pace;
- Potential for multiple rate cases in one year;
- Negative impact on certain accrued deferred tax benefits that benefit utility customers, and which could result in increasing rates.

I. VIOLATION OF IRS NORMALIZATION RULES

The anticipated amendments related to the timing of a required change in rates appears to eliminate our previous concern related to normalization violations. However, the consequences to a normalization violation would ultimately result in significantly higher rates for our customers. Because of the potentially harmful results of a normalization violation, thoughtful consideration should be given to normalization issues. Kansas Gas Service urges the Committee to add additional language to the amended section 1(b) requiring retail rate changes be made "in a manner approved by the state corporation commission *and consistent with state and federal tax code*."

II. SYMMETRY IN APPLICABILITY

The amendments, if accepted by the Committee, provide for changes in rates to reflect the impact of both increases and decreases in tax rates. This change addresses Kansas Gas Service's previous concern related to symmetry. It is reasonable to amend the language of this bill to apply changes (increases or decreases) in the tax rate so that neither the customer nor the utility is unfairly disadvantaged by a change in the tax rate.

III. 30-DAY IMPLEMENTATION PERIOD IS TOO ABBREVIATED

While the amendments improve upon the pace at which utilities and the Kansas Corporation Commission ("Commission") may address changes to the tax rate, Kansas Gas Service continues to believe that the proposed time allowed is insufficient to provide the utilities with due process and to allow time to determine the accurate calculation of the effect(s) on customer's rates. Changes to the tax code often include more than just simplistic changes to the enacted tax rate. Associated consequences of the tax changes can include modifications to the deductibility of certain expenses for income tax purposes. These changes can be complex and often require additional guidance to accurately calculate the impact of the new tax code and how those changes would impact the level of income taxes collected in rates. We suggest that the 240 days allowed for processing a rate case is a more appropriate timeframe to provide appropriate discovery and due process for addressing tax changes.

IV. MULTIPLE RATE CHANGES

The amendments do not address the concern raised in the testimony attached as Exhibit I that this process may lead to multiple rate changes in one year. Multiple rate changes can be confusing for our customers. This confusion is especially pronounced when a rate decrease is followed by an increase in rates.

V. NEGATIVE IMPACT ON DEFERRED TAX BENEFITS TO CUSTOMERS

Finally, making the exemption from Kansas income tax permanent eliminates many of the concerns identified by Kansas Gas Service and other conferees related to the original temporary reduction. Our customers and shareholders will appreciate the opportunity to be exempt from Kansas income taxes as it lowers our overall cost of service and, as a result, the rates we charge for our services. However, the Study of Retail Rates of Kansas Electric Public Utilities prepared for the Kansas Legislative Coordinating Council by London Economics International LLC, as mandated by Substitute for Senate Bill 69, states:

> At face value, higher tax rates imposed on Kansas utilities as compared to the regional averages can result in higher consumer electricity rates.
>
> However, while reducing the tax rates may help improve the competitiveness of utilities by modestly lowering their costs and providing ratepayers with lower electric rates, there can also be socio-economic concerns. For example, state and local governments may suffer from fiscal imbalances, forcing them to increase their revenues from other sources. In addition, a cut in corporate income tax may impair the utilities' credit, exposing them to higher borrowing costs and delaying their cashflows associated with deferred tax liabilities.

> Therefore, lowering taxes alone may not be a solution to address the electricity rates competitiveness issue in Kansas without having unintended side effects.[1]

While an exemption will reduce the level of income taxes collected by a utility from its customers, there may be effects of this exemption that increase costs to customers One possible effect would result in the elimination of deferred tax benefits that had accrued for the benefit of our customers. The elimination of the deferred tax benefits would trigger a refund of those deferred tax benefits to customers but will also increase the utility's rate base and ultimately lead to an increase in a utility's cost of service. Additionally, if the deferred tax amounts must be refunded faster than over the life of the asset, as had been expected, the cash needs of a utility will increase. Those cash needs will be supplied by either the utility's customers or the financial markets. If the utility seeks additional debt, its borrowing costs will increase, thereby increasing our cost of service for our customers.

VI. CONCLUSION

While Kansas Gas Service appreciates the efforts of KIC to address concerns we identified, each of the concerns mentioned in my testimony can best be addressed by the Commission without making any changes to the current law and allowing the Commission to utilize its current authority to assure customers receive the benefits of any tax law changes. This was certainly demonstrated by the actions taken by the Commission in assuring the tax benefits relating to the recent TCJA were passed on to customers in a reasonable manner and time frame while effectively considering and addressing each of the above-mentioned concerns.

Thank you for your consideration of these comments in opposition to Senate Bill 126. I will be available for questions at the appropriate time.

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[1] Study of Retail Rates of Kansas Electric Public Utilities prepared for the Kansas Legislative Coordinating Council by London Economics International LLC, as mandated by Substitute for Senate Bill 69, page 251.

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OPPONENT TESTIMONY

Senate Bill 126

Janet Buchanan
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Senate Committee on Utilities
March 20, 2019

Good afternoon Chairman Masterson and members of the committee. Thank you for the opportunity to present testimony in opposition to Senate Bill 126 on behalf of Kansas Gas Service; the state's largest regulated natural gas utility serving more than 635,000 commercial, industrial and residential customers in 341 communities across Kansas. My name is Janet Buchanan and I am Director of Rates and Regulatory Reporting.

Kansas Gas Service appreciates the opportunity to share its concerns raised by Senate Bill 126 and why it believes the proposed bill is unnecessary. The bill as drafted:

- could cause a violation of Internal Revenue Service (IRS) normalization rules; which would result in increasing rates to customers;
- imposes a requirement to implement a rate reduction at an unreasonable pace;
- could result in multiple rate cases in one year;
- lacks symmetry; and
- could negatively impact certain deferred tax benefits that have been accrued for a utility's customers, which would result in increasing rates to customers.

I. VIOLATION OF IRS NORMALIZATION RULES

Senate Bill 126 defines overcollection of income tax expense as ". . . the portion of utility revenue representing the difference between the cost of service as approved by the state corporation commission in the utility's most recent base rate proceeding and the cost of service that would have resulted had the provision for state or federal income taxes been based upon the reduced corporate income tax rate." It is unclear whether this includes the effect of the change in income tax expense on a utility's accumulated deferred income taxes. If such impact is included, then the required treatment of excess deferred income tax will create a violation of the Internal Revenue Service's normalization rules. Normalization is a set of accounting rules within the Internal Revenue Code used by regulated utilities to reconcile the tax treatment of accelerated depreciation of utility assets with their regulatory treatment. If a utility is found to have violated normalization rules, it would be required to pay existing deferred taxes to the government over a much shorter period than the life of the property, plant and equipment which is the expected time-period. Additionally, the utility would no longer be eligible to utilize accelerated depreciation for tax purposes in the future which would eliminate the related deferred tax liabilities that reduce rate base. The consequences to a normalization violation would ultimately result in significantly higher rates for its customers.

II. 30-DAY IMPLEMENTATION PERIOD IS TOO SHORT

The bill requires new rates to be implemented within 30 days of a change in state or federal corporate income tax rates. While we understand the desire to distribute the benefits of a reduction in income tax expense to utility customers as quickly as possible, based on recent experience, this bill imposes a pace that is impossible for Kansas Gas Service to meet. The Tax Reform and Jobs Act (TCJA) was enacted on December 22, 2017, and reduced the federal corporate income tax rate from 35% to 21%. The Kansas Corporation Commission (Commission) issued an order on May 15, 2018, requiring Kansas Gas Service to defer the difference (reduction) between: (1) the cost of service as approved by the Commission in its most recent rate case; and (2) the cost of service that would have resulted had the provision for federal income taxes been based upon the corporate income tax rate approved in the TCJA. Given the demands placed on the Commission to conduct an evaluation for each utility, the deferral associated with the reduction in the cost of service for Kansas Gas Service was not approved until five months following the passage of the TCJA. Thus, it would not have been feasible to reduce rates within 30 days of the change in the tax rate. This deferral was then addressed in the Company's general rate proceeding which culminated with an order on February 25, 2019.

Additionally, there are often nuances to tax legislation, other than the change in the tax rate, that can affect utility rates. It is common for additional guidance to be issued after enactment that could have a significant impact on the regulatory treatment of taxes. For example, in the TCJA, companies are no longer allowed to deduct employee parking expenses as business expenses in determining taxable income. The IRS is still working on guidance for tax preparers on how to apply this guidance to company-owned facilities that include parking. The loss of this deduction will ultimately cause the amount of taxes incurred by the company and included in the cost of service to increase. This bill does not provide a mechanism or remedy for the application of that new guidance on utility rates after the 30-day period

III. MULTIPLE RATE CHANGES

As mentioned above, the treatment of the TCJA tax reform was addressed within a rate case filed by Kansas Gas Service. In the recently completed rate case, it was shown that the Company was not earning its authorized rate of return even with the reduction in the corporate income tax rate and was therefore providing utility service at rates subsidized by Company shareholders. The Commission approved increased rates, to allow Kansas Gas Service the opportunity to recover its reasonable and necessary costs of providing service inclusive of the lower (21%) federal income tax rate. Thus, even if reduced rates could have been implemented within 30 days of passage of the TCJA as contemplated by this bill, customers would have experienced multiple rate adjustments within a 12-month period when the Commission subsequently approved a rate increase for the Company (as identified within this example). The fluctuation in bills down and then up caused by multiple rate changes in a relatively short period of time would create customer confusion. This confusion is especially pronounced when a rate decrease is followed by an increase in rates.

IV. LACKING IN SYMMETRY

While Senate Bill 126 contemplates reductions in the corporate income tax rate, it is does not address increases in the tax rate. It is reasonable to amend the language of this bill to apply to changes (increases or decreases) in the tax rate so that neither the customer nor the utility is unfairly disadvantaged by a change in the tax rate.

V. NEGATIVE IMPACT ON DEFERRED TAX BENEFITS TO CUSTOMERS

Senate Bill 126 also makes utilities exempt from Kansas income taxes for the tax years 2019 through 2022. This will reduce the level of income taxes collected by a utility from its customers; however, there could be effects of this exemption that increase the costs to customers. If a utility has Kansas net operating loss carryforwards that expire during this exemption period or shortly thereafter, absent some form of statutory or regulatory relief, it would be likely that the utility would not be able to utilize these carryforwards. This would result in the elimination of a deferred tax benefit that had accrued for the benefit of our customers. The elimination of the deferred tax benefit would trigger a write off of the corresponding deferred tax asset and result in an increase in a utility's cost of service.

VI. CONCLUSION

Each of the concerns mentioned in my testimony can best be addressed by the Commission without making any changes to the current law and allowing the Commission to utilize its current authority to assure customers receive the benefits of any tax law changes. This was certainly demonstrated by the recent actions taken by the Commission in assuring the tax benefits relating to the recent TCJA were passed on to customers in a reasonable manner and time frame while effectively considering and addressing each of the above-mentioned concerns.

Thank you for your consideration of these comments in opposition to Senate Bill 126. I will be available for questions at the appropriate time.