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Neutral Testimony on Senate Bill 126

Submitted by Justin Grady, Chief of Accounting and Financial Analysis, Utilities Division  
On Behalf of The Staff of the Kansas Corporation Commission

Chair Masterson, Vice Chair Petersen, Ranking Minority Member Francisco, and members of the committee, thank you for the opportunity to provide testimony to your committee today on behalf of the Staff of the Kansas Corporation Commission (KCC or Commission).

The Commission Staff (Staff) is taking a neutral position on SB 126. However, I would like to use this opportunity to discuss some of Staff's concerns and suggest some potential revisions to this bill.

SB 126 would enact the following changes to existing law:

- 1.) Any public utility (that is subject to the jurisdiction of the KCC) which collects income tax expense in its retail cost of service, shall track any over collection of income tax expenses that would result from the enactment of a change in state or federal law that reduces the income taxes assessed on that utility;
- 2.) Whenever a change in state or federal law reduces the amount of income taxes assessed on a utility, that utility is required to implement new lower rates reflecting the change in tax law within 30 days; and
- 3.) For the years 2019, 2020, 2021, and 2022, every investor-owned electric and natural gas utility that is subject to the jurisdiction of the KCC would be exempt from paying state income taxes. This section also bars these utilities from including state income tax expense in their retail rates.

Staff's first concern with Section 1 of SB 126 is that this language is asymmetric, in that it only requires a tracking of over collection of income taxes, not under collection of income taxes.

The Commission is required by law to balance the interests of ratepayers and shareholders when setting utility rates. Legislation that only tracks over collection of taxes, but not under collection of taxes, does not balance the interests of both shareholders and ratepayers for what is considered to be a pass-through expense. Additionally, this could cause unintended consequences if changes in tax law that increased taxes had to be collected through a rate case. This includes the possibility of higher rates due to additional rate case expenses or other cost increases since the previous base rate case.

*If SB 26 is going to be considered by the Committee, language should be added to the bill that requires utilities to track and recover both over and under collection of income taxes in rates.*

Staff's second concern with Section 1 of SB 126 is the requirement that a utility change its rates within 30-days of a change in tax law.

There are several problems with this proposal. First, it mandates a one-size-fits-all solution that is unnecessary. Recent experience has proven that the Commission has the tools and authority to respond to changes in tax law to ensure that both ratepayers and shareholders are treated equitably and fairly. For example, in response to the passage of the Tax Cuts and Jobs Act of 2017, the Commission required public utilities subject to its jurisdiction to establish a regulatory liability to track the federal tax savings, with interest, for examination and potential crediting back to customers in further proceedings. Since that time, the Commission has acted to reflect the lower federal taxes in the rates of Westar, KCP&L, KGS, Atmos, Black Hills and Empire. Each of these utilities also returned all deferred tax savings from the regulatory liability, with interest.

Second, the 30 days allowed in SB 126 before rates must be changed to reflect the lower taxes is dramatically insufficient to ensure that the rate calculations are done accurately and that due process of law is followed to protect the legal rights of all interested parties. Changes in tax law are often complicated, multi-faceted pieces of legislation, and a full review of all of the impacts of the law are required before parties can begin to calculate how the law would affect a utility's revenue requirement calculation. Additionally, these calculations need to be submitted to the KCC and other interested parties for review, and a decision by the KCC must be supported by substantial competent evidence, often meaning reports or testimony has to be prepared in support of the calculations. Lastly, a KCC decision has to be made in an open meeting that requires proper notice.

Adding to the difficulty of completing all of these tasks in 30 days is that every investor owned utility in the state would be required to complete all of these tasks in that same 30 days. Depending on the caseload of the KCC at the time, this deadline might be extremely difficult if not impossible to meet. The risk of such a shortened deadline is that the rate calculations performed may be inaccurate, which would not be in the public interest.

Additionally, it is not always in the public interest to change rates immediately in order to reflect a change in tax law. For example, if a utility was earning above or below its Commission-authorized rate of return, a full rate case might make more sense than lowering rates to reflect the single issue of income tax expenses. Consider the example where a utility is earning below its Commission authorized return by \$40 million (before the reduction in tax rates). If the reduction in tax rates saves the utility \$30 million, the utility still needs to increase rates by \$10 million. If rates were first reduced by \$30 million, then increased by \$40 million, the end result is the same, yet consumers have experienced significant rate volatility. It might make more sense in this example to just have a full rate case and sort out all changes in the utility's costs, thus avoiding the rate volatility as described.

The Commission has the authority and expertise to react to changes in tax law and ensure that, when proper, rates should be decreased to reflect the reductions in tax expense. SB 126 introduces several possible consequences associated with a one-size-fits-all solution to solve a problem that

Staff believes does not exist.

*If SB 126 is going to be considered by the Committee, this 30-day timeframe to change rates should be revised to a requirement for utilities to file an application within a set time frame, but the Commission should have at least 120-days to rule on the applications. Additionally, the Commission should be allowed to maintain the flexibility to rule on the rate application for refunds and rate changes as the facts and circumstances of each case dictate. Lastly, it might make sense to add a materiality threshold for a rate impact beyond which a rate change application would be required to be filed. Staff suggests that .25% of a utility's base rate level last approved by the Commission in a general rate proceeding might be a good threshold.*

Staff is not taking a position on the provisions of SB 126 that pertain to exempting utilities from paying State income taxes. That is a public policy decision that is properly evaluated by the Legislature and Governor. However, to inform this decision, Staff has estimated the impact on utility rates of the impact of exempting Kansas public utilities in the state from income taxes. The information found in the table below estimates the approximate annual impacts on each utility's revenue requirement based on the most recent rate proceedings of each utility.

<b>Utility</b>	<b>Annual Impact to Revenue</b>
Westar Energy	\$19,996,465
Kansas City Power and Light Company	\$8,580,710
Empire District Electric Company	\$223,943
Kansas Gas Service	\$5,326,461
Black Hills Kansas Gas Utility Company	\$699,780
Atmos Energy Corp	<u>\$1,037,054</u>
Total	<b>\$35,864,413</b>

Note that these approximate annual impacts do not include the effect of amortizing (refunding) state Excess Deferred Income Taxes (EDIT) into rates. Refunding these state EDIT balances will further reduce utility rates in the State beyond the estimates in the table over some period. However, once these state EDIT balances are all refunded, they will no longer be an offset to a utility's rate base (to reflect their nature as cost free capital) as is currently the case. This will mean a corresponding increase in the rate base upon which utilities have an opportunity to earn a return in the ratemaking process. While the net result will likely be a rate reduction overall, this impact cannot be overlooked.

The degree to which these rate reductions would affect the State Treasury would differ by utility and would be impacted by items such as:

1. Temporary timing differences between the actual tax deductions available to the utility and the normalized or ratemaking tax deductions used to set rates; and
2. Any reductions in Kansas income tax payments that the utility realizes because of using consolidated tax losses from other business to offset its regulated tax liabilities in the State.

Thank you again for the opportunity to present Staff's concerns and suggest revisions to SB 126.

