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Neutral Testimony on Senate Bill 126

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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 regarding 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.

Staff's second concern with Section 1 of SB 126 is the requirement that a utility lower 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, and Black Hills. A rate case is currently under way for Empire to do the same. Westar, KCP&L, Atmos, KGS and Black Hills also returned all deferred tax savings from the regulatory liability, with interest. While KGS and Empire argued to keep the tax savings that were recorded to the regulatory liability to offset existing cost of service deficiencies, Staff has recommended the Commission deny these requests, and the Commission is well suited to rule on this issue. Recently this Commission ruled against KGS's request in this regard, requiring KGS to give ratepayers all deferred tax savings.

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 <u>every</u> 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 lower 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 concerns and possible consequences associated with a one-size-fits-all solution to solve a

problem that Staff believes does not exist.

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:

Utility	**Annual Impact to Revenue**
Westar Energy	$22,839,784
Kansas City Power and Light Company	$8,580,784
Empire District Electric Company	$400,678
Kansas Gas Service	$5,142,870
Black Hills Kansas Gas Utility Company	$632,070
Atmos Energy Corp	$1,037,054
Total	**$38,633,240**

The degree to which these revenue requirement 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 regarding SB 126.