



Before the Senate Committee on Utilities

February 12, 2020

Opposition Testimony
On Senate Bill 339

Submitted by Jeff McClanahan, Director, 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 (Commission).

The Staff of the Commission (Staff) is opposed to Senate Bill 339 (SB 339). While Staff is opposed to this bill, Staff is not opposed to economic development rates and we are appreciative of Evergy's willingness to submit a bill that starts a dialogue. Staff's opposition to SB 339 is based on the following factors:

1. SB 339 does not comport with the majority of London Economics International (LEI) recommended key considerations in designing economic development riders (EDR).
2. SB 339 does not comport with all of the criteria established in the Commission's order (described below) on the proper ratemaking treatment for revenue losses related to competitive discounting and the development of criteria to review and evaluate discounted rates.
3. Stakeholders should have an opportunity to research the EDRs in neighboring states and perform other relevant research to determine best practices. Therefore, it is premature to pass legislation on EDRs.

DISCUSSION

SB 339 does not comport with the majority of LEI's recommended key considerations in designing economic development riders (EDR). LEI's key considerations in designing successful EDRs are at Section 6.3.3 on pages 172-174. The key considerations are cited below along with Staff's analysis as to whether SB 339 comports with the considerations.

- First, is the EDR *necessary* to secure the load? Or asked a different way, will the customer choose to locate elsewhere or otherwise leave the system should the EDR not be offered? If the answer is yes, then it can be inferred that the EDR is necessary. In order to make this determination, utilities and/or regulators in jurisdictions across the country have required customers potentially eligible for an EDR to provide evidence that this is the case. For example, as mentioned previously in the description of Colorado’s House Bill 18-1271, customers must “*demonstrate that the cost of electricity is a critical consideration in deciding where to locate or expand their business and that the availability of lower rates is a substantial factor.*” Aside from a sworn affidavit, alternative forms of evidence can be submitted by the customer to demonstrate the EDR’s necessity, such as documented communications with neighboring utilities scouting competing service, or financial reports demonstrating its financial distress or risk. [Emphasis LEI’s].

Staff’s Analysis: Neither New Section 1 or New Section 2 explicitly indicate that determining the necessity of securing the load is required to be documented or analyzed. While it is possible this element is considered in SB 339, most of the required elements are overly broad and vague. For example, New Section 1(a)(1)(A) only requires a determination that the facility would not continue operations, or resume operations that had previously been suspended, in the state of Kansas without such contract rate. This language could be interpreted to be either stringent or lenient since it does not provide any specific guidance as to *how* to determine a facility would not continue operations or resume operations.

- Second, is the EDR *sufficient*? Or, can it be minimized? This criterion seeks to overcome the free-rider problem, as an EDR should only be used to incent businesses to locate or expand to the state, and “*any discount beyond the minimum necessary to secure the load is a superfluous subsidy.*” As the free-rider problem is a difficult issue to quantify, this particular consideration requires a subjective assessment on the part of the utility and/or regulator.

Staff’s Analysis: Again, neither New Section 1 nor New Section 2 explicitly indicate that determining whether the EDR is sufficient or can be minimized is required to be documented or analyzed. While it is possible this element is considered in SB 339, most of the required elements are overly broad and vague.

- Third, does the EDR exceed the *marginal cost* of providing electric service? This criterion is important to ensure the regulatory compact is upheld, such that utilities should be allowed to earn an appropriate return. Therefore, implementation of the EDR and serving the eligible commercial or industrial customers should not cause the utility to incur negative margins. To ensure this is achieved, the EDR must be set such that it exceeds the utility’s marginal cost of serving the eligible customers.

Staff’s Analysis: New Section 1(a) indicates that “...the commission shall have the authority to approve a contract rate, outside a general rate proceeding, that is *not based on the electric public utility’s cost of service for a facility*”. While New Section 1 (a)(1)(B)(ii) also requires an “evaluation” of the incremental costs to serve the facility, it is only an

evaluation and appears to be only for informational purposes. While LEI's concern regarding marginal cost is to prevent the utility from being unable to earn an appropriate return, LEI's concern appears to be based on an assumption the utility would not be reimbursed by its customers for negative margins. Under SB 339, customers will be responsible for paying any negative margins. Therefore, this element of SB 339 does not comport with LEI's recommendations.

- Fourth, does the EDR benefit *all* ratepayers? Or, at the very least, are other ratepayers made no worse off by the implementation of the EDR? As discussed in Section 6.3.2.1, the additional load secured through an EDR tends to expand a utility's customer base, thus easing the fixed cost contributions of all ratepayers on the system. Hence, by definition, the EDR should satisfy this criterion, as "*the other ratepayers benefit because this recovery of some utility fixed costs would not occur if the [additional] load were not served by the utility.*"

Staff's Analysis: New Section 1(a)(1)(B)(i) requires a determination that the contract rate is in the interest of the state of Kansas based on the interests of the customers of the electric public utility serving the facility. How the interests of the customers is to be determined is not defined, making this requirement overly broad and vague. However, given the fact that New Section 1(a) does not require the contract rate to be based on the public utility's cost of service, it appears as if all ratepayers are not required to benefit or be no worse off. New Section 2 provides a number of elements that must be met in order for new or expanded facilities of industrial or commercial customers to be eligible for discounts. However, New Section 2 does not include any element(s) that require a determination of benefits for all ratepayers.

- In terms of additional considerations, utilities and/or regulators must consider *who* pays for the discount. Jurisdictions across the country have either: (1) *required shareholders to absorb the discount, or (2) required this responsibility to be shared between both the utility's customers and its shareholders, as both parties benefit from the EDR indirectly* (with customers enjoying lower rates through an expanded customer base, and shareholders enjoying larger returns due to increased utility earnings). [Emphasis added].

Staff's Analysis: SB 339 is structured such that only non-contract customers absorb the contract rate discount. Whether and to what extent sharing of the discount in the contract rate between customers and shareholders is a matter that the stakeholders should discuss to see if a consensus can be reached.

- When designing EDRs, one must also consider whether additional *eligibility* requirements should be implemented, including thresholds for commercial and industrial customers relating to a minimum level of increased employment, or a minimum level of new capital investment. Regulators can even associate eligibility with the location of the load, incenting new load to locate to "*targeted areas, including brownfield sites, vacant industrial buildings, economic or area development zones*" of the state.

Staff's Analysis: New Section 1 and 2 do have some eligibility requirements. For example, New Section 1 requires the facility to have an existing or expected load equal to, or in excess of, a monthly demand of 50 megawatts. However, the eligibility requirements in SB 339 may not be as robust as LEI envisioned.

- Finally, are there mechanisms in place to ensure the load is *maintained* once the EDR has ended? For instance, EDR schedules are usually offered such that customers obtain decreasing discounts over the course of their agreement with the utility. This aids in reducing the impact of rate shock and helps to ensure the benefits associated with the EDR are maintained once the discount has ended.

Staff's Analysis: New Section 1(e) does not allow any change in the contract rate discount during the specified term of the contract. New Section 2(c)(1) and (2) defines the level of rate discounts that cannot be exceeded during the term of the rate discounts, but does not require any decreasing discounts over the contract term.

SB 339 does not comport with all of the criteria established in the Commission's order on the proper ratemaking treatment for revenue losses related to competitive discounting and development of criteria to review and evaluate discounted rates.

Staff Analysis: The competitive discounting criteria is established in Docket No. 01-GIME-813-GIE and a partial list of the criteria is as follows:

- In order to be approved, the utility must show that the special contract provides a cost benefit to the remaining core customers.
- When filing the contract with the Commission, the utility must also file all documents and information that support the contract.
- The utility is to provide a narrative explanation of why the special contract is necessary and of why the price and other terms of the special contract are just and reasonable.
- The utility is to provide specific information on the customer's operations and needs, information on the effect of the contract on the utility's system over the term of the contract, a detailed cost analysis of the proposed contract, and a statement of the benefits from the contract to the utility and its other customers.
- Costs to provide the contracted service should be identified, and at a minimum separated into generation, transmission and distribution components.
- Failure to file all of this information with the contract will be grounds for dismissing the contract without consideration.
- Specific prices or data may be filed confidentially if such treatment is warranted.

The Commission also noted the following at paragraph 8 of its order:

CURB and Staff raise issues related to the protection of core customers from costs associated with discounted contracts. The Commission finds that these are legitimate concerns which may be considered when the special contract is reviewed. The Commission provides the following non-exclusive list as examples of factors that may be part of the contract review:

- The load characteristics of the customer
- The presence of an ECA [energy cost adjustment] or other risk management tool
- The nature of the discount – what component(s) of the service are being discounted
- Benefits such as curtailment provisions, or use of system at non-peak times the length of the special contract
- Information regarding the pricing terms of the contract the existing capacity of the utility

A review of SB 339 will indicate many of these elements are not specifically included. While SB 339 does note at New Section 1(d)(1) and (2) that nothing in New Section 1 shall affect or diminish the authority of the Commission to approve just and reasonable rates and that the Commission can establish standards for approval of contract rates, it is not clear that the same criteria already established by the Commission can be retained given the new statutory provisions contained in SB 339.

Stakeholders should have an opportunity to research the EDRs in neighboring states and perform other relevant research to determine best practices. Therefore, it is premature to pass legislation on EDRs.

As LEI notes in Section 6.3 at page 167, “However, EDRs need to be carefully designed to avoid cross-subsidies within and between customer classes. LEI also notes in Section 6.3.2 at page 170 “Based on the experiences of other jurisdictions, the implementation of EDRs can have both positive and negative impacts. The benefits are far-ranging, from job creation to improved efficiencies for utility systems. However, the potential drawbacks, including the free-rider problem and a focus on larger, energy-intensive businesses only, must also be considered.”

Staff Analysis: Staff suggests the stakeholders should take a collaborative approach by sharing and analyzing information on EDRs between now and the next legislative session to determine the best economic development mechanism(s) for Kansas.