

SESSION OF 2020

**SUPPLEMENTAL NOTE ON SENATE SUBSTITUTE FOR
HOUSE BILL NO. 2585**

As Recommended by Senate Committee on
Utilities

Brief*

Senate Sub. for HB 2585 would create and amend law relating to a tax exemption for and the tracking and collection of state and federal income tax by certain public utilities and would create law related to the authority of the Kansas Corporation Commission (KCC) to regulate electric public utility rates to allow contract and discounted rates for certain facilities, as specified below. The KCC would be authorized to approve such rates notwithstanding provisions governing its power to require utilities to establish just and reasonable rates to maintain efficient and sufficient electric service and to prohibit variations from established rate schedules.

The bill also would make technical changes.

Income Tax Exemption

The bill would exempt the following utilities from Kansas income tax:

- Any utility that is a cooperative, as defined in law, or owned by one or more cooperatives; and
- For tax years ending on or after January 1, 2021, every electric and natural gas public utility, as defined in law, that is subject to rate regulation by the KCC.

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

The bill would prohibit electric and natural gas public utilities subject to rate regulation, not including cooperatives or utilities owned by one or more cooperatives, from being included in a consolidated or unitary combined return, or to collect income tax as a component of retail rates.

Tracking Changes to Income Tax Collection

The bill would require a public utility, as defined in KSA 66-104, that includes expenses related to income taxes as a component of its retail rates to track and defer into a regulatory asset or liability, as appropriate, an overcollection or undercollection of income tax expenses if the income tax rates assessed on a utility are adjusted as a result of any changes in state or federal law.

Application for New Rates

The bill would require a utility to file an application for new retail rates reflecting adjusted income tax rates with the KCC within 60 days of enactment of such a change in state or federal law if the adjustment results in an overcollection or undercollection of income tax expenses that is equal to or exceeds 0.25 percent of a utility's KCC approved base revenue level from the utility's most recent rate proceeding. The utility would then be required to refund or collect the tracked amounts from their retail customers in a manner approved by the KCC.

KCC Order

The KCC would be required to issue an order addressing an application for adjusted retail rates due to a change in income tax expenses within 120 days. The bill would require the order to:

- If requested by the utility, give due consideration to the common interests of the utility and its customers, including, but not limited to:
 - The use of a two-year implementation of current period rate changes to maintain the credit quality of the utility by ensuring that any such change in rates would not cause the utility's credit metrics that are traditionally considered by credit rating agencies to deteriorate to a level that could impair the utility's current credit rating.

If a retail rate change to address adjusted income tax expense is implemented over a period of time, the utility would be required to track and defer any overcollection or undercollection of income tax expenses as a regulatory liability or asset, as appropriate, that would accrue interest at the utility's weighted cost of capital, as determined by the KCC in the utility's most recent general rate proceeding, and refund or collect the balance in the next full general rate proceeding.

In the event a utility has a full general rate case pending or has notified the KCC of its intention to file such an application, at the time any adjusted income tax rates become effective, the bill would allow the KCC to issue an order finding that such adjusted income tax rates should not be reflected in retail rates until a utility's new retail rates become effective following its general rate proceeding. The bill would require the utility to demonstrate the public interest would be promoted by excluding adjusted income tax rates from its retail rates.

Full Rate Proceeding Clarification

The bill would make clear that a filing resulting from adjusted income tax rates could not require the utility to file a full general rate case or require the utility to update any component of retail rates other than the income tax expense

component. The bill would provide that rate updates resulting from changes in income tax expenses would not be considered a violation of any existing rate moratorium agreement.

Excess Accumulated Deferred Income Tax Balances

The bill would require excess accumulated deferred income tax balances resulting from income taxes adjusted due to changes in state or federal law remain unamortized on the utility's books of account until new retail rates from its next full general rate proceeding after the adjusted income tax rates take effect, at which time such balances would be required to be amortized and reflected in retail rates.

If requested by the utility, excess accumulated deferred income tax balances resulting from changes in state law effective January 2021 would be amortized into retail rates over a period of not less than 30 years by order of the KCC.

Excess accumulated deferred income tax balances resulting from any other changes in state or federal law would be amortized into retail rates by order of the KCC in a manner consistent with requirements of state and federal tax law and relevant regulations and in a manner that will not impair the utility's credit rating.

Municipal and Cooperative Utilities

The bill would clarify that provisions related to adjustments for state or federal income tax expenses would not apply to municipal electric or natural gas utilities or to a cooperative.

Definitions

The bill would define "overcollection or undercollection of income tax expense" as the portion of utility revenue

representing the difference between the cost of service as approved by the KCC 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 adjusted corporate income tax rate. The bill would specify that "overcollection or undercollection of income tax expense" would not include the effects of accumulated deferred income taxes or excess accumulated deferred income taxes.

Contract Rates Not Based on Cost of Service to Facility

The bill would allow the KCC 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, if the KCC:

- Determines such facility would not continue operations, or continue operations that had previously been suspended within the state, and the rate is in the interest of the state based on:
 - The interests of the customers of the utility serving the facility;
 - An evaluation of the incremental cost to serve the facility;
 - The interests of the citizens of the state generally in promoting economic development, retaining the tax base, keeping employment opportunities in the state, and other benefits created by approval of the contract rate, as determined by the KCC; and
- Allocates the reduced revenues from the contract rate (as determined by a comparison of the contract rate to the revenues that would have been generated at the retail rate the facility would have paid without such contract rate) to the utility's other non-contract customers through a uniform percentage adjustment. The bill would require the

reduced revenues to be applied in the base rates of all customer classes, except the base rates for service provided to customers under any approved contract rate, in each general rate proceeding involving the utility serving the facility.

Contract Rates Based on Incremental Cost of Service to a Facility

The bill would allow the KCC to approve a contract rate, outside a general rate proceeding, that is based on the utility's incremental cost of service for a facility, if the KCC:

- Determines the facility would not commence or expand operations in the state without a contract rate;
- Determines the contract rate recovers the incremental cost of providing service to the facility and is in the best interest of the state based on:
 - The interests of the customers of the utility serving the facility;
 - The incremental cost of serving the facility; and
 - The interests of the citizens of the state generally in promoting economic development, expanding the tax base, increasing employment in the state, and other benefits created by approval of the contract rate, as determined by the KCC; and
- Uses the reduction in revenues that result from any contract rate approved by the KCC pursuant to the bill during the rate's effective period for the purposes of determining the utility's revenue requirement in each general rate proceeding concluding after July 1, 2020.

Terms and Renewal

The bill would specify the KCC could approve each type of contract rate for a term of up to ten years, with the ability to renew such rates, upon the utility's application for reapproval. The KCC would not have the authority to modify or eliminate any approved contract rate during the specified term.

Effect on Prior Contract Rates

The provisions of the bill would not affect, or establish standards for approval of, any contract rates approved by the KCC prior to and in effect on July 1, 2020, and would not affect or diminish the KCC's general ratemaking authority to approve just and reasonable contract rates prior to July 1, 2020.

Discounted Rates

The bill would authorize the KCC to approve the implementation of economic development rate schedules providing discounts from standard rates for electric service for new or expanded facilities of industrial or commercial customers that are not in the business of selling or providing goods or services directly to the general public.

Eligibility

To be eligible for discounted rates, the industrial or commercial customer would be required to:

- Have incentives from one or more local, regional, state, or federal economic development agencies to locate new or expanded facilities in the utility's certified service territory;

- Qualify for service under the utility's nonresidential and non-lighting rate schedules for a new or expanded facility; and
- Not receive the discount together with service provided by the utility pursuant to any other special contract agreements.

Applicability

The discount authorized by the bill would be applicable only to new facilities or expanded facilities that meet the following requirements:

- A peak demand that is reasonably projected to be at least 200 kilowatts within two years of the date the customer first receives service under the discounted rate and is not the result of shifting existing demand from other facilities of the customer in a utility's certified service territory; and
 - Has an annual load factor that is projected to equal or exceed the electric public utility's annual system load factor within two years of the date the customer first receives service under the discounted rate; or
 - Otherwise warrants a discounted rate based on any of the following factors:
 1. The number of new permanent full-time jobs created or the percentage increase in existing permanent full-time jobs created;
 2. The level of capital investment;
 3. Additional off-peak usage;
 4. Curtailable or interruptible load;
 5. New industry or technology; or
 6. Competition with existing industrial customers; or

- A peak demand that is reasonably projected to be at least 300 kilowatts within two years of the date the customer first receives service under the discounted rate and is not the result of shifting existing demand from other facilities of the customer in the utility's certified service territory; and
 - An annual load factor that is reasonably projected to be at least 55 percent of the utility's annual system load factor within two years of the date the customer first receives service under the discounted rate; and
 - The facility maintains the peak demand and load factor for the remaining duration of the discounted rate.

Calculation of Discount

The discount authorized by the bill would be determined by reducing otherwise applicable charges associated with the rate schedule that applies to the new or expanded existing facility by a fixed percentage for each year of service under the discount for a period of up to five years.

The average of the annual discount percentages could not exceed 20 percent for discounts for facilities that have a projected peak demand of at least 200 kilowatts, but could be between 5 percent to 30 percent in any year. For facilities that have a projected peak demand of at least 300 kilowatts, the average of the annual discount percentages could not exceed 40 percent, but could be between 20 percent to 50 percent in any year.

In each general rate proceeding concluded after July 1, 2020, the KCC would be required to allocate the reduced level of revenues arising from the discounted rates provided by the bill through the application of a uniform percentage adjustment to the revenue requirement responsibility for all

customer classes of the utility providing the discounted rate, including the classes with customers that qualify for discounts under the bill, except for contract rates either approved by the KCC pursuant to the bill or its general ratemaking authority.

Tracking Mechanisms and Deferred Regulatory Assets

For both contract rates and discounted rates, the KCC would be required to approve a mechanism to track the utility's reductions in revenue as a result of the contract rate or discounted rate from the date the rate becomes effective. The bill would require such reductions in revenue to be deferred to a regulatory asset and would accrue interest at the weighted average cost of capital used by the KCC to set the utility's rates in its most recent general rate proceeding. The balance of the regulatory asset would be included in the rate base and revenue requirement of the utility in each of its general rate proceedings through an amortization of the balance over a reasonable period until fully collected from the utility's non-contract rate customers.

General Applicability

The bill would clarify provisions related to discounted rates would not apply to those related to contract rates approved by the KCC pursuant to the bill or the KCC's general ratemaking authority in place prior to July 1, 2020.

Definitions

The bill would define various terms used in the bill:

- “Electric public utility” would have the same meaning as used elsewhere in Chapter 66 of the *Kansas Statutes Annotated*, but would not include any utility that is a cooperative or is owned by one or more such cooperatives;

- “Facility” would mean an existing or proposed building or buildings of an existing or potential electric customer with existing or expected load equal to, or in excess of, a monthly demand of 50 megawatts, and the load may represent the aggregate demand of multiple meter accounts;
- “Expanded facility” would mean a separately metered facility of the customer, unless the utility determines the additional costs of separate metering of a facility would exceed the associated benefits or that it would be difficult or impractical to install or read the meter, that has not received service in the electric utility’s certified service territory in the previous 12 months; and
- “New facility” would mean a building of the customer that has not received electric service in the electric utility’s certified service territory in the previous 12 months.

Status Reports

The bill would require the KCC to provide a status report to the Legislature biennially, starting in January 2023, regarding utilities’ use of contract rates and discounted rates, with the following items to be included:

- Number of entities with such contract or discounted rates;
- Number of entities with increased load;
- Number of entities with decreased load;
- Aggregate load and change in aggregate load on an annual basis;
- Total subsidy and the subsidy for each individual contract;

- Annual and cumulative rate increase on non-contract rate customers; and
- Estimated economic development impact of entities with contract rates or discounted rates that occurred as a result of such contract rates through an evaluation of the entities' annual total employment, change in employment, and tax revenue generated.

Background

The bill was introduced by the House Committee on Energy, Utilities and Communications at the request of Representative Schreiber. The bill, as amended by the House Committee of the Whole, contained provisions relating to the retail sale of electricity for electric vehicle charging stations and procedures for electric transmission line siting.

On March 17, 2020, the Senate Committee on Utilities (Senate Committee) deleted the contents of the bill, inserted the language of Sub. for SB 126 and SB 339, both as passed by the Senate, and further amended the bill. Prior to recommending the substitute bill, the Senate Committee amended the bill to clarify that cooperatives are exempt from income taxation but may be included in a consolidated or unitary combined income tax return. In addition, the Senate Committee amended the bill to exempt certain electric and natural gas public utilities effective for tax years ending on or after January 1, 2021, and make technical changes.

An updated fiscal note was not available when the Senate Committee took action on the substitute bill.

Sub. for SB 126 (Tracking and Collection of Income Tax for Electric Public Utilities)

SB 126 was introduced by the Senate Committee on Assessment and Taxation. The bill was referred to the Senate Committee on Utilities on February 8, 2019.

In the Senate Committee on Utilities (Senate Committee) hearing on March 20, 2019, a representative of the Kansas Industrial Consumers Group (KICG) and Kansans for Lower Electric Rates (KLER) provided proponent testimony, stating reduction in utility income tax collection would directly reduce utility rates because tax expenses are passed on to consumers. Written-only proponent testimony was provided by representatives of Renew Kansas Association and the Kansas Grain and Feed Association.

Opponent testimony was provided by representatives of Black Hills Energy, Evergy, Kansas Gas Service, and Liberty Utilities. Opponents stated the bill could negatively impact certain deferred tax benefits that have accrued for utility customers, resulting in increased rates, multiple rate cases in a single year, and implementation of rate reductions at an unreasonable pace. Written-only opponent testimony was submitted by Atmos Energy Corporation.

Neutral testimony was provided by a representative of the KCC, outlining concerns with various provisions of the bill identified by KCC staff.

In the Senate Committee hearing on January 28, 2020, representatives of the Citizens' Utility Ratepayer Board (CURB), KICG and KLER, and the Wichita Regional Chamber of Commerce provided proponent testimony. The proponents stated generally the bill would offer an opportunity to lower electric rates for residential and industrial consumers. Written-only proponent testimony was provided by Americans for Prosperity Kansas and by a representative of Renew Kansas Association and the Kansas Grain and Feed Association.

Opponent testimony was provided by representatives of Black Hills Energy, Evergy, Kansas Gas Service, Liberty Utilities, and Sunflower Electric Power Corporation. The opponents generally stated they are not opposed to the concept of the bill, but are concerned it would not achieve the desired result of lowering electric rates and have a negative impact on utility credit ratings.

Neutral testimony was provided by a representative of the KCC. The representative's testimony was substantially similar to testimony provided at the previous Senate Committee hearing.

The Senate Committee adopted a substitute bill that included the following changes:

- Allow provisions of the bill to apply in situations where income tax is undercollected;
- Establish what circumstances must exist before a utility must file an application for new rates;
- Clarify that a utility would not need to file a full general rate case when overcollection or undercollection of income tax occurs;
- Clarify that an application for adjusted rates would not constitute a violation of any existing rate moratorium agreement if it only updates income tax expense components of a utility's base rates;
- Establish requirements for an order issued by the KCC in response to an application for adjusted rates resulting from a change in state and federal income tax law;
- Clarify that provisions related to adjustments for state or federal income tax expenses would not apply to municipal electric or natural gas utilities, or a cooperative; and

- Clarify that provisions related to the income tax exemption would not apply to cooperative utilities or to a utility owned by one or more cooperative, subject to rate regulation by the KCC.

The Senate Committee of the Whole amended the bill to:

- Increase the amount of time a utility would have to file an application for new retail rates;
- Clarify how the rate of interest on a recorded income tax expense that is implemented over time is calculated;
- Clarify procedure for when a utility has a pending rate case before the KCC or has notified the KCC of such an intent at the time any adjusted income tax rates become effective;
- Clarify language regarding amortization of excess accumulated deferred income tax balances;
- Clarify provisions related to exemption from Kansas income tax;
- Clarify the definition of “overcollection and undercollection of income tax expense”; and
- Make several technical and conforming changes.

In the House Committee on Energy, Utilities and Telecommunications (House Committee) hearing on March 10, 2020, representatives of CURB, KCC, KICG and KLER, and the Wichita Regional Chamber of Commerce provided proponent testimony. The representatives’ testimony was substantially similar to the testimony provided at the Senate Committee hearing, with the exception of the KCC. The KCC testified as a neutral conferee in the Senate Committee hearing, but supported the substitute bill in the House

Committee hearing. Written-only proponent testimony was provided by Kansas Grain & Feed Association and Renew Kansas, Kansas Chamber of Commerce, and Americans for Prosperity.

Neutral testimony was provided by a representatives of Evergy and Kansas Electric Cooperatives, Inc., (KEC), stating many of their initial concerns with the bill as introduced had been addressed by the substitute bill. Written-only neutral testimony was provided by representatives of Black Hills Energy and Kansas Gas Service. No opponent testimony was provided.

According to the fiscal note prepared by the Division of the Budget on SB 126 as introduced, the KCC indicates enactment of the bill would have no effect on agency expenditures. The fiscal note reported the Department of Revenue was unable to determine the fiscal effect enactment of the bill would have, if any, on the agency or state revenues. A fiscal note was not available on the substitute bill, as recommended by the Senate Committee. Any fiscal effect associated with enactment of the bill is not reflected in *The FY 2020 Governor's Budget Report*.

SB 339 (Contract Rates and Discounted Rates for Electric Public Utilities)

The bill was introduced by the Senate Committee at the request of a representative of Evergy.

In the Senate Committee hearing on February 11-12, 2020, representatives of Cavern Technologies, Databank, Ltd., Evergy, Kansas Economic Development Alliance (KEDA), KICG, and the Wichita Regional Chamber of Commerce provided proponent testimony. The proponents generally stated the bill would make Kansas businesses more competitive with those in surrounding states. Written-only proponent testimony was submitted by the Greater Topeka Chamber of Commerce, Greater Wichita Partnership, Kansas

Chamber of Commerce, Kansas City Area Development Council, Lenexa Chamber of Commerce, Liberty Utilities, Olathe Chamber of Commerce, and Overland Park Chamber of Commerce.

A representative of the KEC provided neutral testimony, requesting an amendment to exempt electric cooperatives from the definition of “electric public utility” under the bill.

Representatives of CURB and KCC provided opponent testimony. The CURB representative stated concerns that the bill would unfairly benefit utilities over ratepayers and reduce the ability of the KCC to regulate rates. The KCC representative stated the bill’s provisions do not follow the recent London Economics International rate study’s considerations in designing economic development riders and is premature as a result and does not comply with established criteria established by KCC order regarding ratemaking treatment for revenue losses.

The Senate Committee amended the bill to clarify cooperatives are excluded from the definition of “electric public utility” and adopted a technical amendment to remove references to current law governing the KCC’s power to require utilities to establish just and reasonable rates to maintain efficient and sufficient electric service and to prohibit variations from established rate schedules.

The Senate Committee of the Whole amended the bill to require the KCC to submit a biennial report, starting in January 2023, to the Legislature regarding utilities’ use of contract rates and discounted rates.

In the House Committee hearings on March 10 and 12, 2020, representatives of Cavern Technologies, Databank, Ltd., Evergy, KEDA, KICG, and the Wichita Regional Chamber of Commerce provided proponent testimony. Written-only proponent testimony was submitted by the Greater Topeka Chamber of Commerce, Kansas Chamber of Commerce, Lenexa Chamber of Commerce, Liberty Utilities,

Olathe Chamber of Commerce, and Overland Park Chamber of Commerce.

A representative of the KEC provided neutral testimony. Representatives of CURB and KCC provided opponent testimony.

According to the fiscal note prepared by the Division of the Budget on SB 339 as introduced, the KCC indicates the agency would need to hire outside consultants to assist in determining the special contract rates authorized by enactment of the bill and estimates the cost of each study to be \$10,000 to \$20,000 for each utility that files an application, with total annual costs totaling \$75,000 to \$200,000. Any fiscal effect associated with enactment of the bill is not reflected in *The FY 2021 Governor's Budget Report*.