KANSAS
CORPORATION COMMISSION

BEFORE THE SENATE UTILITIES COMMITTEE

Presentation of the Kansas Corporation Commission
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HB 2033

Thank you, Chairman and members of the Committee. I am Don Low, Director of the Utilities Division for the Kansas Corporation Commission. I appreciate the opportunity to testify for the Commission on HB 2033.

Because this bill would remove the Commission's discretion on whether to allow cost recovery for certain utility projects that are still under construction, the Commission opposes the bill. The bill would instead mandate that ratepayers begin paying immediately for such projects before they begin providing service. Before I discuss the KCC's concerns with this bill, I want to provide some background on the CWIP issue, which has been the subject of debate for many years.

In general, under traditional utility regulation, ratepayers are not required to pay for utility assets unless those assets are "used and useful" or, as stated in K.S.A. 66-128, "used and required to be used." This general principle has been aimed at protecting ratepayers from paying for "gold-plated" facilities or plant that represents "excess capacity." It has also generally meant that ratepayers shouldn't pay for plant under construction and not yet in service, or as it is commonly referred to: "Construction Work in Progress" or "CWIP". However, as reflected in the statute, there is no absolute prohibition against allowing cost recovery of CWIP. Instead, the current statute lays out specific situations in which the KCC may consider CWIP to be used and required to be used. That discretion allows the Commission to evaluate on a case by case basis

the conflicting considerations that come into play on this issue. Some of those considerations are:

- Not allowing CWIP corresponds to the general practice in the marketplace of consumers paying for goods or service only when such goods or services are ready to be used. This logical practice especially makes sense if it is unknown either when development of the product will be finished or if the consumers will fully utilize the product when it is produced.
- With regard to utility assets, there is a general regulatory philosophy that one generation of ratepayers should not pay for facilities that will only provide service to future generations. This "intergenerational equity" concern should be greater as the construction period lengthens since there will be a corresponding increase in the number of current customers who move or pass on before the plant is completed.
- On the other hand, assuming that a construction project is eventually put into service and fully utilized, the total cost to ratepayers over the life of the asset is usually greater if the facility is added to rate base after it begins providing service than if cost recovery commences during construction. This is because of the accounting recognition given to the carrying costs associated with the money that is tied up during the construction period if CWIP is not recognized.[1] However, the net difference in cost is very dependent on the assumptions made about the time value of money for ratepayers. A commitment to allow CWIP cost recovery can also reduce costs of debt because lenders generally view such an approach as a reduction in risk that will merit a lower cost of money.
- Aside from policy considerations, there are accounting considerations. For example, the Commission has generally agreed that Staff should be able to audit the actual costs incurred rather than rely on projections or estimates. This has meant as a practical matter that CWIP is usually allowed only for projects that are completed about six months after the close of the

[1] This "Allowance for Funds Used During Construction" ("AFUDC") is added to the cost of the facility that is put into ratebase when the plant is completed and in service. The "return of" (through annual depreciation expense) and "return on" (through the overall rate of return given on net ratebase) the AFUDC component increases the total costs to ratepayers.

test year in rate cases. Also, if the project is likely to have offsetting effects on the costs or revenues of the utility, CWIP is not allowed without consideration of such offsets in order to provide a fair representation of the company's overall revenue requirements.

With regard to the CWIP issue, K.S.A. 66-128 originally gave the KCC discretion to allow only projects that would be completed within a year.[2] In 1995, the legislature added to the eligible CWIP facilities: generation from a renewable resource that is 100 megawatts or less, and transmission lines or generating facilities that have received siting approval from the KCC. In 2001, the legislature added all generation placed in service after 2000, and all transmission lines and appurtenances. There have been no requests for CWIP under the latter amendments.

The Commission believes it has reasonably exercised its discretion to allow CWIP in appropriate circumstances and has been flexible in meeting utility financial needs with regard to major projects and therefore opposes the proposed change in this statute to *mandate* cost recovery of CWIP. (For example, KCPL is in the midst of a complicated four year resource plan that was negotiated with staff and approved by the Commission. Also, the KCC's approval of Westar's mechanism to annually recover costs of new pollution control equipment was recently upheld by the Court of Appeals.) We therefore see no compelling need to make the change proposed in this bill.

The proposed change could lead to undesirable or uncertain results. For example, what happens if a new generating facility gets CWIP treatment during construction but never gets put into service because of changes in environmental rules, technical, economic or other problems? The Commission could be foreclosed from requiring a refund of any of the costs that were paid by ratepayers, even though they will never receive any benefits from the un-completed plant. The amendment made by the House committee, the addition of subsection (b)(4), does not address that problem. Nor can we foresee all other potential problems with an absolute mandate. With this bill, the KCC is potentially handicapped in how it addresses varying circumstances.

[2] The 1984 amendment clarified the 1978 version to state that construction of the project had to be *commenced* and completed within one year or less rather than just completed in one year or less.

Without this bill, the KCC continues to have the discretion to consider the potential problems with allowing cost recovery for CWIP in specific circumstances and impose appropriate conditions or otherwise tailor make solutions.

This bill reminds me of what has happened with regard to K.S.A. 66-1237, which addresses recovery of electric transmission costs. Because that statute, enacted in 2003, was so specific, it was interpreted by the Court of Appeals as not providing the Commission with the discretion it attempted to exercise in implementing the statute. House Bill 2220 addresses a court decision that reversed the KCC's approval of Westar's proposal for a Transmission Delivery Charge in its last rate case. I don't believe the original problems with K.S.A. 66-1237 caused any irreversible harm to either ratepayers or electric utilities. However, I can't say that HB 2033's changes to remove KCC discretion under K.S.A. 66-128 wouldn't result in greater problems.

Thank you for your consideration. I will be happy to answer questions at the appropriate time.