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Opposition Testimony on Senate Bill 349

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On Behalf of The Staff of the Kansas Corporation Commission

Chair Thompson, 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).

Executive Summary

Commission Staff is opposed to Senate Bill 349. This Bill raises serious questions as to the legality of establishing an arbitrary 1% limitation on annual rate increases in order to benefit today's ratepayers, while shifting that burden to future ratepayers, along with the carrying costs caused by the delay. **This Bill appears to be a clear violation of the Kansas Supreme Court mandate that ratemaking proceedings must consider and balance the interests of: (1) the utility's investors vs. ratepayers; (2) present ratepayers vs. future ratepayers; and (3) the public interest**.[1]

If this Bill could survive the inevitable litigation and Appeals process, it would be certain to increase the cost and litigiousness of ratemaking proceedings before the KCC. It is also likely to increase the cost and decrease the availability of investment capital necessary to fund the construction and maintenance of critical infrastructure systems that are necessary to provide safe and reliable utility service for Kansas customers. **Unfortunately, both of these unintended consequences would end up increasing utility rates in Kansas, not decreasing them.**

Purpose and Effect of the Bill

SB 349 would establish a limitation that electric rate increases for investor-owned electric utilities in the State could not exceed 1% per year for the next ten years. Because this 1% limitation is not tied to a utility's costs of providing safe and reliable electric service, the Bill allows costs above this level to be deferred, with carrying charges at the utility's Weighted Average Cost of Capital (WACC), to be recovered from future ratepayers after July 1, 2032.

This Bill would exclude from this 1% limitation rate increases that are tied to fuel and purchased power costs, as well as Ad Valorem taxes. The Bill also contains an exemption that allows rate increases above 1% if necessary to "protect reliability" or to prevent "material negative impact"

[1] *Kan. Gas and Electric Co. v. State Corp Comm'n*, 239 Kan. 483, 488 (1986).

to the utility's credit rating. Included in the 1% limitation would be all other causes of rate increases, including rate increases necessary to pay for transmission costs previously authorized by K.S.A 66-1237, costs associated with maintaining and operating electric generating plants predetermined to be "reasonable, reliable and efficient" pursuant to K.S.A. 66-1239, energy efficiency cost recovery required by K.S.A. 66-1283, and other necessary electricity expenditures required to provide efficient and sufficient service as required by K.S.A. 66-101b. As such, this Bill is clearly in conflict with several existing Kansas Statutes governing the utility ratemaking process in Kansas.

Analysis of the Bill

K.S.A. 66-101b requires the Commission to set an electric utility's rates at a just and reasonable level that allows the utility to provide reasonably efficient and sufficient service. The Kansas Supreme Court has ruled that a just and reasonable rate is a rate set during a ratemaking proceeding in which the following interests were considered and balanced: (1) the utility's investors vs. ratepayers; (2) present ratepayers vs. future ratepayers; and (3) the public interest.[2]

SB 349 would require the Commission to limit electric rate increases to no more than 1% annually, even if a rate increase larger than that was necessary for the provision of efficient and sufficient electric service. If a rate increase larger than 1% was necessary to support the provision of efficient and sufficient service, then those rate increases would be deferred for ten years with carrying charges at the company's WACC. This arbitrary limitation on electric rate increases raises two important concerns about the legality of this proposal: 1.) whether this would constitute "just compensation" as required by the 5th Amendment to the United States Constitution, and 2.) whether this would result in unlawful intergenerational inequity, i.e., unfairly benefitting today's ratepayers and the expense of future ratepayers. Each issue is explored in more detail below.

Just Compensation: Staff contends that the arbitrary limitation on electric rate increases in SB 349 would only be likely to be upheld by Kansas Courts (or the U.S. Supreme Court) if any deferred rate increases were afforded carrying charges at the utility's WACC, and the period of deferral/delay were not significant. While we can't be certain what time period would likely be deemed too long (unjust), we haven't found anything longer than three years that has been upheld by the Courts. A ten year delay before compensation is provided, as called for in SB 349, seems excessive and not likely to be considered "just compensation" in exchange for the public benefit utilities and their private shareholders provide. If it was found to be legal, carrying charges over that time period would be quite substantial, and would be paid for by future generations.

Intergenerational Inequity: As stated above, the Kansas Supreme Court has found that one of the balancing tests required to be performed during ratemaking proceedings is the interests of today's ratepayers versus future ratepayers. SB 349 would explicitly benefit today's ratepayers at the expense of future ratepayers by deferring any expenses necessary to provide efficient and service while simultaneously keeping rate increases below 1% annually. Moreover, because these deferred costs would accumulate carrying charges at the utility's WACC, future ratepayers would pay substantially more than if these costs had been recovered in a timely fashion through the ratemaking process. Assuming for simplicity a WACC of 7.2%, deferred charges that accumulate

[2] *Kan. Gas and Electric Co. v. State Corp Comm'n*, 239 Kan. 483, 488 (1986).

would double approximately every ten years.[3] Given this obvious intergenerational inequity, Staff contends that is likely SB 349 would not survive judicial review.

Inconsistency with Other Prominent Kansas Statutes

As stated above, SB 349 would exempt rate increases caused by changes in fuel and purchased power expense, and Ad Valorem taxes from the 1% annual rate increase limitation. Notably absent from this list however, is transmission investments previously authorized for cost recovery pursuant to K.S.A. 66-1237; cost recovery associated with operating and maintaining electric generating plants determined to be reasonable, reliable, and efficient pursuant to K.S.A. 66-1239; and energy efficiency cost recovery as authorized by K.S.A. 66-1283. SB 349's limitation on annual rate increases is directly contrary with all three of these statutes, which call for cost recovery certainty after utility investments are made to benefit the public interest.

Ambiguity of Key Provisions, Likelihood for Litigation, Unintended Consequences

SB 349 contains an exception to the 1% annual rate increase cap if the Commission determines it is needed to "protect reliability" or prevent a "material negative impact" to the utility's credit rating. These terms are not defined in the bill, and an attempt to define them would be counterproductive because these terms are so all encompassing as to render the effect of the Bill meaningless. In fact, every rate increase is in some way tied to reliability or the prevention of negative credit degradation of the utility, or the Commission would not allow these costs to be recovered from ratepayers. Ratemaking proceedings before the Commission are detailed, fact specific, data intensive proceedings that root out imprudent or inefficient expenditures. While Staff works hard to ensure this, it is also assured by the fact that there are often several organizations representing consumer interests that intervene in these proceedings. Just and reasonable rates are by definition just enough to compensate the utility for the provision of efficient and sufficient service, and to ensure that the utility has an opportunity (not a guarantee) to earn its lawfully authorized return.

If SB 349 were to become law and were upheld on appeal, every party to a KCC ratemaking proceeding would have a different idea of whether a particular expenditure was necessary for reliability or the prevention of a credit downgrade. The ambiguity of these provisions would certainly lead to highly contentious and time consuming rate cases, which ultimately increases costs for all ratepayers.

The prospect of time consuming, contentious, and litigious rate cases, as well as the potential that prudently incurred costs would not be recovered for ten years or longer, would lead to higher costs of capital for utilities and diminished access to the highly competitive public financing markets. This is highly problematic because utilities are capital intensive firms that must access the capital markets several times per year during a normal year. This capital is used to construct and maintain the State's utility infrastructure, which is necessary in order to provide safe and reliable utility service. Also, increases in a utility's cost of capital will eventually be borne by customers.

As the Committee can see, SB 349 may very well result in unintended consequences which will

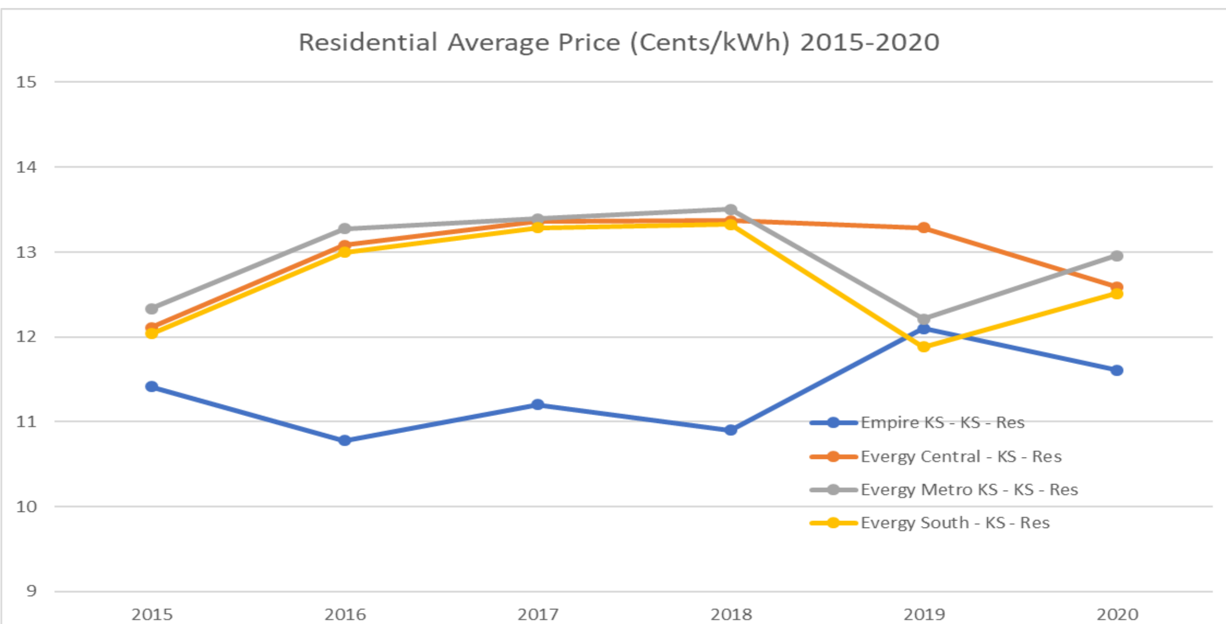
[3] In reference to the well-known rule of 72.

end up increasing utility rates, instead of the stated goal of the bill to decrease or hold down utility rates.

Recent Changes in Electric Rates in Kansas

Residential electric rates for investor owned utilities in Kansas have grown at around half the rate of inflation since 2015. Industrial rates have been lower and grown much less than this.

Residential Average Price (cents/kWh) Row Labels	Empire KS	Evergy Central	Evergy Metro KS	Evergy South
2015	11.41	12.11	12.33	12.04
2016	10.78	13.08	13.27	13.00
2017	11.20	13.36	13.39	13.28
2018	10.90	13.37	13.50	13.33
2019	12.10	13.29	12.21	11.88
2020	11.61	12.59	12.96	12.51
CAGR (2015-2020)	0.34%	0.77%	0.99%	0.77%



Kansas Electric Rate Changes Going Forward

While this recent rate history has shown the potential for Kansas electric utilities to manage rate increases below 1%, the reality of the ratemaking process and the exposure of utilities to macroeconomic forces like inflation make it difficult to predict the future. Elevated inflation levels like experienced recently would make it very difficult to maintain the level of rate stability that electric utilities in Kansas have been able to accomplish over the last six years. Thank you again for the opportunity to present Staff's testimony regarding SB 349.