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Before the Senate Commerce Committee
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Neutral Testimony
On Senate Concurrent Resolution No. 1612

Submitted by Jeff McClanahan, Director, Utilities Division
On Behalf of
The Staff of the Kansas Corporation Commission

Chair Lynn, Vice Chair Suellentrop, Ranking Minority Member Holland, 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 Commission Staff is taking a neutral position on Senate Concurrent Resolution No. 1612 (SCR 1612). But I would like to use this opportunity to explain and highlight some of the provisions of the bill from our perspective.

Staff views SCR 1612's policy as contrary to the Commission's existing statutory requirements because it urges the Commission to establish a rate making paradigm based on comparisons to other regional states, which is most likely illegal. In addition, SCR 1612 is premature because the reasons for the differences in Kansas' rates versus the region has yet to be determined through a study. That being said, Staff, KCP&L, and Westar have just agreed to undertake a study to identify the differences between KCP&L's rates, Westar's rates and the region's rates. This agreement is a part of the recently filed Settlement Agreement in the proposed Westar and KCP&L merger (Docket No. 18-KCPE-095-MER).

The Commission is mandated to establish just and reasonable rates per K.S.A. 66-101b, which states:

> **66-101b. Electric public utilities; efficient and sufficient service; just and reasonable rates.** *Every electric public utility governed by this act shall be required* to furnish reasonably efficient and sufficient service and facilities for the use of any and all products or services rendered, furnished, supplied or produced by such electric public utility, *to establish just and reasonable rates*, charges and exactions and to make just and reasonable rules, classifications and regulations. Every unjust or unreasonably discriminatory or unduly preferential rule, regulation, classification, rate, charge or exaction is prohibited and is unlawful and void. *The commission shall have the power*, after notice and hearing in accordance with the provisions of the Kansas administrative procedure act, *to require all electric public utilities governed by this act to establish and maintain just and reasonable rates*

> when the same are reasonably necessary in order to maintain reasonably sufficient and efficient service from such electric public utilities. [Emphasis added].

In establishing just and reasonable rates, the courts have mandated the Commission consider certain interests. These include the following:

> The Kansas Supreme Court mandates the Commission consider and balance the interests of the utility's investors vs. the ratepayers, the present ratepayers vs. the future ratepayers, and the public interest. "[C]ases in this area clearly indicate that the goal should be a rate fixed within the zone of reasonableness after the application of a balancing test in which *the interests of all concerned parties are considered*." [Order Approving Stipulation and Agreement, Docket No. 15-WSEE-115-RTS (September 24, 2015) (15-115 Order) at ¶ 71 citing Kansas Gas and Elec. Co. v. State Corp. Com 'n, 239 Kan. 488 (1986)]. [Emphasis added].
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> "The KCC is required to *balance* the public need for adequate, efficient, and reasonable service with the public utility's need for sufficient revenue to meet the cost of furnishing service and to earn a reasonable profit." [15-115 Order at ¶ 71, citing Danisco Ingredients USA, Inc. v. Kansas City Power & light Co., 267 Kan. 760, 773 (1999)]. [Emphasis added].

There is also a constitutional relevance for the just and reasonable standard. If the Commission were to set rates that specifically favor customers over investors by ignoring legitimate utility costs and investments, then the Commission will most likely have violated the Takings Clause of the Fifth Amendment as well as the Due Process Clause of the Fourteenth Amendment. The *Process of Ratemaking* describes this issue as follows:

> The just and reasonableness test has become in more recent years even more than the prevailing legislative test for a lawful rate of a regulated enterprise. It is also relevant to the constitutionality of a regulated rate under the Takings Clause of the Fifth Amendment and the Due Process Clause of the Fourteenth Amendment of the Constitution.
>
> The Fifth Amendment provides that, "No person shall…be deprived of…property, without due process of law; nor shall private property be taken for public uses without just compensation." The Fourteenth Amendment provides that "No State …shall deprive any person of…property, without due process of law…"
>
> A just and reasonable rate is a constitutional rate, but, as we shall see, a rate need not pass every just and reasonable test, which indeed may vary from state to state, to pass muster as a constitutional rate.
>
> The judiciary at first attempted to formulate their own threshold test for a constitutionally approved rate of a regulated company. The experiment was eventually abandoned in deference to the emerging just and reasonable standard already applicable to those companies.[1]

[1] *The Process of Ratemaking*, Leonard Saul Goodman, Public Utility Reports, Inc., p. 24.

The new rate setting paradigm "urged" by SCR 1612 will require a bias towards Kansas residential and business customers be implemented by the Commission in order to set rates that are lower and thus more regionally competitive. This bias will be in direct opposition to the balancing of customer and investor interests mandated by Kansas statutes as well as the courts. The logical end result will be that the Commission will become an advocate for customers through its rate case decision making contrary to its statutory mandate. Moreover, residential and business customers have historically been adequately represented by advocates such as the Citizen's Utility Ratepayer Board (an independent agency chartered to represent residential and small commercial customers) and the Kansas Industrial Consumer group (certain industrial customers).

From Staff's perspective, SCR 1612 is also premature. SCR 1612 is premature because it seeks a remedy to the issue of higher regional rates prior to gaining an understanding of why Kansas' rates are higher than those of other states in the region. And, as stated previously, Staff, KCP&L, and Westar have just agreed to undertake a study to identify the major differences between KCP&L's rates, Westar's rates, and the region's rates.

It is imperative to understand why Kansas' rates are higher than the region because there are thousands of inputs into the determination of a revenue requirement and the resulting rates derived in a rate case, some of which are within the control of the electric utility and some of which are not. For example, intuitively Staff knows that a major reason for increased rates for both Westar and KCP&L are the cost of Environmental Protection Agency mandated environmental retrofits to existing coal plants that cost in excess of $3.3 billion coupled with flat volumetric electric sales. Both of these ratemaking inputs are outside the control of Westar and KCP&L. And it would be inherently unfair to mandate lower rates – which would reduce the opportunity for a Kansas electric utility to recover its revenue requirement – based solely on embedded cost inputs that are outside of the utility's control. Only costs that are within the control of the utility should be evaluated for possible reductions. And, it should be noted that, if the current Westar and KCP&L merger is approved, there is estimated to be approximately $800 million dollars in merger and non-merger related controllable savings reductions over the next five years. While this will be very beneficial in stabilizing electric rates, it will also make benchmarking Westar's and KCP&L's controllable costs to those of the region more challenging because the companies controllable costs will be trending down over the next five years.

It is also important to understand that ratemaking inputs are different from utility-to-utility, which will create differences in utility-to-utility, state-to-state, and regional rate comparisons. To further this point, any comparison of rates between utilities is not a simple process due primarily to differing cost structures. A partial list of some of the reasons for different cost structures are as follows:

- Customer Related:
  - The relationship between the number of customers per rate class (i.e., residential, commercial, and industrial) and the design of the electric infrastructure to support the customer's energy and demand needs.
  - The more customers the higher the overall sales volumes will be.
  - The more customers in a given larger volume class – such as industrial – will generate higher sales volumes and drive a different system design (e.g., more transmission and less distribution).
- Geographical:

    - The more urban an electric utility's service territory is the less the overall system costs due to higher customer density.
    - The more rural an electric utility's service territory the more the overall system costs are due to lower customer density.
- Generation:
    - The makeup of a utility's generation fleet has a significant impact on fuel costs, generator upkeep, environmental costs, and original costs for the facility. For example, Kansas' generation fleet is heavily weighted to coal generation, which has required expensive environmental retrofits to meet clean air standards.
    - Wind generation tends not to be near population centers, thus requiring additional transmission.
- Economy:
    - The more robust the overall economy the more likely rates will be lower due to increased sales. For example, Denver's high growth compared to Topeka's flat growth.
- Policy:
    - Progressive energy efficiency requirements, special rates for low income, renewable energy requirements, and CO_2 goals can result in increased costs for the utilities, which increases rates for customers.

As the partial list above indicates, there are many reasons that utilities rates are different. Therefore, it is critical that the differences between the Commission's jurisdictional electric utilities rates and regional rates are studied.

Thank you for the opportunity to offer our perspective on the proposed bill and the opportunity to appear before your committee.