## Utility Rates—Income Tax Exemption, Contract Rates, and Discount Rates; Senate Sub. for HB 2585

**Senate Sub. for HB 2585** creates and amends law relating to a tax exemption for the tracking and collection of state and federal income tax by certain public utilities and creates 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 is 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.

### *Income Tax Exemption*

The bill exempts 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.

The bill prohibits 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 requires 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, any 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 requires 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 is required to refund or collect the tracked amounts from their retail customers in a manner approved by the KCC.

*KCC Order*

The KCC is 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 requires 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 is 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.

If 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 allows 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 requires 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 clarifies that a filing resulting from adjusted income tax rates does 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 provides that rate updates resulting from changes in income tax expenses are not considered a violation of any existing rate moratorium agreement.

*Excess Accumulated Deferred Income Tax Balances*

The bill requires excess accumulated deferred income tax balances resulting from income taxes adjusted due to changes in state or federal law to 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 must 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 will 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 are 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 clarifies that provisions related to adjustments for state or federal income tax expenses will not apply to municipal electric or natural gas utilities or to a cooperative.

*Definitions*

The bill defines "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 specifies that "overcollection or undercollection of income tax expense" does not include the effects of accumulated deferred income taxes or excess accumulated deferred income taxes.

***Contract and Discounted Utility Rates***

*Contract Rates Not Based on Cost of Service to Facility*

The bill allows 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; and
  - 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 though a uniform percentage adjustment. The bill requires 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 allows 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 specifies the KCC may 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 does 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 do 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 do 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 authorizes 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 is 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 is 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 2 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:
    - The number of new permanent full-time jobs created or the percentage increase in existing permanent full-time jobs created;
    - The level of capital investment;
    - Additional off-peak usage;
    - Curtailable or interruptible load;
    - New industry or technology; or
    - Competition with existing industrial customers; or
- A peak demand that is reasonably projected to be at least 300 kilowatts within 2 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 2 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 is 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 cannot exceed 20 percent for discounts for facilities that have a projected peak demand of at least 200 kilowatts, but may be between 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 cannot exceed 40 percent, but may be between 20 percent to 50 percent in any year.

In each general rate proceeding concluded after July 1, 2020, the KCC is 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 is 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 requires 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 is 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 clarifies provisions related to discounted rates will 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 defines various terms for purposes specific to bill provisions regarding contract and discounted utility rates:

- "Electric public utility" has the same meaning as used elsewhere in Chapter 66 of the *Kansas Statutes Annotated*, but does not include any utility that is a cooperative or is owned by one or more such cooperatives;
- "Facility" means 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" means 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" means 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 requires 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 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.