

BEFORE THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS

In the Matter of the Complaint of Kansas )  
Industrial Consumers' Group, Inc., against )  
Kansas Electric and Natural Gas Public ) Docket No. 18-GIMX-252-COM  
Utilities regarding Federal Income Tax )  
Reform of 2018 and Its Effect on )  
Jurisdictional Retail Utility Rates. )

**COMPLAINT**

COMES NOW the Kansas Industrial Consumers Group, Inc. (KIC), and respectfully files this *Complaint* against all investor-owned electric and natural gas public utilities in Kansas, whose retail rates will become unjust and unreasonable upon the effectiveness of reduced federal income tax rates, and requests the Kansas Corporation Commission (Commission) act promptly to ensure customers are not charged for these substantial costs related to income taxes, which are currently included in rates, but will not be incurred by the utilities. KIC also requests an immediate investigation of the impact of federal income tax reform on all retail utility rates subject to the jurisdiction of the Commission. In support of its Complaint, KIC states as follows:

**I. Background**

1. KIC is a corporation organized and existing under the laws of the state of Kansas. KIC was incorporated in Kansas on April 13, 2005. The Secretary of State of Kansas has assigned to KIC, the business Identity I.D. No. 3771185. KIC is a Kansas Corporation in good standing under the laws of the state of Kansas.

2. KIC is organized for the purpose of "Representation, advancement, and protection of the interests of commercial, industrial, and other large volume users of energy (oil, natural gas, electric energy, renewable energy resources) in matters before state and federal administrative agencies, state and federal courts, and before other private and governmental entities, and in the

public generally." In particular, this representation includes advancement of such interests in proceedings at this Commission regarding the rates and services of electric and natural gas public utilities. The Commission has granted KIC's Intervention/Participation in numerous Commission Dockets.

3. The resident agent of KIC is James P. Zakoura, and the address of the registered office of KIC in Kansas is: 7400 W. 110<sup>th</sup> Street, Suite 750, Overland Park, Kansas 66210.

4. Relevant to this Complaint, the primary retail rate-regulated investor-owned electric and natural gas utilities in Kansas are as follows: The Empire District Electric Company (Empire), Westar Energy, Inc. (Westar Energy), Kansas Gas and Electric Company (KG&E) (Westar Energy and KG&E are collectively referred to as "Westar"), Kansas City Power and Light Company (KCP&L), Atmos Energy (Atmos), Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills), and Kansas Gas Service, a division of ONE Gas, Inc. (KGS).<sup>1</sup>

5. The afore-mentioned utilities are the subject of this Complaint,<sup>2</sup> and KIC requests Commission action with respect to these investor-owned utilities' retail rates, as described below. However, KIC does not oppose the joining of additional utilities to the extent those entities' rates are implicated by the allegations herein.

## **II. Ratemaking Treatment of Utility Income Taxes**

6. Commercial, industrial, and other large users of retail electric energy and retail natural gas pay rates for such products that are established by orders of the Commission.<sup>3</sup> These

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<sup>1</sup> KIC understands Southern Pioneer Electric Company (Southern Pioneer) is a corporate entity, and its retail rates are subject to Commission jurisdiction. However, it is also KIC's understanding that Southern Pioneer maintains formula-based retail rates using ratemaking principles typically applied to cooperative entities. Therefore, KIC does not believe Southern Pioneer to be a proper subject of this Complaint.

<sup>2</sup> Although KCC regulations provide for the Commission to serve a Formal Complaint once it is accepted, KIC is serving courtesy copies of this Complaint on multiple representatives of each above-listed entities.

<sup>3</sup> K.S.A. 66-101c, 66-1,203, 66-109, & 66-117.

Commission-ordered rates are "cost-based," i.e. the Commission permits a public utility to include within its retail rates all costs, including operating expenses, which are reasonably and necessarily incurred by the utility for the provision of jurisdictional services.<sup>4</sup> This paradigm is often referred to as "cost-of-service" ratemaking.

7. Federal corporate income taxes are a component of all cost-based retail rates approved by the Commission for jurisdictional investor-owned utilities. Therefore, these utilities recover the cost of federal corporate income taxes from their retail customers as a component of Commission-approved, cost-based rates.

8. If the federal corporate income tax rate decreases, so does a utility's cost of service.

9. More specifically, a declining corporate income tax rate should reduce a utility's cost of service – and, in turn, cost-based utility rates – in two ways:

- (a) Reduction of income tax expense; and
- (b) Recognition and reduction of "excess" accumulated deferred income tax (ADIT) balances for the benefit of customers.<sup>5</sup>

10. The following is a simple example of how a reduction in the federal income tax rate will directly lower a utility's cost of service by reducing the utility's income tax expense:

- Income tax expense is calculated in the ratemaking process by "grossing-up" for income taxes the equity component of the utility's rate of return. The current federal corporate income tax rate is 35%.
- This ensures that the utility has the opportunity to earn its after-tax authorized return-on-equity. For example, for a utility to earn an authorized 10% after-tax ROE, the utility will charge consumers the pre-tax cost of

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<sup>4</sup> K.S.A. 66-101b, 66-1,202, Traditionally, utility rates are set by determining (1) a rate base, (2) a fair rate of return, and (3) reasonable operating expenses. *Farmland Indus., Inc. v. State Corp. Comm'n of Kansas*, 24 Kan. App. 2d 172, 188, 943 P.2d 470, 485 (1997). *Sw. Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 46-47, 386 P.2d 515, 524 (1963); Also see, *Sw. Bell Tel. Co. v. State Corp. Comm'n of Kansas*, 4 Kan. App. 2d 44, 49, 602 P.2d 131, 136-37 (1979), "The reasonableness of the expense to the utility, for ratemaking purposes, will depend, among other factors, on whether the services provided themselves are necessary or beneficial to Kansas ratepayers."

<sup>5</sup> See "Implications of a Federal Corporate Income Tax Reduction on Kentucky Utility Rates," Michael L. Kurtz, Boehm, Kurtz, & Lowry, dated March 23, 2017, p. 2, <http://kiucenergy.com/wp-content/uploads/2016/03/Mike-Kurtz-Presentation-Reflecting-Tax-Reductions-in-Utility-Rates.pdf>. (KIUC Presentation, p. 2).

15.4% (10%/0.65) (this example does not include the gross-up for state corporate income taxes).

- If the income tax rate is reduced, then the income tax expense will be reduced through a reduction in the "gross-up."<sup>6</sup>

11. As noted above, utilities' ADIT balances are also implicated by a reduction in corporate income tax rates. ADIT is the difference between the level of tax recovered in rates and the amount of tax actually paid by the utility. The following is a straightforward description of the nature of ADIT:

The Internal Revenue Code (IRC) and [State] law allow businesses certain tax incentives, which cannot be passed through immediately to ratepayers. The most notable example is the timing difference associated with accelerated depreciation on plant investment. For tax filings, utilities calculate income tax liability using accelerated depreciation as a deduction. For book (i.e., regulatory and financial reporting) purposes, businesses must use "straight-line" depreciation to determine depreciation expense and to calculate income taxes. The difference in income taxes calculated using the two methods is the utility's "deferred tax," which represents the utility's tax liability in future periods.

IRC regulations require utilities to use normalization accounting for calculating income taxes in setting rates. Regulators are prohibited from immediately flowing through to customers, through rates, the higher tax deduction (the amount greater than provided by spreading the tax benefits of depreciation evenly over the life of the asset) from accelerated depreciation. The result is that, for most depreciable assets, actual taxes paid are lower in the earlier years of an asset's life than is calculated for financial statement and ratemaking purposes. This timing difference turns around in the later years of an asset's life so that book depreciation is greater than accelerated depreciation, and actual tax liability is higher than taxes calculated for ratemaking purposes. The total tax deduction over the life of the asset is generally the same as for the financial statement and the ratemaking calculation.<sup>7</sup>

12. As described above, there is a timing difference between when a utility pays its taxes and when it recovers those amounts from ratepayers. However, assuming the utility's income

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<sup>6</sup> KIUC Presentation, p. 3.

<sup>7</sup> "Treatment of Income Taxes in Utility Ratemaking: A White Paper Prepared for The Oregon Legislative Assembly By Public Utility Commission of Oregon Staff," February 2005, pp. 6-7, [www.puc.state.or.us/leg/sb408/white/taxpaper.pdf](http://www.puc.state.or.us/leg/sb408/white/taxpaper.pdf).

tax rate remains constant, the amount of taxes paid by the utility is generally equal to the amount recovered from customers over the course of a utility asset's life.<sup>8</sup>

13. However, if the federal tax rate is reduced, a portion of the utility's ADIT will never be owed to the federal government, creating "excess" deferred taxes. Because the excess ADIT balance will never be paid to the federal government as taxes, ratepayers – who paid these taxes to the utility – are entitled to a refund or credit of excess amounts.<sup>9</sup>

14. On November 16, 2017, the United States House of Representatives passed the "Tax Cuts and Jobs Act." This legislation reduces the federal corporate income tax rate from 35% to 20%, effective for tax-year 2018. On December 2, 2017, the United States Senate passed its own version of the "Tax Cuts and Jobs Act," which also reduces the federal corporate income tax rate from 35% to 20%. The reduced rate is not effective until tax year 2019 under the Senate's legislation. While the House and Senate are still in the process of reconciling certain provisions, significant tax reform is imminent and will likely become effective in a matter of days.<sup>10</sup>

15. The Tax Cuts and Jobs Act is the most significant tax legislation since the Tax Reform Act of 1986, and it will affect public utilities and their retail ratepayers in many and diverse ways. In response to the 1986 Tax Reform Act, 40 jurisdictions opened proceedings to address the impacts of the legislation on public utility rates and accounting.<sup>11</sup> Considering its momentous and wide-ranging impacts, the Tax Cuts and Jobs Act will undoubtedly stir similar regulatory activity throughout the United States.

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<sup>8</sup> KIUC Presentation, p. 4; For additional Kansas-specific discussion of income tax treatment, See KCC Docket No. 09-MKEE-969-RTS, Direct Testimony of Jeffrey D. McClanahan, October 19, 2009, pp. 7-9.

<sup>9</sup> KIUC Presentation, p. 4.

<sup>10</sup> As of the filing of this Complaint, the most recent reporting indicates the corporate income tax rate will be reduced to 21% and will be effective January 1, 2018.

<sup>11</sup> KIUC Presentation, p. 14.

### III. Complaint against all Kansas Investor-Owned Utilities

16. As noted above, rates for utility service in Kansas are generally required to be cost-based and reflect the utility's cost of serving its customers. In particular, Kansas law does not authorize a public utility to charge retail rates including income tax expense above the prevailing corporate income tax rate applicable to that entity.

17. On and after January 1, 2018,<sup>12</sup> the retail rates of all Kansas investor-owned utilities will immediately become unreasonable, unfair, and unjust, in violation of Kansas law, because such rates will include, as a component thereof, a 35% federal income tax rate, a cost for federal income tax which is far in excess of each utility's actual federal income tax rate. Such rates will also become unreasonable, unfair, and unjust, in violation of Kansas law, because such rates will allow the utilities to retain excess amounts of customer funds in their ADIT accounts that were collected from Kansas retail customers but will not be paid as federal income tax.<sup>13</sup>

18. Because the investor-owned utilities' retail rates do not contain a mechanism to account for this immediate and substantial reduction to the utilities' costs of service, the Commission must act affirmatively and swiftly to ensure customers do not pay any unjust or unreasonable portion of these rates. Absent Commission action granting the relief requested by KIC, Kansas retail customers *will pay excessive rates*, including income tax expense far above the utilities' actual federal income tax obligations, and such excessive charges on and after January 1, 2018, will be unreasonable, unfair, unjust, and unlawful - - all in violation of Kansas statutes, regulations, and case law interpretation thereof.

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<sup>12</sup> Depending on the outcome of the reconciliation process, KIC recognizes reduced corporate income tax rates could become effective at a later date, such as January 1, 2019. However, due to this uncertainty, the Commission must act immediately to protect customers.

<sup>13</sup> K.S.A. 66-101b, 66-101e, 66-1,202, 66-1,205, & K.A.R. 82-1-220.

19. The magnitude of the above-described excessive retail rates will be immense and extremely material.

20. For example, KCP&L-KS recovers approximately \$60 million per year for income tax expense in its Kansas retail electric rates and has an Accumulated Deferred Income Tax balance of approximately \$499 million related to its Kansas retail operations.<sup>14</sup> A substantial portion of KCP&L's income tax expense is related to federal income tax obligations, and a comparatively smaller amount is related to Kansas income taxes.

21. Westar collects approximately \$154 million per year for income tax expense from its Kansas retail ratepayers and has an Accumulated Deferred Income Tax balance of approximately \$1.3 billion related to its Kansas retail operations.<sup>15</sup> A substantial portion of Westar's income tax expense is related to federal income tax obligations, and a comparatively smaller amount is related to Kansas income taxes. In addition, these amounts are significantly higher when accounting for Westar's significant federally-jurisdictional transmission operations. In fact, Westar's 2016 Form 10-K, filed with the U.S. Securities and Exchange Commission, reports a net deferred income tax liability of \$1.75 billion.

22. KIC recognizes current rates may not reflect unjust, unreasonable, and excessive charges related to federal income taxes as of the date of this filing.<sup>16</sup> However, the near certainty of tax reform, potentially effective at January 1, 2018, necessitates immediate Commission action to protect Kansas retail ratepayers. Absent immediate action, customers may have no legal

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<sup>14</sup> Docket No. 17-KCPE-201-RTS, Staff Schedules, April 6, 2017; See also, Application, Schedule 3(i), November 9, 2016.

<sup>15</sup> Docket No. 17-WSEE-147-RTS, Staff Schedules, April 11, 2017; See also, Docket No. 15-WSEE-115-RTS, Application, Schedule 11-H, March 2, 2015.

<sup>16</sup> K.A.R. 82-1-220(b)(1) does not require identification of an existing violation. Instead, Commission regulations allow a Complainant to identify violations that *will* occur "by a continuance of acts or omissions." Assuming the investor-owned utilities continue charging their current rates for service, they will collect unjust and unreasonable rates upon the effectiveness of the anticipated income tax reform legislation.

recourse to recover significant amounts of unjustified and excessive rates paid to the utilities. To protect customers, KIC requests the Commission immediately notify all investor-owned electric and natural gas utilities and those utilities' customers regarding its remedy for this issue.

23. Pursuant to K.A.R. 82-1-220(b)(3), KIC requests the following relief:

(a) An Order from the Commission requiring every public utility listed in paragraph 4 above, as of the effective date of any reduction in the federal income tax rate, to account for and accumulate the portion of collected revenues associated with the difference between the previous and current corporate income tax rates. Such amounts must be accumulated as a regulatory liability, with carrying charges equivalent to the utility's current allowed return, to be refunded to customers in the utility's next general or abbreviated rate case. KIC respectfully requests the Commission issue this order on or before December 31, 2017;

(b) an Order from the Commission that public utilities are not entitled to retain excess levels of ADIT resulting from a reduced corporate tax rate and, as of the effective date of any reduction in the federal income tax rate, every investor-owned utility in the state of Kansas is required to account for excess amounts of ADIT resulting from the reduced corporate tax rate. In addition, KIC requests the Commission order immediate refunds of excess ADIT or adopt other appropriate mechanisms to return excess amounts to retail ratepayers within a reasonable timeframe;<sup>17</sup> and

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<sup>17</sup> KIC recognizes ADIT is currently a source of cost-free capital to the utilities. Therefore, it may be that the refund to retail ratepayers must be phased in over a (reasonably short) period of time. However, KIC is also concerned with intergenerational inequities that may occur if refunds are provided over an extended timeline. Past ratepayers contributed the excess amounts, and future ratepayers will receive the refunds. To minimize intergenerational inequities, the refunds should be provided as quickly as practicable.

(c) an Order from the Commission opening a general investigation to examine the impact of all aspects of the "Tax Cuts and Jobs Act" on the rates and terms and conditions of service of all retail rate-regulated Kansas electric and natural gas public utilities.<sup>18</sup>

WHEREFORE, KIC respectfully requests the Commission grant the relief set forth above.

Respectfully submitted,

/s/ **James P. Zakoura**

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**Attorneys for Kansas Industrial  
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<sup>18</sup> These items may include, but will not be limited to, identification of changes to rules on net operating loss deductions and changes to rules on the expensing of capital investment.

VERIFICATION

STATE OF KANSAS )  
 )  
COUNTY OF JOHNSON ) ss:

James P. Zakoura, being duly sworn upon his oath, deposes and states that he is the Attorney for the Kansas Industrial Consumers Group, Inc., that he has read and is familiar with the foregoing *Complaint*, and the statements therein are true to the best of his knowledge, information and belief.

  
James P. Zakoura

SUBSCRIBED AND SWORN to before me this 14<sup>th</sup> day of December, 2017.

  
Notary Public

My Appointment Expires:



## CERTIFICATE OF SERVICE

I hereby certify that true copy of the foregoing was served by electronic mail (when available) or regular U.S. mail (unless otherwise noted), the 15th day of December, 2017 to the parties below:

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