

**THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of a General Investigation)
Regarding the Effect of Federal Income Tax)
Reform on the Revenue Requirements of) Docket No. 18-GIMX-248-GIV
Kansas Public Utilities and Request to Issue)
an Accounting Authority Order Requiring)
Certain Regulated Public Utilities to Defer)
Effects of Tax Reform to a Deferred)
Revenue Account.)

STAFF'S RESPONSE TO RURAL TELEPHONE COMPANIES' RESPONSE

The Staff of the Kansas Corporation Commission (Staff and Commission, respectively), hereby submits the following in response to the rural telephone companies' (RLECs') *Response to Motions by Staff and CURB* (Response) filed in this docket on January 2, 2018:

OPENING REMARKS

1. At the outset, Staff would note that any hypothetical situations presented in *Staff's Motion to Open General Investigation and Issue Accounting Authority Order Regarding Federal Tax Reform* (Staff's Motion)¹ are no longer hypothetical as the Tax Cuts and Jobs Act (TCJA) was signed into law December 22, 2017, with most provisions effective January 1, 2018.

2. Staff would also note that, although the RLECs are rate-of-return regulated entities, they are generally permitted to maintain service rates near the statewide "affordable rate"² and collect the difference between their revenues and their revenue requirements from the Kansas Universal Service Fund (KUSF).³ Additionally, high-cost KUSF determinations are generally made by analyzing the same cost of service data any other regulated utility would provide.

¹Filed in this docket on December 14, 2017.

²The "affordable rate" is price floor for purposes of determining Kansas Universal Service Fund (KUSF) support. RLECs that price their jurisdictional service rates below the "affordable rate" receive reduced KUSF support equal to the amount they could have received had their service rates been increased. *See* K.S.A. 66-2005(e).

³*See* K.S.A. 66-2008.

Therefore, there is functionally no difference in the effects on cost of service data for the RLECs and other utilities as a result of tax reform.

3. With respect to the RLECs' Response, it appears that three main arguments are raised: (1) the Commission should hold a hearing before ruling on Staff's Motion because the administrative expenses necessary to comply with Staff's requested Accounting Authority Order (AAO) are unknown and could potentially outweigh any tax benefits, and the effects of requiring utility revenues to be encumbered are unknown; (2) Staff's Motion constitutes single-issue ratemaking; and (3) Staff's Motion ignores the fact that the RLECs were not required to track and defer tax information in the 1986 Tax Reform Order. Staff will address these three issues below.

(1) A HEARING IS NOT NECESSARY AS THE MATERIAL FACTS ARE NOT IN DISPUTE, ENCUMBRANCE IS NOT OCCURRING, AND DELAY IS UNFAIR TO RATEPAYERS

4. The RLECs argue that before issuing Staff's requested Accounting Authority Order (AAO), there should be hearings on the merits.⁴ Such a hearing is unnecessary and detrimental to ratepayers. Additionally, when opposing a motion for summary judgment, which is essentially what Staff is asking for, an adverse party must come forward with evidence to establish a dispute.⁵ The RLECs have not brought forward any evidence, but instead just raised questions about unknown expenses. The material facts in issue regarding tax reform and its general impacts on rates have not been disputed. Although the RLECs give the illusion that they are trying to protect ratepayers from "significant regulatory and administrative costs, potentially exceeding any saving to customers," they are in fact causing great harm by attempting to delay the AAO. The

⁴Response to Motions by Staff and CURB, p. 2 (Jan. 2, 2018) (RLEC Response).

⁵See *Osterhaus v. Toth*, 39 Kan. App. 2d 999 (2008); K.S.A. 66-537 (authorizing the use of summary proceedings at Kansas administrative agencies); K.S.A. 66-519 (authorizing motions for summary judgment).

administrative and regulatory costs associated with tracking and deferring over-collections of income taxes are likely immaterial compared to the over-collections themselves.

5. For example, assume a company has \$1,000,000 in earnings before taxes and under the old tax rate, 39.55%, or \$395,500 of that income would become payable to the state of Kansas and the IRS.⁶ The reduction in the federal tax rate from 35% to 21% would result in a reduction of taxes payable of \$130,200 annually. This is a conservative estimate as some Kansas regulated entities have earnings before taxes in the hundreds of millions of dollars, such as Westar and Kansas City Power & Light.

6. Granted, some of the RLECs are smaller entities with lower amounts of earnings before taxes, but even assuming \$100,000 in earnings before taxes provides a \$13,200 annual over-collection based upon the above presented example. The RLECs did not provide any sort of estimates or evidence regarding how much it would cost to comply with the AAO. Therefore, it is impossible to analyze their claim regarding administrative expenses. Even still, the RLECs are regulated entities that should be required to comply with reasonable accounting requirements. The RLECs have cited no statutory requirement that the Commission analyze the administrative and regulatory costs associated with its Orders. The RLECs' argument should be rejected.

7. With respect to the other argument raised by the RLECs - that the Commission should investigate the unknown effects on utility operations due to "encumbered utility revenues" - the Commission should decline.⁷ The Commission should decline because it is both a misleading characterization of the AAO and the effects of Staff's request are known.

⁶This combined effective tax rate accounts for the tax deductibility of state income taxes for the determination of taxable federal income. The calculation is as follows: $((1-.07)*.35)+.07= .3955$.

⁷See RLEC Response at 2.

8. First, no “encumbrance” will occur so the use of this word is inaccurate. The AAO will in no way restrict or control utility resources, as alleged by the RLECs. The AAO would merely require an exercise in accounting. Staff is not asking the utilities to place any funds in escrow or otherwise restrict their use.

9. Second, the effects on the utilities as a result of Staff’s requested AAO are known. The effects are that utilities will be required to calculate and set aside on their financial records the effect of the new corporate tax rates on their regulated revenue stream. The amounts will then be evaluated in a comprehensive fashion during a rate case, KUSF determination, or company specific financial investigation, where full due process and an analysis of offsetting revenues and expenses will occur. The AAO prevents these potential ratepayer benefits from being lost until a Commission determination is made on how these benefits should flow back through to ratepayers.

10. Just to reiterate, the funds Staff is targeting with its AAO are funds that are being collected from ratepayers to pay an expense that no longer exists. Accordingly, it is only just and reasonable to require these funds to be isolated and accounted for as a regulatory liability until the Commission has an opportunity to examine the effects of this new corporate tax rate on the financial position of the utilities operating in the state. The Commission should not delay the issuance of an Order in this docket.

(2) SINGLE-ISSUE RATEMAKING IS NOT PROHIBITED IN KANSAS; NOR IS AN AAO EVEN CONSIDERED SINGLE-ISSUE RATEMAKING BECAUSE AN AAO SETS ACCOUNTING REQUIREMENTS - NOT RATES.

11. The RLECs argue that Staff's requested AAO would modify rates and/or KUSF support based solely on claimed tax savings which would constitute single-issue ratemaking, contrary to longstanding Commission policy and practices.⁸

12. First, single-issue ratemaking is not prohibited in Kansas. Staff does agree that it should be avoided when possible, but single-issue ratemaking is routinely utilized by the Commission and is in fact statutorily authorized for certain items. For example, the ad valorem tax adjustment or the Gas System Reliability Surcharge (GSRS).⁹ Other examples are fuel clauses, energy efficiency riders and environmental recovery riders. In general, single-issue ratemaking is utilized for items that are extraordinary or have a material financial impact to the utility and are outside the scope of the utility's control. A sudden and dramatic change in federal income tax rates meets these parameters.

13. Second, an AAO does not set rates. Therefore, no "ratemaking" is occurring. An AAO simply requires a company to perform its regulatory accounting in a specific way so that the financial effects of a discrete issue can be examined in a future period.¹⁰ Rate changes/KUSF adjustments are contemplated to be performed later, in individual rate cases or company specific financial investigations, with full analysis of all expenses and revenues that may offset the tracked and deferred tax reductions. An AAO is an "accounting" order, not a "ratemaking" order. The issue is a red-herring.

⁸RLEC Response at 3.

⁹See K.S.A. 66-117(f); K.S.A. 66-2203.

¹⁰See *Bus. & Prof'l People for the Pub. Interest v. I.C.C.*, 205 Ill. App. 3d 891, 896 (1990) (stating: "The ICC order of June 1, 1989, was an order to affect accounting procedures, not a ratemaking decision. As such, that order does not foreclose any discussion or presentation of evidence that would normally occur when ICC conducts the ratemaking hearing for Braidwood Unit 2. Nor does the order constitute a backdoor approach to single-issue or retroactive ratemaking."); *Bus. & Prof'l People for Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 246 (1991) (stating: "This decision highlights the fact that there is a fundamental difference between a decision to record deferred charges and a decision to recover deferred charges.").

(3) REFUNDING OVER-COLLECTED TAX LIABILITIES FROM KUSF PAYERS IS APPROPRIATE FOR THE RLECs, REGARDLESS OF WHAT WAS DECIDED IN 1986.

14. The RLECs' final argument is that Staff's Motion contains no explanation of why its proposal for reductions in KUSF support to RLECs due to prospective tax savings is necessary or appropriate now in 2018 when it was not considered necessary or appropriate in 1986.¹¹

15. First, the KUSF was not statutorily created until 1996. Therefore, any consideration of KUSF support could not have occurred back then. That does not prohibit the Commission from considering it now, when it is statutorily authorized to periodically review costs of providing telecommunications service to determine if modifications to the KUSF are necessary.¹²

16. Second, consideration of the tax savings is appropriate now because KUSF support amounts based upon previously applicable tax expenses should be evaluated to ensure that they are still necessary given the company's current cost of service, revenues, expenses, etc.¹³ It is simply unjust to require Kansans to pay for tax liabilities that no longer exist, whether it is through rates or subsidies.

CONCLUDING REMARKS

17. Staff is mindful of the fact that a minority of utilities may experience losses in the interim sufficient to justify retention of the tax savings. This is why Staff is recommending an AAO to track the information and analyze it in a complete rate case, company-specific financial investigation or KUSF determination in the future, where all expenses and revenues can be

¹¹See RLEC Response at 4.

¹²See K.S.A. 66-2008(d).

¹³See K.S.A. 66-2008(e)(1).

analyzed together. Staff's AAO approach avoids any single-issue ratemaking problems and ensures that customers will receive the benefits to which they are entitled.

18. The Commission should deny the RLECs' request for hearing, and instead issue an order as soon as is practicable so that the potential tax benefits may be captured for ratepayers.

WHEREFORE, for the reasons set forth above, Staff respectfully requests that the Commission issue an Order granting Staff's Motion filed December 14, 2017.

Respectfully Submitted,



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VERIFICATION

Michael Neeley, being duly sworn upon his oath deposes and states that he is Litigation Counsel for the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Staff's Response to Rural Telephone Companies' Response* and that the statements contained therein are true and correct to the best of his knowledge, information and belief.



Michael Neeley # 25027
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Subscribed and sworn to before me this 8th day of January, 2018.



Notary Public

My Appointment Expires: August 17, 2019

CERTIFICATE OF SERVICE

18-GIMX-248-GIV

I, the undersigned, certify that a true and correct copy of the above and foregoing Staff's Response to Rural Telephone Companies' Response was served by electronic service except to Barton Water District and theirs was placed in the United States mail, postage prepaid, on this 8th day of January, 2018, to the following:

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