KANSAS MUNICIPAL UTILITIES

Written Testimony Submitted to the

House Energy & Utilities Committee
February 13, 2012

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Municipal Rates & Defined Service Territory

Chairman Holmes and Members of the Committee:

On its face, House Bill 2661 appears to be a simple, straightforward and easily applied piece of legislation. In actuality, nothing could be further from the truth. The two short sentences that comprise HB 2661 would instead undo decades of established practice and law regarding utility ratemaking and defined service territory, thwart local economic development efforts, and throw into disarray many well-crafted and finely-honed agreements for public-private and city-county partnerships.

Drafted to accommodate a single rural customer of a single, small municipal utility in western Kansas, the unintended consequences of HB 2661 are staggering. The bill would impact everything from school buildings in Coffeyville and industrial economic development efforts in McPherson to the city lake in Winfield serving nearby rural water districts and the TransCanada pipeline pumping station in Clay Center. This one small bill could be the most damaging piece of legislation potentially inflicted on municipal utilities in decades.

In an ideal world, no customer should pay for a service that he or she does not utilize. Moreover, customers should only pay for their portion of the service they receive in direct relation to how large that portion is. Rural customers should not pay for city services not received. City customers should not pay for county services not received. Similarly, no customer should take advantage of one these services, paid for by his neighbor, without also contributing. Thankfully, we don't live in this "ideal" world.

I would assert that the vast majority of rural customers are very content with the water, gas and electric service they receive from their local municipal utility. In many cases, municipal water, natural gas and electric services offered are often far more attractive than the other options available in these rural areas.

It might be instructive to look closely at the value that a typical municipal utility brings to a rural customer. Due to lower customer density and a larger geographical area requiring substantially longer electric lines, natural gas mains and water pipes, the cost to serve rural areas is often significantly higher than urban customers. As an example, typical residential developments can often be served with a single transformer that might serve four separate residential services. Meanwhile, a single rural customer in a more isolated area could potentially require their own transformer and miles of electric distribution line.

Even with this difference in cost-of-service, municipal utilities do not typically charge a significant rate differential between the two customer classes. If there is a slightly higher rate for the rural customer, it is normally below the true cost of providing service according to a formal cost-of-service study. I believe it to be the case that rural customers are far more often undercharged for the true cost of utility services than they are over-charged for franchise fees or payments in lieu of taxes (PILOT) that may fund various city services they do not receive.

In addition, rural customers often benefit from their proximity to city services. Even if they are not directly paying for the services the city provides, they still benefit from the various opportunities that the city provides. In some cases, this can be as fundamental as equal access to city streets and roads, libraries, city parks, golf courses, swimming pools and other city-funded assets.

Defined Service Territories

Municipal utilities provide electricity to customers within their defined service territories, as authorized and determined by the Kansas Corporation Commission (KCC). In most cases, the service area for municipal systems includes the corporate city limits and a defined area surrounding the city. In a limited number of situations, the service territory for a municipal electric or natural gas utility may extend to some customers more than three miles outside of city boundaries.

These defined electric service territories were first established in the state of Kansas by the Retail Electric Suppliers Act of 1976. This hard-fought and delicately-balanced compromise took over four years of negotiation, but in the end provided, for the first time, a Kansas state map determining which electric utility served which customer. The purpose of the act and the establishment of defined service territories was to avoid wasteful duplication of facilities and minimize disputes between retail electric suppliers so as to avoid inconvenience, decreased efficiency, and higher costs.

In agreeing to the 1976 compromise, municipal utilities in the state gave up a great deal of territory. Prior to 1976, municipal electric systems could serve any loads within a 3-mile radius of their city limits. Meanwhile, investor-owned utilities and rural electric cooperatives (RECs) operated in sometimes overlapping service territories, guided in disputes by wire stringing rules issued by the Kansas Corporation Commission (KCC).

KMU, and presumably its utility colleagues, believes that any attempt at reopening established service territory law would be a costly, time-consuming and divisive effort and one that would cause considerable hardship for each utility group at no additional benefit to the electricity consumer.

Municipal Utility Ratemaking
Municipal utility rates or tariffs are established by the local governing body or public utility board or commission. With 119 municipal electric utilities, 65 municipal gas systems, and hundreds of public water systems, there are literally hundreds of different ways in which these rates are calculated.

Municipal utilities have the authority to make transfers or payments in lieu of taxes (PILOT) from an enterprise fund to other funds. Most municipal electric utilities – and many municipal gas systems and water utilities – do make some type of PILOT or franchise fee transfers to the city's general fund, and many have written policies for making those payments.

Many municipal utilities have these payments set up similar to a franchise fee that might be charged to an investor-owned utility in communities not served by a municipal utility. In these cases, the payment is based on a percentage of electric sales or revenues (i.e., 2-5%). Others communities have set a specific dollar value to be transferred on an annual basis through the community's budget process. These funds assist the community with providing necessary public services to the community while attempting to keep local property and sales taxes as low as possible. They are not typically earmarked for a specific service but instead simply the "cost of doing business" for items such as maintaining public rights of way as well as the return on investment to the city for taking on the risk of owning and operating a utility.

These payments have often been declining in some cities because the financial margins for these utilities have been declining over time. Utility fund transfers have allowed communities to offset declining revenues from other sources including state transfers to local units. The transfers have allowed communities to sustain critical local services and programs. This, combined with municipal utilities serving as the "anchor tenant" in many small cities, has been essential to the ongoing viability of these communities.

Unintended Consequences
It is difficult to exactly predict what the passage of HB 2661 would mean across Kansas, but I believe that the unintended consequences would be massive. The legislation could easily drive a wedge between city and rural customers and effectively destroy well-established public-private partnerships.

As mentioned previously, the "franchise fee" or "PILOT" paid by municipal utilities is not done on behalf of a specific service. Instead, it is a flat fee paid on behalf of all utility customers to the city as the utility owner. As such, we believe that HB 2661 could put at risk <u>any</u> transfer from the municipal utility to the city derived from serving rural customers. Cities with municipal electric utilities could stand to lose hundreds of thousands, even millions, of funding for crucial city services.

Just a few examples include:

- TransCanada and Clay Center Public Utilities negotiated an agreement by which TransCanada pays a franchise or subsidy fee to the City of Clay Center for the utility's investment in infrastructure to serve a Keystone Pipeline pumping station. Without this transfer, the City would not have taken the risk and additional cost to extend electric service to the TransCanada pumping station. Passage of HB 2661 could potentially mean the loss of over a half million dollars in revenue per year for the city.

- A small portion of the payment-in-lieu-of-taxes (PILOT) charged by the City of Coffeyville to all electric customers funds improvement to school buildings. This benefits all the city's electric customers, rural or otherwise.

- Last year, McPherson BPU, the City of McPherson and the McPherson Industrial Development Company (MIDC) celebrated 50 years of highly successful and forward-thinking industrial development efforts. The cooperation between the city, utility and its industrial base – most of which is located outside of McPherson city limits but well within the defined service territory of McPherson BPU – would be impossible upon passage of HB 2661.

- New, federally required stormwater utilities could be jeopardized. Many times, the only option available to the city is to charge every citizen the cost of this mandate whether or not they are tied to a public water or sewer supply, urban or rural customer notwithstanding.

- Taken to its extreme, the percentage of rates that support particular capital improvement projects could be debated depending on the project and its direct benefit or cost to a customer. Should the rural customer on the east side of town help pay for the new water tower that will support the rural customer on the west side of town?

Cost of Implementation

Implementing the two short sentences that make up House Bill 2661 would require thousands of man-hours and generate new and completely unnecessary costs that would increase the rates of utility consumers. Most utilities are not set up to separately track each rural customer's bill and then correlate those charges directly to each particular city service that he or she does or does not receive. The additional cost to administer HB 2661 would increase the cost-of-service for all customers, particularly the rural ones, and likely be reflected in increased rates that would exceed any cost savings on their part.

Conclusion

The unintended consequences and costs of HB 2661 are massive, potentially undoing many decades of public-private partnerships, city-county agreements, economic development programs, and other local efforts. KMU strongly opposes HB 2661.