

MINUTES OF THE HOUSE UTILITIES COMMITTEE

The meeting was called to order by Chairman Carl Holmes at 9:00 A.M. on March 14, 2006 in Room 231-N of the Capitol.

All members were present except:

Jim Ward- excused

Committee staff present:

Mary Galligan, Kansas Legislative Research
Dennis Hodgins, Kansas Legislative Research
Heather Klaasen, Research Intern
Renaë Hansen, Committee Secretary

Conferees appearing before the committee:

Steve Johnson, Kansas Gas Service
Kimberly Gencur, Aquila
Steve Jurek, Vice President, Regulatory Services, Aquila
Ron Gauches, Atmos Energy
Larry Berg, Midwest Energy
Dave Springe, CURB
Don Low, KCC

Others attending:

See attached list.

Hearing on:

SB 414 **Enacting the gas safety and reliability policy act.**

Proponents:

Steve Johnson, Kansas Gas Service, (Attachment 1), presented testimony in favor of **SB 414** because it furthers the ability of Kansas Gas Service and other natural gas utilities operating in the state to achieve the named purpose of the bill: that is to provide safe and reliable gas service.

Kimberly Gencur, Aquila, introduced Steve Jurek, Vice President, Regulatory Services, (Attachment 2), who offered comments in favor of **SB 414**.

Ron Gauches, Atmos Energy, (Attachment 3), presented testimony before the committee that outlined **SB 414** with simple language of the benefits that this bill would provide to consumers and producers.

Larry Berg, Midwest Energy, (Attachment 4), echoed the comments made by previous proponents adding that the benefits for Western Kansas from **SB 414** would be helpful as their load growth is much smaller than the companies that have customers on the Eastern part of the state and **SB 414** would help them with manage their financial health in a more timely manner.

Opponents:

Dave Springe, Citizens' Utility Ratepayer Board, CURB, (Attachment 5), offered testimony in opposition to **SB 414**, stating how the citizens would not benefit from the passage of this bill as it creates an annual surcharge on consumer bills to pay for normal utility expenditures.

Don Low, Kansas Corporation Commission, KCC, (Attachment 6), spoke in opposition to **SB 414** as it allows gas companies to increase rates by up to 40 cents a month each year to recover the costs of eligible projects, without a rate case.

Questions were asked and comments were made by Representatives: Rob Olson, Tom Sloan, Lynne Oharah, Oletha Faust-Goudeau, Carl Krehbiel, and Carl Holmes.

CONTINUATION SHEET

MINUTES OF THE House Utilities Committee at 9:00 A.M. on March 14, 2006 in Room 231-N of the Capitol.

The hearing on **SB 414** was closed.

The next meeting is scheduled for March 15, 2006.

Meeting Adjourned.



KANSAS GAS SERVICE

A DIVISION OF ONEOK

Before the House Utilities Committee

SB 414

Testimony of Steve Johnson,
Manager, Governmental Affairs

Kansas Gas Service

7421 W. 129th Street, Overland Park, Kansas

913-319-8604

March 14, 2006

Chairman Holmes and Members of the Committee,

I appreciate the opportunity to testify in support of Senate Bill 414, which is known as the Gas Safety and Reliability Act. Kansas Gas Service, which provides natural gas service to over 650,000 customers in the State of Kansas, supports this bill because it furthers the ability of Kansas Gas Service and other natural gas utilities operating in the state to achieve the named purpose of the bill: that is to provide safe and reliable gas service.

Pursuant to this bill, natural gas public utilities operating in the state of Kansas will be able to more effectively and efficiently comply with state and federal requirements for natural gas safety. The legislation will also enable natural gas public utilities to comply with the requests of federal, state and local jurisdictions that request the utilities to relocate their facilities which may be located in streets and highways to facilitate street and highway improvement projects which occur throughout the state.

Kansas Gas Service and the other natural gas utilities operating in the state spend significant sums on an annual basis to provide safe reliable service. We also spend significant sums to relocate our facilities in streets and highways to facilitate highway and street improvement projects. For the years, 2003, 2004 and 2005, Kansas Gas Service spent approximately \$24 million per year on these groups of expenditures. This would equate to an annual charge of less than \$5.00.

These expenditures are not revenue enhancing to Kansas Gas Service and the natural gas utilities. The expenditures do not relate to providing service to new load. The expenditures are made to fulfill mandates required by governmental units. We do not contest the need for these mandates. They are appropriate. These mandates enhance safety, and promote the public well being through enhanced infrastructure in our local communities. These expenditures however, as I said, do not generate additional revenue for the natural gas utilities operating in the state.

HOUSE UTILITIES

DATE: 3/14/06

ATTACHMENT 1

Under Senate Bill 414, natural gas public utilities will be able to make timely recovery of these expenditures. The bill will enable natural gas utilities to make filings before the Kansas Corporation Commission showing how much money has been expended and the amount to be recovered. This bill has been modeled upon legislation passed in the state of Missouri in 2003.

In addition to enhancing safety through more timely recovery of non-revenue enhancing safety expenditures, the legislation will assist in reducing regulatory expense and large rate increases. By allowing more timely recovery for safety related and infrastructure enhancement programs through the mechanism set forth in Senate Bill 414, there will be less frequent need for expensive contested rate case filings, the costs of which are passed on to customers. When such filings are made, the rate increases requested will also be less than they would otherwise be thereby reducing rate shock to customers at the time of their regular filings.

There are provisions to protect consumers against inappropriate expenditures. Utilities are limited in the number of filings they can make under this legislation. The filings will be subject to a review by the Kansas Corporation Commission. The legislation requires the utility to make a major rate case filing every five years. To the extent that the Commission determines in the major filing that any expenditures were inappropriate, they will be subject to disallowance and refund. The utilities are limited by the amount of revenues that they could request under this filing procedure to no more than 10% of their base revenues as determined in their last rate case. To the extent that there is any over collection of the surcharge, such over collection will be credited back to consumers on an annual basis.

You may question why we need this legislation when you could simply file for a rate increase. It is our opinion that the traditional regulatory model does not efficiently fit the current financial environment for natural gas utilities in meeting their obligations to provide safe and reliable natural gas service. Kansas Gas Service and the other utilities operating in Kansas are continuously replacing aging infrastructure and relocating infrastructure to meet safety needs and infrastructure enhancements. These investments do not enhance revenues. The assets that they are replacing were initially installed at a significantly reduced cost compared to today and they were installed to meet a growing customer base. Today, we might replace a main line extension on a major thoroughfare that was initially installed more than 50 years ago. That line may have been installed at a cost of approximately \$1.00 per foot and today is replaced at a cost of approximately \$28.00 per foot. When the line was installed, it was there to meet the growing needs of a thriving community. Today, there is no additional load associated with that line, simply the same amount of consumption as was there before. We are past the days in the natural gas industry when an increasing customer load will offset the cost of infrastructure placements obviating the need for rate cases. We are past the time when a natural gas utility can make investments and make up for these investments through load growth or cost cutting. We are faced with a situation where we are in a constant need for additional capital to make necessary capital replacements.

To file for an annual increase to meet these increasing costs over which we have no control is inefficient and costly. Annual rate cases are time consuming and costly. This bill provides a more streamlined approach to provide for non-revenue generating investments. Customers will be protected under this bill against charges for imprudent investments. The customer will avoid the significant regulatory cost of annual rate filings which would be necessary to timely recover our investments to provide service to our customer.

The bill has been passed by the Senate Utilities Committee and the Senate as a whole after certain clarifying amendments and further limitations on recovery. The bill was amended to clarify that expenditures eligible for recovery were clearly limited to safety related investments and facility relocation expenditures. The amendments further limited recovery to an annual increase no greater than \$.40 per month in a year or \$2.00 per month over a five-year period for residential customers. At the end of the five-year period, the utility must file for a rate case and the surcharge will be reset to zero. Notwithstanding these clarifications and limitations, the consumer protection review provision still remains in place that these expenditures are subject to prudence review and subject to refund when the major rate case filing is made.

Thank you for the opportunity to address you today and I will be available for questions.



Aquila

Testimony in Support of Senate Bill 414

Remarks of Steve Jurek

Aquila, Inc.

Vice President, Regulatory Services

Good morning Mr. Chairman and Members of the House Utilities Committee.

Thank you for the opportunity to present testimony this morning. My name is Steve Jurek, Vice President of Regulatory Service for Aquila, Inc. I am based in Omaha, Nebraska.

Aquila's natural gas operations in Kansas serve approximately 105,000 customers in over 40 communities across the state, including Lawrence, parts of Wichita, Dodge City, Garden City, Liberal and Goodland.

Aquila stands in support of Senate Bill 414. It is fair to say that replacing and improving infrastructure is a challenge for many. State highways, city streets, sewer systems, water systems all serve as examples of infrastructure that must be replaced and improved over time. Typically, gas utility franchises allow gas lines to be installed in public right of way. When a city or the state undertakes an infrastructure improvement project, the gas utility may be required to move its gas lines in the public right of way. Senate Bill 414 allows gas utilities to recover the cost of these relocation projects in a more timely manner. Aquila's investment in relocation of gas mains has averaged approximately \$400,000 annually in the past three years.

HOUSE UTILITIES

DATE: 3/22/06

ATTACHMENT 2

Aging gas utility infrastructure is a challenge for gas utilities as well. Original installation of natural gas mains and service lines occurred many years ago, and due to age, corrosion, and other factors have led to deterioration over time. To ensure a safe, reliable gas distribution system, Aquila invests \$2 - \$3 million annually for gas main, service line and other facility replacements. Senate Bill 414 helps to address a challenge faced by gas utilities relating to recovering the cost of investing in safety related pipeline replacement projects in a more timely manner than occurs in the historical regulatory process.

As a utility invests capital in pipeline relocation and replacement projects, there is a lag in cost recovery from the time the investment is made until such investment is included in the utility's rate base, typically through a rate case filing. This lag is often referred to as regulatory lag. Generally, these types of investments are not controversial issues, but are a regular part of maintaining integrity throughout the gas systems. This bill allows recovery of utility investment in these non-revenue generating projects through a gas system replacement surcharge, while maintaining the necessary and appropriate checks and balances in the regulatory system to ensure utility investments are prudent.

Aquila also recognizes another potential benefit from passage of this bill. During 2005, nearly 100 rural customers in Southwest Kansas were disconnected from natural gas service due to potentially unsafe levels of hydrogen sulfide in the gas supply. Most of the customers were converted to propane. Under this bill, Aquila may be able to extend service to customers to allow continued provision of safe, reliable natural gas service.

Aquila believes that implementation of a Gas System Replacement Surcharge as envisioned in this bill will result in a more efficient and effective regulatory process. We remain committed to discussing and resolving concerns that the Kansas Corporation Commission or other parties may have. I appreciate the opportunity to present remarks to you this morning and am happy to stand for questions at the appropriate time. Thank you.



GACHES, BRADEN, BARBEE & ASSOCIATES
PUBLIC AFFAIRS & ASSOCIATION MANAGEMENT

825 S. Kansas Avenue, Suite 500 ♦ Topeka, Kansas 66612 ♦ Phone: (785) 233-4512 ♦ Fax: (785) 233-2206

**House Utilities Committee
Regarding SB 414 – The Gas Safety and Reliability Act
Testimony of Atmos Energy
Presented by Ron Gaches
March 14, 2006**

Thank you Chairman Holmes for this opportunity to comment in support of Senate Bill 414, the Gas Safety and Reliability Act. I am Ron Gaches appearing on behalf of Atmos Energy.

Passage of SB 414 will encourage natural gas companies to increase the investment levels necessary to maximize the safety and reliability of their systems. In some cases these investments are mandated by federal or state agencies and in other instances there is some level of discretion associated with the scheduling and timing of those investments.

Under current Kansas law and regulatory practice, investments made to replace gas system infrastructure may not be recovered until the investment is in the ground, the investment is deemed “used and required to be used” prudent in a regulatory rate case before the Kansas Corporation Commission. The current system produces a significant regulatory lag time between when the dollars are spent for infrastructure replacement and when the company begins to recover these expenditures in the rates.

Because the current system allows recovery of such expenses only following approval in a rate case, there is often a multi-year delay in beginning the recovery of such expenditures. Rate cases are slow and expensive. The only alternative available under our current regulatory system is to file a rate case each year, an unnecessarily expensive proposition for the utility and ultimately our ratepayers.

SB 414 will allow a gas utility to apply a surcharge to customers’ bills and start to recover costs expended to replace infrastructure in a timely manner. This will reduce the costs associated with filing rate cases and reduce the

HOUSE UTILITIES

DATE:

3/14/06

ATTACHMENT

3

regulatory lag associated with recovery of such funds, thereby making available additional funds for investment in the integrity of our system.

- The industry proposal contains several safeguards:
- Capital dollars must be expended and the new pipe in the ground before any investment can be recovered.
- The surcharge is capped at 10 percent of their base revenues.
- The KCC would review all expenditures before they are allowed to be recovered in customer rates, and the Commission is not bound until costs are reviewed as part of a reconciliation or general rate proceeding.
- Surcharges are subject to adjustment after annual reconciliations conducted by the KCC.
- Eligible capital projects must be non-revenue producing and the costs must not be already be part of the utility's base rates.
- A utility can apply for a GSRS adjustment no more than twice per 12-month period.
- Full rate cases will be required at least every five years with the KCC and any overcharges would be subject to refund and true-up.

The environment in which utilities make investment decisions has changed over time, while the manner in which costs for infrastructure investments has not changed for many years. This proposal has been adopted in several states with great success. It will produce significant benefits in terms of assurance of safety and reliability of our systems and we encourage your support.

Atmos Energy is a regional natural gas company serving approximately 3.2 million customers in 12 states. Our Kansas service territory provides natural gas service to approximately 125,000 customers through 111 communities in 33 counties of Kansas. Our Kansas regional office is located in Olathe and our national headquarters is in Dallas, Texas.

Before the House Utilities Committee
SB 414
Testimony of Larry Berg, Vice President of Corporate Relations
Midwest Energy, Inc.
1330 Canterbury Road, Hays, Kansas
785-623-8148 (cell)
March 14, 2006

Chairman Holmes and Members of the Committee,

I appreciate the opportunity to testify in support of Senate Bill 414, the Gas Safety and Reliability Act. Midwest Energy is a customer-owned utility that provides natural gas service to nearly 43,000 customers in small towns and rural areas of Western Kansas. This legislation would help us to continue the provision of safe and reliable natural gas service.

In addition to those comments made by representatives from Aquila and Kansas Gas Service, Midwest Energy faces unique challenges. The demographic trends in Western Kansas are no secret. Midwest Energy does not enjoy the load growth present in more populated areas. Most of our towns are losing population. Therefore, in addition to the usual inflationary pressures, we have fewer customers using natural gas. In the last two years, we have lost three percent of our customer base.

Compounding that problem is the low customer density of our service area. Midwest Energy only serves about 14 customers per mile of gas line. Compare that to the number of homes or business that might be served by a single block of line in an urban setting.

The ability to pass through the cost of prudent safety and reliability investments in a timely manner is crucial to our on-going financial health and the customer base that remains. Although rate cases are necessary from time to time, we believe any measure that helps avoid the costs of preparing, filing and litigating rate cases is good for our customers. The estimated cost of filing a GSRS is \$15,000 to \$25,000, whereas a full rate case filed by a natural gas public utility is estimated to be between \$600,000 and \$1,500,000. The alternative to SB 414 is an increase in natural gas public utility rate cases and increased costs for consumers.

SB 414 includes a number of protections for the Kansas ratepayer, including:

- A natural gas public utility cannot file for more than one (1) GSRS surcharge per year.
- A surcharge allowed under SB 414 can be no more than 40 cents per residential customer per month.
- A GSRS surcharge cannot be applied for at the KCC until the investment is made, in the ground and operational.
- KCC staff must review all GSRS filings to insure that they are in conformity with the provisions in SB 414.
- Once a GSRS surcharge is approved, the utility is required to file for a permanent rate case within five (5) years as a “true up” mechanism.

A GSRS surcharge is revenue neutral in that it is not intended to recover costs incurred by a natural gas public utility in providing gas service to new customers.

Prior to introduction of SB 414, the natural gas utilities met with the KCC staff and CURB to discuss this proposal. Many of the proposed changes are incorporated in the bill before you. In addition, changes were made to the bill as suggested by Senate Utilities prior to its passage.

In closing, we believe SB 414 is a reasonable and responsible approach to cost recovery of safety and reliability investments that are mandated by local, state and federal governments.

I appreciate the opportunity to stand in support of SB 414 and will address questions at the appropriate time. Thank you!

Citizens' Utility Ratepayer Board

Board Members:

Gene Merry, Chair
A.W. Dirks, Vice-Chair
Carol I. Faucher, Member
Laura L. McClure, Member
Douglas R. Brown, Member



State of Kansas
Kathleen Sebelius, Governor

David Springe, Consumer Counsel
1500 S.W. Arrowhead Road
Topeka, Kansas 66604-4027
Phone:(785) 271-3200
Fax: (785) 271-3116
<http://curb.kcc.state.ks.us/>

HOUSE UTILITIES COMMITTEE S.B. 414

Testimony on Behalf of the Citizens' Utility Ratepayer Board
By David Springe, Consumer Counsel
March 14, 2006

Chairman Holmes and members of the committee:

Thank you for this opportunity to offer testimony on S.B. 414. The Citizens' Utility Ratepayer Board is opposed to this bill for the following reasons:

This bill is overly broad and one sided in favor of the utilities. The "safety and reliability" costs addressed in this bill are no different than those the utilities have dealt with throughout history. The result of this bill will not be increased safety or increased reliability. This bill is simply about allowing the gas utilities in Kansas to increase consumer rates between rate cases without the traditional oversight and due process consumers receive in the a rate case proceeding. The legislature should not create this annual surcharge on consumer bills to pay for normal utility expenditures.

The bill is extremely broad in application. Section 2(f) of the bill sets forth the three types of "natural gas utility plant projects", the cost of which are to be collected through the new surcharge. First, the cost of "mains, valves, service lines, regulator stations, vaults, and other pipeline system components installed to comply with state or federal safety requirements as replacements for existing facilities" is allowed in the surcharge. For a natural gas utility, the replacement of any existing facility would arguably be safety related and fall within this provision. Second, the cost of "main relining projects, service line insertion projects, joint encapsulation projects and other similar projects extending the useful life or enhancing the integrity of the pipeline system components undertaken to comply with state or federal safety requirements" is allowed in the surcharge. This language would cover the routine maintenance projects that are not the full replacement of facilities as allowed in the above section. Finally, the cost of moving facilities when required by construction or other public works (i.e., road widening) projects ordered by a government entity. This last category of costs are not safety or reliability costs, but are simply costs the utility currently pays between rate cases, but that the utility wants to shift to consumers.

So, to summarize, this bill allows a surcharge on consumer bills between rate cases to recover the costs for every facility the utility **replaces, repairs or moves**. About the only facilities the bill does not cover is for brand new pipes and mains extended to new developments. However, for new developments, often the developer is required to

HOUSE UTILITIES

DATE:

3/14/06

ATTACHMENT

5

pay for the extension and is later paid back when the project comes online, reducing the risk for the utility.

While the bill is overly generous in the types of costs that the utility can recover in the surcharge, the bill is overly restrictive in the type of review that is allowed at the commission. The bill allows the surcharge to be used for up to 60 months before the utility must come before the commission for a full cost review in a rate case. During that 60 month period, for the costs to be collected in the surcharge the bill only allows staff (and presumably CURB) to review whether the “underlying costs are in accordance with the provisions” of the act and to “confirm the proper calculation”. The bill specifically states that “no other revenue requirement or ratemaking issues may be examined” in consideration of the petition. (Section 4(b)(2)) In other words, during the 60 month surcharge period, staff and CURB can only check the utility’s math. Staff and CURB are specifically precluded from bringing forth evidence that may result in offsetting cost savings to the proposed rate increases.

The majority of the costs for a natural gas utility in Kansas are already passed directly to consumers or collected in a stable and predictable manner.¹ One of the few protections consumers have is that customer charges and volumetric rates will not change between rate cases, and will only change after thorough review and due process at the commission. The legislature should not be so quick to eliminate this protection for consumers. At a minimum the legislature should ask, what do consumers receive in return? Should utilities be allowed less profit through capped returns on equity? If so, write it into the bill. Should the utilities be required to provide weatherization in return for this surcharge? If so, tie the surcharge to the level of weatherization and write it into the bill. If you are going to place this surcharge on consumer bills, what will you tell consumers they received under this bill?

Customers receive no real benefit from this bill. The gas system in Kansas will be no less safe if the bill is doesn’t pass. The utilities will not go bankrupt. We will have rate cases, as we always have. This bill only benefits the utilities by providing annual rate increases without due process protections for consumers. CURB respectfully requests the Committee not pass this bill.

¹ More than 70% of a gas utility’s costs (natural gas and upstream transportation) are passed directly to customers through the PGA mechanism. Of the remaining 30% of the utility’s costs, close to half are collected through the monthly customer charge, which is a stable and predictable revenue stream. (Utilities routinely ask for the customer charge to be increased in a rate case, hoping to increase the percentage of stable and predictable revenue it receives.) The other half of the 30% is collected from consumer through volumetric charges, when customers are using gas. However, every natural gas utility has a weather normalization adjustment, which serves to eliminate the weather risk from the utility’s revenue stream. (Note: The WNA also benefits consumers) The Commission passes property tax changes through to consumers annually. And recently the Commission changed 30 years of policy and is now allowing natural gas utilities to recover the gas portion of uncollectible bills every year through the PGA mechanism.

Without withdrawing or waiving CURB's outright opposition to this bill, CURB is providing the Committee some suggested mark-up's to the bill to remove what CURB considers some of the most egregious language in the bill. While CURB does not recommend the Committee pass this bill, if the Committee does decide to move forward with a bill of this nature, CURB request that the Committee make the following changes, at minimum, to bring some level o balance and protection back into the bill.

1) To reduce the scope of projects to only those necessary to comply with state and federal safety requirements that were not in effect at the time of the utilities last rate case.

(at page 1 line 40-page 2 line6)

Sec 2. (f) "natural gas utility plant projects" may consist only of the following:

(1) Mains, valves, service lines, regulator stations, vaults, and other pipeline system components installed pursuant to Commission approval to comply with new or extraordinary state or federal safety requirements that were not in effect at the time of the utility's last rate hearing as replacements for existing facilities ~~that have worn out or are in deteriorated condition;~~

~~(2) Main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements; and~~

2) To eliminate the language precluding the Staff or CURB from bringing forth other evidence that may benefit consumers.

(at page 3 line15- line 23)

Sec. 4 (b)(2) The staff of the commission ~~may~~ **shall** examine information of the natural gas public utility to confirm that the underlying costs are in accordance with the provisions of sections 2 through 4, and amendments thereto, and to confirm proper calculation of the proposed charge. The staff ~~may~~ **shall** submit a report regarding its examination to the commission not later than 60 days after the petition is filed. ~~No other revenue requirement or ratemaking issues may be examined in consideration of the petition or associated proposed rate schedules filed pursuant to the provisions of sections 2 through 4, and amendments thereto.~~

3) To add additional language to give the commission some flexibility as to recovery calculation methodologies. This would allow the mechanism used in the last Aquila case.

New Section 5: Notwithstanding the above sections, the Commission shall retain the option of expensing directly on consumer bills, the cost of eligible infrastructure system replacement costs for natural gas utility projects, rather than calculating and imposing the GSRs in a manner that recovers the appropriate pretax revenues as defined in the bill.



KANSAS

CORPORATION COMMISSION

KATHLEEN SEBELIUS, GOVERNOR

BRIAN J. MOLINE, CHAIR

ROBERT E. KREHBIEL, COMMISSIONER

MICHAEL C. MOFFET, COMMISSIONER

BEFORE THE HOUSE UTILITIES COMMITTEE
PRESENTATION OF THE
KANSAS CORPORATION COMMISSION
March 14, 2006

SB 414

Thank you, Chairman and members of the Committee. I am Don Low, Director of the Utilities Division for the Kansas Corporation Commission. I appreciate the opportunity to testify about SB 414 on behalf of the Commission. The Commission opposes this legislation because it mandates a surcharge for all natural gas utilities rather than allowing for a determination of the reasonableness of the surcharge based on the individual circumstances of each natural gas utility.

Surcharges such as the proposed GSRS represent what is known as "single issue ratemaking." Single issue ratemaking occurs when customer rates are changed based on only a single aspect of the numerous factors that normally go into determining the revenue requirements for a traditionally regulated company. Single issue ratemaking is a departure from the normal practice of determining appropriate rates by looking at all the expenses, investment, cost of capital and revenues of a utility in a test period. The concern that must be addressed in evaluating single issue rates is that changing rates based on only one factor necessarily ignores potential offsetting changes in other factors. For example, increases in some costs may be offset by decreases in other costs or by increased revenues. If there are such offsetting changes, the rates resulting from the examination of only one factor might not accurately reflect the real financial needs of the company. Conceivably, the increase in rates may not be justified at all. That, of course, means that ratepayers are paying too much for service.

For example, under this bill, as amended in the Senate, gas companies will be allowed to increase rates by up to 40 cents a month each year to recover the costs of the eligible projects.

HOUSE UTILITIES

DATE:

3/14/06

ATTACHMENT

6

For a company with 500,000 customers, this would be \$2.4 million a year. By the end of five years, this would be an increase of \$12 million per year or \$36 million on a cumulative basis over the five years. At the end of five years the bill does require a general rate case to be filed. If it is determined at that time that the rates are too high, the overall rates can be adjusted prospectively. However, the Commission cannot order a refund of any of that \$36 million because of the legal prohibition against "retroactive" ratemaking.

Because of the potential for excessive rates, the KCC believes that proposals for surcharges should be reviewed by the Commission on a case by case basis to determine whether there is enough justification to override the general concern about single issue ratemaking, whether there is a likelihood that the company will over-earn with a surcharge, whether there should be conditions or limitations associated with the surcharges and, most importantly, whether there are alternatives which are beneficial to both the company and ratepayers. A statutory mandate to allow a specific kind of surcharge under specific circumstances removes that desirable Commission discretion. (I should note here that some might argue that specific statutory allowance of this surcharge prevents the Commission from using its discretion to allow other surcharges.)

Let me also make a couple of observations about one of the primary justifications that has been put forth for this bill - that it is costly for companies (and customers) to file frequent rate cases to recover the costs that are the subject of the bill. First, the bill would require a company that imposes a surcharge to file a rate case at least every five years. It's not evident that this is really a reduction in the frequency of rate cases. In the last ten years, of the natural gas utilities, only Aquila has filed more than one rate case, in 1999 and 2004. KGS did file a case in 2003 and is expected to file shortly but that still means only two cases in ten years.

If the goal is to avoid rate cases, the ultimate answer is to impose surcharges for all kinds of significant costs. Thus, companies could regularly increase rates to reflect increases in employee salaries, employee health insurance, or other cost categories that appear to be steadily increasing. That is clearly not a reasonable response. Obviously, the more that surcharges are

mandated, the greater the potential that excessive rates will be paid by customers. Again, the Commission can mitigate that potential problem only by evaluating proposed surcharges as each company may propose them,

Furthermore, I must note that some would suggest that immediate recovery of increased costs, even if it doesn't result in over-earnings by the company, isn't necessarily desirable. On the contrary, some regulatory "lag" in the time before companies recover increased costs is one way in which utility monopolies are encouraged to hold down costs and operate efficiently.

This concludes my testimony. Thank you for your consideration. I will be happy to answer any questions.