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Neutral Testimony  
On Senate Bill 279

Submitted by Leo Haynos, Chief Engineer, Utilities Division  
On Behalf of  
The Staff of the Kansas Corporation Commission

Chair Olson, Vice Chair Petersen, Ranking Member Hawk, and members of the committee, thank you for the opportunity to provide testimony to your committee today on behalf of the staff of the Kansas Corporation Commission (Commission).

The Commission Staff is taking a neutral position on SB 279. But I would like to use this opportunity to explain and highlight some of the provisions of the bill from our perspective.

Since 2008, Kansas natural gas public utilities have used the Gas Safety Reliability Surcharge (GSRs) for recovery of capital investment costs associated with infrastructure replacement projects. To be eligible for the GSRs, the replacement project had to be associated with a requirement of Kansas pipeline safety regulations or a relocation for a public works project. Under the GSRs in its present form, not all pipe replacement programs would be eligible for GSRs rate treatment because they would not be necessarily required by pipeline safety regulations.

Traditional ratemaking practice in Kansas requires utility operators to file a rate case with the Commission in order to recover operating costs and have an opportunity to earn a return on utility investment. The allowed return on equity provides incentive to the utility and its shareholders to take the risks necessary to operate a utility. During the period between rate cases, the utility carries the cost of these investments which can negatively affect its earnings. This time period in which the utility carries the cost of its investments is commonly known as “regulatory lag”. From the utility’s point of view, regulatory lag serves as a disincentive to make investments that will reduce earnings. On the other hand, the ratepayer views regulatory lag as an incentive for the utility to maximize the efficiency of its investments between rate cases.

An alternative ratemaking mechanism such as a surcharge is one means of balancing the opposing points of view by allowing the recovery of certain types of investments between rate cases. The GSRs in its present form only allows the utility to recover its costs for investments that are required because of regulation or eminent domain relocations – both of which are somewhat outside the control of the utility. Investments ineligible for GSRs recovery can be

considered to be the conventional investments made by a utility in the normal course of business. The utility is compensated for such costs through the return on equity set in the next rate case. As a protection for ratepayers from an unlimited surcharge between rate cases, the present GSRS sets the maximum annual increase in a surcharge as \$0.40 per customer per month for no more than 60 months. GSRS also limits the overall GSRS surcharge to no more than 10% of the utility's base revenue level set in the most recent rate case. Staff also notes that a recent Commission Order in Docket No. 15-GIMG-343-GIG (15-343 Docket) allows an additional \$0.40 per customer per month surcharge that can include any pipe replacement that qualifies for GSRS, but is in excess of the \$0.40 GSRS cap. The 15-343 Docket surcharge also expands the definition of pipe replacements eligible for recovery to include obsolete pipe. In addition, the 15-344 Docket surcharge has a number of conditions that provide oversight through a ten-year plan detailing the goals, objectives, yearly replacement levels and capital expenditures and an annual update report. The conditions also include disincentives to file rate cases in order to attempt to contain rate increases.

SB 279 changes the GSRS paradigm by expanding the scope of the investments eligible for surcharge treatment to any capital investment and the corresponding monetary cap on the surcharge is effectively eliminated through the regulatory asset.

Under the proposed amendments to K.S.A. 66-2202(d) and (f)(1), all investments to "replace, upgrade or modernize existing facilities" will be eligible for recovery using a surcharge mechanism. Although SB 279 provides regulatory compliance as an example of a reason for replacement, the bill does not limit how a utility decides which facilities are in need of replacement.

In addition to the scope expansion for infrastructure replacement, subparagraphs (f)(4) and (f)(5) of 66-2202 add two new categories of investments that may be recovered from ratepayers through a surcharge. The first addition defined in 66-2202(f)(4) and further discussed in 66-2202(i) would allow the inclusion of any capital expenditure associated with protecting a utility's capital, physical, and cyber assets in Kansas. The second addition to GSRS found in 66-2202(f)(5) would allow the recovery of any type of investment (not necessarily limited to capital or infrastructure investments) that are made in accordance with a utility's self-defined safety and risk management programs.

The proposed amendment to 66-2202 (d)(1) limits ineligible replacement investments to a specific type of infrastructure investment that increases revenues from new customers directly connected by the new infrastructure. Indirectly, the proposed amendment to 66-2202(f)(1) which defines natural gas utility plant projects as existing facilities that are replaced, upgraded, or modernized would exclude investment in new infrastructure from GSRS recovery.

SB 279 doubles the amount of revenue that can be recovered through the GSRS surcharge between rate cases, and it doubles the annual increase (in \$/month/customer) that can be charged to customers. Presumably, such an increase would be necessary in order to compensate for the proposed scope expansion.

In addition to the changes discussed above, SB 279 adds an entirely new ratemaking element to

the currently effective GSRS mechanism. The proposed bill allows all investment that would produce a surcharge over the \$.80 rate cap to be afforded “regulatory asset treatment.” This would allow all depreciation expense and compounding interest charges (inclusive of income taxes) associated with the investment to be recorded in a special account and carried forward to the next base rate case or GSRS surcharge filing. These charges would typically be managed by the company until the next rate case. This proposed addition to the current GSRS framework would effectively shift all of this regulatory lag from shareholders who shoulder this burden today, to Kansas utility consumers. Given the fact that there are no limits to the magnitude of this regulatory asset account, coupled with the expansion of the scope of eligible projects discussed above, this provision of SB 279 has the possibility of significantly increasing utility rates for natural gas service in Kansas over the years to come.

Thank you for the opportunity to offer our perspective on the proposed bill and the opportunity to appear before your committee.