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Before the House Energy, Utilities, and Telecommunications Committee
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Neutral Testimony
On Senate Bill 279

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On Behalf of
The Staff of the Kansas Corporation Commission

Chair Seiwert, Vice Chair Garber, Ranking Minority Member Kuether, 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 residential 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 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 obsolete *pipe replacement* that qualify for GSRs, but is in excess of the \$0.40 GSRs cap. Kansas natural gas public utilities estimate replacing obsolete piping in Kansas will require from 17 to 35 years to complete. In addition to the surcharge allowance for obsolete pipe replacement, the 15-343 Docket 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. In many ways, SB 279 is aligned with the Commission's position in the 15-343 Docket but without the conditions found in the Docket, such as completing the work within a 10 year window, agreeing to disincentives to file frequent rate cases, and limiting eligibility to obsolete pipe replacements.

Instead of the current GSRs restriction that limits project eligibility to those projects required by pipeline safety regulations, SB 279 allows any pipeline system components deemed by the utility to be obsolete as eligible for GSRs rate treatment. For example, this expansion in GSRs eligibility could include replacement of metering, remote site automation equipment, or vaults – all of which are not related to pipeline safety regulation – if the utility could demonstrate such items were obsolete. Staff would consider all of these examples to be “facilities” of the utility that are eligible for recovery in a conventional rate case scenario. SB 279 would allow recovery of such costs through a GSRs surcharge.

In addition to the scope expansion for facility 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 defined 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 capital investment that is made in accordance with a utility's self-defined safety and risk management programs.

Given the amount of obsolete gas piping that may need to be replaced, Staff would prefer that these two new categories not be included in the proposed bill. Staff's preference is based on a desire to ensure that the entire amount of the \$0.80 GSRs cap is spent on replacing obsolete piping. More specifically, (1) capital expenditures for cyber security can be significant and our interpretation of the bill is that it would allow any capital costs for cyber security to be flowed through the GSRs, and (2) the utility's self-defined safety and risk management program costs are not well defined and have the potential to be significant because the cost category could be overly broad.

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 obsolete 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, and due to the effects of inflation on the monthly cap figures in the original GSRS statute.

In summary, SB 279 changes the GSRS paradigm by expanding the scope of the investments eligible for surcharge treatment. The bill also doubles the amount of revenue that a utility can recover through a GSRS surcharge between rate cases. As described in the 15-343 Docket, Kansas natural gas public utilities expect the replacement of obsolete gas piping to require 17 to 35 years to complete. Under the expanded scope of SB 279, the GSRS investment opportunity will increase beyond pipe replacement required by pipeline safety regulations to include investments in cyber security, safety plans and other obsolete facilities.

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