

Citizens' Utility Ratepayer Board

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SENATE UTILITIES COMMITTEE S.B. 414

Testimony on Behalf of the Citizens' Utility Ratepayer Board
By David Springe, Consumer Counsel
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Chairman Emler 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:

First, CURB does not support codifying in statute the type of mechanism in statute. While CURB would likely oppose before the Commission the implementation of an unnecessarily broad and one sided mechanism, as is proposed in this bill, codifying this type of mechanism in statute removes the Commission's flexibility to design a fair and balanced approach to capital recovery. Further, CURB believes that this type of mechanism is unnecessary. The utilities throughout history have had to deal with unexpected extraordinary capital expenditures. The Commission has historically granted accounting orders for extraordinary capital expenditures that are outside of the utility's normal operating parameters, or are outside of a utility test year. There is simply no reason to create this type annual surcharge. In fact, through the flexibility of the regulatory process, we did in fact place a small surcharge on Aquila bills in Aquila's last gas rate case to pay for a specific right of way project (21st street in Wichita). CURB would note that this was limited, specific, and the product of an agreement of all parties, meaning that customers also received other benefits within the agreement. It was a balance approach to a specific issue that benefited all parties, unlike the current bill.

Second, providing this type of one sided cost recovery mechanism favors the utility by shifting further risk onto ratepayers. Natural gas utilities already pass 100% of the gas costs directly to consumers each month. Of the total annual revenues that the utility needs to collect to pay its operating costs and profits for shareholders, the monthly customer charge provides accounts for over 40%. The monthly customer charge revenues are safe and risk free and non-volatile sources of capital recovery for the utility. Strategically every utility attempts to increase the customer charge to higher levels in each ratecase to "front load" costs into higher customer charges to reduce financial risk exposure. The remaining 50%-60% of annual revenues due a natural gas utility are collected through volumetric charges collected when customer uses the natural gas. However, through agreements with each gas utility, we have created a Weather Normalization Adjustment, that guarantees that the utility will collect its annual revenue requirement, regardless of whether it is colder or warmer than normal. This is a

mechanism that removes financial risk of changing weather from the utility. (CURB would note that the WNA mechanisms are a balanced risk reduction, benefiting consumers when weather is colder than normal) 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. It is clear that in the broadest sense, natural gas utility rates, and policies implemented by the Commission, have served to minimize the financial risk that Kansas natural gas utilities face.

It is within this broad context that this bill must be understood. What this bill proposes to do is take one of the few remaining financial risks to the utility, that is timing difference between when the utility expends capital and when it can begin recovering capital in a rate case (regulatory lag), and create a mechanism to move that risk directly onto consumer bills. This bill will allow the utilities to increase rates twice a year as they spend money, without having the Commission or CURB examine the utility's other costs. From an accounting standpoint, the depreciation expense that is already in consumer rates should be adequate to fund the capital expenditures necessary to replace worn out or unsafe facilities. Using the depreciation expense to fund new capital expenditure replaces depreciated utility ratebase with new utility ratebase. (For example, assume a utility has a rate case every year, and has \$10 million in depreciation expense and \$10 million in new capital expenditures. Consumers should be held harmless, since rates would go down as rate base decreased by \$10 million through depreciation, but that ratebase is replaced by the new \$10 million capital expenditure, causing the consumer rates to go back up to the level they started. Under this bill, consumer rates would go up to account for the \$10 million spent by the utility, but rates would not be allowed to reflect the reduction for the \$10 million of depreciated rate base. Consumers pay higher rates, but don't get the benefit of any offsetting reductions.)

Third, while the utilities suggest that this bill, and the surcharge it creates will apply narrowly to a small subset of capital expenditures (safety and right of way), as drafted, the language in the bill will allow a natural gas utility to place almost all of its annual capital expenditures into this surcharge. For example, to be an "eligible infrastructure system replacement" and therefore eligible for the surcharge, the capital expenditure can be to "replace or extend the useful life of an existing infrastructure". (Section 2(d)(4) at page 1, line 35) With the exception of new lines placed in service to supply brand new developments, this language is broad enough to make every capital expenditure made by a utility on plant replacement or upgrade in every year an eligible infrastructure system replacement.

Also, the "natural gas utility plant projects", the cost of which will be placed in the surcharge are "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 that have worn out or are in deteriorating condition" (Section 2(f)(1) at page 1, line 41) Given that every utility has an ongoing obligation to operate a safe and reliable system, and must replace "worn out and deteriorating" facilities to maintain safety levels, again, every capital expenditure would fall within this

category and be eligible for inclusion in the surcharge. This bill is not narrow or specifically tailored.

Under the bill, utilities can avoid a rate review for up to 60 months, or longer, while increasing rates to consumers through the surcharge up to twice a year. (Section 3(b)-(c) and Section 4(c)) The bill only allows staff to review whether the “underlying costs are in accordance with the provisions” of the act and to “confirm the proper calculation”, and specifically states that “no other revenue requirement or ratemaking issues may be examined” in consideration of the petition. (Section 4(b)(2)) These provision are remarkably one sided and unfair to consumers. The bill goes on to state specifically what the Commission “shall only” consider in determining the “appropriate pretax revenue” to be generated by the surcharge. (Section 4(d)) Designating these categories as the only things that the Commission can consider specifically precludes CURB or the staff of the Commission from bringing forth evidence that may result in offsetting cost savings to the proposed rate increases. In fact, in calculating some of the costs, the bill specifically excludes any input from CURB. For example, if the utility’s last case was settled in a “black box” (a number is negotiated, but the specific adjustments are not specified) then to calculate the surcharge the bill requires the use of the average of the Staff and Company recommendations from the last case. (Section 4(d)(9)). Using only staff and the company completely ignores CURB’s recommendations in the last case, and will tend to bias upwards what consumers pay under the surcharge. Again, this provides protection and benefit to the utility, but provides nothing to the consumers that have to pay the costs.

This bill is clearly over-broad, ill-defined and one-sided in favor of the utilities. Nothing in this bill benefits, aids or provides protection and balance for consumers. The bill is clearly designed to create a regulatory system that simply reimburses the gas utilities for nearly everything they expend in an immediate and risk free fashion. As such CURB recommends that the Committee protect consumers and not pass this bill.

Thank you.

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.

An Act concerning public utilities; relating to natural gas.

Be it enacted by the Legislature of the State of Kansas:

New Sec. 1 **Citation of act.** This act may be cited as the Gas Safety and Reliability Policy Act.

New Sec. 2 **Definitions.** For the purposes of this act.

(a) “GSRS” means gas system reliability surcharge.

(b) “Appropriate pretax revenues”, means the revenues necessary to produce net operating income equal to:

(1) The natural gas public utility’s weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective GSRS; and

(2) Recover state, federal, and local income or excise taxes applicable to such income; and

(3) Recover depreciation expenses.

(c) “Commission” means the state corporation commission.

(d) “Eligible infrastructure system replacement” means natural gas public utility plant projects that:

(1) Do not increase revenues by directly connecting the infrastructure replacement to new customers;

(2) Are in service and used and required to be used;

(3) Were not included in the natural gas public utility’s rate base in its most recent general rate case; and

(4) ~~Replace or extend the useful life of an existing infrastructure;~~

(e) “Natural Gas Public Utility” shall have the same meaning respectively ascribed thereto by K.S.A. 66-1,200(a).

(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 as replacements for existing facilities that have worn out or are in deteriorated condition; that were not in effect at the time of the utility’s last rate hearing;

~~(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~~

(3) ~~(2)~~ Facilities, Facility relocations required due to construction or improvement of a highway, road, street, public way, or other public work by or on behalf of the United States, this state, a political subdivision of this state, or another entity having the power of eminent domain provided that the costs related to such projects have not been reimbursed to the natural gas public utility.

(g) “GSRS revenues”, means revenues produced through a GSRS exclusive of revenues from all other rates and charges.

New Section 3. Rate schedules, procedures to establish or change.

(a) Notwithstanding any provisions of K.S.A. 66-117, and this chapter to the contrary, beginning July 1, 2006, a natural gas public utility ~~providing gas service~~ may file a petition ~~and proposed rate schedules~~ with the commission to establish ~~or change a~~ GSRS rate schedules that will allow for the adjustment of the natural gas public utility’s rates and charges to provide for the recovery of costs for eligible infrastructure system replacements. ~~The commission may not approve a GSRS to the extent it would produce total annualized GSRS revenues below the lesser of one million dollars or one half of one percent of the natural gas public utility’s base revenue level approved by the commission in the natural gas public utility’s most recent general rate proceeding. The commission may not approve a GSRS to the extent it would produce total annualized GSRS revenues exceeding ten percent of the natural gas public utility’s base revenue level approved by the commission in the natural gas public utility’s most recent general rate proceeding. A GSRS and any future changes thereto shall be calculated and implemented in accordance with the provisions of New Sections 2 through 4. GSRS revenues shall be subject to a refund based upon a finding and order of the commission to the extent provided in subsections (e) and (h) of New Section 4.~~

(b) The commission shall not approve a GSRS for any natural gas public utility that has not had a general rate proceeding decided or dismissed by issuance of a commission order within the past 60 months, unless the natural gas public utility has filed for or is the subject of a new general rate proceeding.

(c) In no event shall a natural gas public utility collect a GSRS for a period exceeding sixty months unless the natural gas public utility has filed for or is the subject of a new general rate proceeding; provided that the GSRS may be collected until the effective date of new rate schedules established as a result of the new general rate proceeding, or until the subject general rate proceeding is otherwise decided or dismissed by issuance of a commission order without new rates being established.

New Section 4 Documentation to be submitted—notice to be published—examination of proposal—authorization by commission, when—pretax revenues, factors to be considered—revised rate schedule, filed when—rulemaking authority.

(a) At the time that a natural gas public utility files a petition with the commission seeking to establish or change a GSRS, it shall submit proposed GSRS rate schedules and its supporting documentation regarding the calculation of the proposed GSRS with the petition, and shall serve a copy of said petition upon the Commission Staff and the Citizens Utility Ratepayer Board. ~~with a copy of its petition, its proposed rate schedules, and its supporting documentation.~~

(b) (1) When a petition, ~~along with any associated proposed rate schedules~~, is filed pursuant to the provisions of New Sections 2 through 4, the commission shall conduct an examination of the proposed GSRS.

(2) The staff of the commission ~~may examine information of the Natural gas public utility to confirm that the underlying costs are in accordance with the provisions of New Sections 2 through 4 and to confirm proper calculation of the proposed~~

~~charge, and may~~ shall submit a report regarding its examination to the commission not later than sixty 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 New sections 2 through 4.~~

3) ~~(2)~~ The commission may hold a hearing on the petition and any associated rate schedules and shall issue an order to become effective not later than one hundred twenty days after the petition is filed.

~~(4)~~ ~~(3)~~ If the Commission finds that a petition complies with the requirements of New Sections 2 through 4, the commission shall enter an order authorizing the natural gas public utility to impose a GSRS that is sufficient to recover appropriate pretax revenue, as determined by the commission pursuant to the provisions of New sections 2 through 4.

(c) A natural gas utility may effectuate a change in its rate pursuant to the provisions of this section no more often than ~~two times~~ once every twelve months.

(d) In determining the appropriate pretax revenue, the commission shall consider ~~only~~ the following factors:

(1) The net original cost of eligible infrastructure system replacements. The net original cost shall be defined as the original cost of eligible infrastructure system replacements less associated retirements of existing infrastructure;

(2) The accumulated deferred income taxes associated with the eligible infrastructure system replacements;

(3) The accumulated depreciation associated with the eligible infrastructure system replacements;

(4) The current state, federal, and local income tax or excise rates;

(5) The natural gas public utility's actual regulatory capital structure as determined during the most recent general rate proceeding of the natural gas public utility;

(6) The actual cost rates for the natural gas public utility's debt and preferred stock as determined during the most recent general rate proceeding of the natural gas public utility.

(7) The natural gas public utility's cost of common equity as determined during the most recent general rate proceeding of the natural gas public utility.

(8) The current depreciation rates applicable to the eligible infrastructure system replacements; and

(9) In the event information pursuant to subdivisions (5), (6), and (7) of this subsection is unavailable and the commission is not provided with such information on an agreed-upon basis, the Commission shall utilize the ~~average of the recommendations contained in the testimony submitted by the natural gas public utility, and~~ Commission staff during the most recent general rate proceeding of the natural gas public utility to determine the capital structure, recommended cost rates for debt and preferred stock, and recommended cost of common equity to determine the average weighted cost of capital.

(e) (1) The monthly GSRS charge shall be allocated among the natural gas public utility's classes of customers in the same manner as costs for the same type of facilities was allocated among classes of customers in the natural gas public utility's most recent general rate proceeding. If that allocation is not available or determinable, the

Commission shall utilize ~~the average of the recommendations contained in the testimony submitted by the natural gas public utility and the commission staff during the most recent general rate proceeding of the natural gas public utility~~ regarding class allocation of costs.

(2) At the end of each twelve-month calendar period the GSRS is in effect, the natural gas public utility shall reconcile the differences between the revenues resulting from a GSRS and the appropriate pretax revenues as found by the commission for that period and shall submit the reconciliation and a proposed GSRS adjustment to the commission for approval to recover or refund the difference, as appropriate, through adjustments of the GSRS charge.

(f) (1) A natural gas public utility that has implemented an GSRS pursuant to the provisions of New Sections 2 through 4 shall file revised rate schedules to reset the GSRS to zero when new base rates and charges become effective for the natural gas public utility following a commission order establishing customer rates in a general rate proceeding that incorporates in the utility's base rates, subject to subsections (h) and (i) of this section, eligible costs previously reflected in the currently effective GSRS.

(2) Upon the inclusion in a natural gas public utility's base rates subject to subsections (h) and (i) of this section of eligible costs previously reflected in a GSRS, the natural gas public utility shall immediately thereafter reconcile any previously unreconciled GSRS revenues as necessary to ensure that revenues resulting from the GSRS match as closely as possible the appropriate pretax revenues as found by the commission for that period.

~~(g) A natural gas public utility's filing of a petition or change to an GSRS pursuant to the provisions of New Sections 2 through 4 shall not be deemed to be a rate increase for purposes of K.S.A. 66-117.~~

~~(h)~~ (g) Commission approval of a petition, and any associated rate schedules, to establish or change a GSRS pursuant to the provisions of New Sections 2 through 4 shall in no way be binding upon the commission in determining the ratemaking treatment to be applied to eligible infrastructure system replacements during a subsequent general rate proceeding when the commission may undertake to review the reasonableness and prudence of such costs. In the event the commission disallows, during a subsequent general rate proceeding, recovery of costs associated with eligible infrastructure system replacements previously included in a GSRS, the natural gas public utility shall offset its GSRS in the future as necessary to recognize and account for any such over collections.

~~(i)~~ (h) Nothing in this section shall be construed as limiting the authority of the commission to review and consider infrastructure system replacement costs along with other costs during any general rate proceeding of any natural gas public utility.

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.

New Section 6 ~~5~~. **Effective Date.** This act shall take effect and be in force from and after its publication in the statute book.

