20180629150106
Filed Date: 06/29/2018
State Corporation Commission
of Kansas

In the Matter of the Application of Kansas Gas Service, a Division of ONE Gas, Inc. for Adjustment of its Natural Gas Rates in the State of Kansas.	))))	Docket No. 18-KGSG-560 - RTS

DIRECT TESTIMONY

OF

JANET L. BUCHANAN

ON BEHALF OF KANSAS GAS SERVICE

A DIVISION OF ONE GAS, INC.

DIRECT TESTIMONY

OF

JANET L. BUCHANAN

ON BEHALF OF KANSAS GAS SERVICE

A DIVISION OF ONE GAS, INC.

I. <u>Position and Qualifications</u>

Q. Please state your name and business address.

A. My name is Janet L. Buchanan, and my business address is 7421 W 129th St., Overland Park, KS 66313.

Q. By whom are you employed and in what capacity?

A. I am the Director of Rates and Regulatory Reporting for Kansas Gas Service ("KGS" or the "Company"), which is a division of ONE Gas, Inc., ("ONE Gas").

Q. Please describe your education and professional experience.

A. I earned a Bachelor of Arts degree and a Master of Arts degree in economics from the University of Kansas. From June 1993 through August 1998 and from May 1999 through August 2011, I worked for the Kansas Corporation Commission in various positions with varying levels of responsibility for examining rates for natural gas, electric and telecommunications utilities, researching current policy issues within the industries, and managing projects.[1] Positions held include: Utility Rates Analyst, Senior Research Economist, Managing Research Economist, Telecommunications Economist, Senior Telecommunications Analyst, Senior Managing Research Analyst, Chief of Telecommunications and Chief of Energy

[1] I worked for the Kansas Department of Revenue as a Policy and Program Analyst providing the fiscal impact of proposed changes in the mineral severance tax and the motor fuel tax from September 1998 through April 1999.

Efficiency and Telecommunications. In September 2011, I joined Texas Gas Service Company, a Division of ONE Gas, Inc., as a Manager of Rates and Regulatory Analysis. I was promoted to my current position in October 2017.

Q. Was this testimony prepared by you or under your direct supervision?

A. Yes, it was.

Q. Have you previously testified before this Commission?

A. Yes, I have testified before the Commission on numerous occasions.

II. <u>Executive Summary</u>

Q. Please summarize the key issue(s) identified in the Company's request.

A. KGS is committed to providing safe and reliable natural gas service to our customers. To accomplish this goal, it is essential that the rate-making process provide KGS the ability to: (1) recover all reasonable costs incurred to provide service to its customers; (2) attract capital so that it can continue to meet the utility's capital expenditure requirements; and (3) have a reasonable opportunity to earn a fair rate of return for its shareholders. While a rate of return was not specified for KGS in its last rate case, this filing demonstrates that KGS it is currently earning a return that is well below a reasonable level. . Accordingly, KGS seeks an increase in its rates in this filing.

This filing demonstrates that KGS has a revenue deficiency of $45.6 million. As shown in Section 3 of the Minimum Filing Requirements ("MFR") on Schedule 3-A, the Company's current rate of return is 4.41%. In this filing, the Company is requesting approval of several mechanisms that will improve the likelihood that KGS will have the opportunity to earn the rate of return approved by the Commission. KGS is proposing the implementation of a Revenue Normalization Adjustment ("RNA") mechanism, a cyber-security expense tracking and deferral mechanism and a depreciation expense tracking and deferral mechanism. I will discuss the RNA mechanism later in my testimony. The cyber-security mechanism is discussed in the testimony of Ms. Lorna Eaton and the depreciation expense mechanism is discussed within the testimony of Mr. Dick Rohlfs. Additionally, this filing incorporates the effects of the Tax Cuts and Jobs Act on the Company's cost of service. Also, tax reform is discussed later in my testimony as well as in the testimony of Mr. Jeff Husen.

III. Explanation of Proposed Increase, Residential Customer Impact and Residential Bill History

Q. What is the amount of the requested increase?

A. KGS is seeking an overall increase in base rates of $45.6 million, resulting in a net increase in rates of $42.7 million (net of the $2.9 million in Gas System Reliability Surcharge ("GSRS") revenues that are reclassified to base rates).

Q. Please explain the basic components of customer bills as it relates to the Company's residential customers.

A. The basic component of the residential customer bill that first comes to mind for most people is the cost of the natural gas (also referred to as the commodity) provided to the customer. The "cost of gas" is billed to customers at the cost charged to the Company by upstream suppliers for gas delivered to KGS. To be clear, the delivered cost of gas on the customer's bill does not include any fees or expenses sought to be recovered by KGS in this rate case. All cost of the commodity delivered to KGS's sales customers is recovered through the Cost of Gas Rider ("COGR").

The next primary component on the residential bill is the fixed monthly "service charge" which allows KGS to recover a portion of the fixed costs incurred to serve each customer. Fixed costs, such as the cost of a service line, do not vary regardless of how much gas is purchased by the customer. Currently, residential rates are designed to allow KGS to collect approximately 54% of its revenue requirement through the monthly service charge.

Also appearing on the residential bill is the "delivery charge". The delivery charge is applied to each unit of gas (Mcf) consumed by the customer. KGS recovers that portion of its fixed costs not recovered through the fixed monthly service charge, in this volumetric-based delivery charge, along with the cost of providing service that varies with usage.

The next component on the bill is the line item for the "Gas Service Reliability Surcharge". The GSRS charge is a fixed monthly fee which recognizes the Company's capital costs expended in between rate cases for safety-related infrastructure replacements and to move/relocate facilities at the request of cities and/or state agencies. These costs are reviewed by Commission Staff annually and approved by the Commission. As in prior rate case filings, KGS seeks to move the recovery of costs currently being recovered under the GSRS into base rates and reset the GSRS rate to zero.

The bill also contains a line item for the "weather normalization adjustment rider" ("WNAR"). Through the WNAR, KGS compares the actual usage of the residential class to the usage that would have occurred if weather had been normal. The WNAR line item either increases or decreases the customer's bill to reflect the effects of normal weather.

The final items on the residential bill include line items to recover: any gas hedging fees; city and county taxes; and franchise fees the Company is required to collect from its customers. The "gas hedging fee" covers the cost of the Company's program to manage the price volatility associated with the natural gas commodity. The franchise fees are city specific and are collected pursuant to contracts and City Ordinances as required by Kansas law and are negotiated and agreed upon between the city and the Company.

Q. What is the anticipated impact of the proposed increase on residential customers?

A. Net of the rebasing of the GSRS, the impact on the average residential customer is an increase of \$5.67 per month, or \$68.04 per year. The proposed residential rate increase represents a net increase in rates of approximately 20%. The overall proposed net increase in residential customer bills, inclusive of the cost of gas, is 10%.[2] At the date new rates become effective, the current residential GSRS rate (as well as the applicable GSRS rates charged to other customer classes) will be reset to zero.

Q. Did KGS complete a class cost of service study? If so, what was the result as it relates to the Residential class?

A. Yes, a class cost of service study was conducted and is being sponsored in this filing by Mr. Paul Raab. The class cost of service study indicates the Residential and Irrigation classes have the lowest realized return on common equity, which identifies that these customers are not paying their fair share of costs incurred to provide them with service and are being subsidized by other customer classes.[3] As a result of this study, KGS is proposing that much of the requested increase be assigned to the Residential class.

Q. Please provide background on the history of the average KGS residential customer's bill.

A. Figure 1, included below, illustrates the annual average residential customer's bill from 2004 through 2017, based upon actual usage. This chart distinguishes between the cost of gas portion of the bill and the costs billed by KGS to provide service to residential customers. Please note, the annual cost of gas includes the total costs KGS incurred to purchase natural gas to serve its customers' demands, plus the cost of upstream storage and transportation from third-party companies.

[2] The cost of gas used for this calculation is based upon the weighted average cost of gas during the test period.
[3] *See*, PHR-7, page 1, line 29.

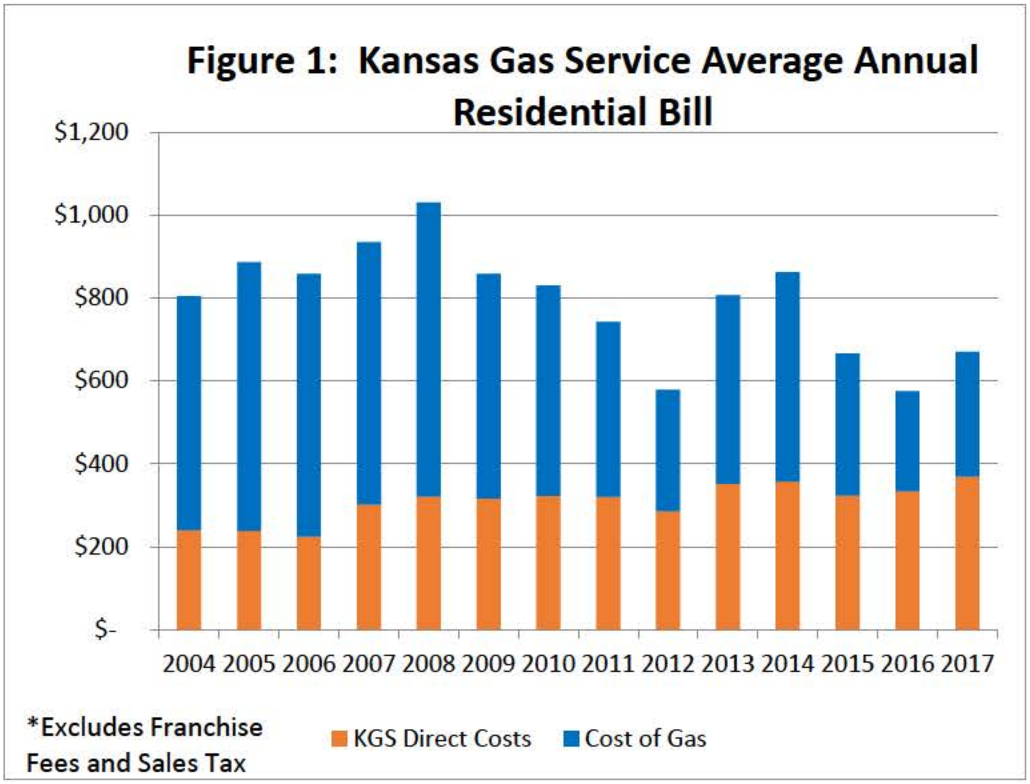


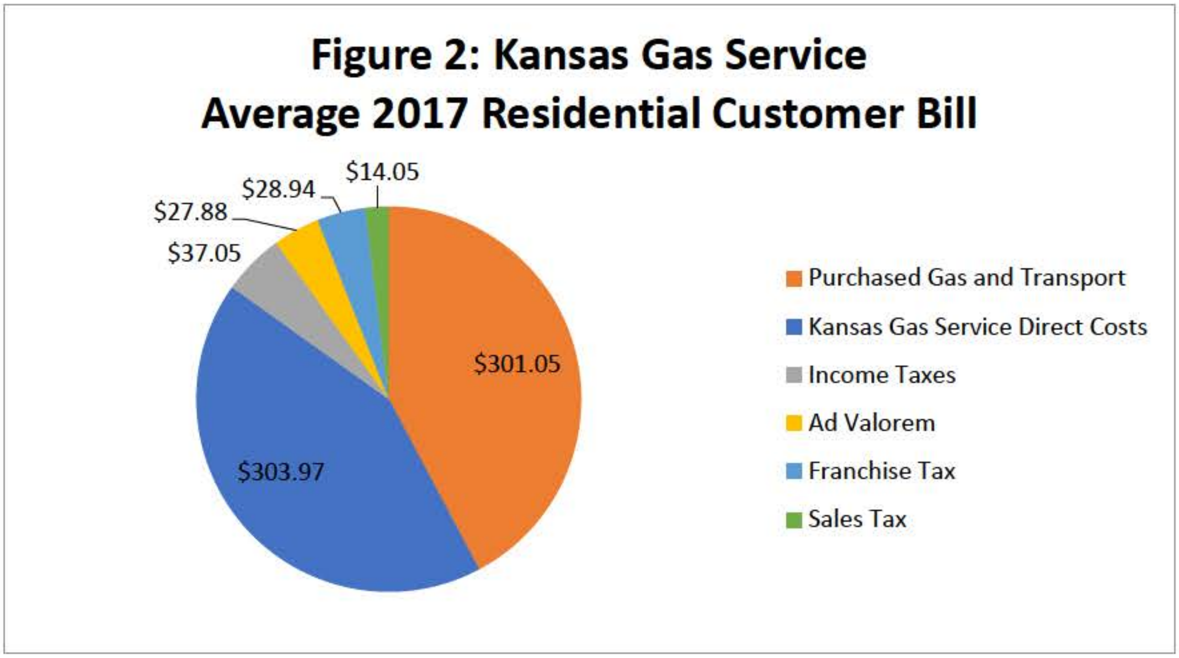
Figure 1 shows the average annual residential bill before adjusting for weather. It is clear that since 2008, residential customers are experiencing a significant reduction in their total gas bills.

Q. What is shown in Figure 2 below?

A. Figure 2, included below, illustrates the primary components of the average 2017 residential customer's costs over a twelve-month period. In 2017, the average KGS residential customer was billed $712.94. Based upon average actual usage of 63 Mcf, approximately $301.05 or 42% of a residential customer's bill was associated with commodity costs. The base rates approved by the Commission are designed to recover not only KGS direct costs[4]

[4] The rates approved by the Commission do not reflect the full cost of providing service to residential customers. As is discussed by Mr. Paul Raab, the class cost of service study indicates that other customer classes subsidize the residential class. Additionally, as discussed by Mr. Dick Rohlfs, there are costs incurred by the Company that the Commission has disallowed, such as portions of variable compensation.

($303.97), but also state and federal taxes ($37.05), and ad valorem taxes ($27.88) that KGS incurs in providing service. The sum of these three components totals $368.90 or 52% of the residential customer's bill.



The average total of income taxes, ad valorem taxes, franchise fees and sales taxes levied on a residential customer's bill in 2017 was $107.91. However, this average does not include other taxes that are incurred in the provision of service, such as payroll taxes and various taxes incurred by the suppliers of the natural gas commodity and interstate pipeline companies which are incorporated in their pricing.

Q. How do the bills of KGS's customers compare to bills for electric service?

A. According to the Commission's "2018 Utilities and Common Carriers Annual Report," ("Report") the weighted average monthly residential electric bill for Kansas customers was $121.40 (for the period of July 2016 through June 2017), assuming usage of 916 kWh.[5] The

[5] Kansas Corporation Commission, "2018 Utilities and Common Carriers Annual Report," page 23.

Report also states that the average monthly residential bill for a KGS customer was $51.15 (for the period of July 2016 through June 2017), based on usage of 5.117 Mcf.[6] Converting the weighted average monthly residential electric bill to its equivalent thermal value results in an average rate of approximately $38.84 per Mcf for electric service compared to the approximately $10.00 per Mcf for natural gas service provided by KGS. Therefore, natural gas provides nearly four times the value of electricity.

IV. <u>Revenue Normalization Adjustment</u>

Q. Please provide an overview of the proposed Revenue Normalization Adjustment ("RNA") mechanism.

A. The RNA mechanism is a form of decoupling which removes the link between consumption and revenue and provides for revenue stability. The RNA mechanism will compare the actual base revenue received by the Company, computed on an average revenue per customer basis, with the base revenue and billing determinants as approved in this rate proceeding. The RNA mechanism proposes that the resulting difference (positive or negative), be refunded or collected from customers through a monthly credit or surcharge. Since this mechanism will address all changes in consumption, the current WNAR mechanism will be eliminated once all associated credits or surcharges have been completed. As proposed, the RNA mechanism will apply to: Residential, General Sales Service (Small), General Sales Service (Large), General Sales Service Transport Eligible, Small Transportation Service-t and Small Transportation Service-k rate classifications.

[6] Id., page 40.

Q. Has the Commission made a policy statement concerning decoupling for natural gas utilities?

A. Yes, they have. In Docket No. 08-GIMX-441-GIV ("441 Docket") the Commission acknowledged that decoupling fixed cost recovery from the volumetric portion of rates is important for a natural gas utility to maintain revenue stability. The Commission stated:

> Because a significant portion of a gas utility's fixed costs are recovered via volumetric charges, the decline in per customer usage has limited gas utilities' ability to recover the revenue necessary to maintain their distribution systems and meet other fixed costs. Because gas utilities have rising costs due to an ageing infrastructure, the lack of revenue presents a serious problem.
>
> For this reason, with regard to gas utilities, the issue of decoupling involves broader considerations than the impact of energy efficiency measures. The issue is maintaining revenue stability. Separating fixed cost recovery from the volumetric portion of rates for natural gas utilities is a potential remedy for this problem. This is a different matter than the context in which the throughput incentive is discussed here—where the issue is removing a disincentive to pursuing energy efficiency programs—and involves a different set of considerations. It constitutes a separate policy issue.
>
> In response to this situation, many states that have implemented decoupling have done so for natural gas utilities. Staff's Report, 10-11. ***The Commission recognizes its responsibility to regulate natural gas utilities in a manner that provides them with the ability to maintain their economic vitality***.
>
> For purposes of this docket, the Commission has decided to focus on the throughput incentive in the context of energy efficiency. However, the Commission wishes to acknowledge that it will consider decoupling proposals from natural gas companies with concerns about revenue stability. Gas companies with such concerns are invited to make an application to the Commission, and the Commission will address each application on a case-by-case basis.[7] (Emphasis added)

[7] Final Order, Docket No. 08-GIMX-441-GIV dated November 14, 2008, pages 19 and 20, paragraphs 58 – 60, emphasis added. ("Final Order").

While the Commission's focus in the 441 Docket was on energy efficiency programs and impediments to implementing such programs, the Commission also made clear that it was concerned about revenue stability for natural gas utilities. The Commission indicated it would consider decoupling to be a potential solution regardless of implementation of an energy efficiency program.

Q. Why is KGS proposing a RNA mechanism at this time?

A. The cost of delivering natural gas to our customers is largely comprised of fixed costs of providing a physical connection to the Company's system. These costs do not vary with the volume of gas delivered to our customers. As discussed by Mr. Paul Raab, the vast majority of costs are either customer or demand related. The only material costs that vary with usage are those costs covered by the Company's Cost of Gas rider. However, the rates approved for recovering the cost of providing service consist of both a fixed customer charge and a charge applied to consumption. The Residential rates approved in Docket No. 16-KGSG-491-RTS were designed to recover 46% of the Residential rate class revenue requirement from revenue generated from throughput. If normalized consumption varies from the normalized consumption established in the rate case, KGS will experience either an under- or over-recovery of its Commission approved revenues. Figure 3 demonstrates that the weather normalized usage of KGS's residential customers has been declining, which clearly indicates that KGS's ability to recover its revenues and fixed costs is compromised.

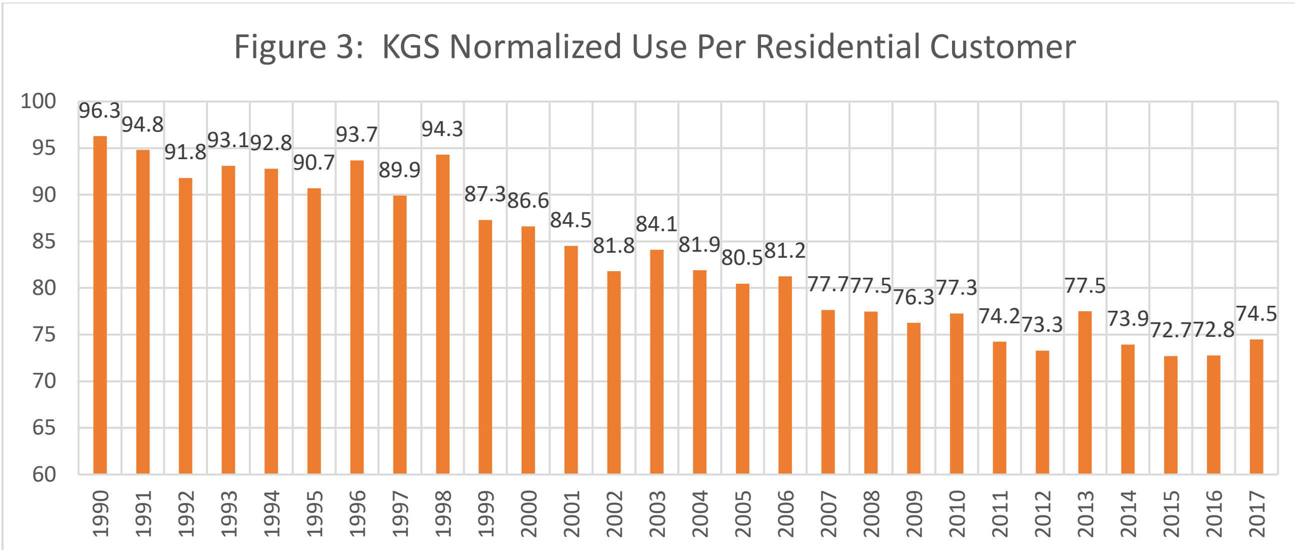
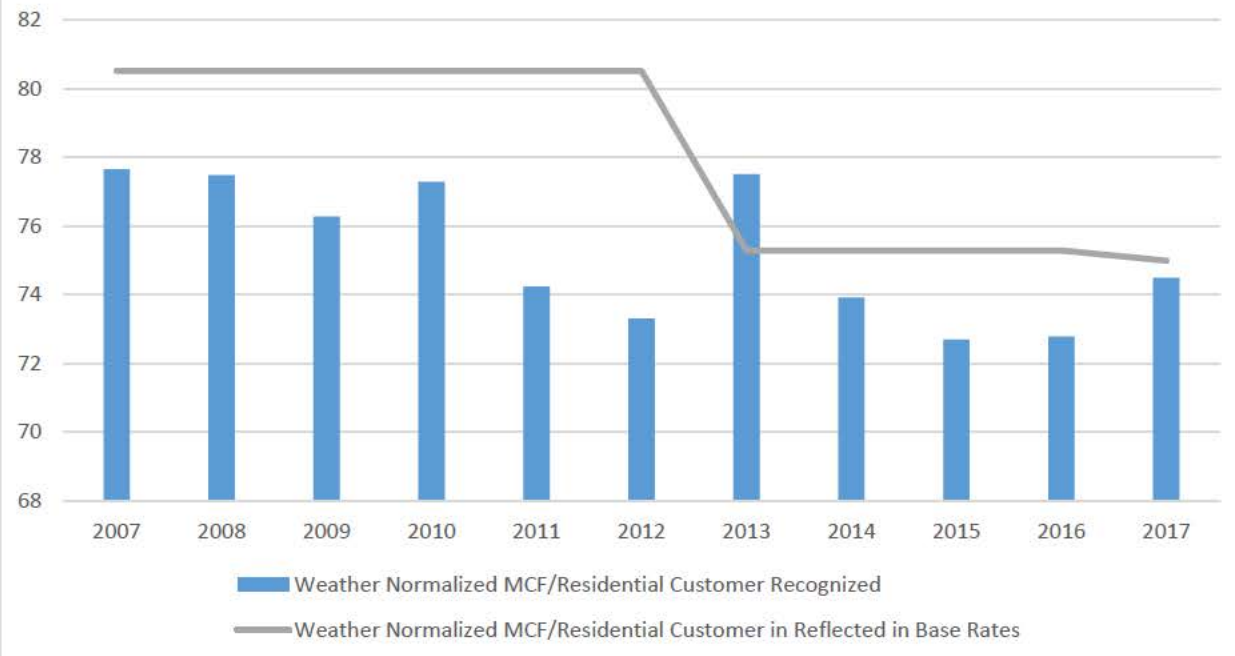


Figure 3: KGS Normalized Use Per Residential Customer

Q. Doesn't KGS have a WNAR in place to address the variability in usage related to weather?

A. Yes. KGS has a WNAR which addresses variability in revenue related to weather. However, the WNAR does not address the decline in usage that is occurring for other reasons, such as gains in efficiency of appliances. Figure 4 illustrates the difference between the normalized volumes approved in rate cases and the normalized volumes experienced by KGS for the years 2007 through 2017. In all but one year, the actual weather normalized volumes are less than the volumes used to establish base rates. Thus, in most years, KGS has no opportunity to recover its Commission approved revenues.

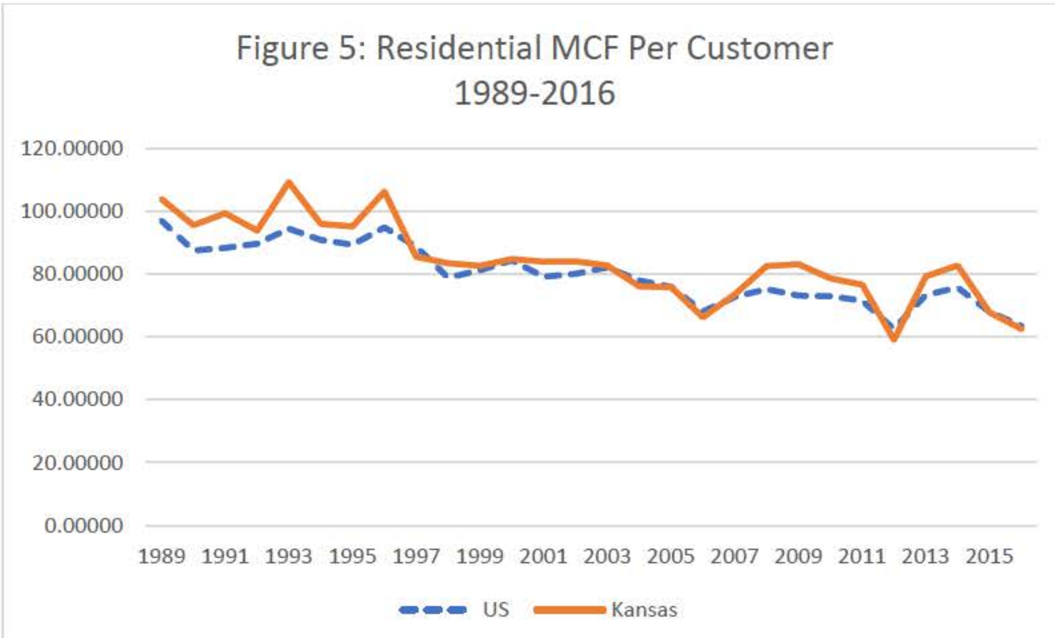
Figure 4: Weather Normalized Usage per Residential Customer Recognized vs Normalized Usage Reflected in Base Rates



Again, weather normalized volumes are used in this analysis. Thus, the information provided above demonstrates the remaining financial risk associated with recovering fixed costs through rates based on consumption. When multiplying the difference in the volumes times the then effective delivery charge (ranging from \$2.123/Mcf to \$2.1267/Mcf) times the number of residential customers for a year, it is apparent that there is a significant financial burden on KGS in most years. For the entire time-period, KGS revenues fell approximately \$38.8 million short of the Commission approved revenues. It is evident from this analysis that the WNAR has not addressed the issue of declining consumption.

Q. Is the trend of reduced consumption likely to continue?

A. Yes, it is. Even though KGS customer's bills have declined as a result of a reduction in natural gas prices, consumption also continues to decline. As customers replace older, less efficient appliances/equipment with newer, more efficient models, the long-term trend of declining consumption will continue. Figure 5, included below, depicts the actual residential consumption per customer, for both Kansas and the United States, from 1989 through 2016, using data made available by the U.S. Energy Information Administration.[8] This figure demonstrates, the downward trend in consumption is long-term rather than a recent and/or temporary occurrence. The trend of declining consumption is also evident even when examining actual - rather than weather-normalized usage.



Q. To your knowledge, have both the Commission Staff and the Commission acknowledged this trend in natural gas consumption?

A. Yes, they have. In the 441 Docket, the Commission stated:

> The Commission is aware that natural gas utilities face a unique situation in that natural gas usage per customer in general has declined over recent years.[9]

More recently, in Docket No. 12-KGSG-835-RTS, Dr. Robert Glass acknowledged that:

[8] U.S. Energy Information Administration ("EIA), Residential Consumption of Natural Gas (Summary) http://www.eia.gov/dnav/ng/ng_sum_lsum_a_epg0_vrs_mmcf_m.htm and Number of Natural Gas Residential Customers http://www.eia.gov/dnav/ng/ng_cons_num_a_epg0_vn3_count_a.htm

[9] Final Order, paragraph 56.

> [o]ver the past thirty years, natural gas usage has declined as customers have replaced older, less efficient appliances with newer, more efficient models. . . . The decline in KGS' residential sales has resulted in under-collection of the revenue requirement.[10]

Q. Does KGS realize any material reduction in its cost as a result of the reduction in consumption per customer that the Company has experienced?

A. No, as most of the cost incurred by KGS to provide safe and reliable service to its customers does not vary with consumption, KGS does not realize a material reduction in cost as consumption per customer declines. The Commission acknowledged this fact in the 441 Docket and recognized that a decoupling mechanism (such as the RNA mechanism presented herein), addresses the mismatch in the way costs are incurred and rates are designed.

Q. Has KGS considered other forms of decoupling or means of achieving revenue stability?

A. Yes, in past filings, KGS has proposed alternative rate design mechanisms, non-traditional ratemaking mechanisms and the RNA.

In its rate case filed in 2006, the Company proposed an alternative rate design that would recover the majority of the Company's fixed costs through the customer charge. Moving recovery of fixed costs to the fixed monthly charge increases revenue stability for the Company. To address concerns about the rate impact for residential customers, two rate options were proposed and customers would be assigned to the most economic option based on historical usage patterns. This proposal did not receive support from witnesses from either Staff or the Citizens' Utility Ratepayer Board ("CURB"). Ultimately the case was settled using a more traditional rate design.

In its 2012 rate case, KGS proposed an RNA mechanism similar to that being proposed in this case. Staff indicated support for a modified version of the RNA mechanism; however,

[10] Direct Testimony of Robert H. Glass, Docket No. 12-KGSG-835-RTS, pages 4-5. ("Glass Direct")

CURB was not supportive of decoupling in this manner. Ultimately, this case was settled without an agreement on the proposed RNA mechanism.

Similarly, in its 2016 rate case, KGS proposed a non-traditional ratemaking mechanism to address, among other things, revenue stability. The Company proposed implementation of a Cost of Service Adjustment ("COSA") mechanism which would examine both capital expenditures and operations and maintenance expense annually and adjust rates up or down to reflect changes in the cost of providing service. Staff indicated several concerns with this mechanism as did CURB. The case was settled without addressing the implementation of a COSA.

Because the RNA received some support, and because the Commission has explicitly stated its support for decoupling through this type of surcharge, KGS determined that this was the best option to propose for addressing revenue stability. While the Commission stated a preference for total revenue decoupling, it indicated it would consider revenue per customer decoupling mechanisms. KGS believes revenue per customer decoupling is reasonable and that the Commission's concerns, which will be addressed later in my testimony, can be alleviated.

Q. Could you explain how the mechanism will work?

A. Yes. The RNA factor used to adjust customer bills will be calculated using four steps for each customer class. First, the monthly customer charge revenues and volumetric charge revenues as defined in the test year are added together to arrive at the monthly test year base revenues.

Second, customer growth adjustment is calculated. The difference between the monthly test year number of customers and the current month number of customers is determined. This change in the number of customers (which could be positive or negative) is multiplied by the current customer charge to arrive at the customer charge revenue impact. Next, the volumetric charge impact is calculated in two steps:

1) multiply the monthly test year average volumes per customer, by the change in the number of customers to calculate the change in volumes; and then

2) the change in volumes (as calculated above) is multiplied by the volumetric charge.

The total customer growth adjustment is calculated by adding the customer charge revenue impact and the volumetric charge revenue impact.

Third, the required revenue adjustment is calculated. The customer growth adjustment is added to the monthly test year base revenues to calculate the target base revenue. The actual customer charge revenues and volumetric charge revenues for the month are added together to arrive at the actual calendar month base revenues. The actual calendar month base revenues are subtracted from the monthly target base revenue to calculate the required revenue adjustment.

Finally, the difference between actual base revenues and target base revenues is divided by the actual customer count to develop the RNA factor which is a fixed charge applied to customers' bills on a two-month lag basis.

This process can be simply stated as comparing the approved revenue per customer to the actual revenue per customer for each customer class.

Q. Could you please provide the Company's proposed formula for calculating the RNA surcharge or refund?

A. The Company will calculate separate RNA surcharges or refunds for each customer class to which it will apply. A positive result shall be additive to the Service Charge and a negative amount shall be subtractive. The RNA surcharge or refund will be calculated by the following formula:

RNA Surcharge or Refund = BR – AR + RC

Where:

BR = Base Revenue per Customer is calculated using values approved by the Commission in the Company's most recent base rate case. BR shall be calculated by the formula:

BR = BRR/BCUST

Where:

BRR = The Monthly Revenue Requirement allowed for recovery from the rate class through the Service Charges and Delivery Charges set in the most recent rate case.

BCUST = The number of customers used for the approved rate design in the most recent rate case.

AR = Actual Revenue per Customer is calculated using values applicable during the most recent RNA month. AR shall be calculated by the formula:

AR = ARR/CCUST

Where:

ARR = Total Monthly Revenue received from Service Charges and Delivery Charges for the rate class during the RNA month.

CCUST = Total Revenue received from Service Charges in the rate class during the RNA period divided by the Service Charge in effect during the RNA month.

RC = Reconciliation per customer is the calculation of the over- or under-recovery of the RNA surcharge or refund. An over-recovery will be indicated by a negative result and will be subtractive to the RNA calculation; likewise, a positive number will indicate an under-recovery and will be additive. RC shall be calculated by the formula:

RC = (Revenue authorized to be collected by the previous RNA Calculation minus Revenue collected under the previous RNA Surcharge or RNA Refund)/CCUST.

Q. What do you mean by the phrase "base revenue" as used in the RNA calculation above?

A. "Base revenue" is that revenue resulting from the rates developed in this proceeding and includes revenue derived from the customer charges and volumetric rates. Other revenue sources, such as revenue from GSRS filings made after this case, will not be included in the RNA calculation. Future annual GSRS revenue will not be included in the base revenue calculation since the corresponding investment is not included in this rate proceeding. Additionally, revenue associated with the ad valorem tax rider would not be included in the RNA calculation since it is associated with increases or decreases in property taxes incurred after this case. The RNA mechanism applies *only* to that base rate revenue authorized in this proceeding (and future full-rate proceedings) and is compared to the actual revenue generated from rates approved in this proceeding.

Q. Please provide an example of the proposed RNA calculation.

A. On the following page is a table demonstrating the calculation of the RNA surcharge (refund) for the residential class for the month of May. The "rate case data" is based on the data in the company's filing for the pro forma monthly residential customer count, the proposed residential revenue requirement, and the proposed residential rate design. Later in this testimony, I provide charts with the calculation of the BR for each month for each customer class to which the RNA mechanism will apply. The data provided below for the month of May following the conclusion of the rate case is hypothetical data. In this example, the RNA would be a refund of $0.05 per residential customer. This refund would be applied to residential bills in the month of July. A similar calculation would be made each month for each customer class for which the RNA mechanism is applicable.

Example: May Calculation of RNA Surcharge (Refund)

RNA Surcharge (Refund) = BR-AR+RC

Rate Case Data

BR = Base Revenue per Customer Based on Commission Approved Values

BRR = Approved Monthly Revenue Requirement	$17,369,437
BCUST = Approved Number of Customers for Month	587,073
BR = BRR/BCUST	$29.59

Assume for May

AR = Actual Revenue per Customer for Month

ARR = Revenue received from Service and Delivery Charges	$17,269,437
Service Charge Revenue	$13,203,071
Service Charge	$22.66
CCUST = Service Charge Revenue/Service Charge	582,660
AR = ARR/CCUST	$29.64
RC = Reconciliation per Customer	$0.00
RNA Surcharge (Refund) = BR-AR+RC	($0.05)

Q. Why do you recommend that the RNA factor be applied to customers' bills as a fixed charge?

A. As stated above, the majority of costs incurred by KGS to provide service are fixed in nature. Decoupling is being implemented to address the mismatch between the way in which costs are incurred and recovered so that the Company's revenues match those approved by the Commission in its rate case.[11] Including the RNA factor on the bill as a fixed charge is consistent with the stated purpose of decoupling. Moreover, Dr. Robert Glass has testified that Staff prefers that the RNA factor be a fixed charge since it ". . . more closely aligns revenue collection with how costs are actually incurred by KGS."[12] He also indicates that use of a fixed charge will lead to less rate volatility.[13]

Q. Does KGS propose the implementation of a cap on the level of the RNA factor?

A. No. While the Commission expressed a concern in the 441 Docket that decoupling could cause volatility in rates between rate cases and that annual caps could be implemented to address that concern, KGS does not believe it is appropriate.[14] As Staff has indicated in prior

---

[13] Morgan, Pamela, "A Decade of Decoupling for US Energy Utilities: Rate Impacts, Designs and Observations, revised February 2013, page 6. http://www.raponline.org/wp-content/uploads/2016/05/gracefulsystems-morgan-decouplingreport-2012-dec.pdf

[12] Glass Direct, page 10.

[13] Glass Direct, pages 10 - 11.

[14] Final Order, paragraph 65.

testimony, when the WNA mechanism is eliminated along with the implementation of decoupling, much of the volatility associated with decoupling results from variations in weather. [15] The Commission has not found it necessary to apply a cap to the KGS WNAR mechanism, and the same principle applies here. Thus, it is not necessary to apply a cap to the RNA mechanism.

Q. Does KGS propose an adjustment to address a change in risk?

A. No. Although the Commission expressed its belief in the 441 Docket that decoupling reduced the risk faced by the utility and that this risk should be considered when setting the rate of return, KGS does not believe a risk adjustment is necessary.[16] KGS agrees with Staff's position expressed in Docket No. 12-KGSG-835-RTS, that decoupling is prevalent among the companies included in the cost of equity analysis and therefore any reduction in risk is already incorporated into the analysis.[17]

Q. Will KGS provide its monthly RNA calculations to the Commission?

A. Yes, KGS will make a monthly compliance filing for the Commission to review the calculations.

Q. Do you anticipate this monthly compliance filing will have a significant impact on Staff?

A. No, I do not. I expect that both Staff and the Company will adjust quickly to the routine of these monthly filings and that any impacts will be minimal.

Q. Will there be a true-up mechanism associated with the RNA?

A. Yes. Authorized RNA revenues will be compared with the actual revenues collected through the RNA and any differences will be incorporated into the next RNA calculation.

Q. Does KGS believe carrying charges will be necessary for the over/under recovery balances?

---

[15] Glass Direct, Docket No. 12-KGSG-835-RTS, pages 11 - 12.
[16] Final Order, paragraph 64.
[17] Direct Testimony of Adam H. Gatewood, Docket No. 12-KGSG-835-RTS, pages 6 – 9.

A. Because KGS proposes only a two-month lag in recovery, the Company does not believe a carrying charge is necessary. Because no carrying charge is proposed, the Commission's previously expressed concern about the growth of the RNA balance due to the application of a carrying charge is eliminated.

Q. How widespread is the use of revenue decoupling mechanisms by natural gas utilities?

A. The American Gas Association reports that, as of December 2016, 58 natural gas utilities had implemented decoupling mechanisms. Additionally, five states (Florida, Missouri, Nebraska, North Dakota, and Ohio) had implemented straight-fixed-variable rate design. While this is not strictly decoupling, this rate design similarly increases the likelihood that a utility will recover its Commission-approved revenues.

Q. You mentioned that with an RNA mechanism, the WNA mechanism would no longer be needed and that the WNA would be eliminated. Please explain the process for winding down the WNA.

A. The current WNAR includes a WNA Calculation Period for calculating the WNA factor. The WNA Calculation Period covers the twelve billing months of April through March. It also includes a WNA Collection Year over which the WNA factor is collected. The WNA Collection Year is the twelve-month period ending May 31 of each year. The calculation period is the basis for the subsequent WNA charge or credit and the collection year is the period over which the charge or credit is applied. At the time new rates go into effect, KGS would terminate the calculation of the WNA. At that time, the WNA balance would be determined (including the cumulative over- or under-recovery from prior periods). No further WNA accruals to KGS revenue would occur. This final WNA balance would then either be recovered from, or credited to, customers over the subsequent twelve months. Thus, there would be no overlap between the WNA mechanism and the RNA mechanism other than the collection or refund of amounts previously accrued on the books of KGS pursuant to the WNA.

Q. If the RNA mechanism is not approved by the Commission, does KGS propose that the WNA mechanism remain in place?

A. Yes. If the RNA is not approved, KGS proposes that the WNA mechanism remain in place with modification. KGS proposes extending application of the WNA mechanism to Small Transportation Service-t and Small Transportation Service-k rate classifications. Evidence indicates that these rate classes are weather sensitive and therefore should be included in the WNA mechanism. Additionally, KGS proposes the Commission adopt the recommendation of Mr. Paul Raab to define normal temperature using a 10-year rolling average, such that the normal heating degree days used in the WNA calculation would be based on a 10-year rolling average rather than the 30-year decadal average.

Q. Does implementation of the RNA mechanism have implications for how KGS records revenue?

A. Yes. KGS will record a monthly accrual to increase or decrease actual revenue for each rate class for which the RNA mechanism is applicable to match the monthly test year approved revenue. The charts on the following two pages provide the proposed revenue per customer (or the "BR" in the formula on page 19) that would be used for this calculation. This data utilized in the charts incorporate the analysis of Mr. Paul Raab for weather normalized volumes and customer annualization.

	Residential		General Service Small		General Service Large	
	Design Volumes per Customer	Monthly Revenue Target per Customer	Design Volumes per Customer	Monthly Revenue Target per Customer	Design Volumes per Customer	Monthly Revenue Target per Customer
January	15.47	$57.17	24.97	$87.26	107.13	$272.84
February	13.05	$51.77	19.05	$73.37	89.82	$235.75
March	9.43	$43.69	13.42	$60.14	64.72	$181.97
April	5.43	$34.78	6.93	$44.91	37.55	$123.76
May	3.10	$29.59	3.32	$36.43	21.97	$90.38
June	1.63	$26.29	1.61	$32.44	14.09	$73.50
July	1.29	$25.53	1.32	$31.75	12.78	$70.69
August	1.18	$25.28	1.21	$31.50	10.37	$65.53
September	1.39	$25.76	1.46	$32.08	12.73	$70.58
October	1.69	$26.43	1.70	$32.64	13.86	$73.01
November	5.78	$35.57	6.93	$44.93	36.58	$121.68
December	9.82	$44.58	13.05	$59.28	63.25	$178.82
Total	69.26	$426.44	94.98	$566.73	484.85	$1,558.51
Proposed Rates						
Service Charge	$22.66		$28.65		$43.31	
Delivery Charge	$2.23		$2.35		$2.14	

	General Service Transport Eligible		Small Transport "k" System		Small Transport "t" System	
	Design Volumes per Customer	Monthly Revenue Target per Customer	Design Volumes per Customer	Monthly Revenue Target per Customer	Design Volumes per Customer	Monthly Revenue Target per Customer
January	418.15	$861.22	315.05	$521.09	280.53	$598.67
February	334.47	$700.88	375.24	$608.97	330.39	$694.21
March	282.15	$600.63	218.48	$380.10	199.67	$443.73
April	170.74	$387.15	170.27	$309.71	148.99	$346.61
May	124.77	$299.07	108.56	$219.62	97.46	$247.87
June	69.16	$192.52	74.51	$169.90	63.02	$181.88
July	56.14	$167.57	51.93	$136.94	43.10	$143.71
August	53.11	$161.76	49.35	$133.17	41.48	$140.60
September	66.18	$186.81	58.00	$145.80	48.04	$153.17
October	78.62	$210.64	50.88	$135.40	44.74	$146.85
November	177.52	$400.15	93.45	$197.56	79.10	$212.69
December	269.65	$576.68	164.69	$301.57	149.99	$348.53
Total	2,100.66	$4,745.07	1,730.41	$3,259.84	1,526.51	$3,658.54
Proposed Rates						
Service Charge	$60.00		$61.12		$61.12	
Delivery Charge	$1.92		$1.46		$1.92	

V. <u>Tax Reform</u>

Q. How has tax reform affected KGS?

A. As indicated in the testimony of Dr. Bruce Fairchild, Moody's lowered its rating outlook for ONE Gas from "stable" to "negative" in January 2018, because of the adverse impact on credit metrics resulting from the reduction of the corporate income tax rate from 35% to 21% provided for in the Tax Cuts and Jobs Act ("TCJA"). The Company has indicated that it is committed to maintaining investment quality credit metrics. To maintain investment quality credit metrics and the access to lower cost debt those metrics enable, the Company will need to maintain its existing capital structure. As noted by Dr. Fairchild, this capital structure has benefited customers through a lower cost of debt.

Q. What are the requirements of the Commission's Order in Docket No. 18-GIMX-248-GIV?

A. On January 18, 2018, the Commission issued its *Order Opening General Investigation and Issuing Accounting Authority Order Regarding Federal Tax Reform* ("Tax Reform Order") in Docket No. 18-GIMX-248-GIV. In its Tax Reform Order, TCJA which, among other things, reduced the corporate tax rate from 35% to 21% had the potential to significantly reduce the cost of service for utilities by reducing operating expenses and affect accumulated deferred income tax assets and liabilities. The Commission determined that an investigation should be conducted to quantify the economic impacts of the new lower tax rates on Kansas utilities, and where appropriate, directed that any cost savings be passed on to Kansas utility customers.[18] To that end, all regulated public utilities that are taxable at the corporate level were directed to accrue monthly (in a deferred revenue account), the portion of its revenues representing the difference between: (1) the cost of service approved by the Commission in

[18] Order Opening General Investigation and Issuing Accounting Authority Order Regarding Federal Tax Reform ("Tax Reform Order"), Docket No. 18-GIMX-248-GIV, at page 5 and 6.

its most recent rate case; and (2) the cost of service that would have resulted had the provision for federal income taxes been based upon the corporate income tax rate approved in the TCJA.[19] The Commission also stated that it intended to capture excess ADIT for the benefit of customers using a methodology that is consistent with the tax normalization requirements specified in the tax legislation or IRS Tax Normalization Rules, as applicable.[20] Finally, the Commission indicated that it would conduct its investigation into the effect of the TCJA on a case-by-case basis.

Q. Has KGS worked with Staff and the CURB to address the Commission's Tax Reform Order?

A. Yes, we have. Following the Tax Reform Order being issued, KGS met with Staff and CURB on February 28, 2018, to discuss the calculation of the amount of revenue to accrue as a regulatory liability (based on the Commission's instructions), and how cost savings related to the lower tax rates should be passed on to KGS customers.

After that meeting, Staff, CURB and KGS were able to reach a settlement agreement on how to address the Tax Reform Order. The annual amount of the regulatory liability was agreed to be $14.1 million. The parties agreed that treatment of excess accumulated deferred income taxes ("EDIT") would be addressed in the Company's next rate case to be filed no later than 150 days after filing of the Settlement Agreement. The settlement agreement also included a reservation of KGS's right to demonstrate that the Company had experienced offsetting cost increases. The Settlement Agreement was filed with the Commission on March 30, 2018. An order approving the agreement was issued by the Commission on May 15, 2018.

---

[19] *Id*., at page 5 and 7.
[20] *Id*., at page 6 and 8.

Q. Does the agreement state that any unresolved issues will be addressed in this KGS rate case?

A. Yes. The agreement specifies that the treatment of the EDIT will be determined in this rate case. Mr. Jeff Husen addresses this issue for the Company in his direct testimony. The agreement also specifies that KGS, Staff and CURB will be permitted to present evidence concerning the amount of the refund, if any, associated with the reduction in operating expenses from lowering the tax rate from 35% to 21%. These provisions of the Settlement Agreement are consistent with the Commission's Tax Reform Order.

Q. Does the Commission's Tax Reform Order address whether a utility should be permitted to demonstrate cost increases which offset the benefit of the TCJA?

A. Yes. In its Tax Reform Order, the Commission states:

> Any affected utility that believes other components of their cost of service have more than offset the decrease in its income tax expenses will have the ability to file such information and supporting data with the Commission, to be considered on a case-by-case basis. The Commission's intention here is not to materially impact regulated utilities' profitability, but rather, ensure that the affected utilities are neither positively nor negatively impacted by the passage of federal income tax reform.[21]

The Commission clearly states that a utility will be afforded an opportunity to show it has experienced increases in its cost of service that offset the decrease in income tax expense.

Q. Does this filing establish the total cost of providing service to KGS customers and demonstrate that KGS has experienced cost increases offsetting the decrease in income tax expense?

A. Yes, it does. This filing, based on a test year ending 2017, demonstrates the cost of providing service to KGS customers. This filing shows that as of the end of 2017, adjusted for known and measurable changes, KGS experienced a revenue deficiency of $45.6 million. This

[21] *Id.*, at page 7 and 11.

revenue deficiency, which incorporates the change in the tax rate, demonstrates that the benefit of the decrease in the corporate income tax rate has been offset by increases in other operating expenses and investments in capital.

Q. How does KGS propose that the Commission address any potential refund in this proceeding?

A. KGS suggests that once the Commission has made a determination concerning the Company's revenue deficiency in this case the refund, if any, can be determined.. If the revenue deficiency is *greater* than zero, then KGS has experienced cost increases that offset the decrease created by the change in the corporate tax rate. On the other hand, if the revenue deficiency is *less* than zero, then that amount (not to exceed the amount of the regulatory liability) will be returned to KGS customers through a one-time refund. Refund amounts will be distributed among the rate classes based on the spread of the revenue requirement as approved in this rate case. The refund will consist of fixed and variable components based on the rate design approved in this rate case as well. KGS has included language in the proposed Tax Change Rider that will govern any credit that might be owed to customers, with a true-up provision and establish that the rider would be reset to zero provision after the true-up. The tariff would remain in place to address any future change in the federal tax laws and federal tax expenses included in rates.

Q. How does KGS intend to address the excess ADIT?

A. In Mr. Jeff Husen's direct testimony, he describes the re-measurement of ADIT to reflect the new tax rate. KGS proposes that a bill credit be issued once each year to reflect the annual value of the remeasured ADIT. Refund amounts will be distributed among the rate classes based on the spread of the revenue requirement as approved in this rate case. The refund will consist of fixed and variable components based on the rate design approved in this rate case as well. KGS proposes an Tax Change Rider which describes the calculation of the credit, contains a true-up provision and would set the rider to zero once the final true-up has occurred. The tariff would remain in place to address any future changes in federal tax laws affecting ADIT.

Q. Does this conclude your testimony.

A. Yes, it does.

VERIFICATION

STATE OF KANSAS)
) ss.
COUNTY OF JOHNSON)

Janet L. Buchanan, being duly sworn upon her oath, deposes and states that she is Director, Rates and Regulatory Reporting for Kansas Gas Service, a division of ONE Gas, Inc.; that she has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of her knowledge, information, and belief.

Janet Buchanan

Janet L. Buchanan

Subscribed and sworn to before me this 21st day of June 2018.

NOTARY PUBLIC

My appointment Expires:

06/05/2022

STATE OF KANSAS NOTARY PUBLIC
STEPHANIE FLEMING
My Appointment Expires
June 5, 2022