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Kansas Corporation Commission
/S/ Susan K. Duffy

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Thomas E. Wright, Chairman
Joseph F. Harkins

STATE CORPORATION COMMISSION

APR 2 3 2010

Susan Talbott

In the Matter of the Application of Kansas Gas Service, a Division of ONEOK, Inc., for Approval to Implement the Efficiency Kansas Energy Efficiency Program, to Implement Natural Gas Energy Efficiency Programs to Improve Building and Equipment Efficiency and to Educate about Efficient Energy Usage, to Provide for Program Cost Recovery through a Rider Mechanism, to Establish Administrative Charges and a Program Initiation Fee, Permit the Implementation of a Revenue Decoupling Mechanism, and Appropriate Accounting Authority to Defer Expenses And Revenues Associated with the Filing.	)	Docket No. 10-KGSG-421-TAR

DIRECT TESTIMONY

OF

STACEY HARDEN

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

APRIL 23, 2010

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Stacey Harden and my business address is 1500 SW Arrowhead Road, Topeka, KS 66604-4027.

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

A. I am employed by the Citizens' Utility Ratepayer Board ("CURB") as a Regulatory Analyst.

Q. Please describe your educational background?

A. I received a Bachelors Degree in Business Administration from Baker University in 2001. I received a Masters Degree in Business Administration from Baker University in 2004.

Q. Please summarize your professional experience.

A. I joined the Citizens' Utility Ratepayer Board as a Regulatory Analyst in February of 2008. Prior to joining CURB, I was the manager of a rural water district in Shawnee County, Kansas for five years. I am currently an adjunct faculty member at Friends University, where I am an undergraduate instructor in business courses such as Data Development and Analysis, Financial Decision Making, Financial Reporting of Debt & Equity, and Managerial Statistics.

Q. Have you previously testified before the Commission?

A. Yes. I previously offered testimony in KCC Docket No. 08-WSEE-1041-RTS.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On December 18, 2009, Kansas Gas Service, a division of ONEOK, Inc. ("Kansas Gas Service" or "company") filed an application with the Kansas Corporation Commission ("KCC" or "Commission") seeking:

- permission to become a Partner Utility in the Efficiency Kansas loan program,
- approval of a portfolio of energy efficiency programs including an education program,
- program cost recovery for the Efficiency Kansas loan program and the portfolio of energy efficiency programs,
- the establishment of a revenue decoupling mechanism within the Energy Conservation Rider to recognize changes in customer consumption, and
- specific Commission authority to defer all program costs and accrued revenue pursuant to the proposed decoupling mechanism.

In my testimony I will evaluate Kansas Gas Service's planned energy efficiency initiatives, including its proposed participation in the Efficiency Kansas loan program and education proposal. In addition, my testimony will evaluate the company's proposed decoupling mechanism and will provide recommendations for consideration by the Commission. In my evaluation of the company's energy efficiency portfolio and cost recovery mechanisms, I will assess whether these programs conform to the recommendations of the Commission's June 2, 2008 *Order Setting Energy Efficiency Policy Goals* in Docket No. 08-GIMX-442-GIV ("442 Docket") as well as the Commission's November 14, 2008 *Final Order Regarding Cost Recovery and Incentives for Energy Efficiency Programs* In Docket No. 08-GIMX-441-GIV ("441 Docket").

III. SUMMARY OF CONCLUSIONS

Q. Please summarize your conclusions and recommendations.

A. Based on my analysis of the Company's filing and other documentation in this case, my conclusions are as follows:

- The Commission should deny the company's proposal to become an Efficiency Kansas partner utility because of the high administrative costs that must be paid by all Kansas Gas Service customers, including those who do not participate in Efficiency Kansas and do not receive any benefit from the program.
- The Commission should deny the Seasonal Check-up Program, because it does not address energy efficiency in a comprehensive, "whole-house" way, as was directed by the Commission's Order in the 442 Docket.
- The Commission should deny the Natural Gas Direct-Use Program, because it promotes fuel-switching and does not pass the appropriate

benefit-cost tests. In the alternative, if the Commission chooses to approve the Natural Gas Direct Use program, Kansas Gas Service's shareholders should shoulder some, if not all, of the program's expenses.

- The Commission should deny the company's budget for educational energy-efficiency programs as it is proposed. In the alternative, the Commission should at minimum require the company to resubmit an educational plan that conforms to the 5% budgetary guideline provided by in the 442 Docket.
- The Commission should deny the company's request for a full decoupling mechanism because the company has not met the requirements set forth in the 441 Docket. In the alternative, if the Commission chooses to allow a decoupling mechanism, it should only do so only after a full evaluation, measurement and verification of energy-efficiency programs, and during a base rate case, so that the Commission has the opportunity to review the company's finances and adjust the company's return on equity to reflect the reduction in risk that results from such mechanisms.

IV. DISCUSSION OF THE ISSUES

A. Efficiency Kansas

Q. Please describe Kansas Gas Service's proposal to become an Efficiency Kansas partner utility.

A. Kansas Gas Service is seeking approval to become a partner utility in the Efficiency Kansas program. The Efficiency Kansas program is a revolving loan fund that was established in July 2009 by the Kansas Corporation Commission to facilitate energy conservation and efficiency improvements in existing Kansas homes and small businesses. Operated by the State Energy Office ("SEO"), a division of the KCC, Efficiency Kansas was funded with approximately $34 million in federal economic stimulus dollars, which were authorized by the American Recovery and Reinvestment Act of 2009 (ARRA). Under the program, the utility serves as a conduit between the KCC, which is providing the loan, and the customer receiving the loan.

If Kansas Gas Service becomes an EK partner utility, its customers will be able to access funding by contacting Kansas Gas Service and completing several steps, including a home energy audit, completion of a conservation plan, and installation of approved, cost-effective energy-efficiency measures. The customers will then agree to repay the principal amount of the loan and additional administrative fees through a line item on their monthly Kansas Gas Service bill. Kansas Gas Service will then remit the corresponding customer payment to the State Energy Office.

Kansas Gas Service is seeking approval to become a full participant in the Efficiency Kansas program under Option 1 of the Efficiency Kansas manual dated November 12, 2009. Efficiency Kansas has two options for partner utilities:

- Option 1: In this option, the utility will initially receive funds from the KCC to provide loans to ratepayers, on a regular monthly schedule, only after the State Energy Office has received a signed Certificate of Project Completion for each project. With regard to loan repayment, under Option 1, the utility is responsible for submitting monthly payment to the KCC only upon receipt of payment from the customer. In the event that customers fail to make their monthly payment of the program charge, the utility will be expected to make every effort to collect payment of delinquent program charges. At such time as the utility determines that it has exhausted its means of collection, the utility will notify the SEO and submit the "Verified Statement" form, as stipulated in the Memorandum of Agreement, at which time the KCC will assume the collection process for the defaulted Efficiency Kansas loan.
- Option 2: If utilities select this option, they will receive initial funds from the KCC to make the loans earlier in the process—upon approval of the Energy Conservation Plan by the State Energy Office. With regard to repayment, unlike Option 1, under Option 2, the utility is responsible for submitting monthly payment to the KCC, regardless of whether the customer has paid the utility bill. In the event of nonpayment by the customer, the utility will still remit payment to the KCC until the full cost

of the approved project has been repaid. The utility will be responsible for collection from customer and can request recovery of bad debts in a regular rate case; such recovery may or may not be approved by the Commission.

Q. What is the five-year budget for Kansas Gas Service to become an Efficiency Kansas partner utility?

A. Exhibit DND-7 in the company's filing estimates the five-year budget for becoming an Efficiency Kansas partner utility is $1,729,346.

Q. Do you have concerns regarding the budgeted amount for Kansas Gas Service to become a partner utility in Efficiency Kansas?

A. Yes. Kansas Gas Service is the first regulated utility to seek Commission approval to become an Efficiency Kansas partner utility. The Commission's decision in this case will set a precedent for other regulated utilities that follow. While the Efficiency Kansas program was designed with a utility track, I think that the Commission should be concerned about the level of utility spending that Kansas Gas Service claims is required to become a Efficiency Kansas partner utility.

According to the company's estimates, the budgeted expenses for the initial five years of Kansas Gas Service's participation as an Efficiency Kansas partner utility are as follows[1]:

[1] Exhibit DND-7.

- $932,405: a portion of salaries for four new energy-efficiency department employees (the remaining portions are allocated to specific Step One energy efficiency programs)
- $763,799: reference materials and education/marketing
- $33,143: evaluation, measurement and verification

All of these budgeted expenses are administrative in nature and are expected to occur whether this program has one participant or 400 participants. In addition, in his direct testimony, Mr. Dixon indicates that "(t)he resources necessary to administer the program will increase with the growth in customer participation."[2] While Kansas Gas Service will charge Efficiency Kansas participants administrative fees to offset some of the budgeted program expenses, the bulk of the Efficiency Kansas program expenses will be collected from Kansas Gas Service customers that do not participate in Efficiency Kansas.

Q. What are the administrative fees for a customer wanting to participate in Efficiency Kansas through Kansas Gas Service?

A. Each participant that wishes to access Efficiency Kansas funding through Kansas Gas Service will be required to pay a one-time fee of $120 – which will be used to help cover the incremental labor costs that will be dedicated to the implementation of Efficiency Kansas. Participants will also be required to pay a monthly fee of $2.00 – payable to the SEO for administrative costs – and a $4.00 monthly maintenance fee to defray Kansas Gas Service's costs of Efficiency Kansas billing and the associated reporting requirements.

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[2] Direct Testimony of Bradley O. Dixon at page 5.

Q. Will the administrative fees paid by program participants be sufficient to recover the expenses associated with this Efficiency Kansas program?

A. No. For the first five years, Kansas Gas Service estimates that $199,200 will be recovered from 400 customers participating in the Efficiency Kansas program. This recovered amount would offset against the program budget, with all remaining costs to be recovered from all of Kansas Gas Service's residential and general sales customers, including those customers who do not participate in the Efficiency Kansas program, through the company's proposed Energy Conservation Rider (ECR). If Kansas Gas Service's initial estimates of participation are correct, over 91% of the program charges will be paid by Kansas Gas Service customers who do not participate in the Efficiency Kansas program.

Q. Is Kansas Gas Service's estimate of participant charges correct?

A. No. In Mr. Dittemore's Exhibit DND-1, he indicates that for "purposes of underlying cost calculations, KGS has assumed 400 participants." However, later in Mr. Dittemore's Exhibit DND-7, estimated participant charges appear to be based upon 700 participants. Attached to my testimony is Exhibit SMH-1, which shows the Kansas Gas Service Efficiency Kansas budget summary for years 1-5 assuming an estimated 400 participants. By decreasing the participant count to 400 customers, Kansas Gas Service will receive $112,800 from participants. The remaining $1,616,547 will be recovered from all Kansas Gas Service's residential and general sales customers, including those customers who have received no direct benefit from the Efficiency Kansas program.

Q. If the Kansas Gas Service customers who participate in the Efficiency Kansas program were to pay the total administrative expenses, would the Efficiency Kansas program be cost-effective?

A. No. Based on Kansas Gas Service's estimated five-year budget of $1,729,347, each of the 400 customers participating in the Efficiency Kansas program would pay approximately $865 each year in administrative fees alone. This payment for administrative expenses would be made *in addition* to the payment on the principal amount of the loan the customer received from Efficiency Kansas. Because the SEO specifically requires that the program charge must not exceed 90% of the estimated energy savings, the program would not be cost effective if participants had to shoulder the burden of the utility's administrative expenses. The Commission must take into consideration that Kansas Gas Service estimates only 400 of its over 600,000 residential and general sales service customers (less than 0.06%) will take advantage of the Efficiency Kansas program.

Q. Will some customers pay for the Efficiency Kansas program twice, while not participating in, or receiving benefits from the program?

A. Yes. If the Commission requires customers who do not receive any direct benefit from Efficiency Kansas to subsidize the Efficiency Kansas program costs, it is likely that some customers will have to pay twice. For example, customers who receive utility service from more than one company and do not participate in the Efficiency Kansas program offered by either utility will be asked to pay the administrative expenses for both utilities to offer the Efficiency Kansas program. Many Kansas Gas Service customers receive electric utility service from either Westar Energy ("Westar") or Kansas City Power & Light ("KCP&L"). It is likely that these same customers will be required to pay expenses for Westar or KCP&L if they choose to become an Efficiency Kansas partner utility.

Q. What is your recommendation to the Commission about Kansas Gas Service's proposed Efficiency Kansas program?

A. While Kansas Gas Service is right to propose that participants pay the cost for the Efficiency Kansas program, it is clear that the administrative cost of being an Efficiency Kansas partner utility will overwhelm the benefits of the program. I encourage the Commission to recognize that a precedent will be set in this filing. If the Commission approves Kansas Gas Service's application as proposed, other utilities will use the application as a blueprint for their own Efficiency Kansas programs, making excessively high administration fees a normal occurrence within the program. Further, since Efficiency Kansas can only serve a very small portion of any utility's customers, the majority of customers are likely to end up paying these high Efficiency Kansas administrative fees to two utilities. I recommend that the Commission deny Kansas Gas Service's request as proposed in its filing. I encourage the Commission to direct Kansas Gas Service and the SEO to work together in order to find ways to improve operational efficiencies, so that the cost of the program will not be burdensome for customers who do not participate in Efficiency Kansas.

B. Step One Portfolio of Energy-Efficiency Programs

Q. Please describe the company's Step One energy-efficiency portfolio.

A. Kansas Gas Service has requested Commission approval for a suite of six energy-efficiency programs, as well as an educational component. The suite of energy-efficiency programs includes:

- Seasonal Check-Up Program
- Water Heater Program
- Space Heating System Program
- Natural Gas Direct Use Program
- ENERGY STAR ® New Homes Program
- Commercial Custom Program

Q. Do you have concerns about the Step One portfolio of programs?

A. Yes, I do. I have specific concerns regarding the seasonal check-up program, the natural gas direct use program and the educational component of the portfolio.

Q. Please describe the proposed Seasonal Check-Up program.

A. The Kansas Gas Service Residential Heating System Check-Up program provides residential customers with an incentive payment to cover a portion of the cost of having a third-party contractor conduct a seasonal home heating system check-up. A home check-up is typically a 21-point inspection, which may include general maintenance such as checking gas pressure, checking heat exchangers and cells, checking valves, checking all safety controls, etc.

Through this program, Kansas Gas Service customers can hire either an independent contractor or select one of Kansas Gas Service's preferred installers to perform a home heating system check-up. Upon completion of the check-up, customers submit the invoice and rebate form - if the customer selected an independent contractor - and receive a $30 incentive payment. If the customer selected one of Kansas Gas Service's preferred installers, the $30 rebate will be applied by the installer to the customer's invoice. Alternatively, customers can choose to apply the $30 incentive payment towards a setback thermostat.

Q. What is the budget for this program?

A. According to Exhibit PHR-1, the first-year budget for the seasonal check-up program is $196,676.

Q. Does this program meet the recommendations of the Commission in the 442 Docket?

A. No it does not. In the 442 Docket, the Commission encouraged utilities to consider programs or a suite of programs that will address energy efficiency in a comprehensive way and that will recognize the need to address the total home or building, utilizing sound building science principles to achieve energy efficiency. In addition, the Commission provided a specific example to clarify its statement: "a program that seeks to increase the efficiency of heating or cooling systems in a

[7] June 2, 2008 *Order Setting Energy Efficiency Policy Goals* in Docket No. 08-GIMX-442-GIV at paragraph 71.

home without a program that addresses inadequate insulation will not achieve the best result."[7] Kansas Gas Service's Step One portfolio of programs does not offer a program targeting inadequate insulation or other building envelope problems. Without such measures, the seasonal check-up program as proposed by Kansas Gas Service does not comply with the Commission's directives in the 442 Docket.

Further, this program requires only an analysis of the customer's heating system and the replacement of filters, if necessary, for a customer to receive an incentive payment. If a check-up of a customer's heating system requires no further customer action, no energy savings would be gained as a result of the check-up, but the customer would still receive the incentive payment. There is also no requirement that the customer carry out any of the recommendations of the contractor performing the check-up. This clearly contradicts the Commission's order in the 442 Docket.

Q. What does Kansas Gas Service estimate for participation in the seasonal check-up program.?

A. According to Exhibit PHR-1, Mr. Raab estimates that 6,264 customers will participate in the seasonal check-up program during the first year it is offered. He assumes this same level of participation for all five years of the seasonal check-up program.

Q. Do other states offer a seasonal check-up program similar to the proposal by Kansas Gas Service?

A. Yes. Virginia Natural Gas, Inc. ("VNA") had a similar seasonal check-up plan approved by the Virginia State Corporation Commission in 2008. The program is functionally the same as the proposal by Kansas Gas Service, offering a $25 incentive payment to customers that have a check-up of their heating system completed. VNA began offering the incentives through this program in March 2009.

Q. Please describe the initial results of VNA's seasonal check-up program.

A. A December 2009 report from the Virginia State Corporation Commission shows that in the first seven months of the program (March – September 2009), only 123 customers participated in the seasonal check-up program.[8] If the trend in participation remained the same through the end of February 2010, VNA's seasonal check-up program may have had 211 participants, which is far less than the 7,550 participants that were assumed by VNA in its application.

Q. What is your concern regarding the results of VNA's seasonal check-up program?

A. My primary concern is that the participation level seems to have been greatly over-estimated in Virginia, and given that the two programs are very similar, the

[8] December 1, 2009 Commonwealth of Virginia State Corporation Commission, Report to the Governor of the Commonwealth of Virginia, the Speaker of the House of Delegates, the President Pro Tempore of the Senate, and the Chairs of the House and Senate Committees on Commerce and Labor, Report: Implementation of the Natural Gas Conservation and Ratemaking Efficiency Act, at page 15.

participation in Kansas could also be over-estimated. While there are likely some differences attributable to demographics and location between Virginia and Kansas, if the customer participation in the seasonal check-up program offered by VNA is any indication of the participation levels that can be in Kansas, Kansas Gas Service's program will fall far short of achieving its savings goals.

Q. What is your recommendation regarding the seasonal check-up program as proposed by Kansas Gas Service?

A. I recommend that the Commission deny the company's application for this program because it is not consistent with the standards set in the Commission's order in the 442 Docket and because the company's estimate of participation may be greatly over-estimated. Further, the budget estimates for program cost recovery and lost margins associated with the seasonal check-up program should be removed from the budget assumptions for the company's Step One portfolio of programs.

Q. Has the Commission made a previous ruling that supports your recommendation?

A. Yes, it has. In Docket No. 08-KCPE-581-TAR ("581 Docket") the Commission denied the application of KCP&L to implement a Home Performance with ENERGY STAR® Program. The Commission rejected the program – which, as part of a comprehensive portfolio of programs, would have provided a rebate to customers to help offset the cost of a home energy audit – because it did not require the participant to implement recommended improvements in a manner that is logical and cost-effective from a whole-house concept point of view, nor did it require the customer to select the most effective energy-efficiency improvement identified by the audit. The Commission specifically expressed its concern that "because a participant is not required to implement recommended improvements in a comprehensive and logical way, energy efficiency savings from the program are not likely to be as dependable as possible, in the sense of a resource."[10] This Commission decision set a standard for energy-efficiency programs that offer an incentive payment, yet do not require that actual energy-efficiency measures be installed.

Q. Please describe the proposed Natural Gas Direct-Use program.

A. The natural gas direct-use program is intended to promote energy efficiency by replacing inefficient residential electric heating appliances with efficient gas heating equipment. Through this program, a customer (who is an existing electric heating customer in the Kansas Gas Service territory) must allow a Kansas Gas Service representative to conduct a residential energy evaluation. When this evaluation is complete, the company representative will advise the customer of the availability of an incentive payment to switch from an electric heating appliance to a natural gas heating appliance. Upon completion of the replacement of the customer's existing electric heating system with an 80% energy efficiency

[10] Docket No. 08-KCPE-581-TAR, Order on Staff's Report and on Petition for Reconsideration at paragraph 30 & 31.

or higher natural gas heating system, the customer will receive a $1,500 incentive payment from Kansas Gas Service.

Q. What is the budget for this program?

A. According to Exhibit PHR-1, the first-year budget for the Natural Gas Direct Use program is $150,140.

Q. What is your recommendation regarding the Natural Gas Direct-Use program as proposed by Kansas Gas Service?

A. I recommend that the Commission deny the company's application for this program. Further, the budget estimates for program cost recovery and lost margins associated with the Natural Gas Direct-Use program should be removed from the budget assumptions for the company's Step One portfolio of programs.

Q. Why should the Commission deny the company's application for this program?

A. The Commission should deny the company's application for two reasons: (1) the program encourages fuel-switching behavior and (2) the program will not pass the benefit-cost tests as adopted by the Commission in the 442 Docket.

Q. Please elaborate on the fuel-switching policy of the KCC.

The issue of whether it is appropriate to offer incentives to consumers for switching from one fuel source to another (*i.e.* from electricity to natural gas or vice versa) was raised by Kansas Gas Service in the 442 Docket.[12] The Commission opened Docket No. 09-GIMX-160-GIV ("160 Docket") in August 2008 in order to develop a policy regarding incentives paid to customers for fuel-switching for end-use applications.

Q. Has the Commission issued a final order in the 160 Docket, thereby setting policy regarding fuel-switching applications?

A. No, it has not. The Commission last issued an Order Accepting Staff's Report and Recommendation, Motion for Leave and Directing Parties to Submit Responsive Comments by May 29, 2009 and any Reply Comments by June 12, 2009, on May 13, 2009. No final order has been issued by the Commission.

Q. What were the recommendations of the Commission's Staff ("Staff") in the 160 Docket?

A. Staff suggested the Commission could find that a utility "would not be permitted to offer a specific incentive for replacing a piece of existing equipment that is fuel biased but could offer a general incentive to encourage energy efficiency improvements to insulation, the building envelope, or other items that either increase total site efficiency or efficiency for the specific fuel supplied by the utility."[13]

Additionally, Staff suggested the Commission find that "energy efficiency programs should be designed in a manner that does not bias an end-user toward a

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[12] April 16, 2008 Kansas Gas Service, Reply Comments for the Workshop, Docket No. 08-GIMX-442-GIV,.

[13] April 13, 2009 Notice of Filing of Staff Report and Recommendation in Docket No. 09-GIMX-160-GIV at page 27.

particular fuel but allows the end-user to make an efficiency improvement at the end-user location. Clearly, this would allow an electric utility to offer an incentive to an end-user with an existing heat pump to invest in a more efficient heat pump or a natural gas utility to offer an incentive to an end-user with an existing natural gas fueled furnace to install a higher efficiency gas furnace."[14]

The Natural Gas Direct Use program, as presented by Kansas Gas Service, clearly contradicts Staff's recommendation to the Commission in the 160 Docket. Since the Commission has not yet issued a final ruling in the 160 Docket, it would be premature for the Commission to approve Kansas Gas Service's Direct Use program, as it clearly has fuel-switching implications.

Q. What are your concerns regarding fuel-switching in energy-efficiency programs, like the Direct Use program proposed by Kansas Gas Service?

A. My primary concern is that allowing utilities to provide financial incentives to customers who agree to switch fuel sources will begin a never-ending bidding war between electric and natural gas utilities. As previously discussed, many of Kansas Gas Service's customers receive electric utility service from either Westar or KCP&L. Through the Direct Use program, Kansas Gas Service is proposing to offer a $1,500 rebate to a customer who agrees to switch from an electric heating appliance to a natural gas furnace. It is likely that this competition for customers will encourage an electric utility, in this case, Westar or KCP&L, to attempt to "outbid" Kansas Gas Service by offering a greater rebate to customers who switch from a natural gas furnace to a high-efficiency heat pump.

[14] April 13, 2009 Notice of Filing of Staff Report and Recommendation in Docket No. 09-GIMX-160-GIV at page 26.

These energy-efficiency programs that encourage fuel-switching will be funded by ratepayer dollars. Customers who receive natural gas service from Kansas Gas Service and electric service from an electric utility will be paying for the rebates offered to customers who switch from electric to natural gas and vice versa. Without safeguards in place to control the amount of financial incentives that encourage fuel-switching, the game being played by utilities to outbid each other will be played with customer's dollars and will likely become excessively costly to ratepayers.

Q. What benefit-cost tests were emphasized by the Commission in its order in the 442 Docket?

A. In the Commission's order in the 442 Docket, the Commission indicated that it would place emphasis on the Total Resource Cost (TRC) Test, because the TRC test reflects the benefit of implementing an energy-efficiency program throughout the utility's territory. Further, the Commission "has also identified the mitigation of customer bill increases as a primary goal. Thus, the Commission will also place an emphasis on the review of the Ratepayer Impact Method (RIM) Test."[15]

Q. Does Kansas Gas Service provide a summary of benefit-cost tests for the Direct Use program?

A. Yes they do. Exhibit PHR-3 shows that the Direct Use program has a TRC ratio of 1.42 and a RIM ratio of 0.77.

[15] June 2, 2008 *Order Setting Energy Efficiency Policy Goals* in Docket No. 08-GIMX-442-GIV at paragraph 39-40.

Q. Do you agree the Direct Use program passes the TRC test?

A. No, I do not. Generally speaking, a TRC ratio greater than 1.0 indicates a program is beneficial to the utility and to the utility's consumers as a whole. However, according to the *California Standard Practice Manual,* in fuel-switching applications, the "TRC cannot be applied meaningfully to load building programs, thereby limiting the ability to use this test to compare the full range of demand-side management options."[16] Therefore, if the Commission determines that a fuel-switching program, such as the Direct Use Program, will have load-building consequences, the TRC test cannot be used to assess the program's benefits.

Q. Since the Direct Use program cannot pass the TRC test, which benefit-cost test should the Commission use when evaluating the program?

A. Because the Direct Use program is a load-building program, rendering the TRC test invalid, only the RIM test remains as an effective way to measure the program's economic efficiency. The RIM Test provides a measure of program impacts on utility rates or on customer bills. Programs that cause utility rates to increase will have a RIM ratio of less than 1.0. In its initial comments in the 442 Docket, Kansas Gas Service made the following recommendation to the Commission: "In addition to the Participants Test, the Total Resource Cost Test and the Program Administrator Cost Test, the RIM test should also be used for program evaluations, and a program should be required to pass the RIM test before implementation."[17] Because the TRC test cannot be applied, and the calculations provided by Kansas

[16] *California Standard Practice Manual: Economic Analysis of Demand-Side Programs and Projects;* July 2002, at 21.
[17] December 21, 2007 Comments of Kansas Gas Service, In the Matter of the General Investigation Regarding Cost Recovery and Incentives for Energy Efficiency Programs, Docket No. 08-GIMX-442-GIV, at page 31.

Gas Service indicate that the Direct Use program has a RIM ratio less than 1.0, the Commission should deny this program.

Q. Do you have an alternative recommendation to the Commission regarding the Natural Gas Direct Use program?

A. Yes. If the Commission allows Kansas Gas Service to offer a fuel-switching program like the Direct Use program, shareholders should shoulder some, if not all, of the expense. The Direct Use program as proposed by Kansas Gas Service would grow the company's rate base by increasing the number of customers and therefore its investment, which in turn will benefit shareholders directly through higher operating income awards. A current Kansas Gas Service customer will experience no direct benefit from the addition of new Kansas Gas Service customers, and therefore should not be asked to fund a fuel-switching program.

Q. Please describe the company's proposed education program.

A. Kansas Gas Service has proposed an educational component within its Step One portfolio that is designed to raise awareness of the benefits of energy-efficiency and inform customers how to conserve energy. The educational component will also be used to advise customers of rebates and tax incentives, as well as to increase public awareness of the Efficiency Kansas loan program.

In his direct testimony, Mr. Dittemore indicates that in the first year, the majority of educational expenses will be for research and customer analysis, as well as web-site development and other marketing costs. After the initial year of the programs, annual educational expenses will include web-site maintenance fees and the costs of preparing and printing various education program materials.

Q. What is the Commission's position regarding energy-efficiency programs that are classified as educational programs?

A. In the Commission's April 13, 2009 *Order Following Collaborative on Benefit-Cost Testing and Evaluation, Measurement, and Verification* in Docket No. 08-GIMX-442-GIV, the Commission stated that educational programs should not be subjected to the five benefit-cost tests as defined in the California Standard Practice Manual. The Commission further stated that it "believes a 5% level is useful as a guideline for total energy efficiency portfolio funding devoted to educational programs."[18]

Q. Does the budget proposed by Kansas Gas Service for educational programs meet the Commission's guidelines?

A. No. Exhibits DND-7 and DND-8 show expenses classified as "education" are $668,799 and $1,048,609 for the five-year budgets of Efficiency Kansas and the Step One portfolio, respectively. When compared to the respective total program budgets of $1,729,346 and $10,431,463 for Efficiency Kansas and the Step One portfolio, the education component of Kansas Gas Service's energy-efficiency portfolio is over 14%. This is clearly above and beyond the 5% guideline that was recommended by the Commission in the 442 Docket.

[18] April 13, 2009 *Order Following Collaborative on Benefit-Cost Testing and Evaluation, Measurement, and Verification* in Docket No. 08-GIMX-442-GIV @ paragraph 29 & 32.

Q. What is your recommendation for the Commission regarding the company's proposed educational program budget?

A. It is important the Commission recognize that the trend in declining average customer use of natural gas use in Kansas has occurred with no comprehensive energy-efficiency programs in place. Customers have made independent choices to reduce their energy consumption, without the assistance of utility-sponsored education or energy-efficiency programs. The Commission should deny the Kansas Gas Service budget for educational programs as presented. In the alternative, the Commission should at minimum require the company to resubmit an educational plan that conforms to the 5% budget guideline.

Q. Do you have other general comments regarding the other programs in the company's Step One portfolio?

A. Yes, I have two general concerns. First, I am concerned about the financial burden placed on Kansas Gas Service customers who do not participate in the proposed energy-efficiency programs. While I have not offered a specific opinion regarding the company's proposed water heater program, space heating program, ENERGY STAR® New Homes program, or the commercial customer program, I would encourage the Commission to recognize the inherent inequities of these programs for participants and non-participants. While electric utilities may offer energy-efficiency programs as an alternative to building new generation facilities, natural gas utilities like Kansas Gas Service can only avoid the cost of fuel. While each of the programs proposed by Kansas Gas Service may have direct benefits for the customer who takes advantage of the program – because the cost of fuel is passed on to the customer, customers who decrease their individual consumption will experience a direct benefit in fuel savings – the programs offer no direct benefit to the customer who does not participate, but who still has to pay for them.

Second, I do not believe that the benefit-cost test results given in Mr. Raab's direct testimony are accurate. In its filing, Kansas Gas Service indicates that "there are other Kansas Gas Service employees who will be heavily involved in the deployment of our programs."[19] Later it is again clarified that "a number of other existing KGS employees will be involved in various aspects of program implementation…"[20] Because the cost of existing resources are considered by Kansas Gas Service as "overhead", the corresponding costs have not been included in the program budget or in benefit-cost tests.

In its response to CURB Data Request 10, Kansas Gas Service admitted that the expenses associated with existing resources "were not included in the benefit-cost tests in Mr. Raab's testimony."[21] Kansas Gas Service later acknowledged in CURB Data Request 15, that it "has not done studies in an effort to estimate the embedded overhead costs associated with these programs, nor can they be reasonably estimated, especially since they are new programs."[22] Because the company has not recognized the actual expenses, whether classified as incremental or existing resources, which are incurred in an energy-efficiency program, the results of the benefit-cost tests will be overstated.

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[19] Dixon direct testimony at page 6.
[20] Dittemore footnote on page 11 of direct testimony.
[21] KGS response to CURB data request 10, included at exhibit SMH-3.
[22] KGS response to CURB data request 15, included at exhibit SMH-4.

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

Q. Please describe the company's revenue normalization adjustment.

A. Kansas Gas Service has proposed a revenue normalization adjustment (RNA) to be implemented in conjunction with its Efficiency Kansas and Step One programs. The RNA mechanism proposed by Kansas Gas Service is a full decoupling mechanism, based upon the company's total allowed revenue in its most recent rate case, Docket No. 06-KGSG-1209-RTS ("1209 Docket"). The RNA is a component within the ECR and will be calculated as the difference between the actual, weather-normalized revenue for the Residential and General Sales Service classes, respectively, and the base revenues for these classes that were established in the 1209 Docket. In short, the RNA mechanism will guarantee Kansas Gas Service receives its approved revenue requirement regardless of the level of sales to its customers.

Kansas Gas Service has indicated that unless the Commission approves the company's ECR proposal, along with its RNA mechanism, the company will not implement these energy-efficiency programs. Kansas Gas Service further points to the Commission's order in the 441 Docket, and suggests that its filing is consistent with the Commission's order.

Q. Please discuss revenue decoupling in general.

A. Decoupling is a regulatory mechanism that separates, or "decouples," a utility's revenues from its sales of energy, in this case natural gas. Decoupling is a departure from traditional cost-of-service principles, which historically provide utilities with only the opportunity to earn a fair return. With a decoupling mechanism in place, a utility is guaranteed recovery of its authorized revenues and is therefore insulated from the impact of changing economic conditions, weather, or new technologies on sales.

In traditional ratemaking, rates are based on an evaluation of the utility's costs incurred during a single period, the test year. Once the utility's revenue requirement is determined, rates are designed with the goal of providing the utility a reasonable opportunity to recover its authorized revenue requirements. However, there is no guarantee of recovery. Traditionally, utilities are motivated to promote gas sales and find economic efficiency in operations between rate cases in order to increase revenues and profit. By contrast, with a decoupling mechanism, utilities are allowed to adjust rates between rate cases to ensure that its authorized revenue requirement is recovered. Thus, utilities may be less motivated to promote sales between rate cases and are indifferent to changes in customer usage because the stream of revenue required to meet its revenue requirement will be guaranteed.

There are various forms of decoupling mechanisms, including weather normalizations, lost revenue recovery mechanisms, revenue per customer, straight-fixed variable (SFV), and a full decoupling mechanism. Kansas Gas Service has requested a full decoupling mechanism which provides the utility guaranteed recovery of any shortfall in actual revenue from its authorized revenue requirement, through a rate surcharge on customer bills.

Q. Why is Kansas Gas Service requiring approval of a decoupling mechanism before it begins implementing energy efficiency programs?

A. Kansas Gas Service contends its current rate structure provides a disincentive to help its customers reduce consumption, due to the fact that it recovers a portion of its total fixed costs through volumetric rates. The company theorizes that if it offers the proposed energy-efficiency programs, consumers would decrease consumption as a result of their participation in these programs, thereby making it difficult for Kansas Gas Service to recover a portion of its fixed costs.

Kansas Gas Service presents its proposal for decoupling as a *quid pro quo*: the company will implement a portfolio of energy-efficiency programs if, and only if, the Commission allows the company to implement a full decoupling mechanism.

Q. Do you agree that the Kansas Gas Service RNA mechanism is consistent with the Commission's ruling in the 441 Docket?

A. For several reasons, no, I do not.

Q. Please discuss why Kansas Gas Service's proposal is not consistent with the Commission's order in the 441 Docket.

A. There are five specific guidelines relating to decoupling in the Commission's order in the 441 Docket that Kansas Gas Service fails to meet. Kansas Gas Service:

- fails to include programs that target low-income or fixed-income customers,

- fails to demonstrate that the company's finances would experience a significant negative impact as a result of implementing its portfolio of programs,
- fails to include analysis of the expected financial outcome for the utility without the EE portfolio in place for comparison,
- fails to include rate caps to prevent rate volatility, and
- fails to recognize the reduction in risk by appropriately reducing the company's return on equity ("ROE").

Q. Discuss the Commission's concerns regarding low-income or fixed-income customers.

A. In the 441 Docket, the Commission stated its strong preference that companies' energy-efficiency plans include proposals to target low-income and fixed-income customers. The Commission further stated that it "... will not approve a rate design proposal that, as a whole, harms low-income and fixed-income customers or disproportionately negatively affects such customers." [23] In addition, the Commission expressed its concern about the potential negative impact on low-income and fixed income customers, and stated that "natural gas utilities must include an estimate of the impact their proposed rate structure will have on these customers, and if negative, how to address any disproportionate impact to these customers."[24]

[23] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV @ 76.
[24] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV @ 75-76.

Q. Has Kansas Gas Service included programs that target low-income or fixed-income customers?

A. No. Kansas Gas Service's current filing includes no program that targets low-income or fixed-income customers.

Q. Do you have other comments regarding the Commission's requirements for low-income or fixed-income customers?

A. Yes. The Commission clearly expressed concern for low-income customers in its order in the 442 Docket, stating that while "recognizing that addressing societal inequalities is not its primary mandate, the Commission nevertheless believes program proposals should provide an analysis of anticipated impact on low-income consumers and urges utilities to propose programming aimed at low-income consumers where appropriate."[26] Kansas Gas Service's application contains no such analysis or estimate of the impact on low-income or fixed-income customers, nor does it explain how the company plans to address any disproportionate impact.

Given the Commission's firm insistence that the company provide analysis of potential negative impact on low-income and fixed-income customers from its proposed decoupling mechanism, Kansas Gas Service's Application falls short. It not only fails to provide the required analysis, but also fails to conform to the Commission's strong preference that a company's portfolio of EE programs includes at least one program that targets such customers' needs.

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[26] June 2, 2008 *Order Setting Energy Efficiency Policy Goals* in Docket No. 08-GIMX-442-GIV at paragraph 28.
[28] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraph 47.

Q. Did the Commission require that a company must demonstrate a significant impact on its finances before a decoupling mechanism would be approved?

A. Yes. In the 441 Docket, the Commission accepted Staff's position, indicating that it would "consider decoupling as a method if a utility can show that a program will have significant detrimental impact on company finances."[28]

Q. Did the Commission quantify what "significant" is, when considering decoupling proposals?

A. No. In the 441 Docket, the Commission used the term "significant" in two different contexts: (1) for the recovery of programs costs and (2) when referring to the impact on company finances when considering decoupling mechanisms. When discussing the requirement for program cost recovery, the Commission defined "significant" as "... a level of expense necessary to justify putting a rider on customers' bills." The Commission further explained that it may define "significant" program costs by using the guideline of ½% of base revenue that has been established by the legislature as a minimum level of expense for approval of a GSRS in K.S.A. 66-2203.[29] However, the Commission did not define "significant" in terms of the impact on company finances for consideration of a decoupling mechanism.

[29] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraph 36.

Q. Did Kansas Gas Service identify the financial effects of their proposed energy-efficiency programs?

A. Yes. In Exhibit PHR-4, Mr. Raab calculates the impacts of the company's six proposed energy-efficiency programs. According to his exhibit, Mr. Raab indicates that Kansas Gas Service will experience lost margins of $1,572,758 because of energy-efficiency programs.

Q. Do you agree with Mr. Raab's calculation of lost margins in Exhibit PHR-4?

A. No, I do not. Mr. Raab calculates volumes saved for each of the six proposed energy-efficiency programs, including the Seasonal Check-up Program and Natural Gas Direct Use Program. As identified previously in my testimony, the Seasonal Check-up Program makes no requirement that any energy-efficiency measures are performed. Because there is no requirement for a customer to install any energy-efficiency measures in order to receive an incentive payment, the company's estimate of energy savings associated with the seasonal check-up program are likely overstated.

In addition, the Natural Gas Direct Use Program offers an incentive payment to consumers who switch from electric heating appliances to natural gas heating appliances, thereby increasing load for Kansas Gas Service. By definition, this program is a load-building application, which would not result in volumes saved, but rather, would directly result in an increase in volumes sold by Kansas Gas Service. By removing the $118,577 and $110,406 of lost margins associated with the Seasonal Check-up Program and the Natural Gas Direct Use Program, respectively, the company's claim for margins lost due to energy-efficiency programs is $1,343,775.

Q. Does the lost margin of $1,343,775 demonstrate a significant detrimental impact on the finances of the company, as required by the Commission?

A. No. Kansas Gas Service has authorized revenue requirements of $182,113,692 and $40,798,857 for the residential and general sales service customers, respectively. Based upon the estimate of lost margins, Kansas Gas Service will experience a 0.6% revenue shortfall from the implementation of its energy-efficiency programs. A loss of 0.6% should not be considered as "significant" by the Commission.

Q. Discuss the Commission's requirement that utilities provide a comparison of financial impacts with or without energy-efficiency programs.

A. The Commission stated in the 441 Docket that "the utility should provide a comparison of the potential financial impacts of the energy efficiency programs it has received approval for or intends to seek approval for and the expected financial outcome without energy efficiency programs in place."[30] This requirement derives from Staff's recommendation that in order to consider a decoupling mechanism, the company must demonstrate that energy-efficiency programs will have a significant detrimental impact on company finances.

[30] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraph 72.

Q. Why is a comparison of potential financial impacts important?

A. A comparison of the financial impacts, with and without energy-efficiency programs, is important for two reasons: (1) to provide a baseline for comparison and (2) to establish that the energy-efficiency programs have a significant impact on the company's finances.

A baseline determination of the company's revenues must be done in order to correctly anticipate the impacts of energy-efficiency programs. Without a baseline for comparison, there can be no assurance that decoupling will relieve revenue volatility for the company or that it will not create rate volatility for the customers.

A comparison of financial impacts will demonstrate whether or not the company expects its suite of energy-efficiency programs to have an impact on its finances. This comparison is vital in determining what impacts are occurring due to successful energy-efficiency programs as opposed to other external factors, like the weather or the economy.

Q. Does Kansas Gas Service include a comparison of the potential financial impacts without energy-efficiency programs in place?

A. No. Kansas Gas Service's application fails to provide the required comparison of the potential financial impacts with its proposed energy efficiency programs and the expected financial outcomes without the proposed energy programs in place.

Q. Discuss the Commission's requirement that decoupling applications must include annual caps in order to prevent rate volatility.

A. In the 441 Docket, the Commission stated that "(o)ne of the dangers of decoupling is that rates for utility customers can be more volatile between rate cases since it is the utility that has the 'price guarantee' and not the customer." The Commission concluded that annual caps would mitigate this problem, and determined that "(t)he Commission will require any decoupling proposal to include such a safety mechanism." [31]

Q. Why are annual rate caps necessary in order to prevent rate volatility?

A. Annual rate caps protect consumers from sizeable bill increases from one year to the next. A full decoupling mechanism without a cap as proposed by Kansas Gas Service, leaves the customer vulnerable to large swings in bill amounts, due to fluctuating customer usage. Annual caps protect the customers by limiting the amount the company can recover through its RNA mechanism.

Q. Does the company's decoupling mechanism include annual caps in order to address rate volatility for consumers?

A. No it does not.

[31] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV 65.
[33] Direct Testimony of Paul Raab at page 41.

Q. What safety mechanism, if any, does Kansas Gas Service offer to reduce volatility?

A. Kansas Gas Service's decoupling proposal does not include annual rate caps that will help alleviate rate volatility for customers. In his direct testimony, Mr. Paul Raab simply indicates that appropriate safety mechanisms are in place because "customer bills will not be able to be adjusted to a higher revenue level than was authorized by the Commission in Docket No. 06-KGSG-1209-RTS ..."[33]

Q. Is the safety mechanism Mr. Raab references in compliance with the Commission's stated requirement for decoupling proposals?

A. No, it is not. The company's proposed decoupling mechanism does not provide a cap on rates for customers to alleviate unwarranted rate volatility. Kansas Gas Service's assertion that the Company is constrained from collecting more class revenue than it would have been able to collect in its last rate case misses the point entirely: the Commission was speaking of an annual cap on *rates*, not revenues. Given that Kansas Gas Service's proposal does not include annual rate caps, it fails to meet the Commission's minimum requirements for a decoupling mechanism.

Q. Does the Commission believe that decoupling lowers the level of risk for a utility?

A. Yes. The Commission stated in its final order in the 441 Docket that "decoupling lowers risk for a utility, because utility revenues are stabilized and protected from sales fluctuations." As a result, "The utility's likelihood of receiving its rate-case established revenue requirement is significantly increased. The Commission will accordingly factor this lowered risk in setting rates of return in rate cases." [34]

Q. Is the Commission correct to consider the reduced risk that decoupling provides the company?

A. Yes. The Commission is correct to recognize the reduction of risk for Kansas Gas Service shareholders. Kansas Gas Service customers currently bear the risk of the cost of gas, any improvements to infrastructure made through the Gas Safety and Reliability Surcharge (GSRS) tariff, and the risk of fluctuating weather. If the Commission were to grant Kansas Gas Service full decoupling, Kansas Gas Service shareholders will be insulated from any sales declines caused by all factors, including recessions, the weather, and purely customer-initiated conservation efforts. Consequently, if Kansas Gas Service is to be insulated from such risks, then its authorized ROE should be reduced.

The Commission's decision to factor in the utility's reduction of risk when a decoupling mechanism is approved is supported by statements from Moody's Investors Service. In a June 2005 Special Comment on the Impact of Conservation on Gas Margins and Financial Stability in the Gas LDC Sector, it was determined by Moody's that "having utility rate designs that compensate the gas LDCs for margin losses caused by variations in gas consumption due to conservation as with variations due to weather, would serve to stabilize the

[34] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraph 64.

utility's credit metrics and credit ratings. Utilities having these ratemaking mechanisms also tend to carry "A" credit ratings."[35]

This reduction of risk is also voiced in a June 30, 2008, Report to the Minnesota Public Utilities Commission by The Regulatory Assistance Project where it is stated that "(d)ecoupling can significantly reduce earnings volatility due to weather and other factors and can eliminate earnings attrition when sales decline, regardless of the cause (*e.g.*, appliance standards, energy codes, customer or utility-financed conservation, self-curtailment due to price elasticity, etc.). This in turn, lowers the financial risk for the utility, which in turn is reflected in the company's cost of capital."[36]

Q. Does Kansas Gas Service propose lowering its ROE, as a reflection of its reduced risk?

A. No. Instead of addressing the Commission's concerns regarding risk, rate volatility and ROE, Kansas Gas Service simply tries to dismiss the Commission's decision in the 441 Docket.

Q. Please explain the company's position on the reduction of risk?

A. Kansas Gas Service contends that a full decoupling mechanism would not reduce the company's level of risk. In his direct testimony, Mr. Raab says the inherent risk associated with customers choosing alternate energy sources, like electricity,

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[35] Moody's Investor Service: Special Comment on the Impact of Conservation on Gas Margins and Financial Stability in the Gas LDC Sector, June 2005.

[36] Shirley, Wayne, et al, Regulatory Assistance Project, *Revenue Decoupling Standards and Criteria,* June 30, 2008, page 8. *(Decoupling Standards).*

is not accounted for anywhere in the company's RNA proposal. Mr. Raab identifies this as a major risk for a natural gas utility, which is not alleviated with the implementation of decoupling.

Q. Do you agree with Mr. Raab's statement that decoupling does not reduce the company's level of risk?

A. No, I do not. Instead of discussing the risk reduction associated with a full decoupling mechanism, Mr. Raab attempts to identify other risks that may exist for the utility. Mr. Raab identifies "the major risk" for a natural gas utility is a customer deciding to choose an alternate energy source, like electricity, instead of natural gas. However, this "major risk" would be mitigated by the company's proposed full decoupling mechanism. Because Kansas Gas Service has requested approval for a full decoupling mechanism, it would not matter if the company lost customers, for any reason. Under the company's proposal, the number of customers or the average consumption per customer would not affect the company's ability to recover its authorized revenue requirement. The decoupling mechanism as proposed by Kansas Gas Service would simply "true-up" annual revenues to the amounts authorized in the 1209 Docket, without any regard to a change in the number of customers. If Kansas Gas Service is granted a full decoupling mechanism, the company will be completely insulated from "the major risk" of customers choosing to leave the system.

Q. Can the Commission adequately evaluate a company's ROE in this kind of tariff filing?

A. No. If the Commission is to follow through with its intention to reflect the lower risk of revenue recovery with decoupling by reducing the company's rate of return, the Commission could only do so on the basis of the kind of evidence that is presented in a base rate case, not on the limited evidence presented in this filing. Before approving the implementation of a revenue recovery mechanism that provides recovery for deviations from the norm, the Commission must establish a base line for the norm. Such a base line norm can only be established in a base rate case.

Further, the company's last rate case was filed in May 2006, using test year data from January 1, 2005 to December 31, 2005. The figures used to determine the authorized revenue requirement, as well as the company's ROE, are now over four years old. By asking the Commission to approve full decoupling based upon data obtained from a test year over four years ago, the company is, in essence, asking the Commission to conclude that the cost of service and revenue requirement authorized in 2006 remains just and reasonable, without a factual basis or a review.

Q. Have other states recognized the need for a full rate case review in order to approve a decoupling mechanism?

A. Yes. In 2007, the Nebraska Commission recognized the possibilities of increased rates and risk shifting from decoupling, without a full review of the company's financial operations:

> Automatic rate mechanisms raise concerns of piecemeal rate making by adjusting for only one element of cost without accounting for other increases and decreases in costs incurred by the utility. Such automatic mechanisms can lead to excessive rates, an inappropriate shifting of risks from stockholders to ratepayers, and decreased incentives to operate efficiently. Therefore their use should be limited.[37]

Nebraska Public Service Commission, Application No. NG-0041, July 24, 2007.

The Indiana Public Service Commission also recognized that timing the implementation of new rate design mechanisms is best served in a full rate case:

> The Commission recently recognized in its October 21, 2009 Order in Cause No. 43180, *In re Commission's Investigation into Rate Design Alternatives and Energy Efficiency Measures for Natural Gas Utilities,* that addressing rate design is most reasonable in a base rate case. (p.10.) "In the context of a rate case, parties, and ultimately this Commission, can address and thoroughly review issues regarding revenues, expenses, and cost of service. Further, we agree with the OUCC's comments that decoupling mechanisms clearly shift risk from the utility to ratepayers, and that reduction of risk should be considered in determining the appropriate return on equity .... "[38].

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[37] In the matter of Aquila, Inc. d/b/a Aquila Networks (Aquila) Omaha, seeking individual rate increases for Aquila's Rate Area One, Rate Area Two, and Rate Area Three. Before the Nebraska Public Service Commission. Application No. NG-0041. July 24, 2007.

[38] State of Indiana, Indiana Utility Regulatory Commission, Cause No. 43427. Order By the Commission, December 16, 2009..

Q. Does the Kansas Gas Service request for approval of a full decoupling mechanism, prior to implementing energy-efficiency programs, conform to recommendations made in the 441 Docket?

A. No, it does not. In its October 10, 2008 Notice of Filing of Staff's Report to Commission, Staff recommends that energy efficiency programs be in place prior to the approval of a decoupling mechanism. The Commission agreed in its order in the 441 Docket, saying "that it is highly unlikely to address a decoupling proposal without a demonstrated connection to an energy efficiency program . . ."[39]

Q. Please elaborate on the requirement that decoupling proposals be made with a demonstrated connection to energy-efficiency programs.

A. The requirement that decoupling proposals be made with a demonstrated connection to energy-efficiency programs helps establish whether the utility is offering successful programs that are reducing customer usage, or whether the utility is simply suffering from rate-stability issues. In its order in the 441 Docket, the Commission made it clear that "the issue of decoupling involves broader considerations than the impact of energy efficiency measures." In discussing the trend in declining per-customer usage of natural gas, and acknowledging the unique challenges that natural gas utilities face in meeting their revenue needs, the Commission in the order in the 441 Docket noted that decoupling is a "potential remedy" for "maintaining revenue stability," and said it would "consider

[39] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV, at paragraph 70.

[41] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraphs 57-58.

decoupling proposals from natural gas companies with concerns about revenue stability" on a case-by-case basis.[41]

Q. Do you believe that the decoupling proposal submitted by Kansas Gas is related to revenue stability, as opposed to energy-efficiency measures?

Yes I do. Mr. Raab explains the revenue stability problem in his direct testimony stating that "(w)hen customers use less natural gas, utility profitability always suffers ..."[42] Further, in the company's last rate case, Mr. Bradley Dixon, President of Kansas Gas Service, provided testimony describing factors that were contributing to a revenue deficiency. In direct testimony, Mr. Dixon was asked "(h)ave the company's earnings also been impacted by the trend of declining gas consumption?" Mr. Dixon responded "Yes. Average residential customer consumption has experienced a continuing and significant decline. The trend of using natural gas more efficiently will continue to reduce the individual customer consumption and erode the company's revenues."[43]

When that testimony was provided by Mr. Dixon in May 2006, Kansas Gas Service did not have a portfolio of energy-efficiency programs. Mr. Dixon's testimony in 2006 identifies a specific trend of consumers making independent decisions to reduce their personal energy consumption. Specifically, consumers responded to the high price of natural gas by using less, without utility-sponsored energy-efficiency programs, which in turn resulted in more volatility in Kansas Gas Service's revenues.

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[42] Direct Testimony of Paul Raab at page 37.

[43] Docket No. 06-KGSG-1209-RTS, Direct Testimony of Bradley Dixon, at page 7.

Q. Is there other evidence that leads you to believe that Kansas Gas Service's request for a full decoupling mechanism is related to revenue stability as opposed to energy-efficiency?

A. Yes. ONEOK, the parent company of Kansas Gas Service, gave a presentation at the Credit Suisse Energy Summit in Colorado on February 13, 2010. The presentation highlighted ONEOK's key investment considerations and strategies for its distribution companies, like Kansas Gas Service. ONEOK's discussion about its distribution companies in Kansas, Oklahoma and Texas highlight the changes seen in the three states since 2005. According to ONEOK's presentation, in 2005, ONEOK's distribution companies in Oklahoma, Kansas, and Texas were at risk for losses because they were not guaranteed capital cost recovery, recovery of bad-debt expense, and each state had low customer charges. Policies in place in 2005 permitted ONEOK to achieve a return on equity of 5.3% in 2006. [44]

Q. How has ONEOK mitigated its level of risk?

A. ONEOK has been able to mitigate its level of risk with successful execution of rate strategies. In 2009, ONEOK distribution companies in Oklahoma, Kansas, and Texas have reduced their level of risk by gaining regulatory approval for measures such as an increased customer charge, a weather-normalization adjustment, and other innovative rate designs, such as decoupling and performance-based rates. Specifically, ONEOK points out that its distribution companies have been able to provide a low-risk, stable cash flow through rate

[44] ONEOK February 3, 2010 Presentation at the Credit Suisse Energy Summit in Vail Colorado, at slide 21-22. Slides 21-22 are provided in Exhibit SMH-2. The entire presentation can be viewed at http://ir.oneok.com/events.cfm.

design strategies, which have in turn led to an increase in sustainable earnings and an improved return on equity. According to its presentation at the Credit Cuisse Energy Summit, in 2009, thanks to these innovative rate mechanisms, ONEOK was able to an ROE of 10.1% (a 91% increase from its 2006 ROE).

Q. In its February 3, 2010, presentation at the Credit Suisse Energy Summit, does ONEOK address energy-efficiency or conservation and the distribution risks associated with decreased customer usage due to conservation?

A. No, it does not. ONEOK's presentation at the Credit Suisse Energy Summit detailed over 73 slides the different divisions of ONEOK's operations, including its distribution companies in Oklahoma, Texas and Kansas. At no point during the presentation does ONEOK recognize any risk incurred by its distribution companies with decreased customer usage due to energy-efficiency programs. Instead, ONEOK focuses on its successful execution of rate strategies and how these strategies have helped the company increase its level of earnings and have mitigated the distribution companies' level of risk, despite the trend of decreasing natural gas consumption. From ONEOK's presentation, it is clear that its goals are not related to energy-efficiency, but rather to achieving a level of ROE through the implementation of innovative rate designs.

Q. Based on ONEOK's presentation, do you think that the request for a full decoupling mechanism is related to the energy-efficiency programs proposed by Kansas Gas Service?

A. No, I do not. It is clear from its presentation at the Credit Suisse Energy Summit that ONEOK is assuring its investors that the company is financially sound and is implementing innovate rate strategies in order to reduce its risk further. The proposal by Kansas Gas Service to implement a full decoupling mechanism is clearly intended to further increase the company's revenue stability and to decrease the level of risk for ONEOK shareholders.

Q. Is this tariff filing the appropriate place for the Commission to address revenue stability issues?

A. No. If Kansas Gas Service has concerns about revenue stability, then the forum for determining whether revenue volatility threatens to have a significant negative impact on the company's finances is a base rate case. If Kansas Gas Service wishes to provide evidence that its energy-efficiency portfolio has been so successful that it has significantly reduced its revenues, it should wait to request decoupling until an evaluation, measurement and verification ("EMV") review of the portfolio's performance after two or three years has confirmed the impact of the portfolio on revenues. A tariff docket, in and of itself, is not the appropriate venue for establishing evidence of the financial stability of the company and distinguishing between impacts of the general trend of decreasing per-customer sales of natural gas and the specific impacts of the company's EE portfolio on those customer sales. Only in a rate case can we assess how those various influences have impacted sales so that we have a true picture of a utility's financial condition. Without such an assessment, Kansas Gas Service's purported need for decoupling cannot be confirmed.

Q. Do you have other general concerns regarding the implementation of a full decoupling mechanism as proposed by Kansas Gas Service?

A. Yes, I do. When the Commission issued its order in the 441 Docket, the nation was just entering what appeared to be a recession. In its final order, the Commission expressed concern whether "raising short term costs" was appropriate "at this time." The Commission also expressed concern that "this potential economic downturn may have a negative effect on energy usage independent of any energy efficiency program." As the Commission noted, "declines in energy usage per customer will result in increases in customer rates" under decoupling. The Commission's concern in 2008 that "(t)his is a time when a Kansas experiment with a throughput incentive approach must be carefully considered" is an even more valid concern today.[45] Experiments with decoupling mechanisms should not be conducted on customers who are already struggling to meet their utility needs, especially when decoupling has the potential of increasing customer rates and making them more volatile. Simply stated, economic conditions in Kansas are not amenable at this time to exposing utility customers to the significant risk of increased rates and rate volatility without offsetting that significant risk with a requisite reduction on the overall return.

[45] November 14, 2008 Final Order in KCC Docket No. 08-GIMX-441-GIV at paragraphs 9 & 61.

In addition, a fully-decoupled form of cost recovery shifts all revenue risks to the ratepayers, by providing the company with a revenue guarantee. Guaranteed revenues will certainly dampen the consumers' incentive to conserve if, regardless of how much they reduce consumption, they will continue to owe the utility the same amount of revenue. Where consumers benefit from decoupling is when the Commission balances the ratepayers' assumption of virtually all of the utilities' revenue risks by substantially reducing the return on equity to the utilities.

Q. What is your recommendation in regards to the company's RNA mechanism?

A. Because the company has failed to meet specific requirements set forth in the 441 Docket, I recommend the Commission deny the company's proposed RNA mechanism.

Q. Do you have a recommendation, in the event that the Commission approves the company's proposed RNA mechanism?

A. Yes. While I contend that this filing is not the appropriate forum to implement new rate design concepts, if the Commission were to grant Kansas Gas Service's petition and approve a full decoupling mechanism, the Commission should require the following:

(1) a full decoupling mechanism not be granted until Kansas Gas Service's next full rate case, so that the Commission has a chance to examine the company's complete finances;

(2) only after the company's successful implementation of a suite of energy-efficiency programs and a full EM&V review of the program will the Commission consider a full decoupling mechanism;

(3) elimination of the weather normalization adjustment, with a simple annual revenue true-up to Kansas Gas Service's approved revenue requirement; and

(4) the Commission will recognize a reduction in risk for the company by reducing the approved ROE.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

STATE OF KANSAS)

COUNTY OF SHAWNEE) ss:

I, Stacey Harden, of lawful age, being first duly sworn upon her oath states:

That she is a regulatory analyst for the Citizens' Utility Ratepayer Board, that she has read the above and foregoing testimony, and, upon information and belief, states that the matters therein appearing are true and correct.

Stacey Harden

SUBSCRIBED AND SWORN to before me this 23rd day of April, 2010.

Notary Public

My Commission expires: 01-26-2013.

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2013

Efficiency Kansas Budget Summary **Exhibit SMH-1**

Year 1-5

	Description		Year 1		Year 2		Year 3		Year 4		Year 5		Total 5 Year Budget
	Labor Costs Includes Loadings												
1	Manager, Energy Efficiency	$	77,028	$	79,339	$	81,719	$	84,170	$	86,696	$	408,952
2	Supervisor, Energy Efficiency	$	55,601	$	57,269	$	58,987	$	60,757	$	62,580	$	295,194
3	Energy Efficiency Specialists (2)	$	42,994	$	44,283	$	45,612	$	46,980	$	48,390	$	228,259
4	Rebates and Customer Costs												
5	Rebate Costs												
6	Reference Materials	$	19,000	$	19,000	$	19,000	$	19,000	$	19,000	$	95,000
7	Education/Marketing	$	164,707	$	126,023	$	126,023	$	126,023	$	126,023	$	668,799
8	Education Materials, Travel												
9	KCC EMV			$	16,296			$	16,847			$	33,143
11	Subtotal	$	359,330	$	342,210	$	331,341	$	353,777	$	342,689	$	1,729,347
12	**Less: Estimated Participant Charges**												
13	Assumed level of customers		100		100		100		50		50		400 participants
14	Monthly Maintenance Charges	$	4,800	$	9,600	$	14,400	$	16,800	$	19,200	$	64,800
15	Origination Fees	$	12,000	$	12,000	$	12,000	$	6,000	$	6,000	$	48,000
16	Total Costs	$	342,530	$	320,610	$	304,941	$	330,977	$	317,489	$	1,616,547

SMH - 2

Credit Suisse Energy Summit

Vail, Colorado | February 3, 2010

ONEOK

SMH-2

Distribution

Successful Execution of Rate Strategy

- Synchronized rates and regulatory actions
- Capital and bad-debt recovery in all states
- Innovative rates (performance-based, decoupling)

		2005			2009		
Opportunities	**Solutions**	**Oklahoma**	**Kansas**	**Texas ***	**Oklahoma**	**Kansas**	**Texas ***
Earnings Lag	**Capital Recovery**			**36%**	✓	✓	✓
Margin Protection	**Bad-Debt Recovery**				✓	✓	✓
	Customer Charge				**Increased**	**Increased**	**Increased**
	Weather Protection	✓	✓	**46%**	✓	✓	✓
Innovative Rate Mechanisms	**Performance-based Rates, Cost of Service Adjustments, Decoupling**				✓	**Filed**	**60%**

**Percent of customers within the Texas jurisdictions*

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SMH-2

Distribution

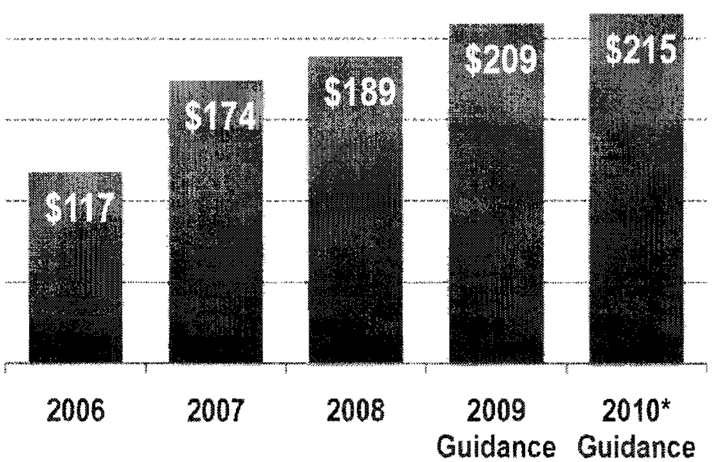
Earnings Growth to Close the Performance Gap

- Increased level of sustainable earnings
- Rate mechanisms reduce regulatory lag

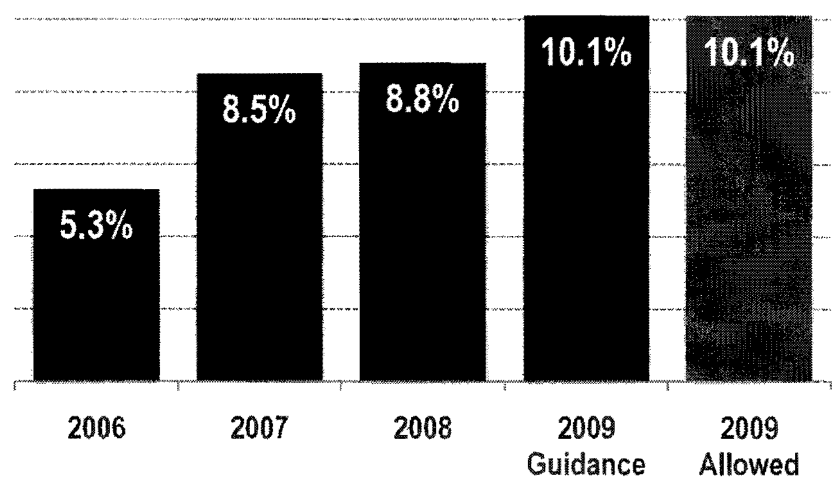
- Closing the gap between actual and allowed returns
  - $70 million operating income gap in 2005

Operating Income

($ In Millions)



Return on Equity**



**2010 operating income excludes retail business moved from Energy Services*

***ROE calculations are consistent with utility ratemaking in each jurisdiction and not consistent with GAAP returns*

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SMH-3

Home Page Change Password

Tuesday, April 13, 2010
Logged in as: [**Stacey Harden**] Logout

Docket: [10-KGSG-421-TAR] Tariff-10: Efficiency Programs
Requestor: [Citizens Utility Ratepayer Board] [David Springe]
Data Request: CURB-10 :: Dixon Testimony
Date: 0000-00-00

Question 1 (Prepared by Paul Raab)

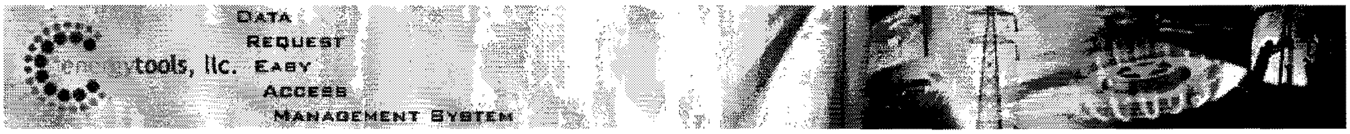
In Mr. Dixon's testimony, page 6, he states, "...there are other Kansas Gas Service employees who will be heavily involved in the deployment of our programs ... These tasks will be performed with existing resources, thus there are no incremental costs associated with the internal labor. We are requesting recovery of incremental labor costs of existing employees since, in theory, these costs are being recovered in base rates." Please elaborate on how these existing resource amounts will be allocated or charged to each of the Step ONE programs and the Efficiency Kansas program. In addition, please provide an analysis of these expenses and indicate if these expenses were included in the benefit-cost tests in Mr. Raab's testimony.

Response:

These expenses are considered to be overhead expenses and will not be allocated or directly charged to either the Step ONE or Efficiency Kansas programs. Because the benefit/cost tests employed by Mr. Raab measure the incremental costs of implementing the specific program measures, these expenses were not included in the benefit-cost tests in Mr. Raab's testimony.

No Digital Attachments Found.

SMH-4



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Friday, April 23, 2010
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Docket: [10-KGSG-421-TAR] Tariff-10: Efficiency Programs
Requestor: [Citizens Utility Ratepayer Board] [David Springe]
Data Request: CURB-15 :: Overhead Expenses
Date: 0000-00-00

Question 1 (Prepared by David Dittemore)
This is a follow-up to data request CURB-10. Please quantify the dollar amount of overhead expenses that will be used for both the Efficiency Kansas and Step One programs. Provide an estimate of these overhead expenses.

Response:
Incremental overhead costs for the Efficiency Kansas and the Step ONE programs are set forth in Exhibit DND-7 and Exhibit DND-8, respectively. KGS has not done studies in an effort to estimate the embedded overhead costs associated with these programs, nor can they be reasonably estimated, especially since they are new programs. As contained in the Exhibit PHR-3, page 6 there is a net benefit under the Total Resource Cost Test of $2,584,538. This amount of net benefit would far exceed any assignment of embedded overhead costs.

No Digital Attachments Found.

CERTIFICATE OF SERVICE

10-KGSG-421-TAR

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was placed in the United States mail, postage prepaid, electronic mail, or hand-delivered this 23rd day of April, 2010, to the following:

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* Denotes those receiving the Confidential version