

**THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS**

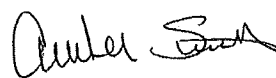
In the Matter of the Application of Kansas Gas )  
Service, a Division of ONE Gas, Inc.'s )  
Submission of its Insurance Policy ) Docket No. 18-KGSG-392-CON  
Agreements with Utility Insurance Company, )  
Pursuant to K.S.A. 66-1402. )

**NOTICE OF FILING STAFF'S REPORT AND RECOMMENDATION**

The Staff of the State Corporation Commission of the State of Kansas (Staff and Commission, respectively) files its **redacted** report and recommendation relevant to Kansas Gas Service, a Division of ONE Gas, Inc.'s submission of its insurance policy agreement with Utility Insurance Company. Staff recommends the Commission not take action pursuant to K.S.A. 66-1402 to prevent KGS from participating in the establishment of ONE Gas' wholly-owned captive insurance company.

WHEREFORE, Staff submits its Report and Recommendation.

Respectfully submitted,



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For Commission Staff

# STATE OF KANSAS

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SHARI FEIST ALBRECHT, CHAIR | JAY SCOTT EMLER, COMMISSIONER | DWIGHT D. KEEN, COMMISSIONER

## REPORT AND RECOMMENDATION UTILITIES DIVISION

### REDACTED

**TO:** Chair Shari Feist Albrecht  
Commissioner Jay Scott Emler  
Commissioner Dwight D. Keen

**FROM:** Bill Baldry, Senior Auditor  
Justin Grady, Chief of Accounting and Financial Analysis  
Jeff McClanahan, Director

**DATE:** August 29, 2018

**SUBJECT:** Docket No. 18-KGSG-392-CON – In the Matter of the Application of Kansas Gas Service, a Division of ONE Gas, Inc.’s Submission of its Insurance Policy Agreements with Utility Insurance Company, Pursuant to K.S.A. 66-1402.

### **EXECUTIVE SUMMARY:**

ONE Gas created the Utility Insurance Company (UIC) (a wholly owned pure captive insurance company) to provide ONE Gas’ distribution companies with insurance coverage for claims greater than \$250,000 and less than \$2,000,000. The benefits to ONE Gas’ distribution companies of purchasing insurance from UIC will be a reduction in the deductible per incident to \$250,000 from \$2 million, UIC will have access to the reinsurance markets, and UIC (being an insurance company) would be in a stronger position in negotiating with other insurance companies. The disadvantage initially to KGS in purchasing insurance from UIC is the extra fees UIC will incur that will be allocated to Kansas Gas Service. Over time, ONE Gas expects the decrease in insurance costs and claims will more than offset the additional operating costs. Based upon our review, Staff recommends the Commission not take action pursuant to K.S.A 66-1402 to prevent KGS from participating in the establishment of ONE Gas’ wholly owned captive insurance company (UIC).

### **BACKGROUND:**

Kansas Gas Service, a division of ONE Gas, Inc. (“Kansas Gas Service” and “ONE Gas,” respectively) filed an Application notifying the Commission that it had created a wholly owned

pure captive insurance company (Utility Insurance Company or UIC) to better control the cost of insurance. ONE Gas submitted five insurance policy agreements attached to its Application. UIC will provide insurance coverage to Kansas Gas Service (KGS) and the other natural gas distribution company divisions of ONE Gas in accordance with K.S.A. 66-1402.<sup>1</sup>

The Application includes Exhibits A through E that show UIC will provide the following insurance coverage to Kansas Gas Service:

- a. auto liability claims (Exhibit A);
- b. general liability and employment practice liability claims (Exhibit B);
- c. workers' compensation and employer's liability claims (Exhibit C);
- d. general liability and property claims (Exhibit D); and
- e. miscellaneous types of coverage (Exhibit E).

After filing the original Application, KGS discovered errors in its workers' compensation (Exhibit C) and excess liability coverage (Exhibit E) policies. KGS filed an amended Application on May 25, 2018.

Prior to the formation of UIC, ONE Gas was self-insured for claims up to \$2 million. ONE Gas purchased insurance coverage for claims greater than \$2 million from insurance companies not related to ONE Gas. By having UIC as ONE Gas' captive insurance company, ONE Gas and its subsidiaries will be self-insured for claims up to \$250,000. UIC will cover all claims greater than \$250,000 but less than \$2 million. UIC will continue ONE Gas' current policy of purchasing insurance coverage from insurance companies unrelated to ONE Gas for claims greater than \$2 million.

Captive insurance is insurance that is provided within a corporate group, through a subsidiary that is controlled by a parent company. Instead of purchasing insurance from an external commercial insurance company, the parent company manages the risks of the corporate group through the subsidiary. The captive then either reinsures these risks or retains the risks itself. The parent company pays premiums to the captive insurance company.

When a company has risks that are difficult or impossible to cover with traditional insurance, a captive insurance company is a good vehicle to use to cover those risks. The parent company may also be able to save on premium costs by using a captive insurance company because traditional insurance companies charge higher premiums to cover their own costs and turn a profit. Using a captive insurance company allows the insured entities to pay only for coverage and retain any profits within the corporate group.

A captive insurance company can be organized domestically in any state that has a captive statute permitting organization or in a variety of offshore locations. UIC's place of domicile is in Oklahoma.<sup>2</sup>

A captive insurance company can be a pure captive, group captive, industrial captive, or a risk retention group. A pure captive is a captive company with a single owner and provides insurance

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<sup>1</sup> Each insurance policy and related premium is apportioned between Oklahoma Natural Gas, Kansas Gas Service, Texas Gas Service, and ONE Gas, Inc.

<sup>2</sup> See response to Staff Data Request No. 12.

coverage only to its parent company. UIC is a pure captive.<sup>3</sup> A group captive provides insurance to companies outside of a single business group. Industrial insurance captives insure the risk of an industrial insurance group. Risk retention groups allow members of an industry (such as doctors, lawyers, and hospitals) who face similar risk exposure to come together and form their own insurance company.

### **ANALYSIS:**

In this Application, ONE Gas is filing five insurance policies (attached to the Amended Application) with the Commission under K.S.A. 66-1402. The purpose of the filing is to provide formal agreements where UIC will provide insurance coverage to Kansas Gas Service and the other natural gas distribution company divisions of ONE Gas. Section 66-1402 provides that ONE Gas must file these contracts with the Commission before they can be effective. Section 66-1402 further states that if any of the contracts is found to not be in the public interest, the Commission, after investigation and a hearing in accordance with the provision of the Kansas Administrative Procedure Act, is hereby authorized to disapprove such contract.

### **Staff's Analysis:**

Staff did extensive research on captive insurance companies, read technical manuals, read Internal Revenue Service Revenue Rulings and a U.S. Supreme Court decision, and issued 34 data requests. Staff prepared an analysis for only Kansas Gas Service that compared the cost of insurance in KGS's last rate case to the cost of insurance for KGS if ONE Gas had a captive insurance company.<sup>4</sup> Staff's analysis in attachment A shows that if KGS incurred no claims greater than \$250,000, a captive insurance company would result in insurance costs \*\* \*\* greater than KGS's cost of insurance in its last rate case. Over time, KGS expects insurance costs and claims will decrease enough to cover the \*\* \*\* of additional costs<sup>5</sup>.

A captive insurance company would provide ONE Gas with the following benefits:

- \*\*
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- 
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- 
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- \*\* and
- Insurance costs and claims will decrease enough to cover the additional operating costs shown below.<sup>6</sup>

A captive insurance company would incur costs ONE Gas does not currently have:

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<sup>3</sup> See response to Staff Data Request No. 5.

<sup>4</sup> Attachment A.

<sup>5</sup> See response to Staff Data Request No. 34.

<sup>6</sup> See response to Data Request No. 34.

• Actuarial review fees	\$45,000 <sup>7</sup>
• Financial statement audit	\$15,000 <sup>8</sup>
• Annual fee to the Oklahoma Insurance Commission	\$20,000 <sup>9</sup>
• Captive insurance manager	\$45,000 <sup>10</sup>
• Initial premium increase	**      ** <sup>11</sup>
• **      ** <sup>12</sup>	

KGS's share of the new costs ONE Gas will incur due to having a captive insurance company is estimated to be \*\*      \*\*. Even though KGS will initially incur additional costs due to the new captive insurance company, KGS expects insurance costs and claims will decrease enough to cover the additional operating costs.

### **RECOMMENDATION:**

UIC is a new company so the dollar amounts for fees and claims are based on forecasts and estimates. It is known that ONE Gas will incur additional costs by operating a captive insurance company compared to not having a captive insurance company, but ONE Gas believes that insurance costs and claims will decrease enough to cover these additional operating costs.

Because of the potential for benefits of KGS getting insurance coverage through UIC (even though those benefits are partially offset by higher initial operating costs), Staff is not recommending that the Commission take action to deny KGS's participation in the formation of the Utility Insurance Company as a captive insurance company. However, in arriving at this conclusion, Staff is not expressing an opinion about the ultimate ratemaking treatment of all future unknown costs associated with UIC. If in the future it is shown that UIC is required to make changes in its reserve requirements, UIC has several years of low claims, or the company experiences increases in fees and operating costs in the future that might harm ratepayers, Staff will make recommendations to the Commission in order to ensure that KGS's rates remain just and reasonable and in the public interest.

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<sup>7</sup> See response to Data Request No. 7.

<sup>8</sup> See response to Data Request No. 7.

<sup>9</sup> See response to Data Request No. 7.

<sup>10</sup> See response to Data Request No. 7.

<sup>11</sup> See response to Data Request No. 11 Amended.

<sup>12</sup> See Attachment A.

Kansas Gas Service  
Docket No. 18-KGSG-392-CON  
Confidential Data Requests

Attachment A is confidential.

Data Request Nos. 3, 11, and 21 are confidential.

**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-001: Self Insurance  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 4/2/2018  
Date Information Needed: 4/10/2018  
Requested By: Bill Baldry

Page 1 of 1

Please provide the following:

Does ONE Gas currently self-insure claims incurred between \$250,000 and \$2 million, or does ONE Gas have insurance policies that cover claims between \$250,000 and \$2 million through an outside insurance company?

**KGS Response:**

Prior to establishing the lower deductible policies, ONE Gas did self-insure at the level from \$250,000 to \$2,000,000 as traditional insurance companies did not want to offer this level of coverage at reasonable rates. For instance, to bring the deductible down on general liability insurance to \$1,000,000 from \$2,000,000, the insurance market was requesting a premium of \$1,200,000 per year.

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: Mark W. Smith  
Mark W. Smith (Apr 10, 2018)

Date: Apr 10, 2018

**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-005: Type of Captive Insurance Company  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 4/2/2018  
Date Information Needed: 4/10/2018  
Requested By: Bill Baldry

Page 1 of 1

Please provide the following:

Will the Utility Insurance Company provide insurance coverage to only ONE Gas and its subsidiaries (a "pure captive") or will UIC provide insurance coverage to other companies outside of ONE Gas?

KGS Response:

The Utility Insurance Co., is a pure captive and will only insure ONE Gas and its divisions.

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Mark W. Smith  
Signed: Mark W. Smith (Apr 10, 2018)

Date: Apr 10, 2018



**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-007: Expenses of a Captive Insurance Company  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 4/2/2018  
Date Information Needed: 4/10/2018  
Requested By: Bill Baldry

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Please provide the following:

Paragraph 8 of the Application states that the primary benefit from purchasing insurance coverage from Utility Insurance Company will be a reduction in the deductible per incident from \$2 million to \$250,000.

1. Please list the various expenses and the related dollar amounts Utility Insurance Company would incur on an annual basis. For example the costs of:

- a. Processing, managing, and payment of claims between \$250,000 and \$2 million;
- b. Annual actuarial reviews;
- c. Annual financial statement audits;
- d. Continuing tax compliance oversight;
- e. Premium tax or annual fees to the state or country of domicile; and
- f. Other regulatory compliance needs.

2. Does ONE Gas currently process and manage the claims between \$250,000 and \$2 million in-house, or does a third party administrator process and manage the claims or does an insurance company process and manage the claims?

3. Please list the benefits and the related dollar amounts of having Kansas Gas Service purchase insurance from Utility Insurance Company for claims between \$250,000 and \$2 million.

**KGS Response:**

- 1a. Costs associated with processing, managing, and payment of UIC claims are not material, as these processes will continue to be performed by existing internal staff.
- b. Annual actuarial review fees are estimated at \$45,000.
- c. Annual financial statement audits are estimated to cost \$15,000.
- d. Costs associated with continuing tax compliance oversight are deemed immaterial, as these tasks will be performed by existing internal staff.
- e. Premium tax and/or annual fees to be paid to the Oklahoma Insurance Commission are estimated to range between \$15,000-\$20,000.
- f. Aon will be serving as the captive manager and will oversee all the items listed in responses 1a – 1e above, for an annual fee of \$45,000.
2. A Third-Party Administrator hired by ONE Gas handles workers' compensation and automobile liability and will continue to do so. The company handles all other claims.
3. The financial benefit will be determined by loss history over time. We do anticipate lowering premiums in subsequent policy years. However, if KGS were to experience adverse loss experiences in the future, their premiums would be increased. Likewise, if another division incurs losses in the future, KGS will not bear the impact of that division's losses. We believe this arrangement provides a long term financial incentive.

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

*Mark W. Smith*

Signed: Mark W. Smith (Apr 10, 2018)

Date: Apr 10, 2018

**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-012: Domicile of Captive Insurance Company  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 4/2/2018  
Date Information Needed: 4/10/2018  
Requested By: Bill Baldry

Page 1 of 1

Please provide the following:

1. What state or country will the Utility Insurance Company be domiciled in?
2. What are the capital and surplus minimum requirements of the state or country of UIC's domicile?
3. Does the state or country where the Utility Insurance Company is domiciled have a franchise, premium or self-procurement tax that UIC will pay each year?
  - a. If yes, please identify the tax and the applicable dollar amount.

KGS Response:

1. UIC's place of domicile is Oklahoma.
2. The capital and surplus minimum is \$250,000; however, the Oklahoma Insurance Commission requested ONE Gas fund \$1,000,000 initially. ONE Gas funded as requested.
3. Yes. For 2017, UIC paid a Net Direct Written Premium Tax of .2% (or \$16,186.00) plus, .01% tax on Assumed Premiums for a total of \$278.00. We expect future years' taxes to be similar. In the past, ONE Gas paid a "surplus lines" tax in the amount of 6% on some placements. These savings will be captured in the cost for the associated reinsurance.

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Mark W. Smith  
Signed: Mark W. Smith (Apr 10, 2018)

Date: Apr 10, 2018

**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-016: Insurance Premiums Charged by Utility Insurance Company  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 4/2/2018  
Date Information Needed: 4/10/2018  
Requested By: Bill Baldry

Page 1 of 1

Please provide the following:

Will the mere existence of the Utility Insurance Company keep insurance premiums down when insurance brokers know that if the premium prices offered to ONE Gas are not efficient, then ONE Gas may decide to cover the insurance risk through the Utility Insurance Company?

KGS Response:

Yes, the Utility Insurance Co., can now be viewed as a competitor to traditional insurance markets (not brokers).

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: Mark W. Smith  
Mark W. Smith (Apr 10, 2018)

Date: Apr 10, 2018

**Kansas Corporation Commission**  
Docket Number 18-KGSG-392-CON  
Information Request

Data Request: 18-392 KCC-034: DR No. 31  
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.  
Request Date: 6/27/2018  
Date Information Needed: 7/9/2018  
Requested By: Bill Baldry

Page 1 of 1

Please provide the following:

1. Does ONE Gas expect insurance costs to decrease so much (by having a captive insurance company) compared to not having a captive insurance company that insurance cost savings will more than offset a claim of \$1.75 million each year?
2. a. Does ONE Gas expect insurance costs and claims will decrease enough to cover the additional \$86,322 of operating costs for Kansas Gas Service that will be incurred each year by having a captive insurance company?  
b. If yes, please provide a copy of the work papers that show a decrease in insurance costs of more than \$86,322 for KGS.

KGS Response:

1. Yes. In this first year for a cost of \$86,322, the company is able to purchase an additional \$1.75M in property insurance, \$1.75M in liability insurance, \$1.75M in Workers' Compensation insurance and \$1.75M in automobile liability insurance.
2. a. Yes. Over time, ONE Gas expects insurance costs and claims will decrease enough to cover the additional operating cost incurred by KGS.  
b. Please see the Feasibility Study provided in response to KCC DR No. 4.

Prepared by: Mark Smith

**Verification of Response**

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Mark W. Smith  
Signed: Mark W. Smith (Jul 9, 2018)

Date: Jul 9, 2018

## CERTIFICATE OF SERVICE

18-KGSG-392-CON

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing Staff's Report and Recommendation (Redacted) was served via electronic service this 31st day of August, 2018, to the following:

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