BEFORE THE CORPORATION COMMISSION

OF THE STATE OF KANSAS

IN THE MATTER OF THE GENERAL INVESTIGATION REGARDING THE ACCELERATION OF REPLACEMENT OF NATURAL GAS PIPELINES CONSTRUCTED OF OBSOLETE MATERIALS CONSIDERED TO BE A SAFETY RISK	]]]]]]	KCC Docket No. 15-GIMG-343-GIG

DIRECT TESTIMONY OF

ANDREA C. CRANE

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

January 29, 2016

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is PO Box 810, Georgetown, Connecticut 06829. (Mailing address: 16 Old Mill Road, Redding, CT 06877).

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

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989. I became President of the firm in 2008.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 400 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of Columbia. These proceedings involved gas, electric, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony since January 2008 is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The Kansas Corporation Commission ("KCC" or "Commission") initiated Docket No. 15-GIMG-343-GIG ("343 Docket") on March 12, 2015 in response to a Staff Report[1] that recommended "the Commission open a general investigation docket to receive comments on proposed parameters of an accelerated natural gas pipeline replacement program."[2] Pursuant to the procedural schedule issued in this case, Atmos Energy Corporation ("Atmos"), Black Hills Energy/Kansas Gas Utility Company, LLC ("Black Hills"), and Kansas Gas Service

1 Recommendation to Initiate a General Investigation Regarding the Acceleration of Replacement of Natural Gas Pipelines Constructed of Obsolete Materials Considered to be a Safety Risk ("Staff Report"), dated February 2, 2015.

2 Order Opening General Investigation, KCC Docket No. 15-GIMG-343-GIG, March 12, 2015, para. 1.

("KGS") filed testimony on October 8, 2015 proposing various infrastructure replacement programs and methodologies for accelerating recovery of the associated costs. The Columbia Group, Inc. was engaged by the State of Kansas, Citizens' Utility Ratepayer Board ("CURB") to review the Staff Report and the recommendations made by the state's gas utilities, and to provide recommendations to the KCC. I am providing testimony on cost recovery issues relating to the various proposals for accelerated cost recovery. Edward McGee, of Acadian Consulting Group, is also submitting testimony on certain engineering issues relating to the condition of the gas utility systems and the need for accelerated infrastructure replacement programs.

III. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. What are your conclusions and recommendations concerning the gas utilities' requests for an accelerated cost recovery mechanism to address infrastructure replacement issues?

A. My conclusions and recommendations are as follows:

1. The issue of whether to accelerate infrastructure investment programs should be evaluated separately from the issue of cost recovery.

2. The Kansas gas utilities acquired the current systems at premiums over net book, even though the acquired systems were constructed with obsolete materials.

3. In presentations to shareholders, the Kansas gas utilities have made it clear that increasing rate base by accelerating infrastructure investment provides benefits to

shareholders through higher earnings.

5. Kansas gas utilities already have an accelerated cost recovery mechanism in place - the Gas System Reliability Surcharge ("GSRS").

4. There is no evidence that additional accelerated cost recovery mechanisms are necessary at this time in order for the Kansas gas utilities to continue to provide safe and reliable utility service.

5. If the KCC determines that an additional acceleration of cost recovery is necessary, then it should implement a revised GSRS with a cap of $0.80 per year on increases to residential customers, along with the additional safeguards recommended by KCC Staff in the Staff Report.

6. If the KCC determines that a cap of $0.80 per year on residential increases is not sufficient, then any additional annual increases should be subject to a lower return requirement until such costs are included in base rates.

7. Kansas ratepayers should not be burdened with more than one accelerated cost recovery mechanism relating to infrastructure investment.

IV. DISCUSSION OF THE ISSUES

A. Background

Q. Please provide a brief background of this proceeding.

A. To put this proceeding in a broader context, for most of the past century, utilities had traditionally recovered the cost of their investment in infrastructure through base rates.

Between base rate cases, utilities funded infrastructure investment that was necessary to provide safe and reliable utility service to regulated ratepayers. As plant was completed and placed into utility service, the utility began to record depreciation expense, which reflected recovery of the investment over its useful life. When new utility rates were established in the next base rate case, the utility began to recover its annual depreciation expenses from ratepayers. In addition, the new utility rates also reflected a return on the undepreciated investment included in rate base. It was up to the utility to decide when it would file for a base rate increase. Between base rate cases, utility shareholders took the risk of under-earning but shareholders also benefitted from any overearnings during this period.

In addition to recovering their investment through base rates, utilities traditionally recovered operating costs through base rates as well. With the "energy" crisis of the 1970s, utilities argued that fuel costs were increasing rapidly, were extremely volatile, and were largely outside of the control of management. Therefore, most utilities successfully petitioned for fuel clauses that would allow them to pass through to ratepayers increases in fuel costs. In addition, any reductions in fuel costs were similarly passed through to ratepayers.

From this relatively modest beginning, surcharges for utilities have proliferated, especially over the past ten years, as utilities have argued that the regulatory paradigm no longer provides adequate returns to shareholders. Accordingly, utilities have successfully proposed a host of surcharge mechanisms and cost trackers. These include weather normalization adjustment clauses, Ad Valorem Tax surcharges, pension and other postemployment benefit ("OPEB") trackers, energy efficiency surcharges, renewable energy surcharges, and other tracking mechanisms including, in some cases, complete decoupling of revenues from sales. Moreover, the recording of regulatory assets has also been used as a tool to ensure that shareholders recover 100% of certain costs, such as rate case costs, storm-related costs, security costs, and other costs. All of these mechanisms – surcharges, trackers, and regulatory assets - transfer risk from a utility's shareholders to its ratepayers. However, in virtually every case, these mechanisms have been instituted without a commensurate reduction to the cost of equity awards to utility shareholders.

Among other tracking mechanisms, utilities have argued that shareholders can no longer afford to replace obsolete plant and otherwise upgrade utility infrastructure without an additional assessment on regulated ratepayers. In 2006, the Kansas gas utilities successfully petitioned the Kansas Legislature to pass legislation authorizing the GSRS. The GSRS allowed gas utilities in Kansas to implement an annual surcharge to recover the return of investment and depreciation expenses associated with infrastructure replacement projects and facility relocation projects. The annual revenue requirement related to the GSRS surcharge must be allocated among customer classes in the same manner as similar costs were allocated in the company's last base rate case. In addition, the annual surcharge applicable to residential customers cannot increase by more than $0.40 per month. The Kansas gas utilities have all implemented GSRS surcharges since the legislation was adopted.

Q. Since the GSRS was adopted, have the Kansas gas utilities requested that the KCC

approve other trackers and mechanisms to further accelerate recovery of infrastructure replacement program costs?

A. Yes, they have. Although the Kansas gas utilities were successful in getting legislation passed that authorized the GSRS, these same utilities have since argued that the GSRS does not provide them with returns sufficient to replace the obsolete infrastructure in their systems. Moreover, the gas utilities argue that the annual GSRS includes an unacceptable level of regulatory lag. Accordingly, since the GSRS was authorized, the Kansas gas utilities have continued to request additional ratemaking mechanisms to provide further acceleration of returns to shareholders.

In Docket No. 12-KGSG-721-TAR, the KCC rejected a request by KGS to implement a cast iron replacement program and associated annual Infrastructure Replacement Program ("IRP") surcharge. The company proposed that the initial IRP surcharge initially be set to recover a revenue requirement based on estimated capital expenditures projected for the upcoming twelve-month period. The surcharge would have recovered the return on and the return of investment on expenditures to replace cast iron and unprotected bare steel mains, including a return at the authorized weighted average cost of capital. KGS proposed to true-up the actual revenue requirement for these expenditures with the IRP surcharge recoveries as part of the annual surcharge review process.

In Docket No. 14-ATMG-320-RTS ("320 Docket"), Atmos requested that the KCC implement a ratemaking mechanism whereby the company would be permitted to defer the costs of various investment projects that went into service between base rate cases, including system integrity projects. Atmos proposed to defer both the return on and the return of these projects until such time as they were included in rates resulting from a subsequent rate case. The KCC denied the company's request, but the KCC stated that

> The Commission would...entertain the possibility of roundtable discussions with industry to discuss proposing to the legislature either an adjustment to the GSRS Act or an additional system integrity RA [Regulatory Asset] as well as any specific projects, goals and concerns it would address. Additionally, the Commission finds its decision on the RA in this case does not prevent its consideration of other infrastructure improvement mechanisms which Atmos or other utilities may propose in the future.[3]

In addition, in its 2014 rate case, KCC Docket No. 14-BHCG-502-RTS, Black Hills requested an alternative cost recovery mechanism for accelerated pipeline replacement. Black Hills requested that the KCC authorize an Accelerated Pipeline Replacement Rider ("APRR"), similar to the surcharge that had previously been requested by KGS. In the Settlement Agreement in the Black Hills' rate case, the company agreed to withdraw its proposal without prejudice, "[i]n light of the Commission's comments in the recent Atmos Energy rate case (Docket No. 14-ATMG-320-RTS) that the Commission would entertain discussions among the natural gas utilities, Staff and CURB regarding possible legislative changes to the existing GSRS Act...".[4]

Q. Did KCC Staff subsequently undertake any further action on the issue of infrastructure replacement?

3 Order in 14-ATMG-320-RTS, paragraph 56.
4 Stipulation and Agreement in KCC Docket 14-BHCG-502-RTS, page 5.

A. Yes, it did. As a result of the KCC Order in the 320 Docket, KCC Staff subsequently held a series of roundtable discussions with the three major natural gas utilities. According to the Staff Report, "[t]he goal of the roundtable discussions was the development of proposals to address the aging infrastructure issue." After hosting two meetings with the investor-owned utilities, on February 2, 2015 the KCC Staff issued a report recommending that the KCC initiate a proceeding "to receive comments from the affected parties and fully develop the record regarding the efficacy of a pipe replacement program to enhance public safety and the parameters that should be included in a pipe replacement program plan to assure equitable recovery of the investment costs."[5] As a result of the Staff Report, the KCC initiated this proceeding on March 12, 2015.

Q. What were the conclusions reached in the Staff Report?

A. Staff concluded that "accelerating the rate of replacement for all utilities would be in the public interest because it would provide the public with the benefit of achieving these safety goals sooner than a program that simply replaces pipe based on the current leakage rate."[6] Staff noted that the Commission could implement regulatory options "to reduce the disincentive of regulatory lag associated with the acceleration of the replacement of infrastructure."[7] Such options included allowing the utility to recover costs more quickly or allowing the utility to defer costs for future recovery. Staff went on to state that "an

5 Recommendation to Initiate a General Investigation Regarding the Acceleration of Replacement of Natural Gas Pipelines Constructed of Obsolete Materials Considered to be a Safety Risk, February 2, 2015.
6 Staff Report, page 3.
7 Id, page 4.

accelerated pipe replacement program will be a burden on ratepayers regardless of the method of cost recovery." Moreover, Staff noted in the Staff Report that it "is not advocating for a total elimination of regulatory lag...[r]egulatory lag does provide an important incentive to utility companies to control costs...".[8]

Q. Did Staff include any recommended parameters for an accelerated infrastructure replacement plan in its Staff Report?

A. Yes, it did. In the Staff Report, Staff proposed several parameters that it recommended be considered for any accelerated infrastructure replacement program. These included:

- An initial five-year pilot program that will allow the KCC to evaluate the effectiveness and cost of the program and decide if it is in the public interest to continue;
- A requirement that extraordinary ratemaking treatment be limited to capital expenditures that the utility would have otherwise not made under traditional ratemaking practices;
- An initial filing containing a roadmap for replacement of all undesirable pipe so that the KCC and the ratepayers will understand the magnitude of the program;
- A prioritization program focused on removing the highest risk piping in the utility's infrastructure first;

8 Id.

- A requirement that the program result in an increase in the overall level of capital expenditures made by the utility;
- A requirement to provide projected yearly replacement levels and capitalized costs in order to ensure transparency;
- A requirement for annual compliance filings;
- An agreement not to seek a general rate increase more often than every three years, or in the alternative to have shareholders bear a portion of rate case costs;
- A commitment to track savings and use any savings to mitigate the incremental costs.

In response to the Staff Report, the KCC initiated this proceeding and established a procedural schedule that required the state's gas utilities to file testimony on October 8, 2015. Testimony was filed by Atmos, Black Hills, and KGS. I understand that these three gas utilities collectively serve 90% of the natural gas customers in Kansas. In their testimonies, both Atmos and Black Hills proposed accelerated pipeline replacement programs. KGS already has an accelerated infrastructure replacement program in place and did not recommend any expansion of its program at this time. However, all three utilities recommended that the KCC adopt an accelerated cost recovery mechanism.

B. Summary of Gas Utility Proposals

1. Atmos Energy Company

Q. Please provide a brief description of the Atmos system.

A. Atmos serves 107 communities and approximately 131,182 customers in Kansas. According to page 1 of Christian Paige's testimony, the Atmos system in Kansas has approximately 682 miles of bare steel pipe. In addition, it has approximately 109 miles of polyvinyl chloride ("PVC") and 707 miles of Aldyl-A and Century pipe. Mr. Paige goes on to state at page 2 of his testimony that at the current rate of replacement, it would take approximately 187 years to replace all of the bare steel and early generation plastic pipe.

Atmos witness John McDill acknowledges that the Company's natural gas pipeline system in Kansas is currently safe and that there is no imminent danger of catastrophic failure. Nevertheless, Atmos is proposing to replace all of the bare steel, PVC, Aldyl-A and Century pipe over a period of 35 years, in order to mitigate the potential for future failures. Atmos has indicated that it does not have concerns about pipe constructed with other materials at this time.

Q. How does Atmos propose to recover the costs of the accelerated pipeline replacement program?

A. Atmos is proposing to implement a System Integrity Program ("SIP") Tariff to recover the costs of the program. The SIP Tariff would provide for quarterly rate adjustments to recover incremental spending related to natural gas pipe replacement projects. The Company states that the SIP would not include costs incurred under its current pipe replacement program. Thus, the SIP Tariff would recover incremental investment that the Company claims would not be undertaken in the absence of an accelerated recovery mechanism. The Company is proposing a five-year pilot program for the SIP Tariff.

Under the Company's proposal, the incremental revenue requirement would be calculated quarterly, and would include a return, at the weighted average cost of capital authorized in this case, on the net investment related to the projects that have been completed. Net investment would include gross plant, accumulated depreciation, and accumulated deferred income taxes. The revenue requirement would also include retirement and removal costs related to SIP projects, depreciation expense, and associated taxes including property taxes.

In its original testimony, Atmos proposed to file a multi-year plan on February 1, 2016. The company further proposed that the plan be reviewed and accepted by May 1, 2016. The actual SIP plan year would begin on July 1, 2016 and run through March 31, 2017. Thereafter, the SIP plan year would run from April 1 to March 31 of each subsequent year.

Atmos proposed to make its first quarterly adjustment filing in mid-October 2016, covering the period July 1, 2016, through September 30, 2016. It also proposed that new rates resulting from that filing become effective November 1, 2016. Subsequent quarterly rate adjustments would be effective on February 1, May 1, and August 1, and November 1 of each year. In addition to the quarterly filings, the Company would make annual filings in

December of each year. These annual filings would identify the SIP projects for the upcoming plan year and provide details of projects completed through the preceding September. The Company made a similar proposal in its current rate base case, KCC Docket No. 16-ATMG-079-RTS.

2. Black Hills Energy

Q. Please provide a brief description of the Black Hills system.

A. According to the testimony of Jerry Watkins at page 3, Black Hills serves approximately 112,000 retail customers in 64 communities and areas in 48 counties in Kansas. Black Hills operates approximately 293 miles of transmission pipeline, 2,801 miles of distribution pipeline and 99,570 service lines in Kansas. Black Hills acquired its operations in Kansas in 2008 when it purchased the Kansas gas assets from Aquila. As described in the testimony of Todd Jacobs, Black Hills has increased its spending to replace aged infrastructure since it acquired the system. The company replaced 115.6 miles of main and 8,302 services from 2007-2013. As stated in Mr. Jacobs' testimony on page 6, Black Hills has spent $30 million since 2008 on assets eligible for accelerated cost recovery through the GSRS. According to Table 1 of Mr. Watkins' testimony, the Company estimates that it would take 74 years to complete these replacements given its current schedule.

Q. Please describe the Accelerated System Replacement Program ("ASRP") being proposed by Black Hills in this case.

A. Although Mr. Watkins describes the company's current operation and safety standards, and concludes that the Company is currently operating a safe system, the company is proposing an accelerated program to replace obsolete service lines and yard lines within ten years and to replace obsolete mains within 31 years. As shown on page 9 of Mr. Jacobs' testimony, Black Hills' 2015 capital budget included \$6.5 million of GSRS-eligible investment, as well as \$6.4 million of non-eligible investment. (These amounts exclude \$2.3 million of capital expenditures associated with growth). If the ASRP is approved, Black Hills proposes to spend an additional \$6.5 million per year on infrastructure replacement projects, based on 2015 dollars. Black Hills proposes to accrue a return on and a return of the investment in the month in which the investment goes into service. The Company proposes that the KCC review and approve a surcharge to collect the deferral on an annual basis, using a process and timeline similar to the GSRS. In addition, Black Hills is proposing an annual true-up process. Black Hills is not proposing a sunset provision but is proposing that the program be reviewed every five years. As part of its proposal, Black Hills is committing to a three-year rate case moratorium, or it will forego seeking recovery of all or a portion of its rate case costs. Based on expenditures of \$6.5 million per year, the Company estimates that the year 1 revenue requirement would be \$370,659, the year two revenue requirement would be \$970,129, and the year 3 revenue requirement would be \$1,541,960. The Company estimates that the average residential impact would be \$0.21 per month in year 1, increasing to \$0.55 in year two and to \$0.88 in year three. Black Hills indicates that it is "open to changes in the timing and priority of investments and the amount of annual investments, but cannot consider additional investments at this time that will increase regulatory lag or erode returns."

3. Kansas Gas Service

Q. Please provide a brief description of the KGS system.

A. According to the testimony of Randal Spector, the KGS system includes 11,361 miles of mains and nearly 630,000 service lines. Approximately 20.4% of its mains and 11.8% of its services are comprised of unprotected coated steel, bare steel, or PVC. As discussed on page 6 of Mr. Spector's testimony, the Company is currently operating under both a Bare Steel Service Line Replacement Program and a Cast Iron Replacement Program. Based on an agreement between KGS and the KCC, the Company has committed to replacing 10,000 service lines annually. From May 2011 when the program was begun through September 2015, the Company replaced 48,079 service lines. A total of 68,869 service lines remain to be replaced under the original approved plan. In addition, KGS agreed to replace all of its cast iron mains by December 31, 2014. It has replaced approximately 27.7 miles over the past two years, and still has approximately 70 miles to replace under its previous commitment. KGS has spent $320.3 million over the past ten years on infrastructure replacement projects.

Q. Does KGS believe that a further acceleration of infrastructure replacement is necessary?

A. It does not appear so. Mr. Spector noted on page 9 of his testimony that "[w]e believe we have been replacing vintage assets at a responsible pace that enhances safety, with minimal rate impact to our customers, while ensuring all work performed is adequately supervised and in compliance with relevant safety standards." In fact, it appears that KGS is not sure than a further acceleration is even desirable. As noted by Mr. Spector, "...there are limits to the amount of work that can be accomplished, based on established employee and contractor levels."[9] Mr. Spector further notes that the acceleration by some utilities of replacement programs "increases the demand for outside contractors with experience in pipeline construction and correspondingly increases costs."

Q. Does KGS recommend that the KCC adopt an accelerated pipeline replacement cost recovery mechanism?

A. Yes, it does. While the Company is not proposing an expansion of its accelerated pipeline replacement program at this time, KGS witness David Dittemore stated on page 3 of his testimony that "...the Commission should adopt a new cost recovery mechanism that better aligns public safety with a utility's financial incentives." Moreover, the Company stated that it believes the previously approved service line and bare steel projects should qualify for accelerated rate recovery "[i]n the event the Commission provides for alternative recovery mechanisms to foster accelerated pipeline replacement...".[10] Mr. Dittemore indicated that acceptable methodologies would include the SIP Tariff proposed by Atmos, a deferral method as discussed in the Staff Report, or the IRP Surcharge described in KGS's filing in

9 Testimony of Mr. Spector, page 9.

Docket No. 12-KGSG-721-TAR. Mr. Dittemore states that KGS does not support proposals that would require a rate case moratorium in order to utilize accelerated cost recovery mechanisms.

C. Evaluation of the Need for an Accelerated Cost Recovery Mechanism

Q. What are the issues that must be addressed by the KCC as it evaluates the proposals put forth by Staff, the various gas companies, and other parties in this case?

A. First, the KCC should consider whether current investment plans of the utility are adequate to ensure the continued provision of safe and reliable gas service to Kansas ratepayers or if an accelerated infrastructure investment program is necessary. Second, if the KCC finds that an accelerated program is necessary, the KCC then has to determine whether it should be financed through the traditional base rate case process or if it should be subject to some special ratemaking treatment. Third, if the KCC finds that some extraordinary ratemaking treatment is appropriate, then the Commission needs to design an appropriate cost recovery mechanism, including any parameters than should be adopted or limitations that should be applied.

Q. Do you believe that accelerated infrastructure investment programs are necessary for the three major Kansas gas utilities?

A. This issue is being examined by CURB witness Ed McGee. According to Mr. McGee,

10 Testimony of Mr. Spector, page 11.

CURB does not believe that an accelerated program is necessary but does believe than an accelerated program may provide some benefits to the ratepayers in Kansas.

Q. What factors should the KCC consider when determining whether to authorize an accelerated cost recovery mechanism?

A. There are many factors that should be considered by the KCC. These include whether the utility has been reasonable in in its past investment strategies, the impact on the utility's shareholders if accelerated cost recovery is not authorized, the availability of other programs from which to fund the accelerated investment program, the impact on ratepayers of an accelerated recovery plan, and others. It is critical for the KCC to recognize that the implementation of an accelerated investment program does not necessarily require the implementation of an accelerated cost recovery mechanism. In fact, as noted above, Kansas' largest gas utility has already implemented an accelerated investment program without extraordinary ratemaking treatment.

Q. Is there a common factor among the three gas utilities that the KCC should keep in mind as it evaluates the responsibility that the gas utilities should bear with regard to infrastructure replacement?

A. Yes, there is. Atmos, Black Hills, and KGS all acquired their gas assets in Kansas well after the investment that is the subject of accelerated recovery programs was installed. Therefore, none of the three companies were directly involved in the original installation of the obsolete assets. Atmos acquired its gas assets from Greeley Gas Company and United Cities Gas Company in 1993 and 1997 respectively. Black Hills acquired its assets from Aquila in 2008 and KGS acquired its assets from Western Resources, Inc. in 1997. However, in all three cases, the gas utilities made a conscious decision to not only acquire the assets, but to pay a premium for them as well. In none of the three acquisition cases did the acquiring company state that it needed a new ratemaking mechanism in order to operate the Kansas assets in a financially-viable manner. It is reasonable to assume that the acquiring companies all expected to earn a reasonable return not only on the net book value of the assets, but also on the premiums that were paid by the acquiring company, even if those premiums were excluded from rate base. It seems a bit disingenuous to now turn around and seek an extraordinary ratemaking mechanism to recover investment costs when the shareholders were willing to pay premiums for these systems knowing the conditions of the systems at the time.

Q. What would be the impact on the utility's shareholders if the traditional base rate case process was utilized to fund accelerated infrastructure programs.

A. It is important to remember that the traditional base rate case process does not require shareholders to forego the entire revenue requirement associated with the accelerated program – it only requires them to forego the return of and the return on the investment until the Company's next base rate case. Assuming a 50-year depreciable life and an average regulatory lag of 26 months[11], shareholders would be responsible for funding 4.33% of the

11 This lag would reflect a three-year period between base rate cases. Assuming that plant was added continually

investment prior to it being included in base rates. Thus, even if the base rate case process is used, and even if the utility stays out for a period of three years, the impact on return would be 4.33%. If the Company files a base rate case sooner, or uses the abbreviated rate case process, the impact would be less.

If the gas utilities believe that a new regulatory mechanism is required in order to accelerate the rehabilitation and replacement of its infrastructure, then they should also recognize that a new regulatory paradigm may require sacrifice on the part of all parties - both investors and ratepayers. Each of the Kansas gas utilities paid a premium when they purchased the gas systems in Kansas that are the subject of this proceeding. Moreover, each of the three gas utilities has now owned and operated the Kansas system for a number of years. The utilities themselves should bear some responsibility for their decisions to pay a high price for assets constructed of obsolete materials and for their failures to proactively replace infrastructure since these systems were acquired. Given the condition of the systems, both utility management and shareholders should bear some responsibility for the current situation. If some sacrifice is necessary in order to accelerate replacement of these systems, there is no reason why 100% of that sacrifice should be borne by ratepayers, especially when one considers the benefits that accrue to shareholders from accelerated investment.

Q. Do increases in utility investment benefit utility shareholders?

A. Yes, absolutely. It is undeniable that increased investment helps utility shareholders. The

during this period, on average, shareholders would finance 18 months of plant between base rate cases. In addition, utilities suggest that the additional financing requirements caused by accelerated replacement programs put a strain on investors – but actually the opposite is true. A review of the presentations made by the gas utilities to investors tells a very different story from the positions presented by the utilities' testimony in this case.

In its November 18, 2015 presentation to security analysts, Atmos promoted its stock as a "pure play, high growth Natural Gas Delivery Investment Proposition" and highlighted the fact that 95% of earnings are regulated and rate base driven. It also emphasized that it expects "[s]trong forecasted regulated rate base growth through Fiscal 2020." In addition, Atmos did not identify regulatory lag as a major concern, but instead noted that it receives earnings "on over 90% of annual Capex within 6 months." The company's presentation made it clear that its earnings growth through 2020, which is projected to increase from $3.05 per share in 2015 to the $4.10-$4.40 range, was being driven directly by increases in its rate base. In addition, Atmos presented Kansas as a jurisdiction with a 7-12 month lag except for plant recovered through the GSRS, which it identified as having only a 1-6 month lag. Accordingly, the story being told to the investment community is very different from the story being presented in this case by Atmos, who claims that regulatory lag in Kansas is stifling investment in the state. Moreover, Atmos' presentation shows that since implementing a "Growth Though Infrastructure Investment Strategy", its total shareholder return has been 79.6%, above the peer group's growth of 70.0%.

There was also a strong correlation between rate base growth and financial stability

an eight-month litigation period would result in a total lag of 26 months.

presented by Black Hills in its November 2015 presentation at the Edison Electric Institute ("EEI") Financial Conference. In this presentation, Black Hills highlighted its capital investment strategy. In fact, in discussing its 2015 Scorecard with regard to "Profitable Growth", the first point made by Black Hills was to "[c]onstruct cost effective rate-base generation and transmission to serve existing utility customers." It is also interesting to note that in discussing "Optimizing Regulatory Recovery", Black Hills presented a chart showing the various cost recovery mechanisms available for its electric and gas utilities. Of the six gas cost recovery mechanisms considered, Kansas already has five of the six, the most of any of the Black Hills gas jurisdictions.

Finally, Kansas Gas Service, which is now a division of One Gas, Inc. since Oneok, Inc. separated its natural gas distribution business from its other energy activities in 2014, also emphasizes the importance of growing the regulated rate base in order to enhance future earnings. The One Gas Five Year Financial Outlook, presented at the Evercore ISI Utilities Conference in January 2016, highlights that average annual net income growth of 5-8% is expected between 2014 and 2019, which will be "[d]riven by capital investments and customer growth" and that "[r]ate base [is] expected to grow an average of 5-6% per year between 2014-2019." One Gas lists capital investments as its first point for Creating Value for Shareholders. Thus, it is indisputable that the natural gas utilities in Kansas are relying upon capital investment to enhance earnings over the next five years.

Q. But isn't it correct that additional investment does not change the rate of return, it

simply changes the amount of dollars earned on a larger investment base?

A. Yes, however, shareholders still stand to benefit even if there is no change to the actual rate of return authorized by a regulatory commission. The stock market is largely driven by earnings per share, which is the measure generally used by publicly-traded companies to provide earnings guidance to the financial community. In addition, because much of the equity capital used by utilities to fund infrastructure replacement projects is internally generated, utilities do not routinely issue new equity in order to fund additional investment. Therefore, increases in a utility's rate base generally result in increases in earnings per share, which is the primary measure used by investors to evaluate performance. In fact, all of the presentations discussed above highlight the anticipated earnings to shareholders based on earnings per share. Increasing rate base does increase earnings per share, thereby making the utilities' stocks more attractive to investors, all other things being equal. Of course, there are many factors that impact on stock price, some of which are outside of the control of utility management, such as the overall market environment. But increasing rate base is one way that utility management can grow earnings, and the gas utilities have each made it a point to inform investors of their plans to increase earnings per share by increasing rate base.

Q. Please comment on the suggestion by some utilities that it will favor investment in those states that provide the Company with the most favorable returns and the most liberal regulatory policies.

A. As noted in my testimony in the 320 Docket, in my opinion, this is a thinly-veiled threat that ignores several important points. Atmos, Black Hill, and KGS are regulated monopoly utilities that have an obligation to provide safe and reliable utility service at the lowest reasonable rates. This obligation has existed since regulation of utilities in Kansas began. Any suggestion that shareholders should expect immediate returns on their investment and that shareholders are being unfairly penalized in Kansas through the regulatory review process is a very short-sighted view. Regulated utilities enjoy an enviable position in financial markets in that they do not have to worry about competition. The monopoly franchises awarded to the Kansas gas utilities grants the companies the exclusive right to serve customers in a certain service territory, but also imposes the obligation to serve them at the lowest reasonable cost. The utilities' threats to direct investment resources away from Kansas because it does not believe that shareholders are making enough here is an insult to the ratepayers of this state and inconsistent with the regulatory obligations of the utilities.

In addition, as noted above, shareholders actually benefit from accelerated replacement programs even if accelerated cost recovery is not approved. Under the traditional rate case process, utility shareholders may have to wait a few years for new investment to be reflected in utility rates. However, given the long-lives of utility assets, shareholders will receive a long revenue stream once those costs are reflected in rates. Even if shareholders must wait a few years to begin collecting these revenues, they will enjoy many, many years of higher earnings if the utility continues to invest. Moreover, this investment is substantially less risky than investing in many competitive companies.

Q. Do you believe that a new accelerated cost recovery mechanism is necessary in order to fund infrastructure replacement projects?

A. No, I do not. I am not convinced that any new cost recovery mechanism is required in order to fund infrastructure replacement projects. KGS has already implemented an accelerated infrastructure replacement program without any corresponding cost recovery mechanism other than the GSRS. Moreover, KGS has expressed its hesitation to further accelerate infrastructure replacement projects at this time. While both Atmos and Black Hills have taken the position in this case that an accelerated cost recovery mechanism is necessary, these companies are painting a different picture for the investment community. In addition, there is no indication that any of the gas companies is having difficulty attracting capital to fund infrastructure projects. It is to the benefit of the gas utilities and their shareholders to increase investment in the regulated utilities, regardless of whether an accelerated cost recovery mechanism is approved. Therefore, even if the KCC finds that an accelerated infrastructure investment program should be adopted, it does not follow that an accelerated cost recovery mechanism is required.

D. Recommended Revisions to the GSRS

Q. If the KCC believes that some accelerated cost recovery mechanism is necessary, what would you recommend?

A. The Kansas gas utilities already have one accelerated cost recovery mechanism in place – the

GSRS. The GSRS was authorized by the Kansas legislature at the behest of the gas utilities themselves. I understand that one of the complaints about the existing mechanism is that the $0.40 per month annual residential increase permitted under the cap is insufficient to finance the level of annual capital expenditures that would be required to fund the proposed accelerated infrastructure replacement programs. Therefore, if the KCC decides that the current GSRS is inadequate to recover the costs associated with infrastructure programs, then the first step should be to build on the existing GSRS cost recovery mechanism and seek to have the current residential cap modified. If the KCC is concerned about the possible delay in getting the Legislature to raise the cap, in the interim, the KCC could establish a similar mechanism - GSRS2, with a higher residential cap, that would replace the GSRS previously approved by the Legislature. In any case, I recommend that the KCC limit accelerated cost recovery relating to infrastructure replacement programs to only one rate surcharge, either the existing GSRS as approve by the Legislature or a new GSRS2, authorized by the KCC with a higher residential cap. Increasing the GSRS cap would preserve the framework initially adopted by the Legislature while recognizing that the magnitude of the replacement projects faced by Kansas utilities may require more funds than those that could be provided under the current residential cap, which has not been increased since the GSR was first implemented in 2006.

Q. Why do you believe that there should be only one infrastructure surcharge?

A. Two surcharges for infrastructure replacement projects unnecessarily complicates the regulatory process. Two surcharge mechanisms would require twice as much work by the KCC, KCC Staff, and other parties in reviewing and evaluating the proposed surcharges. In addition, I believe that two surcharges would be confusing for customers, who have the right to expect the utility to maintain its system in good working order and to undertake replacements as necessary. Rather than add yet another surcharge mechanism, either the current GSRS cap should be raised or the KCC should authorize a new surcharge similar to the GSRS but with a higher cap, for utilities that voluntarily agree not to file for a GSRS rider.

Q. Does the GSRS help to reduce regulatory lag?

A. Yes, of course it does. The GSRS was adopted by the Kansas Legislature at the behest of the state's gas utilities, who argued that some alternative regulatory mechanism was required in order to reduce regulatory lag associated with incremental investment in decaying infrastructure. The Legislature responded with a GSRS mechanism. Now the state's gas utilities are arguing that the GSRS mechanism is inadequate. Moreover, since the GSRS was adopted, the Kansas gas utilities have also implemented several other mechanisms that reduce regulatory lag or otherwise protect shareholders, such as the weather normalization adjustment charge, the ad valorem tax surcharge, and a tracking mechanism for pension and OPEB costs. In addition, a significant portion of the gas utilities' costs are for gas supply, for which shareholders also bear no risk. However, utilities argue that these mechanisms are not enough, and instead the companies are seeking additional cost recovery mechanisms that would result in annual rate increases for Kansas ratepayers with minimal scrutiny. If the KCC decides that some further action is warranted, it should start by revising an existing regulatory mechanism, especially considering that the GSRS was implemented at the specific request of the state's gas utilities.

Q Is regulatory lag a new concept?

A. No, it is not. Regulatory lag is not a new concept. It has existed as long as the current regulatory mechanism has been in place. Moreover, regulatory lag is not always detrimental to the utilities - it can work to the benefit of shareholders. For example, in a period of declining capital costs and/or sales growth, regulatory lag can provide a benefit to shareholders because shareholders enjoy increased returns between base rate case filings. In addition, it is the utility that generally decides when to file for a base rate change so utilities take advantage of regulatory lag and avoid rate cases when regulatory lag makes it advantageous for them to do so.

Q. If the KCC decides to change the mechanics of the GSRS, e.g. to increase the frequency of surcharge filings or to permit the companies to accrue costs for future recovery as soon as a project goes into service, then would you recommend other changes to the mechanics of the GSRS?

A. Yes, I would. The basic mechanics of the GSRS has been vetted and approved by the Kansas Legislature. If the KCC makes any changes to the timing of recovery under the GSRS, or adopts a different mechanism that is more onerous on ratepayers, then it should also make other changes that will provide some benefit to ratepayers and at least partially offset the negative ratepayer impact.

Therefore, if recovery is further accelerated from the one-year period currently proscribed by the GSRS, then I recommend that the KCC reduce the return that is applied to the investment until such time as the investment is placed into rate base in a full or abbreviated base rate case. This would allow shareholders to be compensated more quickly but would also provide ratepayers with a benefit relative to the current GSRS mechanism. Since ratepayers would be losing the protection that the Kansas Legislature built into the GSRS program that rate changes take place no more than once each year, it is entirely reasonable that ratepayers be compensated in some way. I am recommending a return on equity adjustment of 50 basis points if a semi-annual adjustment is utilized, and an adjustment of 100 basis points if a shorter adjustment period is adopted. Once the investment is rolled-into base rates, then this return on equity discount would no longer apply.

I also recommend that the KCC adopt a return on equity discount if it decides to permit annual GSRS increases that exceed the $0.80 per month on residential customers noted above. While I am concerned about eliminating the protections imposed by the Kansas Legislature when they adopted a hard cap on residential increases, the KCC may find that an increase exceeding $0.80 is necessary in some instances. In that case, again in order to mitigate the impact on ratepayers, I recommend that the KCC adopt a 100 basis point adjustment in the return on equity until such time as the investment is rolled-into rate base. This recommendation provides the KCC with tremendous flexibility to accelerate cost recovery for infrastructure replacement programs but at the same time provides some temporary relief to ratepayers and recognizes the financial benefits that shareholders accrue as a result of accelerated investment programs.

Q. Why is it reasonable to consider applying a lower cost of capital to the return on projects that receive accelerated recovery?

A. It is appropriate for several reasons. First, it recognizes that the three Kansas gas utilities acquired the systems that are at issue in this case with full knowledge of their physical conditions, and were each willing to pay an acquisition premium for the systems being acquired. Second, a temporary reduction in the equity return provides some benefit to ratepayers, which is appropriate given the benefit to shareholders of accelerated replacement programs and growth in rate base. The KCC should keep in mind that it is to the benefit of shareholders if the utility increases its rate base because every dollar invested is another dollar on which shareholders can earn a return. While the gas utilities want ratepayers to provide for accelerated cost recovery, they do not want shareholders to lose any of their profit potential. In fact, the gas utilities seek to increase shareholder returns by accelerating recovery, while shifting risk of recovery from shareholders to ratepayers. A temporary reduction in the cost of equity would allow shareholders to begin recovering a return on these costs sooner but would mitigate the impact on ratepayers, at least for a short period of time.

E. Other Considerations and Conclusion

Q. In addition to the conditions outlined above, do you generally support the parameters outlined by Staff in the Staff Report?

A. Yes, I do. I support the parameters outlined by Staff and I recommend that they be adopted, should the KCC determine that an accelerated cost recovery mechanism is appropriate. These include the requirements that any accelerated cost recovery program be adopted on a five-year pilot basis, that extraordinary ratemaking treatment be used only for those expenditures that would not otherwise be made under traditional ratemaking practices and result in an overall increase in capital expenditures, that the gas companies provide an initial roadmap for pipe replacement as well as a prioritization program, that the gas utilities make annual compliance filings and ensure transparency, that the gas companies agree to a three-year rate moratorium or agree that shareholders will bear a portion of rate case costs, and a commitment by the gas utilities to track savings and use any savings to mitigate the incremental costs.

Q. Please summarize your recommendations with regard to an accelerated cost recovery mechanism.

A. I recommend that the KCC reject requests by the Kansas gas utilities to implement a new accelerated cost recovery mechanism for infrastructure replacement projects, although I would support an increase in the current GSRS residential cap from $0.40 per month to $0.80 per month. If the KCC further accelerates the cost recovery currently provided in the GSRS, then I recommend that it also reduce the utility's cost of equity on the incremental investment, until such time as the investment is rolled-into base rates. In addition, I recommend that the KCC adopt the additional parameters outlined in the Staff Report.

Q. Does this conclude your testimony?

A. Yes, it does.

VERIFICATION

STATE OF CONNECTICUT)

COUNTY OF FAIRFIELD) ss:

Andrea C. Crane, being duly sworn upon her oath, deposes and states that she is a consultant for the Citizens' Utility Ratepayer Board, that she has read and is familiar with the foregoing Direct Testimony, and that the statements made herein are true to the best of her knowledge, information and belief.

Andrea C. Crane

Andrea C. Crane

Subscribed and sworn before me this 28th day of January, 2016.

Notary Public Benjamin D Cotton

BENJAMIN D COTTON
Notary Public-Connecticut
My Commission Expires
June 30, 2017

My Commission Expires: ______________________

CERTIFICATE OF SERVICE

15-GIMG-343-GIG

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 29th day of January, 2016, to the following:

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