REBUTTAL TESTIMONY
OF
DAVID SCALF
KANSAS GAS SERVICE
DOCKET NO. 17-KGSG-455-ACT

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David Scalf. My business address is 15 E. 5th Street, Tulsa, Oklahoma.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by ONE Gas, Inc. ("ONE Gas") as the Vice President of Rates and Regulatory Affairs. In that role, I am responsible for the rates and regulatory activities of ONE Gas' three natural gas distribution utilities – Oklahoma Natural Gas ("ONG"), Kansas Gas Service ("KGS" or the "Company") and Texas Gas Service.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I graduated from Southwestern Oklahoma State University with a Bachelor of Science Degree in Finance. I am a Certified Public Accountant in the state of Oklahoma and practiced in public accounting for ten years. For approximately nine years, I was employed by the Oklahoma Corporation Commission ("OCC") where I served as a Regulatory Audit Manager in the Public Utility Division. In August of 2003, I joined ONG as a Regulatory Analyst. I served in various roles at ONG, including Manager of Financial Accounting, Manager of Contract Administration, and Director of Rates and Regulatory. I assumed my current position with ONE Gas in October of 2016.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE KANSAS CORPORATION COMMISSION ("Commission" or "KCC")?

A. I have not previously testified before this Commission. However, I have testified numerous times before the OCC.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to address and rebut the positions taken by Commission Staff ("Staff") in their direct testimony filed in this Docket on September 8, 2017 that conflict with the cost recovery mechanism that this Commission approved in the Kansas Public Service ("KPS") case.

II. RESPONSE TO STAFF'S PROPOSAL TO DEVIATE FROM THE COMMISSION'S DECISION IN THE KPS CASE WITH RESPECT TO RECOVERY OF KGS'S MANUFACTURED GAS PLANT ("MGP") COSTS

Q. DOES STAFF'S PROPOSAL WITH RESPECT TO THE DEFERRAL AND RECOVERY OF KGS'S MGP COSTS AND TREATMENT OF INSURANCE PROCEEDS RELATING TO THOSE MGP COSTS DEVIATE FROM THE COMMISSION'S DECISION IN THE KPS CASE?

A. Yes. Staff's proposal deviates from the Commission's decision in the KPS case in several significant ways.

Q. **WHAT IS THE MOST SIGNIFICANT DEVIATION FROM THE COMMISSION'S DECISION IN THE KPS CASE?**

A. The most significant deviation from the Commission's decision in the KPS case is that Staff's proposal would require the Company to immediately write-off 40% of the MGP costs in year one. Under the KPS case, the utility was allowed to recover 100% of the MGP costs over a ten-year period. The impact in the KPS case was that the utility's stockholders ended up paying for 40% of the MGP costs because of the 10-year amortization period. However, the utility was not required to write-off 40% of the MGP costs in year one, and did not incur a negative impact to its earnings in that year as a result of the Commission's decision. Consider the following portion of the Commission's decision in the KPS case on this point:

"Disallowing carrying costs on the deferred expenses and excluding the unamortized balance from rate base would represent a "cost" to the shareholders because KPS would not be allowed to earn a return on the deferral. However, this treatment would allow KPS to recover the **<u>total cleanup costs</u>** in nominal dollars from ratepayers yet not allow the company to recognize a profit as a result of these costs." (KPS Order, page 4, paragraph 9 emphasis added).

Staff's proposed deviation from this part of the Commission's decision in the KPS case will harm KGS because of the required write-off in year one and the negative impact that such will have on the utility's earnings.

Staff's proposal is also inconsistent with what the Commission did in the KPS case, because Staff's proposal allows the utility to recover carrying costs on the unamortized amount of the MGP costs and effectively treats those costs as if they were in rate base. While this part of Staff's proposal is done to provide the utility some compensation for having to write off 40% of the MGP costs in year one, it is in fact inconsistent with the Commission's position in the KPS case to exclude the unamortized balance of MGP costs from rate base, (KPS Order, Page 4, paragraph 9).

Q. MR. GRADY INDICATED THAT THE REASON HE MADE THIS DEVIATION FROM THE COMMISSION'S DECISION IN THE KPS CASE WAS TO ACCOUNT FOR THE FACT THAT THE CARRYING CHARGE PERCENTAGE IN 1993 WAS GREATER THAN THE CURRENT CARRYING CHARGE PERCENTAGE AND THEREFORE WITHOUT HIS DEVIATION KGS'S STOCKHOLDERS' SHARE OF THE MGP COSTS WOULD BE LESS THAN THE 40% SET IN THE KPS CASE. IS THERE ANOTHER WAY TO STILL ACCOUNT FOR THAT DIFFERENCE IN CARRYING COST PERCENTAGES WITHOUT CAUSING THE NEGATIVE IMPACT TO THE UTILITY'S EARNINGS?

A. Yes. In order to take into account the difference in carrying costs so that KGS shareholders' pay for 40% of the MGP costs and to avoid the negative impact Staff's proposal would have on the utility's earnings, the Commission could increase the amortization period associated with the MGP deferral amortization from ten to thirteen years. The calculation showing how increasing the amortization period to account for the difference in carry charges results in the same calculation made by Mr. Grady without the utility having to incur a negative impact to its earnings is attached as Exhibit DS-1.

Q. WHAT OTHER DEVIATIONS DID STAFF MAKE FROM THE COMMISSION'S DECISION IN THE KPS CASE?

A. Staff has proposed that MGP costs be divided into two categories and those costs be treated differently for ratemaking purposes, with part of the MGP costs to be recovered through base rates and part of the MGP costs being deferred and recovered in a subsequent rate case over a 10-year amortization period. MGP costs in the KPS case were not separated and treated differently.

Q. WHAT IS THE CONCERN WITH THIS PART OF STAFF'S PROPOSAL?

A. There is no reason to separate the MGP costs into two categories and no reason to recover some MGP costs through base rates and some MGP costs to be deferred and recovered over an amortization period. However, there are reasons as to why it is more appropriate to recover all MGP costs using the method approved by the Commission in the KPS case. As indicated in Mr. Haynos' testimony, the MGP costs that KGS has incurred over the years vary greatly from year to year, from a quarter of a million dollars a year to over three quarter of million dollars a year (See Exhibit LMH-1). This makes it impossible to use annual historical costs to determine a proper amount that should be included in base rates. If such was done, customers would either be paying too much or too little. The better approach is to defer all the MGP costs to be amortized over the 10-year period as what was done in the KPS case. This way, customers end up only paying for their portion of the actual cost incurred by the utility with respect to all MGP costs.

In the same way, there is no reason to separate costs by MGP site. Having a separate docket for each site and having separate applications for authorization of an accounting order ("AAO") for each site is unnecessary if the Staff's concern is it will be unable to track MGP costs if they are all recovered under one AAO. This is explained in more detail in Mr. Haught's rebuttal testimony, but under KGS's proposal Staff would receive annual reports showing costs incurred by MGP site and Staff and the Commission will be able to track and verify those costs by site.

Q. STAFF INDICATED THAT IT WAS RECOMMENDING A SEPARATE AAO FOR EACH MGP SITE AND RECOVERY OF A PORTION OF MGP COSTS IN BASE RATES BECAUSE OF ITS CONCERN THAT THE TOTAL FUTURE MGP COSTS ARE UNKNOWN AND DID NOT FEEL COMFORTABLE RECOMMENDING APPROVAL OF AN AAO WHERE THE COSTS WERE UNKNOWN. HOW DO YOU RESPOND TO THAT CONCERN?

A. It is important to note that in the KPS case, the Commission explicitly recognized in its findings that the full extent of cleanup costs at the MGP site at the time KPS filed its application for an AAO was "unknown." (KPS Order, Pages 1-2). The Commission in its KPS Order stated that while the utility provided a cost estimate, it also identified the fact that such costs could escalate rapidly for remedial action depending on the site investigation. (KPS Order, Pages 5-6, Paragraph 13). The Commission also recognized in its KPS Order that there were many other former MGP sites in Kansas for which cleanup costs will be necessary and that such costs and that treatment of the recovery of these costs may be a significant factor in utility rates. (KPS Order, Page 6, paragraph 13). If there is a requirement that utilities seek approval of an AAO before they begin spending money to clean up MGP sites, then it is likely that the ultimate costs, as they were in the KPS case and in the present case, are going to be unknown. KGS appreciates Staff's concern, but that concern can be addressed without the need to have separate AAOs for each MGP site and requiring part of the MGP costs to be recovered in base rates and part of the MGP costs recovered through a deferral and amortization. Such a process will pose administrative issues and ratemaking problems that are unnecessary and can easily be avoided. If Staff is uncomfortable recommending approval of an AAO for all future unknown MGP costs for KGS, then that concern can be addressed by placing a reasonable cap on those MGP costs that can be recovered under the current AAO. If KGS were to exceed that cap, then it could seek to either amend the current AAO or file for a new AAO.

Q. WHAT ARE SOME OF THE ADMINISTRATIVE ISSUES AND RATEMAKING PROBLEMS THAT ARE LIKELY TO EXIST UNDER STAFF'S PROPOSAL TO HAVE SOME MGP COSTS RECOVERED IN BASE RATES AND SOME MGP COSTS RECOVERED UNDER AN AAO?

A. One ratemaking issue is the potential that certain MGP costs included in base rates are subsequently included in a future AAO. If the utility is in between rate case filings there is no way to adjust base rates. In addition, insurance proceeds will not be obtained on a site-specific basis. Therefore, it will be difficult to match up insurance recoveries with specific MGP sites and difficult to ascertain what portions of the proceeds should be applied to the costs recovered under the AAO and which proceeds should be applied to the costs being recovered in base rates. In addition, under Staff's proposal, 100% of the insurance proceeds would be used to reduce the *gross* amount of MGP costs. If KGS is required to write-off 40% of the MGP costs in a base rate case and later receives insurance proceeds to cover those MGP costs, then it may be difficult to create a true-up mechanism to account for those insurance proceeds. For example, if KGS incurs $1 million in MGP costs that must be recovered in base rates under Staff's proposal, then customers would pay $600,000 and KGS' shareholders would pay $400,000. If KGS later recovered insurance proceeds to cover that entire $1 million, then some type of true up mechanism would be required to go back and account for the amount paid for by shareholders. This process could become very complicated depending on the timing of when insurance proceeds are received. This problem is avoided if all MGP costs are treated the same and covered by one AAO. As insurance proceeds are received the portion not retained by KGS as its incentive would go to reduce the amount of MGP costs that had yet to be recovered under amortization.

Q. WHAT OTHER DEVIATIONS DID STAFF MAKE FROM THE COMMISSION'S DECISION IN THE KPS CASE?

A. In the KPS case, the Commission made it clear in that order to encourage the utility to continue to seek reimbursement for property damages from insurance companies, the utility would be allowed to retain 40% of the insurance proceeds. (KPS Order, page 5, paragraph 11). Even though the language in the Commission order is clear that the Commission was allowing the utility to retain 40% of the insurance proceeds as an incentive to aggressively pursue insurance proceeds to reduce MGP costs to be paid by customers, Staff's proposal in this case removes all that incentive. Instead of the clear incentive offered to the utility by the Commission in the KPS case, Staff suggests that the "stick" that it offers in its proposal (KGS will reduce the amount of MGP costs that its shareholders will have to pay) is sufficient encouragement for KGS.

Q. STAFF INDICATED IN ITS TESTIMONY THAT THE COMMISSION IN THE KPS CASE DID NOT MEAN TO PROVIDE KPS AN INCENTIVE TO AGGRESSIVELY SEEK INSURANCE PROCEEDS BY ALLOWING THE UTILITY TO RETAIN 40% OF THE INSURANCE PROCEEDS AND THAT PROVISION WAS POORLY WORDED OR CRAFTED BY THE COMMISSION IN THAT ORDER. THEREFORE, THERE IS NO REASON FOR THE CURRENT COMMISSION TO FOLLOW THE PRECEDENT SET IN THE KPS CASE. DO YOU AGREE WITH STAFF?

A. No. The language used by the Commission in its Order in the KPS at page 5, paragraph 11 is clear and unambiguous and a reading of that language clearly indicated that the Commission wanted to "encourage" the utility to continue to seek reimbursement for property damage from the insurance companies so it allowed the utility to retain 40% of those proceeds.

III. <u>CONCLUSION</u>

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does at the current time.

VERIFICATION

STATE OF OKLAHOMA)
) ss.
COUNTY OF TULSA)

David Scalf, being duly sworn upon his oath, deposes and states that he is Vice President, Rates and Regulatory Affairs for ONE Gas, Inc.; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

David Scalf

David Scalf

Subscribed and sworn to before me this 25 day of September 2017.

Joanne C Davis

NOTARY PUBLIC

JOANNE C. DAVIS NOTARY # 05009895 EXP. 10/25/21 PUBLIC STATE OF OKLAHOMA

My appointment Expires:

October 25, 2021

Calculation per Justin Grady

Line No.									
1				# of Periods	1	2	3	4	5
2				Year	2018	2019	2020	2021	2022
3	Balance	$ 10,000,000		Annual Amortization	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
4	Periods	10		Present Value Factor	91.0226%	82.8512%	75.4133%	68.6432%	62.4808%
5	Rate of Return	9.8628%		Present Value	$ 910,226	$ 828,512	$ 754,133	$ 686,432	$ 624,808
6	Pymts	$ 1,000,000							
7	PV	$ 6,180,950							
	Shareholder %	61.81%							
	Ratepayer %	38.19%							

Calculation using KGS's methodology

with one year lag

Line No.									
1				# of Periods	1	2	3	4	5
2				Year	2018	2019	2020	2021	2022
3	Balance	$ 10,000,000		Annual Amortization	$ -	$ 666,667	$ 666,667	$ 666,667	$ 666,667
4	Periods	15.0	2	Present Value Factor	93.2142%	86.8889%	80.9927%	75.4967%	70.3737%
5	Rate of Return	7.2798%		Present Value	$ -	$ 579,259	$ 539,952	$ 503,312	$ 469,158
6	Pymts	$ 666,667							
7	PV	$ 5,561,230							
	Ratepayer %	56%							
	Shareholder %	44%							

Calculation using KGS's methodology

with one year lag

Line No.									
1				# of Periods	1	2	3	4	5
2				Year	2018	2019	2020	2021	2022
3	Balance	$ 10,000,000		Annual Amortization	$ -	$ 769,231	$ 769,231	$ 769,231	$ 769,231
4	Periods	13.0	2	Present Value Factor	93.2142%	86.8889%	80.9927%	75.4967%	70.3737%
5	Rate of Return	7.2798%		Present Value	$ -	$ 668,376	$ 623,021	$ 580,744	$ 541,336
6	Pymts	$ 769,231							
7	PV	$ 5,898,808							
	Ratepayer %	59%							
	Shareholder %	41%							

	6	7	8	9	10
	2023	2024	2025	2026	2027
	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
	56.8717%	51.7661%	47.1189%	42.8888%	39.0385%
	$ 568,717	$ 517,661	$ 471,189	$ 428,888	$ 390,385

6	7	8	9	10	11	12	13	14	15	16
2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667	$ 666,667
65.5983%	61.1469%	56.9976%	53.1298%	49.5245%	46.1639%	43.0313%	40.1113%	37.3894%	34.8522%	32.4872%
$ 437,322	$ 407,646	$ 379,984	$ 354,199	$ 330,164	$ 307,759	$ 286,875	$ 267,409	$ 249,263	$ 232,348	$ 216,582

6	7	8	9	10	11	12	13	14	15	16
2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ 769,231	$ -	$ -
65.5983%	61.1469%	56.9976%	53.1298%	49.5245%	46.1639%	43.0313%	40.1113%	37.3894%	34.8522%	32.4872%
$ 504,602	$ 470,361	$ 438,443	$ 408,691	$ 380,958	$ 355,107	$ 331,010	$ 308,548	$ 287,611	$ -	$ -

17	18	19	20	21	
2034	2035	2036	2037	2038	
$ -	$ -	$ -	$ -	$ -	0
30.2827%	28.2278%	26.3123%	24.5268%	22.8625%	
$ -	$ -	$ -	$ -	$ -	

17	18	19	20	21	
2034	2035	2036	2037	2038	
$ -	$ -	$ -	$ -	$ -	0
30.2827%	28.2278%	26.3123%	24.5268%	22.8625%	
$ -	$ -	$ -	$ -	$ -	