

**BEFORE 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. 24-KGSG-460-CON
Agreements with Utility Insurance Company,)
Pursuant to K.S.A. 66-1402.)

NOTICE OF FILING OF STAFF'S REPORT AND RECOMMENDATION
(PUBLIC)

The Staff of the Kansas Corporation Commission (Staff and Commission, respectively) hereby files its Report and Recommendation, dated October 10, 2024, recommending the Commission not take action to disapprove the 2023 contract between Kansas Gas Service, a Division of ONE Gas, Inc. and its wholly-owned captive insurance company, Utility Insurance Company.

WHEREFORE, Staff respectfully submits its report and recommendation.

Respectfully Submitted,

/s/ Ahsan Latif

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Andrew J. French, Chairperson
Dwight D. Keen, Commissioner
Annie Kuether, Commissioner

Laura Kelly, Governor

**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

REDACTED VERSION

**** _ ** DENOTES CONFIDENTIAL INFORMATION**

TO: Andrew J. French, Chairperson
Dwight D. Keen, Commissioner
Annie Kuether, Commissioner

FROM: Bill Baldry, Senior Auditor
Kristina Luke Fry, Managing Auditor
Chad Unrein, Chief of Accounting and Financial Analysis
Justin Grady, Deputy Director of Utilities
Jeff McClanahan, Director of Utilities

DATE: October 10, 2024

SUBJECT: Docket Number: 24-KGSG-460-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:

On December 21, 2023, in the above captioned Docket, ONE Gas filed a renegotiated insurance contract with its wholly-owned captive insurance company, Utility Insurance Company (UIC), which it created in 2018. ONE Gas is required by Kansas law to file each new contract with the Commission. Over the last five years, UIC has been able to provide insurance coverage in the difficult to obtain coverage range of \$250,000 to \$2,000,000 at a reasonable cost to ONE Gas and its three distribution companies. In 2018, UIC estimated that it would initially incur additional operating expenses, but the expenses would eventually decline. Over the last 5 years, UIC did incur higher than expected operating expenses, but the expenses were offset by lower insurance premiums and cost savings compared to the public insurance market. After five years of operating as an insurance company, UIC has saved money for ONE Gas. Because of the benefits KGS receives from getting insurance coverage through UIC, Staff recommends that the Commission not take action to disapprove the new 2023 contract between ONE Gas and UIC.

BACKGROUND

The Commission derives its authority review contracts with affiliated interests from K.S.A. 66-1402, which states:

“No management, construction, engineering or similar contract, hereafter made, with any affiliated interest, as defined in K.S.A. 66-1401 and amendments thereto, shall be effective unless it shall first have been filed with the commission. *If it be found that any such contract is not in the public interest, the commission, after investigation and a hearing in accordance with the provisions of the Kansas administrative procedure act, is hereby authorized to disapprove such contract.*”
(emphasis added)

In 2018, ONE Gas created a wholly owned pure captive insurance company, UIC. Staff reviewed the contract and costs in Docket No. 18-KGSG-392-CON and recommended that the Commission take no action to prevent the establishment of ONE Gas’ wholly owned captive insurance company (UIC). UIC was established to better control the cost of insurance. UIC provides insurance coverage to KGS and the other natural gas distribution company divisions of ONE Gas in accordance with K.S.A. 66-1402. UIC provides auto liability, general liability and employment practice liability, workers’ compensation, general liability, property damage,¹ and cyber security² for ONE Gas.

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 method 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 earn a profit. Using a captive insurance company allows the insured entities to pay only for coverage that it needs.³

To keep the premiums at competitive prices, UIC continues to conduct pricing studies and review indications from the commercial markets each year to ensure that UIC is providing an equal or lower premium. UIC cannot pay out its profits in the form of dividends to ONE Gas without the Oklahoma Insurance Commission’s approval. UIC, to date, has not paid out any dividends.⁴

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 coverage only to its parent company. UIC is a pure captive. A group captive provides insurance to

¹ See response to Staff Data Request No. 22 in Docket No. 18-KGSG-392-CON.

² See response to Staff Data Request No. 12 in Docket No. 24-KGSG-460-CON.

³ See response to Staff Data Request No. 3, page 13, in Docket No. 18-KGSG-392-CON.

⁴ See response to Staff Data Request No. 16 in Docket No. 24-KGSG-460-CON.

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.

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. Over the last five years, claims have been favorable enough that UIC was able to expand the threshold of coverage to the range of greater than \$100,000, but less than \$2,000,000.⁵ UIC will continue ONE Gas' current policy of purchasing insurance coverage from insurance companies unrelated to ONE Gas for claims greater than \$2 million.

ANALYSIS:

Before filing the 18-392 docket, it had been difficult for ONE Gas to get reasonable premium coverage for claims in the \$250,000 to \$2,000,000 range, causing ONE Gas to establish UIC, a captive insurance company, to provide insurance coverage for claims in this range. This Docket was filed to allow Staff to review the changes in the insurance contracts.

The benefits of having a captive insurance company are:

- Reducing the overall cost of insurance;
- Custom tailored insurance program;
- Budget stability;⁶
- More control over the resolution of the company's claims;
- Expansion of coverage where markets are constrained;
- Providing direct access to the re-insurance marketplace;
- Collection of risk data and loss information to better understand the risk and its volatility;⁷

Some specific UIC benefits for KGS are:

- UIC is in a better position in negotiations with external markets;⁸
- Other insurance companies would view UIC as a competitor to traditional insurance markets that might result in getting a lower rate compared to ONE Gas not owning a captive insurance company;⁹
- UIC allows for consistent, competitive insurance rates over the long-term, lower priced reinsurance re-insurance in the retail marketplace, and premium tax savings;¹⁰

⁵ See response to Staff Data Request Nos. 5 and 6 in Docket No. 24-KGSG-460-CON.

⁶ See response to Staff Data Request No. 3, pages 13-14 in Docket No. 18-KGSG-392-CON.

⁷ See response to Staff Data Request No. 3, page 3 in Docket No. 18-KGSG-392-CON.

⁸ See response to Staff Data Request No. 3, page 3 in Docket No. 18-KGSG-392-CON.

⁹ See Response to Staff Data Request No. 6, in Docket No. 18-KGSG-392-CON.

¹⁰ See Response to CURB Data Request No.4 in Docket No. 24-KGSG-460-CON.

- The market has allowed ONE Gas to keep its \$2 million deductible with outside insurance companies;¹¹ and
- It is beneficial to Kansas Gas Service ratepayers.¹²

A retail insurance company will provide its customers with a single premium amount. Being a captive insurance company, UIC is able to be more transparent in the disclosure of its premium cost. Excluding the cost of insurance claims, examples of those costs are:

- Direct Placement Tax;
- Letter of Credit cost;
- Premium Taxes;
- Management fees of the captive insurance company;
- Audit fees;
- Actuarial fees;
- Incorporation fees;
- Government fees;¹³
- UIC is exposed to claims between \$100,000 and \$2 million. Claims above \$2 million are insured with a retail insurance company.¹⁴

During the review of this filing, Staff issued multiple data requests. As a whole, Staff is still supportive of the use of a captive insurance company. Any concerns Staff had, were addressed through the discovery process with KGS.

Staff's first concern is regarding the UIC contracts since 2018. Whenever ONE Gas negotiates a new insurance contract with UIC, KGS is required to file the new insurance contract with the Commission. ONE Gas has renegotiated the insurance contract every year since 2018, however ONE Gas has not filed the new contracts with the Commission until the 2023 contract was renegotiated.

In response to Staff Data Requests, KGS detailed the following procedures to ensure that this mistake is not made again:

1. The Rates and Regulatory Department has set reminders two weeks prior to the renewal date;
2. A Rates Analyst will then remain in contact with the Risk and Insurance Department on a weekly basis until the policy has been finalized;
3. Once KGS receives the new insurance policy, the Rates Analyst will contact KGS Legal asking the legal department to prepare the required filing for submission to the Commission;

¹¹ See Response to Staff Data Request No. 6, in Docket No. 24-KGSG-460-CON.

¹² See Response to Staff Data Request No. 11 in Docket No. 24-KGSG-460-CON.

¹³ See Response to Staff Data Request No. 3, page 47, in Docket No. 18-KGSG-392-CON.

¹⁴ See Response to Staff Data Request Nos. 5 and 6 in Docket No. 24-KGSG-460-CON.

4. When the legal department has made the filing, the Risk and Insurance Department will notify the Rates and Regulatory Department that the renewal has been completed.¹⁵

These procedures have provided Staff with confidence that the company has established a process that will prevent this noncompliance in the future.

Staff's next concern was that there was a material increase in the annual premium costs for general insurance since 2018. The premiums UIC charges to ONE Gas and the three distribution companies have increased over the last 5 years due to:

- a. The deductibles were reduced from \$250,000 to \$100,000;
- b. Property premiums are determined based on each ONE Gas division's statement of replacements costs;
- c. Inflation;
- d. Significant industry events that the reinsurers have had to pay out causing the overall markets to increase all property premiums; and
- e. Reinsurers seeing an increase in nuclear verdicts which has caused all premiums to go up with General Liability and Excess Liability Auto coverages.¹⁶

Finally, in the 18-KGSG-392-CON Docket, KGS predicted that the operating costs of using a captive insurance company would end up costing ratepayers more initially compared to not creating a captive insurance company, but KGS estimated that the cost would come down over the years.¹⁷ As shown in the table below, operating costs have increased over time rather than decrease as had been predicted.¹⁸

	2018	2019	2020	2021	2022	2023
Actuary	\$45,000	\$60,000	\$50,000	\$85,500	\$73,000	\$87,000
Audit Fee	\$0	\$34,575	\$24,885	\$26,319	\$41,175	\$59,210
Management Fee	\$22,500	\$67,866	\$45,000	\$45,000	\$45,000	\$45,000
Premium Tax	\$16,774	\$18,032	\$23,072	\$26,489	\$31,535	\$36,216
Grand Total	\$84,274	\$180,473	\$142,957	\$183,308	\$190,710	\$227,426

Although operating costs have increased, UIC is still saving customers money due to lower premiums through UIC compared to the cost of the same amount of insurance coverage purchased from a retail insurance company.¹⁹

Total premium savings by having a captive insurance company compared to the cost of buying from a public insurance market for the period 2018 through 2023 totaled ** [REDACTED] **. ²⁰

¹⁵ See response to Staff Data Request Nos. 12 in Docket No. 24-KGSG-460-CON.

¹⁶ See response to Staff Data Request Nos. 5 and 14 in Docket No. 24-KGSG-460-CON.

¹⁷ See response to Staff Data Request No. 31 in Docket No. 18-KGSG-392-CON.

¹⁸ See response to Staff Data Request No. 1 in Docket No. 24-KGSG-460-CON.

¹⁹ See response to Staff Data Request No. 14 in Docket No. 24-KGSG-460-CON.

²⁰ See response to Staff Data Request No. 15 in Docket No. 24-KGSG-460-CON. Savings excluding the premium tax totaled \$11,084,111 while the premium tax savings amounted to \$4,181,715.

Based on the record, Staff did not find any evidence that the contract is not in the public interest, pursuant to K.S.A. 66-1402; therefore, Staff recommends the Commission not take action to disapprove the 2023 contract between ONE Gas and UIC.

RECOMMENDATION:

UIC has been able to provide insurance coverage to ONE Gas and its subsidiaries in the \$250,000 to \$2,000,000 claims range when other insurance companies could not provide insurance at a reasonable price, but UIC's operating expenses have increased significantly since 2018.

Over the last five years, UIC has incurred higher than expected operating expenses, but those expenses have been more than offset by lower insurance premiums and cost savings for UIC as compared to the public insurance market. After five years of operating as an insurance company, UIC has saved money for ONE Gas. Because of the benefits KGS receives from getting insurance coverage through UIC, and because Staff does not find anything in the record to indicate the contract is not in the public interest, Staff recommends that the Commission not take action to disapprove the new 2023 contract between ONE Gas and UIC.

CERTIFICATE OF SERVICE

24-KGSG-460-CON

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing (Public) was served via electronic service this 10th day of October, 2024, to the following:

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CERTIFICATE OF SERVICE

24-KGSG-460-CON

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