THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of a General Investigation Regarding the Acceleration of Replacement of Natural Gas Pipelines Constructed of Obsolete Materials Considered to be a Safety Risk.	)))))	Docket No. 15-GIMG-343-GIG

CURB's Brief on Jurisdiction

The Citizens' Utility Ratepayer Board (CURB) herein provides its legal arguments on the question of whether the Commission has jurisdiction to approve a system integrity surcharge that provides the same sort of remedies that the legislature provided the utilities in enacting the Gas System Reliability Surcharge Act.

For all the reasons stated below, the answer to that question is no.

I. Introduction

1. The Commission's Staff requested the Commission open this docket to consider approving a system integrity surcharge. In explaining the need for a surcharge, Staff's memo noted that much of the state's natural gas infrastructure is old and obsolete, and stated, "[A]s pipe ages, failure will be become more frequent, and more frequent failures increase the probability of at least one of the failures being catastrophic in nature. Delaying pipe replacement until a threat to public safety is obvious is not good public policy." (*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,* filed as an attachment to *Order Opening General Investigation*, at 3,

Mar. 12, 2015, KCC Docket No. 15-GIMG-343-GIG). The memo raised Staff's concern that "the rate of replacement may not be sufficient to stem the threat of leakage from old pipes." (*Id.*).

2. In proposing that the Commission consider implementing a new surcharge, Staff stated, "While current replacement programs are making progress, Staff believes 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." (*Id.*). The Commission asked the parties to address the question of whether the Commission has jurisdiction to adopt the proposed new surcharge.

II. The current surcharge mechanism for pipeline safety expenditures is the GSRS Act

3. During the 2006 session of the Kansas Legislature, the state's regulated public natural gas utilities jointly proposed a surcharge to the legislature that would assist the utilities in maintaining and enhancing pipeline safety through replacement of non-revenue producing infrastructure. The utilities were united in their support of the proposed surcharge and offered several reasons why it would be beneficial:

> Passage of SB 414 will encourage natural gas companies to increase the investment levels necessary to maximize the safety and reliability of their systems. (Ron Gaches, Atmos Energy, Senate Testimony, Feb. 2, 2006).
>
> The traditional regulatory model does not efficiently fit the current financial environment for natural gas utilities in meeting their obligation to provide safe and reliable natural gas service. Kansas Gas Service and the other utilities operating in Kansas are continuously replacing aging infrastructure and relocating infrastructure to meet safety needs and

> infrastructure enhancements. These investments do not enhance revenues." (Brad Dixon, KGS, Senate Testimony, Feb. 2, 2006).
>
> Generally, these types of investments are not controversial issues, but are a regular part of maintaining integrity throughout the gas systems. (Richard C. Loomis, Aquila, Senate Testimony, Feb. 2, 2006.)
>
> The ability to pass through the cost of prudent safety and reliability investments in a timely manner is crucial to our ongoing financial health. (Larry Berg, Midwest Energy, Senate Testimony, Feb. 2, 2006).
>
> We believe SB 414 is a reasonable and responsible approach to cost recovery of safety and reliability investments that are mandates by local, state and federal governments." (Larry Berg, Midwest Energy, House Testimony, Mar. 14, 2006).

The utilities also offered testimony in favor of the GSRS as a means of recovering expenditures that are incurred outside of the test year, and noted the benefits of reducing regulatory lag between the time that expenditures are made by the utility and when the revenues are recovered in rates:

> Under current Kansas law and regulatory practice, investments made to replace gas system infrastructure may not be recovered until the investment is in the ground, the investment is deemed 'used and required to be used' prudent in a regulatory case before the Kansas corporation commission. The current system produced significant regulatory lag time between when the dollars are spent for infrastructure replacement and when the company begins to recover these expenditures in rates. . . . .SB 414 will allow a gas utility to apply a surcharge to customers' bills and start to recover the costs expended to replace infrastructure in a timely manner. (*Id.,* Ron Gaches, Atmos Energy).
>
> Senate Bill 414 helps to address a challenge faced by gas utilities relating to recovering the cost of investing in safety related pipeline replacement projects in a more timely manner than occurs in the historical regulatory process. (*Id.*, Richard C. Loomis, Aquila).

Another purpose of the legislation, the utilities testified, was to reduce rate case expenses that customers have to pay for through their utility bills:

> By allowing more timely recovery for safety related and infrastructure enhancement programs through the mechanism set forth in SB 414, there will be less frequent need for expensive contested rate cases. . . . to file for an annual rate

> increase to meet these increasing costs over which we have no control is inefficient and costly. (Brad Dixon, Kansas Gas Service, Senate Testimony, Feb. 2, 2006).
>
> We believe any measure that helps delay the cost of preparing, filing and litigating rate cases is good for our customers. (Larry Berg, Midwest Energy, Senate Testimony, Feb. 2, 2006).

4. The comments of Brad Dixon of Kansas Gas Service at the Senate Utilities Committee hearing on the legislation were typical of those also made by the other utilities: "We do not contest the need for these [pipeline safety] mandates. They are appropriate. These mandates enhance safety, and promote the public well-being through enhanced infrastructure in our local communities. These expenditures however. . . do not generate additional revenue for the natural gas utilities operating in the state." (Brad Dixon, Kansas Gas Service, Senate Testimony, Feb. 2, 2006). "The customer will avoid the significant regulatory cost of annual rate filings which would be necessary to timely recover our investments," said Dixon. (*Id.*).

5. After hearings before the utilities committees of both the House and the Senate, the legislature passed the requested legislation, but imposed a 40 cent per month per year cap on increases for the surcharge—an amendment proposed by Senator Janice Lee. She had expressed her concern to the committee members that an unlimited surcharge would generate runaway increases in rates. Her amendment was approved by the Senate Utility Committee and incorporated into the final bill. Otherwise, the legislation's provisions were consistent with the purposes for which the legislation was proposed: providing a means for maintaining and enhancing pipeline safety through replacement of non-revenue producing infrastructure, reduction of regulatory lag, and

reduced costs of rate cases. The statute also limited the authority of the Commission in numerous ways.

6. In Chapter 66 of the Kansas statutes, the legislature has granted the Commission "full power, authority and jurisdiction to supervise and control the public utilities, and is "empowered to do all things necessary and convenient for the exercise of such power, authority and jurisdiction." K.S.A. 66-101 and 66-101g. These two statutes have been consistently interpreted by the courts as conferring upon the Commission very broad power and discretion to determine how it will regulate the utilities and set rates. By contrast, virtually all the other statutes in Chapter 66 circumscribe and limit that broad power in various ways. Some statutes are prohibitive, some are prescriptive—but all serve to limit the scope of the Commission's broad "power, authority and jurisdiction" in some way.

7. The GSRS Act, K.S.A. 66-2201 *et seq.,* is not an ambiguous statute. It imposes precise limits on the Commission's usually broad power to set utility rates. The Commission may not approve cost recovery of costs through the GSRS if the costs are below or above specified percentages of the utility's approved base rate revenues, and requires a utility with a GSRS to have had a rate case with the Commission within five years, or six with an extension approved by the Commission. [K.S.A. 66-2203(a) and (b)]. K.S.A. 66-2204(e)(1) limits the Commission to setting an initial GSRS rate to no more than 40 cents per residential customer per month, and prohibits the Commission from allowing annual increases of more than 40 cents per month over the previous year's rate. [K.S.A. 66-2204(e)(2)]. The statute requires that the annual surcharge be trued-up annually to actual approved costs, and reset to zero when new base rates become

effective after a general rate case, at which time the GSRS costs are incorporated into base rates. (K.S.A. 66-2204(f)(1). The statute provides how the return on investment included in rates will be determined. K.S.A. 66-2204(b)(4). Thus, the Commission's usual broad discretion to set rates is circumscribed considerably by the GSRS Act. Finally, the legislature limited cost recovery to two types of projects. Recovery is limited to the costs that the utility is forced to undergo because of public projects such as highway improvements or because of pipeline safety requirements. K.S.A. 66-2202(f). The costs of projects that connect new customers and increase revenues are explicitly not eligible for recovery. K.S.A. 66-2202(d)(1). The types of costs to be recovered in the GSRS and the method of recovery are precisely what the utilities that sponsored the legislation proposed—with the notable exception of Senator Lee's amendment to impose a 40 cent cap, which was not included in the utilities' proposed legislation until after the Senate heard testimony on the bill.

III. Passage of the GSRS statute limited the KCC's broad ratemaking authority

8. The question at issue in this docket is whether the Gas System Reliability Surcharge (GSRS) Act, K.S.A. 66-2201 *et. seq.* limits the authority—or the jurisdiction—of the Commission to approve a surcharge of its own that would allow natural gas utilities to recover the same sort of costs as the legislatively-created GSRS, and whether the Commission has authority to approve a higher rate for its surcharge than the GSRS permits the Commission to approve. First, one might wonder if an analysis depends on whether there is a difference between "power", "authority" and "jurisdiction." The answer for the judiciary is yes, but the answer for an agency is no.

Whether an agency is exceeding its authority or whether it is acting outside the scope of its jurisdiction makes little difference, according to United States Supreme Court Justice Antonin Scalia:

> "The reality, laid bare, is that there is no difference, insofar as the validity of agency action is concerned, between an agency's exceeding the scope of its authority (its "jurisdiction") and its exceeding authorized application of authority that it unquestionably has. 'To exceed authorized application is to exceed authority. Virtually any administrative action can be characterized as either the one or the other, depending on how generally one wishes to describe the 'authority.'"

Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354, 381, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988) (J. Scalia concurrence).

9. Concerning the Commission's own view of the GSRS, at the House Utilities Committee hearing on the GSRS bill, the then-Director of Utilities for the Commission said, "A statutory mandate to allow a specific kind of surcharge under specific circumstances removes [the] desirable Commission discretion" to take into consideration the particular circumstances of each utilities' proposals. (Don Low, KCC, House Testimony, Mar. 14, 2006). Parenthetically, he added, "I should note here that some might argue that specific statutory allowance of this surcharge prevents the Commission from using its discretion to allow other surcharges." (*Id.*).

10. As the Commission itself has argued on appeal, when the legislature creates its own surcharge mechanisms such as the Transmission Delivery Charge (K.S.A. 66-1237) and the property tax surcharge [K.S.A. 66-117(f)], the legislature is limiting the Commission's power, not authorizing an expansion of that power. (Brief of Appellee at 20-22, *Kansas Industrial Consumers Group, Inc. v. State Corporation Comm'n*, 36 Kan.App.2d 83 (2006), appeal from KCC Docket No. 05-WSEE-981-RTS). In that

appeal, the Commission argued that these statutory pass-through mechanisms limit the broad power of the Commission by requiring the Commission to approve them. "In other areas, such as environmental costs," argued the Commission, "the policy determination [to approve pass-through mechanisms] is with within the sound discretion of the Commission." *Id.*, at 22. Utilities would likely argue in this case that the holding in the *KIC* case allowing the Commission to approve an environmental surcharge supports the notion that the Commission may approve a system integrity surcharge, but the logic is flawed. The legislature had not passed any statutes limiting the authority of the Commission to approve a surcharge for environmental costs, thus the subject of extraordinary cost-recovery mechanisms for environmental costs remained under the broad authority of the Commission's powers to regulate. The passage of the GSRS Act, however, has clearly limited the authority of the Commission to approve a surcharge for recovery of system integrity costs to enhance pipeline safety. Thus, the holding in the KIC case is inapplicable, because the order addressed the authority of the Commission to act in absence of any statutory limitations. In this case, the legislature has imposed statutory limitations.

11. Regarding the statutory analysis of agencies' own interpretations of statues affecting their power and jurisdiction that is enshrined in *Chevron*, "'When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. 467 U.S., at 842, 104 S.Ct. 2778. First, applying the ordinary tools of statutory construction, the court must determine 'whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously

expressed intent of Congress.' *Id.*, at 842–843, 104 S.Ct. 2778. But 'if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute'." Id., at 843, 104 S.Ct. 2778. (*City of Arlington v. Federal Communications Comm'n*, 133 S.Ct. 1863, 1868). An Oregon court agreed with a similar conclusion: "where statutes containing specific provisions relating to rates are applicable, they control and narrow PUC's general authority in the specific circumstances to which they apply." *Citizens' Utility Board v. PUC,* 154 Or.Appl. 962, at 715, 962 P.2d 744 (1988). (*Gearhart v. PUC,* 255 Or.App. 58, 69, 299 P.3d 533 (2013).

12. Directly on point is a Pennsylvania Public Utility Commission case where an electric utility requested a "Distribution system improvement service charge" (DSIC) which was a surcharge that would have allowed the utility to recover between rate cases the capital costs of three categories of distribution expenditures and earn a return on the investments: facilities that are worn out, are in deteriorated condition, or need to be upgraded to meet new regulations; unreimbursed costs to relocate facilities due to highway relocations; and security improvements recommended by a state or federal government entity with jurisdiction over security matters. *Pennsylvania Public Utility Comm'n v. PPL Elec. Utilities Corp.*, 237 P.U.R.4th 419 at 67 (2004); (Note: page citations herein are to the Westlaw version of the opinion, which does not provide the pagination of the original version). The utility cited the Commission's statutory authority to approve automatic adjustments for distribution system improvements made between rate cases. (*Id.,* at 70).

13. Some of the intervenors argued that the provision should be read in conjunction with a later statute section that approved DSIC mechanisms for water utilities. (*Id.*, at 67). The administrative law judge found that although the legislature had granted the Commission broad powers to fashion adjustment mechanisms under the utility code, with the passage of several later amendments, "the Legislature appears to have circumscribed the Commission's authority to approve automatic adjustment mechanisms." (*Id.*, at 72). The Commission said in reviewing the ALJ's findings, "Obviously, if the Legislature intended to give the Commission the authority to grant a DSIC to electric distribution utilities it would have specifically identified the industry in this section or, alternatively, created an additional section specifying the applicability of this section to the electric industry. DSIC surcharges were clearly intended to pertain only to the water industry." (*Id.*, at 69-70). Further, the Commission noted that legislator testimony in the proceeding indicated that their intent in passing the amendment was to limit this mechanism to water utilities. (*Id.*). Although intervenors had raised multiple other arguments against the DSIC, the Commission's final order concluded that the Commission would not approve a DSIC, and rested its decision on the argument that the later amendments to its general authority to approve automatic adjustment mechanisms had circumscribed its power to approve a DSIC for any utility other than a water utility. (*Id.*, at 151; none of the parties appealed this ruling). The Commission's reasoning in the *KIC* case is also consistent with other cases discussed above that have similarly determined that when the legislation unambiguously limits the agency's power to act for a particular purpose, the Commission is barred from devising other means of accomplishing that same purpose.

14. Since the GSRS Act as enacted allows the utilities the timely recovery of costs for safety and public projects that they requested, as well as contains the customer-protective measures that were also proposed by the utilities—it is fair to presume that the intention of the legislature was to grant the utilities' proposal to circumscribe the Commission's broad powers to determine rates while also providing the sort of customer protections that the Commission often imposes on extraordinary ratemaking mechanisms. In fact, the only discretion that the Commission exercises in this process is to ensure that the petition meets the statutory requirements of the Act and ensure that the types and total amount of the expenditures meet the specific limitations set forth in the Act. Outside the GSRS process, the statute does mention that the Commission is not limited from considering the recovery of infrastructure system replacement costs …during any general rate proceeding." K.S.A. 66-2204(i). It appears that the legislature wanted to make sure that there were two choices: Commission can either allow the eligible costs to be recovered through the GSRS surcharge or through base rates.

15. That the legislature took action at all is indicative of its intent to limit the authority of the Commission in the area of recovery of pipeline safety costs through alternative rate mechanisms. First, general authority over ratemaking is clearly the province of the Commission. To place this matter in the hands of the Commission would have required no legislative action at all. So the fact that the GSRS Act was passed at all strongly implies that the legislature intended to deprive the Commission of its authority over this subject matter. The fact that proponents of the bill sought this remedy from the legislature rather than the Commission was a conscious choice; in enacting the proposed

bill with all of its major provisions intact the legislature clearly intended to provide the utilities the remedies they sought.

16. Further, the Act unambiguously usurps a precise range of powers normally exercised with broad discretion by the Commission, and even provides customer protections that the Commission often provides. The Commission has no choice but to conclude that the legislature has intentionally usurped its power, authority and jurisdiction to act in the realm of approving alternative cost-recovery mechanisms that provide timely recovery of pipeline safety costs.

17. Whether a Commission-approved system integrity surcharge would provide the same sort of remedy intended by the passage of the GSRS is the last question that must be addressed in determining whether the Commission has the authority to approve a system integrity surcharge. The Gas System Reliability Surcharge (GSRS) Act, K.S.A. 66-2201 *et seq.*, requires the Commission to allow the natural gas utilities to implement a surcharge for the timely recovery of costs of "eligible infrastructure replacements" that include projects "undertaken to comply with state or federal safety requirements" [K.S.A. 66-2202(f)(1) and (2); 66-2204(b)(4)]. The purpose of this legislatively-created alternative cost recovery mechanism is a limitation on the Commission's authority to develop a different pass-through mechanism that provides for recovery of costs of "eligible infrastructure replacements" that include projects "undertaken to comply with state or federal safety requirements." *Id.*

18. These subjects appear to be the same, and the purpose appears to be the same. Pipeline safety covers a wide range of subjects, but for the most part, pipeline safety projects are system infrastructure integrity projects. Of particular relevance to the

question of whether the Commission has jurisdiction to devise a system integrity surcharge is the fact that the Gas System Reliability Surcharge permits recovery of "pipeline system components installed to comply with state or federal safety regulations" and projects "enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements" K.S.A. 66-2202(f)(2). These are precisely the same sort of costs proposed to be recovered through a Commission-devised "system integrity" surcharge, and the same sort of costs that the utilities identified as their reason for seeking more timely recovery through the proposed GSRS.

19. Poor natural gas system integrity is a fancy term for leaky pipes. Poor system integrity is not only costly because the commodity is wasted, but natural gas leaks can be dangerous. So pipeline safety requires pipeline integrity. Unfortunately, much of the state's natural gas infrastructure has aged past the point of optimal integrity. Pipeline safety regulators as far back as 1971 recognized the problems of corrosion in cast-iron and uncoated bare steel pipes, noting their tendency to corrode and develop leaks. *See Federal Register, Vol. 36, No. 126, June 30- 1971, Title 49, Ch. 1, Part 192,* "Transportation of Natural and Other Gas by Pipeline: Minimum Federal Safety Standards", Hazardous Materials Regulations Board, Dept. of Transportation (Docket OPS-5; Amdt. 192-4). Later regulations recommended replacement of leaking cast-iron and bare steel, and also barred PVC and Aldyl-A pipe materials from new installations because of various safety problems identified over the years. (Leo Haynos, D. Test. At 3-4, KCC Docket No. 14-BHCG-502-RTS).

20. In applying the statutory scheme of the GSRS Act, the Commission has interpreted the Act to require that replacements of pipeline system components that are

consistent with the utility's Operation and Maintenance plan and are replaced pursuant to a specific pipeline safety code requirement regulation are eligible for GSRS recovery. (*Order*, Dec. 13, 2010, at 3, 7; KCC Docket No. KGSG-177-TAR). In that docket, the utility received conditional approval for recovery of the costs of replacements of non-leaking bare steel pipe. The Commission conditioned recovery on the utility filing a revised Operation and Maintenance plan that requires replacement of bare steel pipe even if it has no history of leakage and also cites a specific pipeline safety code requirement as the justification for replacement. The utility's plan only included replacing bare steel pipe with a leakage history. *Id.,* at 7. As noted above, bare steel has been prohibited in new installations since the 1970s because of its tendency to corrode and eventually leak.

21. In the context of natural gas pipeline safety regulation, expenditures for "system integrity" and "pipeline safety" are virtually synonymous, because improving the integrity of a natural gas pipeline system improves pipeline safety. Further, in determining the reasonableness of the expenditures the Commission would have to make a finding that they contribute to pipeline safety. Replacing pipes made of cast-iron and other obsolete materials subject to corrosion or premature deterioration serve the intertwined purposes of improving system integrity and system safety. The GSRS appears to limit recovery of pipeline safety expenditures to those directly related to replacing the components of the system infrastructure; the GSRS does not permit recovery of expenditures for other types of safety-related measures such as employee training or public awareness campaigns. But otherwise it is clear that any proposal to allow utilities to recover the costs of replacing obsolete materials in a system infrastructure integrity

surcharge would not be within the jurisdiction of the Commission to approve, because the legislature deprived the Commission of doing so in passing the GSRS Act.

22. The Commission should consider whether, in seeking a system integrity surcharge, the utilities are seeking the same or a different remedy than the GSRS. It's clear that they are seeking recovery of the precise types of pipeline safety expenditures eligible for GSRS recovery, but the utilities have argued that the 40 cent cap is too low. Rather than go back to the legislature to request an amendment to the statute to increase the cap, the utilities instead went to the Commission to request a surcharge for pipeline safety expenditures that wouldn't be limited by the legislature's 40 cent cap. The Commission has no authority to provide the relief they seek. The GSRS has so many detailed its requirements that explicitly usurp the broad ratemaking powers of the Commission—particularly the 40 cent cap on increases—that one can make no other conclusion that the legislature intended to deprive the power, authority and jurisdiction of the authority to act on this issue. The legislature has unambiguously chosen to preclude the Commission from free exercise of its powers of ratemaking on the issue of more timely recovery of expenditures related to pipeline safety and system integrity. If the Commission acts to provide a new alternative cost-recovery mechanism and allow a higher level of recovery of costs than the GSRS cap, then the Commission would be attempting to overrule the balance struck by the legislature in imposing the limits contained in the GSRS Act. The Commission simply has no authority to do so.

IV. Conclusion

23. When the Kansas Legislature enacted the Gas System Reliability Surcharge Act, it deprived the Commission of jurisdiction to approve an infrastructure integrity surcharge or any other alternative cost-recovery scheme or surcharge intended to recover the costs of components installed to comply with state or federal safety regulations or the costs of enhancing the integrity of pipeline system components undertaken to comply with pipeline safety regulations. The legislature may also have deprived the Commission of the jurisdiction to approve accounting orders for such costs, because an accounting order is also an alternative cost-recovery mechanism that serves a similar purpose to the GSRS in providing the utilities an opportunity to recover out-of-test year expenditures for pipeline safety, and both also require eventual inclusion of the costs in base rates. The mechanism of an accounting order is considered within the base rate case, but it nevertheless is not the normal method of recovery of test-year costs in a traditional ratemaking scheme. The state courts have not addressed this question, but these mechanisms are so similar that approving an accounting order for this purpose is likely outside the Commission's jurisdiction. There is no doubt, however, the Commission has no authority to provide the utilities any alternative cost-recovery mechanism for pipeline safety costs that provides a higher level of recovery than the legislature has mandated in the GSRS.

Respectfully submitted,

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VERIFICATION

STATE OF KANSAS)

COUNTY OF SHAWNEE) ss:

I, Niki Christopher, of lawful age and being first duly sworn upon my oath, state that I am an attorney for the Citizens' Utility Ratepayer Board; that I have read and am familiar with the above and foregoing document and attest that the statements therein are true and correct to the best of my knowledge, information, and belief.

Niki Christopher

SUBSCRIBED AND SWORN to before me this 17th day of April, 2015.

Notary Public

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2017

My Commission expires: 01-26-2017.

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 or placed in the United States mail, postage prepaid on this 17th day of April, 2015, to the following:

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