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 for Adjustment of	**)**	**Docket No. 18-KGSG-560-RTS**
its Natural Gas Rates in the	**)**	
State of Kansas	**)**	

DIRECT TESTIMONY

PREPARED BY

KRISTINA A LUKE FRY

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

October 29, 2018

Contents

I. Introduction and Qualifications of Testimony

Q. Would you please state your name and business address?

A. My name is Kristina Luke Fry. My business address is 1500 Southwest Arrowhead Road, Topeka, Kansas, 66604.

Q. Have you ever filed testimony under a different name?

A. Yes, I have previously filed under my maiden name, Kristina Luke.

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

A. I am employed by the Kansas Corporation Commission (Commission) as a Managing Auditor.

Q. Please describe your educational background and professional experience?

A. In December of 2014, I earned a Master of Business Administrative degree from Washburn University. I also hold a Bachelor's of Science in Business Administrative with a major in Accounting from Kansas State University. I began employment with the Commission as a Regulatory Auditor in September 2010 and became a Senior Auditor in July 2013. I assumed my current position in August 2015.

Q. Have you ever testified before this Commission?

A. Yes. I have filed testimony in Docket Nos. 11-MKEE-439-RTS, 11-MDWE-609-RTS, 12-WSEE-112-RTS, 12-MKEE-380-RTS, 12-KGSG-835-RTS, 12-GRHT-633-KSF,13-CRKT-268-KSF, 13-WSEE-629-RTS, 14-WTCT-142-KSF, 14-ATMG-320-RTS, 14-BHCG-502-RTS, 14-S&TT-525-KSF, 15-WSEE-115-RTS, 16-ATMG-079-RTS, 16-MDWE-324-TFR, 17-WSEE-147-RTS, 17-RNBT-555-KSF, and 18-WSEE-328-RTS.

II. Executive Summary

Q. What are your responsibilities in the review of the rate case filing made by Kansas Gas Service (KGS), a division of ONE Gas, Inc. (ONE Gas), in Docket No. 18-KGSG-560-RTS (18-560 Docket), which was filed on June 29, 2018?

A. My responsibilities as the lead auditor in this case are to analyze, audit, and review KGS's rate case Application and oversee the preparation of Staff's revenue requirement recommendations. In addition, I calculated and am sponsoring selected Staff adjustments to KGS's Pro Forma Rate Base and Income Statement. My duties are carried out under the direction of the Chief of Accounting and Financial Analysis, Justin Grady.

Q. What is the purpose of your testimony?

A. In summary, I recommend that the Commission:

- Update KGS's Accumulated Deferred Income Tax (ADIT) balances, and the adjustments to ADIT that pertain to Pensions and Other Post Retirement Benefits (OPEB), Incentive Compensation, and Net Operating Losses (NOLs) to August 2018.
- Update KGS's Pension Expense from an estimated amount in KGS's Application to actual expenses recorded through August 2018.
- Update KGS's Pension and Postretirement Tracker to include actual balances as of February 2019.
- Reverse KGS's adjustment for Pension Savings Sharing to reflect Staff's rejection of the Pension and OPEB Savings Sharing request.
- Update KGS's Corporate Pensions, Postretirement, and Medical Benefits adjustment to reflect actual expenses recorded through August 2018.
- Remove short-term incentive compensation expenses associated with financial performance metrics, 50% of equity compensation associated with long-term Restricted Stock Units (RSU), and 100% of equity compensation associated with long-term performance-based RSU.
- Decrease rate case expense to reflect the most recent information available and to reflect Staff's recommended disallowance of unamortized rate case expenses from the 16-KGSG-491-RTS Docket.
- Reverse KGS's adjustment to move Brehm Storage costs from base rates to the cost of gas rider (COGR).

- Update and normalize bad debt expense based on Staff's recommended operating revenue.
- Update Interest on Customer Deposits to mirror Staff's update to Customer Deposits.
- Remove miscellaneous corporate costs that Staff contends are not appropriate for ratepayer recovery.
- Remove Taxable Income based on Staff's treatment of RSU awards.

Q. Please provide the list of Staff witnesses and a brief description of the testimony they are sponsoring.

A. Lana Ellis: Ms. Ellis sponsors testimony related to class cost of service which serves as a guideline for establishing class delivery charges.

Katie Figgs: Ms. Figgs sponsors testimony related to updating various KGS payroll and benefits adjustments, ONE Gas Distrigas allocation, reversing KGS's GTI Cost, and removing dues and donations that are not appropriate for ratepayer recovery.

Josh Frantz: Mr. Frantz will be sponsoring Staff's adjustment to Miscellaneous Charges. He will also provide Staff's response to KGS's proposed changes to its Electronic Flow Measurement Rider and Section 10.09 of its General Terms and Conditions regarding the Cash Out valuation of transportation customers' gas volume imbalances.

Adam Gatewood: Mr. Gatewood sponsors testimony related to Staff's recommended cost of capital.

Dr. Bob Glass: Dr. Glass sponsors testimony regarding Staff's response to KGS's Revenue Normalization Adjustment, KGS's proposed shift to the calculation of the weather normal based on 2008 to 2017 weather data, and Staff's rate design.

Justin Grady: Mr. Grady sponsors testimony addressing KGS's requested Depreciation and Cyber Security Trackers. He also discusses the Tax Cuts and Jobs Act of 2017 (Tax Reform Act) and the differences between KGS and Staff's recommended treatment of the Tax Reform Act in this Docket.

Leo Haynos: Mr. Haynos provides testimony recommending disapproval of KGS's request to include GTI membership in the cost of service.

Roxie McCullar: Ms. McCullar sponsors testimony related to Staff's 10 recommended depreciation rates.

Justin Prentiss: Mr. Prentiss sponsors testimony to support Staff's adjustment rate and Contract Annualization.

Darren Prince: Mr. Prince sponsors testimony relating to Staff's weather normalization and Customer Annualization adjustments.

Tim Rehagen: Mr. Rehagen sponsors testimony discussing Staff's adjustments to plant in service, accumulated depreciation, corporate ADIT, materials and supplies, prepayments, customer deposits and advances, annualized depreciation expense, and advertising expense.

Q. How is the rest of your testimony organized?

A. The remainder of my testimony is organized as follows:

(1) Overview – I provide an overview which presents some of the significant components of the rate case and how they differ from KGS's last two general rate cases. I also discuss the major drivers of this rate case.

(2) Just and Reasonable Review – I discuss Staff's revenue requirement analysis. I also present a table of Staff's adjustments to the pro forma Income Statement and Rate Base that defines the differences between Staff's and KGS's recommended revenue requirement.

(3) Rate Base – I discuss and support my adjustment to KGS's pro forma rate base.

(4) Income Statement – I discuss and support my adjustment to KGS's pro forma income statement.

III. Overview

Q. Please provide an overview of KGS.

A. KGS is a natural gas public utility that was formed in 1997 when ONEOK, Inc. (ONEOK) purchased natural gas assets from Western Resources. In January 2014, ONEOK separated its natural gas distribution business to create ONE Gas, one of the largest publicly traded, 100 percent-regulated, natural gas utilities in the United States. ONE Gas is made up of Oklahoma Natural Gas, KGS, and Texas Gas Service. KGS is the largest natural gas distribution utility in Kansas, providing natural gas to approximately 636,000 customers located in over 360 communities.

Q. Please provide an overview of the rate case request as filed by KGS.

A. KGS's Application, filed June 29, 2018, requests a gross revenue requirement increase of $42,693,177 or 15.20 percent increase in its natural gas service rates. The net rate impact of this request to residential customers would result in a $5.67 increase per month net of rebasing of the amounts currently collected through the Gas System Reliability Surcharge (GSRS).[1] This increase is supported by pro forma revenues of $299.61 million, pro forma expenses of $254.78 million, and a pro forma rate base of $1,016.08 million. KGS has requested a 10.0 percent return on equity and a 7.7076 percent overall rate of return (after tax weighted average cost of capital). The table below summarizes how some of these elements have changed since KGS's last two general rate cases, Docket Nos. 12-KGSG-835-RTS (12-835 Docket) and 16-KGSG-491-RTS (16-491 Docket).

KGS Pro Forma Rate Base, Revenue, Expenses, Income (in Millions)			
Description	**12-835 Docket**	**16-491 Docket**	**18-560 Docket**
Net Plant	$964.61	$1,166.36	$1,296.95
Net Rate Base	$772.43	$902.97	$1,016.08
Total Operating Revenue	$258.80	$287.93	$299.61
Total Operating Expense	$223.64	$243.62	$254.78
Operating Income	$35.16	$44.31	$44.84

Q. What are the primary drivers of KGS's requested rate increase?

A. According to KGS testimony, there are nine major drivers behind KGS filing this rate case, including: (1) significant capital expenditure investments since its last rate case; (2) increases in employee wages and benefits and other costs; (3) reduction in federal tax expenses; (4) a request to share the savings between customers and shareholders that have resulted from pension expenses having been prefunded by the Company; (5) a request to update its depreciation rates; (6) a request to establish a decoupling mechanism entitled the Revenue Normalization Adjustment; (7) a request to establish the Cyber

[1] The $42,693,177 net revenue increase is the result of offsetting the $45,566,463 requested increase by $2,873,286, already being recovered from ratepayers through the GSRS.

Security Tracker to allow KGS to track and defer expenses for future recovery relating to cyber security; (8) a request to establish a Depreciation Expense Tracker to allow KGS to track and defer expenses for future recovery relating to depreciation expense; and (9) a request to implement a traditional two-part rate design with an increase in the monthly customer charge.

Q. What is the total rate impact of KGS's proposed revenue requirement?

A. While KGS requests an overall revenue requirement increase of $45.6 million, the net impact to customers equates to $42.7 million as a result of rebasing the amount currently collected from customers associated with the GSRS. Staff has also presented its revenue increase in the same manner. The net result being as follows:

Net Rate Impact		
Description	**KGS**	**Staff**
Base Revenue Requirement Increase	$45,566,463	$19,828,862
GSRS Rebased	$2,873,286	$2,873,286
Net Revenue Increase to Customers	$42,693,177	$16,955,576

Q. What test year did KGS use in its Application before the Commission?

A. KGS's revenue requirement schedules are based on a historical test year of the 12-months ending December 31, 2017.

Q. What are the results of Staff's revenue requirement analysis?

A. Staff recommends KGS be granted a revenue requirement increase of $19.83 million, a net increase to ratepayers of $16.96 million, which is comparable to KGS's proposed net revenue requirement increase (with GSRS rebased) of $42.6 million. I have presented a table below that captures the major differences between KGS's and Staff's revenue requirement analysis (the following amounts are presented in millions).

Description	KGS	Staff
Total Revenue Increase	$45,566,463	$19,828,862
Pro Forma Rate Base	$1,016,084,260	$1,032,949,144
Operating Income	$44,838,030	$55,718,398
Return on Equity	10.00%	9.15%
Rate of Return	7.7076%	6.8045%

IV. Just and Reasonable Review

Q. Do you believe that Staff's revenue requirement analysis results in just and reasonable rates?

A. Yes. The result of Staff's revenue requirement analysis meets the balancing test set forth by the Kansas Supreme Court, which stated in pertinent part is as follows:

> The leading cases in this area clearly indicate that the goal should be a rate fixed within the 'zone of reasonableness' after the application of a balancing test in which the interests of all concerned parties are considered. In rate-making cases, the parties whose interests must be considered and balanced are these: (1) The utility's investors vs. the ratepayers; (2) the present ratepayers vs. the future ratepayers; and (3) the public interest.[2]

Each of the balancing factors will be discussed in turn:

(1) Investors vs. ratepayers – Each of Staff's adjustments presented below are presented with the intention of producing a revenue requirement that is reflective of KGS's ongoing normalized operations to the extent practicable and necessary. This affords KGS (and its investors) the opportunity to earn its authorized return, but does not guarantee such. Also, Staff has removed expenses from the cost of service that Staff contends are inappropriate to recover from KGS ratepayers or are more appropriately shared between ratepayers and shareholders. As discussed in Adam Gatewood's testimony, Staff believes its Return on Equity recommendation is an accurate reflection of the capital

[2] *Kan. Gas and Electric Co. v. State Corp Comm'n*, 239 Kan. 483, 488 (1986).

costs currently required in the market for public utility equity and is representative of a just and reasonable return on invested capital.

(2) Current vs. future ratepayers – Where possible, Staff has attempted to identify any intergenerational issues (such as the proper depreciation techniques and the amortization of infrequent events or elimination of non-recurring events) and has made recommendations that Staff contends are appropriately balanced between present and future ratepayers.

(3) Public interest generally – Generally speaking, the public interest is served when ratepayer's interests are carefully considered and balanced against the interests of management and the shareholders of the utility. This process/review includes protecting ratepayers from unreasonably high prices, discriminatory prices, and/or unreliable service. This also includes assuring that rates are not so low that the utilities that serve those ratepayers are unable to provide reliable service, remain financially stable, and attract capital on reasonable terms. Staff has carefully considered the public interest in developing its recommendations presented in this Docket and feels that the public interest will be served if its recommendations are adopted by the Commission.

Staff's revenue requirement does not adversely impact KGS's ability to provide efficient and sufficient service, as it is based on KGS's ongoing, normalized cost of service and includes provisions such as updated construction work in progress balances as of August 31, 2018, updated payroll and pension expense for all KGS employees as of August 31, 2018, and other updated, current cost of service items. Staff's revenue requirement allows KGS sufficient revenues and cash flows to allow it the opportunity to earn its rate of return, but does not guarantee such.

Q. What accounts for the differences between Staff's and KGS's recommended revenue requirement increase?

A. Listed below is a table of each Staff adjustment and the Staff witness sponsoring each adjustment. Although the particulars of each adjustment are different, Staff adjustments are usually made in order to correct an error present in KGS's Application, to revise a pro forma adjustment to utilize more current known and measureable data, or to remove expenses that would not be appropriate to recover from ratepayers, etc. These adjustments are made with the intention that the end result will be a revenue requirement that is in the public interest because it is representative of ongoing, normalized operations and will result in just and reasonable rates for all stakeholders involved.

Adjustment No.	Witness	Description	Effect on Rate Base or Operating Income
RB-1	Luke Fry	Accumulated Deferred Income Taxes	$2,707,563[3]
RB-2	Rehagen	Plant in Service	$38,078,012
RB-3	Rehagen	Accumulated Depreciation	$(20,966,981)
RB-4	Rehagen	Accumulated Deferred Income Taxes	$(2,802,813)
RB-5	Rehagen	Accumulated Deferred Income Taxes	$(693,196)
RB-6	Rehagen	Materials and Supplies	$410,400
RB-7	Rehagen	Prepayments	$(260,866)
RB-8	Rehagen	Customer Deposits	$64,246
RB-9	Rehagen	Customer Advances	$286,759
IS-1	Luke Fry	Update Pension Expense To August 31	$504,996
IS-2	Luke Fry	Pension & Postretirement Benefit Tracker	$310,042
IS-3	Luke Fry	Pension and OPEB Savings Sharing	$3,325,367
IS-4	Luke Fry	Corporate Pension, OPEB, and Medical	$39,554
IS-5	Luke Fry	Incentive Compensation	$2,043,404
IS-6	Luke Fry	Rate Case Expense	$51,265
IS-7	Luke Fry	Brehm Storage	$(1,248,371)
IS-8	Luke Fry	Bad Debt Expense	$(343,538)
IS-9	Luke Fry	Miscellaneous Corporate Charges	$40,842
IS-10	Luke Fry	Interest on Customer Deposits	$1,041

[3] It should be noted that this amount was corrected late in the process. The correction decreases Rate Base by $41,761, which decreases Staff's Revenue Requirement by $3,635 from $19,828,859 to $19,825,224.

IS-11	Prince	Weather Normalization	$2,926,431
IS-12	Prince	Revenue Annualization	$(30,937)
IS-13	Prentiss	Test Year Revenue	$153,467
IS-14	Frantz	Miscellaneous Charges	$(34,340)
IS-15	Figgs	Payroll	$122,473
IS-16	Figgs	Worker's Compensation	$(45,983)
IS-17	Figgs	Corporate Allocation Ratio	$688,851
IS-18	Figgs	Gas Technology Institute	$316,479
IS-19	Figgs	Medical Reserve	$(239,747)
IS-20	Figgs	Donations	$202,920
IS-21	Rehagen	Depreciation Expense	$1,618,432
IS-22	Rehagen	Advertising	$10,789
IS-23	Luke Fry	Income Taxes	$525,937

Q. Did Staff allocate its adjustments before inclusion in Staff's schedules?

A. Yes. Staff's adjustments were first calculated on a total company basis, then allocated to the respective division (if applicable) based upon the appropriate allocation percentage.

V. Rate Base

A. Accumulated Deferred Income Tax

Q. Please explain Staff Adjustment No. 1 to rate base.

A. Staff Adjustment No. 1 (RB-1) increases Accumulated Deferred Income Tax (ADIT) by $2,707,563.[4] ADIT is included in rate base as an offset to Plant in Service, so the increase in ADIT will decrease rate base. Staff's adjustment is comprised of four parts:

1. Update of ADIT associated with Pension and OPEB funding to August 2018.
2. Update of ADIT associated with NOL to August 2018.
3. Update of ADIT Liability balance to August 2018.

[4] *See* Staff Exhibit KALF-1. It should also be noted that this amount was corrected late in the process. The correction decreases rate base by $41,761 which decreases Staff's Revenue Requirement by $3,635 from $19,828,859 to $19,825,224.

4. Remeasurement of excess ADIT to reflect Staff adjustment to Incentive Compensation.

Q. Please explain what ADIT represents.

A. ADIT represents the net income tax that is deferred due to larger deductions reported on a Company's income tax return compared to the amount of expenses reported for book purposes. A larger deduction for income tax purposes compared to the expenses reported for book purposes results in lower taxable income and a lower income tax amount owed to the government compared to the income tax expense reported for book purposes. As the years go by, each year's deferred income tax is added to the previous years' deferred income taxes and are accumulated in an liability or asset account, respectively (representing either positive or negative deferred taxes). The net ADIT balance represents the accumulation of the various years' deferred income tax activity. In traditional rate base rate of return ratemaking, the net balance of ADIT is recognized as cost-free capital and thus is an offset to rate base.

The timing difference for deductions between book and income tax purposes is temporary. Eventually, the income tax deductions will become smaller compared to the deductions for book purposes. The smaller future deductions for income tax purposes compared to deductions for book purposes will result in the Company paying more in income taxes to the government than the income tax expense recorded on its books. In a year where the Company pays more in income taxes than it records on its books, the Company's ADIT balance will be reduced.

Q. Does an ADIT account increase or decrease rate base?

A. Depending on whether the temporary timing difference results in the Company's taxable income being more than or less than book income, the timing difference can result in an ADIT asset or liability. ADIT assets increase rate base and ADIT liabilities decrease rate base. Currently, KGS's net ADIT balance is a liability, so it reduces the Company's rate base. The net ADIT liability is included in rate base because it represents a source of cost-free financing to the utility.

Q. Please provide an explanation of KGS's and Staff's adjustments to the ADIT liability balance.

A. The first portion of Staff's Adjustment decreases ADIT by $2,749,324. In its Application, KGS utilized an ADIT liability balance as of December 31, 2017. Furthermore, KGS recalculated its ADIT balance to reflect the federal tax rate change from 35% to 21%, which occurred on January 1, 2018, as a result of the Tax Cuts and Jobs Act (the Act) which was reflected as a regulatory liability in the case. KGS calculated excess deferred income taxes (EDIT) then adjusted this EDIT amount (to eliminate the amounts associated with Pensions/OPEB and the offset to the NOL adjustment associated with Pensions/OPEB) to properly state the balance. Staff's adjustment updates KGS's ADIT liability balance to the August 2018 balance in order to synchronize this rate base offset with Staff's updated Plant in Service balance through August 2018. Staff also removed the deferred tax asset associated with the "2018 Tax Refund Obligation Liability" from KGS's updated balance. Staff removed this deferred tax asset from the updated balance because the underlying regulatory liability that this amount is related to is not included as a rate base offset in the case. Accordingly, the deferred tax asset also should not be included in rate base. Again, Staff's decision to update to August 2018 balances is done to synchronize with Staff's update to Plant in Service and other balances to August 2018.

Q. Please provide an explanation of KGS's and Staff's adjustment to ADIT associated with Pension and OPEB.

A. In its Application, KGS made an adjustment based on the ADIT balance associated with the excess pension and OPEB contributions as of December 31, 2017. KGS also made an adjustment to remove the EDIT associated with Pension and OPEB related ADIT. Staff's adjustment RB-1 updates KGS's ADIT Pension and OPEB balance from December 2017 to August 2018. This portion of Staff's Adjustment increases ADIT by $2,225,022. It is important to remove the Pension and OPEB related ADIT from rate base because the Pension and OPEB related ADIT is the simply the cost-free capital impact associated with the timing differences created by the Company funding Pensions and OPEB in excess of the amount required for Generally Accepted Accounting Principles (GAAP). Because the funding difference doesn't receive rate base treatment, it is appropriate to remove this ADIT balance from rate base as well. Staff's adjustment to update is necessary as it is done to synchronize this rate base offset with Staff's updated ADIT Liability balances through August 2018.

Q. Please provide an explanation of KGS's and Staff's adjustments to NOL deferred tax asset.

A. The third portion of Staff's Adjustment decreases ADIT by $3,128,761. In its Application, KGS makes an adjustment to NOL related ADIT and also adjusts the aforementioned regulatory liability created by the Act. This portion of Staff's adjustment updates the NOL deferred tax asset that acts as an offset to ADIT to KGS's actual balance as of August 2018. This adjustment is necessary to synchronize the ADIT-NOL, with Staff's updated ADIT balance as of August 2018. A NOL occurs when a Company's tax deductions exceed its tax revenue, therefore, the NOL creates a deferred tax asset that acts as an offset to the gross amount of ADIT represented on the Company's books. This is basically a recognition that the Company hasn't actually been able to take advantage of the full amount of cost free capital that is represented by the ADIT liability on its books, because of the fact that during certain of those years in which the ADIT liability balance was accumulating, the Company was operating in an NOL position and thus had no more taxable income to offset.

Q. Please provide an explanation of Staff's adjustment to remeasure ADIT relating to Incentive Compensation.

A. In its Application, KGS made multiple adjustments to remeasure ADIT balances to reflect the new tax rate of 21% implemented by the Act. This calculation becomes EDIT, which is reflected in the Application as a reduction to rate base. While reviewing the ADIT balances and calculations, Staff discovered that there was a portion of ADIT that related to Short Term Incentive Expense. KGS made no adjustment to the ADIT associated with incentives. Since Staff is removing a portion of the expenses related to incentives from the test year, it is appropriate to remove the same portion of EDIT relating to incentives. Staff's calculation mirrors KGS's calculation used for other EDIT, but with the removal of incentives. If the Commission does not approve Staff's adjustments to eliminate a portion of incentive compensation expense from the test year, then this adjustment will need to be revised.

VI. Income Statement

A. Pension and Post-Retirement Expense

Q. Before your discussion pertaining to specific pension adjustments, please explain the history and mechanics of how the trackers work.

A. In Docket No. 10-KGSG-130-ACT (10-130 Docket), KGS was allowed to defer, as a regulatory asset or liability, the difference between the level of pension and postretirement costs incurred under generally accepted accounting principles and the amount of expense recovered through base rates. These deferrals were identified as Tracker 1 deferrals in the Order issued in the 10-130 Docket. The Company began recording the deferrals on January 1, 2009. Under the Commission's Order, in future proceedings, the Company was to amortize the balance of the regulatory asset or liability over a reasonable period of time not to exceed five years.

As a result of the Commission's Order in the 16-491 Docket, KGS began amortizing the Tracker 1 balances over a three-year period. The result was a Tracker 1 amortization expense of $1,020,120 per year. All Tracker 1 balances are then amortized over three years. Tracker 1 is amortized over three years instead of the five years previously recommended by Staff due to the fact that KGS appears to be filing rate filings more frequently and Staff’s goal is to keep the amortization as close as possible to the amount of time between rate cases.

In summary, the amount of pension expense approved by the Commission in the 16-491 Docket was set in rates. Every month after the rate effective date, KGS had pension expense that did not exactly equal what was in rates. That difference is what makes up part one of KGS’s tracker balance.

Finally, there is the Tracker 2 which keeps track of the difference between a company's contributions to its pension and OPEB funds and pension and OPEB costs for each year. For instance, if a company contributes more to the pension fund than that year's pension cost, the excess is added to the pension Tracker 2 balance. In a future year, the company may not want to make a contribution to the pension fund. If the pension Tracker 2 account has a balance, the company can reduce its Tracker 2 balance by the amount of that year's pension cost instead of making a cash contribution to the pension fund.

Q. Please discuss Staff Adjustment No. 1 to the income statement.

A. Staff Adjustment No. 1 (IS-1) decreases Administrative and General Expense by $504,996.[5] KGS witness Lorna Eaton adjusted test year pension and OPEB expense to include 2018 pension and OPEB expenses.[6] Staff's adjustment updates KGS's projected pension and OPEB expenses with actual amounts based on the twelve months ending August 2018. Staff's pension and OPEB expense values should be used rather than the Company's because Staff's values are based on known and measurable amounts compared to the Company's projected pension amounts. Using the most updated information for this expense reduces the possibility of unnecessarily large or small tracker balances in future rate cases, which, at an extreme, could lead to intergenerational inequities.

Q. For Tracker 1 purposes, what are KGS's pension and OPEB expenses?

A. Staff is recommending that $9,740,013 of pension expense and $(188,871) of OPEB expense be included in KGS's base rates.

[5] *See* Staff Exhibit KALF-2.
[6] *See* pages 24-25 of KGS witness Lorna Eaton testimony.

Q. Why is it important to identify the dollar amounts for pension and OPEB expenses in base rates?

A. KGS will use these dollar amounts to calculate the difference between actual pension and OPEB expense in future months and the amounts included in base rates that were determined in this rate case. KGS will accumulate the difference between future actual pension and OPEB expense and the amount of pension and OPEB that are in base rates in the Tracker 1. When KGS files its next rate case, KGS will amortize the balance in the Tracker 1 and include the amortization in the Company's pension and OPEB expense. If the Tracker 1 has a positive balance, the amortization of the Tracker balance will increase the Company's pension or OPEB expense. If the Tracker 1 has a negative balance, the amortization of the Tracker 1 balance will decrease pension or OPEB expense.

B. Pension and Post-Retirement Expenses Tracker

Q. Please continue by discussing Staff Adjustment No. 2 to the Income Statement.

A. Staff Adjustment No. 2 (IS-2) increases tracker expense for pension and postretirement benefits by $310,042.[7] On pages 25 through 26 of the Direct Testimony of KGS witness Lorna Eaton, Ms. Eaton explains that she recommends the removal of the current amortization established in the 16-491 Docket from the test year and then establishing a new three-year amortization for the projected accumulated balance as of December 2018. Staff's adjustment updates the unamortized Tracker 1 expenses by amortizing over a three-year period the Tracker 1 balances as of February 2019. The new rates from this Docket should go into effect around March 1, 2019, so the current amortization rates will remain in effect through February 2019. The other part of Staff's adjustment takes the

[7] *See* Staff Exhibit KALF-3.

amount of Pension and OPEB expense that was agreed to be recovered in the 16-491 Docket and compares it to what actual expenses were since the last case through August 2018.

Q. Why does Staff recommend a three-year amortization period for the Tracker 1 balances?

A. A three-year amortization period is a reasonable time frame to amortize these costs as the Commission Order in Docket 10-KGSG-130-ACT stated that these costs could be amortized over a period not to exceed five years. Given the fact that these balances are amortized over time without compensation for the time value of money during the amortization period, it is appropriate to amortize them over a relatively shorter time frame. Staff proposes that the amortization of the Tracker 1 balances from the current rate case begin in March 2019, when the new rates go into effect.

C. <u>Pension Savings Sharing Program</u>

Q. Please explain Staff Adjustment No. 3 to the income statement.

A. Staff Adjustment No. 3 (IS-3) decreases operating expense by $3,325,367.[8] This adjustment reverses KGS's pro forma adjustment IS–28 where KGS proposes to retain two-thirds of the savings generated by the funding of its pension and OPEB plans in excess of what is required by GAAP.

Q. Please continue your discussion by explaining how prefunded pension and OPEB balances can result in a savings.

A. Pension and OPEB cost is composed of service cost, interest cost, actual return on plan assets, amortization of prior service cost, gain or loss, and amortization of transition asset

[8] *See* Staff Exhibit KALF-4.

or obligation. The return on a pension and OPEB plan's assets, any recognized gains, and amortization of a transition asset decrease a Company's pension and OPEB costs. All of the other components increase a Company's pension and OPEB cost.

The rate of return KGS's pension and OPEB plans earn on the $67,687,815 prefunded balance helps to reduce the pension and OPEB costs compared to the plans' cost without the prefunded balance. If the pension and OPEB plans earned a 7.37%[9] rate of return on the $65,319,744 prefunded balance, ratepayers are benefiting from reduced pension and OPEB costs of $4,987,801. KGS's argues that the reduction in the pension and OPEB costs KGS in the form of a lost opportunity cost. KGS argues that, had it not contributed the $67,687,815 to the plans and had earned a 7.37% return, KGS would have received the benefit of $4,987,801. This argument is an oversimplification and ignores the fact that KGS was simply managing its pension in a least cost and prudent fashion, as utility companies are required to do by law and is good business practice. In exchange for its prudent and cost conscious behavior, KGS is proposing to be rewarded by keeping two-thirds of the savings and giving one-third to its customers in this rate case. KGS is not currently seeking rate base recognition of the prefunded balance in this proceeding; however, it does reserve the right to make a request in a subsequent proceeding. In such future proceeding, the ratepayers would keep all of the savings from the prepaid pension asset but pay KGS a rate of return on the prepaid pension asset balance. The impact of including this prepaid pension asset in rate base would actually increase rates by a larger amount than 100% of the reduced pension cost associated with the existence of the

[9] *See* page 10 of KGS witness Mark Smith's Testimony.

prepaid pension asset. Accordingly, the Commission should reject KGS's request to retain two-thirds of the savings generated from the prepaid pension and OPEB asset.

Q. Why would KGS contribute more to its pension and OPEB plans than what GAAP requires?

A. Congress passed the Pension Protection Act in 2006 because it was concerned various corporations' pension plans were under-funded. To discourage the under-funding of pension plans, the law now contains restrictions if a pension plan's funding falls below certain levels. If the fair value of the plan's assets is less than 80% of the plan's pension obligations, plan amendments that would increase benefits are prohibited[10] and lump sum payments are limited to 50%.[11] If the fair value of the plan's assets falls below 60% of the plan's pension obligations, benefit accruals are frozen[12] and no lump sum payouts are allowed.[13] The law places no restrictions on plans that are funded at least 80% or higher.

Q. Does KGS have a minimum funding percentage it attempts to maintain?

A. Yes. To avoid any restrictions being placed on its pension plan, KGS has a targeted funding percentage of at least 80% of the plan's liability. Mr. Smith states in his testimony, "At a minimum, the Company targets the plan funding to ensure plan assets equal at least 80% of the plan's liability. This is a prudent approach because a failure to fund at least 80% of the plan's liability may result in benefit limitations, prohibition of lump sum payments, cessation of benefit accruals and restrictions on plan amendments,

[10] Internal Revenue Code 436(c)(1).
[11] Internal Revenue Code 436(d)(3).
[12] Internal Revenue Code 436(e)(1).
[13] Internal Revenue Code 436(d)(5)(A).

among other issues."[14] By targeting a funding percentage of at least 80%, KGS is acting in a prudent manner as it should.

Q. Does Staff agree with KGS's savings proposal?

A. No. KGS's proposal is essentially that it be allowed to recover from ratepayers more pension expense than it actually incurs until a time in a future rate case in which it can earn a return on prefunded amounts of pension expense through inclusion of Tracker 2 in rate base. This is despite the fact that KGS's primary rationale for its build-up of prepaid pension costs is that it has been behaving in a prudent and cost conscious fashion and has, therefore, kept pension costs lower than they otherwise would have been.[15] What KGS is requesting is basically rewarding them for doing what they should be doing as a responsible Company.

D. <u>Corporate Pensions, Postretirement Benefits, and Medical Reserve</u>

Q. Please explain Staff Adjustment No. 4 to the income statement.

A. Staff Adjustment No. 4 (IS-4) decreases administrative and general expense by $39,554.[16] ONE Gas allocates its corporate division's pension, OPEB, and health benefits costs to its various operating divisions. Ms. Davidson explains that KGS's adjustment annualizes the known and measurable changes in OPEB, Pension, and Employee Health Benefit costs for corporate employees.[17] KGS annualized these costs as of December 31, 2017, in its filing. Staff's adjustment updates the corporate division's allocated costs through August 2018. Accordingly, Staff's adjustment compares the actual expenses incurred for the twelve-months ending August 2018 to KGS's forecasted

[14] *See* page 7 of KGS witness Mark Smith's Testimony.
[15] *See* page 9 of KGS witness Mark Smith's Testimony.
[16] *See* Staff Exhibit KALF-5.
[17] *See* page 11 of KGS witness Ashely Davidson.

expenses. Staff's approach is more appropriate than KGS's because it relies on actual, known and measurable expenses. Staff's adjustment also updates the level of costs allocated to KGS by reflecting the three year average of Distrigas allocation factor as discussed in Staff Witness Katie Figg's testimony.

E. <u>Incentive Compensation</u>

Q. Please continue by discussing Staff Adjustment No. 5 to the income statement.

A. Staff Adjustment No. 5 (IS-5) decreases operating expenses by $2,043,404. This adjustment reflects Staff's policy recommendation to remove the following from KGS's pro forma cost of service:

(1) 70 percent of executive short-term incentive (STI) compensation that is financial performance-based; and

(2) 50 percent of executive equity compensation expense associated with restricted stock units and 100 percent of executive equity compensation expense associated with performance-based units.[18]

Q. Please describe ONE Gas' executive compensation philosophy.

A. As stated in ONE Gas' 2018 Proxy Statement: "We provide executive compensation programs designed to attract, engage, motivate, reward and retain highly effective key executives who drive our success and who are leaders in our industry. We pay for performance in order to align the long-term interests of our executive officers with those of our stakeholders while also rewarding behaviors that drive collaboration, execution, teamwork, and safety within our culture."[19]

[18] The calculations for each of these three components are depicted in the attached Exhibits KALF-6A through KALF-6B.

[19] ONE Gas, Inc. (2018), *Schedule 14A (Definitive Proxy Statement),* p. 36.

Q. Please describe the short-term incentive plan in more detail.

A. The STI plan provides for an annual cash incentive based on certain performance criteria that are established each year by the ONE Gas Board of Directors. While all regular, full-time active non-bargaining unit employees are eligible to participate in the Company's Annual Employee Incentive Plan, Staff's adjustment relates to the portion of ONE Gas and KGS officer and executive STI compensation included in the test year. According to its Proxy, ONE Gas' Annual Officer Incentive Plan "(a)ligns executives' efforts with the interests of our stakeholders by providing a financial cash incentive tied directly to key measures of the company's financial and operational performance aligned with our long-term strategy."[20] To coincide with this goal, the Company's STI awards are granted based on the achievement of specific key safety and business measures, along with individual accomplishments.

In 2017, the STI plan was based on diluted earnings per share, total recordable incident rate, preventable vehicle incident rate, and days away, restricted or transferred. In addition to the financial and operational measures, an individual performance modifier (ranging from 0 to 125 percent) was also used to recognize each individual's performance against established goals and objectives.[21] The performance criteria generated the following payout of awards:[22]

Diluted Earnings per Share	70%
Total Recordable Incident Rate	10%
Preventable Vehicle Incident Rate	10%
Days Away, Restricted or Transferred	10%

[20] ONE Gas, Inc. (2018), *Schedule 14A (Definitive Proxy Statement)*, p. 38.
[21] The calculation of how an executive's STI amount is determined is as follows:
Base Salary x STI Target Percentage x Company Performance Modifier x Individual Performance Modifier
[22] ONE Gas, Inc. (2018). *Schedule 14A (Definitive Proxy Statement).* p. 39.

Q. Why does Staff propose to eliminate 70 percent of the expense related to officer and executive STI compensation?

A. As can be seen in the table above, the payout metrics related to the STI plan are primarily financially based, with a 70 percent weighting for diluted earnings per share. The incentive to grow earnings per share benefits shareholders much more directly than ratepayers and could even incent behavior that is detrimental or harmful to ratepayers over time. In effect, as earnings increase outside of a rate case, the amount of STI expense KGS incurs increases. This growth in earnings between rate cases benefits shareholders more than customers. If the STI plan is successful at incenting the growth of earnings per share between rate cases, then shareholders will be handsomely rewarded and should pay for the expense necessary to produce that benefit. Therefore, Staff removed the portion of the payout that was based on financial metrics.

Q. Please continue by describing in more detail the components of the Equity Compensation Plan subject to Staff's adjustment.

A. The Equity Compensation Plan offers various types of long-term incentive (LTI) equity awards to qualifying executives and certain key non-officer employees. During the test year, ONE Gas granted two forms of LTI compensation: restricted stock units and performance stock units.[23] The ONE Gas Board of Directors' Executive Compensation Committee oversees this plan and approves all LTI grants and awards on an annual basis. As stated in its Proxy, ONE Gas' executive LTI compensation is designed to "promote

[23] Restricted stock units represent the right upon vesting to receive one share of ONE Gas common stock for each restricted stock unit granted after three years of employment following the grant date. Performance stock units represent the right upon vesting to receive a percentage of the performance units granted in shares of ONE Gas common stock three years from the date of grant.

retention, increase long-term equity ownership, and further promote the alignment of our executives' interests with those of our stakeholders."[24]

Restricted stock units vest solely with the passage of time and only become viable if the officer remains employed with the Company three years from the vesting period. The performance-based units vest three years from the date of grant, subject to the following payout percentages based on ONE Gas' Total Stockholder Return (TSR) performance relative to its peer group during the same three-year period.

TSR Performance:	**Payout Percentage:**
Below 25th Percentile	0%
25th Percentile	50%
50th Percentile	100%
75th Percentile	150%
90th Percentile and Above	200%

Q. Please explain why Staff is eliminating one-half of the restricted stock units' expense.

A. The restricted stock units vest after three years of service with the Company. This assists in the retention of qualified executives and encourages executives to perform in a way that is conducive to the long-term health and growth of the Company. Ratepayers and stockholders benefit when the Company maintains its viability and grows over the long term. Since both parties benefit, it is reasonable for ratepayers and stockholders to share equally in this portion of executive compensation.

Q. Why is Staff proposing to eliminate 100 percent of the expense related to the performance-based units?

[24] ONE Gas, Inc. (2016). *Schedule 14A (Definitive Proxy Statement). p. 42.*

A. Staff recommends eliminating 100 percent of the expense associated with the performance-based portion of the LTI plan because the award is provided in the form of performance-based stock units in which the criteria used to establish the payout amount is solely financial in nature. Staff's concern with this portion of the plan is similar to the concern expressed above regarding the STI plan in that plan participants are focused on purely shareholder returns to the potential detriment of ratepayers. This is a consequence of designing a plan which causes participants to focus solely on financial performance measures instead of concentrating on a broad range of financial and operational measures more likely to benefit ratepayers and shareholders alike. Staff believes having participants focusing on a single financial measure, TSR, results in an over-weighting of a participant's focus on the financial aspects of KGS's business compared to operational functions.

Q. Why is Staff recommending the Commission disallowance of a portion of KGS's executive incentive compensation from the cost of service in this case?

A. Staff reviewed KGS's executive incentive compensation and made its recommendation under the framework approved by the Commission in Kansas City Power & Light Company's (KCP&L) rate case, Docket No. 10-KCPE-415-RTS (10-415 Docket). In that case, Staff recommended, and the Commission ordered, a disallowance from rates of 50 percent of time-based restricted stock expense and 100 percent of performance-based restricted stock expense. The Commission Order in that case stated the following:

> In examining employee incentive compensation programs, the Commission will consider how criteria are weighted between operational and financial measures. Incentive compensation awards tied to the

> Company's financial interests will improve the profitability of the Company and, as a result, benefit shareholders more than ratepayers.[25]

In approving Staff's recommendation in the case, the Commission found the following:

> The Commission approves allowances of executive incentive compensation plan expenses as recommended by Staff and agreed to by KCP&L. The Commission finds Staff's rationale for its adjustments properly balances the interests of ratepayers and shareholders. The incentive programs developed by KCP&L provide measurable incentives. To the extent these incentives cause executives to focus singularly on financial aspects of the business rather than operational, shareholders should be responsible for those payouts. The Commission allows the inclusion of executive incentive in operating expenses as recommended by Staff.[26]

Since the Commission decision in the 10-415 Docket, Staff has analyzed executive incentive compensation expenses in accordance with this framework in every investor-owned utility rate case to come before the Commission. Furthermore, the Commission's decision in the 10-415 Docket was affirmed by the Commission in Docket No. 12-KCPE-764-RTS (12-764 Docket), and, as a result of this, in KCP&L's two most recent rate cases, Docket Nos. 15-KCPE-116-RTS (15-116 Docket) and 18-KCPE-480-RTS (18-480 Docket), the Company made a voluntary adjustment to incentive compensation that removed the amount of expense that was ordered in the 10-415 Docket.

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[25] *Order: 1) Addressing Prudence; 2) Approving Application, in Part; & 3) Ruling on Pending Requests*, 10-415 Docket, p. 46 (Nov. 22, 2010).
[26] *Ibid*., pp. 50-51.

Q. Why should KGS's executive incentive compensation described above be analyzed according to the framework described by the Commission Order in the 10-415 Docket?

A. KGS's executive incentive compensation should be analyzed consistent with the decision in the 10-415 and 12-764 Dockets because the facts and circumstances of those cases are essentially the same as presented before the Commission in this case. KGS's executive incentive compensation is designed to incent behaviors which are far more beneficial to and focused on shareholders rather than ratepayers. Therefore, justness and reasonableness favors requiring shareholders to pay more of the costs of these programs than ratepayers. That is the result that is most balanced between KGS's shareholders and its ratepayers.

Q. Why does Staff only recommend a partial disallowance of the LTI executive incentive compensation expense rather than a full disallowance?

A. Staff's recommendation is consistent with our position in the 10-415 Docket and is appropriately applied in this case as well. While the Company's restricted share units arguably provide more benefit to shareholders than ratepayers, there is an element of benefit to ratepayers for ONE Gas to incent stability and longevity of its executives; therefore, Staff contends it is appropriate to allow an equal sharing of this compensation expense. However, performance-based restricted stock units clearly benefit shareholders more directly than ratepayers (if ratepayers receive any direct benefit at all); therefore, this component should be funded entirely by shareholders.

Q. Do you think shareholders are willing to pay for a portion of executive compensation if it means keeping executives' interests aligned with theirs?

A. Yes. In its Proxy Statement, there is a discussion regarding ONE Gas' 2017 Shareholder Advisory Vote which was held at its annual meeting of shareholders in 2017. This is an advisory vote where shareholders get the opportunity to voice their opinions about ONE Gas' executive compensation philosophy and program. ONE Gas reported that its shareholders approved the compensation of its named executive officers for 2017 with 96.8 percent of the votes cast in favor of its compensation practices. Furthermore, in reviewing the Company's compensation program during 2017, it was determined that the Company's pay programs were supported by shareholders. The Executive Compensation Committee therefore determined there was no need to materially change the executive compensation practices.[27] Therefore, it is Staff's belief that if ONE Gas shareholders were unhappy about having to pay for a portion of the executive compensation expense that allows the Company's interests to be aligned with theirs, then the shareholders would have voiced an opinion about it during this vote or have otherwise influenced the change they desired in its compensation practices. In fact, this has occurred since KGS's last general rate filing. In the 16-491 Docket, Staff witness Andria Jackson reduced STI by 75 percent instead of the 70 percent Staff is proposing in this case. The Company changed the weighting for earnings per share and added a new category of Days Away, Restricted or Transferred.

Q. How does Staff's approach compare to the approach taken by other state Commissions that regulate ONE Gas?

A. In its formula rates, Oklahoma Natural Gas, the KGS's equivalent in Oklahoma, is allowed to recover the lesser of 100% of target or the actual amount paid out for STI and

[27] ONE Gas, Inc. (2018), *Schedule 14A (Definitive Proxy Statement), p. 36.*

no LTI. In the most recent ligated case for Texas Gas Service, the Company is allowed to recover 50% of STI at the 100% performance modifier, 50% of restricted LTI, and no performance LTI.[28] Each state removes a majority of the incentive compensation allocated from ONE Gas. Staff's STI treatment appears to be the more aggressive with the removal of 70% based on EPS than Texas and Oklahoma. Texas is close to Staff's position at 50%. However, Staff's LTI treatment is the same as Texas, which both are less aggressive than that of Oklahoma.

F. <u>Rate Case Expense</u>

Q. Please continue by discussing Staff Adjustment No. 6 to the income statement.

A. Staff Adjustment No. 6 (IS-6) decreases administrative and general expense by $51,265.[29] KGS used an estimated total cost of the current rate case plus the remaining unamortized balance of rate case expense from 16-491 Docket.[30] The sum of the estimated rate case cost plus the unamortized balance were amortized over a three-year period. Staff Adjustment No. IS-6 revises rate case expense by removing the Company's estimated rate case expense and replacing it with actual amounts incurred for this Docket by the Company through September 1, 2018, and by CURB and Staff through September 29, 2018, normalized over three years and removes the unamortized 16-491 balance. The Commission should accept Staff's adjustment instead of KGS's proposed adjustment because it is based on the most recent actual, known and measurable rate case expense information available prior to Staff filing its testimony compared to the Company's estimated rate case expense amounts. As actual additional rate case costs become known

[28] *See* Staff Exhibit KALF-13.
[29] *See* Staff Exhibit KALF-7.
[30] *See* pages 26 and 27 of KGS witness Lorna Eaton's testimony.

as this Docket progresses, Staff recommends that the rate case costs be updated later in the case.

Q. Why is Staff proposing to remove unamortized costs in this Docket and did not in the 16-491 Docket?

A. In the 16-491 Docket Staff, honored the Stipulated Settlement Agreement from the 12-835 Docket, which required any unamortized rate case expense balance be carried forward to the next rate case.[31] The recovery of unamortized rate case expense is not a requirement established in the 16-491 Docket's Stipulated Settlement and Agreement. Further, Staff Witness Justin Grady argued in the 16-491 Docket that in future rate cases Staff would recommend that the unamortized balances should not be included in rates.[32] The amortization period in the 16-491 Docket was over a three-year period, but KGS has recognized approximately two years' worth of amortization expense.

Q. How does Staff recommend unamortized rate case expense be treated in this case?

A. Staff is recommending that no unamortized rate case expense be recovered in this filing. Currently, KGS has the discretion to decide when to file a rate case and how much to spend to support the filing. Gas customers have very little power in determining when rate cases are filed and how much is spent to support the filing. Also, if a utility is allowed to amortize its rate case expense over three years and they stay out for six, customers are not refunded the over-recovery of rate case expense. This is exactly what happened between KGS's 06-KGSG-1065-RTS and 12-835 Dockets. Staff's recommendation on this issue is that any unamortized rate case expense be written off by the Company at the conclusion of this rate case.

[31] Docket No. 12-KGSG-835-RTS, Order Approving Stipulated Settlement Agreement, Exhibit A, ¶ 17(c).
[32] Docket No. 16-KGSG-491-RTS, Staff Witness Justin Grady Testimony, pages 21-23.

G. Brehm Storage

Q. Please explain Staff Adjustment No. 7 to the income statement.

A. Staff Adjustment No. 7 (IS-7) increases administrative and general expense by $1,248,371.[33] On page 24 of KGS Witness Lorna Eaton's testimony, KGS proposes to move the costs associated with the Brehm Storage field from base rates to the COGR. Ms. Eaton states that in the 03-KGSG-602-RTS Docket, KGS was not allowed to recover these costs in the COGR, but as time has passed, KGS is no longer affiliated with the Mid-Continent Market Center. Staff does not recommend that the Commission accept KGS's proposal.

Q. Please explain why Staff if rejecting KGS's proposal.

A. Staff contends that the Brehm Storage costs should be kept in base rates because the costs are not expected to change materially in the next five years.[34] Typically, costs included in an alternative ratemaking mechanisms (such as the COGR) are limited to those costs which are likely to fluctuate in a material fashion from year to year. KGS's argument to move the storage costs is because the Company is no longer affiliated with Mid-Continent Market Center. But this does not address the central reason why these costs should be recovered through the COGR instead of through base rates. Staff's position is that the Company simply has not provided enough support for the Commission to accept this proposal at this time.

H. Bad Debt Expense

Q. Please discuss Staff Adjustment No. 4 to the income statement.

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[33] *See* Staff Exhibit KALF-8.
[34] *See* KGS's response to Staff Data Request No. 254 provided in Staff Exhibit KALF-13.

A. Staff Adjustment No. 4 (IS-4) decreases KGS's pro forma test year bad debt expense by $343,538.[35] This adjustment reflects the cumulative effect of Staff's adjustments to KGS's filed rate request and will change based upon any changes the Commission makes to Staff's filed revenue requirement position.

Q. How does Staff's calculation of bad debt expense differ from the pro forma adjustment included in KGS's Application?

A. There are two components to KGS's pro forma adjustment to bad debt expense. First, the Company used a three-year average of non-gas-related bad debt expense to normalize the non-gas portion of bad debt expense included in the test year. The second component of KGS's adjustment is based on the premise that its entire revenue deficiency request would be granted in that the Company recognized the bad debt expense related to its requested revenue increase. In doing so, KGS used a three-year average of bad debt expense as a percentage of non-gas revenue to calculate a normalized ratio for non-gas bad debts and applied it to the requested increase in revenue. KGS's bad debt write off percentage calculation is based upon data for the three years ending December 31, 2017.[36]

Staff's methodology for calculating bad debt expense is consistent with the second component of KGS's adjustment. Staff's adjustment utilizes a three-year average of net write-offs incurred as a percentage of non-gas revenue to calculate a normalized ratio for non-gas bad debt of 0.96438 percent. This percentage is then applied to Staff's pro forma operating revenues to calculate the normalized non-gas-related bad debt

[35] *See* Staff Exhibit KALF-9.
[36] *See* page 27 of KGS witness Lorna Eaton's testimony.

expense. Additionally, Staff's net bad debt write-off percentage calculation is based on updated, actual numbers through three years ending August 31, 2018.

I. Miscellaneous Corporate Expense

Q. Please continue by discussing Staff Adjustment No. 9 to the income statement.

A. Staff Adjustment No. 9 (IS-9) decreases operating expenses by $40,842.[37] On pages 10 and 11 of KGS witness Ashley Davidson's testimony, she supports the Company's adjustment to remove costs allocated from ONE Gas to KGS that management had elected to not seek recovery of. Staff's adjustment eliminates additional miscellaneous corporate charges allocated from ONE Gas to KGS during the test year. Staff's adjustment is comprised of four components:

1. Eliminate 100 percent of scholarships paid by ONE Gas during the test year which can only be awarded to Company employees or their family;
2. Eliminate 50 percent of team building activity paid by ONE Gas during the test year as these costs are not necessary for the provision of efficient natural gas delivery service and are unlikely to benefit customers;
3. Eliminate 50 percent of donations paid by ONE Gas during the test year. The commission has consistently applied the 50 percent elimination to conform with K. S. A. 66-101f(a); and
4. Eliminate 100 percent of promotional events paid by ONE Gas during the test year. The Staff removes promotional activity as it does not provide safe and reliable service to rate payers.

[37] *See* Staff Exhibit KALF-10.

J. Interest on Customer Deposits

Q. Please continue with Staff Adjustment No. 10 to the Income Statement?

A. Staff Adjustment No. 10 (IS-10) decreases operating expenses by $1,041.[38] Staff's adjustment revises KGS's adjustment to interest expense on customer deposits. KGS and Staff use the same Commission-approved customer deposit interest rate for the calendar year of 2018. The only difference between KGS and Staff's adjustments is the use of updated 13-month average customer deposit balances supported in Staff Witness Tim Rehagen's testimony.

VII. Taxable Income

Q. Did Staff have an adjustment for taxes?

A. Yes. Staff makes an adjustment to Staff Schedule B-4 to reduce KGS's taxable income by $446,597[39] in the calculation of current income tax expense.[40] During the test year, ONE Gas received a tax benefit for incentive compensation. This tax benefit was not passed onto KGS customers even though a portion of the cost of incentive compensation is passed onto KGS customers. Staff's rationale for this adjustment is that customers are paying some of the expense associated with the tax benefit that ONE Gas received, so customers should receive some of the tax benefit which occurred during the test year. Staff's adjustment is the result of evaluating the tax deduction amounts related to the restricted stock incentives and calculating a pro rata portion applicable to the 50% of time-based restricted stock incentives expense Staff recommends ratepayers pay in this case. In the event that the Commission does not adopt Staff's incentive compensation

[38] *See* Staff Exhibit KALF-101.
[39] *See* Staff Exhibit KALF-12.
[40] *See* Staff Schedule B-4, Line 16, Column D.

adjustment in total or removes a larger portion of incentive compensation expense from the test year, this adjustment will need to be revised. As an example, if all of KGS' long term incentive compensation expense was included in the test year, the Commission would need to reinstate the entirety of the applicable tax deduction, which would reduce the revenue requirement by $1,464,305.

VIII. Conclusion

Q. Please summarize your recommendations in this Docket.

A. I recommend that the Commission make the following findings as they relate to KGS's requested rate changes in this Docket.

- Update KGS's ADIT balances, and the adjustments to ADIT that pertain to Pensions and OPEB, Incentive Compensation, and NOLs to August 2018.
- Update KGS's Pension Expense to actual expenses recorded as of August 2018.
- Update KGS's Pension and Postretirement Tracker to February 2019.
- Reverse KGS's adjustment for Pension Savings Sharing and reject of the Pension and OPEB Savings Sharing program.
- Update KGS's Corporate Pensions, Postretirement, and Medical Benefits adjustment to August 2018.
- Remove STI compensation expenses that are based on financial performance metrics, 50% of equity compensation associated with long-term RSU, and 100% of equity compensation associated with long-term performance-based RSU.
- Decrease rate case expense to reflect the most recent information available and disallow unamortized rate case expense from previous dockets.

- Reject KGS's proposal to move Brehm Storage costs from the base rates to COGR.
- Update and normalize bad debt expense based on Staff's recommended operating revenue.
- Update Interest on Customer Deposits to mirror Staff's update to Customer Deposits.
- Remove miscellaneous corporate costs that are not appropriate for ratepayer recovery.
- Remove Taxable Income based on Staff's treatment of RSU awards.

Q. Does that conclude your testimony?

A. Yes.

EXHIBITS

KALF-1	Staff Exhibit for Accumulated Deferred Income Tax
KALF-1A	Staff Exhibit providing support for Staff's calculation of Accumulated Deferred Income Tax
KALF-2	Staff Exhibit for Pension and Postretirement Benefits Expense
KALF-3	Staff Exhibit for Pension and Postretirement Benefits Tracker
KALF-4	Staff Exhibit for Pension Sharing Program
KALF-5	Staff Exhibit for Corporate Pension, Postretirement Benefits, and Medical Reserve Expense
KALF-5A	Staff Exhibit updating Corporate Pension, Postretirement Benefits, and Medical Reserve Expense

KALF-5B	Staff Exhibit providing support for Staff's calculation of Corporate Pension, Postretirement Benefits, and Medical Reserve Expense
KALF-6	Staff Exhibit for Incentive Compensation
KALF-6A	Staff Exhibit for Short Term Incentive Compensation
KALF-6 B	Staff Exhibit for Long Term Incentive Compensation
KALF-7	Staff Exhibit for Rate Case Expense
KALF-8	Staff Exhibit for Brehm Storage
KALF-9	Staff Exhibit for Bad Debt Expense
KALF-10	Staff Exhibit for Miscellaneous Corporate Charges
KALF-11	Staff Exhibit for Interest on Customer Deposits
KALF-12	Staff Exhibit for Tax relating to Incentive Compensation
KALF-13	KGS's Responses to Staff Data Requests 138, 229, 254, and 257

Staff Exhibits

Kansas Gas Service
Accumulated Deferred Income Tax
Rate Base Adjustment No. 1
Test Year Ended December 31, 2017

Line No.	Description	Amount
1	ADIT Associated with Pension/OPEB Funding as of August 31, 2018	(51,985,770)
2	Less: ADIT Associated with Pension/OPEB Funding as of December 31, 2017	(54,210,792)
3	Increase to Kansas Gas Service's ADIT Liability Balance (Reduction to Rate Base)	2,225,022
4	ADIT Associated with Net Operating Loss as of August 31, 2018	12,494,691
5	Less: ADIT Associated with Net Operating Loss as of December 31, 2017	15,623,452
6	Decrease to Kansas Gas Service's ADIT Liability Balance (Increase to Rate Base)	(3,128,761)
7	ADIT Liability Balance as of August 31, 2018	248,263,717
8	Less: ADIT Liability Balance as of December 31, 2017	249,509,782
9	Decrease to Kansas Gas Service's ADIT Liability Balance (Increase to Rate Base)	(1,246,065)
10	Staff Adjustment to EDIT to Reflect removal of Incentive Compensttion	(183,616)
11	ADIT Adjusted to reflect Staff's Incentive Adjustment at 26.53%	(374,143)
12	Decrease to Kansas Gas Service's ADIT Liability Balance (Increase to Rate Base)	(557,759)
13	**Decrease in Kansas Gas Service's ADIT Liability Balance (Increase to Rate Base)**	**(2,707,563)**

Sources: Kansas Gas Service's Response to Staff Data Request No. 194
Kansas Gas Service's Application and Supporting Workpapers

Line No.	Description	Amount	
1	Incentives Included in Test Year	1,836,324	
2	Line 1 Multiplied Test Year Tax Rate (39.55%)	726,266	
3	Line 1 Multiplied Test Year Tax Rate (26.53%)	487,177	
4	Adjustment to EDIT	239,089	
5	Line 3 Multiplied by Line 15	374,143	
6	Line 4 Multiplied by Line 15	183,616	
7		557,759	
8	Adjusted STI from Staff Exhibit KALF-6A	1,036,740	
9	Staff's Inclusion Rate	30.00%	
10	Line 8 Multiplied by Line 9	311,022	961,427.82
11	Staff's Distrigas Allocation	32.35%	
12	Line 10 Divided by Line 11	961,428	
13	STI Recorded to Kansas Gas Service Test Year	4,143,755	
14	Staff's Inclusion Allocation	23.20%	
15	1 Less Staff's Inclusion Allocation	76.80%	

Sources: Kansas Gas Service's Supporting Workpapers
Staff Witness Tim Rehagen's Exhibit KALF-6A

Kansas Gas Service
Pension and OPEB Expense
Income Statement Adjustment No. 1
Test Year Ended December 31, 2017

Line No.	Description	Actual Expense for 08/31/2018	Less: Projected Expense	Staff's Adjustment
1	Pension Expense	9,224,862	9,740,013	(515,151)
2	Postreitrement Benefits	(178,716)	(188,871)	10,155
3	Adjustment to Increase Expenses	9,046,146	9,551,142	(504,996)
4	**Staff Adjustment to Decrease Expense**			**(504,996)**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Responses to Staff Data Request Nos. 163 and 166

Kansas Gas Service
Tracker 1
Income Statement Adjustment No. 2
Test Year Ended December 31, 2017

Line No.	Description	Updated to February 2019	As Filed	Staff's Adjustment
1	Remove Test Year Amortization of Deferred Pension	(4,542,211)	(4,542,211)	-
2	Remove Test Year Amortization of Deferred OPEB Costs	5,454,029	5,454,029	-
3	Amortization of Deferred Pension Costs	1,834,955	2,208,867	(373,912)
4	Amortization of Deferred OPEB Costs	(3,165,117)	(3,228,987)	63,870
5		(418,344)	(108,302)	(310,042)
6	**Staff Adjustment to Decrease Amortization Expense**			**(310,042)**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Responses to Staff Data Request Nos. 163 and 167

Kansas Gas Service
Pension and OPEB Savings Sharing
Income Statement Adjustment No. 3
Test Year Ended December 31, 2017

Line No.	Decription	Amount
1	Kansas Gas Service's Adjustment to Remove 2/3 of Pension Sharing Program	3,325,367
2	**Staff's Adjustment to Reverse Kansas Gas Service's Adjustment**	**(3,325,367)**

Source: Kansas Gas Service's Supporting Workpapers

Kansas Gas Service
Corporate Benefits
Income Statement Adjustment No. 4
Test Year Ended December 31, 2017

Line No.	Description	Allocated Adjustment As Filed	Allocated As Of 08/31/2018	Staff Adjustment
1	Postretirement Benefits	(47,800)	(33,613)	14,187
2	Pension	738,129	537,998	(200,131)
3	Medical Reserve	85,896	232,286	146,390
4		776,225	736,671	(39,554)
5	**Staff Adjustment to Decrease Corporate Benefits Expense**			**(39,554)**

Sources: Kansas Gas Service's Supporting Workpapers
Staff Exhibits KALF-5A & KALF-5B

Line No.	Description	Allocated 2017 Corporate Amount	Allocated Adjustment	Allocated Adjusted Total Amount
		A	B = C - A	C
1	OPEB	(36,588)	(33,613)	(70,201)
2	Pension	1,393,049	537,998	1,931,047
3	Employee Benefits Reserve	1,469,567	232,286	1,701,853
4	Gross Margin Gain/(Loss)		736,671	

Source: Kansas Gas Service's Supplemental Response to Staff Data Request Nos. 172

Line No.	Description	2017 September	October	November	December	2018 January	February	March	April	May 18	June	July	August	Total 12 Months
1	Corporate OPEB	(9,694)	(9,694)	(9,694)	(9,694)	(22,366)	(22,357)	(22,357)	(22,357)	(22,357)	(22,357)	(22,357)	(22,357)	**(217,641)**
2	Distrigas Allocation	31.64%	31.88%	31.88%	31.88%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	
3	KGS Allocation of Corporate OPEB	(3,067)	(3,090)	(3,090)	(3,090)	(7,235)	(7,232)	(7,232)	(7,232)	(7,232)	(7,232)	(7,232)	(7,232)	**(70,201)**
4	Corporate Pension	369,078	369,078	369,078	369,078	564,635	564,639	564,639	564,639	564,639	564,639	564,639	564,639	**5,993,420**
5	Distrigas Allocation	31.64%	31.88%	31.88%	31.88%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	32.35%	
6	KGS Allocation of Corporate Pension	116,776	117,662	117,662	117,662	182,659	182,661	182,661	182,661	182,661	182,661	182,661	182,661	**1,931,047**
7	Corporate Employee Benefits Reserve	389,350	389,350	389,350	389,350	429,102	427,710	428,406	488,816	488,816	488,816	458,611	458,611	**5,226,288**
8	Distrigas Allocation	31.64%	31.88%	31.88%	31.88%	32.35%	32.35%	33.04%	33.04%	33.04%	33.04%	33.04%	33.04%	
9	KGS Allocation of Employee Benefits Reserve	123,190	124,125	124,125	124,125	138,814	138,364	141,545	161,505	161,505	161,505	151,525	151,525	**1,701,853**

Source: Kansas Gas Service's Supplemental Response to Staff Data Request Nos. 172

Kansas Gas Service
Incentive Compensation
Income Statement Adjustment No. 5
Test Year Ended December 31, 2017

Line No.	Description	Amount
1	To remove 70% of Costs Related to Short-Term Incentive	(725,718)
2	To remove 50% of Costs Related to Officer Portion of Long-Term Incentive - Restricted Stock	(145,609)
3	To remove 100% of Costs Related to Officer Portion of Long-Term Incentive - Performance	(1,172,077)
4	**Staff Adjustment to Incentive Compensation**	**(2,043,404)**

Source: Staff Exhibits KALF-5A and KALF-5B.

Line No.	Description	Amount	Adjust STI Down to 100%	Adjusted STI	Staff's Distrigas Allocation	STI Included in Test Year	Inclusion Percentage	Adjusted STI	STI Adjustment
1	General Tax FICA Incentive	80,467	77.3395%	62,233	32.3500%	20,132	30%	6,040	(14,093)
2	A&G Salaries Incentive Plan	3,855,048	77.3395%	2,981,475	32.3500%	964,507	30%	289,352	(675,155)
3	A&G Employee Benefit Accr. 401(k) Company Match	176,314	77.3395%	136,360	32.3500%	44,113	30%	13,234	(30,879)
4	A&G Employee Benefit Accr. PSP on STI	31,926	77.3395%	24,691	32.3500%	7,988	30%	2,396	(5,591)
5	Staff Adjustment to Short-Term Incentive Compensation								(725,718)
		4,143,755		3,204,759		1,036,740	1	311,022	
						3,204,759.40		961,427.82	961,427.82

Sources: Kansas Gas Service's Pro Forma Adjustment IS-32 workpaper
Kansas Gas Service's response to Data Request No. 176

Line No.	Description	Amount	Staff's Distrigas Allocation	LTI Included in Test Year	Inclusion Percentage	Adjusted LTI	LTI Adjustment
	Corporate						
1	A&G Salaries LT Incentive - Restricted Stock	844,726	32.35%	273,269	50%	136,634	(136,634)
2	A&G Salaries LT Incentive - Performance	3,442,405	32.35%	1,113,618	0%	-	(1,113,618)
3	Subtotal - Corporate LTI	4,287,131		1,386,887		136,634	(1,250,252)
	Kansas Gas Service						
4	A&G Salaries LT Incentive - Restricted Stock	17,949		17,949	50%	8,975	(8,975)
5	A&G Salaries LT Incentive - Performance	58,459		58,459	0%	-	(58,459)
6	Subtotal - KGS LTI	76,408		76,408		8,975	(67,434)
7	Staff Adjustment to Long-Term Incentive Compensation						(1,317,686)

Sources: Kansas Gas Service's Pro Forma Adjustment IS-32 workpaper
Kansas Gas Service's response to Data Request No. 176

Kansas Gas Service
Rate Case Expense
Income Statement Adjustment No. 6
Test Year Ended December 31, 2017

Line No.	Description	Amount
1	Company Rate Case Expense from through September 1, 2018	289,966
2	Rate Case Expense for Staff and CURB through September 29, 2018	71,906
3	Total Rate Case Expense	361,872
4	Rate Case Expense with a 3-Year Amortization Period	120,624
5	Less: Kansas Gas Service's Estimated Rate Case Expense	(171,889)
6	**Staff Adjustment to Rate Case Expense**	**(51,265)**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Responses to Staff Data Request Nos. 45 and 234

Kansas Gas Service
Brehm Storage Expense
Income Statement Adjustment No. 7
Test Year Ended December 31, 2017

Line No.	Decription	Amount
1	Kansas Gas Service's Adjustment to Remove Brehm Storage Expense from Test Year	(1,248,371)
2	**Staff's Adjustment to Reverse Kansas Gas Service's Adjustment**	**1,248,371**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Responses to Staff Data Request Nos. 138 and 254

Kansas Gas Service
Bad Debt Expense
Income Statement Adjustment No. 8
Test Year Ended December 31, 2017

Line No.	Description	Amount
1	Staff Pro Forma Revenues	322,457,501
2	3-Year Average of Net Write-Offs as a Percentage of Revenue	0.96438%
3	Staff Adjusted Bad Debt Expense	3,109,705
4	KGS Pro Forma Bad Debt Expense	2,766,167
5	**Staff Adjustment to Bad Debt Expense**	**343,538**

Calculation of Net Write-Offs as a Percentage of Revenue

	Year	Revenue	Net Bad Debt Write-Offs	Net Bad Debt Write-Off %
6	September 2015 - August 2016	247,325,393	1,991,702	0.80530%
7	September 2016 - August 2017	274,999,603	2,426,088	0.88222%
8	September 2017 - August 2018	308,913,323	3,724,316	1.20562%
9	3-Year Average			0.96438%

Sources: Kansas Gas Service's Responses to Staff Data Request Nos. 170 and 171
Kansas Gas Service's Application and Supporting Workpapers

Kansas Gas Service
Miscellanous Corporate Expenses
Income Statement Adjustment No. 9
Test Year Ended December 31, 2017

Line No.	Description	Amount
1	To remove scholarships only awarded to employees or employees' family memebers	38,335
2	To remove a portion of team building activity	246
3	To remove a portion of donations to charitable, religious, and non-profit organizations	735
4	To remove promotional expenses	1,526
5	**Staff Adjustment to Miscellaneous Corporate Charges**	**40,842**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Responses to Staff Data Request Nos. 142, 143, and 282

Kansas Gas Service
Interest on Customer Deposits
Income Statement Adjustment No. 10
Test Year Ended December 31, 2017

Line No.	Decription	Amount
1	Customer Deposits at December 31, 2017	18,742,198
2	Customer Deposits at August 31, 2018	18,677,952
3	Staff's Adjustment to Customer Deposits	(64,246)
4	Customer Deposit Interest Rate	1.62%
5	**Staff's Adjustment to Decrease Interest on Customer Deposits**	**(1,041)**

Sources: Kansas Gas Service's Supporting Workpapers
Staff Witness Tim Rehagen's Exhibit TSR-7

Kansas Gas Service
Taxable Income Adjustment
Adjustment to Staff Schedule B-4
Test Year Ended December 31, 2017

Line No.	Description	Restricted Stock	Performance Stock	Total
1	Excess Tax Benefit, Gross (Income Deduction)	2,761,035	10,755,215	13,516,250
2	Distrigas Allocation	32.3500%	32.3500%	
3	Staff's Inclusion Percentage	50%	0%	
4		446,597	-	446,597
5	**Staff's Adjustment to Reduce Taxable Income (Line 16 of Staff Schedule B-4)**			**(446,597)**

Sources: Kansas Gas Service's Supporting Workpapers
Kansas Gas Service's Response to Staff Data Request No. 257

Exhibit KALF-13

Kansas Gas Service's Responses to Staff Data Requests:
138, 229, 254, and 257

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-138: Brehm Storage
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 8/27/2018
Date Information Needed: 9/6/2018
Requested By: Kristina Luke Fry

Page 1of 1

Please provide the following:

Please provide the amount of cost costs associated with the Brehm Storage field for the last ten years.

KGS Response:

Please see the table below for the 10 year Brehm storage field costs from 2008-2017.

Year	Amount
2008	$1,040,000.00
2009	$1,134,451.14
2010	$1,277,438.40
2011	$1,275,990.08
2012	$1,257,195.72
2013	$1,253,756.08
2014	$1,252,137.43
2015	$1,260,011.81
2016	$1,254,540.99
2017	$1,248,371.02

Prepared by: Victoria Noriega-Reyes

Verification of Response

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

Signed: Lorna Eaton

Date: 9/5/18

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-229: Incentive Compensation
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/17/2018
Date Information Needed: 9/26/2018
Requested By: Justin Grady

Please provide the following:

Has OneGas sought rate recovery of Incentive Compensation in Texas or Oklahoma? If yes, please provide the state, case number, and how the costs were either agreed or ordered to be treated.

KGS Response:

Yes, ONE Gas has sought rate recovery of incentive compensation in Texas and Oklahoma. Below is a table containing the state, case number and regulatory treatment. Please note that for several Texas jurisdictions, the parties to the filings agreed to a unanimous settlement agreement, including treatment of incentive compensation costs. The parties agreed that nothing in the settlement agreement resulted in a determination relative to incentive compensation.

State/Case No.	**Short-term incentive (STI)**	**Long-term incentive (LTI) - Restrictive**	**LTI - Performance**
Oklahoma (Cause No. PUD 201500213)(1)	Recovers at the lesser of 100% of target or the actual total amount paid out. Thus, if Oklahoma Natural pays out at the 110% level, then Oklahoma Natural's recovery is capped at the amount equivalent to the 100% level. Accordingly, if Oklahoma Natural pays out at the 90% level, then Oklahoma Natural shall recover the actual total amount paid out.	Not allowed to recover.	Not allowed to recover.
Texas (GUD No. 10739 - North Texas Service Area) (2)	Request included 100% of STI.	Request included 100% of Restricted LTI.	Request included 100% of Performance LTI.
Texas (GUD No. 10766 - Borger/Skellytown Service Area) (3)	Request included 100% of STI.	Request included 100% of Restricted LTI.	Request included 100% of Performance LTI.
Texas (GUD No. 10656 - Rio Grande Valley Service Area)(4)	Request included 100% of STI.	Request included 100% of Restricted LTI.	Request included 100% of Performance LTI.
Texas (GUD No. 10506 - West Texas Service Area)(5)	Final Order allowed 50% of STI at 100% performance modifier.	Final Order allowed 50% of restricted LTI.	Not allowed to recover.
Texas (GUD No. 10526 - Central Texas Service Area)(6)	Request included 100% of STI.	Request included 100% of Restricted LTI.	Request included 100% of Performance LTI.
Texas (GUD No. 10488 - Gulf Coast Service Area)(7)	Request included 100% of STI.	Request included 100% of Restricted LTI.	Request included 100% of Performance LTI.

(1) Cause No. PUD 201500213; Unanimous Settlement Agreement; In the matter of the application of Oklahoma Natural Gas Company, A Division of ONE Gas, Inc., For a review and change or modification in its rates, charges, tariffs, and terms and conditions; Final Order (Jan. 6, 2016) (p7).

Verification of Response

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

Signed: Ashley Davidson

Date: 9/26/2018

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-229: Incentive Compensation
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/17/2018
Date Information Needed: 9/26/2018
Requested By: Justin Grady

(2) GUD No. 10739, Statement of Intent of Texas Gas Service, a Division of ONE Gas, Inc. (TGS), To increase gas utility rates within the NorthTexas Service Area (NTSA); Filed June 20, 2018.

(3) GUD No. 10766, Statement of Intent of Texas Gas Service, a Division of ONE Gas, Inc. (TGS), To increase gas utility rates within the Unincorporated Areas of the Borger-Skellytown Service Area (BSSA); Filed Aug. 30, 2018.

(4) GUD No. 10656, Unanimous Settlement Agreement; Final Order dated (Mar. 21, 2018)

(5) GUD No. 10506, consol., Final Order at FoFs 81-84, 86 and 87 (Sept. 27, 2016) and First Amended Proposal for Decision at pgs. 45-51 (Sept. 16, 2016).

(6) GUD No. 10526, Unanimous Settlement Agreement; Final Order dated (Nov. 16, 2016)

(7) GUD No. 10488, Unanimous Settlement Agreement Final Order dated (May 4, 2016)

Prepared by: Ashley Davidson

Verification of Response

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

Signed: Ashley Davidson

Date: 9/26/2018

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-254: Brehm Storage
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/19/2018
Date Information Needed: 9/28/2018
Requested By: Kristina Luke Fry

Please provide the following:

Is there reason to think or support to think that the Brehm storage costs are likely to change materially in the future?

KGS Response:

No, KGS renewed its Brehm storage agreement for 5 years beginning July 1, 2018.

Prepared by: Matt Robbins

Verification of Response

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

Signed: Janet Buchanan

Date: 9/28/2018

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-257: Board of Director Materials
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/21/2018
Date Information Needed: 10/1/2018
Requested By: Kristina Luke Fry

Please provide the following:

Regarding page 24 of the January 16, 2018 meeting materials, there is a note stating that there was an "adoption of new accounting standard for share-based compensation ($5.2 million, or $0.10 per share) and negative impact for remeasurement of deferred taxes due to tax reform ($2.2 million, or $0.04 per share."
a. Please identify the new accounting standard pertaining to share based compensation.
b. When did ONE Gas adopt the new standard?
c. Please state specifically what the financial impact was on ONE Gas' books and provide all journal entries that were made to implement the standard?
d. Please state specifically how this standard changed how share based compensation expenses are accounted for
e. Was this impact allocated to Kansas Gas Service's books and records during the test year? If not, please explain why not given the fact that share based compensation expenses are included are included allocated from ONE Gas to Kansas Gas Service. If so, please identify where in Kansas Gas Service's application this financial impact can be identified.

KGS Response:

a. The new accounting standard pertaining to share-based compensation is Accounting Standard Update No. 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.*

b. ONE Gas adopted the new standard in the first quarter of 2017.

c. In accordance with the transition requirements, we recorded $5.2 million of excess tax benefit in income tax expense on ONE Gas, Inc., related to the share-based compensation vesting in 2017. In addition, we recorded a noncash cumulative-effect increase of $11.0 million to retained earnings, with an offset to a deferred income tax asset, as of the beginning of the reporting period in 2017, for excess tax benefits earned prior to January 1, 2017, that had not been recognized. Please see, "18-560 KCC-257 Schedules" for the journal entries made to implement the new standard.

d. The new accounting standard update did not fundamentally change how share-based based compensation costs are accounted for by ONE Gas, Inc. Compensation cost continues to be measured generally on the grant date when performance and restricted stock units are issued. For ONE Gas, the new standard modified the accounting and reporting for tax accounting impacts of share-based payments, including the presentation in the statements of operations and cash flows. Prior to the adoption of Accounting Standard Update No. 2016-09, the excess tax benefit over the book expense (a deferred tax asset) was credited to additional paid-in capital, and the excess tax benefit was not permitted to be recognized until the cash benefit was realized. Beginning January 1, 2017, the new standard requires recognition of excess tax benefits and tax deficiencies arising from vesting of stock-based compensation to be recorded as a

Verification of Response

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

Signed: Janet Buchanan

Date: 10/1/2018

Kansas Corporation Commission
Docket Number 18-KGSG-560-RTS
Information Request

Data Request: 18-560 KCC-257: Board of Director Materials
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/21/2018
Date Information Needed: 10/1/2018
Requested By: Kristina Luke Fry

component of income tax expense or benefit through the income statement instead of additional paid-in capital on a prospective basis. Upon adoption, the company was required to record the previously unrecognized tax benefit on a modified retrospective basis through a cumulative-effect adjustment to deferred taxes and beginning retained earnings.

e. Because the change resulting from the new accounting standard only impacted consolidated income tax expense, there we as no allocation of the impact of the new accounting standard to any of ONE Gas' divisions. Income taxes are determined on a division-by-division basis as if each division were a stand-alone-tax payer. However, the deferred taxes associated with our share-based compensation awards continue to be included in our corporate deferred tax balances. The portions which have been included in Kansas Gas Service Rate base historically, have continued to be included in rate base in the current application. The portions of corporate deferred taxes included in Rate base are included in workpapers WC 9 and WC 10.

Prepared by: Kristi Bolles

Verification of Response

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

Signed: Janet Buchanan

Date: 10/1/2018

A4:h201

ACCT	To CC	From CC	Account	EI	AMTCM	Debit	Credit	JDESC
101	0000	0000	4091100	00 000000	(43,687.00)		43,687.00	CURRENT TAX ACCRUAL
101	0000	0000	2360101	00 000000	43,687.00	43,687.00		CURRENT TAX ACCRUAL
101	0000	0000	4101100	00 000000	266,307.00	266,307.00		DEFERRED TAX ACCRUAL
101	0000	0000	2830201	00 000000	(266,307.00)		266,307.00	DEFERRED TAX ACCRUAL
102	0000	0000	4091100	00 000000	1,232,566.00	1,232,566.00		CURRENT TAX ACCRUAL
102	0000	0000	2360101	00 000000	(1,232,566.00)		1,232,566.00	CURRENT TAX ACCRUAL
102	0000	0000	4101100	00 000000	-			DEFERRED TAX ACCRUAL
102	0000	0000	2830201	00 000000	-			DEFERRED TAX ACCRUAL
021	0000	0000	4091100	00 000000	3,986,609.00	3,986,609.00		CURRENT TAX ACCRUAL
021	0000	0000	2360101	00 000000	(3,986,609.00)		3,986,609.00	CURRENT TAX ACCRUAL
021	0000	0000	4101100	00 000000	1,757,585.00	1,757,585.00		DEFERRED TAX ACCRUAL
021	0000	0000	2830201	00 000000	(1,757,585.00)		1,757,585.00	DEFERRED TAX ACCRUAL
051	0000	0000	4091100	00 000000	4,873,016.00	4,873,016.00		CURRENT TAX ACCRUAL
051	0000	0000	2360101	00 000000	(4,873,016.00)		4,873,016.00	CURRENT TAX ACCRUAL
091	0000	0000	4091100	00 000000	882,976.00	882,976.00		CURRENT TAX ACCRUAL
091	0000	0000	2360101	00 000000	(882,976.00)		882,976.00	CURRENT TAX ACCRUAL
091	0000	0000	4101100	00 000000	2,083,332.00	2,083,332.00		DEFERRED TAX ACCRUAL
091	0000	0000	2830201	00 000000	(2,083,332.00)		2,083,332.00	DEFERRED TAX ACCRUAL
051	0000	0000	4101100	00 000000	1,754,293.00	1,754,293.00		DEFERRED TAX ACCRUAL
051	0000	0000	2830201	00 000000	(1,754,293.00)		1,754,293.00	DEFERRED TAX ACCRUAL
051	0000	0000	2550100	00 000000	10,733.00	10,733.00		AMORTIZATION OF ITC
051	0000	0000	4114100	00 000000	(10,733.00)		10,733.00	AMORTIZATION OF ITC
051	0000	0000	4101100	00 000000	4,270.00	4,270.00		DEFERRED TAX ON DEFERRED ITC
051	0000	0000	2830201	00 000000	(4,270.00)		4,270.00	DEFERRED TAX ON DEFERRED ITC
051	0000	0000	4101100	00 000000	12,802.00	12,802.00		FLOW THRU ADJUSTMENT AMORTIZATION
051	0000	0000	1823260	00 000000	(12,802.00)		12,802.00	FLOW THRU ADJUSTMENT AMORTIZATION
051	0000	0000	2830201	00 000000	8,449.33	8,449.33		FLOW THRU GROSS-UP AMORTIZATION
051	0000	0000	1823260	00 000000	(8,449.33)		8,449.33	FLOW THRU GROSS-UP AMORTIZATION
101	0000	0000	4091100	00 000000	(26,294.00)		26,294.00	OFFSETTING ENTRY 38.5 PERCENT
101	0000	0000	2360101	00 000000	26,294.00	26,294.00		OFFSETTING ENTRY 38.5 PERCENT
101	0000	0000	4091100	00 000000	(5,163,207.00)		5,163,207.00	Record Tax Affect of Perm Equity Comp issued In 2017
101	0000	0000	2360101	00 000000	5,163,207.00	5,163,207.00		Record Tax Affect of Perm Equity Comp issued In 2017
101	0000	0000	2830201	00 000000	10,982,005.00	10,982,005.00		Record Excess Tax Benefit of Perm Equity Comp not previously recognized
101	0000	0000	2160990	00 000000	(10,982,005.00)		10,982,005.00	Record Excess Tax Benefit of Perm Equity Comp not previously recognized
Sum to check that debits equal credits					-	33,088,131.33	33,088,131.33	

Journal Entry: OGS131

A.Edwards 3/21/17

KBolles 3/21/17

Vest Year		2017		
Grant year		2014		
Aware	RSU	PSU	TOTAL	
Units Issued	87,607	232,207	319,815	
Units Deferred		11,731	11,731	
Total Units	87,607	243,938	331,545	
FMV on Vesting Date	63.87	63.87		
FMV Total	5,595,471	14,831,085	20,426,555	
GAAP Expense	2,834,436	4,075,870	6,910,306	
Excess Tax Benefit, Gross	2,761,035	10,755,215	13,516,249	
Effective Tax Rate	38.20%	38.20%	38.20%	
Tax Adjustment	1,054,715	4,108,492	5,163,207	Decrease Tax Expense

VERIFICATION

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

Kristina Luke Fry, being duly sworn upon her oath deposes and states that she is the Managing Auditor for the Utilities Division of the State Corporation Commission of the State of Kansas; that she has read and is familiar with the foregoing *Direct Testimony,* and attests that the statements contained therein are true and correct to the best of her knowledge, information and belief.

Kristina Luke Fry
Kristina Luke Fry
Managing Auditor, Utilities Division
Kansas Corporation Commission
of the State of Kansas

SUBSCRIBED AND SWORN to before me this 29th day of October, 2018.

VICKI D. JACOBSEN
Notary Public - State of Kansas
My Appt Expires 6-30-22

Vicki D. Jacobsen
Notary Public

My Appointment Expires: June 30, 2022

CERTIFICATE OF SERVICE

18-KGSG-560-RTS

I, the undersigned, certify that a true and correct copy of the above and foregoing Staff Direct Testimony was served via electronic service this 29th day of October, 2018, to the following:

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CERTIFICATE OF SERVICE

18-KGSG-560-RTS

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/s/ Vicki Jacobsen
Vicki Jacobsen