2012.05.18 15:26:38
Kansas Corporation Commission
/S/ Patrice Petersen-Klein

In the Matter of the Application of Kansas Gas Service, A Division of ONEOK, Inc. for Adjustment of its Natural Gas Rates in the State of Kansas	)))))	DOCKET NO. 12-KGSG-835-RTS

Received
on
MAY 18 2012
by
State Corporation Commission
of Kansas

DIRECT TESTIMONY

OF

DAVID N. DITTEMORE

ON BEHALF OF

KANSAS GAS SERVICE

A DIVISION OF ONEOK, INC

DIRECT TESTIMONY

OF

DAVID N. DITTEMORE

KANSAS GAS SERVICE

DOCKET NO. 12-KGSG-___-RTS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David N. Dittemore. My business address is 7421 West 129th Street, Overland Park, Kansas, 66213.

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

A. I am employed by Kansas Gas Service a Division of ONEOK Inc. (KGS or Company). I am the Manager of Rates and Regulatory Affairs.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration with a major in Accounting from the University of Central Missouri in 1982. I am a Certified Public Accountant. I was previously employed by the Kansas Corporation Commission ("Commission" or "KCC") in various capacities including Managing Auditor, Chief Auditor and Director of Utilities. During my career I have been employed by WorldCom (telecommunications) and the Williams Companies (Williams Energy Marketing and Trading). From 2003 – 2007 I was self employed providing regulatory consulting services on behalf of clients dealing with telecommunications, electric and natural gas regulatory issues.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I have testified before the Commission on a number of occasions.

Q. COULD YOU PLEASE EXPLAIN THE SCOPE OF YOUR TESTIMONY?

A. Yes. I am providing testimony supporting the Company's Revenue Normalization Adjustment (RNA) tariff proposal. In addition, I am sponsoring the following adjustments:

Adjustment Listing

Adjustment Number		Amount
PLT 1 CWIP	$	14,237,712
PLT 3 Asset Retirement	$	(3,255,910)
ADA 2 Accumulated Depreciation - Asset Retirements	$	3,255,910
PLT 6 Reclassification of Plant	$	0
WC 2 ADIT	$	33,759,366
WC 3 ADIT	$	10,382,007
WC 4 ADIT	$	140,671
WC 5 ADIT	$	(4,032,773)
IS 13 Pension/OPEB Expense	$	5,184,587
IS 14 Amort. Of Accum. Pension/OPEB Costs	$	4,602,429
IS 15 Employee Medical Reserve	$	587,928
IS 16 Elimination of Non-Recurring OPEB Costs	$	(2,937,792)
IS 17 Charitable Contributions	$	75,443
IS 18 KCC/CURB Assessments	$	64,948
IS 19 Income Taxes	$	(4,501,926)
IS 20 Out of Period Costs	$	(225,411)
IS 21 Amort. Of Rate Case Expense	$	379,414

II. REVENUE NORMALIZATION ADJUSTMENT

Q. PLEASE PROVIDE AN OVERVIEW OF THE REVENUE NORMALIZATION ADJUSTMENT (RNA).

A. The RNA mechanism is a form of decoupling which eliminates the relationship between the level of consumption and revenue. As explained by the KCC, "decoupling" is the separation of fixed cost recovery from the volumetric portion of rates so the utility is able to maintain revenue stability.[1] The RNA mechanism

[1] Final Order, Docket No. 08-GIMX-441-GIV ("441 Docket") dated November 14, 2008, page 19, paragraph 58.

is very straightforward. It simply compares future actual revenue results, computed based upon the average revenue per customer, with the revenue and billing determinants approved in this base rate proceeding. The difference (positive or negative) is refunded to or collected from customers of the affected classes ratably the following year through a fixed monthly surcharge or credit. Since this mechanism encompasses all changes in usage, regardless of the cause, the current Weather Normalization Adjustment ("WNA") mechanism would be wound down and eventually eliminated. This process is described later in my testimony. The RNA mechanism would apply to the Residential, General Sales Service (Small) and General Sales Service (Large) rate classifications.

Q. COULD YOU PROVIDE AN EXAMPLE OF HOW THE ANNUAL CALCULATION WOULD WORK?

A. Yes. As contained in Exhibit PHR-5 of the testimony of Mr. Paul Raab, the proposed Residential Revenue is $227,455,682, with a corresponding level of residential customers of 575,841. Dividing the two numbers produces an average base revenue per customer of $395.00[2]. For purposes of this illustration, I will use a benchmark of $395 annual revenue per customer. Assume after the first year that new base rates are implemented, KGS's actual residential revenue per customer from base rates is $391. When the actual residential revenue per customer ($391) is compared to the average base revenue per customer ($395), there is a difference (negative) of $4 per customer. Upon approval by the Commission of the calculation through a compliance filing, KGS would collect the $4 shortfall through a charge of $0.33/month, beginning in April the following year. Conversely, if the actual revenue per customer is $399,

[2] The numerator will be the Commission approved pro-forma revenue for each of the following classes; Residential, General Service (Small) and General Service (Large) classes. The KGS proposed revenue is shown for illustration purposes.

there would be an equivalent credit to customers of $0.33 per month. The process is identical for the two General Sales Service classes.

Q. WILL THERE BE A TRUE-UP MECHANISM ASSOCIATED WITH THE RNA?

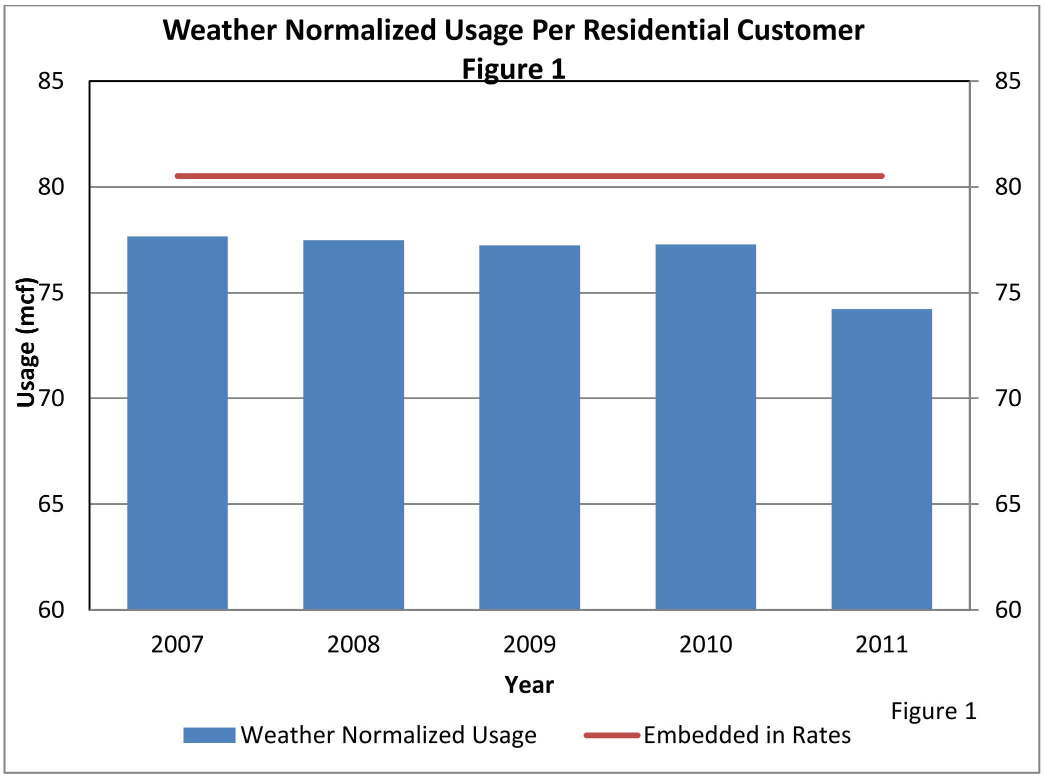
A. Yes. Authorized true-up revenues will be compared with actual RNA revenues and any differences will be incorporated into the next RNA calculation. KGS would make an annual compliance filing for Commission approval of the annual surcharge.

Q. YOU'VE USED THE PHRASE 'BASE REVENUE'. PLEASE EXPLAIN THE SIGNIFICANCE OF BASE REVENUE IN THE RNA CALCULATION.

A. Base revenue is derived from rates established in a general rate proceeding and consists of revenues collected from the service charge and volumetric commodity rates. New revenue sources, such as subsequently approved Gas System Reliability Surcharge ("GSRS") rates would not factor into the calculation since the corresponding GSRS investment is not included in this base rate proceeding. Other revenue sources, such as the recovery of increasing levels of ad-valorem taxes and the weather normalization recoveries would not be included in base revenues, nor the actual revenues to which the base revenues are compared. Thus, the mechanism applies only to those revenue levels authorized in this proceeding, compared with actual revenue generated from rates approved in this proceeding.

Q. PLEASE EXPLAIN WHY KGS IS PROPOSING A REVENUE NORMALIZATION ADJUSTMENT AT THIS TIME.

A. KGS's revenue stream is heavily dependent upon throughput. In the most recent KGS rate proceeding, Docket No. 06-KGSG-1209-RTS ("1209 Docket"), 53.76% of the KGS Residential revenue requirement was designed to be derived from revenue generated from throughput. As the following Figure 1 demonstrates, KGS Residential Sales (Weather Normalized) per customer have decreased significantly from the level used to establish base rates in the 1209 Docket, which utilized a test year ending December 31, 2005. The existing Residential volumetric rate of $2.123/MCF, applied to the decline in the weather normalized usage per customer, imposes a significant financial burden on KGS.



As shown in Figure 1 above, the weather normalized consumption used to establish base rates for Residential customers in the 1209 Docket was 80.52 MCF/yr. For the 2011 test year, weather normalized consumption dropped to 74.23/MCF/yr.

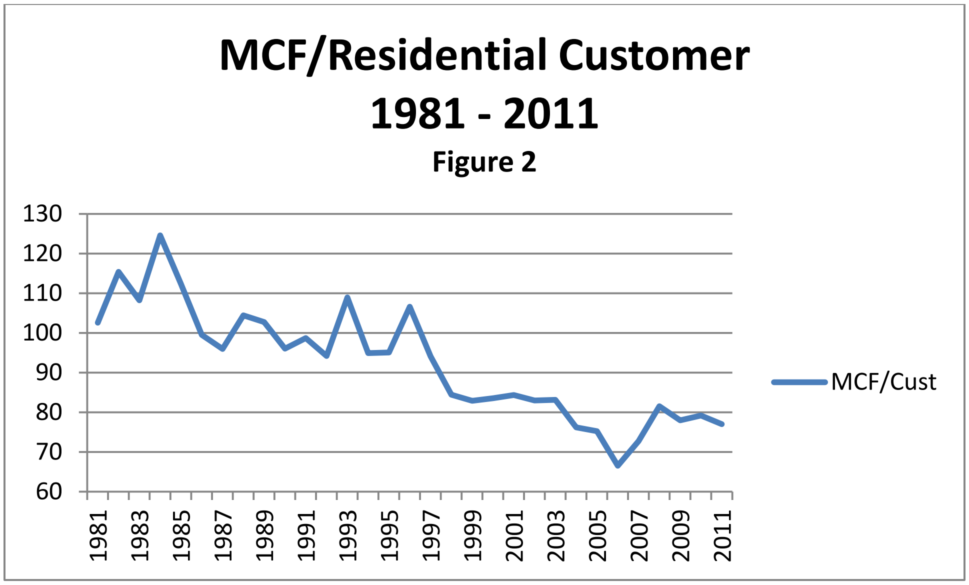
Q. COULD YOU EXPLAIN THE SIGNIFICANCE OF YOUR REFERENCE TO WEATHER NORMALIZED CONSUMPTION RATHER THAN SIMPLY ACTUAL CONSUMPTION?

A. Yes. In 2000 the Commission authorized KGS to implement a weather normalization adjustment which provides protection to both customers and shareholders from abnormal weather on an annual basis. Each year in March, KGS submits a filing with the Commission identifying the variation in consumption due to abnormal weather based upon coefficients established in the last base rate case proceeding. The weather variation is tracked by KGS and if weather is colder than normal, a refund is established. If the weather is warmer than normal, a charge is implemented for the subsequent year. The credit or charge is assessed on a volumetric basis and includes a reconciliation component in the annual filing. This weather adjustment applies only to the portion of the customers' bill associated with KGS base rates. It does not apply to the gas cost portion of customers' bills. Therefore, when evaluating usage patterns over time it is essential to eliminate the variation due to abnormal weather, consistent with the treatment of variable weather through the WNA mechanism.

Q. MR. DITTEMORE, DO YOU THINK THE TREND OF REDUCED CONSUMPTION WILL CONTINUE?

A. Yes. Despite the significant reduction in customer bills due to the decline in natural gas prices, consumption continues to decline as it has for the past thirty years. As customers continue to replace older less efficient appliances with newer more efficient models, the long-term trend of declining consumption will continue.

The following Figure 2 depicts the trend in actual residential consumption over the past thirty years.



MCF/Residential Customer 1981 - 2011

Figure 2

The long-term results shown in Figure 2 are consistent with the short-term results shown in Figure 1 and demonstrate the decline in consumption. This data represents actual rather than weather normalized consumption.

Q. HAS THE COMMISSION ACKNOWLEDGED THE TREND OF DECLINING CONSUMPTION?

A. Yes. In Docket No. 08-GIMX-441-GIV (the "441 Docket'), the KCC in its final order stated:

> *The Commission is aware that natural gas utilities face a unique situation in that natural gas usage per customer in general has declined over recent years*[3].

Q. HAS THE KCC INDICATED IN PREVIOUS DOCKETS THAT IT IS OPEN TO DECOUPLING PROPOSALS?

A. Yes. In the same docket, the KCC stated:

> *However, the Commission wishes to acknowledge that it will consider decoupling proposals from natural gas companies with concerns about revenue stability. Gas companies with such concerns are invited to make an application to the Commission, and the Commission will address each application on a case-by-case basis*[4].

[3] Final Order, page 19, paragraph 56.
[4] Final Order, page 20, paragraph 60.

Q. DOES KGS PROPOSE TO EXTEND THE RNA PROPOSAL BEYOND THE RESIDENTIAL CLASS?

A. Yes. KGS proposes to implement the RNA for the GS Small and GS Large classes. This proposal is designed to more closely match the cost to serve these customers and the rates charged to them. Those two classes represent 70.7% for GS Small and 27.9% for GS Large of the total GS class. Like the residential customers, the customers in these two GS classes continue to replace their older less efficient appliances and equipment with newer more efficient models, which also reduces their consumption.

Q. WHY IS KGS NOT APPLYING THE RNA MECHANISM TO THE THIRD GENERAL SERVICE CLASS ("GENERAL SALES TRANSPORT ELIGIBLE")?

A. The largest class, General Sales Transport Eligible ("GSTE") contains customers whose volumes are significant enough to currently qualify for transportation service, but who have voluntarily chosen to remain a sales customer. These transport eligible customers may elect to migrate to the transportation class where they then are responsible for arranging their own gas supply. Thus, to the extent these GSTE customers migrate to transportation service, KGS may experience no underlying economic harm, but the revenue per customer within this class would decline. Since customers within this newly proposed class are subject to migration, KGS is not proposing to apply the RNA to this class.

Q. DOES KGS REALIZE ANY MATERIAL REDUCTIONS IN ITS COSTS AS A RESULT OF THE REDUCTION IN THROUGHPUT PER CUSTOMER THE UTILITY HAS EXPERIENCED?

A. No. As discussed by Mr. Paul Raab, the only material costs that vary with throughput are those costs covered by the Company's Cost of Gas Rider. KGS's costs included in base rates are by and large fixed in nature. Therefore, there is a mismatch between the fixed costs KGS incurs and the related revenue collection, which is dependent upon throughput. As recognized by the KCC in the 441 Docket, the RNA mechanism reconciles this mismatch.[5]

Q. HAVE YOU QUANTIFIED THE REVENUE EFFECT OF NOT HAVING AN RNA IN PLACE FROM THE TIME OF YOUR LAST RATE CASE?

A. Yes. Figure 1 above demonstrates the significant decline in Residential volumes. The average Residential customer usage has dropped approximately 6.29 MCF from the level adopted by the Commission to set rates in the 1209 Docket.

The 6.29 MCF applied to the current commodity rate of $2.123 multiplied by KGS's Residential customer base indicates a revenue decline of approximately $7.7 Million in 2011 compared to revenues calculated for the Residential class in the 1209 Docket.

Q. HAS KGS PROPOSED TO RECOVER THE RNA THROUGH A VOLUMETRIC SURCHARGE?

A. No. The RNA would be collected, or refunded through a fixed monthly charge. As discussed earlier, KGS currently has a disparity between how its costs are incurred (fixed) and its rate structure which is heavily dependent upon throughput. Since the RNA is intended to solve the problem created by having fixed costs recovered through a volumetric rate, the collection or refund of RNA amounts should not be recovered through a volumetric charge. KGS believes it is appropriate to move towards a rate structure that more closely reflects how its costs are incurred, and thus recommends that the RNA balance be recovered or credited through a fixed rate.

Q. WHAT IMPACT WILL WEATHER HAVE ON THE RNA?

[5] Final Order, page 19, paragraph 58.

A. The weather will be the controlling factor impacting the outcome of the RNA. If weather is abnormally cold, the RNA will most likely produce a credit; if the weather is abnormally warm, the RNA will most likely produce a surcharge. The surcharge or credit will also be impacted by customer usage for reasons unrelated to the weather.

Q. ARE YOU AWARE OF HOW WIDESPREAD REVENUE DECOUPLING IS AMONG NATURAL GAS UTILITIES?

A. The American Gas Association reports that as of March, 2012, 48 natural gas utilities operating in twenty-one states have approved decoupling tariffs. Company witness Paul Raab provides additional testimony regarding decoupling.

Q. EARLIER YOU MENTIONED THAT KGS PROPOSES TO WIND DOWN THE WNA MECHANISM. PLEASE EXPLAIN HOW THAT PROCESS WOULD OCCUR.

A. The current WNA process includes a calculation period (twelve months ended February 28th) and a collection period (twelve month period ending March 31st). The calculation period is the basis for the subsequent WNA charge or credit, while the collection period is the annual period over which the charge or credit is applied. Upon approval of the RNA by the KCC, and the Commission's subsequent approval of the filed RNA tariff, KGS would terminate the calculated WNA. At that time, the WNA balance would be determined (including the cumulative adjustment from prior periods). No further WNA accruals to KGS revenue would occur. This final WNA balance would then either be recovered from, or credited to, customers over the subsequent twelve months. Therefore, there would be no overlap between the WNA mechanism and the RNA mechanism other than the collection or refund of amounts previously accrued on the books of KGS pursuant to the WNA.

Q. DOES THE RNA MECHANISM HAVE IMPLICATIONS FOR THE MANNER IN WHICH KGS RECORDS REVENUE?

A. Yes. KGS will record a monthly accrual to increase or decrease actual Residential revenue to match the calculated monthly revenue according to Figure 3 below. The total of the monthly residential volumes equals the weather normalized residential volumes used in Paul Raab's adjustment IS 8. Similar calculations will be performed to determine the monthly GS Small and GS Large revenue that ties to the approved revenue per customer authorized in this proceeding.

Figure 3
Kansas Gas Service
Calculation of Monthly Revenue Accruals

	Designed Volumes	Monthly Revenue Target
January	16.81	55.86
February	15.13	52.21
March	9.68	40.34
April	6.33	33.03
May	2.97	25.72
June	1.18	21.81
July	1.39	22.28
August	1.22	21.91
September	0.92	21.25
October	1.32	22.13
November	5.46	31.14
December	12.89	47.32
Total	75.31	$395.00

Proposed Rates	
Service Charge	19.25
Commodity Charge	2.1777

III. CONSTRUCTION WORK IN PROGRESS AND RETIREMENT AND RECLASSIFICATION OF PLANT ADJUSTMENTS

Q. PLEASE TURN TO THE ADJUSTMENTS YOU ARE SPONSORING BY EXPLAINING ADJUSTMENT PLT 1.

A, Adjustment PLT 1 increases Rate Base $14,237,712. The adjustment reflects balances of Construction Work in Progress ("CWIP") at the end of the test period which will be in-service by December 31, 2012.

Q. WHAT IS THE BASIS FOR INCLUDING PLANT IN RATE BASE THAT WILL BE COMPLETED SUBSEQUENT TO THE TEST PEROID?

A. This adjustment is consistent with K.S.A. 66-128(b)(2) which states:

> "(b) (1) For the purposes of this act, except as provided by subsection (b)(2), property of any public utility which has not been completed and dedicated to commercial service shall not be deemed to be used and required to be used in the public utility's service to the public.
>
> (2) Any public utility property described in subsection (b)(1) shall be deemed to be completed and dedicated to commercial service if: **(A) Construction of the property will be commenced and completed in one year or less**; (B) the property is an electric generation facility that converts wind, solar, biomass, landfill gas or any other renewable source of energy; (C) the property is an electric generation facility or addition to an electric generation facility; or (D) the property is an electric transmission line, including all towers, poles and other necessary appurtenances to such lines, which will be connected to an electric generation facility." (Emphasis added)

Q. DOES THE PROPERTY INCLUDED IN THE CWIP ADJUSTMENT MEET THE CRITERIA SPECIFIED IN THE STATUTE?

A. Yes. As allowed under (b)(2)(A), KGS's CWIP adjustment is limited to projects that have been or will be completed within one year or less after the test year. Items (b)(2)(B-D) are unique to the electric industry and thus do not apply to the KGS CWIP adjustment.

Q. COULD YOU PLEASE INDICATE HOW THE ADJUSTMENT WAS DETERMINED?

A. Yes. I included the costs of CWIP projects on the books of KGS as of December 31, 2011, of $14,237,712. This is a conservative amount of the ultimate cost of projects that will be in-service within twelve months of the end of the test period.

Q. WHY SHOULD THIS BE CONSIDERED A CONSERVATIVE AMOUNT?

A. The costs of projects included in this account will grow as they are completed and in-service. KGS will monitor the costs associated with these projects and update Staff periodically during the course of its investigation. KGS requests that as the actual costs of these completed projects become known they be included by Staff in its audit review with appropriate adjustments to rate base.

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT PLT 3 AND ADA 2.

A. KGS Adjustment PLT 3 reflects the amount of retired assets associated with the inclusion of CWIP in Rate Base identified in Adjustment PLT 1. The adjustment has no effect on net plant in service as the amount of the adjustment ($3,255,910) reduces gross plant and its offset, Accumulated Reserve for Depreciation, Adjustment ADA 2, by the same amount.

Q. **IF THE ADJUSTMENT HAS NO IMPACT ON RATE BASE, WHY IS IT NECESSARY?**

A. The adjustment is necessary to reflect the appropriate balance of depreciable plant in this proceeding upon which to determine the proper level of pro-forma depreciation expense. Therefore, while the adjustment does not impact the nominal value of Rate Base, it does impact the overall revenue requirement through the annualized depreciation adjustment calculation. The support for the adjustment is that some KGS assets will be retired as a result of the installation of new assets associated with Adjustment PLT 1 and to ensure a proper matching, the retirements associated with the new CWIP projects should be recognized.

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT PLT 6.

A. Adjustment PLT 6 reclassifies $227,227 from Account 380, Services to Account 376.4 Mains-Cathodic Protection. This adjustment is necessary to transfer

Cathodic Protection associated with the Services account to the Amortizable cathodic protection account. Dr. White supports the amortization proposal related to the adjusted balance of Account 376.4 within his study. Because it is a reclassification adjustment between plant accounts, there is no net change to rate base.

IV. ACCUMULATED DEFERRED INCOME TAX LIABILITY

A. INTRODUCTION

Q. MR. DITTEMORE, YOU SPONSOR FOUR DIFFERENT ADJUSTMENTS TO THE ACCUMULATED DEFERRED INCOME TAX LIABILITY. PLEASE BEGIN BY DEFINING ACCUMULATED DEFERRED INCOME TAXES (ADIT).

A. ADIT is the account used to record the cumulative differences between Income Tax Expense recorded pursuant to Generally Accepted Accounting Principles (GAAP) for financial reporting purposes and actual income taxes paid to taxing authorities. While there are a number of contributing factors impacting ADIT balance, generally, the ADIT is a net liability rather than an asset. Significant activity in this account is driven by accelerated tax depreciation contrasted with more conservative book depreciation. These differences in depreciation levels create a difference between 'book income' and 'taxable income' which, when applied to the effective tax rate, results in an entry to the ADIT account, usually creating a liability. The difference between book and tax depreciation rates turns around over time and thus is an example of what is termed a temporary difference. As an asset becomes fully depreciated for tax purposes, the book depreciation continues and the difference between the two cumulative depreciation balances is reduced until it is eventually eliminated, resulting in the elimination of the ADIT balance for that particular asset. Temporary differences affect the timing of the payment of income taxes contrasted with the recognition of Income Tax Expense per GAAP. Over time, however, these temporary differences are eliminated. During the period of time when the annual tax depreciation amount is greater than the annual book depreciation of an asset, the taxable income will be lower and thus taxes paid will be lower than the related book income tax expense, creating a deferred tax liability. When the turn-around occurs the book depreciation will be higher than the tax depreciation, thus producing a lower book income, resulting in a lower income tax expense compared with taxes paid, which reduces the deferred tax liability.

Q. PLEASE EXPLAIN HOW THE ADIT ACCOUNT IS TREATED FOR RATEMAKING PURPOSES?

A. The typical regulatory treatment of the ADIT balance is to reflect it as an offset to Rate Base. This is appropriate because the ADIT liability represents a source of financing to the utility. The application of the ADIT balance as a Rate Base offset is generally not a source of contention in rate proceedings. As shown in Schedule 6-D of the Application, KGS has recorded a net ADIT Liability of ($254,920,319) as of 12/31/11. The pro-forma balance of $214,671,048 is treated as an offset to Rate Base, consistent with traditional regulatory treatment.

Q. HOW IS THE RELATED INCOME TAX EXPENSE DETERMINED FOR RATEMAKING PURPOSES?

A. Income Tax Expense for ratemaking purposes is comprised of two components, current and deferred income tax expense. The current tax expense is that which is calculated from taxable income using accelerated tax depreciation, while the deferred component utilizes the difference between the accelerated and straight line depreciation, using KCC approved depreciation rates. Recognition of Deferred Tax Expense is required pursuant to GAAP as well as for establishing rates. The ADIT balance is used to track the difference between taxes paid and that recorded on the books of KGS as the total income tax expense.

B. ADJUSTMENT WC 2

Q. PLEASE NOW TURN TO ADJUSTMENT WC 2 AND EXPLAIN WHY THIS ADJUSTMENT IS NECESSARY.

A. Adjustment WC 2 reduces the ADIT Liability (thus increasing Rate Base) $33,759,366. This adjustment is necessary to eliminate the impact of pension and Other Post Employment Benefit (OPEB) funding on KGS ADIT balance and is consistent with the Stipulation and Agreement in Docket No. 10-KGSG-130-ACT ("130 Docket").

Q. PLEASE BEGIN BY PROVIDING AN OVERVIEW OF THE 130 DOCKET.

A. The 130 Docket dealt with fairly complex accounting/funding issues related to utility pension and OPEB costs. Essentially, OPEB costs are those costs accrued to provide retiree benefits such as medical and dental coverage. The Order permitted KGS to defer, as a regulatory asset or liability, differences between current year GAAP Pension/OPEB expense and those corresponding expense levels included in each utility's revenue requirement determined in its most recent rate case[6]. The other major element of the approved Order was that the utilities were required to make contributions to an external trust fund. KGS has greatly exceeded the funding requirements set forth in the Order.

Q. WHAT IS THE IMPLICATION OF THIS OVER-FUNDING ON THE BALANCE OF ADIT?

A. The cumulative pension/OPEB funding in excess of that recorded as a book expense has resulted in an increase in the ADIT balance of $33,759,366. The reason is that the funding is deductible for tax purposes, while the lower book

[6] The amortization of this balance is presented as adjustment IS 14.

expense is used within the calculation of the deferred tax expense. This difference between the funding level and the book expense creates a deferred tax liability.

Q. DO CUSTOMERS BENEFIT FROM FUNDING IN EXCESS OF THAT REQUIRED IN THE 130 DOCKET?

A. Yes. The increased funding reduces future years' annual expense because one component within the annual expense calculation is the expected return on assets. The contributions contribute to the pension/OPEB asset base, thus increasing the expected return. The increase in the expected return has the effect of reducing the annual expense for both the pension and OPEB expense, thus benefitting customers.

Q. DOES THIS EXCESS FUNDING RESULT IN AN ASSET THAT IS INCLUDED IN RATE BASE?

A. No. The Order in the 130 Docket provided there would be no rate base recognition for any excess contributions beyond the pension/OPEB funding requirements. KGS has not included a rate base additive for its level of funding in this application. The pertinent language from the KCC's order in the 130 Docket is:

B. KGS's application with respect to Tracker 2, to establish a regulatory asset/liability account to accumulate the difference between the current year pension/OPEB contribution to its established trusts and current year GAAP pension/OPEB costs, not as a component of rate base as set forth by Staff's recommendation is hereby approved.

Q. HOW DOES THIS LANGUAGE SUPPORT YOUR ADJUSTMENT TO ELIMINATE THE ADIT LIABILITY ASSOCIATED WITH THIS EXCESS FUNDING?

A. Absent this adjustment, KGS would be penalized for its excess funding through a reduction in rate base. The excess funding has benefited customers and KGS should not be faced with a reduction to its rate base, through its ADIT account, as a direct result of its level of funding. The language in the Order indicates there should be no rate base recognition of the excess funding as an additive to rate base. To be consistent with the intent of the Order, rate base should not be reduced for the tax liability generated as a result of the funding.

C. ADJUSTMENT WC 3

Q. PLEASE IDENTIFY ADJUSTMENT WC 3 TO RATE BASE?

A. Adjustment WC 3 increases rate base $10,382,007 by reducing the ADIT Liability to update the Net Operating Loss (NOL) balance for KGS for 2011 results.

Q. PLEASE DEFINE NOL'S AND EXPLAIN THEIR IMPACT ON RATE BASE

A. When a company's tax deductions exceeds its taxable income, it cannot realize the cash benefits of its deductions. This can occur due to a lack of profitability, or from other factors such as bonus tax depreciation.

Q. PLEASE DISCUSS THE IMPLICATIONS OF BONUS DEPRECIATION.

A. Bonus depreciation was enacted through legislation applicable to property placed in service in 2008 and 2009. Then in 2010, legislation was passed which extended bonus depreciation in 2010 and 2011. These accelerated tax deductions associated with property created significant ADIT Liabilities in the early years of the life of an asset, which as discussed earlier, is a deduction to rate base. While there are a number of items that factor into the determination of Taxable Income, the tax depreciation deduction is a major component. The NOL for a given year is multiplied by the effective tax rate to determine the ADIT Asset to record on the books, which offsets the underlying ADIT Liability created due to the excess tax deductions compared with book deductions. This means that the Company cannot realize the cash benefit of all the deductions, because it cannot reduce its tax payments below zero. Although KGS was in tax loss situation in 2011, the corresponding accounting adjustment was not made until March, 2012. Therefore, this adjustment is necessary to properly reflect the reduction in ADIT Liability necessary to match the net 2011 ADIT balance with other aspects of the revenue requirement.

D. ADJUSTMENT WC 4

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT WC 4.

A. Adjustment WC 4 reduces the ADIT Liability $140,671 and is necessary to remove the impacts associated with KGS's Cost of Gas Rider. At any point in time, customers have either under or over funded the cost of gas, transportation and storage costs KGS incurs to deliver natural gas to consumers. KGS monitors the status of the over/under account and reports monthly to the KCC Staff. This difference is either taxable or tax deductible depending upon the balance. Since there is an equal likelihood of a positive or negative balance in this account going forward, I recommend that the impact of the balance at the end of the test period be removed for purposes of establishing the appropriate ADIT Liability balance used as a rate base deduction. There is no income statement impact from this issue, thus an adjustment to pro-forma revenues or expenses is unnecessary.

E. ADJUSTMENT WC 5

Q. PLEASE EXPLAIN ADJUSTMENT WC 5

A. Adjustment WC 5 reduces rate base $4,032,773 and is necessary to attribute a portion of ADIT Liability to KGS associated with the allocation of corporate plant as described by Company witness Stacey Borgstadt in Adjustment PLT 2. As discussed in her testimony, these assets are used in the provision of utility service and because they are not recorded on the books of KGS, they must be allocated. Similarly the ADIT liability associated with these assets is not recorded on the books of KGS and thus, an adjustment is necessary to properly allocate this customer provided capital to KGS.

V. PENSION/OPEB EXPENSES – ADJUSTMENT IS 13

Q. PLEASE TURN TO THE INCOME STATEMENT ADJUSTMENTS YOU ARE SPONSORING AND BEGIN WITH AN EXPLANATION OF ADJUSTMENT IS 13.

A. Adjustment IS 13 increases Pension/OPEB expense $5,184,587 to reflect the known and measurable 2012 costs for these items. The adjustment was computed by comparing the pro-forma 2012 KGS costs with those costs expensed in the test period. These test period costs were established in the 1209 Docket.

Q. EARLIER YOU REFERENCED THE 130 DOCKET, IN WHICH KGS RECEIVED PERMISSION TO ESTABLISH A REGULATORY ASSET OR LIABILITY FOR THE DIFFERENCE BETWEEN PENSION/OPEB COSTS ESTABLISHED IN ITS LAST RATE PROCEEDING AND THOSE IT INCURRED IN THE CURRENT PERIOD. HOW DOES THAT ORDER IMPACT THIS PROPOSED ADJUSTMENT?

A. Adjustment IS 13 measures the difference between the 2012 pro-forma costs for Pension and OPEB expense and that used as the baseline costs currently embedded in rates. The annual differences between such costs and the baseline established in the 1209 Docket have been deferred and are the subject of Adjustment IS 14.

Q. WILL THERE BE A NEW BENCHMARK ESTABLISHED FOR PENSION AND OPEB COSTS INCORPORATED INTO FUTURE DEFERRALS FOR PENSION AND OPEB COSTS?

A. Yes. In accordance with the Commission's Order in the 130 Docket, KGS will defer the difference between its actual costs and the benchmarks established in this case for Pension and OPEB costs respectively, as a regulatory asset or liability. KGS will continue to adhere to the funding obligations as set forth in the 130 Docket. For purposes of the deferral mechanism the new benchmarks incorporated into rates are:

Pension Expense:	$9,143,934
OPEB Expense:	$8,271,630

These amounts represent the total pro-forma Pension and OPEB costs respectively requested in Adjustment IS 13, less the portion of pro-forma costs associated with general corporate employees, since those are allocated through the ONEOK DistriGas mechanism. These common employee costs are not included in the new benchmark since they were not a component of the original costs established in the 130 Docket.

VI. AMORTIZATION OF ACCUMULATED PENSION AND OPEB EXPENSES – ADJUSTMENT IS 14

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT IS 14.

A. Adjustment IS 14 amortizes the accumulated balance of Pension and OPEB costs to expense over a three year period. As discussed above these costs were deferred pursuant to the KCC's Order in the 130 Docket. The specific balances of the deferred Pension and OPEB balances are shown below:

Pension:	$	15,273,391
OPEB	$	(1,466,105)

Total	$	13,807,286
Divided by 3 Years	$	4,602,429

Q. PLEASE EXPLAIN WHY THE BALANCE OF THE OPEB DEFERRAL IS NEGATIVE?

A. The annual OPEB costs have declined from those included in the 1209 Docket, therefore, this reduction in costs is reflected as a regulatory liability on the books of KGS.

Q. DID THE KCC'S ORDER IN THE 130 DOCKET DISCUSS THE REGULATORY TREATMENT TO BE PROVIDED TO THE CUMULATIVE DEFERRALS IN KGS' NEXT RATE PROCEEDING?

A. Yes. Paragraph 9 of the KCC's Order in the 130 Docket states:

> *Under Tracker 1, each company will establish a regulatory asset or liability to record differences between current year GAAP Pension/OPEB Expenses and Pension/OPEB Expenses in Rates. The regulatory liabilities and assets recorded in Tracker 1 will be amortized in rates on a straight line basis over a reasonable period of time, not exceeding five years, and will become effective when new rates become effective in each Applicant's next general rate proceeding.*

The KGS treatment of its net regulatory asset is consistent with the language in the Commissions' Order.

Q. EXPLAIN WHY KGS IS RECOMMENDING THAT THE ACCUMULATED PENSION/OPEB EXPENSES BE AMORTIZED OVER THREE YEARS?

A. KGS is required to amortize the cumulative difference over a reasonable period of time not to exceed five years under the KCC Order in the 130 Docket. The three year amortization period proposed by KGS is within the time frame set forth by the Commission. KGS is not allowed to earn a return on the deferred amount. Therefore, a period shorter than five years is reasonable.

VII. EMPLOYEE MEDICAL RESERVE ADJUSTMENT IS 15

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT IS 15.

A. Adjustment IS 15 increases Operating Expenses $587,928 by reflecting the increase in 2012 employee medical reserve accruals compared with 2011 levels.

VIII. ELIMINATION OF NON-RECURRING DEFERRED PENSION/OPEB COSTS ADJUSTMENT IS 16

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT IS 16.

A. Adjustment IS 16 decreases Operating Expenses $2,937,792. This adjustment is necessary to eliminate the amortization of deferred OPEB costs that are non-recurring in nature. In KGS's 2003 rate case, Docket No. 03-KGSG-602-RTS, the Commission approved an S&A whereby KGS would be permitted to amortize its previously deferred OPEB costs. The amortization period expires in 2012 and thus KGS's test period Amortization Expense should be reduced by $2,937,792.

IX. CHARITABLE AND CIVIC CONTRIBUTIONS ADJUSTMENT IS 17

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT IS 17.

A. Adjustment IS 17 increases Operating Expenses $75,443. This adjustment enables the Company to recover 50% of its charitable and civic contributions. K.S.A. 66-1,206(a) provides that public utilities shall recover in rates 50% or more of dues, donations and contributions to charitable, civic and social organizations. This adjustment is consistent with past Commission practice of authorizing recovery of 50% of such expenditures through rates. The adjustment also eliminates costs for sports tickets and sponsorships incurred during the test year.

X. KCC/CURB ASSESSMENTS ADJUSTMENT IS 18

Q. PLEASE CONTINUE WITH AN EXPLANATION OF ADJUSTMENT IS 18.

A. Adjustment No. IS 18 increases Operating Expenses $64,948 as a result of post test period increases in KCC and CURB assessments. This adjustment was determined by totaling the fiscal quarterly assessments recorded in the 3rd and 4th quarters of 2011, plus those recorded in the 1st and 2nd quarters of 2012 compared with those costs recorded in the test period. The result is an increase in such costs of $64,948.

XI. INCOME TAX EXPENSE

Q. PLEASE EXPLAIN ADJUSTMENT IS 19.

A. Adjustment IS 19 reduces Operating Expenses $4,501,926 by updating Income Tax Expense for the various adjustments proposed by KGS in this application. This adjustment is necessary to synchronize income tax expense with the pro-forma adjustments as shown on Schedule 11-A. It also incorporates the interest synchronization as shown on Schedule 11-G.

XII. NON-RECURRING COSTS

Q. PLEASE EXPLAIN ADJUSTMENT IS 20.

A. Adjustment IS 20 reduces Operating Expenses $225,411 by eliminating costs associated with lease expense and Sales Tax that were recorded in the test period, but relate to prior periods. This adjustment is necessary to normalize test period costs.

XIII. AMORTIZATION OF RATE CASE COSTS

Q. WHAT IS THE PURPOSE OF ADJUSTMENT IS 21?

A. Adjustment IS 21 increases Operating Expenses $379,414 to reflect a three-year amortization of estimated rate case expenses arising from this application. These costs should be trued up at the end of the proceeding based upon the actual costs incurred.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

VERIFICATION

STATE OF KANSAS)
) ss.
COUNTY OF JOHNSON)

David Dittemore, being duly sworn upon his oath, deposes and states that he is Manager of Rates and Regulatory Affairs for Kansas Gas Service, a Division of ONEOK, Inc.; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

David N. Dittemore
NAME

Subscribed and sworn to before me this 14th day of May 2012.

Jo M. Smith
NOTARY PUBLIC

My appointment Expires:
9/28/2012

NOTARY PUBLIC -- State of Kansas
JO M. SMITH
My Appt. Exp. 9/28/2012