



**REPORT AND RECOMMENDATION  
UTILITIES DIVISION**

**TO:** Chairman Pat Apple  
Commissioner Shari Feist Albrecht  
Commissioner Jay Scott Emler

**FROM:** Tim Rehagen, Senior Auditor  
Dennis Crupper, Pipeline Safety Engineer  
Justin Grady, Chief of Accounting and Financial Analysis  
Leo Haynos, Chief of Pipeline Safety  
Jeff McClanahan, Director of Utilities

**DATE:** April 19, 2017

**SUBJECT:** Docket No. 17-BHCG-389-TAR – In the Matter of the Application of Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy, LLC for a Gas System Reliability Surcharge per K.S.A. 66-2201 through 66-2204.

**EXECUTIVE SUMMARY:**

On February 21, 2017, Black Hills Energy (Black Hills) filed an Application for approval of its updated Gas System Reliability Surcharge (GSRS). Staff performed an audit, discussed below, and recommends that the \$6,243,896 of capital expenditures requested for recovery by Black Hills be included in the GSRS. This equates to a revenue requirement calculation of \$580,680. The proposed GSRS would cause an increase in residential customer bills of \$0.29 each month or \$3.48 annually.

**BACKGROUND:**

In the subject Docket, Black Hills filed a request for a new tariff schedule, labeled the GSRS. This tariff is designed to allow for the adjustment of Black Hills' rates and charges to provide for the recovery of \$580,680 of revenue requirement associated with \$6,243,896 of capital costs for eligible infrastructure system replacements.

K.S.A. 66-2204 requires Staff to examine information from the utility and confirm that the underlying costs are in accordance with the statutory provisions of the Gas Safety and Reliability Policy Act. Staff is required to file a Report and Recommendation in this Docket by April 24,

2017.<sup>1</sup> The Commission is required to issue a Final Order on the Application within 120 days of the filing date which, in this Docket, is by June 21, 2017.

To make the determination of recommending a given project for inclusion in the GSRS, it is customary for Staff to evaluate the project to determine if infrastructure replacements are required for compliance with pipeline safety regulations or if relocation/replacement projects were incurred due to other public works projects. To perform this evaluation, Staff relies on the description of each project provided in the operator's Application or through responses to data requests.

### History

The Gas Safety and Reliability Policy Act, K.S.A. 66-2001 through 66-2004, was enacted by the Kansas Legislature in July 2006. The statutory provisions allow natural gas public utilities to recover costs for certain infrastructure projects through a monthly customer surcharge. These statutory provisions only apply to projects that entail the replacement of infrastructure or extend the useful life of existing infrastructure. The replacement projects are further limited to those projects that are required for compliance with pipeline safety regulations or for facility relocation projects caused by other public works projects, such as road improvement.

In its review of the Application, the Commission is required to confirm that the included replacement projects meet the provisions of the Act. The Commission is also charged with the obligation of confirming that the proposed surcharge has been properly calculated and is based solely on the projects included in the Application. As a first step in making this determination, Staff relies on two essential statutory provisions. Those provisions are as follows:

- K.S.A. 66-2202 (f)  
“natural gas utility plant projects” may consist only of the following:
  - (1) Mains, valves, service lines, regulator stations, vaults and other pipeline system components installed to comply with state or federal safety requirements as replacements for existing facilities;
  - (2) main relining projects, service line insertion projects, joint encapsulation projects and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state and federal safety requirements; and
  - (3) facility relocations required due to construction or improvement of a highway, road, street, public way or other public work...provided that the costs related to such projects have not been reimbursed to the natural gas public utility.
- K.S.A. 66-2203 (a)  
...a natural gas public utility providing gas service may file a petition...to establish or change GSRS rate schedules...to provide for the recovery of costs for eligible infrastructure system replacements.

Kansas pipeline safety regulations are primarily adopted from federal pipeline safety regulations: 49 CFR Part 192, as adopted by K.A.R. 82-11-4. As stated in the scope of the federal code, the regulations prescribe the minimum safety requirements for pipeline facilities. When evaluating

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<sup>1</sup> The 60-day deadline falls on April 22, 2017, which is a Saturday. Therefore, the Report and Recommendation is due the following Monday, April 24.

projects for the applicability of GSRS, the decision must rest on defining which portion of the project brings the system into compliance with safety regulations and which portion of a given project is being completed as a business decision to renew an aging infrastructure or improve operating efficiency. Often the utility's rationale for performing a replacement project is based on a blend of economic considerations with pipeline safety or relocation requirements.

## **ANALYSIS:**

### **Summary**

Staff recommends the proposed capital costs of \$6,243,896 be included in the surcharge. Exhibit ALS-2, attached to the Direct Testimony of Ann L. Stichler, contains detailed descriptions of the 152 safety-related projects (designated as "SR-1 to SR-154") and 6 relocation projects (designated as "R-1 to R-7") that Black Hills seeks to include in the surcharge.

### **Pipeline Safety**

Black Hills is requesting recovery of capital expenditures totaling \$6,243,896 for 158 specific projects and work orders through the GSRS in this filing. Staff considers all the projects submitted in this filing to meet the pipeline safety requirements for GSRS recovery as discussed further in this section.

Black Hills categorizes the projects being included in its GSRS filing into two groups: 1) Public Improvement Relocations; and 2) Safety Related System Replacements.<sup>2</sup> The Safety Related System Replacement projects can be further divided into two subgroups: one subgroup consists of 38 blanket work orders; and the second subgroup consists of 114 specific project locations. Staff's analysis of the two categories is as follows:

### **Public Improvement Relocations:**

The six projects in this group are submitted by Black Hills as governmentally mandated pipeline relocation projects which have not been reimbursed to the utility.<sup>3</sup> Staff conducted an on-site review of the project documentation for each of these projects. The information provided by Black Hills was compared to the construction plans issued by either the city or state government unit sponsoring the public works project. Using the plans as a reference point, Staff evaluated the public works project request for relocation as well as the amount of gas facilities that needed to be relocated. Staff agrees these projects meet the criteria for recovery of capital costs through the GSRS. The capital cost amount associated with this category that Staff considers eligible for recovery is \$231,425.

### **Safety Related System Replacements:**

For the Safety Related System Replacement projects, Staff reviewed the synopsis of work and pipeline code compliance citation provided by Black Hills for each specifically identified project. As part of the review, Staff issued data requests in order to develop a more complete understanding of the decision making process used by Black Hills to determine GSRS eligibility.

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<sup>2</sup> Exhibits ALS-1 and ALS-2 of Ann Stichler's Testimony list 154 specific safety-related projects numbers: SR-1 through SR-154. Projects SR-151 and SR-152 were intentionally removed from this filing leaving 152 specific safety-related projects and blanket work orders as the subject matter of this filing. Exhibits ALS-1 and ALS-2 list seven specific relocation project numbers: R-1 through R-7. Project R-3 was intentionally removed from this filing leaving six specific relocation projects as the subject matter of this filing.

<sup>3</sup> See Company witness Ann L. Stichler Testimony, page 3.

After conducting discovery and reviewing the Black Hills testimony in this Docket, an on-site meeting with Black Hills was held to verify that the Black Hills project synopsis agreed with project documentation and pipeline safety regulatory requirements. This review was conducted for each of the 114 specifically identified projects. For the 38 blanket work orders, a random sample was audited in a similar fashion.

The specifically identified projects were performed to meet pipeline safety regulatory requirements such as leak repair projects, valve replacements, and obsolete equipment replacements. Based on Staff's review of Black Hills' Application, discovery responses, and on-site records examination, Staff agrees the 114 specifically identified projects are eligible for capital cost recovery through the GSRS.

Black Hills describes blanket work orders as projects that contain several smaller projects, with usually more than one hundred projects collectively in a given blanket project. Black Hills has five blanket projects for repairing leaks on distribution mains and 33 blanket projects for replacing service lines. Based on a review of a random sampling of blanket work orders conducted by Staff, we agree the blanket work order projects are eligible for capital cost recovery through the GSRS. For this category, Staff considers \$6,012,471 as eligible for cost recovery.

#### Accounting

Staff performed an audit of Black Hills' Application to verify that the surcharge was properly calculated and based solely on the projects included in the Application. Staff requested work orders and journal entries in support of a random sample of projects included in the Application. Upon reviewing this documentation, Staff found no material errors or concerns.<sup>4</sup>

It should be noted that the true-up mechanism in this Docket reflects GSRS revenue collected during the period of March 2016 through December 2016. The true-up reconciles actual GSRS revenue collected to GSRS revenue that Black Hills was authorized to collect during this 10-month period. Staff recommends that next year's GSRS True-Up filing reflect GSRS revenue collected from January 2017 through the end of the GSRS period established in next year's filing.<sup>5</sup>

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<sup>4</sup> At Staff's request, Black Hills corrected a couple of minor errors in its GSRS revenue calculation: 1) The incorporation of 50% bonus depreciation into the tax depreciation rates for projects with in-service dates prior to September 8, 2010; and 2) the correction of the tax depreciation rate for a project placed in service during the third quarter of 2016 and all projects placed in service during the fourth quarter of that year. However, this revised calculation would have only resulted in a \$34 increase to the GSRS revenue requirement. This increase is too immaterial to have any impact on the proposed monthly customer surcharges for each customer class. Therefore, Staff has elected not to propose any adjustments to the GSRS revenue requirement.

<sup>5</sup> The amount of GSRS revenue that Black Hills was authorized to collect during this 10-month period was based on the GSRS revenue requirement approved in last year's GSRS filing: Docket No. 16-BHCG-277-TAR (16-277 Docket). The GSRS in the 16-277 Docket became effective on March 1, 2016, and will remain in effect until the proposed GSRS in the current Docket is approved and becomes effective. Therefore, next year's GSRS True-Up filing will need to include a reconciliation of the GSRS revenue actually collected to revenue Black Hills is authorized to collect for the period of January 2017 through the effective date of the proposed GSRS in the present Docket.

**RECOMMENDATION:**

Staff recommends the Commission approve Black Hills' proposed GSRS revenue increase of \$580,680 to be collected via the per-customer surcharge listed in Exhibit KMK-3, as attached to Kathy Kropp's direct testimony, with the following conditions:

- Black Hills must file an updated GSRS tariff to reflect the changes in the per-customer surcharge prior to billing the new surcharge;
- Black Hills must file a GSRS True-Up twelve months after the collection of rates from this filing to reflect revenue collected versus revenue Black Hills is allowed to collect beginning in January 2017; and
- Staff will review Black Hills' True-Up filing to ensure that the amounts recovered via the surcharge are appropriate and any over/under-recoveries will be refunded to or recovered from customers at that time.

**CERTIFICATE OF SERVICE**

17-BHCG-389-TAR

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 21st day of April, 2017, to the following:

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