**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

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KANSAS CORPORATION COMMISSION

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I. Introduction, Qualifications, Purpose of Testimony

Q. Please state your name and business address.

A. My name is Justin T. Grady and my business address is 1500 Southwest Arrowhead Road, Topeka, Kansas, 66604.

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

A. I am employed by the Kansas Corporation Commission (KCC or Commission) as the Chief of Accounting and Financial Analysis.

Q. Please summarize your educational and employment background.

A. I earned a Master of Business Administration degree, with a concentration in General Finance which includes emphases in Corporate Finance and Investment Management, from the University of Kansas in December of 2009. I also hold a Bachelor of Business Administration degree with majors in Finance and Economics from Washburn University. I have been employed by the KCC in various positions of increasing responsibility within the Utilities Division since 2002. I have been employed in my current capacity since May 2012.

While employed with the Commission, I have participated in and directed the review of various tariff/surcharge filings and rate case proceedings involving electric, natural gas distribution, water distribution, and telecommunications utilities. In my current position, I have supervisory responsibility for the activities of the Commission's Audit section within the Utilities Division. In that capacity, I plan, manage, and perform audits relating to utility rate cases, tariff/surcharge filings, fuel cost recovery mechanisms, transmission delivery charges, alternative-ratemaking mechanisms, and other utility filings which may have an impact on utility rates in Kansas including mergers, acquisitions, and restructuring filings.

Q. Have you previously submitted testimony before this Commission?

A. Yes. I have submitted written and oral testimony before this Commission on multiple occasions regarding various regulatory accounting and ratemaking issues. This work includes testimony filings in 55 dockets, including this one. A list of the other dockets that encompass this experience is available upon request.

Q. What is the purpose of your testimony in the review of this rate case filing made by Kansas Gas Service (KGS), a Division of ONE Gas, Inc. (ONE Gas), in Docket No. 18-KGSG-560-RTS?

A. In the testimony that follows, I will present and support Staff's positions regarding the following topics, in the order that they will appear in my testimony:

1. The impact of the Tax Cuts and Jobs Act (TCJA) on the revenue requirements that KGS and Staff recommend in this Docket, as well as Staff's recommended rate credit to customers associated with tax savings that have accumulated in the Regulatory Liability from January 1, 2018, through the date new rates will be effective as a result of this Docket;
2. Staff's response to KGS's requested Depreciation Expense; and
3. Staff's response to KGS's requested Cyber Security Tracker.

II. Executive Summary

Q. Please provide an executive summary of your testimony.

A. In the testimony that follows, I will present and support the following conclusions:

- KGS has reflected the impact of the Tax Cuts and Jobs Act (TCJA) on its requested revenue requirement in this rate case. While KGS did not include the effect of the amortization of Excess Deferred Income Taxes (EDIT) on the requested revenue requirement (KGS instead requests to pass these benefits back to customers outside of base rates through its Tax Change Rider (TCR) proposal), KGS did recalculate current and deferred income tax expense in its rate case schedules to account for the lowering of the corporate income tax rate to 21% from 35% prior to the implementation of the TCJA. The impact of this change to current and deferred income tax expense (exclusive of any EDIT amortization) was a reduction to the revenue requirement of $19,892,130.[1] In other words, absent the adjustments that KGS made in its revenue requirement schedules to reflect the new lower corporate tax rate, KGS's requested revenue requirement would have been for an increase in revenues of $65,458,593, instead of the $45,566,463 that its Application is based on.
- As noted above, KGS did not include the impact of the amortization of EDIT in its revenue requirement calculation. Instead, KGS requests the Commission approve a TCR to flow back the benefit of EDIT amortization to customers over time outside of the base rate process. However, this treatment does not capture the full benefit of the EDIT amortization because KGS's proposal is to pass back only the EDIT amortization and not the tax benefits that will accrue to KGS as a result of the EDIT amortization. This tax benefit is automatically captured if the EDIT amortization

[1] In several places in Mr. Jeff Husen's testimony, Mr. Husen quantifies the impact of the lower tax rate on KGS's rate request as approximately $9 million. This figure is in error as it only accounts for the change to current income tax expense and not the change to deferred income tax expense that is reflected in KGS's Application.

occurs as a reduction to income tax expense in Staff's revenue requirement schedules. This is one of the reasons why Staff recommends the Commission deny KGS's request and instead include an estimated EDIT amortization amount in KGS's base rates. Staff further recommends that any future differences between actual EDIT amortization on KGS's books (as determined when ONE Gas files its future tax returns) and the EDIT amortization included in rates in this Docket be accumulated in a regulatory asset or liability account that can then be addressed in a future rate case.

- Staff recommends that EDIT amortization be included in base rates in this proceeding results in a reduction of $3,118,506 from Staff's revenue requirement in this Docket.[2] This results from using updated estimates of the amount of EDIT amortization for the year 2018 as contained in the response to Staff Data Request No. 222, as adjusted to reflect the removal of EDIT that relates to incentive compensation expense that Staff is recommending be removed from KGS's revenue requirement. This level of EDIT amortization relies on the same amortization periods as the Company requested for both protected[3] and unprotected EDIT. In this Docket, KGS has requested that both protected and unprotected EDIT

[2] Staff's recommended annual amortization of EDIT is $2,269,070. See Exhibit JTG-2 for support for this amount. However, like any other item that directly affects taxes or operating income (for example, production tax credits), this impact is grossed up for income taxes in the final calculation of the revenue requirement. In short, this is because any change in future tax expense that translates into a change in revenue will also have a corresponding income tax impact. In order for KGS to give customers $2.269 million a year, it actually needs to give customers $3.118 million a year because the tax benefit of a $3.118 million reduction in revenue equates to a net cost to KGS of $2.269 million a year.

[3] "Protected" refers to the normalization requirements in Section 13001 of the TCJA. This provision requires EDIT related to book/tax timing differences originating from the difference between accelerated depreciation for tax purposes and straight-line depreciation for regulatory purposes to be amortized over the life of the assets using the Average Rate Assumption Method (ARAM) or acceptable alternative (Reverse South Georgia Method) if ARAM is not possible due to Company record keeping practices. "Unprotected" EDIT is, therefore, EDIT that is not subject to IRS Tax normalization rules and, therefore, may be amortized over any time period that the Commission deems just and reasonable.

be amortized over the average remaining life of the KGS's assets using a calculation methodology known as the Average Rate Assumption Method (ARAM). While normally Staff would only recommend the amortization of unprotected plant-related EDIT over this time frame (with other unprotected EDIT amortized over ten years), in this case, for the reasons discussed in detail below, Staff agrees with the proposal to amortize all KGS EDIT using ARAM.

- The full impact of the TCJA on Staff's recommended revenue requirement calculation results in a reduction to the revenue requirement of $19,755,872. Stated differently, but for the implementation of the TCJA, Staff's revenue requirement recommendation would be higher by $19.755 million in this proceeding.
- In addition to the ongoing reduction to the revenue requirement identified above, Staff recommends that KGS be required to provide a bill credit to Kansas customers in the amount of $17,925,813, which should be distributed to customers in the fashion that Staff witness Dr. Robert Glass recommends in his Direct Testimony.[4] This credit represents the annual regulatory liability of $14,126,503 from Appendix 1 of the KGS Settlement Agreement in Docket No. 18-GIMX-248-GIV, as adjusted to reflect the addition of interest expense at the annual rate of 1.62%[5] compounded monthly. This calculation also reflects monthly deferred revenue accruals through December 31, 2018, for the Gas Safety Reliability Surcharge (GSRS)[6] and through February 28, 2019, for base rates.

[4] See Staff Exhibit JTG-1 for support of the amount of $17,925,813.
[5] 1.62% is the annual interest rate paid to utility customers for customer deposits held by the utility during the calendar year 2018.
[6] KGS has a GSRS filing pending before the Commission currently in Docket No. 19-KGSG-088-TAR. This filing will reset the current GSRS charge to reflect the lower tax rate before the end of the calendar year 2018.

- Staff recommends that KGS be required to provide customers a bill credit, representing the amount of deferred revenue in the regulatory liability resulting from the TCJA, is necessary in order to ensure that the benefit of this significant reduction in corporate income tax expense does not result in a windfall for KGS's shareholders. Instead, KGS's ratepayers should receive the benefits of this significant financial event in total, without consideration of other offsetting costs. This treatment is no different than several other instances where KGS is able to utilize deferral accounting to isolate, on a single-issue basis, the negative financial impacts of events that are outside of its control. These deferrals are later recovered from ratepayers in a future rate case without consideration of other offsetting costs that may have occurred during the time of the original event. Examples include the Cyber Security Tracker KGS has requested in this Docket, the Pension Tracker, the Cost of Gas Rider (COGR), the Bad Debt Expense component of the COGR, and the deferral mechanism established in Docket No. 17-KGSG-455-ACT (17-455 Docket) to account for and capture environmental expenditures associated with manufactured gas plant sites owned by KGS predecessor companies. The Commission should not resist using deferral accounting to benefit ratepayers in this instance, as there are ample instances in which it has been used to the benefit of KGS shareholders.
- KGS's requested Depreciation Tracker should be denied by the Commission. There is simply not sufficient evidence in the record to support the adoption of this extraordinary ratemaking mechanism for KGS at this time. With the recent adoption of Senate Bill No. 279, which amends K.S.A 66-2202 through 66-2204,

the magnitude and types of projects that can be recovered under the GSRS charge has been greatly expanded. Therefore, the regulatory lag that KGS claims it is suffering will either be non-existent or insignificant once this law takes effect on January 1, 2019.

- KGS should be allowed to implement a Cyber Security Tracker for the reasons that the Commission has authorized other public utilities operating in Kansas to utilize this deferred accounting mechanism. This will allow KGS to capture future costs associated with Cyber Security efforts so that they may be evaluated in a future rate case. However, there are several refinements that need to be made to the tracker proposal in order to ensure that only incremental costs that are directly related to KGS's future Cyber Security efforts are included in the Cyber Security Tracker going forward. Additionally, the Cyber Security Tracker should automatically sunset after five years so that the Commission can reevaluate the need for this extraordinary ratemaking mechanism in the future.

III. Tax Cuts and Jobs Act of 2017

A. Background

Q. Please provide a background discussion on this topic.

A. The Tax Cuts and Jobs Act (TCJA) was signed into law on December 22, 2017.[7] Among other changes, the law changed the federal corporate tax rate from an inclining rate with a maximum rate of 35% to a flat 21%. In anticipation of the law taking effect, Staff requested the Commission open a General Investigation into the effects of the TCJA and requested

[7] *Tax Cuts and Jobs Act*, Public Law No. 115-97; Statute 131 Stat. 2054 (Dec. 22, 2017).

that the Commission take action to preserve, for the benefit of ratepayers, the reduction in federal tax benefits. On January 18, 2018, the Commission issued its Order Opening General Investigation and Issuing Accounting Authority Order Regarding Federal Tax Reform in Docket No. 18-GIMX-248-GIV (18-248 Docket).[8]

B. General Investigation (Docket No. 18-GIMX-248-GIV)

Q. What did the Commission's Order in the 18-248 Docket require?

A. The Commission's Order required all jurisdictional public utilities in Kansas that are taxable at the corporate level to defer to a Regulatory Liability the difference between the cost of service last approved by the Commission and the cost of service that would have resulted had the provision for federal income taxes been based upon a 21% corporate tax rate. Additionally, the Commission confirmed that taxable utilities operating in Kansas should consider the portion of their operating revenue that reflects the higher corporate income tax expense to be interim, subject to refund, with interest. Last, the Commission confirmed that it intended to capture excess ADIT for the benefit of ratepayers using a methodology that is consistent with Internal Revenue Service (IRS) Tax Normalization Rules, whether contained within the TCJA itself or IRS Tax Normalization Rules, as applicable.

[8] See http://estar.kcc.ks.gov/estar/portal/kscc/page/docket-docs/PSC/DocketDetails.aspx?DocketId=1314e178-bfbd-4925-b3e3-7dfa0ff11744.

C. Developments after the Commission Order in 18-248 Docket

Q. What has transpired since the Commission issued its Order in the 18-248 Docket?

A. Since the Commission's Order in the 18-248 Docket, Staff has discussed with each of the major utilities operating in Kansas their plan for complying with the Commission's Order and to revise permanent rates to reflect the reduction in the federal corporate tax rate. Specific to KGS, both prior to and shortly after, the Commission issued its Order in the 18-248 Docket, Staff met with KGS to discuss the impact of the TCJA on KGS's revenue requirement in Kansas. On March 30, 2018, KGS, the Citizens Utility Ratepayer Board (CURB) and Staff filed with the Commission a Joint Motion for Approval of Settlement Agreement Regarding Kansas Gas Service (Settlement). The Settlement confirmed the amount of the Regulatory Liability being recorded, by month, associated with KGS's base rates and its then-current GSRS charge and confirmed that all other substantive issues related to the implementation of the TCJA and its impact on KGS's rates were deferred to a rate case to be filed within 150 days from a Commission Order approving the Settlement. The Commission approved the Settlement on May 15, 2018. The issues that are ripe for Commission determination in this rate case are the amount of EDIT that should be returned to customers, the appropriate time period over which the unprotected EDIT is amortized, and how the Regulatory Liability that contains the tax savings associated with the TCJA should be treated including how customer credits (if any) associated with that Regulatory Liability should be calculated.

D. The Impact of the TCJA on KGS's Application

Q. What is the impact of the TCJA on KGS's Revenue Requirement in this Docket?

A. When KGS filed its rate case on June 29, 2018, it included the effect of the TCJA on its revenue requirement request, excluding the amortization of EDIT to the provision for income tax expense in the revenue requirement.[9] KGS reflected the impact of the TCJA on its revenue requirement by making pro forma adjustments to current and deferred taxes which resulted in a reduction to its revenue requirement of $19,892,130.[10] In other words, had the TCJA not been implemented, KGS's requested revenue requirement in this Docket would have been $65,458,593, instead of the $45,566,463 that its Application is based on. Additionally, KGS disputes that any credit is due to customers associated with the Regulatory Liability that has been accumulating the tax savings associated with the TCJA since January 1, 2018.

E. The Impact of the TCJA on Staff's Revenue Requirement

Q. What is the impact of the TCJA on Staff's recommended Revenue Requirement in this Docket?

A. Staff's revenue requirement recommendation contains the effects of a revenue requirement reduction of $19,755,872 associated with the federal corporate tax reduction. This consists of the following: 1) Staff's calculated lower current and deferred tax expense recommendation which lowered the revenue requirement by $16,637,366 (when calculated with Staff's recommended 9.15% ROE and our 55% Equity Ratio capital structure); and

[9] As discussed below, KGS requests a Tax Change Rider (TCR) to pass back the EDIT benefits to customers instead of reflecting this benefit in base rates, which comes at the cost of the tax gross up of these benefits.

[10] While KGS witness Mr. Jeff Husen quantifies this amount as $9 million in his Direct Testimony, this calculation is in error as it only captures the impact of the change to current income tax expense in KGS's revenue requirement model, not the corresponding changes to deferred income tax expense that are reflected in the model as well.

2) Staff's recommended further reduction of $3,118,506, which reflects the reduction in tax expense associated with the amortization of KGS's protected and unprotected EDIT amounts using KGS's current estimated ARAM percentages.[11] Additionally, Staff recommends that KGS be required to provide a bill credit of $17,925,813,[12] which represents the Regulatory Liability required by the Commission Order in the 18-248 Docket adjusted to account for interest expense compounded monthly during the period of January 1, 2018, to February 28, 2019.[13] Staff witness Robert Glass provides the Commission Staff's recommendation on how to distribute the $17,925,813 bill credit to customers.

IV. EDIT Amortization

A. KGS's Position on EDIT Amortization

Q. Please describe KGS's position regarding the amortization of EDIT in this Docket.

A. KGS witness Mr. Jeff Husen begins the discussion of EDIT on page 11 of his Direct Testimony. Mr. Husen explains that EDIT pertains to the "excess" portion of ADIT that was created when the federal corporate tax rate was lowered from 35% to 21% on January 1, 2018. While ADIT by its nature reflects the accumulation of temporary tax timing differences, giving rise to temporary cost free capital that can be used by the utility to finance rate base, EDIT refers to that portion of ADIT that has now become a permanent

[11] See Staff Exhibit JTG-2 for support of the amount of EDIT amortization in Staff's revenue requirement recommendation.
[12] See Staff Exhibit JTG-1 for support of the amount of $17,925,813.
[13] This calculation only includes the monthly deferral associated with the GSRS charge through December 31, 2018, as it is expected that this charge will be revised prior to the beginning of 2019 due to KGS's pending GSRS Application before the Commission in Docket No. 19-KGSG-088-TAR.

source of cost free capital, that is until a regulated utility begins to give this EDIT back to customers. As Mr. Husen explains, Accounting Standards Codification (ASC) 980 requires KGS to establish a regulatory liability on its books if it is probable that the EDIT will be returned to customers through rates.[14] Mr. Husen also explains that ASC 980 requires the regulatory liability to be grossed-up for the income tax effect of the decrease in revenues.

Mr. Husen then introduces an estimated level of EDIT amortization for 2018 using estimated EDIT amounts from KGS's financial books as of December 31, 2017, and estimated ARAM amortization percentages for the year 2018. Mr. Husen explains that these numbers are estimates because the final amortization for 2018 EDIT can actually change until the Company files its 2018 tax return late in 2019. Additionally, he explains the distinctions between protected and unprotected EDIT, that is protected EDIT is required to be amortized to customers over the life of the assets using the ARAM or alternative method if ARAM is unavailable. Unprotected EDIT is not subject to these tax normalization requirements and thus may be amortized over any period of time deemed just and reasonable by the Commission. Since KGS has the data to calculate ARAM, that is the method that is required to be used to amortize protected EDIT if the Company wishes to avoid a tax normalization violation. Mr. Husen then describes the consequences for a tax normalization violation as very punitive to KGS and its customers.[15]

[14] As the Commission confirmed in its January 18, 2018, Order in the 18-248 Docket, KGS is required to disburse this EDIT to customers in a fashion that does not result in a tax normalization violation.

[15] Staff agrees (and the Commission has confirmed via the January 18, 2018, Order in the 18-248 Docket) that a tax normalization violation is to be avoided at all costs.

Beginning on page 15, Mr. Husen explains that KGS is requesting to amortize both its protected and unprotected EDIT using ARAM, because the majority of unprotected EDIT is plant related.[16] This category of EDIT is related to the "repairs" deduction that was allowed for certain capital investments that GAAP and the ratemaking process consider capital expenditures. Mr. Husen describes that because the "repairs" category of EDIT is plant-related and similar to the EDIT that is protected, it too should be amortized to customers over the life of plant using ARAM amortization percentages.

Q. What amount of EDIT amortization does KGS estimate will occur in 2018?

A. On page 16 of Mr. Husen's testimony, he explains that using the most recent information the Company had at the time, KGS was estimating $3.4 million of EDIT amortization during the year 2018. Mr. Husen cautions that this is an estimated amount that can change until the 2018 tax return is finalized in late 2019. The estimated EDIT amortization included in Mr. Husen's testimony is supported by Exhibits JJH-1 and JJH-2 (as attached to his testimony) and is based on an amortization rate of 2.85% for KGS EDIT and 14.08% for ONE Gas Corporate EDIT.[17] It should be noted that the response to Staff Data Request No. 219 confirmed that the $3.4 million in EDIT amortization included in Mr. Husen's testimony was incorrect, with the correct calculation being $2,760,721.[18] Later, in response to Staff Data Request No. 222 (and the amendment to 222), KGS revised its

[16] Actually more than 100% of the net unprotected EDIT balance is due to the repairs deduction because there are several offsetting Deficient Deferred Income Taxes, i.e., negative EDIT items, that are included in the net EDIT balance.

[17] These amortization percentages equate to amortization periods of 35.08 years for KGS EDIT and 7.1 years for ONE Gas Corporate EDIT, respectively.

[18] See response to Staff Data Request No. 219. The problem was that the original amortization of EDIT was calculated from the basis of the unadjusted (or test year) EDIT values in KGS's Application, not the values that reflect KGS's pro forma adjustments, as would be appropriate. Also, it should be noted that this calculation still relied on the original estimated ARAM amortization percentages of 2.85% for KGS EDIT and 14.08% for Corporate EDIT. KGS has since revised those ARAM calculations in response to Staff Data Request No. 222.

calculated ARAM amortization percentages to 2.20% for KGS EDIT and 12.58% for ONE Gas Corporate EDIT, which resulted in an annual amortization amount of $2,185,907. [19]

Q. Are any of the above EDIT amortization amounts included as a reduction to KGS's revenue requirement?

A. No. As Mr. Husen describes on page 17 of his Direct Testimony, KGS is proposing to give the EDIT amortization back to customers as an annual credit to rates (outside of the base rate process) through its proposed TCR filing.

Q. What support does KGS provide for why it is reasonable or preferable to pass these EDIT benefits back to customers using the TCR process instead of through base rates set in this proceeding?

A. Mr. Hussen offers the following support for why the Company believes it is appropriate to flow EDIT benefits through the TCR, outside of base rates:

- The EDIT amount pertains to a period prior to when new rates are becoming effective in 2019;
- The net accumulated balance is not an ongoing cost of service and is best treated as a separate bill credit;
- This approach helps ensure KGS's customers will receive the benefit in a timely manner;
- Under ARAM, the amount of the amortization will vary from year to year and, therefore, it would difficult to determine the proper level of EDIT amortization to put into base rates in order to prevent a tax normalization violation; and

[19] These amortization percentages equate to amortization periods of 45.44 years for KGS EDIT and 7.95 years for ONE Gas Corporate EDIT, respectively.

- Refunding the EDIT liability through a rider will ensure that customers are credited the correct amount in full.

B. Staff's Position on KGS's EDIT Amortization

Q. What is Staff's position on the appropriate treatment of KGS's EDIT amortization?

A. Staff recommends that the Commission establish a level of EDIT amortization in this Docket that is based on the most updated information available to Staff and the Commission. Thereafter, KGS should be required to track the differences between estimated EDIT amortization and actual EDIT amortization on KGS's books (finalized once a corresponding tax years' income tax returns are finalized) in a regulatory asset or liability that can be amortized over a reasonable time frame in a future rate case.

Q. What is Staff's recommended amount of EDIT amortization?

A. Staff's recommended EDIT amortization to be included in this Docket amounts to $2,269,270.[20] As discussed above, when properly reflected as a reduction to income tax expense in Staff's revenue requirement schedules (or KGS's 2018 MFR File[21]), this results in a reduction to the revenue requirement of $3,118,506. Staff's recommended EDIT amortization amount results from applying KGS's updated ARAM amortization percentages provided in Response to Staff Data Request No. 222 (2.20% for KGS Direct and 12.58% for ONE Gas allocated Corporate) to Staff's adjusted EDIT balances as adjusted by Staff witnesses Kristina Luke-Fry and Timothy Rehagen. Staff's adjustments to EDIT are necessary in order to reflect Staff's recommended exclusion of a percentage

[20] See Staff Exhibit No. JTG-2 for support for Staff's EDIT amortization amount of $2.269,070.

[21] Staff received KGS's revenue requirement model in response to Staff Data Request No. 1. The Excel Spreadsheet entitled "2018 Rate Case MFR" contains the electronic working copy of KGS's revenue requirement calculation presented in its Application. This revenue requirement model will calculate the same revenue requirement impact ($3,118,506) with the exception of the bad debt expense multiplier that the two revenue requirement models rely on.

of short and long-term incentive compensation expenses from KGS's test year cost of service.

C. EDIT Amortization in Base Rates Vs. TCR

Q. Why is Staff recommending the base rate approach that you describe above instead of agreeing to KGS's TCR proposal?

A. Staff's primary opposition to the TCR concept is KGS's confounding position that refunding the EDIT through the TCR process would not result in a reduction of future revenues that would result in a tax benefit for KGS. Additionally, Staff believes that the TCR process would be confusing to customers who might think that KGS was agreeing to a single-issue reduction in its base rates in the same fashion that Atmos and Black Hills did earlier this year.[22] Lastly, there are other regulatory tools to address the possibility of future revisions to EDIT amortization amount that is included in base rates in this case. These regulatory tools come without the customer confusion and administrative burden of adding another line item on customers' bills and the administrative time and expense associated with another line-item surcharge for the Commission to review and approve.

D. Explanation of Tax Benefits of EDIT Amortization

Q. Why do you characterize KGS's position on the tax benefits of refunding the EDIT through the TCR as "confounding"?

A. In an attempt to understand KGS's position on this issue Staff issued multiple rounds of discovery (and follow up discovery) and engaged in a conference call with the primary

[22] Both Atmos and Black Hills agreed to reduce rates in a single-issue fashion to begin returning the benefits of the TCJA to customers on an expedited basis. See the Settlement Agreements filed for both companies in Docket No. 18-GIMX-248-GIV. KGS, however, required a full base rate case in order to get this accomplished.

KGS witness on this issue. After all of that, it appears Staff and KGS are still not seeing eye-to-eye on this issue. There appear to be two primary areas of disagreement on this issue:

1) whether any direct reduction to tax expense (for instance, production tax credits, or amortization of EDIT), will be grossed-up for income taxes in the final revenue requirement calculation; and

2) whether a refunding of EDIT through the TCR would be considered a reduction of future revenues that results in a tax benefit to KGS.

Regarding these issues, Staff issued Data Request No. 218, in an attempt to confirm what KGS's intentions were with regard to grossing up the EDIT for taxes through the TCR. The entirety of the question and KGS's response are recreated here:

> DR No. 218: Regarding the company's request to flow the EDIT amortization through the Tax Change Rider. Please confirm whether the company intends to gross up the EDIT amortization for income taxes in the calculation of the credit that flows through to customer bills. In addition, please confirm that the EDIT amortization would be grossed up for taxes if it was included as a rate reduction in this filing, as opposed to the request to utilize the Tax Change Rider.
>
> KGS Response: The Company does not intend to gross up the amortization of the regulatory liability **because the regulatory liability is a refund obligation to customers and not considered a reduction of future revenues.** If the regulatory liability were treated as a reduction of future revenues, ASC 980-740-25 would require the amortization of the regulatory liability to be grossed-up for the income tax effect of the increase or decrease in future revenues. **Correspondingly, there would be an offsetting decrease to income tax expense that is collected from customers that would offset the tax gross up portion of the EDIT Amortization. Because the gross-up amortization of the regulatory liability would generate an offsetting tax benefit, recording a tax gross-up associated with the EDIT regulatory liability has no effect on the amount refunded to rate payers.** Also, because the EDIT liability is a refund obligation and not a reduction of future revenues, the Company has not included either an associated gross up or the corresponding deferred tax asset in rate base. Rate base reflects only the remeasured deferred taxes

> using the current enacted federal tax rate and the related regulatory liability resulting from re-measurement. (**Emphasis Added**)
>
> Prepared by: Jeff Husen

As the Commission can see in the emphasized text above, KGS's response indicates that it believes regardless of whether the EDIT amortization is grossed-up for taxes or not, that does not affect the amount of the refund that goes to customers. Additionally, KGS is of the belief that a refund of EDIT to customers through a bill credit will not reduce future revenues, resulting in a tax benefit.

E. Demonstration of Value of Tax Gross Up of EDIT

Q. How do you respond to the contention that the amount of EDIT refund that goes to customers isn't affected whether the EDIT amortization is grossed-up for taxes or not?

A. This statement reflects a fundamental misunderstanding of the mechanics of a revenue requirement calculation. Simply put, *any* direct change to current or deferred income taxes (as opposed to an indirect change in income taxes that results from a change to revenues or expenses) will result in a tax gross-up that impacts the revenue requirement at the amount of 1 / (1- .2653) or 1.361 times the direct change to income taxes.[23] As stated above, Staff's amortization of EDIT as a direct reduction of $2,269,270 in tax expense in Staff's revenue requirement schedules results in a revenue requirement reduction of $3,118,506.[24] KGS's revenue requirement model would produce similar results if the adjustment was performed

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[23] 26.53% is the combined State and Federal Tax Rate that accounts for the deductibility of federal income tax for state tax purposes.

[24] The difference between this multiplier and the generic one calculated above are due to the automatic calculation of changes in bad debt expense in Staff's revenue requirement schedules as a result of changes in the revenue requirement.

correctly. There's no way around it. A revenue requirement reduction of $3.18 million is a larger revenue requirement reduction than $2.269 million.

In an attempt to clarify KGS's position on this issue, Staff issued a follow-up Data Request No. 291. In this response, KGS admitted that the EDIT amortization would be grossed up for income taxes if it were to be treated as a reduction to income tax expense in base rates, but KGS still holds on to the notion that this tax gross up would not affect the amount of refund that KGS customers would receive. The full text of the question and answer are presented here:

> <u>DR No. 291</u>: In the response lo Staff DR No. 218, the company states as follows: "The Company does not intend to gross up the amortization of the regulatory liability because the regulatory liability is a refund obligation to customers and not considered a reduction of future revenues."
>
> Is it the company's position that if the EDIT amortization were to be treated as a reduction in rates in this case, instead of handled through the future application of the Tax Change Rider, that the EDIT amortization would be grossed up for income taxes prior to being removed from the revenue requirement? In other words, the company's proposal to flow the EDIT benefits back to customers over time through the Tax Change Rider instead of through rates comes at the cost of customers not receiving the benefit of the tax gross up on the EDIT amortization?
>
> <u>KGS Response</u>: Yes, it is the company's position that if the EDIT amortization were to be treated as a reduction in rates in this case, instead of handled through the future application of the Tax Change Rider, that the EDIT amortization would be grossed up for income taxes prior to being removed from the revenue requirement.
>
> No, the company's proposal to flow the EDIT benefits back to customers overtime through the Tax Change Rider instead of through rates does not come at the cost of customers not receiving the benefit of the tax gross up on the EDIT amortization. The customers arrive at the same economic position under either method. By reducing revenues for the EDIT Amortization and an associated tax gross up yields an income tax expense

benefit in the same amount as the tax gross up that offsets the revenue reduction. See an example below showing the net effect of including the gross up. The following example includes an assumed $4 million EDIT Amortization and an associated $1.4 million tax gross up of the EDIT Amortization. All numbers used in the example are for illustrative purposes only.

	Pre- EDIT	EDIT Adjustments	After EDIT Adjustments
Net revenues	$ 100.0	(5.4)	$ 94.6
O&M expense	50.0		50
Depreciation and amortization	20.0		20
Operating income	30.0	(5.4)	24.6
Interest cost	10.0		10
Pre-tax income	20.0	(5.4)	14.6
Income Taxes (26.53%)	5.3	(1.4)	3.9
EDIT Amortization		(4.0)	(4.0)
Net Income	$ 14.7	-	$ 14.7

As the illustration shows, the customer ends up in the same net position, of only a $4 million net credit flowing back to the customer through its rates because the rates would incorporate both the $5.4 million reduction in revenues and an offsetting $1.4 million lower tax expense yielding the same net income for the Company.

Prepared by: Jeff Husen

The response to this DR demonstrates the logical flaw inherent in KGS's position on this issue. While KGS's numerical example shows revenues declining by $5.4 million in the illustrative example (arrived at my multiplying the $4 million in EDIT amortization by 1.361 as discussed in my testimony above), the response then goes on to state that customers will only get a "net" credit of $4 million through rates because of "an offsetting $1.4 million lower tax expense", which yields the same net income for the Company. KGS arrives at its conclusion by improperly conflating the impact of the EDIT amortization in this rate case with the post rate case impact of its ongoing tax obligation. The error here is clear. It is the lower $1.4 million in income tax expense that KGS will experience going forward (all other things being equal) which allows the lower revenue requirement for EDIT amortization in this case totaling $5.4 million. In other words, the $1.4 million in lower tax expense is an ongoing tax benefit that KGS receives *after* giving customers back $5.4 million in EDIT amortization in the current rate case.

What this example confirms is that KGS will receive a $1.4 million income tax benefit in the form of "lower tax expense" each year after rates are set. That benefit goes to KGS at that point, which is why both Staff and KGS's revenue requirement calculation models would gross up the impact of EDIT amortization. Customers appropriately receive the impact of that ongoing lower tax expense by virtue of the tax-gross up mechanics of the revenue requirement calculation. In summary, under Staff's approach KGS will give back exactly $4 million of EDIT, because after giving back $5.4 million in rate revenue, it receives a $1.4 million ongoing income tax reduction. The net result is that KGS gives back $4 million in EDIT, no more, no less. Under KGS's approach, KGS is attempting to retain the $1.4 million in lower tax expense benefit.

F. Rebuttal of "No Tax Benefits for EDIT Refunds"

Q. How do you respond to the contention that the refund of EDIT as a bill credit through the TCR doesn't result in a reduction of future revenues that generates a tax benefit?

A. In an attempt to understand KGS's position on this issue, Staff issued Data Request No. 290. While the response to this discovery response is attached to my testimony, I will not recreate it in full here. Essentially, the Company's position is that as long as the EDIT credit is accomplished through the TCR and not through base rates, the Company would be able to claim that this refund is similar to a debt repayment, which has no income tax benefits. What is less clear is why the Company would even want to consider this approach when the result is the loss of the tax benefits of the EDIT amortization for customers.

Other than this discovery response, the Company has not provided any authoritative guidance from the IRS, GAAP, or other regulatory authority that supports their notion. Moreover, I am not aware of any regulatory proceeding in the country that has ruled that the refunding of EDIT to customers does not result in a tax benefit for customers (and the Company). In the recently filed Westar and Kansas City Power and Light Company rate cases[25] the amortization of EDIT was grossed up for income taxes by every witness that filed a revenue requirement position in those Dockets.

It is worth noting that while the Company has expressed the position in this Docket that refunding the EDIT amortization to customers through the TCR would not result in a reduction of future revenues that generated a tax reduction for the Company, ONE Gas has recorded the tax-gross up of the EDIT Regulatory Liability on its corporate books, as confirmed in response to Staff Data Request Nos. 288 and 289.

G. Staff's Recommended Deferral Accounting Mechanism for EDIT

Q. Given Staff's recommendation to reflect the estimated amortization of EDIT as a reduction to the base rates in this Docket, is Staff recommending any regulatory accounting mechanisms to address the issue of future revisions to this estimated EDIT amortization?

A. Yes. Staff recognizes that the EDIT amount recorded on KGS's books may change once final ONE Gas Tax Returns for the year 2017 are filed in late 2018. Additionally, Staff understands that the 2018 EDIT amortization amount can change with the filing of the 2018 ONE Gas Tax Return in late 2019. In order to account for this variability and ensure that over time KGS gives back no more or no less than the actual EDIT on its books in a fashion

[25] Docket Nos. 18-WSEE-328-RTS and 18-KCPE-480-RTS.

that does not result in a tax normalization violation, Staff recommends that KGS be required to establish a regulatory asset/liability account. This account will track the difference between the EDIT amortization included in rates in this proceeding and the actual EDIT amortization recorded to KGS's financial books in future years. These amounts should be trued-up as any corrections or changes are made in future years when the corresponding financial years' tax returns are filed by ONE Gas. The accumulated balance in this regulatory asset or liability will then be amortized over the current (at the time of a future rate case) ARAM schedule in a future rate case, to prevent an IRS tax normalization violation. This regulatory accounting mechanism will ensure that KGS gives back only the proper amount of EDIT amortization, that KGS avoids a tax normalization violation, and that KGS customers don't lose the value of the tax benefit of the EDIT amortization, like KGS believes would be the case if the TCR mechanism were used instead.

V. Disposition of Tax Savings Regulatory Liability

A. Background/Overview

Q. Please discuss Staff's recommendation for the disposition of the Regulatory Liability KGS is recording due to the Settlement Agreement in the 18-248 Docket.

A. Staff recommends that KGS be required to issue a bill credit to KGS customers in the amount of $17,925,813, in the fashion recommended by Staff witness Robert Glass. This credit represents the annual regulatory liability of $14,126,503 from Appendix 1 of the KGS Settlement Agreement in Docket No. 18-GIMX-248-GIV, as adjusted to reflect the addition of interest expense at the annual rate of 1.62%[26] compounded monthly. This calculation also reflects monthly deferred revenue accruals through December 31, 2018, for the Gas Safety Reliability Surcharge (GSRS)[27] and through February 28, 2019, for base rates.

B. KGS's Position on the Disposition of this Regulatory Liability

Q. What is KGS's recommendation for the disposition of this Regulatory Liability?

A. KGS's position is that customers should only receive a bill credit for the tax savings accumulated in the 18-248 Docket Regulatory Liability in the event that the Commission finds that KGS's rates in this proceeding should be reduced from their current level. This position is discussed on pages 26 through 29 of the Direct Testimony of KGS witness Janet Buchanan. Essentially KGS's view is that because it has demonstrated through this filing that it was experiencing a revenue deficiency as of December 31, 2017, when the tax rate change took place, that it has experienced offsetting cost increases that have more than offset the reduction in federal income tax that the occurred with the passage of the TCJA. On page 28 of her Direct Testimony, Ms. Buchanan refers to a passage in the Commission's Order in the 18-248 Docket that she suggests supports KGS's position in this Docket. The passage is as follows:

> Any affected utility that believes other components of their cost of service have more than offset the decrease in its income tax expenses will have the ability to file such information and supporting data with the Commission, to be considered on a case-by-case basis. The Commission's intention here is not to materially impact regulated utilities' profitability, but rather, ensure that the affected utilities are neither positively nor negatively impacted by the passage of federal income tax reform.

[26] 1.62% is the annual interest rate paid to utility customers for customer deposits held by the utility during the calendar year 2018.

[27] KGS has a GSRS filing pending before the Commission currently in Docket No. 19-KGSG-088-TAR. This filing will reset the current GSRS charge to reflect the lower tax rate before the end of the calendar year 2018.

Mr. Buchanan relies on this passage of the Commission's Order to conclude "[T]he Commission clearly states that a utility will be afforded an opportunity to show it has experienced increases in its cost of service that offset the decrease in income tax expense."

C. Staff's Response to KGS's Position on the Regulatory Liability

Q. How do you respond to KGS's position on the proper disposition of the Regulatory Liability related to the tax savings generated by the TCJA?

A. Staff disagrees that KGS should be allowed to write-off the Regulatory Liability without giving a rate credit to KGS customers for the amount that has been recorded to the Regulatory Liability. The fact that KGS has experienced offsetting cost increases in its cost of service should be a factor that contributes to the setting of KGS's base rates, as the Commission will do in this Docket. But it should not influence whether KGS is required to pass the deferred benefits of tax reform that have accrued between January 1, 2018, and February 28, 2019, onto Kansas customers. The amount of tax savings that have accumulated into the Regulatory Liability should be treated like other extraordinary cost changes that are afforded deferred accounting treatment, that is, they should be evaluated in isolation of all other cost of service items and passed through to rates. This has been Staff's view since the original Report and Recommendation (R&R) was filed on December 13, 2017. This is evident by examining the last paragraph on page four, continuing through the first two paragraphs of page five, of Staff's R&R which state as follows:

> Although the Commission generally examines a utility's revenue requirement from its overall cost of service, this situation warrants a different approach as a significant reduction in income tax expense should not become a windfall for utilities but should rather be captured and flowed back to ratepayers. Just as the Commission has allowed ratemaking for single issues without the examination of other components of cost of service

> in certain extraordinary circumstances, such as the costs of fuel, energy efficiency expenses, environmental expenditures, cyber security expenditures, etc., Staff contends that this circumstance calls for a mechanism to isolate the financial impact of the lower corporate tax rates in order to preserve these lower cost of service benefits for ratepayers.
>
> However, in the event that a utility believes that other costs of service have more than offset the decrease in its income tax expenses, it will have the ability to file such information and supporting data with the Commission to be reviewed and evaluated on a case-by-case basis.
>
> The intent behind the use of this deferred accounting mechanism is to ensure that a utility is neither positively nor negatively affected by the passage of federal income tax reform. As income taxes are simply a pass-through in the cost of service for regulated utilities, a sudden and dramatic reduction in the level of this expense should not inure to the benefit of shareholders. Because the revenue that would be deferred as a result of Staff's recommendation will also be accompanied by an offsetting reduction to income tax expense, the utility's profitability levels should not be materially impacted as a result of the deferral accounting Staff recommends.

Q. What other considerations should the Commission consider when deciding to credit 100% of the deferred tax benefits to KGS ratepayers?

A. There are several reasons why Staff contends this is the right decision. First, the only way to ensure that the deferred tax savings do not inure to the benefit of KGS's shareholders is to credit all of the tax benefits to KGS customers. Otherwise, when KGS's tax liability dramatically declined on January 1, 2018, the benefit of that reduction in income tax expense would flow directly to KGS's shareholders. Whether the result was that KGS would be earning more or less than its authorized return, it is irrefutable that the result of allowing KGS to keep the deferred tax savings would be an increase in KGS's profitability starting on January 1, 2018. That would be directly contrary to the Commission's stated purpose behind issuing the AAO, as quoted above by Ms. Buchanan. The Commission stated in that referenced passage in the Order: "The Commission's intention here is not to materially impact regulated utilities' profitability, but rather, ensure that the affected utilities are neither positively nor negatively impacted by the passage of federal income tax reform." Because KGS's income tax expense went down on January 1, 2018, if 100% of the deferred tax savings are given to customers in the form of a bill credit, the result is that KGS will not be positively or negatively impacted by the passage of federal income tax reform, just as the Commission intended.

Another consideration that should influence the Commission is all of the ways in which KGS shareholders are already insulated from the risks associated with extraordinary or material changes to expenses or revenues that are outside of KGS's control. As a regulated utility, KGS is protected from many of the risks and potential perils of a business that faces unregulated competition. Customers are often asked to make KGS whole when circumstances arise that result in a significant negative financial event for KGS, especially if that event is outside of the control of KGS and results in a material or extraordinary expense. In these circumstances the Commission often utilizes deferral accounting mechanisms (a regulatory asset or regulatory liability) to capture the financial effect of the event and transfer that financial effect to ratepayers in a future rate case. Examples include the Cyber Security Tracker KGS has requested in this Docket, the Pension Tracker, the Cost of Gas Rider (COGR), the Bad Debt Expense component of the COGR, and the deferral mechanism established in the 17-455 Docket to account for and capture environmental expenditures associated with manufactured gas plant sites owned by KGS predecessor companies. In effect, each of these deferral accounting mechanisms utilize single-issue ratemaking to isolate the expenses in question, insulate KGS from the financial effects of the event, and transfer the financial effects of the event to ratepayers in some future forum. Staff is requesting that the Commission treat the positive financial impact of the TCJA in the same fashion, that is, the full impact of this event should be isolated and captured in a regulatory liability on a single-issue basis and that regulatory liability should be given back to customers without any offsets or mitigating factors.

VI. Depreciation Tracker

A. Background/Introduction

Q. Please discuss the Depreciation Tracker that KGS has requested.

A. KGS witness Mr. Dick Rohlfs discusses KGS's proposed Depreciation Tracker beginning on page 19 of his Direct Testimony. Mr. Rohlfs testimony contains a high level and generalized discussion about the perils of regulatory lag, which Mr. Rohlfs describes generally as the time between the period when costs for a utility change and the point in time when the Commission recognizes the cost changes either by raising or lowering rates. Mr. Rohlfs opines that because rates are established based on expenses and rate base that are "stale", a utility will not be able to earn its authorized return. He then goes on to state that KGS is proposing a Depreciation Tracker to address this issue.

B. KGS Support for Depreciation Tracker

Q. What support does KGS provide for the need for this Depreciation Tracker?

A. On page 20 of Mr. Rohlfs testimony, he includes a table that shows the impact of regulatory lag on KGS associated with capital investment and depreciation expense from the time frame 2015 through 2018. After directing detailed questions about this table to KGS witness Mr. Mark Smith, Mr. Rohlfs then attempts to use the table to support KGS's proposed Depreciation Tracker. The referenced table is recreated here for convenience:

Impact of Regulatory Lag					
	Unrecovered Dollars Associated with Return on Capital Investment	Unrecovered Dollars Associated with Depreciation	GSRS Recovery	Unrecovered Dollars	ROE Basis Points Lost
2015	$9,570,218	$5,996,562	($5,209,371)	$10,357,410	209.11
2016	$14,618,922	$7,209,301	($6,839,706)	$14,988,517	270.05
2017	$5,192,846	$1,516,989	($241,667)	$6,468,168	110.13
2018*	$9,741,881	$3,342,541	($2,900,000)	$10,184,422	178.92

* Estimate

In the next two pages that follow this table in Mr. Rohlfs testimony, he explains the following:

- KGS has faced a financial burden over the last several years due to regulatory lag. Over this time period, 40% of this regulatory lag has been due to depreciation expense (*Rohlfs Direct, page 20*);
- The level of depreciation expense in KGS's base rates doesn't keep up with the actual level of depreciation expense it incurs because new investment is more expensive than the original plant that is being replaced, an issue which is exacerbated by the Commission lowering depreciation rates in favor of lower consumer rates in the short-term (*Rohlfs Direct, pages 20-21*);
- As KGS continues to invest in annual capital expenditures at rates in excess of its annualized depreciation to meet the infrastructure replacement requirements set by the Commission, federal regulatory requirements and to extend service to new locations, the Company's depreciation expense will continue to grow. KGS proposes a tracker to address this issue (*Rohlfs Direct, page 21);*

- KGS's proposed Depreciation Tracker is similar to the Ad Valorem Tracker and Pension Tracker that the Commission has approved for utilities, after finding them an appropriate balance of the interests of the customers and the utility. These trackers, and the Depreciation Tracker, ensure that customers will pay no more than the reasonable and prudent costs incurred by KGS, and the Company is able to recover reasonable and prudent costs in a timely manner (*Rohlfs Direct*, page 21); and
- The Depreciation Tracker would compare actual depreciation expense incurred by KGS (and allocated to KGS by ONE Gas) every year to the level of depreciation expense included in base rates and the GSRS charge. Each year the difference would be put into a regulatory asset/liability account with the difference being amortized over three years in the next base rate filing without a deferred return or rate base treatment (*Rohlfs Direct, page 22*).

C. Staff's Response to KGS's Proposed Depreciation Tracker

Q. What is Staff's Position with Regard to KGS's Proposed Depreciation Tracker?

A. Staff recommends that the Commission deny KGS's proposed Depreciation Tracker. Simply put, the passage of Senate Bill 279, which revised the GSRS statutes K.S.A 66-2202 through K.S.A 66-2204, renders KGS's proposed Depreciation Tracker unnecessary and inappropriate.[28] These revisions to the GSRS statutes take effect on January 1, 2019, and will substantially improve KGS's ability to recover increases in its revenue

[28] See Exhibit JTG-3 for the full text of enrolled version of SB 279.

requirement (including increases in depreciation expense) associated with capital investments it will be making in the future.

D. Relevant Changes to the GSRS

Q. What are the changes to the GSRS statutes that have rendered the Depreciation Tracker unnecessary and inappropriate?

A. SB 279 made the following substantial revisions to the GSRS statutes:

- The definition of eligible capital investments was substantially broadened and revised from the original GSRS statutes. Originally, the GSRS only allowed rate recovery of infrastructure system replacements that were required by State or Federal safety requirements, or government relocation requirements. The revised list of eligible capital investments no longer contains the restriction that the capital investment be required by state or federal safety regulations. Now, as long as the capital investment is installed to replace, upgrade, or modernize obsolete facilities, it qualifies. Additionally, investments for system security costs and safety and risk management costs are eligible for inclusion in the surcharge.
- The limitations on the amount of the surcharge that can be billed to residential customers and the limitations on the total amount of revenue that can be recovered under the GSRS both doubled from the previous level. The revisions allow KGS to recover an increase of up to $.80 per month per residential customer on an annual basis after review and approval by the Commission. In total KGS can now recover up to 20% of its base revenue levels in the GRSR charge between rate cases, which must occur every five years if not extended to six years on approval of the Commission.

E. Implications of Changes to the GSRS

Q. What are the practical ramifications of these changes to the GSRS, as authorized by SB 279?

A. These changes to the GSRS mean that KGS will be able to include more capital expenditures in the GSRS annual cost recovery mechanism, than KGS's current projected annual increases in net plant during the next five years. Essentially, if KGS's projected capital expenditures are accurate, then KGS's annual GSRS recoveries will more than compensate it for any increases in net plant during this period. This renders any notion of an alternative ratemaking mechanism over and above the revised GSRS completely unnecessary.

F. Support for Staff's Contentions About Future GSRS Recovery

Q. What support exists for the contention that KGS will be able to recover more capital expenditures through the revised GSRS change than net plant is expected to increase during the next five years?

A. This contention is supported by the data underlying the table presented on page 20 of Mr. Rohlfs testimony, updated to reflect the impact of Staff's proposed depreciation rates in this Docket. Additionally, Staff has calculated the amount of capital expenditures available for recovery under the revised GSRS by utilizing KGS's revenue requirement calculations filed in support of KGS's most recent GSRS filing, in Docket No. 19-KGSG-088-TAR (19-088 Docket). Lastly, in response to Staff Data Request No. 252, KGS confirmed the level of its expected capital expenditures that would qualify for inclusion in the revised GSRS.

Q. Please discuss in more detail what Staff discovered when evaluating the data that underlies the table presented on page 20 of Mr. Rohlfs testimony?

A. In response to Staff Data Request No. 251, KGS provided an excel spreadsheet which provides all of the supporting data and calculations behind the table on page 20 of Mr. Rohlfs testimony. This spreadsheet calculates the change in net plant (as a proxy for rate base) and depreciation expense over time, as compared to the level of rate recovery that KGS is allowed for these two components of the revenue requirement. For example, in 2018, KGS expects to incur total capital expenditures (including costs of removal and allocated corporate capital expenditures) of $120.29 million. However, $53.5 million of that growth in gross plant is financed by depreciation expense and changes in deferred taxes, resulting in a net plant increase of approximately $66.78 million. What this example shows is that KGS has to spend $53.5 million in capital expenditures each year just to keep rate base from declining. This $53.5 million figure will grow by approximately $10.2 million if Staff's depreciation rates are approved.[29] In other words, if we assume that Staff's recommended depreciation rates will be approved in this Docket, then KGS will have to spend almost $64 million a year just to keep rate base from declining. Assuming KGS's capital expenditures over the next five years will remain similar to 2018 (which is a reasonable assumption given the response to Staff Data Request No. 35), then KGS's net rate base is only expected to grow by approximately $56.5 million annually.[30]

[29] Staff witness Roxie McCullar's Direct Testimony shows that Staff's recommended depreciation rates result in an increase of $10.2 million over KGS's current annual depreciation accrual.

[30] $120.29 million in capital expenditures less $63.7 million in annual depreciation expense and deferred taxes equals $56.5 million.

Q. Given the revisions to the GSRS statutes with the passage of SB 279, what level of capital expenditures will KGS be able to recover annually through the GSRS?

A. Using the calculations that KGS filed in support of its recently-requested GSRS filing in the 19-088 Docket, Staff determined that KGS would be able to recover approximately $66.3 million in new capital expenditures annually through the GSRS charge before the $.80 per residential customer cap began to limit KGS's recovery.[31] Above that level of capital expenditures, KGS would be able to recover 29.2% of its revenue requirement from the non-residential customer classes.

Q. Why would KGS be allowed to recover $66.3 million in new capital expenditures through the GSRS filing annually, if its rate base is only expected to increase by $56.5 million annually?

A. The restrictions of the GSRS statutes do not permit the Commission to evaluate KGS's capital expenditures in terms of how much its overall net plant is increasing. The GSRS statutes require the Commission to set the GSRS charge based only on the incremental capital expenditures that qualify for GSRS inclusion as specified in the statutes. In other words, the GSRS statutes don't take into account that KGS must spend $64 million just to keep rate base from declining. In an extreme example, if KGS only spends $64 million next year and that $64 million qualifies for inclusion in the GSRS, then the Commission will be required to turn that $64 million into a revenue requirement for KGS shareholders, despite the fact that rate base will have not increased at all. More realistically, if KGS spends the same $120 million next year (as it is on track to do in 2018), then its rate base will only increase by $56 million, because $64 million of that capital expenditure will have

[31] See Staff Exhibit JTG-4 for support behind the $66.3 million figure.

been financed by depreciation expense and deferred taxes. However, when KGS files its GSRS filing, the Commission will be required to increase KGS's rates to recover up to $66.3 million in capital expenditures.

Q. Does KGS forecast more than $66.3 million in GSRS-eligible capital expenditures for the next several years?

A. Yes. In response to Staff Data Request No. 252, KGS projects more than $66.3 million in GSRS-eligible capital expenditures each year from 2019 through 2022. This means that KGS will have many opportunities to file new GSRS charges before the Commission, whether its actual rate base has increased by the level of GSRS-eligible capital or not.

Q. Please summarize why the Commission should deny KGS's requested Depreciation Tracker?

A. The above examples illustrate why KGS does not need another extraordinary ratemaking mechanism to track the recovery of capital expenditure related costs at this time. KGS's Depreciation Tracker doesn't recognize the reality of the newly expanded GSRS statutes and the enhanced abilities that KGS will have to recover increased capital expenditures in a timely manner, whether its overall rate base position justifies that recovery or not. Simply put, KGS has isolated one area of potential under-recovery (annual depreciation expense) in the future and is asking the Commission to capture and make KGS whole for that under-recovery, while ignoring the likelihood of over-recovery (from a "return on" increases in net plant which exceeds the actual increase in overall rate base) that will occur in the future as KGS begins to utilize the newly revised GSRS process.

VII. Cyber Security Tracker

A. Background/Introduction

Q. Please discuss KGS's request for a Cyber Security Tracker?

A. KGS has requested that the Commission authorize it to establish a Cyber Security Tracker in this Docket. Essentially, KGS is requesting that the Commission allow KGS to defer to a regulatory asset or liability account changes in cyber security costs from a base line set established in this Docket.

B. KGS's Position on the Cyber Security Tracker

Q. What support does KGS provide for this request?

A. KGS's request for a Cyber Security Tracker can be found in the Direct Testimony of Lorna M. Eaton, beginning on page 27. Ms. Eaton describes that cyber security is an area of utmost importance to ONE Gas and KGS and that the costs of cyber security have been increasing. Ms. Eaton states that the cost of cyber security costs at ONE Gas in 2015 was $908,241 and, that by 2017, that level had grown to $2,340,656.[32] Ms. Eaton states that KGS does not know what the level of costs may be in the future, but it expects those costs will continue to increase. KGS is requesting that the baseline for the level of cyber security costs be established at the adjusted KGS level from the test year, or $763,430.

[32] Because these costs are at the ONE Gas level, they must be allocated to KGS using the Distrigas ratio discussed in Staff witness Katie Figgs' testimony.

C. Staff's Position on the Cyber Security Tracker

Q. What is Staff's response to KGS's proposed Cyber Security Tracker?

A. Staff supports a Cyber Security Tracker for KGS but with certain modifications. Staff has recently supported Cyber Security Trackers for Westar and KCP&L, both of which received Commission approval. Staff supports a tracker for these costs because they meet the conditions that the Commission usually evaluates when determining whether a cost category should be eligible for tracking through an extraordinary ratemaking mechanism. These criteria are as follows: whether the expenses are largely outside of management control; whether they are variable, unpredictable, or expected to increase measurably in the future; and whether they are material and recurring.

Q. What modifications does Staff recommend to KGS's Cyber Security Tracker?

A. Staff contends that the Commission should place some restrictions on the types of costs that are allowed to be recorded to the Cyber Security Tracker. This is largely to ensure that KGS doesn't record costs to a regulatory asset that it is already being compensated for in the base rate process. In this case, the cyber security costs that KGS should be allowed to include in the Cyber Security Tracker should be non-labor operating and maintenance (O&M) costs that are definitively associated with cyber security measures taken by ONE Gas or KGS to protect the Company's infrastructure, its data, or customers' data. Additionally, all of the costs that are recorded to the Cyber Security Tracker should be supported by an outside vendor invoice. This ensures that Staff and interveners in future rate cases will be able to verify that the costs included in the Cyber Security Tracker are appropriately included in the regulatory asset or liability account and that the costs were reasonable and prudently incurred. Lastly, the Cyber Security Tracker should have an automatic sunset provision that expires five years from the date of the Commission's Order in this Docket.

Q. Why is Staff recommending that only non-labor O&M costs be included in the Cyber Security Tracker?

A. Staff has a long history of recommending the exclusion of labor related costs from extraordinary ratemaking mechanisms like surcharges or trackers. This is because labor expenses are already the subject of intense normalization adjustments in base rate proceedings. Additionally, labor is literally a component of every FERC account that utility companies manage. As a result, it is simply too difficult to audit whether or not labor expenses are truly associated with cyber security and whether or not that change in internal labor is offset by other labor related savings in the business.

Q. Why is Staff recommending a sunset provision apply to the Cyber Security Tracker?

A. It is simply good ratemaking policy to periodically examine the necessity of an extraordinary ratemaking mechanism. A sunset provision puts the burden for this reasonableness review where it should be, back on the utility after a reasonable time frame.

VIII. Conclusion

Q. Please summarize your recommendations in this Docket.

A. My recommendations in this Docket are as follows:

- KGS has reflected the impact of the Tax Cuts and Jobs Act (TCJA) on its requested revenue requirement in this rate case. While KGS did not include the effect of the amortization of Excess Deferred Income Taxes (EDIT) on the requested revenue requirement (KGS instead requests to pass these benefits back to customers outside of base rates through its Tax Change Rider (TCR) proposal), KGS did recalculate current and deferred income tax expense in its rate case schedules to account for the lowering of the corporate income tax rate to 21%, from 35% prior to the implementation of the TCJA. The impact of this change to current and deferred income tax expense (exclusive of any EDIT amortization) was a reduction to the revenue requirement of $19,892,130. In other words, absent the adjustments that KGS made in its revenue requirement schedules to reflect the new lower corporate tax rate, KGS's requested revenue requirement would have been for increase in revenues of $65,458,593, instead of the $45,566,463 that its Application is based on.

- As noted above, KGS did not include the impact of the amortization of EDIT in its revenue requirement calculation. Instead, KGS requests the Commission approve a TCR to flow back the benefit of EDIT amortization to customers over time outside of the base rate process. However, this treatment does not capture the full benefit of the EDIT amortization because KGS's proposal is to pass back only the EDIT amortization and not the tax benefits that will accrue to KGS as a result of the EDIT amortization. This tax benefit is captured if the EDIT amortization occurs as a reduction to income tax expense in Staff's revenue requirement schedules which is why Staff recommends the Commission deny KGS's request and instead include an estimated EDIT amortization amount in KGS's base rates. Staff further recommends that any differences between actual EDIT amortization on KGS's books (as determined when ONE Gas files its future tax returns) and the EDIT amortization included in rates in this Docket, be accumulated in a regulatory asset or liability account that can then be addressed in a future rate case.

- Staff's recommendation that EDIT amortization be included in base rates in this proceeding results in a reduction of $3,118,506 from Staff's revenue requirement in this Docket. This results from using updated estimates of the amount of EDIT amortization for the year 2018 as contained in the response to Staff Data Request No. 222, as adjusted to reflect the removal of EDIT that relates to incentive compensation expense that Staff is recommending be removed from KGS's revenue requirement. This level of EDIT amortization relies on the same amortization periods as the Company requested for both protected and unprotected EDIT. In this Docket, KGS has requested that both protected and unprotected EDIT be amortized over the average remaining life of the KGS's assets using a calculation methodology known as the Average Rate Assumption Method (ARAM). While normally Staff would only recommend the amortization of plant-related EDIT over this time frame, in this case, for the reasons discussed in detail below, Staff agrees with the proposal to amortize all KGS EDIT using ARAM.
- The full impact of the TCJA on Staff's recommended revenue requirement calculation results in a reduction to the revenue requirement of $19,755,872. Stated differently, but for the implementation of the TCJA, Staff's revenue requirement recommendation would be higher by $19.755 million in this proceeding.
- In addition to the ongoing reduction to the revenue requirement identified above, Staff recommends that KGS be required to provide a bill credit to Kansas customers in the amount of $17,925,813, which should be distributed to customers in the

fashion that Staff witness Dr. Robert Glass recommends in his Direct Testimony. This credit represents the annual regulatory liability of $14,126,503 from Appendix 1 of the KGS Settlement Agreement in Docket No. 18-GIMX-248-GIV, as adjusted to reflect the addition of interest expense at the annual rate of 1.62% compounded monthly. This calculation also reflects monthly deferred revenue accruals through December 31, 2018, for the Gas Safety Reliability Surcharge (GSRS) and through February 28, 2019, for base rates.

- Staff's recommendation that KGS be required to provide customers a bill credit, representing the amount of deferred revenue in the regulatory liability resulting from the TCJA, is necessary in order to ensure that the benefit of this significant reduction in corporate income tax expense does not result in a windfall for KGS's shareholders. Instead, KGS's ratepayers should receive the benefits of this significant financial event in total, without consideration of other offsetting costs. This treatment is no different than several other instances where KGS is able to utilize deferral accounting to isolate, on a single-issue basis, the negative financial impacts of events that are outside of its control. These deferrals are later recovered from ratepayers in a future rate case without consideration of other offsetting costs that may have occurred during the time of the original event. Examples include the Cyber Security Tracker KGS has requested in this Docket, the Pension Tracker, the Cost of Gas Rider (COGR), the Bad Debt Expense component of the COGR, and the deferral mechanism established in Docket No. 17-KGSG-455-ACT (17-455 Docket) to account for and capture environmental expenditures associated with manufactured gas plant sites owned by KGS predecessor companies. The

Commission should not resist to use deferral accounting to benefit ratepayers in this instance, as there are ample instances in which it is used to the benefit of shareholders.

- KGS's requested Depreciation Tracker should be denied by the Commission. There is simply no evidence in the record that supports the adoption of this extraordinary ratemaking mechanism for KGS at this time. With the recent adoption of Senate Bill No. 279, which amends the statutes requiring the Commission to authorize a GSRS charge, the regulatory lag that KGS claims it is suffering will either be non-existent or insignificant once this law takes effect on January 1, 2019.
- KGS should be allowed to implement a Cyber Security Tracker for the reasons that the Commission has authorized other public utilities operating in Kansas to utilize this deferred accounting mechanism to capture future costs associated with Cyber Security efforts so that they may be evaluated in a future rate case. However, there are several refinements that need to be made to the tracker proposal in order to ensure that only incremental costs that are directly related to KGS's future Cyber Security efforts are included in the Cyber Security Tracker going forward. Additionally, the Cyber Security Tracker should automatically sunset after five years so that the Commission can reevaluate the need for this extraordinary ratemaking mechanism in the future.

Q. Does that conclude your testimony?

A. Yes.

KGS Tax Reform Credit Calculation (With Interest)

Staff Exhibit JTG-1

Notes	Month	Monthly Deferral	# of Months of Interest	Monthly Interest	With Calculated Interest
	18-Jan	$2,068,579	14	0.135%	$ 2,108,020
	18-Feb	$1,633,329	13	0.135%	$ 1,662,227
	18-Mar	$1,500,615	12	0.135%	$ 1,525,106
	18-Apr	$866,237	11	0.135%	$ 879,188
	18-May	$804,053	10	0.135%	$ 814,974
	18-Jun	$792,995	9	0.135%	$ 802,682
	18-Jul	$791,338	8	0.135%	$ 799,925
	18-Aug	$783,029	7	0.135%	$ 790,459
	18-Sep	$773,309	6	0.135%	$ 779,594
	18-Oct	$854,265	5	0.135%	$ 860,047
	18-Nov	$1,433,920	4	0.135%	$ 1,441,679
	18-Dec	$1,824,833	3	0.135%	$ 1,832,234
*	19-Jan	$2,023,957	2	0.135%	$ 2,029,425
*	19-Feb	$1,598,096	1	0.135%	$ 1,600,253
Total W/o Interest		$17,748,555			
			Total W/Interest		$ 17,925,813

*--The January and February 2019 monthly deferral amounts are calculated exclusive of the GSRS liability deferral due to the new GSRS charge taking effect December 24, 2018, pursuant to Docket No. 19-KGSG-088-TAR. Therefore, these months reflect only the base rate deferral of $13,821,775 multiplied by the applicable January or February monthly apportionment percentage identified in the KGS Settlement Agreement in Docket No. 18-GIMX-248-GIV.

Line No.	Notes	Workpaper for Support of Amortization of EDIT			Staff Exhibit JTG-2
		Staff Adjusted KGS EDIT			
1	1	Protected EDIT	$	75,310,627	
2	2	Amortization Period (ARAM)		45.44	
3	Line 1/Line 2	Protected EDIT Amortization	$	1,657,527	
4	1	Unprotected EDIT	$	6,200,651	
5	2	Amortization Period (ARAM)		45.44	
6	Line 4/Line 5	Protected EDIT Amortization	$	136,471	
7	Line 3 + 6	Total KGS Direct EDIT Amortization	$	1,793,998	
		ONE Gas allocated EDIT			
8	3	Protected EDIT	$	4,008,377	
9	2	Amortization Period (ARAM)		7.95	
10	Line 8/Line9	Protected EDIT Amortization	$	504,253	
11	3	Unprotected EDIT	$	(231,961)	
12	2	Amortization Period (ARAM)		7.95	
13	Line11/Line 12	Protected EDIT Amortization	$	(29,181)	
14	Line 10+Line 13	Total KGS Direct EDIT Amortization	$	475,073	
	Line 7 + Line 14	Total EDIT Amortization	$	2,269,071	

1--Reflects Elimination of STI --See Staff Exhibit KALF-1A for support for Staff's Adjusted KGS EDIT
2--See Response to Staff DR No. 222
3--See Staff Exhibit TSR-4(a) for support for Staff's Adjusted ONE Gas allocated EDIT

SENATE BILL No. 279

AN ACT concerning utilities; relating to the gas safety reliability surcharge, definitions; amending K.S.A. 2017 Supp. 66-2202, 66-2203 and 66-2204 and repealing the existing sections.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 2017 Supp. 66-2202 is hereby amended to read as follows: 66-2202. For the purposes of this act:

(a) "GSRS" means gas system reliability surcharge;

(b) "appropriate pretax revenues" means the revenues necessary to produce net operating income equal to:

(1) The natural gas public utility's weighted cost of capital *last approved by the commission* multiplied by the net original cost of eligible infrastructure system ~~replacements~~ *investments*, including recognition of accumulated deferred income taxes ~~and~~, accumulated depreciation associated with eligible infrastructure system ~~replacements which~~ *investments that* are included in a currently effective GSRS;

(2) recover state, federal and local income or excise taxes applicable to such income;

(3) recover depreciation expenses;

(c) "commission" means the state corporation commission;

(d) "eligible infrastructure system ~~replacement~~ *investments*" means natural gas public utility plant projects that:

(1) Do not increase revenues by directly connecting the infrastructure ~~replacement~~ *investments* to new customers;

(2) are in service and used and required to be used; and

(3) were not included in the natural gas public utility's rate base in its most recent general rate case;

(e) "natural gas public utility" shall have the same meaning respectively ascribed thereto by ~~subsection (a) of~~ K.S.A. 66-1,200*(a)*, and amendments thereto;

(f) "natural gas utility plant projects" ~~may~~ consist ~~only~~ of the following:

(1) Mains, *meters,* valves, service lines, regulator stations, vaults and other pipeline system components installed to *replace, upgrade or modernize obsolete facilities, including, but not limited to, installation to* comply with state or federal safety requirements ~~as replacements for~~ *replacing* 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 *including, but not limited to, projects* undertaken to comply with state or federal safety requirements; ~~and~~

(3) facility relocations required due to construction or improvement of a highway, road, street, public way or other public work by or on behalf of the United States, this state, a political subdivision of this state or another entity having the power of eminent domain provided that the costs related to such projects have not been reimbursed to the natural gas public utility;

(4) system security costs including allocated corporate costs incurred by a natural gas public utility; and

(5) investments made in accordance with the utility's safety and risk management programs;

(g) "GSRS revenues" means revenues produced through a GSRS exclusive of revenues from all other rates and charges*;*

(h) "obsolete facility" means a facility: (1) Comprised of materials that are no longer produced or supported by the manufacturer; (2) that shows signs of physical deterioration; or (3) does not meet current safety codes or industry standards. "Obsolete facility" includes the cost-effective replacement of other facilities that are not considered obsolete when the replacement of such is done in conjunction with the replacement of an obsolete facility; and

(i) "system security" shall mean capital expenditures to protect a utility's capital assets, including both physical assets and cyber assets, such as networks, computers, servers, operating systems, storage, programs and data, from attack, damage or unauthorized use and access.

Sec. 2. K.S.A. 2017 Supp. 66-2203 is hereby amended to read as follows: 66-2203. (a) Notwithstanding any other provisions of chapter 66 of the Kansas Statutes Annotated, and amendments thereto, beginning July 1, 2006, a natural gas public utility providing gas service may file a petition and proposed rate schedules with the commission to establish or change GSRS rate schedules that will allow for the adjustment of the natural gas public utility's rates and charges to provide for the recovery of costs for eligible infrastructure system ~~replacements~~ *investments*. The commission may not approve a GSRS to the extent it would produce total annualized GSRS revenues below the lesser of $1,000,000 or ½% of the natural gas public utility's base revenue level approved by the commission in the natural gas public utility's most recent general rate proceeding. The commission may not approve a GSRS to the extent it would produce total annualized GSRS revenues exceeding ~~10%~~ *20%* of the natural gas public utility's base revenue level approved by the commission in the natural gas public utility's most recent general rate proceeding. A GSRS and any future changes thereto shall be calculated and implemented in accordance with the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto. GSRS revenues shall be subject to a refund based upon a finding and order of the commission to the extent provided in ~~subsections (c) and (h) of~~ K.S.A. 2017 Supp. 66-2204*(e) and (h)*, and amendments thereto.

(b) The commission shall not approve a GSRS for any natural gas public utility that has not had a general rate proceeding decided or dismissed by issuance of a commission order within the past 60 months, unless the natural gas public utility has filed for or is the subject of a new general rate proceeding.

(c) In no event shall a natural gas public utility collect a GSRS for a period exceeding 60 months unless the natural gas public utility has filed for or is the subject of a new general rate proceeding; except that the GSRS may be collected until the effective date of new rate schedules established as a result of the new general rate proceeding, or until the subject general rate proceeding is otherwise decided or dismissed by issuance of a commission order without new rates being established.

(d) Notwithstanding the 60-month filing deadlines in subsections (b) and (c), upon motion by a natural gas public utility, the commission may extend the 60-month deadline in subsections (b) and (c) for a period of up to 12 months as the commission determines reasonable or necessary.

Sec. 3. K.S.A. 2017 Supp. 66-2204 is hereby amended to read as follows: 66-2204. (a) At the time that a natural gas public utility files a petition with the commission seeking to establish or change a GSRS, it shall submit proposed GSRS rate schedules and its supporting documentation regarding the calculation of the proposed GSRS with the petition and shall serve commission staff and the citizens utility ratepayer board with a copy of its petition, its proposed rate schedules and its supporting documentation.

(b) (1) When a petition, along with any associated proposed rate schedules, is filed pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, the commission shall conduct an examination of the proposed GSRS;

(2) the staff of the commission shall examine information of the natural gas public utility to confirm that the underlying costs are in accordance with the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, and to confirm proper calculation of the proposed charge. The staff shall submit a report regarding its examination to the commission not later than 60 days after the petition is filed. No other revenue requirement or ratemaking issues may be examined in consideration of the petition or associated proposed rate schedules filed pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 and 66-2204, and amendments thereto;

(3) the commission may hold a hearing on the petition and any associated rate schedules and shall issue an order to become effective not later than 120 days after the petition is filed; and

(4) if the commission finds that a petition complies with the requirements of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, the commission shall enter an order authorizing the natural gas public utility to impose a GSRS that is sufficient to recover appropriate pretax revenue, as determined by the commission pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto.

(c) A natural gas utility may effectuate a change in its rate pursuant to the provisions of this section no more often than once every 12 months.

(d) In determining the appropriate pretax revenue, the commission shall consider only the following factors:

(1) The net original cost of eligible infrastructure system ~~replacements~~ *investments*. The net original cost shall be defined as the original cost of eligible infrastructure system ~~replacements~~ *investments* less associated retirements of existing infrastructure;

(2) the accumulated deferred income taxes associated with the eligible infrastructure system ~~replacements~~ *investments, as adjusted to comply with internal revenue service regulations*;

(3) the accumulated depreciation associated with the eligible infrastructure system ~~replacements~~ *investments*;

(4) the current state, federal and local income tax or excise rates;

(5) the natural gas public utility's actual regulatory capital structure as determined during the most recent general rate proceeding of the natural gas public utility;

(6) the actual cost rates for the natural gas public utility's debt and preferred stock as determined during the most recent general rate proceeding of the natural gas public utility;

(7) the natural gas public utility's cost of common equity as determined during the most recent general rate proceeding of the natural gas public utility;

(8) the current depreciation rates applicable to the eligible infrastructure system ~~replacements~~ *investments*; and

(9) in the event information pursuant to paragraphs (5), (6) and (7) are unavailable and the commission is not provided with such information on an agreed-upon basis, the commission shall utilize the average of the recommendations contained in the testimony submitted by the natural gas public utility and commission staff during the most recent general rate proceeding of the natural gas public utility to determine the capital structure, recommended cost rates for debt and preferred stock and recommended cost of common equity to determine the average weighted cost of capital.

(e) (1) The monthly GSRS charge shall be allocated among the natural gas public utility's classes of customers in the same manner as costs for the same type of facilities was allocated among classes of customers in the natural gas public utility's most recent general rate proceeding. If that allocation is not available or determinable, the commission shall utilize the average of the recommendations contained in the testimony submitted by the natural gas public utility and the commission staff regarding class allocation of costs. A GSRS shall be charged to customers as a monthly fixed charge and not based on volumetric consumption. Such monthly charge shall not increase more than ~~$.40~~ *$.80* per residential customer over the base rates in effect for the initial filing of a GSRS. Thereafter, each filing shall not increase the monthly charge more than ~~$.40~~ *$.80* per residential customer over the most recent filing of a GSRS;

(2) at the end of each twelve-month calendar period the GSRS is in effect, the natural gas public utility shall reconcile the differences between the revenues resulting from a GSRS and the appropriate pretax revenues as found by the commission for that period and shall submit the reconciliation and a proposed GSRS adjustment to the commission for approval to recover or refund the difference, as appropriate, through adjustments of the GSRS charge.

(f) (1) A natural gas public utility that has implemented a GSRS pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, shall file revised rate schedules to reset the GSRS to zero when new base rates and charges become effective for the natural gas public utility following a commission order establishing customer rates in a general rate proceeding that incorporates in the utility's base rates, subject to subsections (h) and (i), eligible costs previously reflected in the currently effective GSRS; *and*

(2) upon the inclusion in a natural gas public utility's base rates subject to subsections (h) and (i) of eligible costs previously reflected in a GSRS, the natural gas public utility shall immediately thereafter reconcile any previously unreconciled GSRS revenues as necessary to ensure that revenues resulting from the GSRS match as closely as possible the appropriate pretax revenues as found by the commission for that period.

(g) A natural gas public utility's filing of a petition or change to a GSRS pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, shall not be deemed to be a rate increase for purposes of K.S.A. 66-117, and amendments thereto.

(h) Commission approval of a petition, and any associated rate schedules, to establish or change a GSRS pursuant to the provisions of K.S.A. 2017 Supp. 66-2202 through 66-2204, and amendments thereto, shall in no way be binding upon the commission in determining the ratemaking treatment to be applied to eligible infrastructure system ~~replacements~~ *investments* during a subsequent general rate proceeding when the commission may undertake to review the reasonableness and prudence of such costs. In the event the commission disallows, during a subsequent general rate proceeding, recovery of costs associated with eligible infrastructure system ~~replacements~~ *investments* previously included in a GSRS, the natural gas public utility shall offset its GSRS in the future as necessary to recognize and account for any such over collections.

(i) Nothing in this section shall be construed as limiting the authority of the commission to review and consider *the costs of* infrastructure system ~~replacement costs~~ *investments*, along with other costs, during any general rate proceeding of any natural gas public utility.

Sec. 4. K.S.A. 2017 Supp. 66-2202, 66-2203 and 66-2204 are hereby repealed.

Sec. 5. This act shall take effect and be in force from and after January 1, 2019, and its publication in the statute book.

I hereby certify that the above BILL originated in the SENATE, and passed that body

____

____
President of the Senate.

____
Secretary of the Senate.

Passed the HOUSE ________________________

____
Speaker of the House.

____
Chief Clerk of the House.

APPROVED ______________________________

____
Governor.

Utilization of GSRS Calculation Schedules from Docket No. 19-KGSG-088-TAR to Determine Maximum Gross Plant Recovery

Exhibit JTG-4

(A)	(B)	(C)	(D)	(E)	(F)	
Summary	**New GSRS Safety & Govt. Relocation Projects**	**New GSRS Blanket Work Orders**	**Grand Total With Only New Projects**	**Source**	Extrapolated Total $.80 Charge	
Original Cost	$ 10,111,369	$ 19,018,551	$ 29,129,920		$ 66,332,454	Goal Seek to find $.80 per Residential Customer
Less: Accumulated Depreciation	$ (184,172)	$ (289,119)	$ (473,290.51)		$ (1,077,741)	Based on Ratio of New projects Accumulated Depreciation to Gross Plant
Net Plant in Service	$ 9,927,197	$ 18,729,432	$ 28,656,630		$ 65,254,713	Calculated
Less: Accumulated Deferred Income Taxes	$ (1,353,226)	$ (2,462,913)	$ (3,816,140)		$ (8,689,824.82)	Based on Ratio of New projects ADIT to Gross Plant
Net GSRS Rate Base	$ 8,573,971	$ 16,266,519	$ 24,840,490		$ 74,521,470	Calculated
Carrying Charge [1]	8.33%	8.33%	8.33%		8.33%	
Pre-Tax Required Return	$ 714,220	$ 1,355,017	$ 2,069,238		$ 6,207,713	Calculated
Depreciation Expense	$ 178,957	$ 545,171	$ 724,128		$ 1,648,930	Based on Ratio of New Projects Depreciation Expense to Gross Plant
GSRS Revenue Requirement (Annual)			$ 2,793,366		$ 7,856,643	
Plus (Minus): Over-Recovered Balance from Docket No. 18-KGSG-093-TAR			$ (4,419)			Not included
Revised GSRS Annualized Revenue Requirement			$ 2,788,947		$ 7,856,643	
				Monthly Increase	$ 0.80000	

(1) Carrying Charge of 9.74% gross of tax was established in Docket 16-KGSG-491-RTS. A change in the federal income tax rate lowers the rate of return to 8.33%.

Docket No. 18-KGSG-560-RTS

Staff Exhibits

Attached to Direct Testimony of Justin T. Grady

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

Data Request: 18-560 KCC-218: EDIT Amortization Gross Up
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/14/2018
Date Information Needed: 9/24/2018
Requested By: Justin Grady

Please provide the following:

Regarding the company's request to flow the EDIT amortization through the Tax Change Rider. Please confirm whether the company intends to gross up the EDIT amortization for income taxes in the calculation of the credit that flows through to customer bills. In addition, please confirm that the EDIT amortization would be grossed up for taxes if it was included as a rate reduction in this filing, as opposed to the request to utilize the Tax Change Rider.

KGS Response:

The Company does not intend to gross up the amortization of the regulatory liability because the regulatory liability is a refund obligation to customers and not considered a reduction of future revenues. If the regulatory liability were treated as a reduction of future revenues, ASC 980-740-25 would require the amortization of the regulatory liability to be grossed-up for the income tax effect of the increase or decrease in future revenues. Correspondingly, there would be an offsetting decrease to income tax expense that is collected from customers that would offset the tax gross up portion of the EDIT Amortization. Because the gross-up amortization of the regulatory liability would generate an offsetting tax benefit, recording a tax gross-up associated with the EDIT regulatory liability has no effect on the amount refunded to rate payers. Also, because the EDIT liability is a refund obligation and not a reduction of future revenues, the Company has not included either an associated gross up or the corresponding deferred tax asset in rate base. Rate base reflects only the remeasured deferred taxes using the current enacted federal tax rate and the related regulatory liability resulting from re-measurement.

Prepared by: Jeff Husen

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: ____________________

Date: 9/26/18

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

Data Request: 18-560 KCC-219: EDIT Amortization Support
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/14/2018
Date Information Needed: 9/24/2018
Requested By: Justin Grady

Please provide the following:

Please refer to Exhibit JJH-1, Page 2 of 2, which shows EDIT amortizations for KGS and Corporate EDIT. Staff is not able to replicate the EDIT amortization amounts listed in this exhibit using the ARAM percentages listed here and the amounts of the EDIT Regulatory Liability listed in JJH-1 and JJH-2. Please provide all supporting documentation, calculations, assumptions and work papers that support these EDIT amortization amounts.

KGS Response:

Please see file '18-560 KCC-219 EDIT Amortization Support Worksheet' for support of the ARAM percentages calculations.

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: ____________________

Date: 9/26/18

Kansas Gas Service
Detail of Regulatory Liability
31-Dec-17

DEFERRED TAX CATEGORY	REG LIAB/(ASSET) TOTAL	P	NP
Plant - Book vs. Tax Depreciation	112,901,306	112,901,306	-
Repairs	16,543,223	-	16,543,223
Pension	28,607,278	-	28,607,278
Accrued Expenses & Other			
Bad Debts	(308,000)	-	(308,000)
CIAC	(3,200,790)	-	(3,200,790)
Employee Benefits	5,914	-	5,914
Leasehold Improvements	(400,890)	-	(400,890)
Legal Reserve	-	-	-
PGA	4,188,595	-	4,188,595
Rate Case Expense	7,402	-	7,402
Reg Assets	2,665,496	-	2,665,496
STI	257,085	-	257,085
Workers Comp	(206,683)	-	(206,683)
TOTAL	**161,059,936**	**112,901,306**	**48,158,630**
ODC NOL	(45,258,124)	**(45,258,124)**	-
Federal Benefit of State (FBOS)	(11,274,195)		(11,274,195)
TOTAL REG LIAB W/ FBOS	**104,527,616**	**67,643,182**	**36,884,434**
ADJUSTMENT for FAS87/106, NOL ADJ, and COGR (PGA)	(22,832,716)	7,667,445	(30,500,162)
	81,694,900	75,310,627	6,384,272

Kansas Gas Service
Detail of Regulatory Liability
31-Dec-17

KGS					
	Amortization Period		**Amortization**		
	Protected (ARAM)	**Unprotected (ARAM)**	**Protected**	**Unprotected**	**Regulatory Liability net refund**
Year 1	2.85%	2.85%	2,144,906	181,829	2,326,735

Corporate ADIT Adjustment					
	Amortization Period		**Amortization**		
	Protected (ARAM)	**Unprotected (ARAM)**	**Protected**	**Unprotected**	**Regulatory Liability net refund**
Year 1	14.08%	14.08%	564,208	(130,223)	433,986

TOTAL					
	Amortization Period		**Amortization**		
	Protected (ARAM)	**Unprotected (ARAM)**	**Protected**	**Unprotected**	**Regulatory Liability net refund**
Year 1			2,709,114	51,607	2,760,721

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

Data Request: 18-560 KCC-222: Updated ARAM Support
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/14/2018
Date Information Needed: 9/24/2018
Requested By: Justin Grady

Please provide the following:

On Page 16 of Mr. Jeff Husen's testimony, he states on Line 15 the following: "The Company continues to refine these percentages and will update the amortization schedule with an ARAM percentage when new information becomes available. Updates to the ARAM percentages will occur as we estimate our 2018 tax accrual and will not be finalized until we file our 2018 tax return in 2019." Please provide any updated ARAM calculations or percentages, including any updated EDIT Regulatory Liability balances that the company has produced so far. Additionally, please provide a timeline of when the company expects the 2018 ARAM amortizations to be finalized.

KGS Response:

Please see the attached file '18-560 KCC-222 Worksheet' with our 2018 Estimate updated with our final 2017 information. As of September 27, 2018, the EDIT Regulatory Liability balances have not been updated. We expected the 2018 ARAM amortizations to be finalized on or about October 15, 2019.

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: ____________________

Date: 9/26/18

Kansas Gas Service
Detail of Regulatory Liability
31-Dec-17

DEFERRED TAX CATEGORY	REG LIAB/(ASSET) TOTAL	P
Plant - Book vs. Tax Depreciation	112,901,306	112,901,306
Repairs	16,543,223	-
Pension	28,607,278	-
Accrued Expenses & Other		
Bad Debts	(308,000)	-
CIAC	(3,200,790)	-
Employee Benefits	5,914	-
Leasehold Improvements	(400,890)	-
Legal Reserve	-	-
PGA	4,188,595	-
Rate Case Expense	7,402	-
Reg Assets	2,665,496	-
STI	257,085	-
Workers Comp	(206,683)	-
TOTAL	**161,059,936**	**112,901,306**
ODC NOL	(45,258,124)	**(45,258,124)**
Federal Benefit of State (FBOS)	(11,274,195)	
TOTAL REG LIAB W/ FBOS	**104,527,616**	**67,643,182**
ADJUSTMENT for FAS87/106, NOL ADJ, and COGR (PGA)	(22,832,716)	7,667,445
	81,694,900	75,310,627
ck from walkfwd + NOL tabs	-	
REG LIAB Per GL 254XXXX	149,785,740	
ODC NOL Reg Liab	45,258,124	(7,667,445)
ck to GL	(0)	

NP		Gross Up
-		40,768,635
16,543,223		5,973,754
28,607,278		10,330,081
		-
(308,000)		(111,219)
(3,200,790)		(1,155,805)
5,914		2,136
(400,890)		(144,761)
-		-
4,188,595		1,512,501
7,402		2,673
2,665,496		962,510
257,085		92,833
(206,683)		(74,633)
48,158,630		**58,158,705**
-		**(16,342,698)**
(11,274,195)		(4,071,109)
36,884,434		**37,744,898**
(30,500,162)		(8,244,888)
6,384,272		29,500,010
	Adjusted Bal	0
(30,500,162)	119,285,578	0
	37,590,679	-

	Amortiz
	Protected (ARAM)
Year 1	2.20%

	Amortiz
	Protected (ARAM)
Year 1	12.58%

	Amortiz
	Protected (ARAM)
Year 1	

ation Period	KGS Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
2.20%	1,488,771	537,595	811,796	293,139

ation Period	Corporate ADIT Adjustment Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
12.58%	504,253	182,086	(116,385)	(42,026)

ation Period	TOTAL Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
	1,993,025	719,681	695,412	251,113

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
3,131,302	(830,735)	2,300,568

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
527,928	(140,059)	387,869

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
3,659,231	(970,794)	2,688,437

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

Data Request: 18-560 KCC-222 Amended: Updated ARAM Support
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/14/2018
Date Information Needed: 9/24/2018
Requested By: Justin Grady

Please provide the following:

On Page 16 of Mr. Jeff Husen's testimony, he states on Line 15 the following: "The Company continues to refine these percentages and will update the amortization schedule with an ARAM percentage when new information becomes available. Updates to the ARAM percentages will occur as we estimate our 2018 tax accrual and will not be finalized until we file our 2018 tax return in 2019." Please provide any updated ARAM calculations or percentages, including any updated EDIT Regulatory Liability balances that the company has produced so far. Additionally, please provide a timeline of when the company expects the 2018 ARAM amortizations to be finalized.

KGS Response:

Please see, the attached file "18-560 KCC-222 Worksheet Amended" which corrects the ARAM calculation originally provided in response to 18-560 KCC-222. This amended response syncs up the ARAM calulcation to the as-adjusted ADIT in the case.

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: ____________________

Date: 10/18/18

Kansas Gas Service
Detail of Regulatory Liability
31-Dec-17

DEFERRED TAX CATEGORY	**REG LIAB/(ASSET) TOTAL**	**P**
Plant - Book vs. Tax Depreciation	112,901,306	112,901,306
Repairs	16,543,223	-
Pension	28,607,278	-
Accrued Expenses & Other		
Bad Debts	(308,000)	-
CIAC	(3,200,790)	-
Employee Benefits	5,914	-
Leasehold Improvements	(400,890)	-
Legal Reserve	-	-
PGA	4,188,595	-
Rate Case Expense	7,402	-
Reg Assets	2,665,496	-
STI	257,085	-
Workers Comp	(206,683)	-
RATE CASE ADJUSTMENTS WC 3,4,5,6,7,8	-	
TOTAL	**161,059,936**	**112,901,306**
ODC NOL	(45,258,124)	**(45,258,124)**
Federal Benefit of State (FBOS)	(11,274,195)	
TOTAL REG LIAB W/ FBOS	**104,527,616**	**67,643,182**
ADJUSTMENT for FAS87/106, NOL ADJ, and COGR (PGA)	(22,832,716)	7,667,445
	81,694,900	75,310,627
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ck to GL	(0)	

NP		Gross Up
-		40,768,635
16,543,223		5,973,754
28,607,278		10,330,081
		-
(308,000)		(111,219)
(3,200,790)		(1,155,805)
5,914		2,136
(400,890)		(144,761)
-		-
4,188,595		1,512,501
7,402		2,673
2,665,496		962,510
257,085		92,833
(206,683)		(74,633)
(22,832,716)		(8,244,888)
25,325,914		**49,913,817**
-		**(16,342,698)**
(11,274,195)		(4,071,109)
36,884,434		**37,744,898**
(30,500,162)		(8,244,888)
6,384,272		29,500,010
	Adjusted Bal	0
(30,500,162)	119,285,578	0
	37,590,679	-

	Amortiz
	Protected (ARAM)
Year 1	2.20%

	Amortiz
	Protected (ARAM)
Year 1	12.58%

	Amortiz
	Protected (ARAM)
Year 1	

ation Period	KGS Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
2.20%	1,657,526	598,532	140,513	50,739

ation Period	Corporate ADIT Adjustment Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
12.58%	504,253	182,086	(116,385)	(42,026)

ation Period	TOTAL Amortization			
Unprotected (ARAM)	Protected	Protected Gross Up	Unprotected	Unprotected Gross Up
	2,161,779	780,618	24,128	8,713

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
2,447,310	(649,271)	1,798,038

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
527,928	(140,059)	387,869

Financial Impact		
Total including Gross Up	Income Tax effect	Regulatory Liability net refund
2,975,238	(789,331)	2,185,907

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

Data Request: 18-560 KCC-288: Staff Data Request No. 218
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/27/2018
Date Information Needed: 10/8/2018
Requested By: Justin Grady

Please provide the following:

Please reconcile the company's response to Staff Data Request No. 218 (which states that the company does not plan on grossing up the Regulatory Liability associated with EDIT for the tax effect of the reduction in future revenue) with the support files provided in response to Staff Data Request Nos. 216 and 221, which provide entries for the tax gross up associated with the regulatory liability of $54,087,596 in Account 2540300.

KGS Response:

In the event the regulatory liability was treated as a reduction in future revenues, ASC 980-740-25 would require the regulatory liability to be grossed-up for the income tax effect of the increase or decrease in future years. To account for this contingency, the tax gross up was calculated and recorded on the corporate books for GAAP purposes.

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: ______________________

Date: 10/6/18

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

Data Request: 18-560 KCC-289: Tax Gross Up on EDIT Amortization
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/27/2018
Date Information Needed: 10/8/2018
Requested By: Justin Grady

Please provide the following:

Please provide support for the journal entries on the books of KGS and ONE Gas Inc. that were used to establish the regulatory liability associated with EDIT created when the Tax Cuts and Jobs Act became effective. Please state whether there was a regulatory liability recorded on the books of KGS and or ONE Gas Inc. attributable to the tax effect of the refund of EDIT recorded to any regulatory liability established associated with the implementation of the Tax Cuts and Jobs Act. If there was a regulatory liability established (associated with the tax gross up on the EDIT refund) please identify the amount and the account to which this amount was recorded.

KGS Response:

Please see, "18-560 KCC-289 Support Schedule" attached for support of the journal entries.

A regulatory liability was recorded on the books of ONE Gas, Inc. attributable to the tax effect of the refund of EDIT (tax gross up) established with the implementation of the Tax Cuts and Jobs Act. A regulatory liability for the gross up of the refund of EDIT for KGS in the amount of $54,087,596 was recorded in account 2540300 on ONE Gas, Inc.'s books and records.

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: ______________________

Date: 10/8/18

ACCT	To CC	From CC	Account	Expense Indicator	RFU	AMTCM	Debit	Credit	JDESC	
101	0000	0000	2830300	00	000000	139,774,234.01	139,774,234	-	ACCUM DEF TAXES DTL GROSS UP	
101	0000	0000	2540300	00	000000	(139,774,234.01)	-	139,774,234	OTH REG LIAB EXCESS DTL GROSS UP	
021	0000	0000	2830300	00	000000	(59,484,308.01)	-	59,484,308	ACCUM DEF TAXES DTL GROSS UP	
021	0000	0000	2540300	00	000000	59,484,308.01	59,484,308	-	OTH REG LIAB EXCESS DTL GROSS UP	
051	0000	0000	2830300	00	000000	(54,087,596.08)	-	54,087,596	ACCUM DEF TAXES DTL GROSS UP	
051	0000	0000	2540300	00	000000	54,087,596.08	54,087,596	-	OTH REG LIAB EXCESS DTL GROSS UP	
091	0000	0000	2830300	00	000000	(26,202,329.92)	-	26,202,330	ACCUM DEF TAXES DTL GROSS UP	
091	0000	0000	2540300	00	000000	26,202,329.92	26,202,330	-	OTH REG LIAB EXCESS DTL GROSS UP	
Sum to check that debits equal credits							279,548,468	279,548,468		

ACCT	To CC	From CC	Account	Expense Indicator	RFU	AMTCM	Debit
051	0000	0000	2830201	00	000000	149,785,740.06	149,785,740.06
051	0000	0000	2540200	00	000000	(149,785,740.06)	

Sum to check that debits equal credits 149,785,740.06

2830201	149,785,740.06
2830300	-
	149,785,740.06
2540200	(149,785,740)
2540300	-
	(149,785,740.06)

Credit	JDESC
	DEF TAX ACCRUAL
149,785,740.06	OTH REG LIAB EXCESS DTL
149,785,740.06	

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

Data Request: 18-560 KCC-290: Follow up to DR No. 218
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/27/2018
Date Information Needed: 10/8/2018
Requested By: Justin Grady

Please provide the following:

In the response to Staff DR No. 218, the company states as follows: "The Company does not intend to gross up the amortization of the regulatory liability because the regulatory liability is a refund obligation to customers and not considered a reduction of future revenues."
Please explain the distinction the company is drawing between a refund obligation to customers, and a reduction of future revenues. Is it the company's position that a refund to customers of the EDIT amortization through the Tax Change Rider will not correspondingly result in a reduction in taxable liability to the company, in the same fashion as a reduction to future rates would?

KGS Response:

The Company is considering the regulatory liability to be a debt obligation to our customers not unlike when the Company issues debt obligations in the market. When the Company issues debt in the market, there is neither a tax consequence for the proceeds from the debt offering nor is there a tax "benefit" for the repayment of the corresponding debt. In thinking about the EDIT liability, the Company considered that it collected dollars in its revenues previously for income taxes that it did not pay in the year collected due to accelerated depreciation and other timing differences between our taxable income for tax purposes and our GAAP pre-tax income. The taxes associated with these timing differences were provided for as "deferred taxes" at the rates we expected to repay the taxes to the government. When the enacted tax rate changed as a result of the Tax Cuts and Jobs Act, we remeasured our deferred taxes at the new rate we expected to repay the deferred amounts at and the difference was recorded as a repayment obligation (i.e. a regulatory liability) to our customers.

The Company's intent was to credit the customer back for the regulatory liability through the Tax Change rider, which would not have a tax effect similar to how the repayment of a debt was treated. The Company's position is that if we credit our customers for the amount of the EDIT amortization through the tax change rider and do not credit the customers for a gross up in income taxes, then the company does not consider that a reduction in revenues and there would be no corresponding tax effect. If a tax gross up is also credited to customers, then the Company must consider the EDIT credit as a reduction of revenues otherwise the Customers will get the benefit of the tax gross up without the corresponding reduction in income tax expense that nets the company back to simply the EDIT amortization.

Prepared by: Jeff Husen

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: ____________

Date: 10/8/18

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

Data Request: 18-560 KCC-291: Staff Data Request No. 218
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 9/27/2018
Date Information Needed: 10/8/2018
Requested By: Justin Grady

Please provide the following:

In the response to Staff DR No. 218, the company states as follows: "The Company does not intend to gross up the amortization of the regulatory liability because the regulatory liability is a refund obligation to customers and not considered a reduction of future revenues."
Is it the company's position that if the EDIT amortization were to be treated as a reduction in rates in this case, instead of handled through the future application of the Tax Change Rider, that the EDIT amortization would be grossed up for income taxes prior to being removed from the revenue requirement? In other words, the company's proposal to flow the EDIT benefits back to customers overtime through the Tax Change Rider instead of through rates comes at the cost of customers not receiving the benefit of the tax gross up on the EDIT amortization?

KGS Response:

Yes, it is the company's position that if the EDIT amortization were to be treated as a reduction in rates in this case, instead of handled through the future application of the Tax Change Rider, that the EDIT amortization would be grossed up for income taxes prior to being removed from the revenue requirement?

No, the company's proposal to flow the EDIT benefits back to customers overtime through the Tax Change Rider instead of through rates does not come at the cost of customers not receiving the benefit of the tax gross up on the EDIT amortization. The customers arrive at the same economic position under either method. By reducing revenues for the EDIT Amortization and an associated tax gross up yields a income tax expense benefit in the same amount as the tax gross up that offsets the revenue reduction. See an example below showing the net effect of including the gross up. The following example includes an assumed $4 million EDIT Amortization and an associated $1.4 million tax gross up of the EDIT Amortization. All numbers used in the example are for illustrative purposes only.

	Pre- EDIT	EDIT Adjustments	After EDIT Adjustments
Net revenues	$ 100.0	(5.4)	$ 94.6
O&M expense	50.0		50
Depreciation and amortization	20.0		20
Operating income	30.0	(5.4)	24.6
Interest cost	10.0		10
Pre-tax income	20.0	(5.4)	14.6
Income Taxes (26.53%)	5.3	(1.4)	3.9
EDIT Amortization		(4.0)	(4.0)
Net Income	$ 14.7	-	$ 14.7

As the illustration shows, the customer ends up in the same net position, of only a $4 million net credit flowing back to the customer through its rates because the rates would incorporate both the $5.4 million reduction in revenues and an offsetting $1.4 million lower tax expense yielding the same net income for the Company.

Prepared by: Jeff Husen

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: ____________

Date: 10/8/18

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Justin T. Grady, being duly sworn upon his oath deposes and states that he is a Chief Auditor for the Utilities Division of the Kansas Corporation Commission of the State of Kansas, that he 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 his knowledge, information and belief.

Justin T. Grady
Chief Auditor
State 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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don.krattenmaker@woodriverenergy.com

/s/ Vicki Jacobsen
Vicki Jacobsen