

**THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of Black)
Hills/Kansas Gas Utility Company, LLC, d/b/a) Docket No. 14-BHCG-593-TAR
Black Hills Energy, for Approval of the)
Commission for Gas System Reliability)
Surcharge per K.S.A. 66-2201 through 66-
2204.

**NOTICE OF FILING OF STAFF'S
REPORT AND RECOMMENDATION**

The Staff of the Corporation Commission of the State of Kansas ("Staff" and "Commission", respectively), files its Report and Recommendation, and states the following: Staff hereby files the attached Report and Recommendation recommending the Commission approve Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy's (Black Hills or Company) Gas System Reliability Surcharge (GSRS) increase of \$657,961 to be collected via the per-customer surcharge listed in Exhibit 2, as attached to Staff's Report and Recommendation with the following conditions:

- Black Hills must file updated GSRS tariffs to reflect the changes in the per-customer surcharges as discussed above prior to billing the new surcharges;
- Black Hills should refund \$90,441 to customers in the first month of the Company's new GSRS recovery period; and
- Black Hills will immediately file a GSRS True-Up for the period of May 2014 to date at the time its base rates in the 14-BHCG-502-RTS Docket become effective as required by K.S.A. 66-2204(f)(2) .

Wherefore, Staff submits its Report and Recommendation for Commission review and consideration and for such other relief as the Commission deems just and proper.

Respectfully submitted,



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**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

TO: Chair Shari Feist Albrecht
Commissioner Jay Scott Emler
Commissioner Pat Apple

FROM: Bill Baldry, Senior Auditor
Kristin Casarona, Natural Gas and Pipeline Operations Analyst
Kristina Luke-Fry, Senior Auditor
Justin Grady, Chief of Accounting and Financial Analysis
Leo Haynos, Chief of Pipeline Safety
Jeff McClanahan, Director of Utilities

DATE: August 21, 2014

SUBJECT: Docket Number 14-BHCG-593-TAR: In the Matter of the Application of Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy, for Approval of the Commission for Gas System Reliability Surcharge per K.S.A 66-2201 through 66-2204.

EXECUTIVE SUMMARY:

On June 24, 2014, Black Hills Energy (Black Hills) filed an Application for approval of the Gas System Reliability Surcharge (GSRs). The filing revealed costs available for GSRs recovery in the amount of \$640,637. Staff performed an audit, discussed below, and recommends allowing the proposed \$6,440,271 capital costs be included in the surcharge. Staff also recommends a one-time refund to customer bills totaling \$90,441. Because the refund is removed from the GSRs Recovery amount of \$640,637 in order to be passed back in one month, the updated recovery results in a slightly higher revenue increase of \$657,961. This causes an increase in residential customer bills of \$0.40 each month or \$4.80 annually. The revenue increase of \$657,961 less the proposed \$90,441 refund results in a net increase to customers of \$567,520.

BACKGROUND:

In the subject Docket, Black Hills filed a request for a new tariff schedule, labeled the GSRs. This tariff is designed to allow for the adjustment of Black Hills' rates and charges to provide for the recovery of \$6,440,271 of capital costs for eligible infrastructure system replacements. Black Hills requested a revenue increase of \$640,637.

K. S. A. 66-2204 requires Staff to examine information from the utility and confirm that the underlying costs are in accordance with the statutory provisions of the Act. Staff is required to file a Report and Recommendation in this matter by August 22, 2014 (within

60 days of filing). The Commission is required to issue a Final Order on the Application within 120 days of receipt. In this case, the Final Order is due by October 21, 2014.

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

History

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

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

K.S.A. 66-2202 (f)

"natural gas utility plant projects" may consist only of the following:

- (1) Mains, valves, service lines, regulator stations, vaults and other pipeline system components installed to comply with state or federal safety requirements as replacements for existing facilities;
- (2) main relining projects, service line insertion projects, joint encapsulation projects and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state 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...provided that the costs related to such projects have not been reimbursed to the natural gas public utility.

K.S.A. 66-2203 (a)

...a natural gas public utility providing gas service may file a petition...to establish or change GSRS rate schedules...to provide for the recovery of costs for eligible infrastructure system replacements.

Kansas pipeline safety regulations are primarily adopted from federal pipeline safety regulations: 49 CFR Part 192, as adopted by K.A.R. 82-11-4. As stated in the scope of the federal code, the regulations prescribe the minimum safety requirements for pipeline facilities. When evaluating projects for the applicability of GSRS, the decision must rest on defining which portion of the project brings the system into compliance with safety regulations and which portion of a given project is being completed as a business decision to renew an aging infrastructure or improve operating efficiency. Often the utility's rationale for performing a replacement project is based on a blend of economic considerations with pipeline safety or relocation requirements.

ANALYSIS:

Summary

Commission Staff recommends the \$6,440,271 proposed capital costs be included in the surcharge. In an attachment to its Application, Black Hills provided a list of eight public works projects (designated as "R1-R8") and 138 safety-related projects (designated as "S1-S138") sought to be included in the surcharge.

Pipeline Safety

Staff has reviewed all testimony, exhibits, and data request responses provided by Black Hills. Based on this review and as discussed below, Staff recommends allowing recovery of the capital costs associated with the 146 total projects filed in this Docket.

Black Hills submitted two groups of projects in this filing: Relocation Projects and Safety Related Projects.

Relocation Projects:

This project group consists of governmentally mandated road relocation projects which have not been reimbursed to Black Hills.¹ There are eight of these projects included in this filing. Staff has reviewed and analyzed the projects and the supporting documentation provided by Black Hills and considers all eight projects as meeting the criteria for inclusion in the GSRS tariff. Staff recommends recovery of the \$456,231 of associated capital costs be allowed.

Safety Related Projects:

This project group consists of 122 specific safety-related projects with a capital cost amount of \$4,503,145 and 16 blanket work orders with a capital cost amount of \$1,480,895.

Black Hills defines the safety-related projects included in this filing as replacements for existing facilities installed to comply with state or federal safety requirements;² or

¹ Page 4, lines 7 through 12 of the Direct Testimony of Jerry A. Watkins.

² Page 3, lines 20 through 23 of the Direct Testimony of Jerry A. Watkins.

projects that extend the useful life or enhance the integrity of the existing pipeline system undertaken to comply with state or federal safety requirements.³

Black Hills further defines the blanket work orders included in this filing as a collection of small projects, less than \$10,000 but more than \$5,000, which typically eliminate leaking pipe and normally require immediate replacement.⁴

The purpose of the safety-related projects is to bring the pipeline system into compliance with state or federal pipeline safety requirements. Staff has reviewed and analyzed the projects and the supporting documentation provided by Black Hills and considers all 138 safety-related projects as meeting the criteria for inclusion in the GSRs tariff. Staff also recommends recovery of the \$5,984,040 of associated capital costs be allowed.

Accounting

Staff recommends a GSRs revenue requirement of \$657,961 (before application of the onetime true-up refund) for Black Hills. In addition, Staff recommends that Black Hills be permitted to continue collecting its current GSRs surcharge approved in Docket No. 13-BHCG-404-TAR (404 Docket), amounting to \$2,300,987.

On April 29, 2014, Black Hills filed a rate case Application with the Commission.⁵ The Commission Order in that rate proceeding is due January 6, 2015, and Staff expects those rates to become effective shortly thereafter. Once the rates from the rate case go into effect, K.S.A. 66-2204 requires the GSRs charge be zeroed out.

Black Hills included a \$90,441 credit balance for True-Up Recoveries in determining the Revenue Request in this GSRs Application.⁶ In order to allow the full refund of the \$90,441 credit, Staff removed it from the Company's GSRs Revenue Request so that the credit balance can be fully refunded to customers in November 2014.⁷ The refund should be distributed among customers via the per-customer surcharges listed on Line 16 of Exhibit 3, as attached to Staff's Report and Recommendation.

The \$90,441 refund applies to the time period of November 1, 2012, through April 30, 2014. Pursuant to K.S.A. 66-2204(f)(2), Black Hills will need to perform a new GSRs true-up immediately after the Docket No. 14-BHCG-502-RTS (502 Docket) rates become effective. The period for the new true-up will be from May 1, 2014, to the date the new rates from the 502 Docket take effect.

Black Hills should be authorized to collect \$2,958,948 in GSRs revenues until rates established in the pending rate case become effective via the per-customer surcharges listed on Line 18 of Exhibit 2, as attached to Staff's Report and Recommendation.

³ Page 4, lines 1 through 3 of the Direct Testimony of Jerry A. Watkins.

⁴ Page 5, lines 1 through 7 of the Direct Testimony of Jerry A. Watkins.

⁵ Docket No. 14-BHCG-502-RTS.

⁶ Exhibit SAP-1 of the Direct Testimony of Steven A. Peters.

⁷ See Exhibit 1.

Staff performed an audit of the Black Hills' Application to verify that the surcharge was properly calculated and based solely on the projects included in the Application. The individual findings of Staff's audit and the components that led to Staff's revenue requirement calculation are presented below:

- Staff issued discovery requesting work orders and journal entries in support of a random sample of projects included in the Application. Staff encountered no material errors in its review of these materials.
- Staff sought and obtained various information related to each of the different components of the GSRS revenue requirement requested by Black Hills. These include depreciation expense, accumulated depreciation, accumulated deferred income taxes, and the true-up of revenues collected during the previous year versus revenues authorized in the 404 Docket.

RECOMMENDATION:

Approve Black Hills' GSRS increase of \$657,961 to be collected via the per-customer surcharge listed in Exhibit 2, as attached to Staff's Report and Recommendation with the following conditions:

- Black Hills must file updated GSRS tariffs to reflect the changes in the per-customer surcharge as discussed above prior to billing the new surcharges;
- Black Hills should refund \$90,441 to customers in the first month of the Company's new GSRS recovery period; and
- Black Hills will immediately file a GSRS True-Up for the period of May 2014 to date at the time its base rates in the 14-BHCG-502-RTS Docket become effective as required by K.S.A. 66-2204(f)(2).

BLACK HILLS ENERGY
Docket No. 14-BHCG-593-TAR
PROPOSED RATE ADJUSTMENT FOR GSRS

	[A]	[B]	[C]	[D]	[E]	[F]	[G]	[H]
Line No.	TOTAL	New GSRS Projects	UPDATE 404-TAR	UPDATE 055-TAR	UPDATE 786-TAR	UPDATE 886-TAR	UPDATE 852-TAR	
1	GAS PLANT	\$31,912,103	\$ 6,440,271	\$ 7,297,874	\$ 9,798,846	\$ 2,406,658	\$ 3,564,820	\$ 2,403,634
2	ACCUMULATED DEPRECIATION	307,120	(469,834)	(298,961)	620,318	114,529	175,755	165,313
3	NET GAS PLANT	<u>\$31,604,983</u>	<u>\$ 6,910,105</u>	<u>\$ 7,596,835</u>	<u>\$ 9,178,528</u>	<u>\$ 2,292,129</u>	<u>\$ 3,389,065</u>	<u>\$ 2,238,321</u>
4	ACCUMULATED DEFERRED INCOME TAXES	(8,568,735)	(1,388,498)	(2,446,480)	(2,692,862)	(680,570)	(995,258)	(365,067)
5	TOTAL RATE BASE	<u>\$23,036,248</u>	<u>\$ 5,521,607</u>	<u>\$ 5,150,355</u>	<u>\$ 6,485,666</u>	<u>\$ 1,611,559</u>	<u>\$ 2,393,807</u>	<u>\$ 1,873,254</u>
6	RATE BASE	\$23,036,248	\$ 5,521,607	\$ 5,150,355	\$ 6,485,666	\$ 1,611,559	\$ 2,393,807	\$ 1,873,254
7	RATE OF RETURN	<u>8.6867%</u>	<u>8.6867%</u>	<u>8.6867%</u>	<u>8.6867%</u>	<u>8.6867%</u>	<u>8.6867%</u>	<u>8.6867%</u>
8	REQUIRED OPERATING INCOME	\$ 2,001,090	\$ 479,645	\$ 447,396	\$ 563,391	\$ 139,991	\$ 207,943	\$ 162,724
9	OPERATING INCOME AT PRESENT RATES	<u>(42,188)</u>	<u>3,272</u>	<u>(10,650)</u>	<u>(26,652)</u>	<u>(4,714)</u>	<u>(4,179)</u>	<u>735</u>
10	DEFICIENCY	\$ 2,043,278	\$ 476,373	\$ 458,046	\$ 590,043	\$ 144,705	\$ 212,122	\$ 161,989
11	TAX FACTOR	<u>60.45%</u>	<u>60.45%</u>	<u>60.45%</u>	<u>60.45%</u>	<u>60.45%</u>	<u>60.45%</u>	<u>60.45%</u>
12	TOTAL GSRS REVENUE	<u>\$ 3,380,112</u>	<u>\$ 788,045</u>	<u>\$ 757,727</u>	<u>\$ 976,085</u>	<u>\$ 239,380</u>	<u>\$ 350,905</u>	<u>\$ 267,972</u>
13	TRUE-UP OF RECOVERIES THRU 4/2014	\$ -						
14	GRAND TOTAL	\$ 3,380,112						
15	AUTHORIZED IN DKT 13-BHCG-404-TAR	<u>\$ 2,300,987</u>						
16	INCREMENTAL GSRS REVENUE	\$ 1,079,125						
17	LESS Statutory Limit Adjustment	<u>\$ (421,164)</u>						
18	INCREMENTAL GSRS REVENUE REQUEST	<u>\$ 657,961</u>						

BLACK HILLS ENERGY
GSRs True-Up Refund Allocation
 Docket No. 14-BHCG-593-TAR

Line No.	[A] Description	[B] Total Company	[C] Residential	[D] Small Commercial	[E] [F] [G] [H] Small Volume				[I] [J] [K] [L] Large Volume				
					Firm	Interruptible	Trans.	Total	Firm	Interruptible	Trans.	Total	
1	<u>Units*</u>												
2	Number of Customers	104,180	94,010	8,225	1,175	65	526	1,766	33	12	134	179	
3	Volume - therms	132,877,466	68,764,710	11,678,410	12,965,980	765,130	5,891,281	19,622,391	2,672,570	1,328,030	28,811,355	32,811,955	
4	<u>Rates*</u>												
5	Commodity Charge - \$/therm		0.14524	0.14524	0.12500	0.12500	0.12500		0.05900	0.05900	0.05900		
6	Customer Charge - \$/month		16.00	22.75	40.00	40.00	40.00		256.00	256.00	256.00		
7	<u>Revenue Increase*</u>												
8	Commodity Charge - \$	(273,564)	(401,586)	(68,202)	129,660	7,651	58,913	196,224	0	0	0	0	
9	Customer Charge - \$	5,358,513	4,512,480	567,525	141,000	7,800	63,120	211,920	12,400	4,464	49,724	66,588	
10	Total - \$	5,084,949	4,110,894	499,323	270,660	15,451	122,033	408,144	12,400	4,464	49,724	66,588	
11	<u>GSRs Allocation</u>												
12	Customer Class Allocation Percent		80.84%	9.82%				8.03%				1.31%	
13	GSRs Annual Revenue - \$	(90,441)	(73,116)	(8,881)				(7,259)				(1,184)	
14	Less Statutory Limit Adjustment - \$	0											
15	Net GSRs Annual Revenue - \$	(90,441)	(73,116)	(8,881)				(7,259)				(1,184)	
16	One Time Refund of Overpayments (Line 13 / Line 2)		(0.78)	(1.08)				(4.11)				(6.62)	

CERTIFICATE OF SERVICE

14-BHCG-593-TAR

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 22nd day of August, 2014, to the following:

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