

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)
Approval of Its Purchase of Southern Star)
Central Gas Pipeline, Inc.’s Facilities Used to) Docket No. 24-KGSG-237-CON
Furnish Natural Gas Service to Certain)
Customers and Approval of Customer-Specific)
Certificates of Public Convenience and)
Necessity to Serve Said Customers.)

**RESPONSE OF THE CITIZENS’ UTILITY RATEPAYER BOARD
TO STAFF’S REPORT AND RECOMMENDATION**

COMES NOW the Citizens' Utility Ratepayer Board (CURB) and submits its Response to the Report and Recommendation, filed by Kansas Corporation Commission Staff (“Staff”) with the Kansas Corporation Commission (KCC or “Commission”) in the above-captioned docket on May 1, 2024. CURB supports Kansas Gas Service Inc.’s (“KGS” or “Company”) *Application to Purchase Domestic Meter Facilities and Customers* (“Application”) with the additional recommendation made by Staff based on the reasonableness of the transaction and for promoting the public interest when comparing the benefits to the costs of the acquisition. In support thereof, CURB states as follows:

Background

1. On September 5, 2023, KGS filed its Application with the KCC requesting approval of the terms for a transaction between KGS and Southern Star Central Gas Pipeline, Inc. (“Southern Star”).¹ KGS is seeking approval of a 2022 Asset Purchase Agreement (“APA”) for the sale of Southern Star’s facilities and transfer service for 1042 domestic meters throughout Kansas. While 848 of these customers are currently served by KGS and paying approved rates, the

¹ Kansas Gas Service Application (Sept. 5, 2023).

remaining 194 Southern Star customers will become KGS customers and take service under those rates, notwithstanding pre-existing special arrangements.² KGS asks that it be granted customer-specific certificates of convenience and necessity to serve these customers and to charge them their approved rates.

2. KGS has agreed to purchase the facilities for \$1,400 per domestic meter, based on the net book value of the assets, for a total purchase price of \$1,458,800. KGS is requesting that the purchase price be included in its rate base to be considered for recovery in future rate cases.

3. On September 21, 2023, the KCC granted CURB intervention in this docket.³

4. On March 15, 2024, KGS witness Janet Buchanan submitted direct testimony in support of the APA.⁴ Ms. Buchanan summarized the Commission's Merger Standards as a means to evaluate the APA and whether the same is in the public interest, despite the transaction not being an acquisition *per se*. Her testimony provides an analysis of the standards from KGS's perspective and concludes that the APA is in the public interest.

5. On May 1, 2024, Staff filed its R&R with its analysis of the APA. Staff agreed with KGS's use of the Merger Standards in order to provide context for the transaction and to evaluate the reasonableness of the terms.⁵ Staff largely agreed with KGS's review of the standards, but had a number of different conclusions regarding certain standards. Staff concluded that Southern Star would remain the service provider in the event that the Commission rejects the application, rather than customers immediately switching to alternative sources of power. Staff took inspiration from

² *Id.* at pg. 4, ¶8.

³ Order Granting CURB's Petition to Intervene; Protective and Discovery Order (Sept. 21, 2023).

⁴ Direct Testimony of Janet Buchanan on Behalf of Kansas Gas Service a Division of One Gas, Inc. (March 15, 2024). ("Buchanan Direct Testimony")

⁵ Notice of Filing of Staff Report and Recommendation (May 1, 2024). ("Staff's R&R")

KGS's line extension policy to expand its review of the reasonableness of the purchase price. This included calculations of additional costs to replace a customer's service and/or yard lines based on the average cost to replace such infrastructure to determine the overall acquisition costs. This value was compared to the revenue value for each customer calculated over a ten year period.

6. Staff concluded that the revenue value per customer outweighed the additional costs to acquire that customer and found the purchase price to be reasonable. Staff also referenced other transactions between natural gas utilities and Southern Star and questioned whether revenue from these domestic customers would adequately cover the additional costs to serve them. In light of the uncertainty of the liability costs and potential to exceed revenue estimates, Staff recommended that the Commission condition approval of the APA on the requirement that the Company agree to limit the total acquisition costs recovered from rates to the estimated revenue levels from the R&R. Staff calculated this limit based an estimated ten year revenue value amount of \$4.98 million reduced by the total purchase price of the APA, for a limit of \$3.04 million.⁶ If KGS exceeds this limit over the next ten years, KGS would agree to either: 1. write off any investment over that amount for ratemaking purposes; or 2. seek recovery of those additional costs from Southern Star in the form of a reduction to the original price per customer.

CURB's Position

7. It is clear from the record that Southern Star is actively seeking an exit from owning and operating domestic meters in Kansas. Staff correctly points out that if the Commission rejects the APA, Southern Star will still be responsible for maintaining service to these customers. It has not been alleged that Southern Star would be unable to continue in this role; however, Southern

⁶ Staff's R&R at pg. 2.

Star has an interest in eliminating this aspect of its business as soon as possible. In the event of rejection, it is likely that Southern Star would quickly revisit the issue, address identified shortcomings, and resubmit the request to the Commission. CURB does not see the value in rejecting the change in ownership from an unwilling entity to a willing one without significant deficiencies in the transaction.

8. CURB reviewed the Application and the R&R from the perspective of residential and small commercial ratepayers, in consideration of the potential impacts and benefits under the APA. At the onset, CURB supports the APA terms with Staff's additional condition regarding a cap on the cost of replacement of service lines. CURB believes that the Company's and Staff's application of the Commission's Merger Standards is an appropriate way to evaluate the APA and the public interest. The findings regarding public safety and economic value of the transaction are most compelling to CURB.

9. CURB believes that the Merger Standards regarding public safety and financial implications weigh in favor of approval. Like Staff, CURB has concerns about additional costs beyond the initial purchase price. One of the touted benefits of the transaction is the application of more stringent Kansas pipeline safety requirements. CURB agrees with the Company and Staff in their conclusions that moving regulation under the KCC will result in improved service through higher standards of pipeline safety and maintenance.⁷ It is not clear what impacts this change may have on the timing of replacement of yard lines for these new customers. There is the potential that becoming compliant with new safety standards may require immediate expenditures by KGS. The Application and testimony does not indicate any further financial consideration from either party

⁷ See Staff R&R at pg. 10; Buchanan Direct Testimony at pg. 13.

beyond the \$1,400 per meter price that would recognize this additional risk. CURB examined documents provided by KGS that described the Company's efforts to evaluate the transaction, including due diligence findings. Based on these documents and KGS's long-standing contractual service for these customers, CURB believes that KGS has made reasonable efforts to avail itself of information sufficient to develop the terms of the APA and the price paid for the facilities.

10. CURB agrees with Staff's use of KGS's line extension policy as a means to calculate the financial value of the transaction. Staff highlights a similar situation in KCC Docket No. 24-BHCG-652-ACQ ("Docket No. 24-652"). In that docket, Black Hills is proposing to purchase 273 meters for only \$10 as part of Southern Star's efforts to abandon its retail services in Kansas. The discrepancy in prices for these transactions raised concerns for Staff, but ultimately did not impact Staff's finding that the overall value of the transaction outweighs the total cost of acquisition. Staff's method provides a measurable limit on replacement costs for service lines compared to the revenue value over a ten year period by shifting risk of recovery onto KGS. It is unclear when KGS may reach that limit, considering that projects for these customers would be competing with other locations under KGS's Distribution Integrity Management Plan. Based on differences of safety regulations, Southern Star may not need to make the same kinds of investments as KGS if the transaction is denied. To CURB, Staff's recommendation takes into consideration this variance in replacement spending activities between KGS and Southern Star.

11. CURB believes that the cap places an appropriate amount of risk for additional costs back onto the Company. Under Staff's modification, once replacement expenditures exceed \$3.04 million, KGS must either write off the excess amounts or seek recovery from Southern Star. CURB interprets these options as a way to ensure that any excess costs beyond the limit will not

be recovered from ratepayers. Meaning, in the event that KGS cannot convince Southern Star to reduce the original purchase price, KGS must write off the amount instead. CURB agrees with Staff that the APA may provide neutral to slightly positive benefits for ratepayers and shareholders, but there remains a risk of acquisition costs exceeding revenue.⁸ In other words, there is a slimmer margin of benefits to offset unforeseen costs or reductions to revenue. Complying with new regulations represents a situation that may alter the economics of the APA in the event of immediate action. Customers who experience replacement costs beyond what is paid for by the Company may also view the transaction negatively. Once the transaction is approved, options are limited to reverse the impact on these customers in the face of changed circumstances.

12. Staff's modification to limit the amount of additional acquisition costs appears to treat the new customers as equitably as possible with other KGS customers. CURB agrees with this approach. Staff utilized values for average replacement costs from previous dockets that are currently used in other areas of KGS's operations. As mentioned above, CURB believes that KGS took reasonable efforts to examine the condition of the facilities prior to entering into the APA. Based on the sophistication of the parties, if KGS had discovered serious deficiencies with the infrastructure, it could have negotiated a provision to require Southern Star to address those issues and to make repairs, if necessary.⁹ No such provision is discussed in this docket. While CURB can only speculate as to the exact reason why there is no such provision, the use of a cap on total service/yard line replacement should protect ratepayers from excessive costs beyond what a typical

⁸ Staff R&R at pgs. 5-6.

⁹ See Direct Testimony of Kenneth R. Smith, pg. 6, Ins. 5-8, Docket No. 24-KGSG-284-ACQ (Sept. 22, 2023).

KGS customer would expect. CURB will monitor the pace at which KGS replaces infrastructure for these customers to ensure that quality of service will not be impacted by the transaction.

13. Although CURB supports the use of KGS's line extension policy in order to further develop the economic value of the APA, CURB wonders about the applicability of a generalized approach regarding similar transactions. As previously mentioned, Docket No. 24-652 involves the sale of Southern Star facilities for \$10, below the book value and market value of those meters.¹⁰ The use of the Merger Standards in these transactions may result in a finding that both purchase prices are *reasonable*, but it is clear that one price is *better* than the other. However, the presence of other factors can lead reasonable minds to differ on which factors make up for the disparity in purchase prices to favor approval. CURB does not believe that these related transactions should be compared side-by-side in such a way that would invalidate the reasonableness of the APA in the present docket. The standard only looks at whether the purchase price is within a reasonable range of prices, not the best price. CURB believes that the evidence in this docket supports the conclusion that the purchase price is reasonable. Nonetheless, CURB shares Staff's concern about the disparity between book value and market value and how it is used in determining the overall value of these kinds of transactions. While the book value metric is specifically mentioned within the Merger Standards, CURB does not believe that evaluating market or other appropriate consideration is precluded from a public interest review. Additional clarification on indirect consideration for these exchanges could provide useful context for regulators seeking to reconcile these unclear differences in the future.

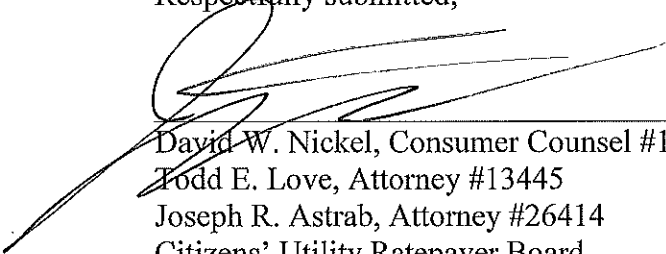
¹⁰ Direct Testimony of Nicholas W. Smith on Behalf of Black Hills/Kansas Gas Utility Company, LLC d/b/a Black Hills Energy, pg. 6, lns. 10-12, Docket No. 24-BHCG-652-ACQ (April 8, 2024).

Conclusion

14. CURB supports approval of the APA with the additional condition to limit the overall acquisition costs that can be recovered from ratepayers. The Merger Standards are helpful to provide context and analyses of relevant factors for the Commission. The APA will provide benefits to the system by adding more customers to contribute to fixed costs while supplementing existing safety regulation oversight through the KCC. Considerations of public safety and economic value appear to be the focus points of this analysis and weigh in favor of approval, despite the potential to shift in the future as other acquisition costs are discovered. CURB supports Staff's creative use of existing policies in order to refine the analyses in this docket. This approach may not be a "one size fits all" method for all such transactions, but it does provide a useful foundation to examine all the evidence in the record.

WHEREFORE, CURB submits its response to Staff's R&R and the Application and asks the Commission to approve the Application as amended by Staff and to provide any and all other orders as deemed appropriate.

Respectfully submitted,



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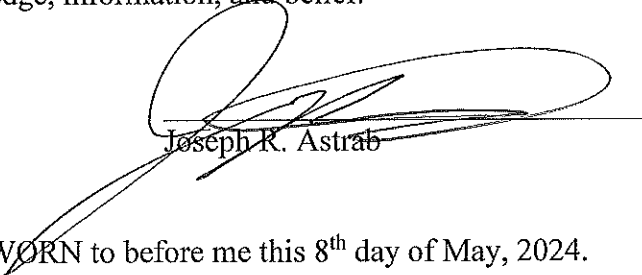
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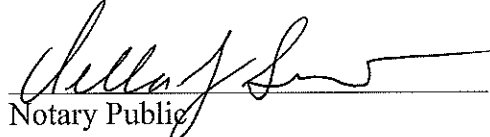
VERIFICATION

STATE OF KANSAS)
)
COUNTY OF SHAWNEE) ss:

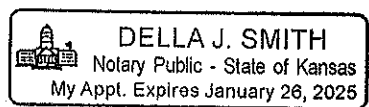
I, Joseph R. Astrab, of lawful age and being first duly sworn upon my oath, state that I am an attorney for the Citizens' Utility Ratepayer Board; that I have read and am familiar with the above and foregoing document and attest that the statements therein are true and correct to the best of my knowledge, information, and belief.


Joseph R. Astrab

SUBSCRIBED AND SWORN to before me this 8th day of May, 2024.


Notary Public

My Commission expires: 01-26-2025.



CERTIFICATE OF SERVICE

24-KGSG-237-CON

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 8th day of May, 2024, to the following:

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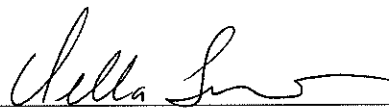
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