BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Freedom	)	
Pipeline LLC, for Approval of its Sales for	)	Docket No. 23-FRPG-461-CON
Approval of its Sales for Resale Customer	)	
Contracts.	)	

PUBLIC NOTICE OF FILING STAFF REPORT AND RECOMMENDATION

COMES NOW the Staff of the State Corporation Commission of the State of Kansas, and for its Public Notice of Filing Staff Report and Recommendation, states as follows:

Staff hereby files the attached Report and Recommendation dated February 22, 2023, providing Staff's review and analysis of the Freedom Pipeline, LLC (FPL) Application for approving Sales for Resale Customer Contracts (Contracts) involving its six member-owners (Owners), as well as a separate contract involving non-affiliates that may need service. The Report and Recommendation indicates FPL is a non-profit public utility providing natural gas transportation and delivery service to its Owners as an intrastate open-access pipeline, subject to Commission rate jurisdiction. FPL was granted a Certificate of Convenience and Necessity in Docket No. 14-FRPG-599-COC (14-599 Docket) and may also provide service to non-affiliates seeking natural gas transportation, but does not serve any non-affiliates at the present time. As a condition of the 14-599 Docket, FPL agreed to apply to the Commission for a maximum tariff rate for transportation services on the completion of the pipeline. Initially, a maximum transportation rate was approved for the pipeline on a pro-forma projected basis, with a rate of $0.81 per Mcf. In Docket 16-FRPG-452-CON, the Commission approved gas purchase and sales agreements between FPL and its Owners with a maximum tariff rate calculated with projected data, awaiting completion of the pipeline. Sometime between 2018 and 2020, the pipeline was completed.

The instant Docket involves the approval of a maximum volumetric rate of $0.8483 per MMBTU and a monthly meter charge of $350.00. The maximum rate and the monthly customer charge are supported by the actual costs incurred in constructing and operating the pipeline. Because of the unique structure of the pipeline and its current service to its Owners, the rates covering the costs of the project are not unreasonable. However, with respect to any non-affiliates that may seek service in the future, the Staff is proposing that they be given an unredacted copy of the Report and Recommendation that highlights the rate components and costs giving rise to the contract rates, in order to permit a potential user the background, the cost recovery that may have otherwise been achieved and information associated with the establishment of the maximum rates, which going forward may not be just and reasonable, as the investment in the pipeline may have been partially or fully recovered.

The Staff recommends the approval of the Amended Gas Purchase and Sales Agreement with the Owners with the volumetric delivery charge of $0.8483 per MMBTU and the monthly meter charge of $350. The Staff also recommends approval of the Gas Purchase and Sales Agreement for non-affiliates, with a one-year renewable term, and the same rate and charge approved for the Owners, but modified for minimum volumes and subject to the condition requiring submission of the Report and Recommendation to prospective customers in advance of contract execution.

Because the Staff Report and Recommendation contains confidential commercial information pertaining to FPL, the Staff has elected to file both a confidential and a public version of the Report and Recommendation in accordance with K.S.A. 66-1220a.

WHEREFORE, Staff presents its Report and Recommendation for the record and for guidance in allowing the Commission to issue an Order on the Freedom Pipeline, LLC Application.

Respectfully Submitted,

/s/ Walker Hendrix

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MEMORANDUM

REDACTED VERSION

To: Chair Susan K. Duffy
Commissioner Dwight D. Keen
Commissioner Andrew J. French

From: Adam Gatewood, Senior Managing Financial Analyst
Justin Grady, Chief of Revenue Requirements, Cost of Service and Finance
Jeff McClanahan, Director of Utilities

Date: February 22, 2023

Re: In the Matter of the Application of Freedom Pipeline LLC, for Approval of Its Sales For Resale Contracts—Docket No. 23-FRPG-461-CON

Executive Summary:

In this filing Freedom Pipeline, LLC (FPL) submits an application and supporting testimony for approval of its Sales for Resale Customer Contracts (Contracts) for its six member-owners[1](Owners) as well as separate, contract for any non-affiliate seeking service. Inclusive within those contracts is the volumetric rate and monthly meter charge. Staff recommends the Commission approve the two contracts with the condition that a non-affiliate seeking service be provided unredacted copies of this memorandum and the Commission's Order.

Background:

FPL was granted a Certificate of Convenience and Necessity to operate as an intrastate open-access natural gas pipeline on August 4, 2015 in Docket 14-FRPG-599-COC. It is organized under K.S.A. 66-104c as a non-profit public utility that provides transportation and delivery of natural gas to its six member-owners each of those being non-profit public utilities certificated by the Commission. Despite its status as a non-profit public utility, as an intrastate open-access natural gas pipeline, it is subject to rate regulation by the Commission. FPL's primary purpose is supplying natural gas to its member-owners which use it to power irrigation well pumps. FPL is unique in that it currently only serves its six member-owners, although with certain limitations expressed in the 14-FRPG-599-COC Order, FPL may serve non-affiliates. FPL states the likelihood of serving non-affiliates is small and it is not actively seeking to serve non-affiliates.[2]

In Docket 14-FRPG-599-COC, as a condition of obtaining a certificate of convenience, FPL agreed it would apply to the Commission for a maximum tariff rate for transportation services on

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[1] Freedom member-owners are: SWKI Stevens North, Inc., SWKI Spikes North, Inc., SWKI Stevens Southeast, Inc., SWKI Seward West Central, Inc., SWKI Stevens NE, Inc., and SWKI Stevens HSW, Inc.. Each is a Non-Profit Utility that is certificated by the Commission.

[2] Heger Direct, p11-12.

the completion of the pipeline. In 14-FRPG-599-COC Staff estimated the maximum transportation rate for FPL at $0.81/MCF based on limited pro-forma, projected financial information.

In Docket 16-FRPG-452-CON the Commission approved the gas purchase and sales agreements between FPL and its six member-owners, again with the maximum tariff rate calculated using pro-forma financials and estimated volumes because the pipeline was not complete and there was a limited amount of operating data. The Commission approved the sales for resale agreements and the rate along with a requirement that FPL refile for approval when construction is complete. FPL states that it completed construction of the pipeline in 2020[3]. Staff contends construction was completed in January of 2018.[4]

Current Filing by FPL:

In this Docket it is seeking a rate of $0.8483/MMBTU volumetric rate in addition to a $350.00/meter monthly charge. The maximum rate and monthly customer charge are supported by the actual costs incurred in constructing and operating the pipeline as opposed to estimates and forecasts relied on in the past rate determinations.

Staff's review and recommendation in this Docket considers FPL's unique structure and ownership. At this time, FPL only serves the six member-owners with some possibility that it might provide service to a non-affiliate in the future. To protect a non-affiliate from rates that are just and reasonable at this point in time, but likely to be excessive in the near future, Staff is proposing the Commission place conditions on Freedom.

FPL's application is supported by testimony from three witnesses. Richard Hanson of Hanson Engineering filed testimony on behalf of Freedom regarding the existing capacity available for non-affiliated customers of FPL, the likelihood of FPL gaining new load, the type of costs to be incurred with a new customer, and factors that may affect FPL's operating margins. Kirk Heger, chairman of FPL, sponsors the sale for resale contracts to be used with FPL's current and any future customers, discusses the status of negotiations with Black Hills Energy regarding service to Moscow, Kansas, and factors that could negatively affect FPL's operating margins. Mr. Hanson's and Mr. Heger's testimony was helpful to Staff in explaining FPL's unique challenges. David N. Dittemore, a regulatory consultant with more than 30 years of experience in the regulated utility industry sponsors the revenue requirement, related adjustments, and rate calculations.

Staff's Review of Freedom Pipeline's Revenue Requirement:

FPL is requesting a small increase in its rate from $0.81/MMBTU to $0.8483/MMBTU plus the inclusion of a monthly meter fee of $350. Its existing revenue requirement of $1,071,790 was set in Docket 16-FRPG-452-CON.

FPL provided its consultant with its 2021 balance sheet and income statement; those documents are the starting point for determining the revenue requirement. These are not audited financial statements.[5] The financial statements are the product of a *preparation engagement* with an accounting firm whereby the firm prepares financial statements using data supplied by the client. The firm does not verify the accuracy or completeness of the information, nor does it express an opinion on the statements. Staff contends that it is not unreasonable a small not-for-profit entity

[3] Heger Direct p4.
[4] 23-FRPG-371-SHO; Staff Report and Recommendation, Sept. 14, 2022, p. 1.
[5] Response to Staff DR 10

to wish to avoid the expense necessary to have its financial statements audited, especially when its only customers are its owners.

From that 2021 test year, FPL's consultant made five pro-forma adjustments to estimate a forward looking cost of operations. Staff issued ten data requests to follow up on the details and support underlying the test-year adjustments. Based on testimony and data request responses, Staff does not have any disagreements with the data or methodology underlying the test-year adjustments. The following is a brief description of the adjustments.

1. An immaterial $24 dollar increase to revenues to match revenues with throughput at the rate of $0.85/MMBTU.
2. A reduction in interest expense from 2021 actual expense by $18,321 supported by annualizing FPL's current interest expense on its three loans.
3. An increase of $125,274 to FPL's depreciation and amortization to accelerate its recovery of start-up and organization costs. Those costs are currently amortized over 15 years, this adjustment will recover the remaining balance over three years.
4. An increase of $58,900 to FPL's amortization expense to reflect a three-year recovery of the projected costs of this filing.
5. An increase of $30,000 to FPL's professional services fees to reflect its estimated costs for professional service to review, evaluate and help remediate imbalance costs incurred from FPL's gas supplier. FPL states it has no employees, therefore no one to perform this work.

Staff does not disagree with the purpose of, or methodology behind, adjustments one and two. A response to Staff DR 1 provided the background and source documents for the interest expense adjustment.

Adjustments three and four are seeking to recover significant account balances over a relatively short period of time, three years. FPL's two amortizations make up 20% of its operating expenses. Staff is not challenging these amortization amounts or period of recovery, given that the only customers currently being served by the pipeline are its owners. But it is evident that in three years FPL will have recovered those account balances and arguably FPL's rates will not remain just and reasonable—barring unforeseen circumstances like a significant reduction in throughput volumes, or a precipitous increase in expenses. To account for this eventuality, Staff will propose a condition aimed at protecting non-affiliates while avoiding the cost of a full rate filing.

Staff also does not disagree with the fifth adjustment for additional professional services, adjustment 5.

FPL applies a 10% margin to the pro-forma operating expenses, an increase from the 6% margin applied in setting rates in the 16-FRPG-452-CON Docket. Applying a margin to operating income is a reasonable method to provide some compensation to equity investors and a revenue cushion for creditors. Staff is fine with 10% as a margin on operating expenses. It is not excessive, in that that margin level equates to less than a 5% return on FPL's booked equity balance.

FPL's Projected Volumes:

Calculating a rate requires an estimate of sales volumes across FPL. FPL relied on volumes from 2021, with no adjustments to those values. Staff agrees with using FPL's unadjusted historic volumes from 2021 because we have only three years of operations of the completed pipeline and the 2021 data does not appear anomalous. Volume data from 2021 is similar to the three-year average. FPL load is driven by irrigation, thus specifics of crop requirements and rainfall timing are the primary variables for gas demand. Attempting to determine an irrigation-demand adjustment with the limited data that is available would certainly add to this docket's complexity and costs over simply using historic data.

<u>Contracts for Affiliates & Non-Affiliates of FPL:</u>
FPL submitted two distinct sales for resale contracts for approval by the Commission. Exhibit A to the Application is the "Amended Gas Purchase and Sales Agreement" that will be executed between FPL and each of its six member-owners. ** [redacted] ** 5) the delivery fee of $0.8483/MMBtu; and 6) a meter charge of $350 per month.

Exhibit B is the Gas Purchase and Sales Agreement between FPL and any non-affiliate seeking service. ** [redacted] ** 3) a meter fee of $350 per month for each meter; 4) the delivery fee of $0.8483/MMBtu; and 5) a term of one year, thereafter continuing year to year.

The terms discussed in the two previous paragraphs are not exhaustive, rather intended to overview primary terms to assess whether a non-affiliated entity would be disadvantaged in comparison to the terms provided to the member-owners. Based on a review of Exhibits A & B to the Application, Staff is satisfied that an unaffiliated entity would not be disadvantaged relative to the terms afforded to the member-owners; in fact, they are afforded more generous terms than those of the member-owners'. For example, non-affiliates are allowed more flexible contract length without any required minimum volumes. In Staff's view, any non-affiliate taking sales for resale service from a pipeline is likely to possess a level of knowledge and sophistication enabling it to review the contract terms and negotiate terms to protect its own interests. The rate is a key issue, including Staff's conditions discussed below would help to protect a non-affiliate from an unreasonable rate.

<u>Staff's Condition:</u>
With regards to non-discriminatory treatment of non-affiliates, Staff's primary issue is the rate which, in just a three year period of time, may no longer reflect FPL's cost of providing service. Rates set in this docket are based on costs that include three-year amortizations of start-up costs and rate case expense totaling about $185,174 per year or 19.8% of operating expenses. After three years of charging the new rate, the account balances will be recovered and FPL's rates, arguably, will no longer be just and reasonable. That is, unless there are significant reductions to throughput volumes, or unexpected large increases in expenses.

There is no economic harm in the owner-members paying to themselves a rate that is no longer just and reasonable as any excess margins will accrue to FPL's retained earnings. To protect non-affiliated parties from harm, without prescribing a mandatory rate filing for the future, Staff proposes that FPL provide a non-affiliate seeking service unredacted copies of this memorandum and the Commission's Order. That information would allow an unaffiliated entity to be fully informed of the costs underlying the rate set in this docket. A non-affiliated party can decide if it wants to challenge the rate should it be unable to reach a negotiated rate with FPL. The contract will have to be approved by the Commission, but that is significantly less costly than a rate case.

Recommendations:
Staff recommends the Commission approve the two contracts with the condition that a non-affiliate seeking service be provided unredacted copies of this memorandum and the Commission's Order.

CERTIFICATE OF SERVICE

23-FRPG-461-CON

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served via electronic service this 28th day of February, 2023, to the following:

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