BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of Application of Kansas Gas Service, a Division of ONE Gas, Inc. for Approval Of an Accounting Order to Track Expenses Associated with the Investigating, Testing, Monitoring, Remediating and Other Work Performed at the Manufactured Gas Plant Sites Managed by Kansas Gas Service.	)	Docket No. 17-KGSG-455-ACT

TESTIMONY IN SUPPORT OF UNANIMOUS SETTLEMENT AGREEMENT

PREPARED BY

JUSTIN T. GRADY

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

OCTOBER 12, 2017

Q. Would you please state your name and business address?

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

Q. Are you the same Justin T. Grady that filed Direct Testimony in this matter on September 8, 2017?

A. Yes.

Q. What is the purpose of your testimony?

A. I am testifying on behalf of the Staff of the Kansas Corporation Commission (Staff and Commission, respectively) in support of the settlement of the issues outlined in the Unanimous Settlement Agreement (Agreement) between Kansas Gas Service (KGS), a Division of ONE Gas, Inc. (ONE GAS), Staff, and the Citizens' Utility Ratepayer Board (CURB), collectively, the Parties.

My testimony will answer the fundamental question as to why the Commission should approve the Agreement as a reasonable resolution of the issues in this docket because it is in the public interest. Specifically, I will:

- Provide background information about this docket;
- Provide an overview and discussion of the Agreement;
- Discuss the standard of review used to guide the Commission in its consideration of whether to accept the Agreement; and
- Discuss the evidence in the record that supports the Agreement.

Background Information

Q. Please provide a brief background of this case.

A. On April 11, 2017, KGS filed an Application seeking Commission approval to defer to a regulatory asset, actual cash expenditures incurred after January 1, 2017, associated with the Company's obligation to perform environmental investigating, testing, monitoring, remediating and other work at 12 former manufactured gas plant sites in Kansas. KGS sought to defer and recover those expenditures over 10 years in its next rate case, without carrying charges accumulating on the unrecovered balance.

KGS also requested:

- To retain all insurance reimbursements received by the Company up to $9.49 million, sharing the proceeds above this amount with ratepayers at 60% of the actual amounts received; and
- To include all future cash expenditures associated with managing and remediating the manufactured gas plant (MGP) sites in the Accounting Authority Order (AAO).

On September 8, 2017, Staff filed its Direct Testimony recommending:

- KGS's AAO and its requested ratemaking treatment for insurance proceeds be denied at this time;
- If the Commission granted an AAO, KGS should be required to file site-specific AAO requests whenever the MGP remediation costs for any site are likely to exceed $1,000,000 at any site;
- All future ratepayer recovery of MGP costs would be accomplished by reducing the net MGP cost amount by 40%, then amortize the remaining balance over 10

years with carrying cost afforded to the unamortized balance at KGS's Commission approved Weighted Average Cost of Capital (WACC); and

- KGS should credit 100% of all insurance proceeds received against any future MGP remediation expense where KGS seeks rate recovery.

On September 8, 2017, CURB filed Direct Testimony recommending the Company's request to defer costs associated with the MGP sites be denied. On September 18, 2017, CURB filed Cross-Answering Testimony advancing the following arguments in response to Staff's positions taken in Direct Testimony:

- The Commission should not define any ratemaking treatment that will apply to future MGP costs at this time;
- Ratepayers should be responsible for no more than 50% of remediation costs, and not the 60% Staff recommended.

On September 25, KGS filed Rebuttal Testimony generally disagreeing with the positions taken by Staff and CURB in filed testimony. KGS continued to advocate that the Commission should adopt the ratemaking treatment/policy approved previously in the 1993 Order in the Kansas Public Service Company proceeding, Docket No. 185,507-U. That is, recovery of MGP costs over 10-years, without carrying charges and crediting of 60% insurance proceeds to ratepayers, 40% to the shareholders of KGS.

On September 28, 2017, the Parties met to discuss the possibility of settlement. Negotiations and modifications to the final settlement were ongoing until October 11, 2017 when the final Agreement was reached between the parties.

Terms of the Settlement Agreement

Q. Please provide an overview of the Agreement.

A. The Agreement calls for the Commission to grant KGS one AAO that would cover all MGP sites and all cash expenditures made by KGS after January 1, 2017. This would allow KGS to defer actual cash MGP expenditures to a regulatory asset, not to exceed a $15 million cap (net of insurance proceeds). KGS would then be allowed to seek recovery of this regulatory asset balance in its next rate case, amortized over a 15-year period. In rate cases following the first rate case in which KGS seeks to recover deferred MGP costs, the Parties may advocate for different amortization periods as long as the result is an effective disallowance of no less than 40% of the net present value of total net MGP costs.

The Agreement also calls for KGS to credit all insurance proceeds received after January 1, 2017, to the regulatory asset to offset the MGP costs incurred. If future MGP costs exceed $15 million, then KGS will be required to file an application in this Docket for approval to increase the $15 million under the AAO. If such a request is filed by KGS, CURB and Staff retain their individual rights to oppose that request and reassert any position taken in this Docket. KGS will also be required to file annual reports detailing the activities performed on the MGP sites, upcoming activities expected, and the costs and insurance reimbursements associated with each MGP site.

Q. Please discuss the details of the provisions of the Agreement.

A. The provisions of the Settlement Agreement are as follows:

- The Commission would issue one AAO that will cover all MGP sites and all cash expenditures made by KGS after January 1, 2017, relating to all MGP Costs. This will allow KGS to accumulate in account 182.3, and seek approval to recover in subsequent rate cases, the actual and prudent MGP Costs it incurs beginning on January 1, 2017, at the twelve (12) former MGP sites currently managed by KGS, which are identified in this Docket.

- MGP costs are defined as actual prudent external costs incurred after January 1, 2017, and which are necessary for the investigation and remediation work at MGP sites approved by KDHE (hereinafter referred to as "MGP Costs"). MGP Costs would also include regulatory costs (except internal labor costs) incurred related to MGP site oversight by the Kansas Department of Health and Environment (KDHE), and well as costs incurred in this Docket and any compliance docket.
- MGP costs would not include internal labor costs. MGP Costs will also not include any and all costs incurred by KGS relating to any causes of action or any third-party claims relating to the MGP sites, including but not limited to claims for third party-damages, claims for injunctive relieve, declaratory judgements, claims pertaining to nuisance and/or claims formed under the common law ("Non-MGP Costs").
- KGS will be allowed to defer and seek recovery of 100% of the MGP Costs that it has deferred in accordance with this Agreement. For the first rate case in which Kansas Gas Service seeks recovery of MGP costs that it has deferred, KGS shall use a 15-year amortization period. KGS will be allowed to continue to defer and seek recovery of 100% of MGP Costs as defined in this Agreement in subsequent rate cases.

- Each respective set of MGP Costs KGS seeks recovery of shall be considered a separate tranche. Excluding the first tranche, which shall be assigned a 15-year amortization period, KGS shall be allowed to seek an amortization period for each separate tranche of MGP Costs provided the amortization period cannot result in ratepayers paying greater than a net present value of 60% of MGP Costs. Parties, other than KGS, reserve the right to argue a different amortization period should apply as necessary to effectuate any and all degrees of ratepayer / shareholder cost recovery. KGS reserves the right to rebut the positions of other Parties in the event other Parties recommend an amortization period that would result in ratepayers paying less than a net present value of 60% of MGP Costs. Once a MGP Cost tranche's amortization period has been approved by the Commission, no Party shall be allowed to recommend the MGP Cost tranche's amortization period should be altered.
- Any unamortized MGP Costs shall not be included in rate base in rate cases or accumulate carrying charges outside of a rate case.
- The expenditures relating to the MGP Costs covered by the AAO shall be limited to $15 million, net of insurance recoveries, under the AAO. If future MGP Costs net of insurance recoveries are expected to exceed $15 million, then KGS will be required to file an application in this Docket for approval to increase the $15 million amount under the AAO.
- Staff and CURB reserve the right to challenge a request to increase the $15 million cap, and in these regards, do not waive their unequivocal right to reassert any argument posed in this docket with respect to any such requested increase,

including the assertion that any such increase should be borne entirely by shareholders of KGS and KGS reserves the right to reassert any rebuttal argument posed in this docket should Staff and CURB reassert any argument posed in this docket.

- 100% of the proceeds paid by insurance companies after January 1, 2017, in reimbursement to KGS for investigation and remediation costs incurred in connection with the investigation and remediation work at the MGP sites approved by KDHE included in this Application, shall be applied by KGS to reduce the gross MGP Costs as defined above.
- To the extent possible, KGS shall track and match up proceeds received from insurance with the cost paid and the site to which it is related. The Parties understand and agree that other general liability claims could be made against the insurance policies for recovery of Non-MGP costs, but neither the costs related to those claims or any insurance proceeds relating to those claims shall be covered under this AAO and this Agreement.
- At the time the Parties mutually agree that this Docket or compliance docket can be closed and there are insurance proceeds in excess of the MGP Costs paid by insurance companies to reimburse KGS for MGP Costs (as defined herein) that KGS has asked its customers to pay, then KGS shall be allowed to retain those excess insurance proceeds at the time the Commission closes out this Docket. Upon closure of the Docket, KGS will not be permitted to seek recovery from Kansas ratepayers of future MGP Costs related to KGS's Kansas MGP sites,

regardless of whether or not such MGP Costs are known or unknown, definite or contingent, or arise from MGP sites covered by this Agreement or otherwise.

- By April 1 of each year, KGS shall file with the Commission an annual report in a compliance docket. The report shall include:
    1. All reports provided to KDHE during the preceding calendar year;
    2. A summary of the MGP Costs incurred in the preceding calendar year;
    3. A description of the scheduled work conducted in the preceding calendar year and work to be conducted in the subsequent calendar year as well as a cost estimate for such work;
    4. The amount of insurance proceeds KGS received related to MGP Costs in the preceding year.
- KGS shall, to the extent possible, include in the annual report: 1) MGP Costs (and invoices reflecting those MGP Costs) broken down by MGP site and; 2) proceeds paid by the insurance company to reimburse KGS for MGP Costs matched up to MGP Cost invoices and broken down by MGP site if possible.
- In addition to the above-mentioned reporting requirements, if KGS becomes aware of additional remediation projects that are reasonably expected to exceed $1 million, it shall meet with the Staff and CURB to provide them the scope of the work to be performed under the project that has been approved by KDHE. During this meeting KGS will provide the estimated cost for the work to be performed, an explanation with support of how the work will be performed, an explanation of the reasonableness of the work to be performed, an explanation as to what other options

KGS evaluated, and an explanation as to why the option chosen by KGS and approved by the KDHE was selected over the other options.

Commission Standards for Approving Settlement Agreements

Q. Has the Commission previously used factors or standards to review a settlement agreement?

A. Yes. The Commission's Order in Docket No. 08-ATMG-280-RTS (08-280 Docket) discusses five factors, or standards, and multiple agreements have been reviewed by the Commission using the five factors since that Order.

Q. What standards does the Commission generally examine when considering a unanimous settlement agreement?

A. The Commission may accept a settlement agreement so long as approval of the settlement is: (1) supported by substantial competent evidence in the record as a whole; (2) results in just and reasonable rates; and (3) is in the public interest. Each of these factors is discussed individually below.

Support for the Settlement Agreement

Q. Please address whether the Agreement is supported by substantial competent evidence in the record as a whole.

A. The Agreement is supported by substantial competent evidence in the record as a whole. The Agreement is supported by KGS's Application, and the Parties' Direct, Cross-Answering and Rebuttal Testimony. Staff analyzed the Application and formed its own conclusions which were filed in Direct Testimony. CURB also reviewed the filing and stated its positions in Direct and Cross-Answering Testimony. These filed positions represent the body of evidence the Commission would rely on to make a determination of the issues presented by this case if the case were to go to a full evidentiary hearing. The Parties also relied on this evidence in negotiations and eventually arrived at an agreed upon resolution of the issues. It is Staff's position that the terms of this Agreement approximate what could be expected if the case were to be fully litigated.

Q. **KGS's Application requested a 10-year amortization period, consistent with the Commission Order in the 1993 Kansas Public Service Company Docket No. 185-507-U. How was the 15-year amortization period contained in the Agreement determined?**

A. There is not a specific quantification or delineation in the Agreement regarding how the 15-year amortization period for the first rate case was determined. Therefore, each party to the agreement would likely have a different opinion as to how that time period was developed. From Staff's perspective, the 15-year amortization period is a negotiated number that recognizes that in today's low capital cost environment, recovering MGP costs over 10-years without carrying charges does not equate to a 40% "effective" disallowance (reduction in net present value recovered) of MGP Costs. In my Direct Testimony I explained that the net present value of MGP Costs recovered over 10-years, using a discount rate equal to the after-tax WACC that resulted from KGS's last base rate case before this Commission, equates to a 28% effective disallowance.

In rebuttal testimony, KGS witness David Scalf countered this argument by suggesting that the period of MGP Cost recovery could be lengthened by three years, for a total 13-year amortization period, in order to effectuate the 40% disallowance. Mr. Scalf supported his 13-year calculation using KGS's requested WACC from its last rate case. When I replicate that same calculation using Staff's recommended WACC from

KGS's last rate case, the amortization period increases to 16.4 years to effectuate the 40% effective disallowance. Ultimately, the effective amount of disallowance associated with amortization over a number of years, without carrying costs, will vary based on the utility's cost of capital at any given time.

Taking all of this into account, including CURB's arguments that the disallowance percentage should be at least 50%, the parties agreed upon a 15-year amortization period for the first tranche of MGP costs, with a process for the Parties to argue for different amortization periods in the future in order to effectuate a disallowance percentage of no less than 40% of net MGP Costs on a net present value basis.

Q. Will the Agreement result in just and reasonable rates?

A. Staff believes the Agreement will result in just and reasonable rates. While the Agreement technically does not affect current rates, it does provide an Accounting Authority Order that will likely affect rates in the future. Staff contends that the Agreement will result in just and reasonable rates because the Agreement resolves many of Staff's concerns with the Application as it was filed.

For example, one of Staff's primary concerns with KGS's Application is that KGS was seeking to shift an open-ended and unquantifiable risk associated with the MGP sites to ratepayers. However, the Agreement limits and caps this potential ratepayer exposure under this AAO to $15 million unless KGS seeks to increase the cap at some future date, which CURB and Staff can oppose. Also, given the length of the amortization period agreed to by the Parties, this $15 million in cost, if incurred, will not cause rate shock for KGS's customers.

Another concern of Staff's with the original Application was KGS's request to retain all insurance proceeds up to $9.49 million, and only share 60% of proceeds above that amount with ratepayers. With this Agreement, KGS will be required to credit 100% of all insurance proceeds received in reimbursement of MGP Costs to the regulatory asset. In other words, only *net* MGP Costs, (gross MGP Costs less insurance proceeds) will be amortized to ratepayers.

Lastly, in Direct Testimony Staff expressed concern that the reporting requirements proposed in the Application were deficient and that there was a need for a more robust and formalized Staff involvement in the review of MGP Costs and KGS remediation activities. The Agreement addresses this concern by requiring KGS to submit extensive and detailed reporting on an annual basis regarding the extent of MGP Costs and remediation activities, by MGP site. Additionally, the Agreement requires KGS to meet with Staff and CURB in the event that a significant MGP remediation project ($1 million or more) is identified. This meeting will allow Staff and CURB to question and review the scope of the work involved in the project, the reasonableness of the project, the other options available to KGS for this project, and other considerations.

With these major concerns alleviated by the Agreement, Staff's position is that this Agreement will assist the Commission in setting just and reasonable rates for KGS in the future.

Q. Does Staff believe that the result of the Agreement are in the Public Interest?

A. Yes. There were multiple interests represented by the Parties involved in the negotiations, with CURB representing the interests of residential and small general service ratepayers, KGS representing the interest of its management and shareholders, and Staff attempting to balance each of these interests while representing the interests of the public generally. Because these varied interests were able to collaborate and present a unanimous resolution of the issues in this case, Staff believes the public interest standard has been met.

Staff offers the following factors in support of the fact that the Agreement is in the public interest:

1. The Agreement provides a formal and efficient resolution of a major policy issue that would have to be addressed in future KGS rate cases. By coming to a resolution of this issue now, the Parties and the Commission know what to expect regarding this issue in future KGS rate cases;
2. The Agreement provides for deferred MGP Costs to be amortized over 15-years for the first rate case. For subsequent rate cases, the amortization period can vary to whatever period of time accomplishes an effective disallowance of at least 40% of the net present value of MGP Costs;
3. The Agreement provides for 100% of all insurance proceeds received by KGS relating to reimbursement of MGP Costs to be credited against the regulatory asset that contains the deferred MGP Costs. In other words, only MGP Costs net of insurance recoveries will be recovered from ratepayers over 15 years;
4. The Agreement requires KGS to report to the Commission annually regarding the nature of current and future MGP Costs and activities, by site. The Agreement also formalizes a requirement for KGS to meet with

Staff and CURB in the event that a new significant (containing costs of at least $1 million) MGP remediation project is identified; and

5. Last, the Agreement avoids the much more costly and time-consuming process of fully litigating these issues before the Commission in an evidentiary hearing. The positions of the Parties in Direct Testimony in this proceeding were widely varied and disparate. The fact that the Agreement avoids the time and expense necessary for the Commission to decide this case at hearing is support for the fact that the Agreement is in the public interest.

Q. Does this conclude your testimony?

A. Yes, it does.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Justin T. Grady, being duly sworn upon his oath deposes and says that he is Chief-Accounting and Finance, Utilities Division, of the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Testimony in Support of Unanimous Settlement Agreement,* and that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Justin T. Grady
Chief-Accounting and Finance, Utilities Division
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 12th day of October, 2017.

PAMELA J. GRIFFETH
Notary Public - State of Kansas
My Appt. Expires 08-17-2019

Pamela J. Griffeth
Notary Public

My Appointment Expires: August 17, 2019

CERTIFICATE OF SERVICE

17-KGSG-455-ACT

I, the undersigned, certify that a true and correct copy of the above and foregoing Testimony in Support of Unanimous Settlement Agreement was served by electronic service on this 12th day of October, 2017, to the following:

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CERTIFICATE OF SERVICE

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