

**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 a Privatization Contract Establishing the)
Terms, Conditions, Rates, and Charges for)
Ownership and Operation of the Natural Gas)
Distribution System Serving Fort Riley, Kansas,)
and for Approval of the Proposed Accounting)
Treatment of the System)**

Docket No. 19-KGSG-194-CON

**PUBLIC TESTIMONY IN SUPPORT
OF UNANIMOUS SETTLEMENT AGREEMENT**

PREPARED BY

JUSTIN T. GRADY

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

May 3, 2019

**** [REDACTED] ****

DESIGNATES REDACTED INFORMATION

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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. Are you the same Justin T. Grady that filed direct testimony in this docket on March 29, 2018?

A. Yes.

Q. Please identify 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 Staff, Kansas Gas Service, a Division of ONE Gas, Inc. (KGS), and the Citizens' Utility Ratepayers Board (CURB) (collectively, the Parties).¹

¹ Joint Motion to Approve Unanimous Settlement Agreement, Docket No. 19-KGSG-194-CON (April 29, 2019). <http://estar.kcc.ks.gov/estar/ViewFile.aspx/S20190429155900.pdf?Id=8baf1631-168c-4b83-a6c8-4d77b4852d71>

My testimony will explain why the Commission should approve the Agreement as a reasonable resolution of the issues in this Docket, which is in the public interest and will produce just and reasonable rates. 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 Agreement²; and
- discuss the evidence in the record that supports the Agreement.

II. Background

Q. Please provide some background information about this Docket.

A. On November 13, 2018, KGS filed public and confidential versions of an Application with supporting testimony of three witnesses seeking approval of a September 27, 2018, privatization contract (the Contract) between KGS and the Defense Logistics Agency (the Government). The Contract established the terms, conditions, rates, charges, and costs for KGS's ownership and operation of the natural gas distribution system at Fort Riley, Kansas (the Distribution System). KGS also sought approval of the proposed accounting treatment for the privatized system.

The Contract, which is subject to Commission approval, provides that KGS will purchase and operate the Distribution System for a 50-year period after completion of an 18-month transition period. Terms of the Contract address the purchase price and payment

² *Order Approving Contested Settlement Agreement*, Docket No. 08-ATMG-280-RTS, pp. 4-6 (May 12, 2008).

1 schedule for the Distribution System, as well as a Contract Rate Charge the (CRC) to be
2 paid by Fort Riley for provision of the privatized natural gas distribution service by KGS.
3 The CRC is to be recalculated at least annually. The CRC includes a return on KGS's
4 undepreciated investment in the Distribution System assets utilizing the rate of return most
5 recently established by the Commission for KGS (if a rate of return is not specified, the
6 carrying charge utilized for Gas System Reliability Surcharge filings will be used). Other
7 components of the CRC are: recovery of operation and maintenance costs based on KGS's
8 system average costs; allocated administrative and general costs (including corporate
9 costs); and depreciation expense. Additionally, Fort Riley will pay a monthly charge
10 designated as the ** [REDACTED] ** to
11 provide for recovery of anticipated incremental costs required to operate and maintain the
12 Distribution System.

13 In the Application, KGS proposed to include revenues, investments, and costs
14 associated with providing the privatized service in its overall calculation of rate base, cost
15 of service, and revenue requirement for its Kansas jurisdictional operations. KGS also
16 proposed that certain costs associated with the privatized service, including Distribution
17 System capital investments and related depreciation, be tracked and accounted for
18 separately.

19 KGS testified that the privatization of the Distribution System was consistent with
20 nationwide efforts by the United States Department of Defense to privatize utility systems
21 on military bases in order to streamline operations and focus on the military's core mission.
22 KGS also testified that the Contract would provide benefits to KGS's other customers
23 because some allocated corporate overhead costs and other fixed costs of operating a

1 natural gas distribution system would be paid for by the Government according to the
2 Contract. These are costs that KGS's other ratepayers would have to pay for, "but for" the
3 Government paying for them pursuant to the Contract.

4 KGS also testified that the Distribution System lies within KGS's certificated
5 service territory but that the Fort Riley military installation current owns and operates the
6 Distribution System. The Distribution System includes an estimated 3,600 service
7 connections and 115 miles of distribution mains and service lines. KGS currently provides
8 regulated natural gas transportation service to Fort Riley at ten border station delivery
9 points under a Commission-approved tariff. The terms of the Contract do not affect the
10 terms and conditions of KGS's transportation tariff, nor Fort Riley's procurement of its
11 natural gas supply.

12 On March 29, 2019, Staff filed Direct Testimony of two witnesses, Mr. Leo Haynos
13 and myself.³ My testimony addressed the fact that the Contract exposes other KGS
14 ratepayers to the potential risk that the revenue requirement associated with serving the
15 Distribution System under the Contract would be less than the total revenue received by
16 KGS from the Government. Because KGS's proposal is to include all revenue, expenses,
17 and capital investment associated with the Contract in its rate cases, any potential revenue
18 deficiency would affect other KGS customers. However, I also recognized that there was
19 the potential for this Contract to benefit other KGS customers in the event that revenues
20 under the Contract exceeded the directly incurred revenue requirement associated with
21 serving the Distribution System.

³ As Mr. Haynos is filing testimony in support of the Agreement as well, for purposes of this testimony I will focus on the issues outlined in my Direct Testimony.

1 Additionally, I recognized and agreed with KGS that the Contract does advance the
2 United States Department of Defense policy of pursuing privatization of Government-
3 owned utility systems on active military institutions. Additionally, I stated that KGS
4 should be able to provide natural gas delivery service more safely and reliably than the
5 Government. Thus, my opinion was that in the absence of ratepayer detriment (in the form
6 of increased rates for other KGS customers), this Contract had the potential to promote the
7 public interest. In order to protect against potential ratepayer detriment, I recommended
8 the following conditions to the Commission's approval of the proposed Contract:

- 9 1. KGS agrees to establish and maintain specifically identifiable subaccounts
10 within its accounting systems in order to separately track and account for all
11 capital investments, revenues, and expenses directly associated with serving
12 Fort Riley under the Contract.
13
- 14 2. KGS agrees to provide testimony and supporting calculations in all future
15 KGS rate cases or tariff rate change proceedings in Kansas that details the
16 following:
 - 17 ▪ The revenue recorded during the test year associated with the Fort
18 Riley Contract, any adjustments to that test year revenue, and the
19 fully adjusted test year revenue reflected in KGS's cost of service
20 schedules;
 - 21 ▪ All capital investments and accumulated depreciation recorded
22 during the test year associated with the Fort Riley Contract, any
23 adjustments to these test year categories, and the fully adjusted test
24 year values for these categories as reflected in KGS's cost of
25 service schedules;
 - 26 ▪ All directly identifiable expenses associated with serving Fort
27 Riley under the Contract, including: operating and maintenance
28 (O&M) expenses, meter reading expenses, payroll expenses,
29 employee benefit expenses and any other expense specifically
30 related to serving Fort Riley under the Contract. These expenses
31 need to be identified for the test year, any adjustments to the test
32 year, and for the fully-adjusted test year;
 - 33 ▪ KGS's determination of whether revenues in the fully adjusted test
34 year cost of service associated with the Contract exceed the
35 revenue requirement associated with all capital investment and
36 expense items directly related to serving Fort Riley under the
37 Contract; and

- All adjustments to the test year that are necessary in order to eliminate any detriment to current ratepayers from the Fort Riley Contract, if the results of the above calculations show that ratepayers would otherwise experience detriment from the Fort Riley Contract.

3. KGS unequivocally agrees to the concept that ratepayers should not experience a detriment (defined as a rate increase that would not otherwise occur but for the Fort Riley Contract) from the Fort Riley Contract in all future KGS rate cases or tariff changes affecting KGS rates. KGS will perform the above calculations and attest to the fact that either ratepayers are benefitting from the Fort Riley Contract or that KGS has made the appropriate adjustments in the rate case or tariff proceeding to eliminate any detriment for ratepayers from the Fort Riley Contract.
4. KGS agrees to file the Contract Rate Charge (CRC) and all documentation, work papers, etc. necessary to support the CRC annually in a KCC Compliance Docket. This will allow for a permanent repository of this data in the event that disputes arise between KGS and the Government, or between KGS and any party to a future KGS rate case affected by the Contract.

On April 18, 2019, KGS filed the rebuttal testimony of three witnesses. While KGS did not agree with the necessity of all of Staff's conditions, it did agree to the majority of Staff's proposed conditions, with some modifications. Because the differences of opinion between the Parties were so minor, formal settlement discussions in this Docket occurred via teleconferences and electronic mail communications. By April 26, 2019, the Parties had reached the Agreement, which was filed in the Docket on April 29, 2019.

III. Terms of the Agreement

Q. Please provide an overview of the Agreement.

A. The Agreement contains the conditions upon which the Parties agree that the Commission should approve KGS's proposed Contract with the Government to provide natural gas

1 delivery service to the Distribution System. The conditions that pertain to my areas of
2 responsibility in this Docket are as follows:

3 14. KGS will establish and maintain a cost center(s) specific to Fort Riley that
4 will enable the Company to separately track and account for all direct, incremental
5 capital investments and expenses, as well as the revenues associated with providing
6 service to Fort Riley under the Contract. In all KGS rate cases or tariff rate change
7 proceedings filed prior to 2030 (after which this provision will be revisited), KGS
8 will provide testimony and supporting calculations that detail:

9 a) The revenue recorded during the test year that is associated with the
10 Contract, any adjustments to test year revenue, and the fully adjusted test year
11 revenue reflected in the cost of service schedules;

12
13 b) The capital investments and accumulated depreciation recorded during the
14 test year that is associated with the Contract, any adjustments to capital or
15 accumulated depreciation, and the fully adjusted test year values for these
16 categories as reflected in the cost of service schedules;

17
18 c) The direct, incremental expenses associated with serving Fort Riley under
19 the Contract. Direct expenses are those expenses for which the responsibility can
20 be specifically traced or attributed to serving Fort Riley. This includes: direct
21 operating and maintenance expense, meter reading expense, payroll expense,
22 employee benefit expense, and any other direct expense specifically related to
23 service Fort Riley under the Contract. (The Parties agree that this calculation
24 specifically excludes all expenses allocated on a causal or ONE Gas Distrigas
25 basis). These expenses will be identified for the test year, any adjustments to the
26 test year, and for the fully adjusted test year;

27
28 d) The determination of whether the fully adjusted test year Contract revenues
29 (as identified in (a) above) exceed the Commission authorized return on net
30 investments and expense cost of service items specified in (b) and (c) above; and

31
32 e) The adjustment to the test year revenue that is necessary to eliminate any
33 detriment of the Contract for current KGS customers. A detriment would occur if
34 the result of the calculation in (d) above shows that the fully adjusted test year
35 revenues are less than the cost of service items specified in (b) and (c).

36
37 15. KGS agrees that other KGS customers should not experience a detriment
38 resulting from the Contract in rate cases or tariff rate changes filed prior to

2030(after which this provision will be revisited). Here, detriment is defined as “a rate increase that would not have occurred but for the Contract.”

16. KGS will attest to the fact that either KGS customers are benefiting from the Contract or that the Company has made the appropriate adjustment in the rate case or tariff proceeding (as may be filed prior to 2030) to eliminate any detriment resulting from the Contract.

17. The Parties recognize and agree that by 2030, KGS will have gained enough knowledge about and experience with the Fort Riley system, and would have also shared a significant amount of data with Staff sufficient to warrant revisiting the requirements and conditions in paragraphs 14, 15, and 16. If no detriment has been identified in this time-period, it may be reasonable to discontinue the administrative obligations contained within paragraphs 14, 15, and 16. Therefore, the parties agree that KGS may initiate a formal Commission review and reevaluation of this provision prior to the conclusion of 2029. This review may be initiated by KGS either within an application of a formal rate case or other proceeding. To be clear, in the absence of a Commission Order approving the discontinuation of the conditions contained within paragraphs 14, 15, and 16, those conditions shall remain in full force and effect until otherwise ordered by the Commission.

18. KGS will file, annually, the CRC and all documentation, work papers, and other documentation necessary to support the CRC, in a compliance docket established by the Commission. This compliance docket will serve as the permanent repository for the CRC reporting and supporting data so that this information is available in the event that a dispute arises between KGS and the government or between KGS and any party to a future KGS rate case who is affected by the Contract.

These conditions differ very little from the conditions I recommended in my Direct Testimony, with one exception. That is, after ten years, KGS has the opportunity to request that the Commission approve the discontinuation of the requirements and conditions contained within paragraphs 14, 15, and 16 of the Agreement.

1 **IV. Standard of Review for the Agreement**
2

3 **Q. Has the Commission previously established standards upon which it will review**
4 **unanimous settlement agreements like the one presented for Commission approval**
5 **in this Docket?**

6 A. Yes. In several Dockets, most recently in Docket No. 19-SEPE-054-MER⁴, the
7 Commission has confirmed that a unanimous settlement agreement (like the Agreement
8 presented in this Docket) must meet three important standards if it is to be approved. The
9 agreement must:

- 10 1. be supported by substantial competent evidence,
11 2. result in just and reasonable rates; and
12 3. promote the Public Interest.

13 **Q. Does Staff contend that the Agreement filed in this Docket meets the standards the**
14 **Commission has established for approval of a unanimous settlement agreement?**

15 A. Yes. In the testimony that follows, I will present each of these standards individually and
16 support why I contend that the Agreement between the Parties in this Docket meets or
17 exceeds each of these standards.

18 **A. Substantial Competent Evidence Standard**

19 **Q. Why does Staff contend that the Agreement is supported by substantial competent**
20 **evidence?**

21 A. The Agreement is supported by KGS's Application and the testimony filed in support of
22 the Application, Staff's Direct Testimony, the Rebuttal Testimony of KGS, and the

⁴ See March 28, 2019 Order Approving Unanimous Settlement Agreement;
<http://estar.kcc.ks.gov/estar/ViewFile.aspx/20190328103840.pdf?Id=29272269-c1cf-4b1d-8fc5-04b424342540>

1 Testimony being filed in Support of the Agreement. Additionally, the conditions contained
2 within the Agreement differ very little from the conditions recommended by Staff in Direct
3 Testimony.

4 **Q. Why is it reasonable to allow KGS to request Commission approval of the**
5 **discontinuation of conditions 14, 15, and 16 after ten years?**

6 A. Staff agreed to this change in our recommended conditions after consideration of KGS's
7 rebuttal testimony. Also, Staff's agreement with this change is in recognition that many of
8 our concerns about this Contract are due to the fact that currently there are many unknowns
9 associated with KGS providing utility service to the Distribution System. These unknowns
10 include the actual condition of the system and exactly how much more complicated it will
11 be to provide utility service on an active military institution. Ultimately, Staff recognizes
12 that after 10 years of KGS operating under the Contract, it is possible that Staff's current
13 concerns about risks to KGS's other ratepayers from the Contract may be alleviated. It is
14 reasonable to leave open the possibility that in the future, should these concerns be
15 alleviated, it may make sense to allow the discontinuation of these conditions. On the other
16 hand, there is no guarantee that the Commission will grant KGS's request in the future, this
17 change simply allows KGS to ask.

18 **B. Just and Reasonable Rates Standard**

19 **Q. Why does Staff contend that the Agreement will result in just and reasonable rates?**

20 A. The Agreement will result in just and reasonable rates because the conditions contained
21 within the Agreement ensure that KGS's other ratepayers will not subsidize any revenue
22 deficiencies that may arise in the future. Additionally, if KGS is successful in its operations
23 under the Contract, then the Government will pay for an allocated portion of general plant

1 and common overhead expenses that KGS's ratepayers would otherwise pay for in a
2 general rate proceeding. In other words, given the conditions contained in the Agreement,
3 the Contract can only help KGS's other ratepayers, but it cannot hurt them.

4 **C. Promote the Public Interest**

5 **Q. Why does Staff contend that the Agreement will promote the public interest?**

6 A. Staff's contention that the Agreement will promote the public interest is due to the
7 following facts:

8 1. Under the Contract, the Government will pay for allocated general plant and
9 common overhead expenses that KGS customers would otherwise pay for in a rate
10 proceeding. This will result in lower rates for KGS's customers than otherwise
11 would be the case. Additionally, given the conditions contained within the
12 Agreement, KGS has agreed to make ratepayers whole for any revenue deficiencies
13 that may arise during the operation of the Contract, so while ratepayers may benefit
14 from lower rates as a result of the Contract, they will not experience any detriment
15 from it.

16 2. The Contract advances the United States Department of Defense policy of
17 pursuing privatization of Government-owned utility systems on active military
18 institutions. Because Fort Riley is an important part of the Kansas economy and
19 the security of this Country, advancing this policy is in the interest of all Kansans.

20 3. Staff is of the opinion that KGS should be able to provide natural gas delivery
21 service more safely and reliably under the Contract than the Government currently
22 can, which is in the public interest.

1 **V. Conclusion**
2

3 **Q. Please summarize your testimony and recommendation in this Docket.**

4 A. I recommend that the Commission approve the Agreement between the Parties in this
5 Docket. The Agreement is based on substantial competent evidence in the record, will
6 result in just and reasonable rates, and will promote the public interest.


7 **Q. Does this conclude your testimony?**

8 A. Yes.
9

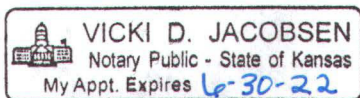
STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

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 *Testimony in Support of Settlement Agreement*, 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 3rd day of May, 2019.




Notary Public

My Appointment Expires: 06-30-22

CERTIFICATE OF SERVICE

19-KGSG-194-CON

I, the undersigned, certify that a true and correct copy of the above and foregoing Staff Justin Grady Testimony in Support of Settlement Agreement was served via electronic service this 3rd day of May, 2019, to the following:

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19-KGSG-194-CON

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