

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,

/s/ Robert Elliott Vincent

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**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

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

FROM: John Bell, Senior Managing Auditor
Gary Dawdy, Utilities Engineer II
Justin Grady, Chief of Accounting and Financial Analysis
Leo Haynos, Chief Engineer
Jeff McClanahan, Director of Utilities

DATE: July 13, 2017

SUBJECT: Docket No. 17-BHCG-511-ACQ
In the Matter of the Application of Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy ("Black Hills") for an Extension of its Certificate of Convenience and Authority to Operate as a Natural Gas Public Utility in an Area Heretofore Served by the City of Attica, Kansas, a Municipally Owned Natural Gas Utility

EXECUTIVE SUMMARY:

Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills or Applicant), has made this filing in 17-BHCG-511-ACQ to acquire the properties and a Certificate to serve the municipal natural gas system currently operated by the City of Attica, Kansas (City or Attica). The City and Black Hills have filed and seek approval by the Commission of an Asset Purchase Agreement providing for the sale of the City's natural gas system to Black Hills. Staff is recommending the following:

- Approval of the Asset Purchase Agreement;
- Grant Black Hills' Certificate request for the territory reflected in Exhibit 3 in Docket No. 17-BHGC-511-ACQ;
- Permit Black Hills to charge the customers acquired from the City Black Hills' current statewide rates and tariff on file with the Commission; and

- Allow Black Hills to record the purchase price of the system assets at its current distribution system average per customer embedded cost for accounting and ratemaking purposes.

BACKGROUND:

On May 19, 2017, Black Hills filed an Application in Docket No. 17-BHCG-511-ACQ requesting, pursuant to K.S.A. 66-131, that the Kansas Corporation Commission (Commission) issue an extension of its Certificate of Convenience and Authority to operate as a natural gas public utility in and adjacent to the area heretofore served by the City of Attica, Kansas, a municipally owned natural gas utility.

Black Hills is a limited liability company organized under the laws of the State of Kansas. It is authorized to do business and is conducting business in the State of Kansas. Applicant is engaged in transporting, distributing, and selling natural gas in Kansas and serves approximately 114,000 residential, commercial, industrial, and public authority customers in Kansas. Applicant's Kansas operations are subject to the jurisdiction of the Commission.

Black Hills will enter into a purchase agreement with the City to purchase all of its properties and facilities used for the distribution of natural gas in the City of Attica, Kansas, for \$300,000. The Asset Purchase Agreement between the City and Black Hills is attached to the Application as Exhibit 2.¹ The price paid does not exceed Black Hills' average embedded cost for distribution facilities per customer and it intends to pay cash for the acquisition.

Attached as Exhibit 1 to the Application are the results of the election where the citizens of Attica voted to sell the distribution system to Black Hills.² Applicant requests that an Order approving the acquisition be issued so that Black Hills can close no later than July 31, 2017.

Black Hills is seeking to change the current rates for natural gas service to customers in the City of Attica, Kansas. Applicant intends to use its statewide approved rates that currently are on file with the Commission and intends to render efficient and sufficient service to the present customers of the City. A comparison of the City of Attica's rates and Applicant's proposed rates is attached to the Application as Exhibit 4. The rate comparison shows that the average residential bill would decrease by approximately \$21.00 annually with the use of Black Hills' rates.

Black Hills also acknowledges that approximately \$50,000 of minor improvements to upgrade service regulators and attach ERT's to meters will be necessary. However, no surcharge is being requested as part of this Application.

Attica currently purchases unprocessed gas³ from the West Wichita Gas Gathering System (WWGGS). At this time, the WWGGS is owned and operated by AKA Energy Group, LLC

¹ The Asset Purchase Agreement was late-filed on June 6, 2017.

² The referendum was held on February 28, 2017. The result was 82 votes for, 11 votes against.

³ Unprocessed gas is defined as natural gas delivered from a wellhead that may contain impurities and various non-methane hydrocarbons and fluids.

(AKA). Black Hills also currently purchases gas from AKA to serve 50 farm tap customers that are connected to the WWGGS. In its Application, Black Hills proposes to terminate the Attica/AKA supply contracts and purchase its supply in accordance with its normal purchasing practices. The Attica gas supply will continue to be unprocessed gas supplied by the WWGGS.

For accounting and ratemaking purposes, Black Hills requests to record the purchase price of the system assets at its current distribution system average per customer embedded cost for meters, services and mains on an original cost basis.

ANALYSIS:

KCC Program For Acquiring Municipalities

On August 22, 2007, in Docket 08-ATMG-182-ACQ (08-182), Atmos Energy (Atmos) filed an Application with the Commission seeking approval of a program to acquire Kansas municipal gas systems. The program lays out a process for the acquisitions that include provisions for determining a purchase price, voting procedures as required by K.S.A. 15-809, noticing affected customers, and assumption of supply and transportation contracts as appropriate. The program also sets forth a separate set of regulatory terms and conditions that govern the recording of the transaction, rate making procedures for any required system improvements, and provisions for the transfer of certificated territory. Following minor modifications by Staff, the program referred to above was approved by the Commission in an Order dated December 18, 2007. Paragraph 11 of the Order lays out the process for acquisitions, and paragraph 12 of the Order lays out the regulatory terms and conditions of the process. In particular, paragraph 13 of that Order states, "...Staff believes the process submitted by Atmos to be a good template for any public utility and municipality considering the sale of a municipal system."

It is Staff's view that this instant filing by Black Hills to acquire the gas distribution system facilities of the City of Attica comports in all material respects with the program approved by the Commission in the 08-182 Docket.

Qualifications of Purchaser

As a certificated gas utility in Kansas, Black Hills is qualified to purchase and operate the City's gas distribution utility system. Further, Black Hills has both the financial resources and technical expertise to provide sufficient and efficient service to the citizens of Attica. As of the date of the Application, the City has approximately 375 customers.⁴ As cited above, the City has approved the sale of the system by a majority vote and desires to free itself from the financial and technical responsibilities of operating a natural gas distribution system.

Purchase Price

The purchase price of \$300,000 is reasonable. This equates to approximately \$800 (\$300,000 / 375) per customer, which is well below Black Hills' average embedded cost per customer of \$1,729. Attached to this Report and Recommendation (R&R) as Exhibit 1 is a rendition of Black Hills' average embedded cost per customer based upon data from the Company's 2016 KCC Annual Report, which supports the \$1,729 figure stated above.

⁴ Application, paragraph 3.

Condition of Acquired Facilities - Rates

Staff notes the terms and conditions approved by the Commission in the 08-182 Docket would require Black Hills to make any improvements to the system at its own expense until the sum of the purchase price and amount invested in improvements equals Black Hills' average imbedded customer cost.⁵ In the event that system improvements require investing more than the average imbedded cost per customer, the 08-182 Order would require Black Hills to recover the overage through a surcharge on the municipality customers that is agreed by the municipality prior to the system purchase. Black Hills states that only minor improvements to the acquired distribution assets will be necessary. Therefore, Black Hills has not requested a surcharge be implemented in the current Application.

As noted above, Black Hills will continue to obtain its source of gas for Attica from the WWGGS which supplies unprocessed natural gas. Because gas supply from gathering systems is limited to local production, there is a possibility that at some time in the future, the WWGGS would not have a sufficient supply of gas for Attica. In this case, supply constraints may also occur because of the financial viability of AKA, the operator of the WWGGS, which is not a public utility subject to Commission oversight. Because gathering system bankruptcies and/or supply shortages have happened in Kansas in the past, Staff believes the awareness of this possibility is warranted in this Docket. That being said, Staff has no evidence that the supply of gas from WWGGS is in danger of any type of disruption. Therefore, Staff does not believe a surcharge to the Attica customers for this possibility would be applicable. In the future event that Black Hills is required to connect Attica to a gas transmission pipeline, the estimated \$1.5 million cost⁶ for such an investment would be eligible for recovery through a traditional rate case filed by Black Hills.

Applicant will use its statewide approved rates, which were last set in Docket No. 14-BHCG-502-RTS and intends to render sufficient and efficient service to the present customers of the City.

Transportation/Supply Contracts – Ratemaking Procedures

Black Hills will consolidate existing transportation capacity and supply contracts with Black Hills' existing contracts at the first available opportunity. Pursuant to the regulatory terms and conditions set out in the Order in 08-ATMG-182-ACQ, it has been the practice of the Commission to allow the purchasing company to record the acquisition at the Company's average embedded cost per customer for accounting and ratemaking purposes. This is an acceptable practice in small acquisitions such as this one where the acquired assets do not have a depreciated net book value or original cost records.

Special Election of City of Attica

Black Hills has provided certified results of a special election where the citizens of Attica voted, pursuant to K.S.A. 15-809, to sell the City's natural gas system to Black Hills by a 82 to 11 margin.

⁵ The Average Embedded Customer Cost is \$648,706 (Exhibit 1, In 31). The amount paid is \$300,000, therefore the difference is \$348,706, which is available for improvements without surcharge.

⁶ Response to Staff Data Request 2.

Notice to Customers - Rate Comparison – Customer Comments

Black Hills has provided an Affidavit of Mailing of Notice to each City customer. The Notice advises of the proposed sale of the natural gas system and provides a comparison of the City and Black Hills' rates.⁷ The rate analysis covers the period March 2016 through February 2017 and shows that the total annual bill for an average residential customer under the city's rate was \$706, while under Black Hills rates the bill would have been \$685. Finally, the Notice to customers directs comments to the KCC. As of July 6, 2017, the KCC Public Affairs Division had received no comments regarding this Docket.

RECOMMENDATION:

Staff recommends that the Commission grant/approve the following:

- Approve the Asset Purchase Agreement for the sale of the City of Attica's natural gas distribution facilities to Black Hills;
- Grant the requested enlargement of Black Hills' Certificate of Convenience and Authority in the territory described in Exhibit 3 of the Application in Docket No. 17-BHGC-511-ACQ;
- Permit Black Hills to put into effect, and charge the customers being acquired from the City, Black Hills' current statewide rates and tariff on file with the Commission; and
- Allow Black Hills to record the purchase price of the system assets at its current distribution system average, per customer, embedded cost for meters, services, and mains, for accounting and ratemaking purposes.

⁷ The Affidavit and Notice to Customers was late-filed on May 25, 2017.

BLACK HILLS GAS
KANSAS GAS UTILITY

Exhibit 1
17-BHCG-511-ACQ

Average per customer embedded cost for Meters, Services, & Mains
2016 Kansas Supplemental Annual Report

FERC Account	Assigned Direct	Allocated	Source	Total	Cost Per Customer	Average Cost Original Cost
374 Land and Land Rights	370,721	14,711	(1)	385,432	\$ 3.46	\$ 1,297.16
375 Structures and Improvements	837,743		(1)	837,743	\$ 7.52	\$ 2,819.39
376 Mains	87,461,209		(1)	87,461,209	\$ 784.93	\$ 294,347.40
377 Compressor Station Equipment	174,659		(1)	174,659	\$ 1.57	\$ 587.81
378 Measure & Regulator Station Equipment-General	4,918,692	9,373	(1)	4,928,065	\$ 44.23	\$ 16,585.22
379 Measure & Regulator Station Equipment-City Gate	61,111		(1)	61,111	\$ 0.55	\$ 205.67
380 Services	53,694,596		(1)	53,694,596	\$ 481.89	\$ 180,707.14
381 Meters	18,636,332	569,699	(1)	19,206,031	\$ 172.37	\$ 64,637.17
382 Meter Install	1,928,246		(1)	1,928,246	\$ 17.31	\$ 6,489.44
383 House Regulators	17,919,667		(1)	17,919,667	\$ 160.82	\$ 60,307.96
384 House Regulators Installed	-		(1)	-	\$ -	\$ -
385 Industrial Measure & Reg Station Equipment	5,843,160		(1)	5,843,160	\$ 52.44	\$ 19,664.93
386 Other Property on Customer Premises	-		(1)	-	\$ -	\$ -
387 Other Equipment	49,909	7,495	(1)	57,404	\$ 0.52	\$ 193.19
388 Asset Retirement Costs - Distribution	256,812		(1)	256,812	\$ 2.30	\$ 864.29
	<u>192,152,857</u>	<u>601,278</u>		<u>192,754,135</u>	<u>\$ 1,729.88</u>	<u>\$ 648,706.77</u>
Number of Kansas Customers in BH 2016 Annual Report			(2)	111,426		
Number of Customers in Attica			(3)	375		
Source						
(1) Page 9 KS Supplemental Annual Report						
(2) Page 12 KS Supplemental Annual Report						
(3) Application Paragraph 3						

CERTIFICATE OF SERVICE

17-BHCG-511-ACQ

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 by electronic service on this 18th day of July, 2017, to the following:

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/s/ Pamela Griffeth

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