**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 Adjustment of its Natural Gas Rates in the State of Kansas.	))))	**Docket No. 24-KGSG-610-RTS**

DIRECT TESTIMONY

PREPARED BY

CHAD UNREIN

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

July 1, 2024

[REDACTED VERSION]

** [redacted] ** **Denotes Confidential Information**

Contents

I. Introduction, Qualifications, Assigned Responsibilities

Q. Would you please state your name?

A. My name is Chad Unrein.

Q. What is your business address?

A. My business address is 1500 Southwest Arrowhead Road, Topeka, Kansas 66604.

Q. By whom are you employed and in what capacity?

A. I am employed by the Kansas Corporation Commission (Commission) as the Chief of Accounting and Financial Analysis.

Q. Would you please describe your educational background and business experience?

A. I graduated with a Bachelor's of Business Administration (B.B.A.) with an emphasis in Accounting and a Certificate in Leadership Studies from Washburn University in 2004. In addition, I hold a Master's Degree in Business Administration (M.B.A) from Washburn University that was completed in 2010.

Prior to graduating with my B.B.A, I started an internship with Westar Energy, Inc. (d/b/a Evergy Central). Following graduation, I accepted a position as an Associate Accountant in the Financial Reporting Department of Westar Energy with various responsibilities, including the preparation of financial statements, FERC Regulatory Reporting, and developing financial analysis for managerial reports. In 2005, I accepted a position as a Risk Management Analyst in Westar's Risk Management Department, which was responsible for the oversight of Westar's asset and non-asset based energy marketing portfolios. My primary responsibilities in this position included counterparty credit analytics to establish credit limits, and virtual transaction reporting.

In 2006, I accepted a position at Security Benefit Group as a Portfolio Performance Analyst in their Asset Management Department. I was responsible for a variety of benchmarking analysis, risk/return evaluations, and portfolio performance assessments to aid fund managers in assessing fund performance.

I began my employment with the Commission as a Regulatory Auditor in January of 2014. At the Commission, I served in a variety of auditing positions with differing levels of responsibilities in the Commission's review of State, Federal, and Southwest Power Pool's regulatory matters. My most recent promotion as Chief of Accounting and Financial Analysis occurred in February of 2024. My current role includes the management of the Audit section of the Utilities Division.

While employed with the Commission, I've participated in and directed the review of various tariff/surcharge filings and rate case proceedings involving electric, natural gas distribution, water distribution and telecommunications utilities. In my new capacity as Chief of Accounting and Financial Analysis, I have a supervisory responsibility for the activities of the Commission's Audit section within the Utilities Division. In that capacity, I plan, manage, and perform audits relating to utility rate cases, tariff/surcharge filings, fuel cost recovery mechanisms, transmission delivery charges, alternative-ratemaking mechanisms, and other utility filings which have an impact on utility rates in Kansas.

Q. Have you ever testified before the Commission?

A. Yes, I filed testimony in Docket Nos. 14-SPEE-507-RTS, 14-BHCG-502-RTS, 14-MRGT-097-KSF, 15-SPEE-519-RTS, 15-SPEE-161-RTS, 15-KCPE-116-RTS, 16-MKEE-023-TAR, 16-SPEE-497-RTS, 16-KGSG-491-RTS, 17-SPEE-476-RTS, 18-WSEE-328-RTS, 18-KCPE-480-RTS, 19-MPCE-064-COC, 19-GBEE-253-ACQ, 19-EPDE-223-RTS, and 24-EKCE-775-RTS.

Q. What were your responsibilities in the review of Kansas Gas Service's Application filed in Docket No. 24-KGSG-610-RTS (24-610 Docket)?

A. My responsibilities as the Chief of Accounting and Financial Analysis were to analyze and audit the rate case Application filed by Kansas Gas Service (KGS or Company), a Division of ONE Gas Inc. In addition, I assigned the audit section there various responsibilities in the review of KGS's Application and provided oversight to the lead auditor, Katie Figgs. I was responsible for the direction and management of all Audit section their responsibilities in the review of KGS Pro-Forma Adjusted position in the 24-610 Docket.

My direct responsibilities in this filing was to review the impact of Kansas Gas Service's capital expenditures (Capex) that occurred between its 2018 rate case filing in Docket No. 18-KGSG-560-RTS, examine the rate recovery KGS has received through various regulatory mechanisms, such as the Gas Safety and Reliability Surcharge (GSRS), and calculate KGS's annual earned return on equity. My testimony provides analysis of KGS's proposed Performance Based Ratemaking (PBR) plan – the Annual Performance-based Rate Adjustment (APRA), as provided in the tariffs attached to the Testimony of KGS Witness Janet Buchanan

While Staff recommends denial of the KGS's APRA proposal, I provide the Commission with a recommendation on the continuation/renewal of the cyber-security expense tracker, the pensions and other post-employment benefits expense tracker, and the Ad Valorem Tax Surcharge Rider, if the PBR Proposal is denied by the Commission. Staff's audit of KGS's application and the recommendations contained in my Testimony were overseen by Justin T. Grady, Deputy Director of the Utilities Division.

II. Executive Summary

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to provide the Commission an overview of alternative ratemaking mechanisms, such as the APRA proposed by KGS. I will discuss the Commission-approved alternative ratemaking structures available to KGS in this case and Staff's current use of these mechanisms as a regulatory tool to manage KGS's investment in certain infrastructure or increases in operating expenses experienced by the company. I will also discuss the benefits and impacts these regulatory mechanisms have on customers.

The second portion of my analysis will focus on KGS's capital growth and its impact of that capital growth on KGS's rate of return and depreciation expense in the filing. My testimony provides the Commission with an overview of capital investment that KGS has made in its Kansas pipeline infrastructure and the growth of its direct and corporate allocated general plant. Next, I calculate the impact of KGS's plant investment on its requested revenue requirement and provide the Commission an overview of the revenue requirement for KGS's eligible project investment contained in its annual GSRS filings. In addition, I will overview KGS's projected capital investment contained in its 2024 Capital Expenditure Plan for investment for year-ending 2024 through 2028.

The remainder of the analysis in this section calculates KGS's actual earned return on equity for each operating period from 2019 – 2023 and explain the adjustments include in the analysis. I compare KGS's unadjusted earned ROE to other ONE Gas utilities' earned ROE generated from the operations of Oklahoma Natural Gas and Texas Gas Service in its Oklahoma and Texas jurisdictions. I also discuss the PBR mechanism available to Oklahoma Natural Gas, which was approved by the Oklahoma Corporation

Commission in 2011 and review the rate impacts the PBR plan has produced during this period in Oklahoma. Finally, I compare Oklahoma Natural Gas's rate increases against the yearly rate increases that KGS has received from its GSRS surcharge and Ad Valorem Tax surcharge.

The last section of my analysis focuses on the review of KGS's APRA benefits, the proposed timelines, and determine whether KGS has demonstrated a convincing case for the need of such a mechanism to further control regulatory lag. I provide the Commission with Staff's recommendation to deny KGS requested APRA due to various factors that will be discussed and identified by Staff from KGS's witness testimony and the additional supporting documentation provided by KGS in response to Staff and interveners discovery requests.

Staff's decision to recommend denial of KGS's requested APRA results from the scope of the APRA filings, the proposed timeline for review, and its effects of transferring KGS's financial risks of rising capital investments and operations and maintenance expenses to ratepayers. Staff continues to support the renewal of the existing ratemaking mechanisms that are currently in place and approved by the Commission, such as the Ad Valorem Tax Surcharge, the cyber security tracker, and the pension and post-retirement benefits tracker requested by KGS if the PBR plan is denied by the Commission.

Q. Please explain how your remaining testimony is structured.

A. My remaining testimony is structured in the following four sections with short summaries of the material discussed in each section:

- Section III: Review of Alternative Ratemaking Structures: this portion of my testimony provides an overview of alternative ratemaking mechanisms and the general purpose of these mechanisms as a ratemaking tool. I overview the current Commission-approved alternative ratemaking structures available to KGS and the targeted use of these mechanisms as a regulatory tool to manage KGS's investment in certain infrastructure or pass-through to ratepayers certain operating expenses experienced by the company. The testimony discusses the benefits and cost impacts these regulatory mechanisms have on customers, provides a short review of the APRA, and states Staff's general concerns regarding KGS's proposed APRA.
- Section IV: Analysis of Capex Growth, Revenue Requirement Impact, and KGS's Earned ROE – this section of my testimony will provided the Commission an overview of KGS's Capex spend since the last rate case through Staff's update period of April 30, 2024 in this rate case. The testimony analyzes the impact of KGS's capital additions on the growth of KGS's rate base (plant in service additions, less accumulated depreciation and ADIT) and depreciation expense and the impact of CapEx on the resulting revenue requirement. The testimony details KGS's calculation of its authorized vs. earned return on equity for KGS's year-end financial position from 2019 – 2023, and the earned ROE of ONE Gas's other utilities – Oklahoma Natural Gas and Texas Gas Service – experienced in its other state jurisdictions. Finally, I outline the rate impact of the PBR currently approved in Oklahoma versus KGS's revenue increases that resulted from the GSRS and Ad Valorem tax surcharges.

- Section V: Overview of KGS's proposed PBR Plan and Staff's Recommendation to Deny the APRA Plan – this section of my testimony provides a broader evaluation of KGS's proposed APRA and discusses KGS's reasoning for introducing the PBR, as detailed through the Testimony of KGS Witness Janet Buchanan. This section highlights Staff's reasons for not supporting KGS's proposed APRA and its recommendation that the Commission deny KGS's APRA plan and tariffs. If the Commission supports Staff recommendation, I recommend the Commission support KGS's requested renewal of the existing alternative ratemaking mechanisms for its Ad Valorem Tax surcharge, the Cyber-security Tracker, and Pension and other Post-employment Expense tracker.

III. Review of Alternative Ratemaking Mechanisms

Q. Please describe the general purpose of alternative ratemaking mechanisms and the benefits of these mechanisms to KGS and its ratepayers?

A. While the purposes of alternative ratemaking mechanisms can vary significantly in terms of the scope and approach to recover utility capital investment or incremental costs of providing service to customers, these mechanisms are designed to streamline the regulatory commission's process of adjusting utilities' rates outside of the traditional requirement of filing rate case applications. Rate cases require a significant commitment of resources by the utility, the staff of regulatory commissions, and the stakeholder groups involved in the ratemaking process. Alternative ratemaking mechanisms may be implemented on a standalone basis or in combination with the traditional ratemaking processes. These mechanism are designed to reduce the costs of the ratemaking process through an agreed upon standard of review for a utility's incremental costs or capital investment. These mechanisms shorten the recovery time or regulatory lag that utilities experience in recovering the capital investment necessary to serve retail customers.

Alternative ratemaking mechanisms are generally viewed as a positive outcome by the investment community and utility shareholders, and the effect on utility ratepayers can have both positive and negative impacts to customers between rate cases. The primary negative impacts that customers experience are the more frequent rate adjustments for utility services. However, alternative ratemaking mechanisms often provide benefits to customers through smaller incremental rate adjustments for utility infrastructure investment, resulting in a more reliable and safe gas system.

Staff has traditionally been receptive to alternative ratemaking approaches that are narrow in scope and provide some level of customer protections. Staff's support for these structures for infrastructure investment has resulted in recent updates to Kansas Statutes, like the GSRS Statute. Other rate mechanisms approved by the Kansas Commission, such as the Purchase Gas Adjustment, or Legislative Statutes, like the Ad Valorem Tax Surcharge,[1] operate as a pass-through to make certain that both the customer and the company only pays for the actual gas costs or property taxes that utilities incur in providing service to customers.

Q. Please provide an example of a targeted ratemaking mechanism available to KGS?

A. As an example, the GSRS approved by the Kansas Legislature allows KGS and other gas utilities to recoup certain capital investment in upgrades to aging existing pipeline infrastructure. The Kansas Statute K.S.A. 66-2201 - 2204[2] (GSRS Statute) includes a

[1] *See* K.S.A. Statute 66-117f.
[2] *See* K.S.A. 66-2201 – 2204 for a complete review of the GSRS Statute. Following KGS's last rate case in the18-560 Docket, KGS has filed an annual GSRS filing towards the end of August. Staff performs an annual

monthly residential cap of $0.80 per residential customer for the incremental investment and recovery of Gas Safety and Reliability infrastructure. The current GSRS Statute was revised during the 2018 Legislative session with the modifications becoming effective on January 1, 2019. The Statute modification increased the monthly rate cap for residential customers from $0.40 per month to $0.80 per month for the initial GSRS filing or from the most recent Commission-approved GSRS filing. The GSRS Statute allows for the Commission's review of eligible pipeline infrastructure projects, resulting in a new GSRS rate for project investment that were placed in service in the most recent rate period.[3]

The GSRS surcharge reduces regulatory lag experienced by KGS for pipeline infrastructure modernization, while at the same time, customers benefit from improved reliability, safety of the pipeline infrastructure, and smaller incremental increases. With the aid of the GSRS Statute, KGS was able to manage its capital investment and operations and maintenance costs for nearly six years between utility rate filings, which occurred on June 29, 2018, in Docket No. 18-KGSG-560-RTS (18-560 Docket) and March 31, 2024, in the 24-610 Docket.

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audit of the capital project investment to determine whether the projects eligible for recovery under the GSRS Statute.

[3] *See* K.S.A. 66-2202 (f) - (1) – (5) for a breakout of natural gas utility plant projects that qualify for recovery under the GSRS Statute. At a high level, Eligible projects consist of: (1) projects to replace, upgrade or modernize obsolete facilities related to comply with federal and state regulatory standards; (2) projects that extend the useful life or integrity of existing pipeline components; (3) projects that relocate existing infrastructure due to construction or improvement of Kansas highway and road ways; (4) projects that enhance the security of the pipeline system, including allocated corporate costs; and (5) project investment made in response to the utilities safety or risk management assessments. As of January 1, 2019, the Kansas Legislature expanded the scope of eligible projects included in the GSRS to include the five project categories listed above.

Q. Please discuss Staff's reasoning for supporting the targeted existing alternative ratemaking mechanisms.

A. The existing alternative ratemaking structures that Staff has supported in prior utility filings for KGS and other gas utilities served a narrow ratemaking purpose. Both KGS's Purchased Gas Adjustment (PGA) and Ad Valorem Tax Surcharge directly pass on the costs to customers and are intended to capture the actual operational costs, as a flow-through to customers without any added incremental margin. Staff has recommended trackers for cyber security and pensions and post-retirement benefits that allow utilities to track their incremental expenses in between rate cases above an established base line and defers the cost recovery into a regulatory asset or liability. These regulatory asset or liability balances are reviewed in subsequent rate cases and amortized over a selected amortization period to recover or return funds to customers.

Q. Please overview the general purpose of the Purchase Gas Adjustment.

A. The Purchase Gas Adjustment captures the actual cost of natural gas, which is volatile commodity impacted by the demand for natural gas as a heating source for distribution gas utilities and a fuel source for the generation of electricity. The PGA surcharge allows customers to pay the actual cost of gas without any mark-up for margin, allowing utility customers the benefit of low market prices in the current gas market.

KGS and its customers also experienced significantly higher market prices for natural gas during KGS's operation in Winter Storm Uri, with the cost of gas remaining elevated in the subsequent years following the winter weather event. The cost of natural gas KGS incurred for Winter Storm Uri were deferred for recovery in KGS Docket No. 21-KGSG-332-GIG. However, the cost of natural gas contained in the Purchase Gas

Adjustment remained elevated through the close of 2022 into the first operating quarter of 2023 for gas deliveries on the various interstate gas pipelines that serve regional gas utilities and electric utilities throughout the Southwest Power Pool region.

Q. Please provide the relevant data set on the cost of natural gas incurred by customers that has flowed through the PGA and discuss the purpose for providing the data as it relates to alternative ratemaking mechanisms.

A. Staff receives a monthly update on First of the Month (FOM) price contracts for delivery on various interstate pipelines and other gas marketplaces in the Inside FERC Gas Report. This report acts as a general data source for natural gas pipelines that serve Kansas electric and natural gas distribution utilities. Staff pulled the data for FOM pricing contracts for delivery on the Southern Star delivery hubs from the Inside FERC Gas Report from 2018 through 2024. Southern Star's Hub prices for FOM delivery provides a relevant data source for the costs of gas that are passed through to Kansas customers through KGS's PGA mechanism. In the following table, Staff summarizes the yearly FOM contract pricing, with the average market price, high market price, and low market price for delivery on the Southern Star Gas Pipeline from 2018 – 2024.

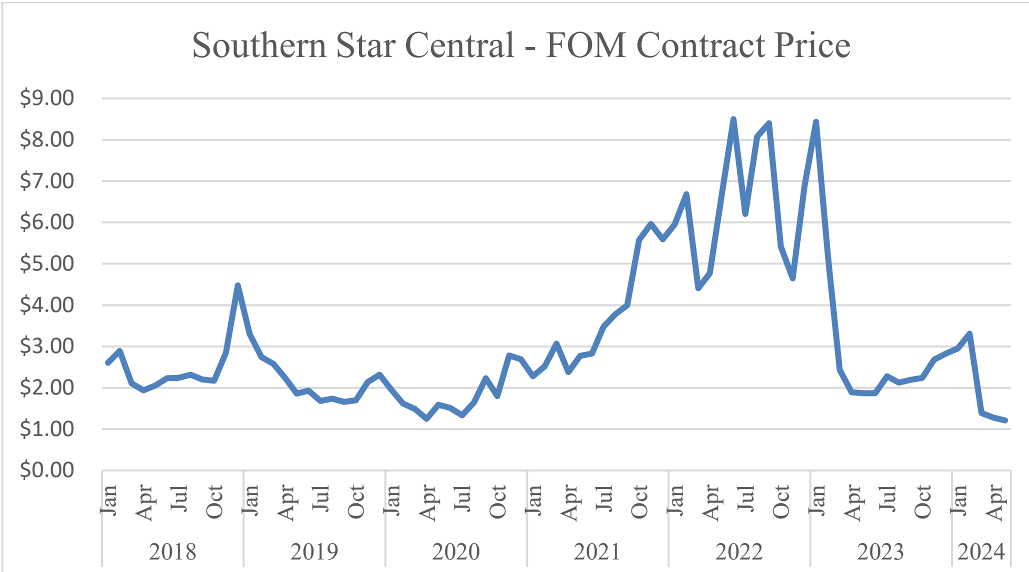
Southern Star Central
First of the Month (FOM) - Contract Price

Year	Location	AVG	HIGH	LOW
2018	SSC - TX, OK, KS	$2.507	$4.480	$1.940
2019	SSC - TX, OK, KS	$2.158	$3.300	$1.660
2020	SSC - TX, OK, KS	$1.824	$2.780	$1.250
2021	SSC - TX, OK, KS	$3.687	$5.960	$2.280
2022	SSC - TX, OK, KS	$6.382	$8.500	$4.410
2023	SSC - TX, OK, KS	$3.003	$8.430	$1.870
2024*	SSC - TX, OK, KS	$2.028	$3.310	$1.210

* For 2024 FOM Contract Pricing, data was available from Jan - May.

Source:
Inside FERC Gas Market Report - First of the Month - Contract Price

The following graph illustrates the monthly FOM contract pricing for delivery on Southern Star's pipeline from January of 2018 through May of 2024.



While KGS provides gas service by utilizing access to multiple interstate pipelines, Southern Star FOM contract pricing is likely the most relevant data that Staff could pull from an independent source that impacts the cost of gas that flows through KGS's Purchase Gas Adjustment. The two primary items that Staff want to highlight from this data set are that the price of gas is a highly volatile commodity and it is cyclical based on the seasonal gas usage. Natural Gas Pricing tends to peak for each rate period sometime during the Winter Season from November through February.

Given these facts, an alternative ratemaking mechanism, such as the Purchase Gas Adjustment, is likely the most efficient and cost effective approach that the Commission could employ to make the Company and the customers whole for the price of natural gas used in providing service to KGS customers. As such, the Commission approved this alternative ratemaking mechanism for use by KGS and other gas utilities in the state. The PGA mechanism provides administrative benefits and acts as a direct pass-through mechanism for the cost of gas; and therefore, the cost of gas component is removed from the traditional ratemaking process for KGS's plant investment and operational costs, which are evaluated and captured by KGS through a rate case Application.

Q. Could you please provide a high-level overview of KGS's PBR plan?

A. At a high-level, KGS's requested PBR plan is a broad proposal to implement a formula-based rate or APRA that includes a performance dead-band of 100 basis points over or under the Commission-approved ROE in this Docket. The APRA filing would include an annual financial review of KGS's year-end financial results, resulting in KGS filing an Application no later than March 15 of the following year. Following the submission of the Application, the Commission would have a total of 120 days to issue an Order. If KGS filed an Application on March 15, Staff would have 45 days to complete an expedited review of KGS's Application, as the APRA requires parties to file any calculation disputes to the Company by May 1. If a settlement cannot be reached, the disputed issues would be presented before the Commission for a determination.

The Application for the APRA could result in several different customer impacts. There could be no change in rate revenues if KGS over- or under-earns within a dead band of 100 basis points. If KGS's earnings fall above or below the Commission's authorized ROE determined in this Docket, KGS would make an incremental revenue adjustment. If KGS were to under-earn its authorized ROE outside of the 100 basis point band, KGS's APRA filing would result in a rate increase. If KGS over-earns outside of the 100 basis-point dead band, KGS would provide customer a bill credit.

In an over-earnings scenario, KGS is requesting to allow customers to receive a minimum of 75% of the benefit with KGS retaining a maximum of 25% for its shareholders based on three performance metrics: (1) answered call rate, (2) the number of estimated bills per thousand customers, and (3) the response time for customer odor reports.

Based on KGS's request, KGS would still be subject to the Commission's normal rate case process at the end of each five-year period if the Commission were to approve the APRA plan.

Q. Does Staff have concerns regarding KGS's APRA plan as proposed?

A. While Staff has a number of concerns with the proposed ratemaking plan that will be addressed throughout my testimony in Section V, the primary concern is that broad formula rate mechanisms transfer financial risks from shareholders to ratepayers for rising operations, maintenance, and administrative costs.

While KGS's APRA would reduce regulatory lag on its capital investment, the regulatory lag experienced in the normal rate case process can be a useful regulatory tool to motivate management to balance increases in capital investment while managing the increases in operating and maintenance and administrative costs. The regulatory lag experienced by KGS incents management to carefully plan and time its infrastructure investment and control operating costs between rate case filings. Another offsetting effect is that KGS is able to retain revenues from customer growth and is provided with adjustments to revenues associated with its GSRS investment and growth in property tax expense. As detailed in the Testimony of KGS witness Janet Buchanan on page 4, KGS's customer growth revenues totaled $20.3 million, which offset other cost drivers in this rate case.

The APRA plan doesn't eliminate regulatory lag in its entirety, as KGS would always incur some regulatory lag on its plant investment. However, KGS's proposed APRA replaces the cost containment inherent in managing regulatory lag with a shareholder driven motivation to retain a portion of the benefit in the event KGS's return exceeds the Commission-authorized ROE. While cost containment and the potential to motivate management through shareholder benefits is the primary concept in the construction of a performance-based ratemaking mechanism, KGS's proposed performance metrics are driven by internal measures related to customer initiatives for answered calls, the number of estimated bills and response times to odor reports. These customer-focused efforts may provide a measure of customer service, however, the APRA metrics do not measure KGS's performance against industry peer groups or externally driven economic or productivity metrics.

As such, Staff has concerns that the PBR mechanism proposed by KGS shifts a substantial portion of the operating risks and cost containment burden away from shareholders and exposes ratepayers directly to these costs. In the current inflationary environment, ratepayers would likely be subjected to more frequent rate increases. The APRA would result in a less-than-efficient ratemaking process due to the yearly cost of service review and the proposed requirement for KGS to file a full rate case review in five-year increments.

IV. Analysis of KGS's CapEx Growth and its Impact on the Calculation of the Revenue Requirement and Earned ROE

Q. Please summarize the Purpose of Section IV analysis?

A. While my analysis of KGS's APRA plan continues in Section V of my testimony, this section of the report is centered around providing the Commission data regarding the impact of KGS's capital investment on the revenue requirement in this Docket. I present data on KGS's cost recovery received in GSRS filings and analyze KGS's projected investment in its 2024 Capital Expenditure Plan for investment from 2024 through 2028.

In addition, I present KGS's calculation of earned ROE from 2019 – 2023 and provide the earned ROE generated by Oklahoma Natural Gas and Texas Gas Service, as a comparison of ONE Gas's gas distribution companies operating in Oklahoma and Texas that were provided in response to intervener and Staff discovery. I will discuss how this data factors into its decision to recommend the Commission deny KGS's requested PBR plan and renew KGS's requested alternative ratemaking mechanisms that have been approved by the Commission in prior rate filings.[4]

Q. Has Staff completed a review of KGS's growth in Capital Additions and their impact on Staff's revenue requirement, and Earned ROE in prior rate case filings?

A. While Staff has not performed this portion of the analysis in KGS's prior rate filings, Staff has relied on the review of its capital additions in its update process and audit of capital additions in the test period. Staff updates KGS's utility plant, accumulated depreciation, accumulated deferred income taxes, and depreciation expense in separate adjustments in each rate filing Staff's update ended April 30, 2024, in this filing. Staff

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[4] If the Commission denies the PBR Plan, KGS requested renewal of its Ad Valorem Tax surcharge, its Cyber Security tracker, and its Pension and other Post-Retirement Benefits tracker.

adjustments to update plant-related investments are contained in Staff Direct Testimony filed by Daniel Buller.

Staff added the analysis of capital investment between rate filings in Evergy's rate case filing to analyze the impact of capital investment and its effects on the return on rate base and depreciation expense. Staff decided to perform a similar review in this Docket. Staff obtained KGS's capital investment from discovery requests and data contained in KGS's Annual Reports filed with the Commission in its FERC Form 2 Report for year ending 2018 - 2023.

A. Review of KGS Capital Investment (August 31, 2018 – April 30, 2024)

Q. Please discuss Staff's review of KGS capital additions in its general and corporate plant and natural gas distribution system?

A. Staff compiled the CapEx data from KGS's Attachment A workpaper contained in its response to KCC Data Request No. 284, which contained KGS's direct Kansas investment in its natural gas distribution system. Staff combined the KGS's system investment with the ONE Gas Corporate Allocated investment that was allocated to Kansas in a table. The following table summarizes KGS's annual capital additions from the close of the update period in the 18-560 Docket through Staff update in this Docket.[5]

[5] *See* KGS Response to KCC Data Request No. 284 for KGS's data for yearly Capital Additions between its rate case filings.

KANSAS GAS SERVICE: Capital Investment								
(Data in Millions)								
Plant Category	2018(1)	2019	2020	2021	2022	2023	2024(2)	Total
GAS PLANT: KGS DIRECT								
Intangible Plant	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Production Plant	-	-	-	-	-	-	-	-
Storage Plant	-	-	-	-	-	-	-	-
Transmission Plant	2.6	10.7	7.3	8.3	5.4	14.1	2.4	50.8
Distribution Plant	34.3	78.7	87.7	87.0	103.8	115.1	48.3	554.8
General Plant	2.9	13.4	14.4	7.2	23.3	20.8	1.0	83.0
Generation Projects - Total	$ 39.8	$ 102.8	$ 109.4	$ 102.5	$ 132.5	$ 150.0	$ 51.6	$ 688.6
ONE GAS - CORPORATE ALLOCATION - KS								
General Plant - Corporate	1.6	5.7	7.8	5.1	3.9	16.0	1.2	41.4
Total KGS Capital Additions	$ 41.4	$ 108.5	$ 117.3	$ 107.7	$ 136.3	$ 166.0	$ 52.8	$ 730.0

(1) KGS Capital Investment for 2018 includes Plant Additions from September 1 through December 31, 2018.
(2) KGS Capital Investment for 2024 includes Plant Additions from January 1 through April 30, 2024.

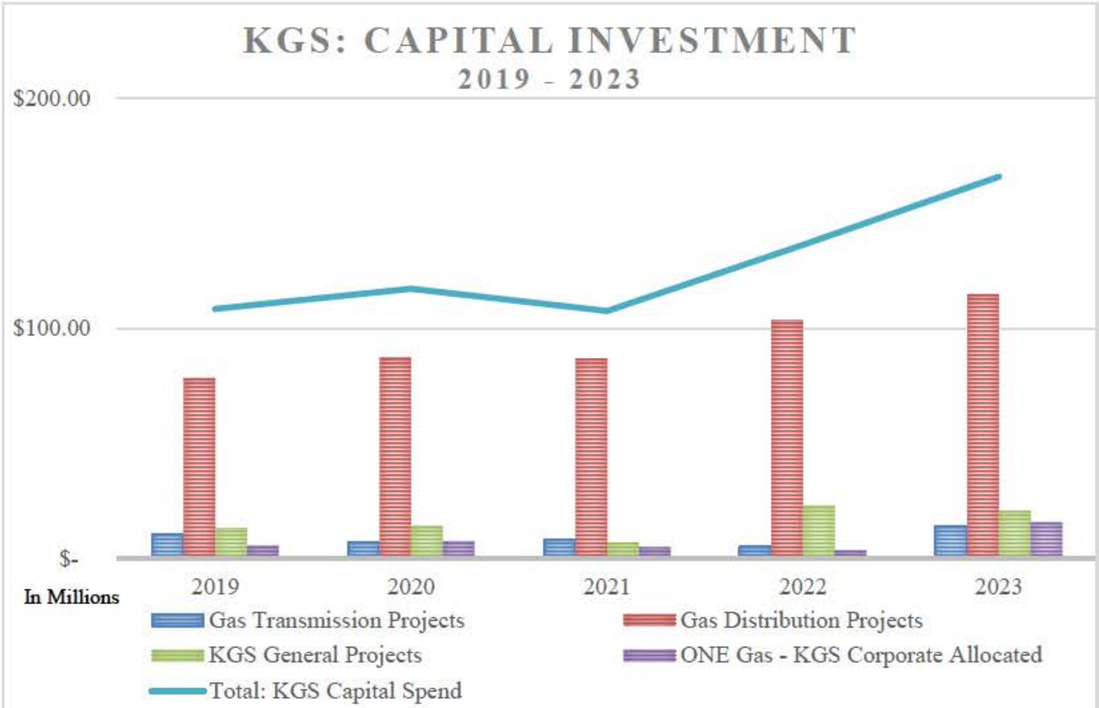
Source:
KGS Response to KCC Data Request No. 284: Capital Investment Workpaper

As seen in the table above, KGS invested just over $730 million in plant investment from September 1, 2018 through April 30, 2024, which was included in the plant adjustment in this proceeding.[6] KGS's investment in its gas distribution infrastructure accounted for $554.8 million or approximately 76% of the growth in Plant in Service. KGS has increased its yearly capital investment from a low of $107.7 million in 2021 to a high of $166 million in 2023. Through Staff's update period, KGS's capital investment totaled $52.8 million, with distribution investment accounting for $51.6 million of the total CapEx.[7]

[6] In the tables, Staff captured the KGS's investment total capital investment between its rate case positions to examine the impact of KGS's plant growth contained in Staff's updated revenue requirement calculation in this Docket. The table captures growth of Plant in Service, but does not include reductions for growth of accumulated depreciation and ADIT. This will be detailed later in Staff's analysis.
[7] Staff would note that its Plant in Service and Accumulated Depreciation adjustments include KGS's investment in Ft. Riley, which KGS calculated separately in its Application in Working Capital Adjustment No. WC-2.

Q. Please include a breakdown of KGS's capital investment by plant category.

A. Staff created the following graph to help illustrate KGS's total capital investment by plant category during each operating period between its rate case filings.[8]



As displayed in the graph above, KGS has increased its total CapEx investment year-over-year in most operating years, with CapEx falling slightly to $107.7 million in 2021. In 2022 and 2023, KGS increased its capital investment to $136.3 million and $166.6 million, respectively. For 2024, KGS CapEx through April totaled $52.8 million, with an anticipated ** [redacted] ** of incremental capital additions projected in its 2024 Capital Expenditure Plan.[9]

As discussed above, KGS's distribution investments are driving the majority of its capital investment with a yearly average of $92.5 million over the six year-period.

[8] *See* KGS Response to KCC Data Request No. 284: Capital Investment

[9] *See* KGS Confidential Response to KCC Data Request No. 36. Staff will discuss KGS Budgeted CapEx for 2024 – 2028 in Section IV, Part E of my testimony.

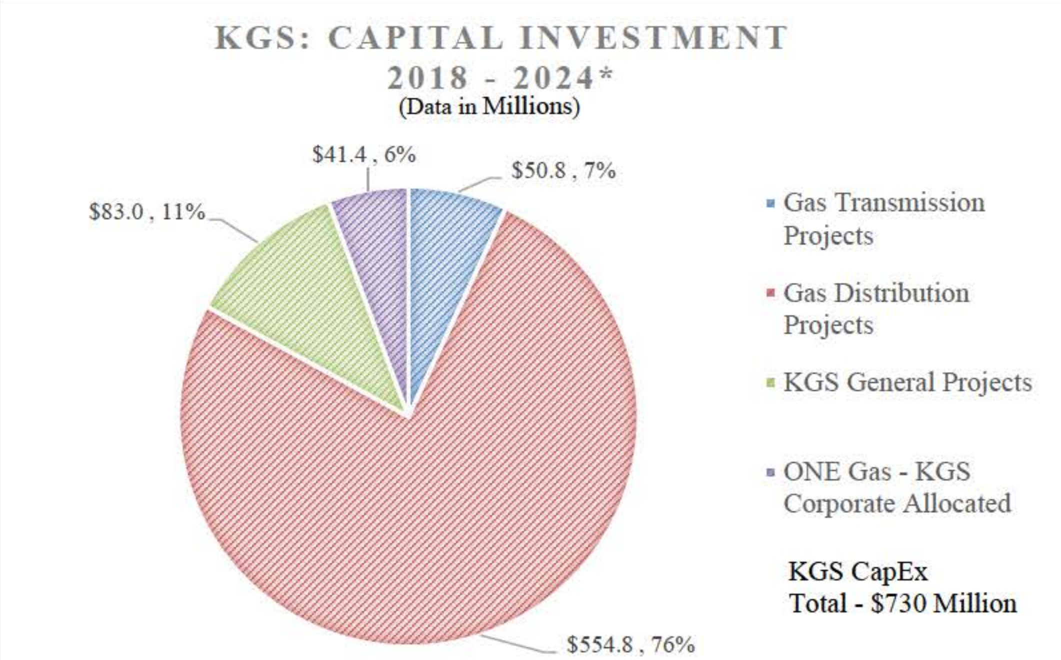
KGS's plant additions in its transmission gas infrastructure totaled $50.8 million, an average of $8.5 million per year. KGS's general plant investment totaled $83 million for its KGS direct plant while KGS was allocated $41.4 million in capital additions from its ONE Gas parent company. As an average, KGS invested in yearly plant growth of $13.8 million for its general plant for the KGS division and $6.9 million in its ONE Gas's corporate allocated plant during the approximate six-year investment period.

From 2019 – 2021, KGS plant investment averaged approximately $111.2 million per year. If KGS reaches its projected capital investment for 2024, KGS plant growth averaged ** [redacted] ** from 2022 through 2024. By comparing the average of these 3-year operating periods, KGS has increased its average yearly growth in capital investment by approximately ** [redacted] ** in the most recent 3-year operating periods as compared to its average capital additions from 2019 – 2021.

Q. Please provide a general breakout of KGS's total capital growth by plant category between its filing in its 18-560 Docket and Staff's updated test period for plant ending April 30, 2024.

A. Staff aggregated KGS's total CapEx investment in plant and compared the total investment by plant category. The following pie chart details KGS's total CapEx spend by plant category and the category's percentage contribution to the $700 million KGS's project investment in the system during this period.[10]

[10] *See* KGS Response to KCC Data Request No. 284: Capital Investment.



*KGS Capital Additions from from September 1, 2018, to April 30, 2024.

As previously discussed, KGS's distribution gas investment accounted for the vast majority of the total system investment from 2018 through June 30, 2023. Gas distribution investment totaled $554.8 million, accounting for 76% of the total system investment. Transmission-related gas investment ranked second with a total capital spend of $83 million or 11% of the total system investment. KGS's general plant investment in infrastructure accounted for $50.8 million or 7% of KGS's total CapEx. The remaining KGS investment resulted from ONE Gas allocation of corporate plant for general projects, totaling $41.4 million or 6% of KGS's total CapEx spend.

Q. Please discuss the primary drivers of KGS's capital investment that it has made in Kansas.

A. While the vast majority of KGS's investment has been on capital projects for its distribution system, the testimony of KGS's witness Sean Postlethwait discuss the driving forces behind the capital investment made in the KGS system. As discussed by Mr. Postlethwait,

> [The] capital investment in infrastructure and other assets is necessary to maintain and expand the natural gas system. Safety, reliability, and growth are the primary driving forces behind most capital investments made in the KGS system.

Mr. Postlethwait goes on to discuss five primary categories of plant investment of capital investment in KGS's system:

1. Replacement of pipeline facilities that have reached the end of their useful service lives;
2. Compliance with regulatory requirements established at the federal, state, and local levels;
3. Reinforcement of the system for periods of adverse weather and growth;
4. Relocation of pipeline facilities as required by city, county, and state roadway projects;
5. Growth from pipeline needed to serve new customers.

Staff issued discovery requesting KGS provide a breakout of its capital investment on pipeline projects in the five categories of investment discussed by Mr. Postlethwait. In KGS's response to KCC Data Request No. 159 A: Capital Expenditure Categories, KGS provided the following table that presents the capital expenditures attributed to each category in 2019 through 2023.[11]

[11] KGS noted that some of the capital investment contained in the table was attributable to multiple groups.

DRIVERS OF KGS CAPITAL INVESTMENT						
Category of Driver:	2019	2020	2021	2022	2023	Total
1: End of Service Life	$ 55,726,266	$ 55,734,191	$ 65,448,653	$ 71,553,374	$ 75,160,985	$ 323,623,469
2: Regulatory	50,325,812	47,990,452	54,148,683	59,338,338	65,542,157	277,345,441
3: System Reinforcement	495,413	1,277,007	3,418,361	3,933,465	2,496,816	11,621,062
4: Public Works	9,240,125	11,123,631	9,507,754	13,426,905	14,115,986	57,414,400
5: New Growth	11,861,452	12,084,415	12,925,111	12,846,049	20,662,465	70,379,493
Total	$ 127,649,068	$ 128,209,696	$ 145,448,562	$ 161,098,131	$ 177,978,409	$ 740,383,865

Source:
KGS Repsonse to KCC Data Request No. 159A: Capital Expenditure Categories

B. Revenue Requirement - Impact of CapEx Additions

Q. How do the Gross Plant and Accumulated Depreciation balances impact KGS's Revenue Requirement?

A. The Gross Plant and Accumulated Depreciation balances net against each other to calculate the difference in KGS's Net Plant position. The Net Plant balances and other adjustments, such as Accumulated Deferred Income Taxes, Regulatory Assets and Liabilities, etc. are reflected in a utility's Rate Base. The Rate Base is what KGS's investors are provided a return on through a Commission-approved Rate of Return (ROR). The Commission authorized ROR results from KGS's costs of debt and return on equity, which are applied based on the weightings of each type of capital in the company's capital structure.

The inclusion of depreciation and amortization expenses in the Revenue Requirement provides investors the return of the investment for the assets across their useful life. The fully adjusted pro forma adjusted plant balances will have a calculated depreciation rates applied to determine the total depreciation expense included in the Revenue Requirement. Depreciation rates are proposed in depreciation studies that are designed to evaluate the useful life of asset classes for utility project investment. Like depreciation expense, amortization expense is used for intangible assets, such as information technology systems, by spreading the costs of the asset across the assets useful life. These costs are combined together to recover the return of the capital investment cost.

Q. Please discuss the process Staff performed to calculate the KGS's plant positions and the impact the Revenue Requirement.

A. When a rate case is filed, Staff updates the Gross Plant balances and Accumulated Depreciation Reserves, and Accumulated Deferred Income Taxes to the most recent actuals through an update period. For inclusion in the update in KGS proceeding, the project had to be completed and placed into service through April 30, 2024.

Staff may apply other proposed pro forma adjustments to the plant in service and accumulated depreciation balances as well. For KGS, Staff's plant in service contains the following adjustments: the update to Plant in Service through April 30, 2024, an adjustment to remove Not Used and Useful plant and compressed natural gas plant that is not used for utility service, plus include the of plant balances related to Ft. Riley, which were incorporated in KGS's Working Capital Adjustment No.2 (WC-2).

Staff calculates its adjustment by comparing Staff's position against KGS Pro Forma Plant in Service in Schedule No 3. Staff applied the same process as described above in its Adjustment to KGS's Accumulated Provision for Depreciation and Amortization in Schedule No. 5. In a separate adjustment, Staff will update depreciation expense, using the Staff's pro forma adjusted plant balances and Staff's proposed depreciation rates, included in Roxie McCullar's testimony.[12]

As stated, Staff also updated Accumulated Deferred Income Taxes through Staff's update for various ADIT adjustments. Accumulated Deferred Income Taxes is included as a rate base offset for tax timing difference in between the accelerated depreciation included in taxes versus the straight-line depreciation used in regulatory filings for KGS's direct and corporate plant. These adjustments can be found in the Testimony of Andria Jackson and Ian Campbell in this filing.

By netting KGS's net plant position against ADIT, Staff calculated the net rate base position for plant, accumulated depreciation and ADIT, and multiplied the net change in rate base by Staff's pre-tax rate of return[13] to calculate the increased return related to KGS's rate base growth between its rate case filings.

Finally, Staff added the return on rate base growth and the net change in Staff's calculation of Depreciation and Amortization expense captured in Staff's update to plant in service and the depreciation rates to the total Revenue Requirement impact related to plant investments between KGS's rate cases.

Q. Please discuss the calculation mechanics Staff performed to calculate the Revenue Requirement impact of KGS Capital Investment between rate cases.

A. In reviewing the Order approving the Stipulation and Agreement in the 18-560 Docket, Staff's filed Schedules related to Plant investment were updated based on Staff's positions during the settlement process that were formulated in the terms of the Black-

[12] KCC Adjustment No. IS-2 included in Daniel Buller's Direct Testimony.
[13] *See* Direct Testimony of Adam Gatewood for Staff's recommendations on KGS's calculated return, based on the cost of debt, return on equity, and its capital structure of debt vs. equity position. Data contained in Staff Schedule No. C-1.

box Settlement for $21.5 million overall annual revenue increase filed in the Partial Unanimous Settlement Agreement (Settlement Agreement).[14] Staff performed the following comparison of the KGS's Net Plant, ADIT, and Depreciation and Amortization expense between Staff's Settlement Schedules; however, Staff would note that KGS contested Staff's position on CWIP and Corporate plant.[15] While Staff settlement schedules were partially updated for CWIP, Staff did not include any adjustments related to KGS's Corporate Plant. The Settlement Agreement included terms that KGS would implement Staff's proposed depreciation rates included in the Direct Testimony of Staff witness Roxie McCullar.[16]

Using Staff's Settlement Schedules, Staff incorporated the Plant in Service balances by plant category and calculated the variance in Plant in Service between the 18-560 Docket and Staff's position in the 24-610 Docket. Similar to Staff's calculation for Plant in Service, Staff calculated the difference in the Provision for Accumulated Depreciation and Amortization positions needed to calculate the difference in Net Plant positions. After determining the differences between Plant and Accumulated Depreciation, Staff calculated the change in Net Plant positions between Staff's recommendations in the 18-560 rate case and the 24-610 rate case. Next, Staff removed the change in Accumulated Deferred Income Taxes (ADIT) and Excess Deferred Income Taxes (EDIT) for both KGS and it corporate-allocated ADIT & EDIT to arrive at a net Rate Base impact.[17]

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[14] *See* Order Approving Partial Unanimous Settlement Agreement, 18-560 Docket (Feb. 5, 2019) (18-560 Settlement Order).

[15] *See* Confidential Rebuttal Testimony Lorna M. Eaton on Behalf of Kansas Gas Service, 18-560 Docket (Nov. 19, 2018).

[16] *See* 18-560 Settlement Order.

[17] ADIT is included as a rate base offset to account for tax timing difference in between the accelerated depreciation included in taxes versus the straight line depreciation used in regulatory filings for KGS's direct and corporate plant.

Staff multiplied the change in Rate Base by its proposed Pre-tax ROR[18] to calculate the Revenue Requirement impact for related to KGS's plant investment occurred between rate filings Next, Staff calculated the change in the total Depreciation and Amortization expenses between rate cases to determine the net increase in Depreciation and Amortization expense. Staff added the return on Rate Base growth and the net change in Staff's calculation of Depreciation and Amortization expense to calculate the net Revenue Requirement impact of plant investments between KGS's rate cases.

C. Calculation of Revenue Requirement Impact for KGS's Capital Investment

Q. Please discuss KGS's Plant Additions in the GSRS Revenue Requirement.

A. To summarize the Revenue Requirement impact of KGS's capital investments, Staff prepared the following table that calculates KGS's Revenue Requirement impact related to its capital additions in its natural gas system between rate cases.[19]

[18] The calculation of the Pre-Tax ROR was supported by Staff's proposed position on KGS's costs of debt and return on equity, which were applied based on the weightings of each type of capital in the company's capital structure. Staff witness Adam Gatewood provides Testimony on these issues.

[19] Staff would note that its black box settlement position for plant and depreciation expense contained in the 18-560 Docket's Settlement Agreement were partially challenged by KGS in its rebuttal; therefore, KGS's view of CWIP and Corporate plant contained in the Settlement Agreement may result in differences in the calculation of Staff's return on rate base and depreciation expense in the table below.

KGS: REVENUE REQUIREMENT IMPACT OF CAPITAL INVESTMENT[1]			
GAS PLANT IN SERVICE:	24-610 DOCKET	18-560 DOCKET	Increase/(Decrease)
INTANGIBLE	$ 6,045	$ 6,045	$ -
PRODUCTION PLANT	852,915	852,915	-
STORAGE PLANT	-	-	-
TRANSMISSION PLANT	320,972,506	273,786,533	47,185,973
DISTRIBUTION PLANT	1,993,724,578	1,498,169,374	495,555,204
GENERAL PLANT	179,718,029	119,250,546	60,467,483
CORPORATE ALLOCATED PLANT	86,320,035	61,227,865	25,092,170
CONSTRUCTION WORK IN PROGRESS	-	913,059	(913,059)
TOTAL ELECTRIC PLANT IN SERVICE	$ 2,581,594,108	$ 1,954,206,337	$ 627,387,771
LESS: ACCUM. PROV. FOR DEPR. & AMORT.	(858,289,853)	(639,231,148)	(219,058,705)
NET GAS PLANT IN SERVICE	$ 1,723,304,256	$ 1,314,975,189	$ 408,329,067
ACCUMULATED DEFERRED INCOME TAX	(212,071,452)	(200,126,664)	(11,944,788)
ACCUMULATED DEFERRED INCOME TAX - CORP	(5,680,081)	(9,778,488)	4,098,407
EXCESS DEFERRED INCOME TAX LIABILITY	(142,658,148)	(81,511,284)	(61,146,864)
EXCESS DEFERRED INCOME TAX LIABILITY-CORP	(4,436,754)	(3,083,221)	(1,353,533)
ADIT & EDIT - TOTAL	(364,846,435)	(294,499,657)	(70,346,778)
RATE BASE IMPACT	$ 1,358,457,820	$ 1,020,475,532	$ 337,982,288
PRE-TAX RATE OF RETURN			9.0670%
REV. REQ. INCREASE FOR PLANT INVESTMENTS			$ 30,644,854
DEPRECIATION & AMORTIZATION EXPENSE	$ 79,789,433	$ 62,067,971	17,721,462
TOTAL REVENUE REQUIREMENT IMPACT			$ 48,366,316

[1] See: Staff Schedules filed in Docket No. 24-KGSG-610-RTS & Docket No. 18-KGSG-560-RTS (Settlement).

Between rate cases, KGS increased its Plant in Service balance by $627.4 million. Of the total, KGS's investment in its gas distribution plant accounted for $495.5 million between rate case periods, or 79% of the total increase to Plant in Service. KGS increased its Accumulated Depreciation Reserve by $219.1 million. After accounting for ADIT & EDIT, KGS's increased its rate base by a total of $338 million. By multiplying the rate base increase of $338 million by Staff's proposed Pre-Tax Rate of Return 9.0670%, Staff calculated KGS's return on rate base as $30.6 million.

Staff's Depreciation Expense and Amortization Expense as contained in its plant update and the proposed depreciation rates from Staff's depreciation study resulted in a net increase of $17.7 million. The net increase of $17.7 million is the difference between its filed position of $62.1 million in the 18-560 Docket and its recommended depreciation and amortization expense of $79.8 million in this Docket.

As calculated in the table, KGS's capital additions accounted for $48,366,316 or 72.5% of the $66,717,969 million included in Staff's proposed revenue requirement. The roll-in of the GSRS for the return on qualifying infrastructure investment and change in depreciation expenses accounted for $35,029,489 or 52.5% of the total revenue requirement in this proceeding. To calculate the net increase in base rates, Staff deducted $35 million for the roll-in of the GSRS revenue requirement, which resulted in the net changes in revenues of $31,688,480 contained in Staff Schedules. Of the total revenue requirement impact of $48.4 million related to capital additions, KGS was able to recoup approximately $35 million or 72.4% through its GSRS filings.[20]

D. KGS – Revenue Requirement included in GSRS filings

Q. Did Staff perform a review of KGS's investment recovered in its GSRS filings?

A. Yes. As stated by KGS in its Application, KGS is currently recovering $35 million in capital investment in qualifying projects through its GSRS. Staff prepared the following table that details the capital additions KGS made for qualifying GSRS projects put into service and approved by the Commission Orders in each yearly GSRS Docket.

[20] Staff would note that the Kansas Legislature expanded the Gas Safety and Reliability Surcharge in 2018, expanding the list of qualifying projects and residential customers cap of an incremental monthly impact of $0.40 to $0.80, effective January 1, 2019. Following its 2018 rate case, KGS filed its first GSRS Surcharge containing $37.6 million of plant investment, resulting in annual revenue requirement increase of $4.2 million. In subsequent years, KGS benefited from the expansion of qualifying projects and the monthly incremental residential rate cap, allowing KGS to include annual plant investment that ranged from $73 million in 2020 to $84.6 million in 2023 and incremental revenues that ranged from 7.5 million in 2020 to $8 million in 2023.

KANSAS GAS SERVICE
A DIVISION OF ONE GAS
GAS SAFETY & RELIABILITY SURCHARGE:

Line No.	(A) Summary	(B) GSRS Projects - Docket No. 20-KGSG-090-TAR	(C) GSRS Projects - Docket No. 21-KGSG-094-TAR	(D) GSRS Projects - Docket No. 22-KGSG-112-TAR	(E) GSRS Projects - Docket No. 23-KGSG-281-TAR	(E) GSRS Projects - Docket No. 24-KGSG-315-TAR
	GSRS Plant Investment - Current Period:					
i.	Corporate Allocated Cyber Security	$ 104,561	$ 366,553	$ 224,968	$ 168,341	$ 157,160
ii.	Govt. Relocation Projects	14,111,298	39,205,315	40,141,739	39,571,423	41,500,983
iii.	Blanket Work Orders	23,423,134	33,461,765	35,974,277	37,795,536	42,908,959
1a.	- Plant in Serice - Current Filing	$ 37,638,993	$ 73,033,633	$ 76,340,984	$ 77,535,300	$ 84,567,102
	GSRS Plant Investment - Dockets:					
1b.	- Plant Additions - GSRS Dockets in Prior Period	$ -	$ 37,641,314	$ 110,662,522	$ 186,990,968	$ 264,508,240
1	GSRS Plant in Service - Total [Sum of (1a + 1b)]	$ 37,638,993	$ 110,674,947	$ 187,003,506	$ 264,526,268	$ 349,075,342
	Less: Accumulated Depreciation					
2	GSRS Accumulated Depreciation - Total	(472,888)	(2,865,768)	(7,758,414)	(14,987,493)	(24,214,096)
3	Net Plant in Service	$ 37,166,105	$ 107,809,179	$ 179,245,092	$ 249,538,775	$ 324,861,246
	Less: Accumulated Deferred Income Taxes					
4	GSRS ADIT - Total	(2,566,411)	(8,079,909)	(14,771,858)	(21,017,324)	(27,642,603)
5	NET GSRS Rate Base	$ 34,599,694	$ 99,729,270	$ 164,473,234	$ 228,521,451	$ 297,218,643
6	Carrying Charge(1)	9.0984%	8.6012%	8.6012%	8.6012%	8.6012%
7	Pre-tax Required Return	$ 3,148,019	$ 8,577,914	$ 14,146,672	$ 19,655,587	$ 25,564,370
8	Depreciation Expense	1,098,692	3,233,339	5,473,809	7,759,076	10,301,921
9	GSRS Annual Revenue Requirement	$ 4,246,711	$ 11,811,253	$ 19,620,481	$ 27,414,663	$ 35,866,291
	Plus/(Minus) Recovered Balance					
10	(Over)/Under Recovery	(14,324)	(78,528)	(251,799)	(369,176)	(556,340)
11	GSRS Annualized Revenue Requirement	$ 4,232,387	$ 11,732,725	$ 19,368,682	$ 27,045,487	$ 35,309,951
12	Reduction of Revenue for Residential Rate Cap					(280,462)
13	Revised GSRS Annualized Revenue Requirement with Residential Cap Adjustment					$ 35,029,489
14	Incremental Revenue Requirement [Year-over-Year]	$ 4,232,387	$ 7,500,338	$ 7,635,957	$ 7,676,805	$ 7,984,002

(1) Carrying Charge of 9.0984% gross of tax was established in Docket No. 18-KGSG-560-RTS. Effective January 1 2021, KGS and other Kansas utilities were exempted from Kansas state income taxes following the enactment of House Bill 2585, which lowered the GSRS carryinc charge to a rate of return to 8.6012%.

Sources:
KGS Capital & Revenue Requirement data taken from Commission Orders Approved in Docket Nos. 20-KGSG-090-TAR, 21-KGSG-094-TAR, 22-KGSG-112-TAR, 23-KGSG-281-TAR, and 24-KGSG-315-TAR.

While KGS included the roll-in of the $35 million for the GSRS revenue requirement in the current rate case, Staff would note that KGS's yearly plant investment increased in each subsequent rate period, with $84.5 million of plant investment captured in its 2023 filing, resulting in an incremental revenue requirement of $7,984,002. In the filing, KGS's requested revenue requirement was reduced by $280,462 due to the residential rate cap.

Staff would note that KGS's roll-in of the GSRS revenue requirement is likely to increase in future rate case filings with the expanded scope of qualifying plant investment and residential customer growth with the incremental monthly cap of $0.80 per residential customer.

E. KGS 2024 Capital Investment Plan from 2024 – 2028

Q. Please provide an overview of KGS's Capital Investment Plan for 2024 through 2028 and discuss the projected capital additions contained in the Plan.

A. Staff issued KGS discovery regarding its projected capital additions for the next five-year operating period in its 2024 Capital Expenditure Plan, which included the projected CapEx for the remainder of 2024 through 2028. Staff issued additional discovery requesting KGS identify any capital project additions that qualified for recovery in its GSRS. KGS provided its 2024 Capital Expenditure Plan in response to KCC Data Request No. 36, which KGS deemed confidential.

In confidential response to KCC Data Request No. 252, KGS outlined,

** [redacted] **

From these confidential discovery responses, Staff constructed an overview of KGS's Capital Expenditure Plan and calculated the qualifying plant additions that would be recoverable in annual GSRS filings. Staff prepared the following confidential table that summarizes KGS's 2024 Capital Plan and the estimated plant projects recoverable in KGS's annual GSRS filings for projected plant investment from 2024 through 2028.[21]

** [redacted] **

[21] *See* KGS Response to KCC Data Request Nos. 36: Capital Construction Budget and 252: Budgeted CapEx – GSRS. These discovery responses were used to construct, the following confidential table that provides an account analysis of KGS's Capital Plan and the qualifying recovery applicable to the annual GSRS surcharge filings.

In the table, Staff would note that KGS's Capital Plan for 2024 – 2028 included a range of yearly capital investment from ** [redacted] **. Staff's estimate of the GSRS CapEx recovery included ** [redacted] **. Staff's adjusted estimate of GSRS eligible projects ranged from ** [redacted] **. On average, the estimate of capital expenditures that were GSRS eligible averaged ** [redacted] ** of total projected CapEx included in operating years 2024 through 2028.

F. KGS's calculation of Earned ROE vs Authorized ROE from 2019 – 2023

Q. Please discuss Staff's analysis of KGS's Earned vs Authorized ROE for the 2019 through 2023 rate periods.

A. KGS provided an analysis of its Earned ROE versus Authorized ROE in response to CURB Data Request No. 10. In the analysis, KGS calculated its Earned ROE with data pulled from its KCC filing of its FERC Form 2: Annual Report for year ending 2019 – 2023. KGS's Earned ROE calculation begins with its rate base and its equity and debt capitalization. KGS allocates its rate base by its capitalization structure for debt and equity. Next, KGS provides its Net Income for the operating year and makes an adjustment for royalty expenses, paid to ONE Gas Properties, LLC for use of the Kansas Gas Service trademark.

KGS adjusts its royalty expenses out of its rate cases, which in this case is captured in KGS Adjustment No. IS-11 to its income statement. This royalty expense adjustment needs to be grossed-up for taxes and added to the existing Net Income contained in its

FERC Form 2 for the current operating year. Finally, KGS divides its Adjusted Net Income by the proportion of rate base allocated to equity to calculate its Earned ROE. The following table includes Staff's calculation of KGS's Earned ROE for each rate period and incorporates Staff adjustment to KGS's Tax Gross-up calculation for the difference in tax gross-up between the 26.53% tax rate and the 21% tax rate, which was effective in its 2021 – 2023 operating periods.

Kansas Gas Service - Docket No. 24-KGSG-610-RTS
KCC Workpapers: Earned Return & Performance Based Ratemaking Analysis

KANSAS GAS SERVICE
EARNED VS. AUTHORIZED ROE ANALYSIS

Line No.	YEAR END:	2019	2020	2021	2022	2023
		EARNED ROE AND AUTHORIZED ROE				
1	RATE BASE	$1,081,083,485	$1,130,299,823	$1,199,867,497	$1,303,140,959	$1,386,670,989
	CAPITALIZATION					
2	EQUITY:	62.37%	58.55%	59.76%	57.91%	59.58%
3	DEBT:	37.63%	41.45%	40.24%	42.09%	40.42%
	CURRENT RATE BASE:					
4	EQUITY:	674,271,770	661,790,546	717,040,816	754,648,929	826,178,575
5	DEBT:	406,811,715	468,509,277	482,826,681	548,492,030	560,492,414
6	NET INCOME - See FERC FORM 1	$ 49,782,485	$ 53,972,405	$ 50,233,705	$ 47,280,144	$ 56,362,562
	ROYALTY EXPENSE ADJUSTMENT & TAX GROSS-UP[1]					
7	ROYALTY EXPENSE [2]	$ 9,851,475	$ 10,116,408	$ 10,433,086	$ 10,872,943	$ 11,518,624
8	KGS TAX GROSSUP CALC FOR ROYALTY (Net of Tax at 26.53%)	7,237,879	7,432,525	7,665,188	7,988,351	8,462,733
9	STAFF TAX GROSSUP ADJUSTMENT FOR ROYALTY (Net of Tax at 21%)			576,950	601,274	636,980
10	CORRECTED ROYALTY ADJUSTMENT[3]	$ 7,237,879	$ 7,432,525	$ 8,242,138	$ 8,589,625	$ 9,099,713
11	ADJUSTED NET INCOME (Line 6 + Line 10)	$ 57,020,364	$ 61,404,930	$ 58,475,843	$ 55,869,769	$ 65,462,275
12	EARNED RETURN ON EQUITY (Line 11/Line 4)	8.457%	9.279%	8.155%	7.403%	7.924%
13	AUTHORIZED ROE: (Black Box Settlement Rates) - Staff Schedules	9.300%	9.300%	9.300%	9.300%	9.300%

[1] Removes the Impact of Royalty Expense from the FORM 1 calculation of net income, contained in KGS adjustment IS-16. KGS's rate filings have removed the royalty expense paid to One Gas for KGS naming rights and needs to be removed from the calculation of Net Income to compare its Earned vs Authorized Return.

[2] Royalty fess are charged by ONE GAS Properties, LLC, who on the trademarks for KGS, Oklahoma Natural Gas, and Texas Gas Service, and are charged a fee for the usage rights calculated by taking 3% of the prior months net margin.

[3] In KGS Response to KCC Data Request No 272, KGS confirmed that the Royalty Expense Adjustment should have been a positive adjustment to calculate the Adjusted Net Income. Staff made an additional adjusment to the Tax Gross-up calculation to account for KGS's exemption as a utility for State Income Taxes that was enacted by the Kansas Legislature, effective January 1, 2021.

Sources:
KGS Response to CURB Data Request No. 10: Return on Common Equity : 24-610 CURB-010 Attachment
KGS Response to KCC Data Request No. 267: Royalty Fees
KGS Response to Staff Data Request No. 271: Follow-up to CURB: Data Request 10 - Royalty Fee
KGS Response to Staff Data Request No. 272: Follow-up to CURB: Data Request 10 - Royalty Fee

As provided in the table, KGS earned ROE has ranged from a low of 7.403% in 2022 to a high of 9.279% in 2020. In the 18-560 Docket, Staff supported a ROE recommendation of 9.30 presented in the Testimony of Staff Witness Adam Gatewood. Throughout KGS APRA analysis, KGS argues that the regulatory lag inherent in the Kansas ratemaking process precludes them from a true opportunity to earn its Commission Authorized ROE; however, KGS was able to earn an ROE of roughly 9.3% in 2020 detailed in its own analysis. From 2019 – 2023, KGS's operations generated an average ROE of 8.243% for its Kansas Jurisdictional operation.

In the calculation of its Earned ROE in Kansas, KGS incorporated an adjustment to its net income to remove Royalty fees, which the Company has removed in each of its rate cases Applications. In a rate case Application, KGS, Staff, and other intervening parties would each present numerous adjustments in the formulation of their rate case positions as filed in the witnesses' supporting testimony. These rate adjustments impact the calculation of operating expenses that KGS recoups from its ratepayers. Staff would note that KGS utilized its actual capital structure at the end of each operating period, which was not used in the Commission's determination of rates in KGS's 18-560 Docket.

G. Comparison of the Earned ROE for KGS, Oklahoma Natural Gas, and Texas Gas Service generated from operations in different state jurisdictions

Q. Please discuss Staff's analysis of KGS's Earned ROE vs the Earned ROE's generated by other ONE Gas utilities in other state jurisdictions.

A. In its response to CURB Data Request No. 10, KGS included a comparative analysis of earned ROE generated by Oklahoma Natural Gas and Texas Gas Service in its Oklahoma and Texas jurisdictions. The analysis presented in the prior section of testimony contained an adjustment for royalty expenses in its calculation of KGS's earned ROE. While KGS performed this adjustment for KGS, KGS did not include the removal of royalty expenses from the earned ROE calculation provided for Oklahoma Natural Gas and Texas Gas Service.

As such, Staff chose to present the unadjusted net income for the following comparison of the earned ROE generated by ONE Gas utilities in its other state jurisdictions. The unadjusted data provides a more direct comparison of the earned ROE generated by ONE Gas's local distribution utilities, Oklahoma Natural Gas and Texas Gas Service, in their respective Oklahoma and Texas jurisdictions. In the following table, Staff summarized the unadjusted earned ROE of Kansas Gas Service, Oklahoma Natural Gas[22], and Texas Gas Service.[23]

	Operating Year				
COMPARISON OF EARNED ROE:	2019	2020	2021	2022	2023
KANSAS GAS SERVICE	7.383%	8.156%	7.006%	6.265%	6.822%
OKLAHOMA NATURAL GAS	8.528%	7.822%	8.024%	7.676%	7.582%
TEXAS GAS SERVICE - Regional Service Territories					
CENTRAL-GULF SERVICE AREA	6.042%	2.248%	6.550%	6.452%	5.429%
RIO GRANDE VALLEY SERVICE AREA	4.172%	4.233%	5.202%	2.962%	
WEST NORTH SERVICE AREA:					
BORGER SKELLYTOWN	8.078%	0.991%			
NORTH TEXAS	9.849%	5.412%			
WEST TEXAS	6.400%	5.768%	6.143%		
WEST NORTH SERVICE AREA				7.302%	7.546%

As seen in the table, KGS's earned ROE without the royalty expense adjustment ranged from a low of 6.265% in 2022 to a high of 8.156% in 2020, with an average

[22] In its annual PBR ratemaking mechanism, the Oklahoma Corporation Commission set an Authorized ROE of 9.5% for Oklahoma Natural Gas in 2019 and an Authorized ROE of 9.4% was set from 2020 – 2023.
[23] Texas Gas Service (TGS) is regulated in three different service territories for Texas ratemaking purposes, TGS – Central-Gulf Service Area, Rio Grande Valley Service Area, and West North Service Area. Texas Gas Service had authorized ROE that ranged from 9.5% to 9.75% from 2019 through 2023.

earned ROE of 7.126% across the 2019 through 2023 operating years. Oklahoma Natural Gas ranged from a low of 7.582% in 2023 to a high of 8.2528% in 2019, or an average earned ROE of 7.926% through the rate period.

Texas Gas Service is divided into three service territories the Central Gulf Service Area (CGSA), Rio Grande Valley Service Area (RGVSA), and West North Service Area (WNSA). Texas Gas Service had the widest range of earned ROE included in the analysis of 2019 – 2023 operating results. CGSA generated an average earned ROE of 5.344% from 2019 through 2023, RGVSA generated an average earned ROE of 4.142% from 2019 through 2022, and WNSA generated an average earned ROE of 6.388% from 2019 through 2023.

As seen in the data, KGS's earned ROE falls in the middle of the Earned ROEs generated by ONE Gas utilities in its Oklahoma and Texas jurisdictions. This indicates that Kansas's current regulatory construct for regulating KGS is not an outlier, or punitive, or unnecessarily restrictive from an investor standpoint. Staff would note that regulatory structures, authorized ROEs, alternative ratemaking mechanisms, and the timing of rate cases in each of ONE Gas's state jurisdictions all impact the net income and earned ROEs experienced by KGS, Oklahoma Natural Gas, and Texas Natural Gas.

Q. Please discuss how KGS's proposed PBR mechanism relates to Oklahoma Natural Gas's earned ROE.

A. First, KGS modeled its proposed APRA off of Oklahoma Natural Gas's PBR mechanism as approved by the Oklahoma Corporation Commission. The Oklahoma Corporation Commission has used an annual formula-based ratemaking approach since 2011 for the regulation of its natural gas utilities that includes intervals for Oklahoma Natural Gas to file expanded rate reviews. The primary difference between the PBR mechanism utilized in Oklahoma and the APRA proposed in this case is that KGS incorporates the use of additional performance metrics as part of its annual formula-based rate review. The Oklahoma PBR model utilizes the performance driven mechanism to adjust rates yearly and allows for the sharing of any benefits that Oklahoma Natural Gas is able to generate between its shareholders and ratepayers.

As such, this annual formula-based rate review allows for Oklahoma Natural Gas to update its plant investment and operating expenses that factors into the yearly earned ROE. Therefore, Staff believes it's important to show the annual effect of this formula-based ratemaking approach on Oklahoma ratepayers across the past five-year period contained in the analysis. In response to KCC Data Request No. 166: Oklahoma Natural Gas PBR, KGS provided Oklahoma Natural Gas's history of rate changes from its PBR filings from 2011 through 2023. The following table included the operating results from 2019 through 2023.[24]

Oklahoma Natural Gas (ONG): Commission-Approved Rate Case Impact from 2011 - 2023					
(Data in Millions)					
Operating Year:	2019	2020	**2021***	2022	2023
PBR Impact in Rates	$ (15.6)	$ 9.7	$ 15.5	$ 19.6	$ 26.3
*ONG filed a rate case in 2021 that resulted in an increase in revenues of $15.5 million.					
<u>Source:</u>					
Response to KCC Data Request No. 166: Oklahoma Natural Gas PBR					

While Staff chose to include the most recent rate impacts for the study period in the table, Oklahoma Natural Gas filed 10 PBR filings from 2011 through 2023, which

[24] Oklahoma Natural Gas filed a full rate case in 2021 that resulted in a $15.5 million rate increase included in the table.

included full rate case filing in 2015/2016 and 2021. Staff would note that the PBR filings resulted in three operating periods that required no change in rates, 2011, 2013, and 2017, while the 2012 and 2014 filings resulted in net rate increases of $9.5 million and $13.7 million, respectively. In the 2018 and 2019 operating periods, Oklahoma Natural Gas provided rate credits of $11.3 million in 2018 and $15.6 million in 2019.

From 2020 – 2024, Oklahoma ratepayers experienced net increases in Oklahoma Natural Gas rates of $9.7 million in its 2020 PBR filing, $15.5 million from its 2021 rate case, $19.6 million from its 2022 PBR filing, and $26.3 million from its 2023 PBR filing. Similar to Kansas Gas Service, Oklahoma Natural Gas has invested heavily in its natural gas infrastructure and experienced increases in its operating costs due to the recent inflationary pressures in the economy as a whole. Oklahoma Natural Gas's annual rate increases, if approved would impact the Earned ROE experienced in the subsequent operating period, with an average change in rate revenue of $11.1 million per year across the five-year study period.

Q. How does Kansas Gas Service rate increases compared to those filed by Oklahoma Natural Gas Service?

A. Kansas Gas Service has two Commission-approved rate making mechanisms that adjust the annual revenue requirement for the GSRS and the Ad Valorem Tax Surcharge rider.[25] Staff prepared the following table for rate impacts that were approved as a result of these tariffs during the study period of 2019 – 2023.[26]

[25] Both Kansas Gas Service and Oklahoma Natural Gas file for changes in natural gas in ratemaking mechanisms that are outside of the rate making mechanisms discussed above.

[26] Staff would note that the Ad Valorem Surcharge filing for 2018 included $1,076,452 that was omitted from the table as the GSRS refund calculated for 2018 was deferred due to the materiality of the adjustment.

KGS: Annual Rate Impact for the GSRS Surcharge and Ad Valorem Tax Surcharge					
YOY Impacts of Surcharge by Rate Period	2019	2020	2021	2022	2023
Gas Safety & Reliability Surcharge	$ 4,232,387	$ 7,500,338	$ 7,635,957	$ 7,676,805	$ 7,984,002
Ad Valorem Tax Surcharge	2,182,255	2,266,592	3,021,790	5,110,137	1,207,041
Total Rev Req. Inc.	$ 6,414,642	$ 9,766,930	$ 10,657,747	$ 12,786,942	$ 9,191,043
Sources:					
Commission Orders approving KGS's annual filings for its GSRS and Ad Valorem Tax Surcharge for year-ending 2019 - 2023.					

As referenced in the table above, KGS's year-over-year rate increases that were contained in the annual surcharge filings included $6.4 million in 2019, $9.7 million in 2020, $10.6 million in 2021, $12.8 million in 2022, and $9.1 million in 2023. KGS's average rate increases totaled $9.7 million approved through KGS's annual ratemaking mechanisms across the five-year study period.

Q. Please summarize Staff's position as it relates to the proposed APRA and the difference between Kansas and Oklahoma's approach in ratemaking structures?

A. The primary driver of Staff's recommendation that the Commission deny KGS's requested PBR mechanism comes from the transfer of the financial risk from shareholders to ratepayers. In Staff's prior recommendations, Staff has used a targeted approach when recommending alternative ratemaking structures compared to the broader approach applied by Oklahoma's formula driven ratemaking structure.

The data presented for Oklahoma's PBR has shown significant growth in the year-over-year rate increases from 2020 through 2023 that has resulted from Oklahoma's approach to a formula-based rate with ratepayers exposed to both rising infrastructure investment and increasing operational and maintenance costs. In Staff's opinion, a performance-driven rate mechanism should swap out regulatory lag for performance driven metrics that allow for the evaluation of the Company's operational results against data that benchmarks a company's performance and cost containment against other economic, productivity or industry driven data. Those performance metrics should be designed to measure the Company's operational performance against comparative economic and productivity benchmarks and only provide a return to shareholders when those benchmarks are successfully met.

The analysis performed by Staff demonstrated that KGS has targeted alternative ratemaking mechanisms available currently that aid in reducing the regulatory lag and the pass-through of targeted operating costs that impact shareholder return. KGS's earned ROE and the yearly revenues provided by these mechanisms falls in line with ONE Gas's operations in other State jurisdictions that Staff analyzed with historical data from 2019 – 2023. The past Commission-approved mechanisms have had a measure of customer protections that are not present in the APRA plan proposed by KGS.

V. Staff Analysis of KGS's proposed PBR and Recommendation

Q. Please discuss some of the benefits of the PBR Plan that KGS addresses throughout its testimony.

A. KGS Witness Janet Buchanan summarized the benefits of PBR mechanisms in her testimony on page Nos. 19 – 21. Ms. Buchanan provides her opinion on a list of important advantages she says are gained through the use of a performance-based ratemaking. I will quickly summarize her list of benefits. Ms. Buchanan states that PBR mechanisms:

- Emphasize customer satisfactions and quality of service preferences, while providing utilities an incentive to meet customer expectations;

- Provide gradualism in changes in rates rather than large rate changes associated with traditional rate cases;
- Incentivize efficient operations and cost management, allowing for utilities to optimize processes and control expenses to improve efficiency;
- Allow for proactive utility responses to changing regulatory requirements around safety and reliability as well as respond to issues identified around the country related to vintage pipe replacement or other infrastructure;
- Incentivize investment in measures of reliability and resilience of the distribution system for risk management and ensure that service is continuous and reliable during extreme weather events, natural disasters or other emergency operations;
- Provide greater transparency by requiring utilities provide annual reports on their financial and operational performance, which provide greater insight into utility operations for regulators, customers, and other stakeholders;
- Encourage the adoption of innovative technologies to enhance their operations in leak detection and advanced metering;
- Assist in economic growth by encouraging infrastructure investment necessary to serve new businesses and the new workforce, while creating job opportunities and contributions to local economies;

- Provide greater flexibility to address changing market conditions, technological advancement, and shifts in energy demand and consumption patterns.
- Reduced administrative and regulatory costs over traditional rate cases.
- Align with environmental goals by providing incentive for utilities to reduce methane leaks and emissions and allow for utilities to invest in infrastructure to connect to alternative sources of gas supply, such as renewable natural gas.

Q. Does Staff agree with the characterization of the benefits of a PBR Plan that KGS addresses throughout its testimony.

A. Staff does not dispute that PBR can offer some benefits to the traditional ratemaking process that provide utilities, their customers, and utility investors with enhancement in infrastructure investment and quicker access to rate adjustments to address changing customer needs. There are a few areas where Staff has a disagreement with KGS's characterization of PBR proposals. The primary areas that Staff wishes to address include whether PBR's incentivize and enhance a utility's efficient operations and cost containment, improve the customer experience, align with customers' expectations, and provide a more efficient process for regulatory oversight.

A. PBR Benefit: Incentivize & Enhance: Efficient Operations

Q. Please address Staff's position on whether KGS's APRA promotes the utility's efficient operations and cost management.

A. The first issue that Staff would like to address is that PBR mechanisms incentivize or enhance a utility's efficient operations and promote cost management. My testimony has touched on this issue throughout the first two sections. As discussed, the reduction in regulatory lag inherent in a PBR mechanism needs to be carefully designed to properly incentivize both the utilities operational performance and cost containment.

As currently constructed, KGS's APRA does not propose really any operational measures of management performance either to benchmark economic or productivity metrics. The proposal does not offer comparative analysis of KGS's performance against other gas utilities in the area of cost containment. Staff would reiterate that the primary goal of performance metrics in a PBR is to drive the utility's management performance and provide customer assurances of the utility's efficient operations. This factor is especially true when utility infrastructure investment is a driving factor in utility rate increases or when inflationary pressures can result in rising utility costs. As currently constructed, KGS's PBR mechanism only drives the utility's cost containment through an incentive mechanism that allows shareholders to benefit if KGS earns an ROE in excess of the Commission authorized ROE in this filing. Given the pace of KGS's anticipated capital invest, Staff contends that it is very unlikely that KGS would ever reach the point of earning in excess of its ROE through this requested PBR mechanism.

Q. Does Staff have any additional data supporting KGS's ability to manage its operations and maintenance expense growth from the prior rate case?

A. Yes, Staff performed an analysis of KGS's management of its operations and maintenance for non-fuel and storage operating and maintenance (O&M) expenses from 2019 – 2023. Staff utilized the O&M expense data contained in KGS's FERC Form 2: Annual Report filed with the Commission for year-ending 2018 through 2023 to conduct this assessment. Staff adjusted the O&M expense to remove the purchase cost of natural gas and storage expenses contained in the Annual Report in the Gas Operation and Maintenance Expenses section. The following table summarizes KGS's annual O&M and A&G expenses, provides the year-over-year growth of the costs, and the percentage of increase or decrease of these expenses for the end of each operating year.

KGS: Review of O&M and A&G Expenses - 2019 - 2023
(O&M Expenses exclude Purchase Gas Costs and Storage expenses)

	(Data in Millions)				
Expense Category	2019*	2020	2021	2022	2023
O&M	$ 77.6	$ 75.5	$ 76.5	$ 82.3	$ 87.1
YOY Increase	$ 0.9	$ (2.1)	$ 1.0	$ 5.9	$ 4.8
Percentage Increase/(Decrease)	1.2%	-2.7%	1.3%	7.7%	5.8%
A&G	$ 84.6	$ 87.9	$ 90.0	$ 88.5	$ 92.4
YOY Increase	$ 0.5	$ 3.3	$ 2.1	$ (1.5)	$ 3.9
Percentage Increase/(Decrease)	0.6%	3.9%	2.4%	-1.7%	4.4%
Total O&M	$ 162.2	$ 163.4	$ 166.5	$ 170.9	$ 179.5
YOY Increae	$ 1.4	$ 1.2	$ 3.1	$ 4.4	$ 8.7
Percentage Increase/(Decrease)	0.9%	0.7%	1.9%	2.6%	5.1%

*2018 Data: O&M expense of $76.7 million and A&G expense of $84.1 million.

Sources: KGS FERC Form 2: Annual Reports for 2018 - 2023.

As seen in the table, KGS's operations and maintenance expenses were relatively flat from the end of the last rate case with O&M expenses of $76.7 million in 2018 and $76.5 million in 2021. During this period, A&G costs grew from $84.1 million to $90.0 million. Following the end of 2021, KGS's operations and maintenance expense increased by $5.9 million in 2022 and $4.8 million in 2023, while its A&G expense fell by $1.5 million in 2022 and increased by $3.9 million in 2023. During the 2022 – 2023 operating periods, KGS experienced an average annual growth in operations and maintenance expense of 6.7%. This was partially offset with lower growth in A&G expenses, averaging 2.6% over the operating period. During the study period, KGS's total growth in operating expenses for these categories increased from $160.8 million in 2018 to $179.5 million in 2023.

Q. Does Staff have any additional supporting data on the expected growth of KGS's operations and maintenance expense that supports Staff's concerns?

A. Staff monitors utility earnings calls and investor presentations to get a bigger picture of the macro-economic trends that are experienced by Kansas utilities through S&P Global and other web platforms. Investor presentations often provide key insights to management decision-making processes and projected operating and earnings targets provided for investor guidance. Staff monitors these calls for the parent companies of both the electric and natural gas utilities that the Commission regulates.

In the most recent One Gas earnings call for the fourth quarter of 2023, Christopher Paul Sighinolfi discussed the impact of rising operations and maintenance expenses at ONE Gas. As Mr. Sighinolfi explains during the investor presentation,

> [ONE Gas's] fourth quarter operations and maintenance expenses were 6.6% higher than the fourth quarter of 2022, continuing the moderating trend that ONE Gas has experienced throughout 2023 as the benefits of our in-sourcing efforts have begun to bear fruit. ONE Gas expects this trend to continue. And as a reminder, ONE Gas projects operating expenses to grow by approximately 5% per year through 2028.[27]

[27] *See* ONE Gas, Inc. [NYSE:OGS]: Earnings Call Transcripts hosted Thursday, February 22, 2024 at 4:00 PM [GMT], as published on S&P Global Market Intelligence.

Q. How does ONE Gas's investor guidance compare to the operation and maintenance costs increases at other Kansas-jurisdictional gas utilities, like Atmos Energy or Black Hills Energy?

A. Staff monitored the investor calls for both Atmos Energy and Black Hills for their fourth quarter of 2023. Both Atmos Energy[28] and Black Hills[29] included growth in their operations and maintenance expenses, with O&M inflation of 3.5% annually through the close of 2028 for their respective fiscal or calendar year.

B. PBR Benefit: Improves & Aligns: Customer Experience

Q. Please address Staff's position on whether KGS's PBR Plan improves the customer experience and aligns better with customer's expectations?

A. Staff's primary issue with KGS's characterization of PBR plans as a customer-driven initiative is that it does not adequately recognize that the customer experience and their goals are not directly aligned as a customer group. Prior to addressing KGS's APRA, Ms. Buchanan addresses the subject matter of the energy burden in Section 3 of her testimony that certain utility customers face when it comes to the financial impact of KGS's natural gas services.

Staff does not believe the APRA would impact all customers to a similar degree, especially those that are impacted by limited financial flexibility or fixed income residents. While KGS allocates resources to aid consumer financial flexibility, the APRA would subject these ratepayers more directly to annual cost increases for both

[28] *See* Atmos Energy Corp. [NYSE: ATO] Q4:2023 Earnings Call transcripts hosted November 9, 2023 at 10 AM, as published on Yahoo Finance
[29] *See* Black Hills Corp. [NYSE:BKH] Q4:2023 Earnings Call Transcripts hosted February 8, 2024 at 11 AM [EST], published on Black Hills Corp website: 8a91d90e-f9b8-49c2-b9be-00184b52a3cc (blackhillscorp.com).

growth-related capital investment and operations and maintenance expenses, each of which are currently outside of the Commission-approved GSRS and Ad Valorem Tax surcharge rate adjustments. Moreover, these customers wouldn't receive the current customer protections that exist within the GSRS surcharge, like the maximum impact of $.80/month, per residential customer.

Staff recognizes that these annual rate reviews would likely result in smaller incremental increases than those addressed through the traditional rate case process; however, the APRA would shift the burden for the *annual* management of operations and maintenance expense increases that are currently a shareholder-related risk and put the responsibility for these costs increases directly on Kansas ratepayers. In addition, the PBR mechanism proposed includes a limited timeline for Staff to overview these expense increases and this timeline will effectively limit the scope of review that Staff would be able to perform in the longer time-frame of a rate case.

In this case, Staff issued nearly 300 discovery requests covering KGS's proposed cost of service in this rate filing. In addition, CURB has issued an excess of 160 data requests that have provided the parties with additional data to make adjustments for non-recurring expenses, review costs for recommended disallowances, and review the capital additions and asset retirements that KGS has incorporated in its recommended revenue requirement. Based on Staff's review of KGS's Application in this Docket, Staff is recommending a revenue requirement increase of approximately $31.7 million in comparison to the requested increase of $58.1 million, with the roll-in of $35.0 million in GSRS-related revenues and capital investment currently being recovered in the GSRS surcharge.

C. PBR Benefit: Enhances the Regulatory Process & Oversight

Q. Please address Staff's position on whether KGS's PBR Plan would enhance the regulatory processes and provide additional oversight to the Commission.

A. Staff has a fundamental disagreement with KGS's characterization that its proposed PBR plan would enhance the process of regulatory review and ratemaking in Kansas. While KGS's APRA proposes an annual rate review process and provides a general structure for the Application of the APRA filing, the Commission would have 120 days to review KGS's Application and issue and Order in each annual filing. KGS's APRA filing would utilize a year-ending December 31 test period and would be filed no later than March 15. Staff would have roughly 45-days to review the filing, as KGS proposes that any calculations that are disputed by the parties be identified to the Company by May 1.

Due to these time constraints, the APRA's calculated earned ROE would allow for limited adjustments to net plant and CWIP balances. KGS proposed to include the net plant balances and CWIP balances as of December 31 of the rate period. As a check, KGS compared the net plant and CWIP balances as of December 31, 2018 through 2022 and compared these amounts to the net plant in service balance as of June 30 of the following year. In four of the five rate years, the net plant in service plus CWIP balance as of December 31 was less than the net plant in service six-months later. As such, KGS concludes the net plant in service and CWIP balances are a reasonable approximation of the net plant in service when a rate change, if necessary, would be implemented.

These APRA filings would not replace the normal rate case process. KGS proposes to file a full rate review every five-years, with a full rate case review being slated for 2030. If the APRA filings were approved, KGS will retain the burden of proof to demonstrate the reasonableness of its APRA Application and the resulting rates. KGS would continue to file testimony explaining the increase, compliance with the tariff, the Commission order from the most recent rate case, and testimony supporting the adjustments included in the filing. Testimony will also address the Company's performance with respect to the performance metrics and targets.

Q. As it relates to the time constraints proposed by KGS, does Staff contend there would be an adequate time to perform an audit and thorough review of the Application?

A. KGS's proposed 120-day time table is identical to Southern Pioneer's formula-based rate on its debt service coverage and 34.5 kV rate, which includes limited adjustments to the test period. Staff would note that Southern Pioneer is a smaller, not-for profit utility, wholly-owned by Pioneer, a deregulated cooperative; and, therefore, the Company does not have shareholders or the traditional profit motive of investor owned utilities. Southern Pioneer's formula-based rate is set with a debt service margin calculation and billed to a significantly smaller customer base than KGS system. While Staff is able to issue discovery, review the application, and file testimony within the agreed upon 120-day timeline for a Commission Order, Southern Pioneer's protocols and the agreed upon adjustments, the formula-based framework results in Staff issuing a limited number of data requests with Staff adjustments are usually limited to the removal of certain A&G related items. Southern Pioneer's Application typically results in one Staff auditor being assigned to the Docket.

If the Commission were to approve this formula-based ratemaking structure as proposed by KGS, Staff would expect the administrative cost of these filings to greatly outpace the cost to administrate Southern Pioneer's formula-based rate. Staff would need to assign more auditors in an attempt to conduct as thorough review as possible of the Application in the proposed time-table of the APRA process. The scope of KGS filing would be significantly greater due to the sheer size of the natural gas system. KGS's level of rate base investment, its operations and maintenance expenses, and the administrative and general expenses from its direct and corporate-driven operations add a significant level of complexity to a formula-driven approach and increase the scope of review from both the amount of expenses and number of expenses to review.

This resource requirement would likely occur during time tables that Staff is processing other rate case Applications for other gas and electric utilities. This would be a significant concern to Staff if the APRA processed occurred during the filing of an Evergy rate case, where Staff employs almost all of its auditing resources to review the Evergy Kansas Central and Evergy Kansas Metro rate cases under the 240-day timeline for a Commission Order. Finally, KGS's APRA still retains the requirement to file full rate case at five-year intervals, similar to Southern Pioneer's 5-year rate case cycle for an expanded review. During KGS's full rate case review, Staff would anticipate that it would employ a similar level of Staff resource to conduct an audit and formulate its recommendations, as employed in the current rate docket.

Q. What other factors did Staff considered in its recommendation to the Commission to approve Southern Pioneer's formula-based rate and contrast these factors against Staff's decision to recommend denial of KGS's requested APRA.

A. The other factors that Staff considered in recommending this formula-driven approach for Southern Pioneer resulted from Southern Pioneer's unique corporate structure and the administrative costs that were present currently present in the traditional rate case process that were billed to Southern Pioneer's limited retail customer base.

Southern Pioneer is a smaller, not-for profit utility, wholly-owned by Pioneer, a deregulated cooperative. As a wholly-owned, not-for-profit corporation, Southern Pioneer is not publically traded and does not have any shareholders. Under Kansas statutes, Southern Pioneer's unique corporate structure limited its ability to deregulate its retail operations, similar to the elective approach taken by the other Sunflower cooperatives in deregulating their retail operations. Due to its limited customer base, the traditional rate case process resulted in higher administrative costs incurred by Southern Pioneer and Staff, resulting in a higher cost burden per customer.

KGS's requested PBR mechanism does not include these same factors in recommending a formula-based approach. KGS's parent-company ONE Gas is a publicly traded company with shareholders and does not mirror the unique considerations of the corporate structure present with Southern Pioneer. KGS's level of rate base investment, its operations and maintenance expenses, and the administrative and general expenses from its direct and corporate-driven operations add a significant level of complexity to a formula-driven approach and scope in both the dollar amounts and number of expenses to review. In addition, KGS customer base is considerably larger than Southern Pioneer, as a result the administrative and regulatory costs contained in the traditional rate cases are spread over a larger number of customers. Therefore, the administrative cost burden impact customers differently.

D. PBR: Impact on GSRS Statute

Q. Does Staff have any additional concerns regarding KGS's alteration of the regulatory structure in Kansas?

A. Yes. As proposed, the PBR mechanism is meant to replace the GSRS process that was modified as part of a natural gas utility's industry-wide initiative, which the Kansas Legislature included in K.S.A. 66-2201 - 66-2204. The Legislature's modifications of the GSRS statute broadened the scope of qualifying projects to include gas safety, reliability, and cyber-security related investment and increased the residential cap of the surcharge from an incremental monthly impact of $0.40 to $0.80 per residential customer, which became effective January 1, 2019.

Staff is concerned that KGS's request sets aside this Legislative Policy that provides significant consumer protections in favor of a broad-based formula rate approach that is driven by performance shareholder-based incentives. If the utility is able to earn an ROE in excess of 100 basis points above the authorized ROE that the Commission has set in the Dockets, KGS proposes to distribute these benefits with at least 75% of the benefits flowing back to customers via bill credits and shareholders retaining up to 25%, if certain customer service metrics are reached. As discussed, the performance metrics that KGS is proposing are based on customer-driven response rates for answered calls, the estimated bill rate per thousand customers and the response time to odor reports. These measures do not really provide any consumer protections in an environment of increasing rates of utility capital investment and cost environment projected through 2028 by ONE Gas in its investor calls.[30]

Q. Does the GSRS Statute have any deficiencies in its approach for the rate recovery of ongoing capital investment in pipeline replacement, safety, reliability, and cyber security investment?

A. Staff would note that GSRS approach to cost recovery has a deficiency that has the potential to allow a utility to over-recover its authorized ROE. In the calculation of GSRS rate recovery, utilities are allowed to recoup its investment in pipeline projects without meeting a requirement that it maintain a capital maintenance obligation equal to the depreciation expense calculated in the most recent rate filing.

In Staff's recommended approval for pipeline modernization in FERC pipeline rate filings, Staff has insisted that the Company only recovers its capital investment once it has met the capital maintenance obligations. The reasons Staff has made this recommendation in past modernization surcharges is to provide customers assurance that the Company is investing in its infrastructure at rates higher than its calculated depreciation in the most recent rate case. If a company didn't maintain this obligation, the Company would have the ability to recover capital investment while potentially having a declining balance of net plant and rate base in future rate applications.

At the current time, utility infrastructure investment in the replacement of existing pipeline infrastructure, technological modernization, and pipeline growth have outpaced the yearly depreciation expense maintenance obligation and pushed up against the limits

[30] *See* Testimony of Janet Buchanan, page 29. Ms. Buchanan address how the performance targets impacts the benefits retained by KGS's shareholders, if KGS were to produce an ROE in excess of 100 basis points of the authorized ROE in this Docket.

of the alternative ratemaking mechanisms. This strategy guarantees that the utilities current infrastructure investment and future projected capital investment growth has resulted in significant increases in the utility rate base, resulting in increased return on rate base in future rate filings. As such, it is unlikely that a utility would over-earn its ROE through the use of the GSRS mechanism.

Q. Does Staff contend that the GSRS mechanism is sufficient to generate ROE's in the range of ROE authorized by the Commission?

A. Staff contends that the current mechanism is sufficient to provide KGS's shareholders an opportunity to earn its authorized return on equity. One of the factors that exists outside of the GSRS mechanism recovery is pipeline growth-related investment. The pipeline investment in infrastructure growth should result in revenue increases from the growth of its system investment. In the current case, KGS witness Janet Buchanan calculates that customer growth driven resulted in an offset of $20.3 million.[31] The growth in KGS's customer base provides the company tangible benefits and allows the company to manage its operations and maintenance cost increases between utility rate case filings.

E. PBR: Summary of Staff's position and Commisison Recommendation

Q. Please summarize Staff's position as it relates to its recommendation to deny KGS's proposed PBR plan?

It is Staff's position that KGS's management decision-making process to set its Capital Plan investment targets and manage its operations and maintenance increases

[31] *See* Testimony of Janet Buchanan, Chart 1: Drivers of the Increase, Customer Growth impact of ($20.3 million), Page No. 4.

should not be done in a vacuum that designed to generate annual rate adjustments via a formula-based rate mechanism. When evaluating utility requests for alternative based ratemaking structures, Staff has generally supported targeted ratemaking structures that provide tangible benefits to both utility investors and customers.

It is Staff's contention that KGS's requested APRA transfers too much of the operating and financial risks of the Company on to Kansas ratepayers, due to rising inflationary costs and capital investment plans that are designed to grow the Company's rate base and ultimately, drive shareholder returns through future filings. Throughout my testimony, I provided data supporting KGS's anticipated growth in Capital Investments for 2024 through 2028, its projected increases for operations and maintenance expenses, and calculated KGS's earned returns that are comparable to the earned returns ONE Gas generates in its other state jurisdictions with the existing Kansas ratemaking structure.

Therefore, it is my recommendation that Commission deny KGS's requested APRA detailed in the Testimony of KGS witness Janet Buchanan and the corresponding APRA proposed tariffs. In the event the APRA tariffs are denied by the Commission, Staff supports KGS requested for renewal of its Ad Valorem Tax Surcharge, its cyber-security tracker, and pension and other post retirement expense trackers. In the testimony of Staff witness Andria Jackson, Ms. Jackson has included adjustments to amortize the deferred cyber security investment and sets a new baseline for the tracker. Bill Baldry addresses Staff's adjustments related to the Pension and OPEB tracker with updated balances through April 30 update period. Finally, Staff witness Adam Gatewood proposes a recommended ROE of 9.6% be utilized in the calculation of Staff's return of 7.5305 included in schedule C-1.

In the event the Commission finds in favor of KGS's proposed PBR plan as detailed in the supporting testimony of KGS witness Janet Buchanan and approves the APRA tariffs, Staff agrees with KGS's position that these alternative ratemaking structures would no longer be necessary and should be discontinued in favor of the APRA tariffs. Finally, Staff witness Adam Gatewood testimony supports a recommended authorized ROE of 9.0% and Staff's recommended rate of return would be 7.1693%

Q. Does this conclude your testimony?

A. Yes.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Chad Unrein, being duly sworn upon his oath deposes and states that he is Chief of Accounting and Financial Analysis for the Utilities Division of the Kansas Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Direct Testimony*, and attests that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Chad Unrein
Chief of Accounting and Financial Analysis
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 26 day of June, 2024.

Notary Public

My Appointment Expires: 4/28/25

NOTARY PUBLIC - State of Kansas
ANN M. MURPHY
My Appt. Expires 4/28/25

CERTIFICATE OF SERVICE

24-KGSG-610-RTS

I, the undersigned, certify that a true and correct copy of the above and foregoing Testimony was served via electronic service on the 1st day of July, 2024, to the following:

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