

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 an Extension of its Certificate of Convenience and Authority to Operate as a Natural Gas Public Utility in and Around the Area Heretofore Served by the City of Lebo, Kansas, a Municipally Owned Natural Gas Utility. )  
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) Docket No. 24-KGSG-825-ACQ  
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**KANSAS GAS SERVICE'S REPLY TO CURB'S RESPONSE  
TO STAFF'S REPORT AND RECOMMENDATION**

Kansas Gas Service, a division of ONE Gas, Inc. ("Kansas Gas Service") files the following reply to the Citizens' Utility Ratepayer Board's ("CURB") response ("CURB Response") to the report filed by the Staff of the Kansas Corporation Commission ("Commission" and "Staff," respectively) in this docket on October 21, 2024 ("Staff R&R").<sup>1</sup> Staff recommends the Commission issue an order approving Kansas Gas Service's application to acquire the City of Lebo's ("Lebo") municipal natural gas utility per the Commission's municipal acquisition process established in Docket No. 08-ATMG-182-ACQ ("08-182 Docket").<sup>2</sup> In its response filed on October 29, 2024, CURB does not object to Staff's recommendation and specifically states in its response it does not object to the application filed by Kansas Gas Service.<sup>3</sup> However, notwithstanding its position that the Commission approve the application, CURB suggests Kansas Gas Service failed to fully comply with the municipal acquisition process by not negotiating a separate surcharge as part of the acquisition to cover future anticipated capital expenditures identified by Kansas Gas Service during discovery.<sup>4</sup> Kansas Gas

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<sup>1</sup>*CURB's Response to Staff's Report and Recommendation*, Docket No. 24-KGSG-825-ACQ, ("825 Docket"), filed October 29, 2024 ("CURB Response"); *Notice of Filing of Staff Report and Recommendation*, 825 Docket filed October 21, 2024.

<sup>2</sup>*Staff R&R*, page 5.

<sup>3</sup>*CURB Response*, pages 10-11, paragraph 18; page 11, paragraph 20.

<sup>4</sup>*CURB Response*, page 5, paragraph 7.

Service disagrees with CURB on this point and files the following reply limited to that disagreement. Kansas Gas Service seeks clarification that it is not necessary to negotiate a separate surcharge as part of the Commission's municipal utility acquisition process in order to cover future anticipated capital expenditures like the ones identified by Kansas Gas Service in this case and that the negotiated surcharge requirement applies only to those situations where the improvements to the acquired distribution assets are immediately necessary and when the purchase price plus the cost of those immediate improvements exceed the utility's average embedded cost to serve a customer. As indicated by the Commission in its orders and the Staff in its reports in the numerous municipal acquisition cases that have come before the Commission, the negotiated surcharge requirement applies in those situations where "immediate improvements to the acquired distribution assets will be necessary."<sup>5</sup> As explained in this reply, Kansas Gas Service fully complied with the Commission's municipal acquisition process in its proposed acquisition of the Lebo municipal natural gas utility. This included its decision that it was not necessary to negotiate a separate surcharge as part of the acquisition in order to cover future anticipated capital expenditures, which would normally be recovered under the utility's Gas System Reliability Surcharge ("GSRS"), and which are not the type of "immediate improvements" contemplated by the Commission under its municipal acquisition process. No immediate improvements to the acquired distribution assets from Lebo are necessary, and therefore,

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<sup>5</sup>Docket No. 09-ATMG-458-ACQ (Atmos Energy acquisition of the City of Hamilton); Docket No. 09-KGSG-ACQ (Kansas Gas Service acquisition of the City of Alta Vista); Docket No. 09-BHCG-967-ACQ (Black Hills acquisition of Neosho Rapids); 10-BHCG-057-ACQ (Black Hills acquisition of Windom); 12-BHCG-678-ACQ (Black Hills acquisition of Milford); 13-BHCG-133-ACQ (Black Hills acquisition of the City of Viloa); 13-BHCG-366-ACQ (Black Hills acquisition of the City of Longford); 13-BHCG-566-ACQ (Black Hills acquisition of the City of Americus); 13-BHCG-798-ACQ (Black Hills acquisition of the City of Agenda); 14-ATMG-298-ACQ (Atmos Energy acquisition of the City of Severy); 14-BHCG-327-ACQ (Black Hills acquisition of the City of Aurora); 17-BHCG-511-ACQ (Black Hills acquisition of the City of Attica); 21-BHCG-417-ACQ (Black Hills acquisition of the City of Ford); 24-BHCG-053-ACQ (Black Hills acquisition of the City of Rozel).

it was not necessary for Kansas Gas Service to negotiate a separate surcharge as part of the acquisition. Even though CURB is not objecting to the approval of the application in this case, Kansas Gas Service submits this reply and its request for clarification in order to ensure that the acquisition process established by the Commission is correctly interpreted so its successful use is continued.

1. On June 6, 2024, Kansas Gas Service filed an application seeking approval to acquire Lebo's municipal natural gas utility.<sup>6</sup> The application was filed pursuant to the Commission's municipal acquisition process established in the 08-182 Docket.<sup>7</sup> That process was adopted by the Commission to streamline regulatory approval in order to promote and encourage large natural gas distribution utilities that operated in Kansas to acquire smaller Kansas municipal gas utilities that were looking to be acquired and may be struggling to (1) maintain employment of personnel qualified to operate a gas system; (2) finance the replacement of aging infrastructure; and (3) comply with pipeline safety requirements.<sup>8</sup> Since its inception in 2007, the three largest natural gas utilities have all used the Commission's municipal utility acquisition process.<sup>9</sup> Nearly a third of the small Kansas municipal gas utilities have been acquired under the process approved by the Commission.<sup>10</sup> In some situations, the acquisitions were done at the request of the Staff. Overall, the Commission's municipal utility acquisition process has been a huge success.<sup>11</sup>

2. The Staff R&R in this docket was filed on October 21, 2024.<sup>12</sup> The Staff found that

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<sup>6</sup>*Application*, 825 Docket filed June 6, 2024.

<sup>7</sup>*Application*, pages 2-3, paragraph 2; *Order Approving Application*, Docket No. 08-ATMG-182-ACQ filed December 18, 2007.

<sup>8</sup>*Order Approving Application*, 08-182 Docket, pages 2-3, paragraphs 6-9; *Corrected Staff Memorandum*, 08-182 Docket filed November 19, 2007, pages 1-2.

<sup>9</sup>See Footnote 5 for list of some of the municipal acquisition dockets.

<sup>10</sup>*Id.*

<sup>11</sup>*Id.*

<sup>12</sup>*Staff R&R*.

Kansas Gas Service complied with the Commission's municipal utility acquisition process in its proposed acquisition of Lebo's municipal natural gas utility and recommended that the Commission approve the acquisition.<sup>13</sup> As a result of discovery issued by CURB in this docket, the Staff specifically reviewed whether Kansas Gas Service acted accordingly in deciding it was not necessary to negotiate a separate surcharge with Lebo as part of the acquisition to cover future anticipated capital expenditures that would otherwise normally be recovered under the utility's GSRS surcharge.<sup>14</sup> The Staff concluded that a surcharge was not necessary and that Kansas Gas Service complied with that provision of the acquisition process.<sup>15</sup> In most of the previous municipal acquisition cases, the Staff has concluded that no surcharge is required when "**immediate improvements** to the acquired distribution assets will not be necessary." (Emphasis added).<sup>16</sup>

3. CURB filed its response to the Staff R&R on October 29, 2024.<sup>17</sup> As mentioned above, CURB does not oppose Kansas Gas Service's application and the Commission's approval of its acquisition of Lebo's municipal natural gas system.<sup>18</sup> CURB concludes that the acquisition would promote the public interest.<sup>19</sup> However, CURB suggests that Kansas Gas Service failed to comply with the Commission's acquisition process by not negotiating a separate surcharge with Lebo as part of the acquisition to cover future anticipated capital expenditures that were identified by Kansas Gas Service in discovery responses submitted in this docket.<sup>20</sup> Kansas Gas Service disagrees with CURB's position

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<sup>13</sup>Staff R&R, page 3 and page 5.

<sup>14</sup>Staff R&R, pages 3-4.

<sup>15</sup>Staff R&R, page 4.

<sup>16</sup>See, dockets cited in Footnote 5. In those few cases where the Commission has determined that a surcharge was necessary, immediate capital expenditures were identified. See, Docket No. 21-BHCG-417-ACQ, *Order on Application for a Certificate of Convenience and Authority to Serve the City of Ford, Kansas* filed August 12, 2021, page 1, paragraph 1 (immediate major improvements required).

<sup>17</sup>CURB Response.

<sup>18</sup>CURB Response, pages 10-11, paragraph 18; page 11, paragraph 20.

<sup>19</sup>Id.

<sup>20</sup>CURB Response, page 5, paragraph 7.

and seeks clarification from the Commission that negotiated surcharges are not necessary to cover future anticipated capital expenditures like the ones identified in this case as part of the Commission's municipal acquisition process. In prior municipal acquisition cases, negotiated surcharges have been required in only those situations where immediate improvements to the acquired distribution assets were necessary and where the cost of the immediate improvements, along with any purchase price, exceeded the utility's current distribution system average per customer embedded cost.<sup>21</sup> In cases where no immediate improvements were necessary, no surcharge was required. In the present case, the capital expenditures identified by Kansas Gas Service are future anticipated capital expenditures and are not necessary immediate improvements.<sup>22</sup> Therefore, it was not necessary for Kansas Gas Service to negotiate a surcharge as part of its acquisition of the Lebo system. Instead, KGS will likely seek to recover the future anticipated capital expenditures through rate cases or using the GSRS surcharge that is charged to all of Kansas Gas Service's customers, including the new customers located in Lebo.<sup>23</sup>

4. CURB's position on when a surcharge is required runs against the context and support the Commission used when it created the municipal acquisition process. For instance, CURB relies heavily on the phrase "any improvements" to sweep in future capital expenditures KGS will make to Lebo's system.<sup>24</sup> But the language CURB quotes is actually the Commission's summary of what

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<sup>21</sup>See, Notice of filing of Staff Memorandum, Docket No. 10-BHCG-057-ACQ filed August 6, 2009, page 2; Notice of Filing of Staff Report and Recommendation, Docket No. 12-BHCG-678-ACQ filed April 23, 2012, page 3; Certificate and Order, Docket No. 13-BHCG-366-ACQ filed January 30, 2013, page 3, paragraph 5.b.; Certificate and Order, Docket No. 14-BHCG-327-ACQ filed March 27, 2014, page 3, paragraph 5.b; Notice of Filing of Staff Memorandum, Docket No. 09-ATMG-458-ACQ filed December 23, 2008, page 2.

In Docket No. 21-BHCG-417-ACQ, *Order on Application for a Certificate of Convenience and Authority to Serve the City of Ford, Kansas* filed August 12, 2021, page 1, paragraph 1, surcharge was required to cover immediate major capital expenditures.

<sup>22</sup> *Staff's Report and Recommendation*, pages 3-4.

<sup>23</sup> *Id.*

<sup>24</sup>See, e.g., *CURB Response*, page 5, paragraph 7; page 7, paragraph 11.

Atmos requested in the 08-182 Docket. The Commission went on to hold, "... the program to acquire Kansas municipal gas systems and for a determination of the reasonableness of an asset purchase agreement **is hereby approved as modified by Staff's recommendations.**"<sup>25</sup> (Emphasis added). Staff's recommendations recognized a municipal system may require "needed repairs prior to the purchase of a system" and in those circumstances a surcharge would allow investments above the utility's average embedded costs to be collected from the municipality's customers.<sup>26</sup> From this, it's clear the Commission's reference to improvements meant those immediate repairs necessary to allow a local distribution company to take on the responsibility of operating and maintaining the municipality's system. The improvements identified by KGS simply do not fall within this category.<sup>27</sup> Neither Staff nor the Commission ever endorsed the idea that any improvement ever made to a municipality's system after its acquisition should count towards a surcharge. Such an interpretation only frustrates the very reasons the Commission believed it was beneficial for municipal natural gas systems to be acquired.

5. CURB's interpretation that a surcharge is required to be negotiated under the Commission's municipal acquisition process to cover future anticipated capital expenditures identified by the utility at the time of the acquisition is totally inconsistent with the purpose of that process and could be harmful to future municipal acquisitions filed for approval under that process if left unanswered. To the extent that portion of the Commission's process is ambiguous, Kansas Gas Service requests that such be clarified. One of the purposes for the Commission adopting its stream-line

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<sup>25</sup>See *Order Approving Application*, 08-182 Docket, page 7, ordering clause (A).

<sup>26</sup>*Corrected Staff Memorandum*, 08-182 Docket filed November 19, 2007, page 4.

<sup>27</sup>See Data Request Response to CURB-004 indicating KGS is not aware of any immediate improvements needed for the majority of distribution system assets, and referring to CURB-005 for future work. See Data Request Response to CURB-005 wherein KGS describes future work to the Lebo system, which KGS considered normal upgrades and enhancements provided to all KGS customers.

regulatory review of these municipal acquisitions was to take advantage of the economies of scale the larger Kansas natural gas utilities could provide to assist smaller Kansas municipal gas systems in terms of manpower, expertise in such things as pipeline engineering, pipeline safety, natural gas purchasing practices, and the ability of the utility to replace aging infrastructure in a way that was not cost-prohibitive. CURB's interpretation that future anticipated capital expenditures of an acquired municipal gas utility, like the ones identified in this case, must be charged only to those municipal customers, as opposed to taking advantage of the economies of scale brought about as a result of the acquisition, defeats the benefits that the Commission found when it adopted its municipal acquisition process. CURB's interpretation is also inconsistent with the Commission's practice of establishing state-wide rates for utility customers so all costs are spread across all customers and paid by all customers in order to take advantage of such economies of scale. Kansas Gas Service's GSRS surcharge is a good example where the utility can take advantage of economies of scale by having all customers in the State pay for all capital expenditures instead of those capital expenditures being paid for only by those customers living in the communities where those capital expenditures were made. In the present case, if the acquisition is approved by the Commission, customers living in Lebo, like Kansas Gas Service's other Kansas customers living throughout the state, will pay the monthly GSRS surcharge and the revenue generated by that surcharge will be used to pay for all future anticipated capital expenditures that qualify under the GSRS tariff, whether located in Lebo or in another community served by Kansas Gas Service. Spreading those costs across a much larger number of customers makes capital expenditures, which would otherwise be cost-prohibitive for a community of only a few hundred people, doable. CURB's position results in the unbalanced treatment of customers. Lebo's customers would contribute towards system improvements in all of KGS's other

communities, but would not receive the same support when system improvements are made in Lebo. At the end of the day, even CURB recognized that fact in recommending approval of this acquisition.<sup>28</sup> However, it is important for the record in this case to clarify that under the Commission's municipal acquisition process that negotiated surcharges are required in only those situations where immediate improvements to the acquired distribution assets are necessary and where the cost of the immediate improvements, along with any purchase price, exceed the utility's current distribution system average per customer embedded cost. Negotiated surcharges should not be required to cover future anticipated capital expenditures like the ones identified in this docket.<sup>29</sup>

6. Finally, KGS seeks to address CURB's comments on line extension policies.<sup>30</sup> KGS did not argue, and has not argued, that the revenue justification process in line extension policies is integrated in the Commission's municipal acquisition process. Since KGS did not make this argument, it is wholly improper for CURB to infer KGS is seeking a new interpretation of the Commission's municipal acquisition process. In response to a data request submitted by Staff,<sup>31</sup> KGS provided 10 years of expected revenue this transaction could result in. Armed with this data, Staff's comprehensive analysis further justified the acquisition. That is, if the Commission elected to consider this transaction outside the municipal acquisition process then the revenues would exceed the purchase price and KGS's capital expenditures. Staff's use of this data shows that the transaction meets the municipal

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<sup>28</sup>*CURB Response*, page 5; Footnote 9. CURB acknowledges the benefits of economies of scale by stating in its Footnote 9 the following: "while KGS plans to upgrade the odorizer and regulation station equipment and flow these upgrades into the GSRS surcharge, the City of Lebo's customers will be charged for other GSRS investments that occur on other infrastructure investments in the KGS system."

<sup>29</sup>The future anticipated capital expenditures identified by Kansas Gas Service in this case: regulator station, odorizing equipment, new meters, replacement of bare steel service and yard lines, are the type of capital improvements commonly done by Kansas Gas Service throughout its Kansas distribution systems and recovered in either in its GSRS surcharge or in the Company's base rates and paid for by all Kansas customers. They are not the type of improvements charged only to those customers who benefit from those specific expenditures.

<sup>30</sup>*See CURB Response*, pages 6-10.

<sup>31</sup>*See Staff R&R*, page 4.



acquisition process, and *even if* the additional capital expenditures were included then the acquisition would still be revenue justified. This is not a "new standard" to evaluate municipal acquisitions. It's another data point showing this acquisition is in the public interest.

WHEREFORE, Kansas Gas Service requests that its application in this docket be approved by the Commission.



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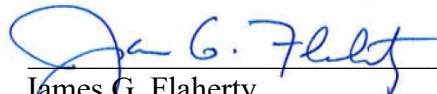
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**VERIFICATION**

STATE OF KANSAS  
COUNTY OF FRANKLIN, ss:

James G. Flaherty, of lawful age, being first duly sworn on oath, states: That he is an attorney for Kansas Gas Service, a division of ONE Gas, Inc., and is duly authorized to make this affidavit; that he has read the foregoing Reply to CURB's Response to Staff's Report and Recommendation, knows the contents thereof; and that the facts set forth therein are true and correct.

  
James G. Flaherty

SUBSCRIBED AND SWORN to before me this 1<sup>st</sup> day of November, 2024.





Notary Public

Appointment/Commission Expires:

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing was sent via electronic mail, this 1<sup>st</sup> day of November, 2024, addressed to:

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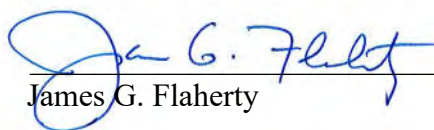
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