

Citizens' Utility Ratepayer Board

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HOUSE UTILITIES COMMITTEE H.B. 2512

Testimony on Behalf of the Citizens' Utility Ratepayer Board
By David Springe, Consumer Counsel
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Chairman Holmes and members of the committee:

Thank you for this opportunity to offer testimony on HB 2512. The Citizens' Utility Ratepayer Board is opposed to this bill.

HB 2512 allows a natural gas public utility to file a rate case with the Kansas Corporation Commission (KCC) and start charging customers the full increase in rates 30 days later. The utility can begin charging these rates without any review by the KCC and can continue to charge the rates until the KCC issues its final order. If the KCC allows a smaller increase than the utility originally requested and has been charging customers, the utility must refund the difference back to customers with interest.

My understanding is that the natural gas utilities are supporting this bill as a means to reduce the time between when a utility expends money and when it can begin collecting that expenditure in customer rates. While there is some time lag between utility expenditures and recovery, that lag is important for several reasons and is mitigated by existing Kansas laws and policies.

1. Regulatory lag is really just due process: evidence matters.

It has long been Kansas law that before a utility can increase customer rates, it must bring evidence to the KCC and prove that its expenditures are necessary and prudently incurred. The law does not allow the KCC or the utility to increase rates based on speculation and conjecture. This is an important and fundamental due process protection for customers.

Kansas natural gas public utilities are required to maintain just and reasonable rates. Unjust or unreasonably discriminatory rates are "prohibited, unlawful and void."¹ A utility is prohibited from changing its rates without first applying to the KCC for approval.² The utility has the burden of proving the allegations of its application by a preponderance of the evidence.³ A KCC order approving a rate change must be both "lawful" and "reasonable". Kansas courts

¹ K.S.A. 66-1,202. (Note: K.S.A 66-101b has the equivalent language for electric public utilities)

² (K.S.A. 66-117)

³ *In re Estate of Robison*, 236 Kan. 431, 439, 690 P.2d. 1383 (1984).

define “lawful” as being within the KCC’s statutory authority and following the appropriate procedural framework. Kansas courts define “reasonable” as being based on “substantial and competent evidence.”⁴ Kansas courts define “substantial and competent evidence” as evidence which possesses something of substantial and relevant consequence and which furnishes a substantial basis of fact from which the issues tendered can reasonably be resolved”⁵

HB 2512 turns the entire Kansas legal framework backwards. A utility, without proof, can charge a level of rates that will most likely be deemed unjust and unreasonable at a later date. Customers will get a refund because the utility was allowed to charge unjust and unreasonable rates without evidence to support the rate.

2. Regulatory lag imposes discipline on management.

Knowing that there is a time lag between expenditures and recovery forces the utility to manage its resources wisely. There is a tacit incentive mechanism that regulatory lag imposes, and this incentive is good for utility customers and shareholders. If a utility is simply allowed to spend money and recover costs immediately, it has little incentive to manage wisely or be conservative in its spending. In fact, the reverse may become true. Quick and easy cost recovery may create an incentive to increase spending as a means of increasing revenue and shareholder profit.

3. Kansas law and policy already minimizes the utility’s revenue risk and regulatory lag.

Nearly 70 percent of a natural gas utility’s cost is for the actual natural gas commodity. The KCC allows the gas utility to flow this cost directly to customers every month. Of the remaining 30 percent of a natural gas utility’s cost, almost half is collected in the monthly customer charge. The other half is collected as customers use the utility’s service throughout the year. To remove the revenue fluctuation that comes with weather the KCC normalizes the weather variation year to year. Property taxes are updated annually on bills. And the legislature has passed the Gas Safety and Reliability Act which allows a gas utility to begin rate recovery for certain capital projects each year through a surcharge on customer bills.⁶

While a rate case is based on prior period data, the KCC routinely updates that data for known and measurable changes to make it more current and representative of going forward costs. If a utility can provide evidence that the level of any cost has changed and will remain at that higher level, the KCC routinely allows the increase. Union wages are an example. If wages per contact are 4% higher today than in the rate case data, that 4% increase is built into current rates.

⁴ *Kansas Gas & Electric Co. v Kansas Corporation Comm’n*, 239 Kan. 483, 496-97, 720 P.2d 1063 (1986)

⁵ *Jones v. Kansas Gas & Elec. Co.*, 222 Kan. 390, 397, (1977);

⁶ K.S.A 66-2201 *et seq.*

Finally, the legislature recently changed the Kansas Construction Work in Progress statute to require the KCC to put into rates the cost of any project that the utility can prove will be commenced and completed within one year or less.⁷

The notion that the legal and regulatory structure in Kansas is somehow putative or unbalanced is simply not supported by the facts. The legislature and the KCC have been very supporting, within the confines of the law and good balanced public policy, to reduce the impact of regulatory lag, to provide a fair level of current expenditures in the rate case process and to maintain a basic level of due process and consumer protection.

4. Allowing interim rates will not reduce cost of capital.

Each Kansas natural gas utility is a small division of a much larger corporation. Most of these corporations have non-regulated business divisions. For example, Kansas Gas Service is about 30% of Oneok's total gas distribution system. Natural gas distribution is only 32% of Oneok's total projected 2012 operating income. The other 68% of Oneok's operating income is from non-regulated investments in pipeline and midstream services and liquids processing that are heavily dependent on drilling activities and natural gas and liquids prices. Oneok also reports that its gas distribution properties are achieving approximately 10% return on equity.⁸

Oneok's non-regulated investments and the price of natural gas will drive capital costs, not HB 2512. From a capital market standpoint, HB 2512 will not have a meaningful impact on capital costs when weighed against other variables that impact the cost of capital. However to Kansas Gas Service customers HB 2512 will have a meaningful impact on their budget and finances.

However, if you choose to accept that HB 2512 will reduce capital costs by reducing cost recovery lag, then by definition, it must be the case that this risk reduction should result in a lower cost of debt and a lower cost of equity in the market. Reduced revenue risk should reduce required shareholder return and reduce the overall cost of equity needed in customer rates. The result should be a lower authorized return on equity set by the KCC.

To insure that HB 2512 in fact results in a lower capital cost benefit for the utility's customers, the committee should require the KCC to reduce the allowed return on equity in a rate case by a minimum of 50 basis points if the utility chooses to impose interim rates.

5. Kansas already has a legal process for interim rates.

If a utility believes that interim rates are needed to address a financial shortfall, the utility can apply to the Kansas Corporation Commission for relief. Kansas courts have rightfully set a high standard for a utility to receive interim rates. The utility must show that "irreparable harm

⁷ K.S.A. 66-128

⁸ <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTIxMTcyfENoaWxkSUQ9LTF8VHlwZT0z&t=1>

would result to the utility by reason of a distinctive and sudden deficiency in revenue”.⁹ This is consistent with other Kansas laws and the general principle that before a utility can raise rates and take money from customers it must prove that the increase is needed and justified. There is rightly imposed a very high standard if the utility wants to abrogate this process and increase rates before KCC has finished its review.

HB 2512 eviscerates this meaningful legal standard. There is certainly no evidence that Kansas natural gas utilities are in dire financial need. If passed, there will be no standard or legal protection that stands between a utility and a customer’s wallet.

6. Interim rates force customers to loan money to the utility.

The KCC almost never grants the full increase requested by a utility. A utility that imposes interim rates will almost always be in a position of having to make a refund to customers. Many customers, like seniors living on fixed income, or the unemployed, can ill afford higher utility expenses. Forcing those customers to loan the utility money and wait over 210 days for a refund is unreasonable and unfair.

More importantly, after the KCC issues its decision, the utility only refunds back to customers the difference between the full rate it has been charging during the review period, and the amount it would have collected if it had been charging the KCC allowed amount during the review period. The result is that customers will have paid the final KCC approved increase during the entire review period. Under current law, customers do not pay any increase during the review period. Getting a refund with interest for the difference they have overpaid will be small comfort to those customers that have paid these increases where current law would not allow.

If the committee does choose to pass HB2512, CURB recommends the committee amend the language to require the utility to pay 3 times the judgment rate in set forth in K.S.A. 16-204. This will make the utility think hard about asking for more than it really needs in a rate case.

Recommendation

For all the above reasons, it is clear that HB 2512 is unnecessary and eliminates important due process protections for customers. There is an important balance between the needs of Kansas utilities and the needs of Kansas utility customers that forms the basis for existing Kansas law and policy. HB 2512 eliminates that balance and tilts the entire process in favor of the utility. CURB respectfully urges the committee to not pass HB 2512.

⁹ *Kansas-Nebraska Natural Gas Company, Inc. v. State Corporation Commission*, 217 Kans. 604m, 538 P.2d 702 (1975)