

Before the House Energy & Utilities Committee

Comments of  
Tom Day, Legislative Liaison  
Kansas Corporation Commission  
January 30, 2012  
House Bill 2512

Chairman Holmes and Members of the Committee:

Good morning and thank you for the opportunity to speak to the committee in regards to House Bill 2512. I am Tom Day of the Kansas Corporation Commission.

The Commission is taking a neutral position on House Bill 2512, and wishes to convey to the committee the “pros and cons” of enacting this bill, which seeks to reduce the effects of regulatory lag for natural gas public utilities.

The Commission considers enactment of HB 2512 to be a policy decision for this Legislature to make with as much information as available. In addition to conveying the “pros and cons” of the bill as introduced, I would also like to provide some suggestions to address a few concerns the Commission has with implementing the bill.

Background

“Regulatory lag” is a term used to describe the time between a utility’s incurred expenses and the time when the utility is able to recover those costs. Because tariffs are prospective and not retroactive, certain costs may not be recovered by the utility when the Commission issues its final order in a docket and approves a utility’s proposed rates. Ordinarily, this fact serves as an inherent pressure for the utility to control costs and allows shareholders to benefit from a utility’s superior performance. However, the Commission recognizes that multi-jurisdictional natural gas public utilities operate in states that allow for interim rates.

The Commission also has several mechanisms already in place to reduce the negative consequences of regulatory lag. For example, the Commission allows utilities to apply for recovery under the theories of AFUDC (Allowance for Funds Used During Construction) and for returns on CWIP (Construction Work In Progress). AFUDC is consistent with FERC practices and allows a utility to capitalize the costs of funds (both debt and equity) used to finance construction projects. Earning a return on CWIP allows a utility recover the financing costs and the carrying costs of a project on a current basis. Both mechanisms reduce the negative effects of regulatory lag by providing advanced regulatory support of capital-intensive projects. This

advanced support tends to reduce strain on cash flow and/or income statements, potentially reducing the need to issue debt during construction and ultimately preserving credit worthiness and reducing the cost of capital.

Our electric and natural gas public utilities can apply for ECA/PGA riders, which adjust automatically to cover the fluctuating costs of fuel. These rates are supervised by Commission Staff and are subject to true-up, representing an efficient and responsive mechanism to avoid regulatory lag.

Natural gas public utilities also have access to a Gas System Reliability Surcharge (GSRS), which allows the utility to recover the expenses related to replacing eligible infrastructure upgrades. Within a certain range of rate base—between 1% and 10%—the utility can apply to recover these expenses automatically for up to 5 years.

Lastly, the Commission has undertaken to reduce the overall length of time for reviewing the applications made by our regulated entities. The Commission testified before this committee in support of House Bill 2436, which imposes a 180-day limit for approving certificates of convenience. Commission Staff has proposed new internal operating procedures to review and resolve consumer complaints more efficiently. Our Litigation Division attempts to propose procedural schedules that reflect the actual amount of time for the parties to draft and rebut testimony instead of automatically bumping up against our 240-day suspension periods. And finally, the Commission recently approved field rules to simplify the processing of horizontal drilling applications in the Mississippi formation in south-central Kansas.

These regulatory mechanisms and procedural improvements individually and collectively reduce the negative effects of regulatory lag in Kansas.

#### Comments Specific to HB 2512

House Bill 2512 amends K.S.A. § 66-117 and allows natural gas public utilities to place into effect temporary or “interim” rates—without Commission review—30 days after filing a rate case with the Commission.

If House Bill 2512 is enacted, natural gas public utilities would have an additional mechanism to avoid regulatory lag. This could potentially lead to both positive and negative consequences for natural gas public utilities as well as for the consumers of natural gas in the State of Kansas.

#### Questions/Concerns

Natural Gas Public Utility is defined in 66-1,200 as any public utility that supplies natural gas. So what utilities does the authority to charge interim rates apply to? e.g., MAPL (certificated natural gas pipeline utility, probably “yes”), Mapleton (private supplier of municipal gas supply, probably “yes”) Natural gas coops (Midwest – would it have to refund excess charges to members with interest?) Southern Star? Kinder-Morgan?

The need for interim rate relief in Kansas may be mitigated by interim/fast track riders that pass through fuel cost increases.

What problem is the bill intended to solve? If the bill is intended to reduce the consequences of regulatory lag, the Commission has made a number of process changes designed to reduce processing time (e.g., attaching a proposed order to Staff Reports and Recommendations rather than a Notice followed by a proposed Order reduces processing time more than 20 days).

### Pros and Cons of Enacting HB 2512

#### Pros:

- Interim rates decrease the amount of regulatory lag, which might otherwise prevent a utility from recouping its costs for up to two years (based on time the costs are incurred to the time the company receives approval from the Commission through a rate case proceeding).
- The presence of a surety bond or other guarantee ensures that the utility will have the financial resources to issue any refunds that may occur from over-collected revenues while interim rates are in effect.
- Some multi-jurisdictional utilities operate in states that allow interim rates. FERC also allows interim rates. Similar regulatory practices across jurisdictions may potentially reduce the costs for multi-jurisdictional utilities.

#### Cons:

- The necessity of comparing interim rates to final rates and calculate a refund adds an additional level of complexity to rate proceedings in a state that already allows multiple riders, automatic adjustments, and advanced recovery mechanisms.
- Interim rates cancel out the inherent pressures of regulatory lag, which consequently removes an incentive for the utility to control costs.
- Unlike the interim rate statutes in Iowa and South Dakota, House Bill 2512 is silent on the subject of rate design. If interim rates have a different rate design than the current or proposed rates, Commission Staff would need to conduct a completely new rate design study on the interim rates to determine whether a refund is necessary. This could add additional complexity, time, and expense to the rate case proceeding.
- Moreover, interim rates can create confusion among customer classes if the final rate design differs from the proposed rate design employed in the interim rates—some customers may get refunds while other customers receive a rate increase.
- Interim rates can also create confusion and frustration among customers on fixed incomes or small businesses with limited cash flow when interim rates go into effect and final rates change within the next eight months.
- Lack of limits on interim rates may become problematic if companies are unrestricted in what they can request in interim rates, especially in circumstances involving very large capital additions to serve systems with a small number of customers. Three extreme gas examples are pending before the Commission that fit this description:
  - a. MidAmerica Pipeline (a certificated natural gas pipeline utility), that serves a single customer (Coffeyville Refinery), the requested rate increase is 930%. That case has now devolved into a matter where MAPL has put interim rates into place under its authority to do so under its FERC tariffs and is now further entangled with a complaint between the utility and its customer.

- b. The Mapleton Gas case involves a natural gas provider that provides service to 68 customers that has been unable to provide reliable service on its marginal system. One solution to its problem is to build 5 miles of pipeline to connect the system to Atmos and completely rebuild the infrastructure in Mapleton. Giving Mapleton Gas the right to charge interim rates to recoup those charges is probably unwise.
- House Bill 2512 does not contain any provision requiring the utility to track refunds by customer account, leading to the possibility that customers may not get accurate refunds and new customers may receive a refund they did not deserve.
- The Commission loses its discretion not to grant an interim rate request based upon economic factors adversely affecting the economy, and Kansas customers. During the most recent downturn during 2008-2009, interim rates would have had a compounded negative effect upon the economy of Kansas.

### Suggestions to Consider for Possible Amendments

Several amendments could be made to House Bill 2512 in order to reduce the risk of confusion and to make the interim rate provision more equitable.

- Include a provision requiring interim rates to either use the utility’s current rate design or the rate design proposed in the rate case. South Dakota Codified Laws § 49-34A-17 contains this requirement, and at least one of our multijurisdictional natural gas utilities is subject to that requirement in South Dakota.
- South Dakota also has other provisions that could serve as a model for Kansas, such as the requirement for the utility to keep “an accurate account in detail of all amounts received by reason of the [interim rate], specifying by whom and in whose behalf the amounts are paid” so that refunds can be more accurate and equitable.
- HB 2512 sets the interest rate as stated in KSA 16-204. The citation that would best fit the refunds of interim rates would be KSA 16-201, and amendments thereto, which specifically sets the rate at “ten percent per annum”.
- HB 2512 is silent on several areas of implementation, such as:
  - Whether refunds may be paid in the form of account credits.
  - Whether the Commission may order a refund during the pendency of an appeal of the final order in the rate case.
    - The date of refund of over payments in interim rates in the proposed bill is unclear. Is it when the rate case is concluded (8 months), when the appeals are concluded or when the Commission concludes petitions for reconsideration and/or remand proceedings are complete. The bill refers only to the difference between interim and “final rates”. If the refund applies only after all court appeals are considered and exhausted, literally years could pass.
  - Whether the utility must keep track of refunds by customer account.
  - Whether the Commission is powerless in the event a utility implements extraordinary or outrageous interim rates. Even an otherwise reasonable increase in rate base may be unduly burdensome for large capital expenditures by a small public utility with a small pool of customers.

- Lastly, the phrase allowing the Commission to order a refund subject to terms “prescribed by the Commission” appears vague as to which part of the process the Commission may address through rules and regulations. A more explicit grant of rulemaking authority would help the Commission resolve several of its concerns with implementing House Bill 2512 if it is enacted by the Legislature and signed into law.

Thank you for your consideration of these comments. I am available for questions at the appropriate time.