

**Testimony in Support of HB 2512: Natural Gas Utility Interim Rates  
Before the House Energy and Utilities Committee  
On behalf of Black Hills Energy  
Vance Crocker, General Manager of Kansas Natural Gas Operations  
January 30, 2012**

Thank you for the opportunity to offer legislative testimony this morning in support of HB 2512, which would allow for the use of interim rates for regulated natural gas utilities in Kansas. My name is Vance Crocker and I am General Manager of Kansas Natural Gas Operations for Black Hills Energy. With me today is Steve Jurek, Vice President -- Regulatory Services for Black Hills Energy. Black Hills Energy provides natural gas service to 110,000 customers in 56 communities across the state. Our state headquarters is in Lawrence with service centers in Wichita, Dodge City, Garden City, Liberal, and Goodland. We want to offer our support for the concept introduced by this Committee. At the outset, I would like to touch on a number of key aspects of this proposed legislation.

Applies to Regulated Gas Utilities and KCC Maintains Oversight of the Interim Rate Process

As drafted, this bill only applies to regulated natural gas utilities that must file rate cases at the Kansas Corporation Commission ("KCC"). Currently, when a natural gas utility files a rate case, the Commission has 240 days to review the filing and issue a decision. This bill would not change the 240-day review period. And most importantly, the KCC would maintain oversight of the interim rate process, just as with the actual rate case process. At the conclusion of a rate case, in the event interim rates exceeded what was deemed to be just and reasonable final rates, the utility would file with the KCC for approval of a refund plan. All interested parties, including CURB, will also have the opportunity to review and comment on the refund plan. As explained below, what this bill will do is make regulation more efficient, encourage investment in Kansas and provide benefits to our customers.

Bill Makes Regulation More Efficient

In a rate case the KCC looks at the capital investment made, the expenses incurred and the revenues received by the utility over an historical test year, a twelve month period that has ended usually about 4 to 6 months prior to when the utility files its rate case. The KCC review process currently takes 240 days or 8 months. This means that by the time new rates are set by the KCC for the utility, the rates are based upon capital investment, expense and revenue levels that are up to two years old. This "lag" in between the historical test year and the date the KCC makes its decision on new rates is called "regulatory lag". Because of this regulatory lag, by the time the new rates go into effect they are already stale. As explained in the attached talking points, this inefficiency in the current rate process leads to a disincentive in attracting capital investment to Kansas for several reasons and it ends up with customers having to pay higher costs.

The interim rate process uses a simple process to reduce the inefficiencies caused by the regulatory lag embedded in the current rate case process. By allowing the natural gas utility to implement the rate change 30 days after making its filing with the KCC, the rates will go into

effect on an interim basis. Any difference between the final rate approved by the KCC and the interim rate will be refunded by the utility to the customers with interest.

#### Bill Will Encourage Additional Investment in Kansas

As set forth in the attachment to my testimony, the proposed interim rate process that makes regulation more efficient will encourage additional investment in Kansas by reducing the period under the current process in which investors lose the opportunity to recover their investment; by improving the regulatory climate in the state through promotion of a more efficient regulatory process thus making it easier for the utility to obtain capital at a reasonable cost; and by making Kansas more attractive to multi-state utilities like Black Hills to invest their finite capital dollars in this state.

#### Interim Rate Process Benefits Customers

As also set forth in the attachment to my testimony, the proposed interim rate process will keep the cost of capital ultimately paid by our customers at a reasonable level by making it easier for the utility to attract capital. The process should also reduce regulatory and rate case costs paid by customers by reducing the inefficiencies under the current process and increasing the period in between rate case filings.

#### Commission Still Allowed its Full Review Period

This bill merely reduces the time for utilities to collect deficiency; while still allowing the commission its full review period.. Under HB 2512, all funds collected during the 240-day review period would be subject to refund with interest if final rates are less than what a utility implements on an interim basis.

#### Proven Concept

What's being proposed here is neither new nor untested. Many of our neighboring states already have laws to allow for the collection of interim rates subject to refund, including Nebraska, Iowa, and South Dakota. Colorado passed legislation in 2010 that included interim rates with a delayed implementation. The bill before you closely mirrors the process used in Iowa.

Although the Commission has the authority to issue interim rate relief, there is not really a current legislative standard at all for interim rates in Kansas. The current standard comes from a Kansas Supreme Court case ruling in 1975 that establishes a multi-part test to allow interim rates. Our belief is that this standard is virtually unattainable to achieve, and no utility has collected interim rates in Kansas for decades.

We respectfully request that you consider minimizing the regulatory lag in Kansas currently faced by natural gas utilities.

Attached to my testimony are responses to some of the key issues relating to the proposed interim rate process. It includes:

- What is the purpose of the bill?
- What is the interim rate procedure?
- How does the interim rate procedure make regulation more efficient?
- How does the interim rate process promote capital investment in Kansas?
- How will the interim rate process benefit Kansas customers?

Thank you for your service to Kansas and your consideration of this important issue.

I will be happy to answer any questions you may have at the appropriate time.

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# **Interim Utility Rates: HB2512**

## **What is the purpose of this bill?**

The interim rate procedure set forth in HB 2512 will make regulation of natural gas utilities operating in Kansas more efficient, will promote capital investment in the state by natural gas utilities, and will reduce regulatory expenses and capital costs paid by the utility customers, while assuring customers continue to pay reasonable rates for their natural gas service.

## **What is the interim rate procedure?**

The interim rate procedure is simple and straightforward and is fashioned on similar laws in neighboring states, including, Nebraska, Iowa and South Dakota.

The interim rate procedure allows a natural gas utility to begin charging their requested rates in a rate filing during the “interim” period between a date 30 days after the filing with the Kansas Corporation Commission (KCC) and the date of the final decision issued by the KCC on the rate request. The “interim rates” would be subject to refund to all customers with interest in the event the KCC did not approve the entire rate request.

## **How does the interim rate procedure make regulation more efficient?**

As you know, the state, through the KCC, sets rates for natural gas utilities. Rates are set by the KCC using a rate case process. In a rate case the KCC looks at the capital investment made, the expenses incurred and the revenues received by the utility over an historical test year, a twelve month period that has ended usually about 4 to 6 months prior to when the utility files its rate case. The KCC review process currently takes 8 months. Some adjustments to the historical test year are allowed, but for the most part this means that by the time new rates are set by the KCC for the utility, the rates are based upon capital investment, expense and revenue levels that are up to two years old. This “lag” in between the historical test year and the date the KCC makes its decision on new rates is called “regulatory lag”. Because of this regulatory lag, by the time the new rates go into effect they are already stale. As explained in more detail below, this inefficiency in the current rate process leads to a disincentive in attracting capital investment to Kansas for several reasons and it ends up with customers having to pay higher costs.

The interim rate process uses a simple process to reduce the inefficiencies caused by the regulatory lag embedded in the current rate case process. By allowing the natural gas utility to implement the rate change 30 days after making its filing with the KCC, the rates will go into effect on an interim basis. Any difference between the final rate approved by the KCC and the interim rate will be refunded by the utility to the customers with interest.

**How does the interim rate process promote capital projects and additional investment to be made in the state?**

The interim rate process will promote capital projects and additional investment to be made in the state by natural gas utilities in a number of ways:

- (1) Under the current rate process, the utility is not allowed to go back and charge the customers over that two year period in between the start of the historical test year and the final rate order issued by the KCC based upon the rates that reflect the levels in investment, expenses and revenues found by the KCC in the rate case to be reasonable. This means investors lose the opportunity to recover the return on their investment that the KCC found to be reasonable. If the interim rate process in the bill is enacted into law, then the period in which investors have lost the opportunity to recover the reasonable return found by the KCC is cut in about half. Thus, investors will be more willing to invest their limited capital dollars in Kansas due to the more efficient rate process followed by the state.
- (2) The regulatory climate in states is a significant consideration made by utilities in deciding to make capital investment in a state. State regulatory commissions, like the current KCC administration, which are attempting to make utility regulation more efficient, while maintaining their obligation to set rates that are reasonable, promote a more favorable regulatory climate, and thus make it more attractive for utilities and their investors to move forward with capital investment in those states. Allowing the use of the interim rate process will make regulation in Kansas more efficient and thus make Kansas more attractive for capital investment.
- (3) Natural gas utilities that operate in multiple states compete for corporate dollars for capital investments. Making the regulatory process more efficient in Kansas will make investment in Kansas more attractive for these multi-state utilities. This is especially important given the fact that neighboring states have implemented an interim rate process to make their state regulation more efficient.

## **How will the interim rate process benefit customers?**

The interim rate process will benefit customers in the following ways:

- (1) The cost incurred by the utilities to obtain the necessary capital to operate their natural gas utilities is ultimately paid by the customers. In fact, this cost is a significant portion of the costs paid by the customers to receive utility service. Investors and bond rating agencies look more favorable upon state regulatory agencies that have implemented more efficient regulation, like the interim rate process. If the more efficient interim rate process is allowed in Kansas, it will make it easier for natural gas utilities to attract capital and will assist those utilities in keeping the cost of their capital at a reasonable level, thus benefitting their customers.
- (2) Because the interim rate process reduces regulatory lag and is a more efficient process, it should lower regulatory expenses paid by customers due to utilities having to file fewer rate filings. As mentioned above, because of the nearly two year lag in between the start of the historical test year used to set rates and when the final order is issued by the KCC in the rate case, by the time the utility starts charging the new rates its level of capital investment, expenses and revenues have already changed and those new rates do not reflect those current levels. This requires the utility to have to consider filing another rate case, which includes the expenses incurred by the utility, the KCC Staff and the Citizens' Utility Ratepayers' Board (CURB) in that rate case process being paid by the customers. If a utility can file fewer rate cases as a result of the interim rate process reducing the regulatory lag and providing a more efficient process, customers will benefit from the reduction in regulatory expenses.
- (3) Utility customers are totally protected under the interim rate process. The KCC still performs a full review of the rate case filing and there is no change in the thorough review process that currently takes place when a rate request is filed by a natural gas utility. Any difference between the final rate approved by the KCC and the interim rate is refunded to the customer with interest at the statutory rate. The utility will be required to place a bond or other guarantee or surety to ensure payment of any refund. Customers end up paying only for those costs the KCC finds to be reasonable.