

**THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

Before Commissioners: Mark Sievers, Chairman
Ward Loyd
Thomas E. Wright

In the Matter of the Application of)
Midwest Energy, Inc. for Approval of a)
Gas System Reliability Surcharge) Docket No. 11-MDWG-862-TAR
Pursuant Based on Calendar Year 2010)
Costs.)

ORDER APPROVING TARIFF REVISIONS

The above-captioned matter comes before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having examined its files and records, and being duly advised in the premises, the Commission finds and concludes as follows:

I. Background

1. On June 17, 2011, Midwest Energy, Inc. (Midwest) filed an application requesting Commission approval of its amended Gas System Reliability Surcharge (GSRS), pursuant to K.S.A. 66-2201 et seq.. The tariff is designed to allow for the adjustment of Midwest's rates and charges to provide for the recovery of \$1.12 million of capital costs for eligible infrastructure system replacements. Midwest's request includes an annual surcharge increase of \$127,941, for a total annual surcharge of \$446,543.

2. On August 15, 2011, Commission staff (Staff) submitted its report recommending conditional Commission approval of Midwest's GSRS.

3. Staff recommended approximately \$1.06 million of the proposed capital costs be included in the surcharge. In its application, Midwest provided a list of 240 infrastructure projects sought to be included in the surcharge. After reviewing this list and Midwest's

responses to Staff's data requests, Staff stated that a number of projects with a total cost of \$61,380 did not meet the requirements for recovery under the Gas Safety and Reliability Policy Act found in K.S.A. 66-2202(t). The projects recommended for disallowance by Staff are described generally as facility abandonment projects, relocation projects not done as part of a public works projects, work performed on unregulated customer owned projects, and those leak repair projects requiring less than 40 feet of pipe replacement.

4. The Commission is required to issue a final order in this docket by November 15, 2011.

5. Staff stated that, according to subpart (b) of K.S.A. 66-2203, the Commission is not allowed to approve a GSRS surcharge for a public utility that has not had a general rate proceeding within the past 60 months. Midwest's last gas rate case was 06-MDWG-1027-RTS which set Midwest's current rates as of October 1, 2006. Based on this requirement, the Commission will not be able to approve a GSRS surcharge for Midwest after October 1, 2011. However, subpart (d) of K.S.A. 66-2203 allows the Commission to issue a 12-month extension to the 60-month time limitation provided Midwest requests this action. Midwest has not requested this extension.

GSRS

6. The GSRS was enacted by the Kansas legislature in July of 2006. This statute allows natural gas public utilities to recover costs for certain infrastructure projects through a monthly customer surcharge. The statute only applies to projects that entail the replacement of infrastructure or the extension of the useful life of infrastructure. The replacement projects are further limited to those projects that are required for compliance with pipeline safety regulations

or for facility relocation projects caused by other public works projects such as road improvement.

7. The Commission is required to confirm the replacement projects included in the application meet the provisions of the Act. The Commission is also charged with the obligation of confirming the proposed surcharge to ensure it has been properly calculated and is based solely on the projects included in the application. In making this determination, Staff relied on two essential provisions of the statute. Those requirements, with emphasis provided, are as follows:

K.S.A. 66-2202 (f)

"natural gas utility plant projects" may consist **only** of the following:

(1) Mains, valves, service lines, regulator stations, vaults and other pipeline system components **installed to comply with state or federal safety requirements as replacements for existing facilities;**

(2) main relining projects, service line insertion projects, joint encapsulation projects and **other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements; and**

(3) facility, relocations required due to construction or improvement of a highway, road, street, public way or other public work . . . provided that the costs related to such projects have not been reimbursed to the natural gas public utility;

K.S.A. 66-2203 (a)

. . . a natural gas public utility providing gas service may file a petition . . . to establish or change GSRS rate schedules . . . to provide for the recovery of costs for eligible infrastructure system **replacements**.

8. Kansas pipeline safety regulations are primarily adopted from federal pipeline safety regulations. As stated in the scope of the federal code, the regulation prescribes the **minimum** safety requirements for pipeline facilities. When evaluating projects for the applicability of GSRS, the decision must rest on defining which portion of the project brings the system into compliance with safety regulations and which portion of a given project is being completed as a business decision to renew an aging infrastructure or improve operating efficiency. Often the utility's rationale for performing a replacement project is based on a blend of economic considerations with pipeline safety or relocation requirements.

9. To recommend a given project for inclusion in GSRS, Staff must determine that the pipeline safety requirement for the project supersedes the economic benefits obtained by replacing a given section of piping. Staff relies on the description of each project provided in the operator's application or through responses to data requests.

10. Staff noted that in this docket, Midwest provided only an abbreviated description for each project. Furthermore, the descriptions of the project categories provided by Midwest indicate that most categories were performed for a variety of reasons – one of which may have been pipeline safety regulatory compliance. Therefore, Staff has reviewed the category classification for each project and the descriptive title of the project. In some cases, the information provided by Midwest is insufficient to reach a determination as to the project being required by pipeline safety regulations. In those cases, Staff recommends the projects be excluded from the GSRS filing.

ANALYSIS

Pipeline Safety

11. In its application, Midwest has asked for recovery of costs associated with 240 replacement projects. Of that total, 239 projects are designated by Midwest as being performed in order to comply with Kansas pipeline safety regulations. Other than a series of citations to pipeline safety code and a project title, Midwest did not include any explanation of how a particular code citation required Midwest to perform a given replacement project. In response to a data request from Staff, Midwest provided a list of categories as additional justification for including the 239 projects in the GSRS filing.

12. Staff recommended that 44 projects be disallowed for recovery through the GSRS because Midwest provided insufficient information in its application and data responses. This lack of information in the filing did not allow Staff to confirm – as required by statute – the disallowed projects were facility replacement projects required by pipeline safety regulations. Staff's rationale is described in the following categories:

13. Abandonment of pipeline facilities: In its application for recovery under GSRS, Midwest listed three projects to abandon various segments of pipeline. The abandonment work that was performed is described in Attachment 2 of Staff's report as belonging to the category "removal of steel/yardlines" and the descriptive titles for the projects simply state moving or removing of the facilities. The total requested recovery for the abandonment projects is \$2,759. Although proper abandonment is a requirement of pipeline safety regulations, abandonment projects are not eligible for recovery under the GSRS because K.S.A. 66-2203(a) specifically limits GSRS recovery to those projects where infrastructure is installed, replaced, or the useful life of the facilities is extended. Abandonment does not meet these criteria. Staff noted that one

of the projects included the installation of anodes which is a regulatory requirement. However, the records provided did not allow Staff to allocate the costs for the anodes or describe why they were needed for a pipeline removal.

14. Replacing Customer-owned Piping or Installing new Facilities: Kansas pipeline safety regulations require an operator to maintain and/or install customer owned piping from the meter to the building wall of single family residences. This section of piping is commonly referred to as a "yardline". The term "fuel line" refers to piping that is lateral to the yardline. Fuel lines have always been considered by Staff (and Midwest's tariff) to be the responsibility of the Customer. While Section 7 of Midwest's tariff allows installation of up to 100 feet of yardline at Company expense, it does not provide for the installation of fuel lines at company expense. Moreover, any yardline construction work performed at the Customer's request is also considered to be billable to the Customer. Therefore, Staff recommended the projects listed as Item Nos. 4-10 of Attachment 2 of Staff's report, totaling \$5,671, be disallowed from collection through the GSRS.

15. Pipeline Relocations: In Item Nos. 11-30 of Attachment 2 of Staff's report, Midwest's application indicated the pipeline facilities in question were relocated as part of a pipeline safety requirement such as unsafe conditions, repairing leaks, or third party damage. No additional description of the work was provided. In response to Staff Data Requests for additional information, Midwest stated they do not have recordkeeping practices in their accounting system that track footage of certain types of pipe installed nor do they keep written documentation of the company's rationale for replacing a given section of piping. Because of the abbreviated description, Staff could not determine if the listed facilities were replaced as a requirement of pipeline safety regulations. Therefore, Staff recommended the projects listed as

Item Nos. 11-30 of Attachment 2 of Staff's report, totaling \$33,972, be disallowed from collection through the GSRS at this time.

16. Pipeline Repairs: Staff noted that almost every task performed in the operation and maintenance of a natural gas distribution system can be connected to a pipeline safety regulatory requirement. Many of the projects in Midwest's application deal with routine repairs that occur when a pipeline is damaged by an excavator or when a leak is found and repaired. However, the GSRS statute was designed to encourage public utilities to make capital investments that will improve or enhance the reliability of their natural gas delivery system. In order to prevent a utility from recovering daily operations and maintenance costs as a surcharge, the statute limited the types of projects that can be considered for GSRS recovery to public works relocations or those required by pipeline safety code. It was not the intent of the GSRS to allow recovery through a surcharge for routine leak repairs – even though leak repair is a pipeline safety code requirement. In its application, Midwest has 15 projects in which some footage of main or transmission line was replaced. While various sections of pipeline safety code are cited for each project as reasons for inclusion in the GSRS application, GSRS recovery should not apply to routine pipeline repairs that do not significantly enhance the integrity of the gas pipeline infrastructure. Therefore, Staff recommended the Commission not allow recovery for projects in which the pipe replaced amounted to less than 40 feet of pipe or was simply a leak repair. The 40 foot limit is based on Midwest's pipe replacement procedure that requires replacement of at least 40 feet of pipe. It seems reasonable to consider any replacement of less than 40 feet in length to be a routine leak repair. Therefore, Staff recommended the projects listed as Item Nos. 31-45 of Attachment 2 of Staff's report, totaling \$18,978, be disallowed from collection through the GSRS.

17. The total amount of capital cost disallowance from all categories combined is \$61,380.

Accounting

18. Staff audited Midwest's application to verify that the surcharge was properly calculated and based solely on the projects included in the application. The findings of Staff's audit are presented below.

- Staff selected a random sample of work orders submitted for inclusion in the GSRS to verify that the amounts included in the application were those incurred and recorded to the work orders. Staff noted no material errors in this regard.
- Staff sought and obtained support for the annualized depreciation expense amounts, accumulated depreciation, and plant retirement amounts that were used in the calculation of Midwest's GSRS. Staff noted that the accumulated depreciation amount used in the application was slightly misstated. As filed, the Application included accumulated depreciation related to additions to plant in service, offset by depreciation amounts no longer incurred on retirements. This offset related to retirements is not necessary, as the accumulated depreciation balance related to additions sufficiently captures the change in accumulated depreciation associated with the GSRS projects. This change was communicated to Midwest.
- Staff ensured that the revenue requirement calculation associated with projects approved for recovery during the 10-MDWG-623-TAR and 09-MDWG-722-TAR Dockets included an additional year of accumulated depreciation associated with these projects. Midwest's filing and Staff's calculation reflects the additional accumulated depreciation for these projects.

- Staff updated the calculation of the surcharge to reflect the projects that Staff recommended for exclusion from the GSRS. This update affected original cost of plant, accumulated depreciation, and depreciation expense. After making all appropriate changes, Staff's revised increase to the GSRS revenue requirement is \$109,769. Staff's total GSRS revenue requirement is \$ 428,372. The work papers that support Staff's revised GSRS calculations are attached to Staff's report as Exhibits KAL-1 through KAL-4.

- Staff reviewed Midwest's calculation of the depreciation expense offset associated with retirements that occurred during GSRS eligible work. In response to Staff Data Request No. 4, Midwest provided support of the calculation of the depreciation expense offset. The retirement amount used by Midwest to calculate this offset was based on a ratio of 2009 GSRS retirements to 2009 GSRS additions. This resulting percentage was then multiplied by the 2010 additions, to come up with the 2010 retirements. In discussions with Midwest, Staff was informed that the actual requirements number is unavailable because of current limitations associated with a new accounting system at Midwest. Staff noted that Midwest expects to gain the ability to track retirements by the end of the year. This is a reasonable approach, but the actual retirement amounts should be used in the future, and Staff recommended that the Commission require Midwest to true-up the revenue requirement using actual retirements when Midwest files its next GSRS filing or true-up proceeding.

- Staff reviewed the 2010 True-Up calculation included in the Application. Midwest's true-up calculation compares actual revenues collected from June 2010 through May 2011 against the GSRS revenue requirement approved by the Commission for July 2010

through June 2011 (Docket No. 10-MDWG-623-TAR). This calculation results in an overstatement of the under recovery amount because the revenue collected during June 2010 was related to the GSRS approved for recovery in Docket No. 09-MDWG-922-TAR (approximately \$14,986 per month), not Docket No. 10-MDWG-623-TAR (approximately \$26,366 per month). The net effect of this mismatch is an overstatement of the under recovery of \$11,911. Staff's true-up calculation compared actual revenues collected to a prorated amount of GSRS revenue requirement in effect from June 2010 through May 2011 (proration assumed 1/12th distribution of authorized GSRS revenue requirement per month). Staff's calculation can be found in attachment KAL-3 of Staff's report.

19. Staff recommended that the Commission require future GSRS applications to provide descriptions explaining how each cited paragraph of pipeline safety code applies to a replacement project included in a GSRS filing. Staff also recommended that the Commission require Midwest, in its next GSRS filing or true-up proceeding, to true-up the revenue requirement coming out of this proceeding with the revenue requirement that would result from the use of actual 2010 retirements associated with GSRS additions, instead of the approximation approach discussed in the accounting section above.

20. Additionally, Staff recommended the Commission approve in part and deny in part the application of Midwest for recovery of costs for eligible infrastructure system replacements under the GSRS. Staff recommended approval of \$1,057,767 of capital projects for recovery that meet the criteria outlined in K.S.A. 66-2201 et seq.. Staff recommended disapproval of \$61,308 of Midwest projects contained in the application that do not meet the criteria mandated in either K.S.A. 66-2203(a) or K.S.A. 66-2202(f). These exclusions, along

with the changes referenced in the Accounting section presented above, amount to a revised GSRs revenue requirement increase of \$109,769 for a total GSRs revenue requirement of \$428,372.

21. The Commission accepts this revised GSRs amount with the following conditions:

- Midwest shall file an updated GSRs Tariff Schedule constructed to collect the final Commission-ordered GSRs amount.
- Either in a future GSRs filing, or in a true-up proceeding, Staff will ensure that the amount of GSRs revenue collected by Midwest is compared to the amount intended to be collected for the period authorized by the Commission. This true-up calculation will include a comparison between the estimated 2010 retirements and the actual 2010 retirements. Any under or over recovery will be collected or refunded through the GSRs.

22. Based on Staff's recommendation, the Commission finds and concludes that Midwest's application for an amended GSRs should be approved.

IT IS, THEREFORE, BY THE COMMISSION ORDERED THAT:

- A. Midwest Energy, Inc.'s Gas System Reliability Surcharge is hereby approved.
- B. The parties have fifteen (15) days, plus three (3) days if service of this order is by mail, from the date this order was served in which to petition the Commission for reconsideration of any issue or issues decided herein. K.S.A. 66-118b; K.S.A. 2010 Supp. 77-529.
- C. The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order, or orders, as it may deem necessary.

BY THE COMMISSION IT IS SO ORDERED.

Sievers, Chmn.; Loyd, Com.; Wright, Com.

Dated: SEP 23 2011



ORDER MAILED SEP 26 2011
Patrice Petersen-Klein
Executive Director

MAS:rms

PLEASE FORWARD THE ATTACHED DOCUMENT (S) ISSUED IN THE ABOVE-REFERENCED DOCKET TO THE FOLLOWING:

NAME AND ADDRESS	NO. CERT. COPIES	NO. PLAIN COPIES
NIKI CHRISTOPHER, ATTORNEY CITIZENS' UTILITY RATEPAYER BOARD 1500 SW ARROWHEAD ROAD TOPEKA, KS 66604 ***Hand Delivered***		
C. STEVEN RARRICK, ATTORNEY CITIZENS' UTILITY RATEPAYER BOARD 1500 SW ARROWHEAD ROAD TOPEKA, KS 66604 ***Hand Delivered***		
DELLA SMITH CITIZENS' UTILITY RATEPAYER BOARD 1500 SW ARROWHEAD ROAD TOPEKA, KS 66604 ***Hand Delivered***		
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DAVID SPRINGE, CONSUMER COUNSEL CITIZENS' UTILITY RATEPAYER BOARD 1500 SW ARROWHEAD ROAD TOPEKA, KS 66604 ***Hand Delivered***		
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MICHAEL S BILLINGER, RESEARCH ANALYST MIDWEST ENERGY, INC. 1330 CANTERBURY ROAD PO BOX 898 HAYS, KS 67601-0898		

ORDER MAILED SEP 26 2011

The Docket Room hereby certified that on this _____ day of _____, 20____, it caused a true and correct copy of the attached ORDER to be deposited in the United States Mail, postage prepaid, and addressed to the above persons.