EXHIBIT

Exhibit No.: 405
Issue(s): Gas Supply Incentive Plan/ Off-System Sales and Capacity Release Sharing Mechanism/ Consistent Treatment of Natural Gas Storage Inventory Costs
Witness/Type of Exhibit: Riley/Direct
Sponsoring Party: Public Counsel
Case No.: GR-2017-0215
GR-2017-0216

DIRECT TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS COMPANY
MISSOURI GAS ENERGY

CASE NO. GR-2017-0215
CASE NO. GR-2017-0216

September 8, 2017

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Request to Increase Its Revenues for Gas Service	)))	Case No. GR-2017-0215
In the Matter of Laclede Gas Company d/b/a Missouri Gas Energy's Request to Increase Its Revenues for Gas Service	)))	Case No. GR-2017-0216

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

John S. Riley, of lawful age and being first duly sworn, deposes and states:

1. My name is John S. Riley. I am a Public Utility Accountant III for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

John S. Riley
John S. Riley, C.P.A.
Public Utility Accountant III

Subscribed and sworn to me this 8th day of September 2017.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2021
Cole County
Commission #13754037

Jerene A. Buckman
Jerene A. Buckman
Notary Public

My Commission expires August 23, 2021.

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JOHN S. RILEY

LACLEDE GAS COMPANY
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Q. Please state your name and business address.

A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Public Utility Accountant.

Q. Please describe your educational background.

A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State University.

Q. Please describe your professional work experience.

A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant. In this capacity I participated in rate cases and other regulatory proceedings before the Public Service Commission ("Commission" or "PSC"). From 1994 to 2000 I was employed as an auditor with the Missouri Department of Revenue. I was employed as an Accounting Specialist with the Office of the State Court Administrator until 2013. In 2013, I accepted a position as the Court Administrator for the 19th Judicial Circuit until April, 2016 when I joined the OPC.

Q. Are you a Certified Public Accountant ("CPA") licensed in the State of Missouri?

A. Yes. I am also a member of the Institute of Internal Auditors ("IIA")

Q. Have you previously filed testimony before the Missouri Public Service Commission?

A. Yes I have. A listing of my Case filings is attached as JSR-D-1

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to explain the OPC's opposition to the continued use of the Gas Supply Incentive Program ("GSIP") and the sharing mechanism used in the distribution of off system sales margins and capacity credits between the Company and ratepayers. The OPC also asserts that Laclede and MGE should both include the carrying cost of gas inventory in their PGA/ACA mechanisms as opposed to including the costs in rate base.

<u>Gas Supply Incentive Plan</u>

Q. Could you summarize the OPC's opposition to the GSIP?

A. The OPC is opposed to the continuation of Laclede's GSIP in this current low price and low volatility natural gas market. There is no need to provide the Company with incentives to keep gas price low when upward volatility is not expected in the near future.

Q. Why does OPC believe a GSIP is not necessary in this current natural gas pricing environment?

A. We have seen little in the way of high prices or volatility since 2009. Natural gas is in a low price and low volatility trend that leading authorities expect to be prevalent for many years. The most recent Energy Information Administration ("EIA") forecast continues to predict low prices:

> In July, the average Henry Hub natural gas spot price was $2.98 per million British thermal units (MMBtu), about the same as in June. Higher natural gas exports and growing domestic natural gas consumption in 2018 contribute to the forecast Henry Hub natural gas spot price rising from an

> annual average of $3.06/MMBtu in 2017 to $3.29/MMBtu in 2018. NYMEX contract values for December 2017 delivery that traded during the five-day period ending August 3 suggest that a range of $2.17/MMBtu to $4.48/MMBtu encompasses the market expectation for December Henry Hub natural gas prices at the 95% confidence level."[1]

The Market Realist, an investment research firm, compiled a short list of recent natural gas price predictions. All indicate low stable prices for the foreseeable future:

"Long-term natural gas price forecast

Below are some of the forecasts for natural gas prices.

> Economist Intelligence Unit estimates that US natural gas prices could average around $3.60 per MMBtu by 2020.
>
> The World Bank forecasts that US natural gas prices could trade around $3.90 per MMBtu by 2020.
>
> The IMF (International Monetary Fund) estimates that US natural gas prices could average about $3.10 per MMBtu during the same period.
>
> The EIA (U.S. Energy Information Administration) forecasts that gas prices could average around $2.71 per MMBtu and $3.32 per MMBtu in 2016 and 2017, respectively.[2]"

Because the purpose of the GSIP was to reduce "the impact of upward natural gas commodity price volatility on the Company's customers"[3], the plan is not necessary at this time to achieve that goal.

Q. Can you provide an overview of the current GSIP?

[1] August 3, EIA Short Term Energy Outlook
[2] http://marketrealist.com/2016/02/whats-long-term-forecast-natural-gas-prices/
[3] Opening line of the Gas Supply Incentive Plan tariff 28-b.-1

A. The current GSIP was developed in and around 2002 to encourage gas distribution companies like Laclede to actively seek the lowest priced natural gas in their market area. Currently, only Laclede is employing a GSIP, however, Spire is requesting that both Laclede and MGE have the same plan. The basic concept is to establish an index price level known as a benchmark where the Company would be rewarded when its gas purchases are priced lower than that benchmark. A tier system was developed in order to determine if the market activity and the Company's actions should qualify for an incentive reward. The current tier system from the tariffs is reproduced below (P.S.C. Mo. No. 5 Consolidated, Third Revised Sheet No. 28-b-1):

a. In order to determine if the Company is eligible for incentive compensation due to its purchasing activities, Net Commodity Gas Price per MMBtu and the Annual Benchmark Price per MMBtu of natural gas for the ACA period will be evaluated to determine in which of the following tiers each respective price falls.

TIER LEVELS

Tier 1	less than or equal to \$4.000 per MMBtu
Tier 2	greater than \$4.000 per MMBtu and less than or equal to the Incentive Sharing Ceiling set forth below
Tier 3	greater than the Incentive Sharing Ceiling set forth below

The Incentive Sharing Ceiling price shall be as follows:
\$8.00 per MMBtu effective October 1, 2007
\$8.48 per MMBtu effective October 1, 2008
\$8.99 per MMBtu effective October 1, 2009

b. In order for the Company to be able to receive incentive compensation, Net Commodity Gas Price per MMBtu must be below the Annual Benchmark Price per MMBtu and the Net Commodity Gas Price per MMBtu must fall within Tier 1 or Tier 2. Further, the Annual Benchmark Price per MMBtu must fall within Tier 2 or Tier 3.

If the current price of natural gas is below the price set in Tier 1 ($4.00) then gas costs are considered low and the Company is not eligible for reward. Recent history has shown that gas prices have not reached the $4.00 level since the summer of 2014.[4]

There are no indications that gas prices will escalate above $4.00 before the Company is required to file another rate case, which supports a suspension of the GSIP at this time.

Q. Please restate the OPC position on the GSIP.

A. The OPC believes the GSIP should be suspended at this time. The natural gas market is not the unpredictable, spiking and expensive platform that the GSIP was created to address by reducing the impact of upward natural gas commodity price volatility on the Company's customers. Reviving the GSIP could be entertained in the Company's next general rate case.

That being said, if the Commission believes that the GSIP should continue, tiers and caps need to remain in place so that the Company does not stand to benefit when prices are such that incentives only benefit the Company.

<u>Off-System Sales and Capacity Release Sharing Mechanism</u>

Q. What is the current off-system sales margin and capacity release sharing mechanism contained in the Company's rates?

A. The current sharing mechanism for Laclede is as follows:

[4] EIA Average monthly natural gas pricing table indicates the last month prices averaged over $4 was July 2014. www.eia.gov/dnav/ng/hist/rngwhhdm.htm

Annual Off-System Sales Margins and Capacity Release Revenues	Firm Sales and Firm Transportation Customers Share	Company Share
First $2,000,000	85%*	15%*
Next $2,000,000	80%	20%
Next $2,000,000	75%	25%
Over $6,000,000	70%	30%

MGE applies the same company sharing percentages but the threshold is $1.2 million instead of $2 million.

Q. Does OPC propose a different approach?

A. Yes. This incentive plan should be revised in favor of a 95/5 sharing mechanism for all off-system sales and capacity release revenues. The Commission has found that a 95/5 sharing mechanism is a sufficient incentive for electric companies employing a Fuel Adjustment Clause ("FAC"). When applying a 95/5 split to an FAC, 95% of any reductions in fuel costs benefit ratepayers while 5% of any reductions benefit shareholders. The theory of this 95/5 split is that allowing the utility to retain 5% of fuel savings is significant enough to incentivize the utility to seek such fuel cost reductions. Under a 95/5 sharing mechanism for Laclede, the company would retain 5% of all off-system sales and capacity release revenues, which, like FAC fuel cost reductions, also result in reductions in fuel costs for gas companies. The current approach of applying different percentages for different revenue amounts would be eliminated and the 95/5 would apply to all off-system and capacity release revenues. The theory would be the same as an FAC in that allowing Laclede to retain 5% of off-system sales and capacity releases is sufficient to incentivize the company to maximize the revenues it recovers through such off-system sales and capacity releases.

Consistent Treatment of Natural Gas Storage Inventory Costs

Q. The Company currently recovers Laclede's gas storage carrying costs through its PGA/ACA. MGE recovers their gas storage carrying costs through its base rates. The Company is proposing that Laclede switch to MGE's rate base method of recovery. How does OPC propose Laclede and MGE recover their storage inventory costs?

A. The carrying cost of maintaining gas storage is nothing more than a cost of gas. Laclede and MGE's gas costs are recovered through their Purchased Gas Adjustment ("PGA") clauses in their respective tariffs. Laclede and MGE should not be allowed to recover the same cost – cost of natural gas – through both the PGA and base rates in a rate case.

In the past Laclede and the Commission have determined that gas costs should be recovered through the PGA rate mechanism. It cannot be reasonably argued that the cost of maintaining natural gas inventories is not a natural gas cost. Therefore, the Commission should order that both Laclede and MGE exclude natural gas costs in the form of a return on natural gas inventories in rate base in this rate case. The Commission should order Laclede to continue its current recovery through the PGA and order MGE to adopt the same methodology currently used by Laclede.

Q. Does this conclude your direct testimony?

A. Yes it does.

John S. Riley, CPA
Summary of Case Participation

ST LOUIS COUNTY WATER COMPANY	CASE NO. WR-88-5
SOUTHWESTERN BELL TELEP9ONE COMPANY	CASE NO. TC-89-21
EMPIRE DISTRICT ELECTRIC COMAPANY	CASE NO. ER-2016-0023
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2016-0156
KANSAS CITY POWER & LIGHT COMPANY	CASE NO. ER-2016-0285
AMEREN MISSOURI	CASE NO. ER-2016-0179
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2017-0065