

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of)	
Laclede Gas Company to Change its)	
Infrastructure System Replacement)	Case No. GO-2016-0332
Surcharge in its Missouri Gas)	
Energy Service Territory)	
)	
)	
In the Matter of the Application of)	
Laclede Gas Company to Change its)	
Infrastructure System Replacement)	Case No. GO-2016-0333
Surcharge in its Laclede Gas Service)	
Territory)	

**MOTION TO DENY PROPOSED RATE INCREASES
AND, ALTERNATIVELY, MOTION FOR HEARING**

COMES NOW the Office of the Public Counsel (“OPC”) and for its Motion to Deny Proposed Rate Increases and, Alternatively, Motion for Hearing, states:

1. On September 30, 2016, Laclede Gas Company (“Laclede”) filed two Infrastructure System Replacement Surcharge (“ISRS”) petitions, one each for its two service areas in the state. The ISRS is a mechanism that allows gas companies to recover costs incurred complying with safety regulations requiring the replacement of infrastructure that is either “worn out or in deteriorated condition,” the enhancement of infrastructure to extend its useful life, or the relocation of facilities. Sections 393.1009, 393.1012, and 393.1015 RSMo.
2. OPC requests a Commission order rejecting the proposed tariff changes and denying the ISRS petitions because Laclede seeks to recover costs through the ISRS ineligible under the Sections 393.1009-393.1015 RSMo. OPC

challenges at least four categories of costs: (1) costs for replacing miles of plastic mains and service lines that are not worn out or in deteriorated condition; (2) costs for certain ineligible employee compensation associated with earnings-based incentive compensation and stock compensation; (3) costs for hydro-testing mains where no replacement or enhancement work was performed; and (4) estimated costs not supported with documentation filed with the petitions contrary to law.

A. Costs Incurred Replacing Recently-Installed Plastic Mains and Service Lines that are Not Worn Out or in Deteriorated Condition are Not Eligible for ISRS

3. Laclede seeks to recover through the ISRS costs incurred replacing recently-installed plastic service lines and plastic mains that have not worn out and are not in a deteriorated condition.¹ In many instances, these plastic mains and service lines being replaced were in service for only a few years before replacement. The service life of plastic service lines and plastic mains, according to the depreciation rates approved by the Commission in Case Number GR-2013-0171 and currently used by Laclede Gas, is **70 years** for plastic mains and **44 years** for plastic service lines. MGE's depreciation rates were set in Case Number GR-2014-0007, where the service life of a main is **50 years** and the service life of a service line is **40 years**. It should be presumed that plastic service lines and mains

¹ *Main* is defined as “a distribution line that serves as a common source of supply for more than one (1) service line” (4 CSR 240-40.030(B)19); and *service line* is defined as “a distribution line that transports gas from a common source of supply to an individual customer, to two (2) adjacent or adjoining residential or small commercial customers, or to multiple residential or small commercial customers served through a meter header or manifold. A service line ends at the outlet of the customer meter or at the connection to a

replaced before the expiration of their estimated useful service life are not worn out or in deteriorated condition. Laclede’s ISRS petitions include millions of dollars for costs incurred replacing miles of plastic mains and service lines that were in service only for a short period of time before being replaced and, therefore, are not worn out or deteriorated as required by Section 393.1009(5)(a) RSMo.

4. The nine work orders shown in the table below were included among the work orders that Laclede Gas seeks to include in this ISRS. This comes from data requests answered by Laclede that provided additional details on the plastic being replaced in the following work orders:

Sample of Ineligible Plastic Service Line and Main Replacement Costs Included in this ISRS				
Work Order No.	Replaced Plastic Installed as Recently as...	Total Feet of Replaced Plastic	Approx Total Project Cost	Portion of Ineligible Plastic Replacements
900836	3 yrs ago	5,168’	\$830,000	39% plastic
900546	1 yr ago	3,041’	\$336,000	51% plastic
900547	2 yrs ago	7,217’	\$418,000	43% plastic
900983	3 yrs ago	3,472’	\$490,000	34% plastic
900882	5 yrs ago	1,642’	\$735,000	33% plastic
900609	10 yrs ago	2,871’	\$231,000	34% plastic
900747	2 yrs ago	2,537’	\$469,000	18% plastic
901163	9 yrs ago	1,549’	\$191,000	38% plastic
901090	10 yrs ago	1,162’	\$828,000	21% plastic

customer’s piping, whichever is further downstream, or at the connection to customer piping if there is no meter” (4 CSR 240-40.030(B)32).

Note the dates of replacement; none are anywhere near the end of their service life. These nine work orders alone include 28,659 feet of plastic service lines and mains that are ineligible for ISRS recovery because they had not reached the end of their useful service life. That equals well over *five miles* of replaced plastic service lines and mains that were not worn out or in deteriorated condition in just a sample of work orders taken from this ISRS petition. Other work orders also included in this ISRS, but not in this sample, include similar replacements.

5. These nine work orders replaced a combination of copper, bare steel, cast iron, and plastic mains and service lines. **The plastic replacements averaged 35% of the total project replacements** - a substantial portion of the overall project costs. OPC asks the Commission to order Laclede to exclude costs incurred replacing ineligible plastic mains and service lines in **all** work orders sought to be included in the ISRS surcharges and not just the sample nine work orders shown in the table.

6. The work orders identified in the table are Laclede Gas work orders only. MGE, however, also included replacement costs for polyethylene pipe in their ISRS petition. OPC requested MGE work orders from the ISRS petition and those work orders confirmed MGE follows Laclede's same replacement practice of replacing large segments of mains and service lines, including those that do not need to be replaced rather than replacing only the portion that is worn out or in deteriorated condition. For example, in work order **009224**, MGE's work order authorization sheet shows MGE replaced 1,923 feet of polyethylene pipe and 2,170

feet of protected coated steel with the same work order. The documentation for this work order does not in any way indicate that the replaced polyethylene was worn out or in deteriorated condition.²

7. While OPC is not arguing the replacement of plastic mains and service lines is improper on its face, it is apparent that Laclede is not replacing the plastic because it is worn out or in deteriorated condition. This was confirmed by Laclede's response to OPC data request No. 7.d. explaining it includes the costs replacing plastic with newer plastic because "[t]he plastic portion of the main was no longer usable because the cast iron and bare steel main that it was connected to was being replaced." Laclede admits it simply made a strategic decision to replace the entire length of main rather than replace only the portion that was worn out or deteriorated. Rather than remove the costs incurred for the portion that replaced the plastic main or service line that was not worn out or deteriorated, Laclede included *everything* in its ISRS request claiming "it is not economically or practically feasible to separate those parts from the entire length of the line." While Laclede may not agree with the practicality of separating out the ineligible replacements, the law requires the Company to separate out those unpermitted replacements or forego any surcharge increase.

8. Laclede's actions are an unlawful expansion of the ISRS statutes. Section 393.1009(5) RSMo limits eligible infrastructure replacements as follows:

² MGE also replaced polyethylene/plastic in a large number of work orders, including but not limited to the following: #800083 (2,301 feet), #800084 (1,073 feet), #009230 (1,362 feet), #009225 (900 feet), #800072 (657 feet), #800178 (650 feet), #800085 (472 feet), #800163 (359 feet), #005456 (625 feet), #800372 (459 feet), #800249 (199 feet), and #800621 (210 feet).

(5) "Gas utility plant projects" may consist only of the following:

(a) 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 that have worn out or are in deteriorated condition;

The ISRS statutes do not allow replacement costs due to the gas company's strategic decision to replace eligible and ineligible pipe at the same time.

9. An order rejecting the proposed increase until Laclede separates out the ineligible plastic pipe replacements is consistent with the Supreme Court's only interpretation of the gas ISRS statutes. That case focused on whether a gas company could include replacements for infrastructure damaged by human conduct. The case is analogous because both involve the replacement of existing infrastructure that is not worn out or deteriorated as required. The Supreme Court explained, to determine eligibility, "this Court must determine if the "existing facilities" were "worn out or ... in deteriorated condition." Section 393.1009(5)(a)." *Office of the Public Counsel v. P.S.C.*, 464 S.W.3d 520, 525 (Mo. 2015). The Court concluded:

The PSC's interpretation conflicts with the clear legislative intent as demonstrated by the plain language of the statute. The PSC erred in relying upon its presumption that any change to a gas utility plant project qualifies for an ISRS surcharge. Only infrastructure which is in a worn out or deteriorated condition, as stated herein, is eligible for an ISRS surcharge. Hence, the PSC's order is not lawful because it is contrary to the plain language of the statute, which limits projects that qualify for an ISRS surcharge.

Id. Hence, the Commission should not presume any change to a gas utility plant project qualifies and only infrastructure that is worn out or in deteriorated condition qualifies for the ISRS surcharge.

10. Rejecting Laclede's ISRS petitions is also consistent with the Commission's recent decision excluding telemetry equipment from Laclede's proposed increase. *See Report and Order*, Case Nos. GO-2015-0341 and GO-2015-0343, effective December 1, 2015. In its Report and Order, the Commission referenced the Supreme Court's 2015 decision by concluding:

The court's decision makes clear that the Commission should evaluate the eligibility of gas utility plant projects narrowly in order to ensure compliance with the legislature's intent. When evaluating the telemetry equipment Laclede replaced, which are pipeline system components installed to comply with state or federal safety requirements, the evidence shows that the specific units at issue in work orders 604180 and 604190 were still operable at the time of the replacements. There were no signs of deterioration, such as corrosion.

While it is clear that telemetry equipment plays a vital role in monitoring and ensuring the safe distribution of gas, Laclede failed to show the specific parts replaced were in an impaired condition... **Since the telemetry equipment replacement occurred at the same time as regulator station upgrades, it appears the timing of the replacement was more likely motivated by the efficiency of changing both at the same time than the age of the equipment or any actual impairment.**

Id., pp. 16-17 [emphasis added]. This case is similar to the present case because both involve Laclede replacing infrastructure for convenience and strategy and not because of an actual impairment. Accordingly, Laclede's replacement of unimpaired plastic pipe is ineligible for ISRS and must be removed. OPC requests the

Commission order Laclede to exclude costs incurred replacing ineligible plastic mains and service lines for all work orders sought to be included in the ISRS.

B. Laclede's ISRS Petitions Seek to Include Ineligible Earnings-Based Employee Incentive Compensation and Stock Compensation

11. OPC also discovered Laclede's ISRS petitions include costs for earnings-based employee incentive compensation and stock compensation this Commission has consistently excluded from rates. OPC moves the Commission to order all earnings-based employee compensation be removed from the ISRS.

12. On November 8, 2016, OPC issued two data requests to Laclede seeking data to quantify the earnings-based compensation included in the ISRS petition. Despite Laclede's answers being due November 28, 2016 per Commission rule 4 CSR 240-2.090(2)(C), and despite the already shortened time-frame to review an ISRS petition, Laclede provided OPC with late answers on December 2, 2016.

OPC's requests asked:

DR 1002: For each and every work order included in Laclede and MGE's current ISRS update application, please list by work order and the dollar amount of a) earnings-based incentive compensation and b) equity (stock)-based incentive compensation included in the work order.

DR 1003: For each and every work order included in Laclede and MGE's existing ISRS (the original and all updates excluding the current application), please list by work order and the dollar amount of a) earnings-based incentive compensation and b) equity (stock)-based incentive compensation included in the work order.

Rather than providing OPC with an accounting of the earnings-based compensation included in the ISRS, Laclede's answers for each data request were identical,

stating “Laclede Gas and MGE do not keep the information in the format requested by OPC. There is no business reason for doing so.” Laclede’s responses are an admission by Laclede that it does in fact include earnings-based compensation in its ISRS and that it is unwilling to provide an accounting of the requested cost information. It is inconceivable to OPC that Laclede does not track the different types of compensation it charges to its general ledger, plant work orders, and continuing property records. This is basic accounting that must be employed to identify the types of costs the Commission allows and does not allow to be charged to a utility’s cost of service. Laclede has the capability to account for and track this compensation, but as Laclede’s answers to OPC’s data requests demonstrates, it chooses not to calculate and provide OPC with an accounting of those costs.

13. Laclede should be well aware of the Commission’s past treatment of earnings-based incentive compensation and never should have included such costs in these petitions. In MGE’s 2004 rate case, Case No. GR-2004-0209, the Commission addressed this very issue and explained why such costs cannot be recovered in rates:

The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. Those financial incentives seek to reward the company's employees for making their best efforts to improve the company's bottom line. Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed, some actions that might benefit a company's bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers.

If the company wants to have an incentive compensation plan that

rewards its employees for achieving financial goals that chiefly benefit shareholders, it is welcome to do so. However, the shareholders that benefit from that plan should pay the costs of that plan. The portion of the incentive compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.³

Laclede seeks to include costs in the ISRS for earnings-based incentive compensation that is not a cost of the replacements nor is it recoverable from ratepayers because such compensation chiefly benefits shareholders. In Union Electric d/b/a Ameren Missouri's 2009 rate case, Case No. ER-2008-0318, the Commission held:

The Commission has frequently disallowed costs relating to incentive programs that are based on measures of the financial return achieved by the utility. It has done so because such measures are based on the level of profits the utility can achieve. At best, a utility's level of profitability has little or no benefit for ratepayers. At worst, an increase in the utility's profitability may be harmful to ratepayers if that profitability is obtained by cutting customer service or system maintenance to cut costs and thereby increase earnings per share. Because eligibility for AmerenUE's long-term compensation plans are based on measures of the financial return achieved by the utility, the cost of those plans should fall on the shareholders who will primarily benefit from the company's increased financial return.⁴

In Kansas City Power & Light's 2006 rate case, Case No. ER-2006-0314, the Commission again rejected an attempt to include earnings-based incentive compensation in rates:

KCPL requests that all of its incentive compensation be included in cost of service. Staff objects, stating that roughly 35% of the cost

³ Missouri Gas Energy, Case No. GR-2004-0209, *Report and Order*, September 21, 2004 [emphasis added].

⁴ Union Electric Company, d/b/a AmerenUE, Case No. ER-2008-0318, *Report and Order*, January 27, 2009.

should be disallowed on the grounds that it is either tied to earnings per share (EPS), and thus has negligible, if any, benefit to ratepayers, or is awarded for vague reasons.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As far as compensation tied to EPS, the Commission notes that KCPL management has the right to set such goals. However, because maximizing EPS could compromise service to ratepayers, such as by reducing customer service or tree-trimming costs, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.⁵

In another 2006 case, the Commission disallowed similar incentive compensation for Empire District Electric Company when it stated, "*We conclude that incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards, and stock options should not be recoverable in rates.*"⁶ These cases show ratepayers are not to be held responsible for paying a utility's earnings-based incentive compensation and such costs should be removed from these ISRS petitions. OPC asks the Commission to direct Laclede to calculate and remove the amount of earnings-based incentive compensation included in these ISRS petitions.

⁵ Kansas City Power & Light Company, Case No. **ER-2006-0314**, *Report and Order*, December 21, 2006; **See also** Kansas City Power & Light Company, **ER-2007-0291**, *Report and Order*, December 6, 2007.

⁶ The Empire District Electric Company, Case No. **ER-2006-0315**, *Report and Order*, December 21, 2006; **See also** Missouri Gas Energy, Case No. **GR-96-285**, *Report and Order*, January 22, 1997.

C. Hydro-testing Costs Alone are Not Eligible for ISRS Recovery

14. The MGE Application shows this Company included costs in its ISRS petition incurred conducting hydro-testing on mains to determine the integrity of the main. In particular, OPC is aware of at least two work orders, #009253 and #007935, where hydro-testing costs were included despite there being no associated replacement or enhancement to the distribution system. Section 393.1009(5) RSMo does not allow testing costs to be recovered through the ISRS, and instead specifically allows only limited costs incurred replacing, enhancing, or relocating facilities. For MGE's work order 009253, MGE incurred over \$179,000 in hydro-testing costs included in its petition. OPC requests the Commission direct Laclede to remove work orders #009253 and #007935 from MGE's ISRS and remove all other costs incurred hydro-testing for both Laclede Gas and MGE where no replacement or enhancement work was performed as required by Section 393.1009(5) RSMo.

D. Replacement Header Main Work Orders

15. OPC also issued data requests to Laclede seeking additional information regarding several work orders described as "Replacement Header Main." The work orders for header main replacements do not provide any indication that any infrastructure was replaced and taken out of service in conjunction with the header main installations. OPC reserves the right to challenge these costs and other costs should Laclede's answers to OPC's data requests indicate these work orders are ineligible for ISRS recovery.

E. Laclede's ISRS Petitions Seek to Include Ineligible Costs Not Identified or Supported with Documentation Filed with the Petitions

16. Lastly, OPC renews its challenge to the Staff practice of permitting Laclede's petitions to include two months of "estimated" projects without identifying any projects or providing any supporting documentation. Laclede did not provide the supporting documentation for the September 2016 and October 2016 costs until weeks into the shortened audit period. Accordingly, OPC opposes all September 2016 and October 2016 costs from being included in this ISRS.

17. This is the same issue that OPC previously raised with the Commission, which is also the subject of two pending appeals. The first appeal is awaiting a decision from the Supreme Court of Missouri on an application to transfer. *See* Case No. SC96048. The second appeal is currently being briefed before the Court of Appeals in Case No. WD79830.

F. OPC Objection to the Staff Recommendations

18. On November 29, 2016, the Commission's Staff filed its Recommendations for the two ISRS petition and recommended the Commission approve the petitions subject to slight adjustments for depreciation. The Staff Recommendations do not identify the concerns raised by OPC in this motion. Instead, the Staff recommends approval of the petitions including the costs OPC has identified herein as unlawful. The Recommendations show the Staff did not perform thorough audits of Laclede's petitions because it reviewed only a small number of documents that could not possibly have provided the Staff with sufficient

information to conclude the work orders Laclede seeks to include in its ISRSs satisfies all eligibility criteria. Accordingly, OPC objects to the Staff Recommendations because they do not represent a thorough audit and because they approve of the costs OPC opposes in this motion.

G. Laclede Has the Burden of Proof

19. OPC asks the Commission to keep in mind that Laclede has the burden to prove the work orders it seeks to include in the ISRS are lawfully eligible. Section 393.150.2 RSMo states, “At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the gas corporation.”

20. For the reasons outlined above, OPC urges the Commission to reject the proposed ISRS surcharge increase. Alternatively, OPC requests the Commission order a hearing be held and direct the parties to file a proposed procedural schedule.

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission reject the proposed tariff sheets and deny the petitions, or, alternatively, order an evidentiary hearing be held and direct the parties to file a proposed procedural schedule.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

By: /s/ Marc D. Poston

Marc D. Poston (#45722)

Chief Deputy Counsel

P. O. Box 2230

Jefferson City MO 65102

(573) 751-5558

(573) 751-5562 FAX

marc.poston@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 9th day of December 2016.

/s/ Marc Poston
