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

OPC POSITION STATEMENT

COMES NOW the Office of the Public Counsel ("OPC") and for its Position Statement, submits the following positions on the issues:

Issue 1. *Whether it is lawful and appropriate to consider the Infrastructure System Replacement Surcharge ("ISRS") adjustments proposed by OPC, since they were not filed until after the 60 day period provided for the Staff to file its report regarding the Staff's examination.*

OPC Position: Yes, OPC's challenge to the ISRS petitions is lawful and appropriate. OPC's December 9th motion was in full compliance with the law and is consistent with the timing of OPC's request for a hearing in Laclede's last ISRS petitions; a request the Public Service Commission ("Commission") specifically concluded was "lawful" after a similar objection by Laclede.[1] This same procedure has been following in multiple ISRS petition cases before the Commission, where

[1] Case Nos. GO-2016-0196 and 0197, *Order Denying Motion for Reconsideration of Procedural Schedule,* April 14, 2016 (EFIS No. 20).

OPC requested an evidentiary hearing after the Staff filed its report. See Case Nos. GO-2014-0006, GO-2014-0179, and GO-2014-0212. Moreover, the Commission's November 30th order directed parties to reply to the Public Service Commission Staff's ("Staff") Recommendations no later than December 9th. OPC replied per the Order's requirements.

Laclede's argument that OPC was required to raise any issue within 60-days is a clear misrepresentation of the law. The 60-day requirement places no restrictions on when any party may raise issues, and only prescribes the time in which the Staff may file a report regarding the Staff's examination. Section 393.1015.2(2) RSMo. Laclede's arguments are inconsistent with the plain meaning of the ISRS statutes, which place no procedural requirement on OPC as to when it must raise issues and/or request an evidentiary hearing. The Legislature easily could have placed in the ISRS statute such a procedural requirement on OPC to raise issues but that language simply does not exist. OPC would have been fully within its legal rights to simply request a hearing without identifying any issues in detail until direct testimony. Instead, OPC contacted Laclede by phone the day after Laclede responded late to OPC's discovery and explained the basis for OPC's objections. Furthermore, OPC provided significant detail in its December 9th response and motion with citations to the law and facts that enabled Laclede to fully understand the basis for OPC's objections. OPC has gone above and beyond its legal obligation and effectively provided Laclede with a full understanding of OPC's issues earlier than required.

Throughout OPC's prior challenges to the "update" procedure used by Laclede and Staff,[2] Laclede argued the 60-day audit requirement is a Staff requirement and does not contemplate an OPC review. It is highly disingenuous for Laclede to now argue that the 60-day window to file a report suddenly applies to OPC. Moreover, Laclede should not be rewarded for causing the delays to OPC's ability to process these petitions that were due in part to Laclede's unlawfully late answers to data requests in violation of 4 CSR 240-2.090(2)(C). Nor should Laclede be rewarded for an extremely unbalanced response time to data requests when it responds to Staff data requests by an average of 4.5 days but takes more than 20 days on average to answer OPC data requests, and then complains that OPC should have raised issues sooner. Accordingly, OPC has complied with all laws and Commission orders in raising the issues in this case. Determining otherwise would be a clear violation of OPC's and the public ratepayers' rights to due process.

Issue 2. *May Laclede and MGE's ISRS filings be updated during the ISRS case to replace two months of budgeted ISRS investments with updated actual ISRS investments?*

OPC Position: The update practice can only occur if the Staff conducts a full and thorough audit. The Court of Appeals opinion in WD79349 concluded, "*Nothing in section 393.1015.1(1) or 4 CSR 240-3.265(20) prevents the Commission from accepting budgeted information at the time a petition is filed, to be later supplemented with updated documentation, <u>so long as such acceptance does not prevent a full and [thorough] review of the ISRS petition</u>*." Before the Laclede/Staff

[2] See Case Nos. GO-2016-0196, GO-2016-0197, GO-2015-0341 and GO-2015-0343, and subsequent appeals in Case Nos. WD79349 and WD79830.

update procedure can pass muster, the facts must demonstrate that the Staff conducted a full and thorough review. OPC's position is that the Laclede/Staff update practice has not enabled the Staff to conduct a full and thorough review of the September and October 2016 late-submitted costs and, therefore, those costs should be rejected and considered in Laclede's next ISRS petitions.

Issue 3. *A. Whether it is appropriate to consider whether earnings-based incentive compensation costs should be included in an ISRS.*

OPC Position: Yes, it is appropriate to consider earnings-based incentive compensation in these petitions. Further, it is not appropriate to include such costs in an ISRS or any rate since the Commission has repeatedly concluded such costs primarily benefit shareholders and should be paid for by shareholders.

Laclede argues the particular costs (in this case earnings-based incentive compensation) it assigns to an ISRS plant project is entirely a "ratemaking issue that is properly determined in a rate case." Laclede bases this argument upon Section 393.1015.2(2) RSMo, which states:

> The staff of the commission may examine information of the gas corporation to confirm that the underlying costs are in accordance with the provisions of sections 393.1009 to 393.1015, and to confirm proper calculation of the proposed charge, and may submit a report regarding its examination to the commission not later than sixty days after the petition is filed. No other revenue requirement or ratemaking issues may be examined in consideration of the petition or associated proposed rate schedules filed pursuant to the provisions of sections 393.1009 to 393.1015.

This subsection includes two provisions relevant to this discussion. First, it establishes that the purpose of the review is to "confirm the underlying cost are in accordance with the" ISRS statutes. Second, it establishes that other revenue requirement or ratemaking issues may not be examined. Each provision supports a conclusion that an ISRS petition is an appropriate venue for considering whether the costs Laclede charges to its ISRS work orders are permissible.

Underlying Costs: To "confirm that the underlying costs are in accordance with" the ISRS statutes, one must begin by looking to see what costs are permitted under the ISRS statutes. For replacement projects, the eligible costs are those costs the Commission allows a utility to charge customers for replacing "mains, valves, service lines, regulator stations, vaults, and other pipeline system components." Section 393.1009(5)(a) RSMo. The ISRS statutes define "ISRS costs" as "depreciation expenses and property taxes that will be due within twelve months of the ISRS filing." Section 393.1009(7) RSMo. This means the permissible costs include only those costs the Commission permits to be included in depreciation expense and property taxes for plant. Since the Commission excludes earnings-based incentive compensation from the depreciation expense in plant, by definition "ISRS costs" also excludes earnings-based incentive compensation. Accordingly, the issue is properly raised here so that these ineligible costs may be removed.

Other Revenue Requirement or Ratemaking Issues: "Other revenue requirement or ratemaking issues" that cannot be included in an ISRS include any revenue or rate issues "other" than those included in the calculation of ISRS costs. In this instance, earnings-based incentive compensation is not an "other" ratemaking issue because Laclede has included that cost in these ISRS petitions claiming them as proper plant costs. Any cost that is claimed to be a cost of an ISRS-eligible project is open for challenge in an ISRS petition. Laclede does not get a free pass to include any cost it wants in a plant project and the ISRS petition is the best venue for excluding impermissible costs before they are charged to ratepayers. Otherwise, Laclede could include millions of dollars in other impermissible costs in its ISRS petitions, such as lobbying costs, and charge those to ratepayers under the argument that lobbying is a rate case issue that cannot be addressed until the next rate case. Once Laclede charges a cost to an ISRS project, that cost is properly before the Commission and ripe for challenge but only to the limited extent of its inclusion in the ISRS. In this case, OPC is permitted to raise the issue of earnings-based incentive compensation but is limited to addressing that issue only to the extent such costs are included in the ISRS.

Issue 3. *B. If the answer to 3A is yes, whether it is appropriate to include those earnings-based incentive compensation costs in Laclede's and MGE's ISRS plant-in-service balances?*

OPC Position: No, it is not appropriate to charge earnings-based incentive compensation to ratepayers as the Commission has consistently charged such costs to shareholders. 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.
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> 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

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

> 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 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.
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> 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 by stating, "*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*

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

[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.

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 remove the amount of earnings-based incentive compensation from its calculations included in these ISRS petitions.

Issue 4. *Whether it is appropriate to include "hydrostatic" testing costs in MGE's ISRS revenues.*

OPC Position: Hydrostatic testing costs cannot be recovered through the ISRS. Section 393.1009(5)(b) RSMo, the law upon which Laclede relies to include such costs, does not permit testing costs in the ISRS. That section limits ISRS eligibility to projects that extend the useful life of plant or enhance the integrity of the system. Hydrostatic testing simply determines whether the pipe has leaks, and in no way extends the life of that pipe or enhances its integrity.

Issue 5. *Laclede's and MGE's strategy when replacing cast iron and steel mains and service lines is to also replace connected plastic mains and service lines at the same time. Can all costs associated with these replacements be recovered through the ISRS?*

OPC Position: No. Laclede seeks to recover through the ISRS costs incurred replacing recently-installed plastic service lines and plastic mains that: (1) are not installed to comply with any state or federal safety requirement, and (2) have not worn out and are not in a deteriorated condition. In many instances, these plastic mains and service lines being replaced were in service for only a few years

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[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.

before replacement – some in service for less than a year. 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. It should be presumed that plastic service lines and mains 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.

Laclede claims these plastic replacements are made pursuant to Laclede's cast iron and bare steel replacement programs, but such programs only require the replacement of cast iron and bare steel, and place no requirements on Laclede to replace plastic lines, especially when such plastic main and plastic service lines are in perfect working condition. *See* 4 CSR 240-40.030(15).

Laclede admits it simply made a strategic decision to replace sections of pipe that were not worn out and deteriorated at the same time it replaced sections 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." The law requires the Company to separate out those unpermitted replacements or forego any surcharge increase.

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

> (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 a company's strategic decision to replace eligible and ineligible pipe at the same time. Replacements must be *required* by state or federal safety laws, and must be replacing existing infrastructure that Laclede can demonstrate is worn out or deteriorated. Laclede's new strategy to replace perfectly functioning plastic infrastructure satisfies neither requirement and must be rejected as required by Section 393.1009(5)(a) RSMo.

An order rejecting the 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.

OPC's position is also consistent with the Commission's recent decision excluding telemetry equipment from a Laclede ISRS petition. *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.
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> 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.

WHEREFORE, the Office of the Public Counsel respectfully offers this Position Statement.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 28th day of December 2016.

/s/ Marc Poston