BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Verified Application and Petition of Laclede Gas Company to Change its Infrastructure System Replacement Surcharge in its Laclede Gas Service Territory.	)))))	Case No. GO-2015-0341
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-2015-0343

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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PUBLIC COUNSEL'S BRIEF

These cases present three unresolved issues to the Public Service Commission regarding whether the infrastructure system replacement surcharge (ISRS) rate increase petitions filed by Laclede Gas Company (Laclede) and Missouri Gas Energy (MGE) include costs that are ineligible under the ISRS statutes, MO. REV. STAT. §§ 393.1009-393.1015 (Cum. Supp. 2013)., and MO. CODE REGS. ANN. tit. 4, § 240-3.265 (2011).[1]

Public Counsel urges the Commission to disallow **$17,987,441** from Laclede's proposed ISRS, and disallow **$9,626,747** from MGE's proposed ISRS, because these amounts: (1) were not supported by actual cost detail or documentation in the petition, including details required by law to be filed with the petitions; (2) violate the public's right to due process by replacing a statutory 60-day review period with a 17-day and a 49-day review period; (3) were incurred primarily after the petitions were filed; (4) were never filed with the Commission and are not supported by the record; and (5) exceed the "estimates" included in the petitions.

Public Counsel also urges the Commission to disallow an additional **$401,258** from Laclede's requested ISRS increase to remove telemetry equipment costs that are ineligible because they are not a pipeline component replacement contemplated by § 393.1009(5)(a) in that telemetry equipment cannot cause gas to leak due to wear or deterioration. This amount also should be disallowed because the replaced telemetric monitoring equipment was in working condition and without incident at the time of removal, and was therefore not "worn out or in deteriorated condition" as required before replacements can be eligible under § 393.1009(5)(a).

The ISRS was never intended to be a recovery mechanism for every safety-related infrastructure investment. Rather, it was intended to address a narrow category of infrastructure investments that were mandated by the Commission-ordered pipeline replacement programs for deteriorating cast iron and steel pipeline components that are prone to corrosion and leaking over time, as well as government-mandated facility relocations. Allowing the telemetry costs into the ISRS would constitute unlawful single-issue ratemaking in violation of § 393.270 and in violation of the ISRS statutes, §§ 393.1009-1015, RSMo. Accordingly, the telemetry costs should be disallowed.

I. ISRS BACKGROUND FACTS

The ISRS is a separate surcharge that gas companies are permitted to collect from customers to recover three types of eligible infrastructure costs: mandated pipeline replacements; mandated pipeline enhancements; and mandated facility relocations. § 393.1009(5)(a), (b), and (c).

[1] All statutory references are to the Revised Statutes of Missouri, Cum. Supp. 2013.

The events that ultimately lead to the ISRS statutes occurred between 1988 and 1989 when a series of natural gas explosions in Missouri raised concerns over the safety of Missouri's aging gas distribution infrastructure.[2] In response, the Commission conducted an investigation of all gas distribution systems and concluded that "unprotected steel is, by its very nature, subject to corrosion over time" (Vol. 14, No. 23 MO. REG., p. 1598 (December 1, 1989)). Because of the "natural gas explosions, ignitions and fires which occurred in the past heating season," the Commission promulgated new rules in 1989 requiring Missouri's regulated gas companies to establish long-term facility replacement programs for the systematic inspection and replacement of unsafe facilities, such as cast iron mains and unprotected steel service lines (*Id*. pp. 1581-1602; MO. CODE REGS. ANN. tit. 4, § 240-40.030(15) (2013)).[3]

While the replacement programs worked as intended and gas companies increased their replacement of unsafe infrastructure, the mandated replacements caused gas companies to incur significant costs between rate cases that they were unable to recoup until rates were reset in the next general rate review. To address this regulatory lag issue,

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[2] **Case No. GS-89-84**, *In the Matter of Union Elec. Co. Regarding an Incident in Jefferson City, Mo. on October 30, 1988;* **Case No. GS-89-98**, *In the Matter of KPL Gas Serv. Involving an Incident in Kansas City, Mo. on November 24, 1988;* **Case No. GS-89-121**, *In the Matter of Cities Utilities of Springfield, Mo. Regarding an Incident in Springfield, Mo. on November 26, 1988*; **Case No. GS-89-122**, *In the Matter of KPL Gas Serv. Regarding an Incident in Kansas City, Mo. on December 5, 1988;* **Case No. GS-89-147**, *In the Matter of Fulton Municipal Gas Regarding an Incident in Fulton, Mo. on January 7, 1989;* **Case No. GS-89-156**, *In the Matter of KPL Gas Serv. Regarding an Incident in Oak Grove, Mo. on February 10, 1989;* and **Case No. GS-89-203**, *In the Matter of Laclede Gas Co. Regarding an Incident in St. Louis, Mo. on April 2, 1989*.

[3] A copy of the 1989 Order of Rulemaking is attached to this brief.

the Commission authorized gas companies to utilize Accounting Authority Orders ("AAOs") to defer program compliance costs for full recovery in the company's next rate case. Costs eligible for the AAOs included costs incurred complying with the required replacement of steel service lines and cast iron mains, and the cathodic protection of unprotected steel (*Laclede Gas Co.,* 5 Mo. P.S.C. 3d 108 (1996); *Missouri Gas Energy,* 7 Mo. P.S.C. 3d 394 (1998); and *Laclede Gas Co.,* 11 Mo. P.S.C. 3d 538 (2002)).

Although the AAOs helped the companies by allowing full recovery of replacement program compliance costs, the AAOs did not address the timing lag that existed between when the utility incurred the costs and when it recovered those costs in a general rate case. Nor could it, because without express legislative authority, an immediate rate increase to recover replacement costs would have been unlawful under § 393.270, which prohibits single-issue ratemaking, that is, raising rates to address a single cost category without considering all costs. *State ex rel. Utility Consumers Council of Missouri, Inc. v. P.S.C.,* 585 S.W.2d 41, 56 (Mo. banc 1979)(*UCC*).

Both the regulatory lag issue and the single-issue ratemaking issue were addressed by the ISRS statutes, which "permit the gas company to make single-issue rate increases between general rate cases in order to timely recover its costs for certain government-mandated infrastructure projects without the time and expense required to prepare and file a general rate case." *Office of the Public Counsel v. P.S.C.,* 417 S.W.3d 815, 821 (Mo. App. W.D. 2014)(*Public Counsel*). Here the Court of Appeals recognized that the purpose of the ISRS was to address a timing lag issue. *Id.* Hence, the ISRS replaced the AAOs because the ISRS permitted more immediate recovery of the government-mandated infrastructure projects by establishing an exception to the

prohibition against single-issue ratemaking. This ISRS background is relevant here because it shows that the purpose of the ISRS is to provide quicker recovery of costs incurred complying with the government-mandated replacement of unsafe infrastructure caused by the wear and corrosion of cast iron, steel, and copper pipeline components. The ISRS statutes in no way encourage more or less replacements, rather, they simply provide a recovery mechanism for replacements that are already required by law. § 393.1009(5).

Public Counsel's interpretation of the ISRS is consistent with an interpretation provided by MGE when it stated in response to a data request that, "The capital items primarily included in the ISRS work orders include the replacement of bare steel and cast iron mains, bare steel or hard copper service line replacements, cast iron joint encapsulation and all un-reimbursed facilities related to public improvements or relocations mandated by some government entity" (Ex. 202).

The issues list developed by the parties in this case presented four issues to the Commission. The first issue challenging costs associated with certain regulator station replacements is no longer contested (Tr. 27).[4] The remaining three issues, however, remain contested.

[4] The regulator station issue was resolved after Laclede provided photographs showing the replaced regulator stations were corroded and in a deteriorated condition (Tr. 27).

II. ARGUMENT

A. Telemetry Costs Should be Disallowed from Laclede's ISRS

Issue: Is the telemetric equipment included in Laclede's ISRS petition eligible for ISRS recovery under Section 393.1009(5)?

Laclede seeks to include **$401,258** in its ISRS for costs incurred replacing telemetry equipment that is *not* eligible for ISRS recovery because the replaced equipment is not the type of equipment eligible for the ISRS, and because the replaced equipment was not "worn out or in deteriorated condition" as required by § 393.1009(5)(a) for eligible infrastructure replacements.

Telemetry is an electronic device consisting of computer circuitry that monitors system pressure by sending data from a regulator station to a Laclede control room through a cellular network (Tr. 53).[5] Laclede employees in the control room monitor system pressure through a series of computer screens. *Id.* Gas does not physically flow through telemetry equipment, and faulty telemetry equipment cannot cause gas to leak (Tr. 52).

Laclede installed the replaced telemetry equipment between 2000 and 2002 (Ex. 3, p.6). Laclede made the decision to replace this telemetry equipment after the manufacturer announced that the computer processor used within the equipment, an Intel processor, no longer would be provided by Intel (Ex. 3, Attachment PAS-DI). Laclede characterized this equipment as becoming "obsolete," necessitating a replacement to upgrade to the manufacturer's new telemetry equipment equipped with a new processor (Ex. 3, p.6). According to Laclede's counsel, the processors installed by Laclede

[5] Laclede showed the Commission a replaced telemetry device in its opening statement during the evidentiary hearing (Tr. 9).

between 2000 and 2002 were 386 processors (Tr. 9-10). During the evidentiary hearing, Laclede attempted to establish that the 386 processor was a dinosaur, having been replaced by at least nine (9) processor versions (Tr. 116). Laclede does not explain, however, why it installed a 386 processor when a line of other, more recent processors were available. Nor did Laclede explain why it claims a 10-year life for the 386 processor when the manufacturer stated that the telemetry equipment has served for nearly 20-years (Ex. 3, Attachment: Bristol Product Overview, p.1).

Laclede's witness on this issue, Patrick Seamands, D.E., testified that at the time Laclede removed the telemetry equipment, the removed equipment was in working condition and performing as intended, and showed no signs of visible corrosion on the exposed components (Tr. 56-57). Dr. Seamands was not aware of any incidents of failure on the removed equipment (Tr. 57).

The ISRS statute, § 393.1009(5)(a), limits eligible replacements to the following:

> 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;

Applying these eligibility criteria to the replaced telemetry equipment shows that the replacements are ineligible for ISRS recovery.

a. Telemetry equipment is not a main, valve, service line, regulator station, vault, or other pipeline system component subject to corrosion and leaks

Laclede's telemetry equipment fails to satisfy the eligibility criteria limiting replacements to mains, valves, service lines, regulator stations, vaults, or other pipeline system components. The legislature provided a list of pipeline system components and limited eligibility to those on the list and "other" pipeline system components, which by

implication include components that are similar in character to the listed components. *See Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118, 122 (Mo. 2014).[6] The common element of the listed components is that they are all underground facilities subject to corrosion which ultimately can cause a gas leak. Dr. Seamands testified that mains, valves, service lines, and regulator stations can all corrode or mechanically deteriorate, causing gas to leak directly from that component (Tr. 48-50). The concrete vault that houses the underground regulator stations also can cause a gas leak if the vault wall were to collapse and cause damage to a pipe or regulator station within the vault (Tr. 51). The common element among these pipeline system components is their ability, through wear or deterioration, to cause a gas leak.

Telemetry equipment, on the other hand, cannot cause a gas leak (Tr. 52). Gas does not flow through the circuitry and wiring of the electronic telemetry equipment and telemetry equipment is not a concrete wall that can be subject to collapsing. In fact, the telemetry equipment may even have been above ground, as Dr. Seamands was unsure of the location of the telemetry equipment removed in this case (Tr. 52-53). Simply put, electronic telemetry equipment is not the type of equipment that can cause gas leaks, it was not specifically mentioned in § 393.1009(5)(a), and it is dissimilar from the listed components that can cause leaks. Accordingly, telemetry equipment is not an eligible pipeline system component under § 393.1009(5)(a).

If the Commission were to conclude that telemetry equipment is a pipeline system component similar to the listed components, the Commission runs the risk of expanding

[6] If a "word at issue appears in the statute within a list of words, the Court will apply the principle of statutory construction known as *noscitur a sociis* - a word is known by the company it keeps." *Union Elec*., 425 S.W.3d at 122.

the ISRS beyond its intended purpose, and inviting more claims of eligibility. Expansive interpretations of the ISRS statutes, however, should be avoided. The ISRS should be narrowly construed to protect ratepayers because it is an exception to the general prohibition against single-issue ratemaking. § 393.270. The Supreme Court of Missouri has held that, "Exceptions in a statute should be strictly construed." *Florida Realty, Inc. v. Kirkpatrick,* 509 S.W.2d 114, 121 (Mo. 1974). The ISRS is an exception to the prohibition against single issue ratemaking. *Public Counsel*, 417 S.W.3d at 821. The general rule, as provided for in § 393.270, and as interpreted in *UCC*, is that rate increases that do not consider all costs and revenues in a general rate case constitute unlawful single-issue ratemaking. *UCC,* 585 S.W.2d at 56. The ISRS exception to the general rule, therefore, should be construed strictly. *Florida Realty,* 509 S.W.2d at 121.

The purpose of the replacement programs was explained in the Commission's 1989 gas safety order of rulemaking creating the replacement programs, where it concluded that the replacement programs target the material used because of the tendency of steel to corrode, and cast iron to crack, as a result of the materials themselves and the natural pressures placed upon these materials due to their location within the ground (Vol. 14, No. 23 MO. REG., p. 1598 (December 1, 1989)). The ISRS statutes show that the legislature followed this same purpose when establishing what replacements would be eligible when it limited eligible replacements to pipeline components that can wear out or deteriorate and cause gas leaks such as mains, valves, service lines, regulator stations, and vaults. § 393.1009(5)(a). This is a distinctly different purpose than replacing working telemetric equipment because of Intel's decision to stop producing a particular processor. Telemetry equipment is distinctly different than mains, valves, service lines,

regulator stations, and vaults, and is therefore not a pipeline system component as that term is used in § 393.1009(5)(a).

The above interpretation of § 393.1009(5)(a) is also consistent with the language of the second category of eligible expenses provided for in § 393.1009(5)(b). This subsection authorizes for ISRS recovery, "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." Although the telemetry equipment does not qualify under (5)(b) because, among other things, it is a replacement and not an enhancement, the types of enhancements eligible for ISRS recovery under (5)(b) show that the legislature's focus was on allowing quicker reimbursement for costs incurred remedying facilities that are prone to causing gas leaks. The types of projects identified - main relining projects, line insertion projects, and joint encapsulation projects – all directly improve the integrity of infrastructure susceptible to gas leaks (Tr. 59-60). This supports the interpretation that eligible projects under the ISRS are limited to projects that replace or repair infrastructure that has the ability to corrode and leak.

b. The Removed Telemetry Equipment Was Not Worn Out or in Deteriorated Condition

The telemetry equipment removed by Laclede also fails the ISRS eligibility criteria because the replaced equipment was not worn out or in deteriorated condition when removed (Tr. 56-57). Replacing working equipment that is not worn out or in deteriorated condition is not consistent with the eligibility criteria prescribed by § 393.1009(5)(a), which is limited to infrastructure that is "worn out or in deteriorated condition." This language shows that the purpose of § 393.1009(5)(a) is to make eligible for ISRS recovery costs incurred replacing pipeline components that have become unsafe

due to wear and corrosion, and which can cause gas leaks. Replacements caused by a manufacturer's decision to discontinue providing parts and support for electronic telemetry are not eligible under a plain reading of the statute.

Earlier this year, the Supreme Court of Missouri interpreted the word "deteriorated" in the ISRS statute as involving "a gradual process that happens over a period of time rather than an immediate event." *Verified Application & Petition of Liberty Energy (Midstates) Corp. v. Office of Pub. Counsel*, 464 S.W.3d 520 (Mo. 2015). "Only infrastructure which is in a worn out or deteriorated condition, as stated herein, is eligible for an ISRS surcharge." *Id*.

The same analysis applies here. Replacements made due to changes in software technology do not involve wear or deterioration as required by § 393.1009(5)(a) because the replaced facilities are otherwise in working order when replaced, and the reasons for the replacements are not due to gradual wear or deterioration. This is not to mean that such costs are ineligible for recovery in general rates following a rate case, because such costs are recoverable through general rates. But the legislature specifically limited the type of costs that it would allow gas companies to recover through an ISRS, and replacing working facilities does not satisfy the necessary criteria. Accordingly, Public Counsel urges the Commission to disallow the **$401,258** costs incurred by Laclede replacing working telemetry (Ex. 200, p.6).

B. Estimated Costs Should be Disallowed from the ISRS

i. Issue: May Laclede and MGE submit estimated "budget" ISRS investments in the petition that are later replaced with actual ISRS investments?

The largest disallowance sought by Public Counsel is for infrastructure costs that were not incurred and/or calculated and documented until *after* the petitions were filed. Laclede and MGE are seeking to include a combined **$27,614,189** in this ISRS for costs that were not calculated or documented in the petitions, and in most instances, were not even incurred until after the companies filed their petitions (Ex. 200, p.5).[7] These late additions unreasonably prevent a meaningful review of over $27 million in costs before those costs go into rates, which violates the public's right to due process under Mo. Const. Art 1, § 10. These late additions are also unlawful and ineligible for recovery because § 393.1015.1(1) and MO. CODE REGS. ANN. tit. 4, § 240-3.265(20) (2011) require cost documentation, rate schedules, and cost calculations to be submitted with the petitions. These additional post-petition costs will, however, be eligible for recovery in the next ISRS petitions, assuming they otherwise comply with the eligibility requirements.

a. The Proposed ISRS Violates § 393.1015.2(2) by Limiting the Statutory 60-Day Review to 17 Days for $20 Million in Costs

In the August 3, 2015 ISRS petitions filed by Laclede and MGE, the companies provided actual data for costs incurred between March 1, 2015 and June 30, 2015, including a breakdown for each project with details regarding the plant account number,

[7] Laclede and MGE now claim $19,752,455 in costs incurred in the month of August, which approximates the total costs incurred after the petition was filed since the petition

work order number, budget project number, a description of the project, the location of the project, the in-service date, the actual cost of the project, the ISRS provision that makes the project eligible for ISRS recovery, and the state or federal safety requirement mandating the project. (Ex. 1; Ex. 2). Other than the telemetry equipment previously addressed, Public Counsel does not oppose the May through June costs because the required detail was provided with the petition, and Public Counsel was provided the full statutory 60-day period to review these costs.[8]

For the July and August 2015 costs, however, the petitions provide *estimated* costs that provide no actual cost detail and do not identify any specific projects that can be audited and verified. *Id.* Combined, Laclede and MGE estimated **$23,847,899** in additional ISRS costs that were not supported by actual detail or calculation in the petitions (Ex. 200, p.4).

On Friday, August 14, 2015, 11-days after the petitions were filed and 11-days into the 60-day review period, Laclede and MGE provided Public Counsel and the Staff with calculations and information regarding **$7,861,742** in actual costs incurred during the month of July 2015 (Tr. 80; Ex. 200, p.5). A month later, on September 14 and September 15, 2015, forty-three (43) days into a 60-day review period, Laclede and MGE provided Public Counsel and the Staff with actual cost calculations for an additional **$19,752,455** incurred during the month of August 2015. *Id.* In total, Laclede and MGE

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was filed on the first working day of August, and all August replacements likely occurred after the petition was filed (Ex. 200, p.5).

[8] Section 393.1015.1.2(2) RSMo provides for a 60-day review period following the filing of an ISRS petition.

now seek July and August costs worth **$27,614,189**, which is **$3,766,290** *higher* than even their original estimates for July and August (Ex. 200, p.5).

The companies' late submissions of project and cost detail greatly reduced the time available to analyze the lengthy cost spreadsheets and perform an audit on those costs before the 60-day review period expired (Public Counsel's testimony and the Staff recommendations were due 60-days after the petitions were filed) (EFIS No.7). Laclede and MGE have effectively shortened the 60-day time period to **49 days** for the July costs, and **17 days** for the August costs, which violates the 60-day review process prescribed by § 393.1015.2(2), and violates the public's right to due process in that it prevents a meaningful review of the claimed costs (Mo. Const. Art. 1, § 10).[9] Moreover, discovery on the **$19,752,455** of claimed August costs (which is approximately 70% of the total July and August costs) was not possible before testimony was due since parties have twenty (20) days to respond to discovery under MO. CODE REGS. ANN. tit. 4, § 240-2.090(2)(C) (2014).

Laclede's practice of estimating two months of ISRS costs was, according to Laclede, the product of an unidentified "agreement" between the Staff and Laclede (Tr. 16). MGE, on the other hand, never included estimates in their ISRS petitions until after MGE was acquired by Laclede in 2013 (Tr. 70). It was not until MGE's first ISRS petition under Laclede ownership, Case No. GR-2015-0025, that MGE engaged in Laclede's practice of estimating future costs in ISRS petitions without supporting documentation or calculations (Tr. 70-71). Instead of allowing MGE to adopt the

[9] Section 10 states, "That no person shall be deprived of life, liberty or property without due process of law."

unlawful practices of Laclede, Laclede should instead be ordered to adopt the lawful practices followed by MGE prior to acquisition.[10]

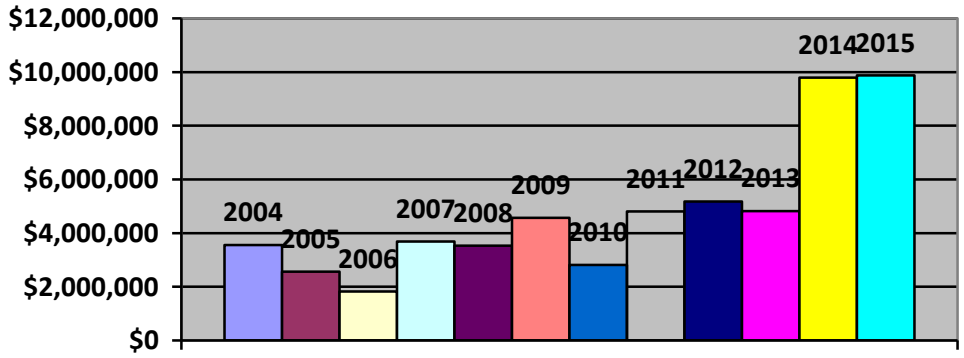
The 120-day period provided for in the ISRS statute includes a 60-day review process for Public Counsel and Staff, and an additional 60-days to hold a contested hearing (if necessary) and allow time for the Commission to issue its decision. § 393.1015.2(2). Laclede's and MGE's estimating practice shortens and defeats the purpose of the 60-day review when, instead, ISRS costs should receive heightened scrutiny because single-issue ratemaking runs the risk of over-collecting from customers, and statutes that permit single-issue rate increases should be narrowly construed. Only projects and costs that are clearly and accurately identified in the petitions should be eligible; anything less defeats the purpose of the process provided for in § 393.1015.

The ISRS statute states specifically that the gas company will service Public Counsel with "a copy of its petition, its proposed rate schedules, and its supporting documentation," which implies a heightened importance that Public Counsel have timely receipt of documents to allow for a full 60-days to review the petition. § 393.1015.1(1). Public Counsel asks that the Commission restore the 60-day review period, and give customers a meaningful opportunity to review proposed surcharge rate increases by disallowing all costs that were not fully identified and detailed in the August 3 petitions.

[10] An argument could also be made that by adopting Laclede's practice following acquisition by Laclede, MGE's customers are experiencing rate increases in violation of the Commission's order granting the acquisition, which ordered the stipulated term that the "transaction shall not have any detrimental effect on Laclede Gas or MGE Division utility customers, including, but not limited to: increased rates…" Case No. GM-2013-0254, *Order Approving Stipulation and Agreement*, Attachment: Stipulation and Agreement, July 17, 2013, p.35.

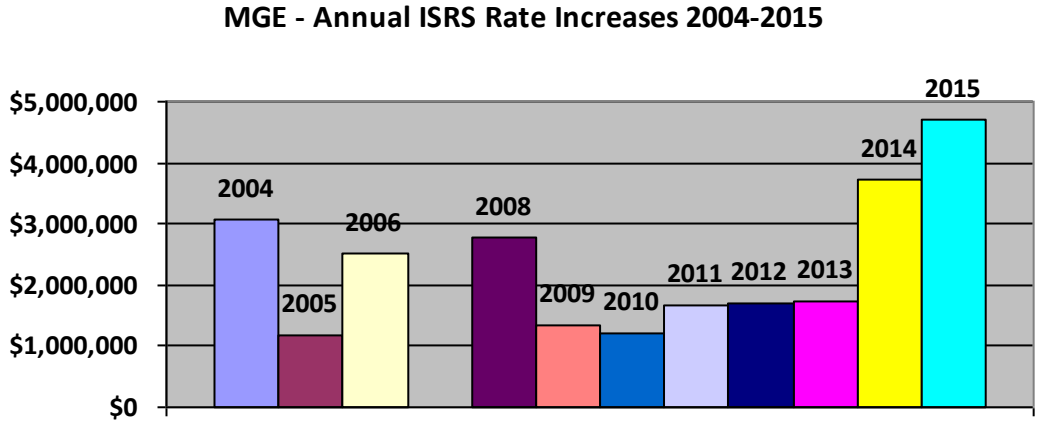
Providing Public Counsel with the full 60-day review period is especially important in light of the significant increases Laclede and MGE have made in their annual infrastructure replacement costs. In 2006, when Laclede began limiting the review of ISRS petitions, it incurred only a fraction of the ISRS costs it incurs today. These increases in projects and expenditures make it far more difficult for Public Counsel to review the costs, understand the costs, and, if necessary, challenge the costs.

Annual Laclede ISRS Rate Increases 2004-2015



Laclede: Between 2004 and 2013, Laclede's average ISRS rate increase was **$3,735,981** per year.[11] Last year, 2014, Laclede more than doubled its infrastructure replacement costs when it increased ISRS rates by **$9,798,270** (Case Nos. GO-2014-0212 and GO-2015-0026). Again this year, Laclede has already increased ISRS rates by **$5,524,406**, and through this ISRS they seek another **$4,499,676** (Case No. GO-2015-0269; Ex. 100).

[11] See orders approving ISRS rate increases in Case Nos. GO-2004-0443, GO-2005-0119, GO-2005-0351, GO-2006-0377, GO-2007-0177, GO-2007-0370, GO-2008-0155, GO-2008-0351, GO-2008-0221, GO-2009-0389, GO-2010-0212, GO-2011-0058, GO-2011-



MGE: Between 2004 and 2013, MGE's average ISRS rate increase was $1,721,143 per year.12 In MGE's first year under Laclede ownership, 2014, MGE more than doubled its infrastructure investments when it increased ISRS rates by $3,720,213 per year (Case Nos. GO-2014-0179 and GR-2015-0025). Again this year, Laclede has already increased ISRS rates by $2,814,826, and through this ISRS, they seek another $1,878,151 (Case No. GO-2015-0270; Ex. 100). If MGE's current ISRS request is granted, it will have raised ISRS rates by $4,692,977 in 2015, far above its average when it was under Southern Union ownership (Ex. 100).

The Commission should be questioning the need for these increased expenditures when there have been no new regulations that would require more than double the average ISRS rate increases. Ratepayers should pay through the ISRS no more than the

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0361, GO-2012-0145, GO-2012-0356, GO-2013-0352, GO-2014-0212, GO-2015-0026, and GO-2015-0341 (requested).

[12] See orders approving ISRS rate increases in Case Nos. GO-2004-0242, GO-2005-0273, GO-2006-0201, GO-2006-0556, GO-2008-0113, GO-2009-0009, GO-2009-0302, GO-2011-0003, GO-2011-0269, GO-2012-0144, GO-2013-0015, GO-2013-0391, GO-2014-0179, GR-2015-0025, and GO-2015-0343 (requested).

necessary replacements mandated by safety regulations – ratepayers should not pay through the ISRS for replacements that simply seek to increase the company's rate base upon which a return is earned. Laclede and MGE together serve the vast majority of gas customers served by a public utility in Missouri. A decision that impacts rates for these two companies is a decision that impacts more than a million homes and businesses. The Commission should demand nothing less than a process that allows for a full 60-day review of cost detail, which is the best way to ensure that these increased expenditures are being incurred only for eligible costs.

b. The Proposed ISRS Violates § 393.1015.1(1) and MO. CODE REGS. ANN. tit. 4, § 240-3.265 (2011) Because the Companies Did Not Submit the Required Documentation for the July and August Costs

The documentation required in an ISRS petition is controlled by § 393.1015.1(1), titled in part, "Documentation to be Submitted," which states:

> At the time that a gas corporation files a petition with the commission seeking to establish or change an ISRS, it shall submit proposed ISRS rate schedules and its supporting documentation regarding the calculation of the proposed ISRS with the petition…

(emphasis added). The statute unambiguously requires schedules and documentation regarding the ISRS calculations to be filed "at the time" the petition is filed.

In addition, the documentation that is to be filed with an ISRS is controlled by the Commission's ISRS rule, which details what the supporting documentation should include (MO. CODE REGS. ANN. tit. 4, § 240-3.265(20) (2011)). The "*minimum"* supporting documentation required by the rule includes the following information that Laclede and MGE failed to provide regarding the July and August 2015 costs:

> For each project for which recovery is sought, the net original cost of the infrastructure system replacements (original cost of eligible infrastructure system replacement, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective ISRS), the amount of related ISRS costs that are eligible for recovery during the period in which the ISRS will be in effect, and a breakdown of those costs indentifying which of the following project categories apply and the specific requirements being satisfied by the infrastructure replacements for each.

(MO. CODE REGS. ANN. tit. 4, § 240-3.265(20)(K) (2011); emphasis added). This subsection alone requires a considerable amount of information that Laclede and MGE either did not provide, or provided estimates only. The petitions did not include the net original costs for the estimated projects, which is a crucial detail for all claimed ISRS-eligible projects because it is necessary to calculate the surcharge rate (Tr. 72). The petitions also failed to include the amount of eligible costs for each estimated project, because those amounts were not known when the petitions were filed. And while the petitions attempt to provide the project categories (replacement, enhancement or relocation), and safety regulations that required the infrastructure investments, these too are only estimates that are loosely tied to unknown estimated costs (Ex. 1; Ex. 2). The estimates provide no meaningful data because it is impossible to verify or audit these claimed costs and other details since no actual projects are identified in the petitions.

The petitions also failed to satisfy the following documentation requirements that are required to be filed with the petitions:

> For each project for which recovery is sought, the statute, commission order, rule, or regulation, if any, requiring the project; a description of the project;

> the location of the project; what portions of the project are completed, used and useful; what portions of the project are still to be completed; and the beginning and planned end date of the project.

(MO. CODE REGS. ANN. tit. 4, § 240-3.265(20)(L) (2011)). For the estimated projects, the petitions do not provide a description of the project, the location of the project, or any other *actual* data regarding a known cost (Ex. 1, App. A; Ex. 2, App. B, p.59; Tr. 72-73). It is impossible to audit or verify projects that are either not known or have not occurred. For the *known* projects in the petition for March through June, the petitions include a project number, a description of the project, the location of the project, and the actual cost of the project. Accordingly, the estimated projects lack the detail required by the ISRS statute, as further narrowed by the Commission's ISRS rule. Because of this, the petitions are not in compliance with § 393.1015.1, and MO. CODE REGS. ANN. tit. 4, § 240-3.265(20)(K) and (L) (2011).

Notably, no actual details associated with the July and August costs were ever filed with the Commission, and no actual cost documentation or calculations regarding those costs are included in the case record. Even if the Commission were inclined to allow this practice despite the petition requirements in the statute, there is not sufficient evidence in the record to support the combined **$27,614,189** in July and August costs.

c. OPC Response to Laclede/MGE's Claims of Authority for Estimating July and August Costs

During the evidentiary hearing, Laclede/MGE's counsel argued that estimating costs for July and August was a lawful process for several reasons. First, Laclede/MGE argued that estimating costs in the ISRS petition, and replacing those estimates with real costs later in the case, "is nothing more than the ISRS-like equivalent to what has been

done for decades in rate cases" (Tr. 17). However, Laclede/MGE's witness Mr. Glenn Buck compared rate cases to ISRS cases and concluded that they are "dissimilar processes" and are "not really the same" (Tr. 71, 78). Rates requested in rate cases are based upon a test year of historical costs that are known and measurable and endure a review period of up to nine (9) months (Tr. 71; § 393.150). Laclede/MGE's proposed use of future estimates, rather than actual historical costs, is remarkably different because estimates provide no meaningful information to review until the real cost data is supplied weeks later.

Laclede/MGE also argued that the ISRS statutes authorize costs to be estimated in the petition because the statutes do not specifically prohibit the practice (Tr. 19). This argument fails to recognize that all Commission authority must be expressly granted by the legislature. "The Commission is an administrative body created by statute and has only such powers as are expressly conferred by statute and reasonably incidental thereto." *PSC v. Mo. Gas Energy*, 388 S.W.3d 221, 230 (Mo. Ct. App. 2012). There is no language in the ISRS statutes that states or implies that ISRS petitions can include unknown estimates. Instead, the requirement that the petition include rate schedules, documentation and calculations, indicates that the Legislature wanted accurate information to be filed with the petition.

Laclede/MGE cite to § 393.1015.2(2) as authority for estimating costs (Tr. 19). This subsection provides, "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." The examination contemplated by this subsection is an examination to consider

"the underlying costs" and the "proposed charge." Neither of these, however, can be examined for the estimated costs because the underlying costs are not known, and the proposed charge is simply an estimate. Laclede/MGE's reliance on this subsection is contrary to their argument because this section shows that the examination contemplated by § 393.1015.2(2) requires actual costs and a calculation of the actual charge.

Laclede/MGE cite to § 393.1009(1), where the definition of "appropriate pretax revenue" is provided. Appropriate pretax revenue defines how the ISRS is to be calculated, and allows three categories of costs: (a) "The gas corporation's cost of capital multiplied by the net original cost of the eligible replacements"; (b) income or excise taxes; and (c) "all other ISRS costs." Laclede/MGE argue that the "all other" category allows for the estimating practice. However, the costs in question are costs for what Laclede/MGE claim are eligible replacements. Eligible replacements are specifically addressed in subsection (a), implying that the "other ISRS costs" of subsection (c) refers to costs other than the current eligible replacement costs.

Laclede/MGE's arguments that the ISRS statutes provide the authority for allowing a gas company to not identify its costs, documents, rate schedules and calculations for a large portion of the costs requested in its petition, is an argument that is not supported by the clear language of the ISRS statute.

i. <u>Issue</u>: May Laclede and MGE update reserves for depreciation and accumulated deferred income taxes related to actual ISRS investments?

The last issue is whether Laclede and MGE may update reserves for depreciation and accumulated deferred income taxes (ADIT) related to actual ISRS investments. Depreciation and ADIT updates recognize that the value of an asset diminishes over time

due to depreciation and ADIT, and the updates attempt to best approximate the value of the asset at the time rates are set (Tr. 89-90). An analysis of the ISRS statutes indicates that the updates are consistent with the statute and should continue.

This issue was not raised by Public Counsel, and was added due to an unwritten "agreement" between the Staff and Laclede (and apparently now, MGE), that Laclede be allowed to add two months of estimated costs not identified in the petition, in exchange for updating depreciation and ADIT on the new ISRS costs. In other words, the Staff allowed Laclede to supplement its ISRS petition with an additional two months of costs (in this case worth over $27 million) in exchange for modest updates to the costs sought to be included in the ISRS to account for depreciation and ADIT.

The first problem with this agreement, other than the fact that it was not agreed to by any consumer party, is that the additional two months of costs far outweigh the deductions, and to that end, Staff gave far more than it received with the agreement (Ex. 1; Ex. 2). The real party on the losing end of this "bargain" is not even a party to the agreement. Ratepayers are now paying higher surcharges due to this lopsided Laclede/ Staff agreement than they would without it. Essentially, Laclede conceded to an update that is already required by the statute to determine the cost of eligible plant, and the Staff conceded to an additional two months of unsupported plant additions that cannot lawfully be added to these petitions.

When the Commission approves an ISRS petition, the amount to be recovered in rates must be sufficient to recover "appropriate pretax revenue." § 393.1015.2(4). *Appropriate pretax revenue* includes the following:

> The gas corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of

> accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective ISRS

§ 393.1009(1)(a) (emphasis added). Depreciation and ADIT offsets are to be recognized for ISRS costs in a currently effective ISRS, which requires that the costs associated with ISRS approvals since the last rate case would be reduced accordingly. *Id*. The Staff states that its calculations "included incremental accumulated depreciation, accumulated deferred income tax and any change in property tax rates for replacements associated with the currently effective ISRS," which appropriately recognizes the reduction required by § 393.1009(1)(a) (Ex. 100; Ex. 102).

The Staff also states that it applied the depreciation/ADIT updates to the new costs being included in this petition. *Id*. The Staff's recommendations do not provide the legal authority for making these offsets, but state that the offsets are "consistent with Staff's view that the calculation of the ISRS revenue requirement should closely reflect the revenue requirement at the 120-day effective date of the ISRS rates, which, in this case, is December 1, 2015." *Id.* Neither the Staff's nor Laclede/MGE's position statements provide a legal citation or legal analysis to support the practice, but Laclede states that these offsets are lawful (EFIS Nos. 23 & 26).

Whether the depreciation/ADIT offsets should apply to the new costs depends on the meaning of "net original cost," as that term is used in § 393.1009(1)(a) of the ISRS statutes for calculating the appropriate pretax revenues. If the "net" implies the original cost less depreciation/ADIT, then the practice of offsetting the new ISRS costs is permissible under the ISRS statutes. The *American Heritage Dictionary* defines "net" as

the amount "remaining after all deductions have been made."[13] Accordingly, depreciation and ADIT incurred since the petitions were filed are lawful and appropriate reductions to the new ISRS costs before they are included in the surcharge. Accordingly, the depreciation/ADIT offsets should continue for all costs - new costs and costs currently in an ISRS. Public Counsel urges the Commission to consider this issue independently and not based upon how the Commission resolves the issue on the estimated July and August costs.

III. Conclusion

The large volume of data associated with an ISRS makes it virtually impossible to audit and verify each and every claimed eligible cost. This should be a concern to the Commission since there has been a clear trend with Laclede, and now MGE after acquisition by Laclede, to significantly increase their ISRS expenditures. This will make it even more difficult to audit the costs. These significant increases in infrastructure expenditures, when no new laws or regulations have been passed that mandate any more expenditures, suggests that the purpose of the increased replacements is not because such expenditures are mandated. The three issues in this case present the Commission with an opportunity to help keep rates lower by recognizing that the ISRS statutes provide meaningful limitations on what can and cannot be included, while recognizing that the true purpose of the ISRS is to allow gas companies to recover costs incurred replacing or repairing pipeline components that are required to be replaced because they are corroded and prone to causing leaks.

[13] https://www.ahdictionary.com

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 26th day of October 2015.

/s/ Marc Poston