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** Tariff No. YG-2017-0048
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** Tariff No. YG-2017-0047

Staff's Brief

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Brief*, states as follows:

Introduction

Laclede Gas Company, Case No. GO-2016-0333

On September 30, 2016, Laclede Gas Company ("Laclede" or "Company") filed its *Verified Application and Petition of Laclede Gas Company to Change Its Infrastructure System Replacement Surcharge in Its Laclede Gas Service Territory* (Case No. GO-2016-0333) pursuant to §§ 393.1009, 393.1012 and 393.1015, RSMo.,[1] and Commission Rule 4 CSR 240-3.265, which authorize gas corporations to recover certain eligible infrastructure replacement costs through an infrastructure system replacement surcharge ("ISRS").

On September 30, 2016, the Commission suspended the tariff sheet filed by Laclede (assigned tariff tracking number YG-2017-0047) until January 28, 2017, and ordered Staff to file a recommendation regarding Laclede's application. Accordingly,

[1] All statutory references are to the Revised Statutes of Missouri ("RSMo.) as currently amended and effective.

Staff filed its *Recommendation* on November 29, 2016, recommending that the proposed tariff sheet be rejected and that Laclede receive ISRS revenues for this case of $4,504,138. Due to the previously approved ISRS rates for Laclede which continue in effect, the total ISRS revenue requirement to be included in rates (including Staff's recommended amount for this case) is $29,526,894.

This case represents Laclede's sixth ISRS filing since the conclusion of its most recent general rate case, Case No. GR-2013-0171. In its current Application, Laclede filed to recover ISRS qualifying infrastructure replacement costs incurred during the period March 1, 2016, through August 31, 2016, with pro-forma ISRS costs updated through October 31, 2016.

Missouri Gas Energy, Case No. GO-2016-0332

On September 30, 2016, Missouri Gas Energy ("MGE" or "Company"), an operating unit of Laclede Gas Company ("Laclede"), filed its *Verified Application and Petition of Missouri Gas Energy, an Operating Unit of Laclede Gas Company, to Change Its Infrastructure System Replacement Surcharge in Its Missouri Gas Energy Service Territory* (Case No. GO-2016-0332) pursuant to §§ 393.1009, 393.1012 and 393.1015 and Commission Rule 4 CSR 240-3.265, which authorize gas corporations to recover certain eligible infrastructure replacement costs through an ISRS.

On September 30, 2016, the Commission suspended the tariff sheet filed by MGE (assigned tariff tracking number YG-2017-0048) until January 28, 2017, and ordered Staff to file its recommendation regarding MGE's application. Accordingly, Staff filed its *Recommendation* on November 29, 2016, recommending that the proposed tariff be rejected and that MGE receive ISRS revenues for this case of $3,362,598. Due

to the previously approved ISRS rates for MGE which continue in effect, the total ISRS revenue requirement to be included in rates (including Staff's recommended amount for this case) is $13,616,021.

This case represents MGE's fifth ISRS filing since the conclusion of its most recent general rate case, Case No. GR-2014-0007. In its current Application, MGE filed to recover ISRS qualifying infrastructure replacement costs incurred during the period March 1, 2016, through August 31, 2016, with pro-forma ISRS costs updated through October 31, 2016.

The updated plant amounts for September were provided to Staff and OPC on October 19, 2016 for Laclede and on October 20, 2016 for MGE, and the updated plant amounts for October for both operating units were provided to the parties on November 10, 2016.[2]

OPC's Objection and Request for Hearing

On November 30, 2016, the Commission by order in each case set a deadline of December 9, 2016, for any response to Staff's *Recommendations.* On December 9, 2016, the Office of the Public Counsel ("OPC") filed in each case its *Motion to Deny Proposed Rate Increases and, Alternatively, Motion for Hearing,* stating:

> 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)

[2] Buck Direct, p. 4.

estimated costs not supported with documentation filed with the petitions contrary to law.[3]

On December 12, 2016, the Commission directed that a *Proposed Procedural Schedule* be filed; it was filed on December 14, 2016, and adopted with modifications on December 15, 2016. The modified schedule called for direct testimony on December 16; rebuttal testimony on December 23; and an evidentiary hearing on January 3, 2017, with a single round of briefs due on January 6, 2017.

On December 27, 2016, the parties filed their *Joint List of Issues* as follows:

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.

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?

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

   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?

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

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?

Thereafter, on January 2, 2017, OPC withdrew Issues 2 and 3.

A proceeding on a petition to establish or change an ISRS is a non-contested

[3] The second and fourth of these grounds were later withdrawn by OPC.

case under the *Missouri Administrative Procedures Act.*[4] Should there be an appeal, the appellate court will look only to the lawfulness of the Commission's order.[5] The issue of whether the Commission's order is reasonable, that is, supported by competent and substantial evidence on the whole record, will not be before it.

Argument

A.

These cases involve the Infrastructure System Replacement Surcharge or "ISRS" for gas utilities set out at §§ 393.1009-1015, RSMo.[6] The ISRS is a statutorily-permitted form of rate adjustment mechanism that allows a public utility to change its rates outside of a general rate case, based on the consideration of a single issue:

> Gas corporations are permitted to recover certain infrastructure system replacement costs outside of a formal rate case though a surcharge on their customers' bills. When a petition to modify an ISRS is filed, the PSC staff must conduct an examination of the proposed ISRS. Section 393.1015.2, RSMo Supp. 2003. The examination may scrutinize the petitioning gas corporation's information to confirm the costs are in accordance with the ISRS code provisions and confirm the proposed charges are calculated properly. A report of the examination may be submitted to the PSC no later than sixty days after the petition was filed. Section 393.1015.2(2).[7]

The ISRS is designed to be "quick and dirty." Staff's report of its examination of a gas utility's ISRS petition and supporting documents must be filed not later than the

[4] Section 536.010, "'Contested case' means a proceeding before an agency in which legal rights, duties or privileges of specific parties are required by law to be determined after hearing"; § 393.1015.2(3), "The commission **may** hold a hearing on the petition and any associated rate schedules …"; ***In re Laclede Gas Co.,*** 417 S.W.3d 815, 819 (Mo. App., W.D. 2014).

[5] ***Laclede Gas,*** *supra.*

[6] All statutory references are to the Revised Statutes of Missouri ("RSMo.) as currently amended.

[7] ***In the Matter of the Verified Application & Petition of Liberty Energy (Midstates) Corp.,*** 464 S.W.3d 520, 522 (Mo. banc 2015).

60th day after the filing of the petition.[8] The Commission may hold a hearing, but its decision must become effective not later than 120 days after the filing of the petition.[9] The ISRS statute specifies that the examination of the ISRS petition and supporting documents is subject only to a very narrow and limited examination:

> 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.[10]

Consequently, the issue most likely to be contested in an ISRS case is whether or not the "underlying costs are in accordance with the provisions of sections 393.1009 to 393.1015," that is, whether or not they are "eligible infrastructure system replacements" in the words of the statute. The ISRS statute provides:

> (3) "Eligible infrastructure system replacements", gas utility plant projects that:
>
> (a) Do not increase revenues by directly connecting the infrastructure replacement to new customers;
>
> (b) Are in service and used and useful;
>
> (c) Were not included in the gas corporation's rate base in its most recent general rate case; and
>
> (d) Replace or extend the useful life of an existing infrastructure;
>
> * * *

[8] Section 393.1015.2(2).

[9] Section 393.1015.2(3).

[10] Section 393.1015.2(2).

> (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;
>
> (b) Main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements; and
>
> (c) Facilities relocations required due to construction or improvement of a highway, road, street, public way, or other public work by or on behalf of the United States, this state, a political subdivision of this state, or another entity having the power of eminent domain provided that the costs related to such projects have not been reimbursed to the gas corporation[.][11]

The OPC has been a steadfast enemy of the ISRS. OPC's sole witness in the present cases testified that the ISRS was enacted through the efforts of the gas utilities and their lobbyists; that its purpose is to protect shareholders from the effects of regulatory lag; and that the ISRS has been forced upon Missouri ratepayers.[12] In fact, the General Assembly determined long ago that the public interest requires "service instrumentalities and facilities" that are "safe and adequate."[13] The Missouri Supreme Court stated in 1925:

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. The woof and warp of our Public Service Commission Act bespeaks these terms. The law would be a dead letter without them, and a commission under the law, that would

[11] Section 393.1009.

[12] Tr. 213, l. 21, to 214, l. 25.

[13] Section 393.130.1.

> not be the law in the proper spirit, would be breathing into it the flames of ultimate deterioration of public utilities. These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.[14]

The reality is that the ISRS law benefits ratepayers by encouraging gas utilities to invest in infrastructure improvements sooner than they might otherwise. As Company witness Mark Lauber testified, "the statute was set forth to incentivize operators to accelerate their replacements of aging infrastructure and expand them. So what I believe OPC's trying to do is take that and diminish that incentive."[15]

B.

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.

Staff and the Company agree that it is not lawful to consider adjustments proposed for the first time more than 60 days after the ISRS change applications were filed. OPC's role in ISRS cases is necessarily analogous to and parallel with Staff's role, a point demonstrated by the requirement that the company serve its application and supporting documentation on OPC at the same time it is filed with the Commission.[16] By allowing OPC extra time, the Commission ignores the scheme devised by the legislature and denies Due Process to the petitioning company.

[14] ***State ex rel. Washington Univ. v. Pub. Serv. Comm'n of Missouri,*** 308 Mo. 328, 344–45, 272 S.W. 971, 973 (banc 1925).

[15] Tr. 132.

[16] Section 393.1015.1(1).

As noted previously, the ISRS law requires that Staff examine the company's petition and supporting documentation and file a report not later than 60 days after the date on which the petition was filed.[17] The Commission may hold a hearing, but its final order must become effective not later than 120 days after the date on which the petition was filed.[18] OPC receives the petition and supporting documentation on the same day as Staff,[19] a point which implies that OPC's objections to the petition and supporting documentation are due the same day as Staff's.

It is true that the ISRS law nowhere states explicitly that OPC must file its objections by the 60th day. However, the Commission has observed before that the ISRS law is ambiguous and that construction is therefore required to determine the legislative intent.[20] When the three sections of the ISRS law are considered as a whole, it is evident that the legislature intended that all objections to the ISRS petition be filed by the 60th day. This is evident when the procedure followed in the present case is considered. OPC's objections were not filed until December 9, the 70th day; and they were filed as a response to Staff's *Recommendations,* which they actually do not address. OPC's issues are with the Companies' petitions and not *per se* with Staff's *Recommendations.*

The purpose of statutory interpretation is to give effect to the legislative intent.[21] Staff suggests that the legislative intent manifest in the ISRS law is that all objections to the company's petition be filed by the 60th day. The Commission has no authority to

[17] Section 393.1015.2(2).

[18] Section 393.1015.2(3).

[19] Section 393.1015.1(1).

[20] ***Laclede,*** *supra,* at 820.

[21] ***Gash v. Lafayette County,*** 245 S.W.3d 229, 232 (Mo. banc 2008).

"change the rate making scheme set up by the legislature."[22] Staff suggests that the Commission is without authority to give OPC extra time.

The practice of giving OPC extra time also has Due Process implications. In an administrative proceeding, "[d]ue process is provided by affording parties the opportunity to be heard in a meaningful manner. The parties must have knowledge of the claims of his or her opponent, and have a full opportunity to be heard, and to defend, enforce and protect his or her rights."[23] Under both the federal and state constitutions, the fundamental requirement of due process is the opportunity to be heard "at a meaningful time and in a meaningful manner."[24] "This does not mean that the same type of process is required in every instance; rather, due process is flexible and calls for such procedural requirements as the particular situation demands."[25] In the context of a proceeding on a petition to establish or change an ISRS, where a specific deadline is established for Staff's report on the company's petition, Due Process requires that OPC's objections, if any, be served on the company at the same time. By affording OPC an additional 10 days after Staff's report, an already short interval for the company to mount a defense of its petition is rendered too short.

The Commission should dismiss OPC's objections embodied in its *Motion to Deny Proposed Rate Increases and, Alternatively, Motion for Hearing* as filed too late.

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[22] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 56 (Mo. banc 1979).

[23] ***Harter v. Pub. Serv. Comm'n,*** 361 S.W.3d 52, 58 (Mo. App., W.D. 2011) (citations and inner quotation marks omitted). ***United For Missouri v. PSC,*** --- S.W.3d ---, --- (Mo. App., W.D. 2016), slip op. at 4.

[24] ***Jamison v. Dept. of Soc. Servs., Div. of Family Servs.,*** 218 S.W.3d 399, 405 (Mo. banc 2007).

[25] *Id.*

C.

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

Staff's position is that it is appropriate to include the hydrostatic testing costs involved in this case in MGE's ISRS revenues because the effect of the one-time testing is to extend the useful life of an existing infrastructure.

Hydrostatic testing of natural gas pipelines is a pressure test process where a pipeline is briefly taken out of service and then tested for strength and possible leaks by filling it with pressurized water.[26] It does not involve any physical change to the pipeline.[27] Several types of flaws can be detected through hydrostatic testing.[28] The test creates a certain amount of stress for a given time to allow these possible flaws to be exposed as leakages that result in a loss of pressure.[29] The test pressure is designed to provide a sufficient tolerance between itself and the maximum operating pressure such that surviving flaws in the pipeline shall not grow over time after the pipeline is placed into service at the intended operating pressure.[30]

The testing that is the focus of these cases is not part of any ongoing program of regular maintenance.[31] Rather, federal regulations require that all pipelines installed after July 1970 undergo a documented one-time pressure test completed in compliance with regulatory requirements to establish a Maximum Allowable Operating Pressure

[26] Lauber Rebuttal, pp. 3-4; Tr. 121.

[27] Tr. 121.

[28] Lauber Rebuttal, p. 4.

[29] *Id.*

[30] *Id.*

[31] Tr. 126; 196-197, 198-199.

("MAOP").[32] Pipelines installed prior to 1970 must meet either a specific pressure test, operating history, or design requirements as outlined in 4 CSR 240-4 40.030(12)(M) [49 CFR part 192.616] to establish an MAOP.[33] Additionally, pressure testing is one acceptable option to assess certain threats defined by 4 CSR 240-40.030(16), Pipeline Integrity Management for Transmission Lines [49 CFR part 192 Subpart O] whose intent is to enhance the integrity of gas transmission lines.[34] The recent PHMSA interpretation – spurred by an explosion in San Bruno, California, in 2010 -- further defined the requirements for that pre-1970 pipe, which resulted in Laclede Gas, MGE and other utility pipeline operators undertaking, or at least verifying that, these one-time tests are or were completed in compliance with the PHMSA requirements.[35] Otherwise, the pipeline would no longer be able to be operated in compliance with pipeline safety rules, and would have to be replaced.[36]

Section 393.1009(5)(b) provides that eligible projects include "[m]ain relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements[.]" Under federal regulations, existing infrastructure installed prior to 1970 must either undergo a one-time hydrostatic test or be replaced. There is no question that the testing is undertaken to comply with state or federal safety requirements. Additionally, performing

[32] Lauber Rebuttal, at pp. 4-5.

[33] *Id.,* p. 5.

[34] *Id.*

[35] *Id.*

[36] *Id.,* at p. 6.

the test undeniably extends the useful life of the pipeline in question.[37] Staff reads the phrase "other similar projects" to refer to other projects that extend the useful life or enhance the integrity of pipeline system components. Thus, the hydrostatic testing meets all the requirements of the ISRS law.

Staff Accounting Director Mark Oligschlaeger testified that hydrostatic testing of the sort at issue here has been allowed in past ISRS applications and that the safety-related nature of the testing is clear.[38] Further, Mr. Oligschlaeger pointed out that Federal Energy Regulation Commission ("FERC") accounting guidelines allow for capitalization of hydrostatic testing costs in circumstances such as this.[39] While FERC accounting guidance is not binding on the Missouri Commission, it is persuasive.[40] Mr. Oligschlaeger testified that where a pipe segment[41] must be replaced if the testing is not done, then the testing can be considered to extend the segment's useful lifetime.[42]

Mr. Oligschlaeger referenced a FERC document during the hearing as part of the basis for his conclusions that MGE's hydrostatic testing costs incurred during this ISRS period should be capitalized.[43] This document is entitled *Accounting for Pipeline Assessment Costs; Notice of Proposed Accounting Release* ("NPAR"), dated November 5, 2004, and is attached to this brief as Appendix A. The NPAR proposed that FERC require all pipeline assessment costs (including hydrostatic testing) associated with

[37] Tr. 193-194.

[38] Oligschlaeger Rebuttal, p. 11; Tr. 182-183.

[39] Oligschlaeger Rebuttal, p. 11; Tr. 183, 189-190. See Appendix A.

[40] Tr. 190-191.

[41] A "segment" is any of the parts into which something may be divided. **Webster's II New College Dictionary,** p. 1000 (Houghton Mifflin Co.:Boston & New York, 2001).

[42] Tr. 193-194.

[43] Oligschlaeger Rebuttal, p. 11; Tr. 183, 189-190. See Appendix A.

pipeline integrity management programs be expensed for accounting purposes. This document references at several places instances in which one-time pipeline assessment costs that were not incurred by utilities in relation to ongoing pipeline integrity management programs were allowed to be capitalized for accounting purposes by FERC. These instances cited by FERC in which capital treatment of the costs were allowed appeared to be very similar or identical to the circumstances under which MGE incurred the hydrostatic testing costs in question in this proceeding.

The attached NPAR led directly to issuance of a later *Order Accounting for Pipeline Assessment Costs* by FERC, dated June 30, 2005, which was introduced as evidence in this proceeding as OPC Exhibit No. 5. Within this document, FERC took official action to order that, in general, all pipeline assessment costs associated with ongoing pipeline integrity management programs be expensed for accounting purposes as first proposed within the NPAR. A review of both the NPAR and the later FERC *Order* shows that these two documents are not inconsistent with each other in content, and neither document reflects any requirement that hydrostatic testing costs of the nature recently incurred by MGE be expensed for financial reporting purposes, contrary to OPC's assertion.

The standard applicable to the hydrostatic testing costs is found at § 393.1009(5)(b), which provides that eligible projects include "[m]ain relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements[.]" Staff understands the phrase "other similar projects" to refer to the purpose and effect of "extending the useful

life or enhancing the integrity of pipeline system components." Staff does not agree that eligibility under the statute requires any physical alteration of the pipeline.

Based on the evidence before it, the Commission should find that the hydrostatic testing at issue here was an eligible project because it was undertaken for safety reasons and extended the useful lifetime of the pipe segments in question.

D.

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?

The costs associated with replacement of incidental plastic components of mains and service lines incurred by Laclede and MGE are appropriately included for recovery in ISRS rates because they are integral components of the worn-out iron and steel facilities and it is not practicable to retain them in use.[44]

When Laclede and MGE replace a deteriorated steel or cast iron pipeline, some plastic main segments and service lines are also incidentally replaced.[45] The plastic mains and service lines, varying from just a few feet in length to several hundred feet, were installed to fix leaks in the deteriorated steel or cast iron mains.[46] In the replacement process, the steel or cast iron pipeline, including its incidental plastic main segments and service lines, are simply abandoned in place.[47] A new plastic pipeline,

[44] Tr. 182 (Mark Oligschlaeger).

[45] Lauber Rebuttal, pp. 3, 8. Most of the pipe at issue here is 2-inch diameter. Tr. 137.

[46] Lauber Rebuttal, p. 9; Bolin Rebuttal, p. 3. A service line connects a customer's premises to a main. Tr. 140.

[47] Bolin Rebuttal, pp. 3, 6.

with new plastic service lines, is installed at a different location and a different depth.[48] Often, the new pipeline is shorter than the pipeline it replaces due to more efficient installation methods as well as the reduced need to provide back-feed as the system is moved from low pressure to intermediate pressure.[49] In some cases, where a long section of existing plastic pipeline is accessibly located, it is reused as part of the new pipeline.[50] With respect to service lines, Company witness Mark Lauber testified, "You can't replace the main without replacing the service line in most cases. … So now you have a different starting point and different ending point for the service line, and it just makes it infeasible in most cases to use that old service line that was there, even if it was plastic. So that's why you have to run a new service line."[51]

The Companies explained the process in their response to DR 7:

> The 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. The plastic portions were usually put into service when main replacements were being done on a piecemeal basis as leaks were discovered. Please note that the pipeline replacements under the current programs are not generally done through insertion or excavation. Rather, the replacement pipe is placed in its entirety separate from the original main. The original pipe is usually maintained in service so customers do not lose their service while the project is completed and then it is abandoned in place. The entire line was both part of a main replacement project and was worn out or in deteriorated condition. While certain parts of any line may not be in such condition, it is not economically or practically feasible to separate those parts from the entire length of the line. The strategic approach to replacements have [sic] led to efficiency savings by reducing the feet of line installed. (In fact, in this case, the removal of cast iron by itself exceeded the amount of plastic main installed.)[52]

[48] Lauber Rebuttal, pp. 10, 11.

[49] *Id.*, pp. 8, 11.

[50] Tr. 138-139.

[51] Tr. 141, ll. 12-14, and 142, ll. 12-17.

[52] Bolin Rebuttal, pp. 3-4. OPC deceptively reproduced only a small portion of this DR response in Mr. Hyneman's testimony.

Laclede changed its pipeline replacement strategy in 2011 in response to the Gas Distribution Pipeline Integrity Management regulations that came out in the mid-2000s, which required all operators to do risk and threat analyses on their distribution systems.[53] Laclede and MGE performed those analyses and determined that cast iron and steel pipeline, in general, posed a relatively higher threat than the rest of the system.[54] For that reason, the Companies placed a greater emphasis on replacing those pipelines.[55]

OPC's witness Charles Hyneman contends that every single component of the facility being replaced must be in a deteriorated or worn out condition in order for the costs to be ISRS eligible.[56] No one has actually excavated and inspected the pipeline being replaced and Mr. Hyneman's position is based solely upon the lifespans used for depreciation purposes.[57] However, the reality is that depreciable lives are merely estimates based upon a company's history of plant longevity.[58] Depreciable lifespan is not the standard under the ISRS.[59] Any piece of plant can be usable for a period longer or shorter than the estimated depreciable life assigned to the plant in a rate case.[60]

More importantly, Mr. Hyneman's position is contrary to law. Commission Regulation 4 CSR 240-430.30(15), *Replacement Programs,* requires an operator of a

[53] Tr. 128-129; Commission Regulation 4 CSR 240-40.30(17).

[54] Tr. 129.

[55] *Id.*

[56] Lauber Rebuttal, p. 9; Bolin Rebuttal, p. 4.

[57] Bolin Rebuttal, p. 4.

[58] *Id.*

[59] Tr. 166.

[60] Bolin Rebuttal, p. 4.

gas pipeline to initiate replacement, to be completed within 18 months, of all unprotected steel service lines and yard lines in a defined area once 25% or more meet established repair, replacement, and leakage conditions.[61] The same regulation requires the replacement of 10% of unprotected steel service and yard lines annually, without regard to their condition.[62] Likewise, operators of cast-iron pipelines must develop and implement replacement programs, whether the lines are leaking or not.[63] The effect of these regulations is to deem cast-iron and steel mains and service lines to be worn out and deteriorated as a matter of law.[64] Staff suggests that this necessarily encompasses the incidental plastic patches contained in such lines.

OPC's position is contrary to the meaning and purpose of the ISRS statute, which allows for temporary fixes that enhance the integrity or extend the useful life of facilities.[65] It follows that a permanent fix would necessarily replace both the original cast iron mains and the temporary fixes interspersed within those mains.[66] Replacing the plastic pipe that was installed to patch a leak in the cast iron or steel main is an essential and indispensable step in completing the cast iron and steel main replacement projects.[67] Company witness Mark Lauber testified that, in fact, it would be uneconomic, unsafe and operationally impractical to even try to integrate the new plastic pipe with the scattered patches of older plastic pipe that are not even aligned with the new

[61] Rule 4 CSR 240-40.30(15)(C)2; *see* 4 CSR 240-40.30(14), *Gas Leaks.*

[62] *Id.*

[63] Rule 4 CSR 240-40.30(15)(D).

[64] Tr. 149, ll. 15-18: "Mr. Zucker: Q. Do you consider any of the cast iron main to not be worn out or deteriorated? Mr. Lauber: A. In general, I consider it worn out and deteriorated."

[65] Lauber Rebuttal, p. 9.

[66] *Id.*

[67] *Id.*

installation.[68] Mr. Lauber testified that tying-in the incidental plastic main segments with the new plastic main would be more dangerous for Company work crews, would likely result in more damage to third-party property, and would result in a pipeline more prone to leakage.[69] Finally, Mr. Lauber testified that the effect of retiring the incidental portions of plastic main along with the cast iron and steel main was to reduce the amount of the ISRS.[70] In other words, the position taken by OPC, if adopted by the Commission, will result in **significantly more cost to ratepayers.** It will also disincent gas utilities from replacing deteriorated pipelines that contain incidental plastic segments; a result exactly contrary to the legislative purpose embodied in the ISRS law.[71]

Staff witness Kim Bolin explained that OPC's position is contrary to the meaning and purpose of the ISRS law and the Commission's implementing rule:

> The logical result of OPC's interpretation of the ISRS statute and rule language is that a section of pipe should only be replaced if every foot of the entire pipe is found to be worn out or deteriorated. As Laclede had stated in response to OPC Data Request No. 7 that was quoted earlier in this testimony, the reason plastic pipe was replaced was because the majority of the section of pipe was worn out or deteriorated. The plastic pipe that was being replaced as a result of these decisions was only present due to earlier actions to fix leaks in sections of pipe on a piecemeal basis as they were discovered. Hazardous leaks need to be repaired immediately for safety purposes. In other words these sections of plastic pipe were installed to take care of an immediate problem until Laclede could schedule and budget for a larger main replacement. Main replacement is a costly and lengthy process which takes a considerable amount of planning and budgeting.[72]

[68] *Id.*

[69] *Id.,* pp. 10-11.

[70] *Id.,* p. 12.

[71] Bolin Rebuttal, p. 5: "In fact, OPC's proposal would appear to encourage a company to avoid replacing any section of pipe that contains plastic pipe." Tr. 168.

[72] Bolin Rebuttal, pp. 5-6.

Staff's position is that the condition of a pipeline must be evaluated as a whole or unit for replacement purposes. Ms. Bolin testified that Staff supports Laclede's approach of making decisions regarding replacement of mains and service lines based upon the condition of the pipe as a whole, including pipe that may include plastic sections.[73] In this manner, pipe constructed largely of cast iron and bare steel that present safety concerns can be replaced in a timely manner, with the full cost of such replacements appropriately recovered in ISRS charges.[74] The Companies take the same view:

> Q.[75] So is plastic 500-foot main installed in 2011, is that an aging infrastructure?
>
> A.[76] If it's part of a cast iron system, yes.
>
> Q. That plastic segment, is that an aging infrastructure?
>
> A. If you cut out that piece of plastic and hold it in your hands, no, that's not an aging infrastructure. But when it's connected to the cast iron system, it's part of the system and, yes, it is.[77]

With respect to main and service line replacement projects, the standard is set by § 393.1009(5)(a), which defines eligible projects as "[m]ains, 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[.]" In this case, OPC's challenge is that the plastic main and service lines incidentally replaced as components of deteriorated steel and cast iron facilities are ineligible for the ISRS because they are not themselves worn

[73] *Id.,* p. 6.

[74] *Id.*

[75] By Mr. Poston.

[76] By Mr. Lauber.

[77] Tr. 133, ll. 12-22.

out or deteriorated. The Missouri Supreme Court construed § 393.1009(5)(a) in a case in which the Commission had allowed ISRS treatment of the costs of the replacement of pipeline facilities damaged by a third party.[78] The Court reversed the Commission because:

> Accordingly, the PSC's interpretation of the statute is incorrect because it would allow any damage to be eligible for an ISRS surcharge rather than the statutorily limited gas utility plant project as delineated by section 393.1009(5)(a). 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. (Emphasis added).[79]

The Court reached its result through plain-language statutory construction turning on the dictionary meaning of the word "deteriorate."[80] The Court concluded, with respect to the dictionary definition of "deteriorate":

> Clearly, this definition indicates that deterioration is a gradual process that happens over a period of time rather than an immediate event. Had the legislature intended to include the replacement of gas utility plant projects which were damaged by a third party's negligence, it could have inserted different language into the statute to effectuate that intent.[81]

The Commission applied the Supreme Court's decision in a previous Laclede-MGE ISRS case in which Laclede sought ISRS treatment for the cost of replacing telemetry equipment that was no longer supported by its manufacturer.[82] The

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[78] ***In Matter of Verified Application & Petition of Liberty Energy (Midstates) Corp.,*** 464 S.W.3d 520, 525 (Mo. banc 2015).

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] ***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*** and ***In the***

Commission stated:

> 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.

Based on its understanding of the Supreme Court's decision in ***Liberty Energy (Midstates) Corp.,*** the Commission disallowed the telemetry equipment because "Laclede failed to show the specific parts replaced were in an impaired condition."[83]

The question before the Commission is whether the incidental plastic main and service lines that were replaced as part of the replacement of deteriorated steel and cast-iron pipelines were like the damaged pipe disallowed in ***Liberty Energy (Midstates) Corp.*** and the telemetry equipment disallowed in Case Nos. GO-2015-0341 and GO-2015-0343. The answer is that they were not. The statute speaks of "facilities," showing that the legislature intended the Commission to consider a replaced pipeline as a whole or unity as do Staff and Laclede. The plain meaning of "facilities" is "[s]omething that facilitates an action or process" and "[s]omething created to serve a particular function."[84] "Something" is not plural; it refers to a whole or a unity.

This application of the statute is supported by the Commission's own gas safety rules, cited previously. As noted, Regulation 4 CSR 240-430.30(15), *Replacement Programs,* requires an operator of a gas pipeline to initiate replacement, to be

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Matter of the Application of Laclede Gas Company to Change its Infrastructure System Replacement Surcharge in it Missouri Gas Energy Service Territory, Case Nos. GO-2015-0341 and GO-2015-0343 (***Report & Order,*** issued Nov. 12, 2015), pp. 15-16.

[83] *Id.,* p. 16.

[84] **Webster's II New College Dictionary,** p. 401 (Houghton Mifflin Co.:Boston & New York, 2001).

completed within 18 months, of all unprotected steel service lines and yard lines in a defined area once 25% or more meet established repair, replacement, and leakage conditions.[85] That means that replacement is required even though 75% of the lines are still sound. The same regulation requires the replacement of 10% of unprotected steel service and yard lines annually, without regard to their condition.[86] Likewise, operators of cast-iron pipelines must develop and implement replacement programs, whether the lines are leaking or not.[87] Staff again suggests that such lines, required by rule to be replaced, are therefore deteriorated as a matter of law. Either way, a worn out cast-iron or steel pipeline with appurtenant service lines, including incidental plastic "patches," is a facility. As a facility, it is worn out and deteriorated and eligible for ISRS treatment.

How Can Ineligible Costs Be Removed?

The Commission showed interest at the hearing in determining how some portion of the cost of a project might be disallowed to reflect the incidental presence of plastic pipe in the segment that was replaced.[88] To physically remove and inspect the plastic portion of the main or service line in order to verify its condition would be more costly and time consuming than the approach that Laclede and MGE are currently using for most line replacements.[89]

[85] Rule 4 CSR 240-40.30(15)(C)2; *see* 4 CSR 240-40.30(14), *Gas Leaks.*

[86] *Id.*

[87] Rule 4 CSR 240-40.30(15)(D).

[88] E.g., Tr. 170: "Chairman Hall: Q. Can you give me any process by which -- or any methodology that would allow us to back out the costs that we have determined are ineligible from their application?"

[89] Bolin Rebuttal, p. 6.

OPC suggested the use of percentages.[90] From the work orders provided to Staff by Laclede and cited by OPC, Staff has determined that about 16% of the replaced main was plastic while 64% of the replaced service lines were plastic.[91] Likewise, about 13% of the main replaced by MGE was plastic.[92] Service lines were not an issue for MGE because MGE had already replaced most of its service lines in the 1990s in its service line replacement program.[93] However, Staff witness Bolin testified that the use of percentages would not be appropriate.[94] She pointed out that OPC raised this issue and that Staff has not developed a methodology for it.[95] Neither has OPC, who has been unable to even state a specific adjustment amount.[96] Staff witness Oligschlaeger also testified that OPC's percentage method was inadequate.[97]

Conclusion

OPC claims that it is protecting the ratepaying public by enforcing the statutory limitations on the ISRS. However, the reality is something else. OPC loathes the ISRS and is once again trying to limit or even extinguish its use. Why? Consider Mr. Hyneman's direct testimony:

> Q. Does the ISRS surcharge calculation consider a utility's need for a rate increase?

[90] Tr. 172, 179: "Mr. Poston: Q. Okay. How about this: Is one method or solution you determine the percentage of pipe in a work order that's plastic and you multiply that by the total cost for the work order and you remove that cost; is that one method?"

[91] Bolin Rebuttal, pp. 7-8.

[92] *Id.,* p. 9.

[93] *Id.*

[94] Tr. 172-173.

[95] Tr. 175.

[96] *Id.*

[97] Tr. 179, 197-198.

A. No. An ISRS surcharge only includes the cost associated with certain plant projects and does not consider increases in revenues or decreases in other costs that would offset a need for an increase in utility rates imposed by an ISRS surcharge.

Q. Does the ISRS statute allow Laclede to raise rates on its customers regardless of its current profit levels?

A. Yes. Laclede has the authority, subject to limited Commission oversight, to increase its profit levels through this ISRS surcharge even during periods of excessive over-earnings.

OPC is opposed to the ISRS as a matter of policy and seeks to impede its use. What other conclusion can be drawn in this case, where OPC has advanced a position that, if adopted, will greatly increase the costs to ratepayers?

WHEREFORE, Staff prays that the Commission will sustain the applications filed herein as recommended by Staff; and grant such other and further relief as is just in the circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail on each of the parties listed in the Service List for this case maintained by the Commission's Data Center on this 6th day of January, 2017.

/s/ Kevin A. Thompson