

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

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

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

**BRIEF OF THE
OFFICE OF THE PUBLIC COUNSEL**

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Surcharge in its Missouri Gas)
Energy Service Territory)

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Laclede Gas Company to Change its)
Infrastructure System Replacement) Case No. GO-2016-0333
Surcharge in its Laclede Gas Service)
Territory)

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

The Office of the Public Counsel (“OPC”) urges the Public Service Commission (“Commission”) to follow the language and intent of the Infrastructure System Replacement Surcharge (“ISRS”) statutes and permit the Laclede Gas Company (“Laclede Gas”) and Missouri Gas Energy (“MGE”) (collectively "Laclede") ISRS rate mechanisms to recover only costs that are lawfully eligible under Sections 393.1009 to 393.1015 RSMo. The facts demonstrate Laclede’s ISRS petitions include the following ineligible costs: 1) costs incurred replacing miles of plastic pipe not worn out or in deteriorated condition and not required to be replaced by any state or federal law; and 2) costs for hydrostatic testing of transmission lines, which only tests integrity and does not extend the service life or enhance the integrity of the transmission line.

A. Plastic Pipe Ineligibility

The Commission must decide whether costs incurred replacing plastic pipe not worn out or deteriorated are eligible for recovery through the ISRS surcharge under Section 393.1009(5)(a) RSMo. Eligible replacements are limited to:

Mains, valves, service lines, regulator stations, vaults, and other pipeline system components installed to comply with state or federal safety requirements as replacements for existing facilities that have worn out or are in deteriorated condition;

The facts and law before the Commission clearly demonstrate there is no mandate for Laclede to replace plastic pipe that is operating safely. The facts also demonstrate the replaced plastic pipe was not worn or deteriorated in any way.

OPC cautions the Commission not to be distracted by Laclede's arguments regarding the prudence of its new strategy to replace more than the unsafe segments of pipe due simply to Laclede's plan to increase the gas pressure on its system, by Laclede's false threats that safety will be compromised by limiting recovery to worn out or deteriorated replacements, by Laclede's false claims that costs will be saved, or distracted by all other arguments irrelevant to the Commission's sole function to ensure the ISRS petition "complies with the requirements of sections 393.1009 to 393.1015." Section 393.1015.2(4) RSMo. These other extraneous claims and arguments are meant to distract the Commission from confirming whether the petitions include only eligible costs and whether the proposed charges are calculated properly.¹

¹ The Missouri Supreme Court explained the Commission's "*examination may scrutinize the petitioning gas corporation's information to confirm the costs are in accordance with the*

1. Laclede Failed to Demonstrate Plastic Pipe Originally Installed in the 1970s, 1980s, 1990s, 2000s, and 2010s Was Worn Out or Deteriorated Before Replacement

Laclede failed to demonstrate the replaced plastic pipe had any wear or deterioration. Nor could it since the replaced plastic segments of pipe were originally installed in the 1970s, 1980s, 1990s, 2000s, and 2010s. This includes pipe originally installed as recently as 2016.² Laclede Gas' average depreciable life of plastic mains and plastic service lines is 70 years and 44 years, respectively, clearly indicating the vast majority of the replaced plastic pipe was nowhere near the end of its useful service life.³ In fact, Laclede readily admitted the replaced plastic pipe had no wear or deterioration when it was replaced and taken out of service.

When asked during the hearing whether Laclede has provided *any* evidence that the replaced plastic pipe was worn out or in deteriorated condition, Laclede's witness Mr. Glenn Buck testified as follows:

Q. Have you provided any evidence to suggest that any of the replaced plastic mains or service lines were worn out or in deteriorated condition?

A. For those discrete pieces that were replaced, no.⁴

Later, Mr. Buck testified in regard to OPC Exhibit No. 3, which is an example of actual retirements in Work Order 900547 from Laclede's ISRS petition.

ISRS code provisions and confirm the proposed charges are calculated properly." Liberty Utilities v. P.S.C., 464 S.W.3d 520, 522 (Mo. 2015).

² See OPC Exhibit No. 1, Schedules CRH-D-2 and CRH-D-3; See also OPC Exhibit No. 2, titled "900547 Retirements."

³ See OPC Exhibit No. 1, Schedule CRH-D-1.

⁴ Tr. 81.

The exhibit shows Laclede replaced a wide range of pipe segments that varied by material, footage, and vintage. Regarding this example, Mr. Buck acknowledged Laclede replaced plant that was not worn or deteriorated:

Q. And if you turn to the second page, you'll see at the bottom of that page it shows the vintage and footage of the replaced plastic mains, correct?

A. That's correct.

Q. And these replaced mains were initially installed between 1997 and 2011; is that correct?

A. That's correct.

Q. Would you agree with me that these mains were not worn out or in deteriorated condition?

A. I personally didn't look at any of them, but I would assume based on their vintage that, in and of themselves, the plastic main was probably not worn out or in deteriorated condition.⁵

The question of eligibility on the plastic replacements should end here since those replacements fail the statutory requirement that the replaced infrastructure be worn out or in a deteriorated condition.

In an attempt to overcome this disqualifier, Laclede argues the plastic pipe segments were worn out or deteriorated *because the adjoining cast iron and steel segments were worn out or deteriorated*.⁶ This argument is inconsistent with

⁵ Tr. 87-88.

⁶ See OPC Exhibit No. 1, Schedule CRH-D-4, where in response to a data request asking Laclede for a detailed explanation of how a plastic main was worn out or in deteriorated condition, Laclede replied in part, "*The plastic portion of the main was no*

the plain and ordinary meaning of the language in Section 393.1009(5)(a) RSMo. The Supreme Court explained, to determine eligibility, the Commission *must* determine if the existing facilities were worn out or in deteriorated condition. *Office of the Public Counsel v. P.S.C.*, 464 S.W.3d 520, 525 (Mo. 2015). The Court concluded:

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

Id. Hence, only worn out or deteriorated replacements qualify. *Id.* In the Commission's Report and Order issued in Case Nos. GO-2015-0341 and GO-2015-0343, effective December 1, 2015, the Commission referenced the Supreme Court's 2015 decision when it denied Laclede's request to include ineligible replacement costs in an ISRS, and concluded:

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

While it is clear that telemetry equipment plays a vital role in monitoring and ensuring the safe distribution of gas, Laclede failed

longer usable because the cast iron and bare steel main that it was connected to was being replaced."

to show the specific parts replaced were in an impaired condition... **Since the telemetry equipment replacement occurred at the same time as regulator station upgrades, it appears the timing of the replacement was more likely motivated by the efficiency of changing both at the same time than the age of the equipment or any actual impairment.**

Id., pp. 16-17 [emphasis added]. Just as the Commission recognized the telemetry equipment replacements were motivated by the efficiency of replacing the telemetry at the same time Laclede replaced the regulator stations, Laclede's plastic pipe replacements in this case were motivated by the efficiency of replacing the plastic pipe at the same time as it replaced cast iron and steel. This case is nearly identical to the present case because both involve Laclede replacing infrastructure for convenience and strategy and not because of an actual impairment.

Laclede and Staff claim the purpose of the ISRS is to provide an incentive for gas utilities to replace or repair unsafe pipe, yet they interpret the ISRS statute in a manner that does not incentivize the company to prioritize the unsafe cast iron pipe over the safe plastic pipe. By allowing a work crew to incur ISRS eligible costs replacing safe plastic mains, that same crew is simultaneously neglecting unsafe portions of cast iron pipe that should be a higher priority.⁷ Unfortunately, this is exactly what is occurring due to Laclede's 2011 "change in strategy" that changes Laclede's focus from replacing cast iron and steel pipe that could be a threat, to a new focus that replaces safe plastic pipe to increase the system's pressure.

⁷ Tr. 168-169.

2. Laclede's Plastic Replacements are Driven by Laclede's New Strategy to Increase the Pressure on its Distribution System

In 2011, Laclede changed how it performed pipe replacements by moving from a practice where it replaced only the unsafe segment of cast iron or steel pipe, to a new practice where it replaces the unsafe cast iron or steel segments and adjoining plastic segments that are operating safely.⁸ This change was not made to comply with any new state or federal safety laws, since Laclede believes it was in compliance with the law before 2011 when it followed its practice of replacing only the unsafe segments of pipe.⁹ Moreover, Laclede's counsel agreed there is nothing physically preventing Laclede from replacing only those segments of cast iron or steel pipe that are worn out or deteriorated.¹⁰ Laclede's strategy is motivated by factors other than safety requirements or a physical inability to replace only those segments of cast iron and steel main that are worn out or deteriorated.

Rather, this strategy is based on Laclede's decision to increase the pressure of its distribution system from low-pressure to intermediate-pressure, requiring the replacement of all low-pressure mains and service lines with intermediate-pressure mains and service lines. Laclede witness Mr. Mark Lauber corroborated this when he testified that the reason more pipe is abandoned than

⁸ Tr. 65.

⁹ Tr. 67-68.

¹⁰ Tr. 29. Laclede witness Mr. Lauber further testified that Laclede does *not* have to replace the service lines when it installs a new main since it can simply use a "tie-over" or "tie-in" method to connect the existing service line to a new main installed at a new elevation below the ground (Tr. 144). MGE's petition includes multiple tie-overs, whereas Laclede's petition does not (OPC Exhibit No. 1, Schedule CRH-D-3, page 4).

installed is because of "the reduced need to provide back-feed as the system is moved from low pressure to intermediate pressure."¹¹ In other words, a low pressure system requires more mains to create this "back-feed" to ensure gas will continue to flow through the distribution system. With an intermediate pressure system, such back-feeds are unnecessary.

When questioned by Chairman Hall as to whether Laclede was able to reuse some of the existing plastic pipe rather than replace it, Mr. Lauber testified the segments of pipe Laclede reuses are those connected to the higher pressure system and the replaced pipe was on the lower pressure system.¹² This fact is further supported by the work orders authorizations provided to OPC and attached to the testimony of Mr. Charles Hyneman showing Laclede installing pipe designated as intermediate pressure ("IP") and abandoning pipe designated as low pressure ("LP").¹³ OPC witness Mr. Hyneman testified Laclede is "going from a low pressure, which required more plastic pipe in the ground, to an intermediate pressure pipe which requires less pipe, and that's the reason why so much plastic pipe is being replaced."¹⁴ This is why Laclede is replacing recently installed low-pressure pipe with newer intermediate-pressure pipe. Laclede is invested in this wide-spread strategy and the evidence here suggests Laclede will continue regardless of the outcome of this case.

¹¹ Laclede Exhibit No. 3, p. 11.

¹² Tr. 138-139.

¹³ For example, see OPC Exhibit No. 1, Schedule CRH-D-2, page 5 of 33, where the "Reason Code" is "Strategic" and the "WO Description" shows Laclede installed "IP" and abandoned "LP."

This strategy raises an unexplored question. Section 393.1009(3)(a) RSMo prohibits plant projects that “increase revenues by directly connecting the infrastructure replacement to new customers.” Is Laclede’s motivation to increase its operating pressure, and therefore its capacity, caused by a strategic plan to add more customers? This question was not raised or answered within the shortened timeframe of this case, but it does raise an issue that should be explored in the rate case during the prudence review of the ISRS costs. If Laclede’s customers are reducing their gas usage, why would Laclede increase its capacity other than to serve new customers?

3 Depreciation Accounting Allows Laclede to Fully Recover the Costs of Both the 2010 Plastic Pipe and the 2016 Plastic Pipe that Replaced It

When Laclede retires a plastic main that it installed just five years ago, it still recovers from ratepayers the full cost of both the 2010 main abandoned in the ground and the new 2016 main that replaced it and now runs parallel to it just a few feet away. A very basic explanation of this was provided with the following testimony from Laclede’s witness Mr. Buck:

Q. [Y]ou're able to recognize the full value of that plant that was retired?

A. Depreciation is supposed to be self-reconciling, yes.

Q. And so when you retire plant that was installed in 2010 with brand-new plant, you're going to get to recover the full value of both of those?

¹⁴ Tr. 237.

A. Anything that's under or retired early or retired too late is all self-reconciling, correct.

...

Q. [T]here's a profit incentive, wouldn't you agree, you get to earn a profit on each foot of plant you put in?

A. Whether I retire it early or late, I'm still getting a profit or -- on the value of the property in the ground.¹⁵

A slightly more descriptive explanation was provided by Mr. Buck when he discussed the retirement book entries used to record the retirement of a plant asset:

...essentially when you do a retirement, you're taking the gross property out of plant in service. You're also taking the gross value of the property out of your depreciation reserve. So it comes out of plant in service and depreciation reserve.¹⁶

When an asset is retired by Laclede there is no net rate base impact because a utility is required to retire original cost from plant and reduce depreciation reserves by original cost as well. Since the reduction is the same, the net or difference remains unchanged. However, the depreciation reserve is decreased by the entire original cost even if the asset has not been fully collected from rate payers.¹⁷

¹⁵ Tr. 106-107.

¹⁶ Tr. 90.

¹⁷ FERC Title 18: Conservation of Power and Water Resources Part 201—Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions Of the Natural Gas Act (Gas Plant Instruction 10 B.) It states: “B. The addition and retirement of retirement units shall be accounted for as follows: (1) When a retirement unit is added to gas plant, the cost thereof shall be added to the appropriate gas plant account, except that when units are acquired in the acquisition of any gas plant constituting an operating system, they shall be accounted for as provided in gas plant

Accordingly, the more plant Laclede installs, the more Laclede profits and customers are left paying for both the replaced plastic and new plastic.

4. Laclede Failed to Demonstrate the Plastic Pipe Replacements Were Required by State or Federal Gas Safety Requirements

To be a replacement eligible for recovery through the ISRS, the replacement must also be made "to comply with state or federal safety requirements" that mandate the replacement of facilities that are worn out or deteriorated. Section 393.1009(5)(a) RSMo. Laclede identified no state or federal gas safety requirements compelling Laclede to replace plastic pipe that was not worn out or deteriorated. Laclede cites vaguely to four laws, but upon inspection not one of the safety requirements cited by Laclede requires a gas utility to replace safe segments of plastic pipe.

Laclede's entire argument falls apart when one considers Laclede's position is that prior to 2011 its practices were lawful when it replaced only the segment of pipe that was worn or deteriorated, leaving the adjoining segments of pipe in place.¹⁸ There has been no change in the Commission's gas safety laws – or

instruction 5. (2) When a retirement unit is retired from gas plant, with or without replacement, the book cost thereof shall be credited to the gas plant account in which it is included, determined in the manner set forth in paragraph D, below. If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to gas plant shall be charged to the accumulated provision for depreciation applicable to such property. The cost of removal and the salvage shall be charged or credited, as appropriate, to such depreciation account.”

¹⁸ Tr. 67-68.

other laws for that matter - to warrant such a change in interpretation. The gas safety requirements in 2011 are the same gas safety requirements in place today.

Laclede cites to Section 393.130 RSMo, 4 CSR 240-40.030(13), 4 CSR 240-40.030(15), and 4 CSR 240-40.030(17) for its alleged authority.¹⁹ There is no language within the statute and rules cited by Laclede that can be interpreted to require Laclede to follow this new strategy it has singlehandedly placed upon itself. As further explained below, there is no requirement, direct or indirect, that Laclede replace safe plastic pipe.

i Section 393.130 RSMo Does Not Require the Replacement of Safe Plastic Pipe

The first authority cited by Laclede is Section 393.130 RSMo - the general safety law requiring a gas utility's facilities to be "safe." This statute makes no mention of pipe replacements or replacement practices, and includes the same general language now as it did when Laclede began charging an ISRS in 2004. This law does not require the replacement of safe and properly functioning plastic pipe any more than it requires Laclede to replace work trucks purchased in 2016 with all new work trucks. Laclede must find a far more specific authority to be able to reach the conclusion that replacing recently installed plastic is *required*.

ii. 4 CSR 240-40.030(13), "Maintenance," Requires Only the Replacement of Each Unsafe Segment

Laclede next cites to 4 CSR 240-40.030(13) for the gas safety requirement that compelled Laclede to replace safely-functioning plastic pipe. But this too fails to support Laclede's new interpretation of the Commission's long-standing gas

safety rules. Commission rule 40.030(13)(B)(2) states in relevant part, "[e]ach segment of pipeline that becomes unsafe must be replaced, repaired, or removed from service." "Segment" is not defined in the Commission's rules, but its usage in 40.030(13)(B)(2) establishes at a minimum that it is less than the length of a pipeline. Rule 40.030(13)(B)(2) requires no more than the replacement, repair, or removal of one continuous and un-jointed portion of pipe since a leak threatens only the integrity of that un-jointed segment. This is especially true when the adjoining pipe is of an entirely different material (cast iron, steel, copper, or plastic) and vintage. The rule requires replacement or repair of the impaired segment only since replacing the adjoining segments would be entirely unnecessary and would needlessly increase rates. Laclede's witness, Mr. Glenn Buck, agreed:

Q. ...this requirement only requires you to replace the segment that becomes unsafe. Would you agree with that?

A. That's correct.

Q. Does not require you to replace an adjoining segment that is not unsafe, correct?

A. I think that's correct, yes.²⁰

OPC concurs with Mr. Buck's understanding of the Commission's rule. There would be no logical reason for the rule to require Laclede to replace any more plant than necessary to bring the system back into compliance with safety requirements.

¹⁹ See OPC Exhibit No. 2; Tr. 62-63.

²⁰ Tr. 70.

Before 2011, Laclede interpreted this rule to require Laclede to replace only the cast iron or steel portion of pipe that was actually in an unsafe condition.²¹ Laclede now interprets the word "**segment**" as broadly as possible to require the replacement of the unsafe cast iron or steel portion of pipe along with adjoining *safe* plastic portions of pipe. There is no support for this interpretation that was raised in an attempt to overcome an obvious weakness in the Laclede and Staff arguments; that is, the lack of a state or federal safety requirement that Laclede is complying with when it replaces plastic pipe that is neither worn out nor deteriorated.

An entirely illogical interpretation of 4 CSR 240-40.030(13) was presented to the Commission during the hearing highlighting the unreasonableness of the Laclede/Staff interpretation. Staff witness Ms. Kimberly Bolin addressed the 4 CSR 240-40.030(13) requirement that any unsafe "segment" of pipe be replaced, repaired, or removed, and suggested that a "segment" of pipe could be interpreted to be a 30-mile pipeline between Fulton and Columbia.²² In other words, the Staff's position is any deterioration could *require* Laclede to replace the entire 30 miles. Arguments such as this appear more aimed at winning rather than presenting the Commission with facts upon which to make an informed decision.

Ms. Bolin's testimony on what constitutes a segment is also entirely inconsistent with her earlier hearing testimony when she stated, "*I don't know how you define a segment exactly, but it's a piece of pipe that they've had to use to fix a*

²¹ Tr. 67-68.

²² Tr. 173.

leak or a problem.”²³ Here Ms. Bolin testified that each portion of plastic pipe installed previously to replace cast iron or steel constitutes a separate “segment” of pipe, which means the cast iron and steel pipe Laclede replaced in this case also constitutes separate segments of pipe.

Guidance on what constitutes a “segment” can also be found in how the word is used throughout the Commission’s gas safety rules. For example, Commission rule 4 CSR 240-40.030(10)(F)1 states:

Each segment of a service line (other than plastic) must be leak tested in accordance with this subsection before being placed in service. If feasible, the service line connection to the main must be included in the test; if not feasible, it must be given a leakage test at the operating pressure when placed in service.

This rule establishes that mains and service lines do not constitute a single segment, and even within a service line, there can be further segmentation. In addition, Commission rule 4 CSR 240-40.030(10)(G)1 states, “Each segment of a plastic pipeline must be tested in accordance with this subsection,” indicating that even within a plastic pipeline there are multiple segments.

Another telling usage of the word appears in 4 CSR 240-40.030(7)(F) regarding general construction requirements for mains:

Repair of Plastic Pipe During Construction. (192.311) Each pipe segment containing imperfection or damage that would impair the serviceability of plastic pipe must be removed.

This rule establishes that a segment is defined as a segment *before* installation, and *before* being connected to other segments already in the ground.

²³ Tr. 163-164.

Logically, “segment” as used in 4 CSR 240-40.030(13) of the Commission’s gas safety rules should be defined as a continuous unbroken or un-jointed portion of pipe as originally installed, or as further segmented after installation to make repairs as necessary. Laclede’s new strategy of replacing safe plastic segments simply because they adjoin cast iron or steel segments is not required by Rule 40.030(13), and does not satisfy the important ISRS eligibility criterion that replacements be “installed to comply with state or federal safety requirements as replacements for existing facilities that have worn out or are in deteriorated condition.” Section 393.1009(5)(a).

iii. 4 CSR 240-40.030(15), "Replacement Programs," Does Not Require the Replacement of Safe Plastic Pipe

Laclede also relies on 4 CSR 240-40.030(15) for the authority it alleges requires it to replace safe pipe at the same time it replaces adjoining unsafe pipe. The actual language of the regulation dispels Laclede’s argument because it refers specifically to “cast iron” with no mention of plastic pipe. Laclede has ended all of its pipeline replacement programs with the exception of its cast iron main replacement program, which explains Laclede’s attempt to tie its plastic replacements to cast iron. But when asked to point to any language in Section 15, or anywhere else requiring Laclede to replace plastic or polyethylene pipe, Laclede’s witness could not.²⁴ This rule cannot be relied upon as a requirement to replace safe plastic pipe.

²⁴ Tr. 77.

iv. **4 CSR 240-40.030(17), "Gas Distribution Pipeline Integrity Management," Does Not Require the Replacement of Safe Plastic Pipe**

Laclede's last claim of authority requiring the plastic replacements is 4 CSR 240-40.030(17), which requires gas companies to develop a written integrity management plan to identify threats to a gas distribution system in the following categories: "corrosion, natural forces, excavation damage, other outside force damage, material or welds, equipment failure, incorrect operation, and other concerns that could threaten the integrity of its pipeline." 4 CSR 240-40.030(17)(D)2. Laclede has identified no credible threat to its system that would require it to take the drastic step of replacing miles and miles of plastic pipe that is operating safely and in compliance with all gas safety requirements as intended.

Threats identified under an integrity management plan are to be based on verifiable data sources such as "incident and leak history, corrosion control records, continuing surveillance records, patrolling records, maintenance history, and excavation damage experience." *Id.* In response to Laclede witness Mr. Lauber's insinuation that Laclede's pipe joints created a safety concern, OPC attempted to determine if there were any safety concerns regarding Laclede's pipe joint fittings when it requested Laclede's Mechanical Fitting Failure Reports required to be filed with the Commission annually by 4 CSR 240-40.030(7).²⁵ Laclede has not provided those reports or any other record to corroborate its new plastic pipe replacement strategy as having anything to do with a true integrity management plan or any safety threat to its distribution system. In fact, Mr. Lauber testified that Laclede's

pipe joints were in compliance with all gas safety rules.²⁶ Laclede's citation to this rule is nothing more than another unconvincing attempt to impermissibly sneak costs unrelated to ISRS eligible projects through the surcharge.

Laclede has not identified a single state or federal safety requirement that mandates the widespread replacements contemplated by Laclede's new strategy. This truly is the product of a strategy to move Laclede's system from low pressure to intermediate pressure. Accordingly, Laclede's ISRS petitions, with regard to the replacement of safe plastic pipe, do not satisfy the ISRS-eligibility requirement that the replacements be required by state or federal law.

5. How Should Laclede Account for Ineligible Costs?

Questions arose during the hearing as to how Laclede would determine the costs to be removed from the ISRS petitions should the Commission conclude the plastic pipe replacements are not eligible. Laclede demonstrated an ability to determine the pipe material, length, and vintage in each work order when sought by the OPC.²⁷ Laclede also demonstrated it could determine how much plastic was removed:

CHAIRMAN HALL: If the Commission were to determine that the plastic patches replacement is not ISRS eligible, is it possible to determine what percentage of the ISRS request will be ineligible? Is that -- is there a mathematical way to do that?

MR. ZUCKER: It would take a lot of work, but I think that we have numbers about how much plastic was replaced at the time

²⁵ Tr. 143.

²⁶ Tr. 143.

²⁷ See OPC Exhibit No. 3; see also Tr. 98-99.

we replaced cast iron. It's a minimum. It's a minimal amount of the total amount, but we could figure it out.²⁸

This was later confirmed by Laclede witness Mr. Buck when he testified, “I'm sure there are a lot of different ways it could be done.”²⁹ Mr. Buck further agreed that it would be “possible” to determine the ineligible amount of plastic by using a simple average.³⁰ For example: If, in a given work order the plastic replacements were 10% of the total replacements, the Commission could reduce the total amount of the work order cost by 10% for ISRS purposes.³¹ This was the *only* method proposed by any party as both Laclede and Staff witnesses refused to come up with a method for calculating the ineligible costs.

If Laclede is unwilling to calculate the footage and/or cost of the ineligible portion of plastic replacements despite having more than enough time to do so, the Commission has limited options in how it should decide this issue. The Commission should deny the petitions in their entirety since the Commission is only able to approve a petition if it “finds that a petition complies with the requirements of sections 393.1009 to 393.1015.” *See* Section 393.1015.1(4) RSMo.

Alternatively, the parties could agree upon a reasonable amount that provides a rough approximation of the costs of the ineligible plastic replacements and remove those costs from these petitions, with the understanding that the parties will develop a more precise method before Laclede’s next ISRS case. In that

²⁸ Tr. 30-31.

²⁹ Tr. 101.

³⁰ Tr. 102.

³¹ Tr. 101-102.

next case the ISRS would be reconciled with a more accurate accounting of the ineligible costs.

Laclede suggested during the hearing that in instances where the eligible footage retired was more or equal to the footage installed, the Commission could assume the entire work order is eligible. The Commission should avoid any such “solution” to Laclede’s ineligible replacements because it ignores the fact that ineligible plastic pipe *was* replaced causing Laclede to incur costs included in the work order. If the Commission were to follow such a solution, would it also reject all costs in projects where the total amount of plastic removed exceeded or approximated the total amount of plastic installed?³² In work order 900547, for example, Laclede retired 6,654 feet of plastic service lines that were not worn out or deteriorated, but installed only 6,390 feet of new plastic service lines.³³ The amount of steel or copper service lines retired in that same work order was 2,604 feet. Just as it would be unreasonable to recognize only cast iron main replacements where they exceed the total installed, it would also be unreasonable to recognize only plastic service line replacements where they exceed the total installed. In either scenario, the solution to removing the ineligible costs should recognize all replacements.

There should be no question the parties have the ability to develop a reasonable solution should the Commission order the parties to remove the ineligible plastic. Mr. Hyneman and Ms. Bolin both testified that inexact cost

³² Tr. 246.

³³ Laclede Exhibit No. 2, Revised Rebuttal Schedule GWB-1.

allocation methods are used in other contexts where warranted, and this may be another such context where the solution may need to be inexact.³⁴

To avoid this problem of how to account for the ineligible costs in the future, OPC requests the Commission order Laclede to modify its accounting systems in a manner that allows it to separate out the eligible projects from the ineligible projects, rather than combine the two in “blanket work orders.” During opening arguments, OPC counsel referenced a Kansas Corporation Commission (“KCC”) decision regarding the Kansas version of an ISRS (Kansas GSRS). The Kansas GSRS was borrowed from and is nearly identical to the Missouri ISRS. In a 2009 case, the KCC encountered similar problems with a utility combining ineligible with eligible projects in a blanket work order and held:

As part of its investigation Staff also performed an audit of KGS' application to ensure that the revenue requirement calculation was conducted accurately and based solely on the GSRS projects included in the application. Staff discovered no errors associated with the accounting audit. However, Staff noted its concern of KGS' use of blanket work orders that include both GSRS eligible and non-GSRS eligible projects. Staff recommended KGS be required to implement a new blanket work order accounting system that separates GSRS eligible projects from the non-GSRS projects in order to protect against the possibility of cost shifting between the project classifications. The Commission agrees with Staff's recommendation.³⁵

A similar Commission order in this case would hopefully avoid future conflicts in Laclede's ISRS petitions.

³⁴ Tr. 232; Tr. 172-173.

³⁵ 2009 Kan. PUC LEXIS 1456, 6-7 (Kan. PUC 2009).

B. Hydrostatic Testing

Hydrostatic testing is a process where a gas utility fills a pipe with pressurized water to identify leaks in that segment of pipe.³⁶ OPC identified at least two projects included in MGE's petition seeking to recover the costs of these pressure tests. These costs must be removed from MGE's ISRS petition because hydrostatic testing is ineligible for recovery. To be eligible for ISRS recovery under Section 393.1009(5)(b), costs must meet three criteria relevant to this issue.³⁷ First, the projects must be a main relining project, a line insertion project, a joint encapsulation project, or "other similar project." Second, the project must extend the useful life or enhance the integrity of pipeline system components. Lastly, the cost must be a capital cost item and not an expense item. Laclede's hydrostatic testing costs fail all three.

1. Hydrostatic Testing is Not Similar to Main Relining Projects, Line Insertion Projects, or Joint Encapsulation Projects

Laclede claims the hydrostatic tests are eligible for ISRS recovery pursuant to Section 393.1009(5)(b), which states that eligible projects must consist of the following:

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.

³⁶ Laclede Exhibit No. 3, pp. 3-4.

³⁷ Eligible projects under Section 393.1009(5)(b) must also be undertaken to comply with state or federal safety requirements. OPC does not at this time contest that Laclede performed the tests to comply with a federal safety requirement.

To be a qualifying project, it first must be a main relining project, service line insertion project, joint encapsulation project, or "other similar project." Laclede is not claiming the hydrostatic test is one of the three listed project types. Rather, Laclede is claiming it is an "other similar project."

Laclede's engineering witness, Mr. Lauber, testified that a main relining project involves relining the interior of a pipe, which he agreed was more than just a test of the line.³⁸ Mr. Lauber testified a service line insertion project involves inserting a new line into an old line, which he also agreed was more than just a test of the line.³⁹ Lastly, Mr. Lauber testified a joint encapsulation project involves placing a clamp, sealant, or mold over the joint that connects two pipe segments, which he also agreed was more than just testing the line.⁴⁰ All three types of projects identified by Section 393.1009(5)(b) RSMo involve a physical improvement to the pipe to extend its useful life or enhance its integrity. Hydrostatic testing is nothing more than a test to determine whether the pipe has leaks. If a leak is identified, and a replacement or repair is necessary, the work to replace or repair that pipe may qualify for ISRS but not the test. A hydrostatic test is in no way "similar" to the three identified projects and therefore not an eligible project under Section 393.1009(5)(b) RSMo.

³⁸ Tr. 123.

³⁹ Tr. 123-124.

⁴⁰ Tr. 124.

2. Hydrostatic Testing Does Not Extend the Useful Life or Enhance the Integrity of a Transmission Line

Projects eligible under Section 393.1009(5)(b) RSMo must also extend the useful life or enhance the integrity of pipeline system components. Laclede's witness, Mr. Lauber, testified the hydrostatic test makes no improvements or physical changes to the pipe.⁴¹ Accordingly, this testing does not extend the useful life or enhances the integrity of the pipeline. If a main's destiny is that it will give out ten years from today, the hydrostatic test in no way prolongs the life of the main or enhances its integrity. The main will still give out ten years from today.

The Federal Energy Regulatory Commission ("FERC") considered this very issue - whether a hydrostatic test extends the useful life of a pipe - and the FERC concluded that it does not. OPC Exhibit Number 5 is the FERC's June 30, 2005, *Order on Accounting for Pipeline Assessment Costs* issued in FERC Docket No. AI05-1-000.⁴² The FERC provides guidance on this issue when it concluded:

Broadly speaking, pipeline assessment activities provide information about the condition of existing facilities to ensure that operation of the pipeline remains within established safety parameters. The act of inspecting or assessing a pipeline segment does not by itself increase the useful life of a pipeline asset or improve its efficiency.

Laclede claims the act of testing or assessing a pipe segment by itself increases the useful life of Laclede's pipeline. The FERC would disagree.

⁴¹ Tr. 121.

⁴² 111 FERC ¶61,501.

The Missouri General Assembly would also disagree. Had they intended to allow mere testing or assessment costs into the ISRS, the General Assembly would not have included the requirement that eligible projects must extend the useful life or enhance the integrity of the pipe. By including these restrictions in the ISRS statute, the General Assembly intentionally *prohibits* the very type of testing costs Laclede now seeks to include.

Laclede argues a hydrostatic test extends the useful life of a pipe because it allows Laclede to determine whether the pipe needs repair or needs to come out of service, and if it does not need to come out, it extends the life of that pipe. Again, the hydrostatic test is nothing more than an assessment of the pipe's condition. Laclede performs a variety of testing and assessment activities on its mains and service lines such as leak detection surveys that it readily admits do not qualify for ISRS.⁴³ A hydrostatic test is no different.

Projects that extend the useful life of infrastructure, according to Mr. Lauber, include joint encapsulation projects or a cathodic protection projects.⁴⁴ Joint encapsulation wraps and protects the joint, thus slowing the rate of corrosion and prolonging the life of the joint and the connected pipe.⁴⁵ A cathodic protection project involves connecting anodes to a steel pipe to manipulate the flow of electrons through the pipe, which slows down the corrosion of the pipe.⁴⁶ This extends the useful life of the pipe.

⁴³ Tr. 125-127.

⁴⁴ Tr. 124-125.

⁴⁵ Tr. 124.

⁴⁶ Tr. 124-125.

Laclede even acknowledged that when it performs a leak test on a service line to determine if the service line is leaking, such test *does not* extend the useful life of the service line.⁴⁷ Laclede provided no explanation for the discrepancy in its positions between testing a service line, which they say does not extend the life, versus testing a transmission line, which Laclede says does extend the life. The reason for this contradiction is clear – the cost of testing a transmission line through hydrostatic testing is significant. The cost difference does not change the fact that both tests merely assesses the pipe to determine its integrity and do not add any time whatsoever to the life of that pipe.

3. Hydrostatic Testing is Not a Capital Cost

If the Commission determines hydrostatic testing costs do not satisfy the eligibility criteria discussed above, the Commission does not need to address this final reason for excluding the hydrostatic testing costs. However, should the Commission address this final eligibility criteria, the Commission should conclude hydrostatic testing is a maintenance expense, consistent with FERC accounting standards and orders, not a capital cost eligible for inclusion in an ISRS.

Laclede and Staff both agree that eligible costs must be capital costs, and not expense items.⁴⁸ Commission rule 4 CSR 240-40.040 adopts the FERC's Uniform System of Accounts ("USOA") for natural gas companies as the required accounting standards. Under the USOA, testing of a pipeline is a maintenance expense and not a capital cost. OPC Exhibit No. 4 includes the relevant section of

⁴⁷ Tr. 127.

⁴⁸ Tr. 22-23; Tr. 83.

the USOA on “Maintenance” and states operating expenses include, “*Inspecting, testing, and reporting on condition of plant specifically to determine the need for repairs, replacements, rearrangements and changes and inspecting and testing the adequacy of repairs which have been made.*”⁴⁹ Staff witness, Mr. Mark Oligschlaeger, agreed that the USOA requires a gas utility to treat testing as an expense and not a capital cost.⁵⁰

Mr. Oligschlaeger qualified his response, however, and stated there are exceptions to the general rule that allow hydrostatic testing to be capitalized. When asked to identify those exceptions, he referred to a letter from a FERC chief accountant in 2004.⁵¹ Mr. Oligschlaeger was referring to a November 5, 2004 *Notice of Proposed Accounting Release (“Proposed Accounting”)*, which as its title indicates, was nothing more than proposed accounting standards.⁵² Such notice of proposal is similar to this Commission issuing a notice of proposed rulemaking. Such proposals do not establish precedent and are merely notifying the public of action the agency is considering, while also soliciting comments on that proposed action.

The FERC document in evidence, OPC Exhibit No. 5, is the actual FERC *Order on Accounting for Pipeline Assessment Costs (“Final Order”)* issued on June 30, 2005. The FERC took into consideration the comments received and issued the

⁴⁹ Part 201 – Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act, Operating Expense Instructions, Maintenance (p. 632) [emphasis added].

⁵⁰ Tr. 189.

⁵¹ Tr. 189.

⁵² *Accounting for Pipeline Assessment Costs*, Notice of Proposed Accounting Release, Docket No. AI05-1-000 (November 5, 2004), 69 Fed. Reg. 67,727 (November 19, 2004).

FERC's *Final Order* on the issues raised in the *Proposed Accounting*. The *Proposed Accounting* referenced by Mr. Oligschlaeger is nothing more than a solicitation for comments, not an authoritative document upon which to rely for guidance on how to account for pipeline assessment costs.

The FERC's *Final Order* states that it addresses the issues proposed to be addressed in the *Proposed Accounting* along with additional issues not addressed in the proposal. The language of the *Final Notice*, and the *Proposed Accounting*, both recognize the document relied upon by the Staff as nothing more than a proposal with no precedential value.

Having established that the *Final Order* is the official guidance on pipeline assessment activities, OPC directs the Commission to the specific language of the *Final Order* where the FERC concludes without question that hydrostatic testing costs are expense items that are not to be capitalized. OPC encourages the Commission to read through the Order, in particular the following conclusions:

The Commission's accounting rules provide that costs incurred to inspect, test and report on the condition of plant to determine the need for repairs or replacements are to be charged to maintenance expense in the period the costs are incurred.⁵³

Further, as noted above, the Commission's accounting rules provide that costs incurred to inspect, test and report on the condition of plant to determine the need for repairs or replacements are to be charged to maintenance expense. Accordingly, costs to inspect affected pipeline segments under

⁵³ *Final Notice*, p.7, para 21.

an IM program must be charged to maintenance expense in the period the costs are incurred.⁵⁴

The FERC also explained when capitalization would be appropriate; “If an entity replaces a retirement unit as part of a remedial action, then those costs should be capitalized to the appropriate plant account.”⁵⁵

A year following the *Final Order*, the Natural Gas Pipeline Company of America (“Natural”) filed a letter with the FERC requesting confirmation that it may capitalize costs incurred conducting “spike testing,” a form of hydrostatic testing. The FERC reaffirmed its *Final Order* and stated:

[T]he Commission finds that the primary purpose of spike pressurization is to serve as an assessment tool rather than a remediation tool. Based on statements by Natural, gas industry literature, and information obtained from the U.S. Department of Transportation spike pressurization is primarily a type of hydrostatic test used to reveal critical cracks that threaten the pipeline’s integrity, albeit with the added benefit of blunting minor cracks. Therefore, Natural must expense rather than capitalize the cost of spike pressurization under the Commission’s accounting requirements, as set forth in the June 30 Order [*Final Order*].⁵⁶

The rebuttal testimony of Laclede witness, Mr. Lauber, claims the hydrostatic test Laclede performed was part of Laclede’s integrity management testing, referring specifically to the state and federal integrity management rules.⁵⁷

⁵⁴ *Id.* p. 9, para. 27.

⁵⁵ *Id.*, p. 9, para. 28.

⁵⁶ FERC Docket No. AC06-18-000, Natural Gas Pipeline of America, June 5, 2006. (Attached).

⁵⁷ Laclede Exhibit No. 3, p. 5, *citing* 4 CSR 240-40.030(16), and 49 CFR part 192 Subpart O, both titled ““Pipeline Integrity Management for Transmission Lines.”

While not evidence, Laclede's counsel contradicted Mr. Lauber's characterization that the test was part of "integrity management," and attempted to backtrack away from this evidence - painting the tests as being similar to a test conducted *before* a pipe is put into service.⁵⁸ Laclede's counsel is essentially contradicting Laclede's own engineering witness' testimony on the purpose of the hydrostatic test.

Apparently, Laclede's counsel found some authority he believes creates an exception when a test is performed before a pipe is put into service to determine the pipe's maximum operating pressure. Laclede now wants the Commission to believe a test done in 2016 on a line installed before 1970 should be treated as if the test was performed in the 1960s before the pipe was installed. This is nothing more than an absurd attempt to mischaracterize Laclede's activities in order to get capitalization treatment of a maintenance expense.

If the Commission weighs in on this issue, OPC urges the Commission to follow the guidance from the FERC on interpreting its own accounting standards and find Laclede's hydrostatic test costs are operating expenses, not capital costs, and are therefore not to be recovered through the ISRS. As OPC witness Mr. Charles Hyneman testified in response to a question from Chairman Hall, excluding the hydrostatic testing costs from the ISRS does not mean Laclede would be unable to recover those costs because as an operating expense Laclede would be able to fully recover the hydrostatic testing costs through the company's base rates.⁵⁹

⁵⁸ Tr. 21.

⁵⁹ Tr. 229.

C. Laclede's Objection to the Standard Procedure

Laclede has once again raised an objection to the procedure followed by the Commission and followed by OPC when OPC requested a hearing ten days after the Staff filed its report. Laclede's argument has no merit and should be once again dismissed for the following reasons:

- OPC fully complied with the ISRS statutes, which specifically apply the 60-day requirement to the Staff's submission of a report, not OPC's request for a hearing;
- The Commission held in GO-2016-0196 and 0197 that OPC's request for a hearing 10 days after the Staff report is "lawful";⁶⁰
- OPC's filing was consistent with established precedent where OPC followed the same practice in five previous cases and filed its request between six and ten days after the Staff report;⁶¹
- OPC complied with all Commission orders in this case, which did not direct OPC to file any sooner;⁶²
- Laclede delayed OPC's ability to respond sooner by unlawfully responding a week late to OPC data requests, despite the answers being due *before* the Staff report was due;

⁶⁰ *Order Denying Motion for Reconsideration of Procedural Schedule*, Case Nos. GO-2016-0196 and 0197, April 14, 2016.

⁶¹ See Case Nos. GO-2014-0006, GO-2014-0179, GO-2014-0212, GO-2016-0196 and GO-2016-0197.

⁶² See *Order Directing Filing and Suspending Tariff*, October 3, 2016; and *Order Establishing Time to Respond to Staff Recommendation*, November 29, 2016.

- Laclede waited the full 20 days, or responded late, to all OPC data requests, but answered all Staff requests within less than 5 days on average;
- OPC's request for a hearing actually provided Laclede with substantially more than what is required. OPC identified all issues with specificity, with citations to evidence and law, when it could have waited for direct testimony to provide this information;

The statutory 60 day requirement specifically applies to the Staff's report regarding the Staff's examination. Section 393.1015.2(2) RSMo. The General Assembly could have placed a similar requirement on OPC, but did not, as the Commission found previously on this matter in the last ISRS cases where Laclede raised this same issue and the Commission concluded Laclede's legal interpretation was incorrect.⁶³ Now Laclede, and the Commission's own Staff, challenge the Commission's legal conclusions. Those arguments should be rejected once again as they were less than a year ago.

Contrary to what Laclede would have the Commission believe OPC has never argued or claimed that the 60 day requirement applies to OPC. However, OPC does recognize that if it does not raise issues within 10 days after the Staff report, it runs the risk of the Commission approving the petition.

To now hold OPC to a different standard than the established practice OPC has followed in all prior ISRS cases, and which the Commission has determined is lawful, would be an unlawful violation of OPC's right to due process.

D. Conclusion

OPC asks the Commission to keep in mind that Laclede has the burden to prove the work orders it seeks to include in the ISRS are lawfully eligible. Section 393.150.2 RSMo states, “At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the gas corporation.” Laclede/Staff have failed to meet their burden on all three issues before the Commission. Accordingly, OPC urges the Commission to order Laclede Gas and MGE to remove the ineligible plastic pipe replacement costs and the ineligible hydrostatic testing costs from their proposed ISRS rate increases.

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 6th day of January 2017.

/s/ Marc Poston

⁶³ *Order Denying Motion for Reconsideration of Procedural Schedule*, Case Nos. GO-2016-0196 and 0197, April 14, 2016.