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GR-2017-0215
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REBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS COMPANY
MISSOURI GAS ENERGY

CASE NO. GR-2017-0215

CASE NO. GR-2017-0216

October 17, 2017

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

In the Matter of Laclede Gas Company's)
Request to Increase Its Revenues for Gas) Case No. GR-2017-0215
Service)


In the Matter of Laclede Gas Company)
d/b/a Missouri Gas Energy's Request to) Case No. GR-2017-0216
Increase Its Revenues for Gas Service)

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Charles R. Hyneman, of lawful age and being first duly sworn, deposes and states:


1. My name is Charles R. Hyneman. I am the Chief Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


Charles R. Hyneman, C.P.A.
Chief Public Utility Accountant

Subscribed and sworn to me this 17th day of October 2017.



JERENE A. BUCKMAN
My Commission Expires
August 23, 2021
Cole County
Commission #13754037


Jerene A. Buckman
Notary Public

My Commission expires August 23, 2021.

TABLE OF CONTENTS

<u>Testimony</u>	<u>Page</u>
Introduction	1
Staff's Ratemaking Treatment of the Gain on Sale of Forest Park Properties	2
Carrying (financing) Cost of Laclede and MGE's Natural Gas Inventories	6
Supplemental Executive Retirement Plan Expense ("SERP")	16
Staff's Prior Position - Lump Sum SERP Payments Must Be Known and Measurable	18
Staff's Prior Position – SERP Payments Must Be Reasonable and Limited	21
Staff's SERP Adjustment for Laclede and MGE In This Rate Case	22
Staff No Longer Applies A Known and Measurable Standard to Utility SERP Expense	23
Staff No Longer Applies A Reasonableness Test to Utility SERP Expense	24
Correction to Staff's SERP Calculation	27
SERP Capitalization	28
Laclede's SERP Payments to Retired Executives Provide No Benefit to MGE Ratepayers	30

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OF

CHARLES R. HYNEMAN

**LACLEDE GAS COMPANY
MISSOURI GAS ENERGY**

CASE NO. GR-2017-0215

CASE NO. GR-2017-0216

1 **Introduction**

2 **Q. Please state your name, title and business address.**

3 A. Charles R. Hyneman, Chief Accountant, Office of the Public Counsel (“OPC” or “Public
4 Counsel”), P.O. Box 2230, Jefferson City, Missouri 65102.

5 **Q. Are you the same Charles R. Hyneman who filed direct testimony in these proceedings?**

6 A. Yes, I am.

7 **Q. Please list the witnesses who will be filing rebuttal testimony on behalf of the OPC in
8 this case and the issues they will be addressing.**

9 A. OPC witnesses and the rebuttal issues are shown below:

OPC Witness	Issues Addressed in Rebuttal Testimony
Amanda Conner	Management Expenses/New Credit Card Fees/Cash Working Capital (“CWC”)
David Pitts	Pensions and OPEBs/Prepaid Pension Asset
Michael Gorman	Capital Structure
Charles Hyneman	Forest Park Gain on Sale/Supplemental Executive Retirement Plan (“SERP”) expenses/Ratemaking Treatment of Gas Inventory Carrying Costs
Lena Mantle	Low Income Affordability
John Robinett	Depreciation/RWIP adjustments /Combined Heat & Power (CHP)

1 **Staff's Ratemaking Treatment of the Gain on Sale of Forest Park Properties**

2 **Q. Did Laclede recognize a gain on the sale of its Forest Park properties?**

3 A. Yes. In Laclede's press release dated November 24, 2015, titled "The Laclede Group Reports
4 2015 Results, Raises Dividend 6.5 Percent Announces Earnings Guidance for Fiscal 2016,"
5 Laclede reported that it recognized a "\$7.6 million non-recurring gain on sale of property in
6 the third quarter of fiscal 2015." The Forest Park property that Laclede sold was used and
7 useful regulated utility plant-in-service and was included in Laclede's rate base and reflected
8 in Laclede's utility rates for many years.

9 **Q. While you are not an attorney, is it your understanding that the Commission requires
10 utilities to seek its authorization prior to removing used and useful utility plant from its
11 plant in service?**

12 A. Yes, that is my understanding.

13 **Q. Did Laclede seek Commission authorization prior to selling its Forest Park properties?**

14 A. No, it did not.

15 **Q. Did Staff take a position in direct testimony on the ratemaking treatment of Laclede's
16 Gain on Sale of its Forest Park properties?**

17 A. Yes. Staff's recommendation, sponsored by Staff witness Jason Kunst, can be found at pages
18 48 to 52 of Staff's direct testimony (Staff's Cost of Service Report).

19 **Q. Describe Staff's position on Laclede's Forest Park gain.**

20 A. Staff's position is that, because it was necessary for Laclede to continue to use the Forest Park
21 facilities after the completion of the sale of the properties, and it was necessary to replace a
22 portion of the Forest Park facilities with a nearby location (approximately ½ mile away) at

1 greater cost, it is appropriate for the Commission to order a sharing of the \$5.8 million gain
2 on sale prorated between shareholders and ratepayers. For the gain on sale, Staff is
3 recommending the Commission order Laclede to create a regulatory liability of approximately
4 \$3 million with a five-year amortization period.

5 **Q. Did Staff use the proper amount of the gain on sale?**

6 A. Yes. My review of Staff's direct testimony has convinced me that the correct amount of the
7 gain on sale to be addressed in this case is not the \$7.6 million I reflected in my direct
8 testimony, but the \$5.8 million proposed by Staff. Laclede's \$7.6 million gain calculation is
9 incorrect because it did not include the reflection of the net book value of the Forest Park
10 assets included in Laclede's regulated utility books and records, as required for such a
11 calculation.

12 **Q. What is your understanding of the basis on which Laclede calculated a \$7.6 million**
13 **dollar gain on the Forest Park sale as opposed to the correct \$5.8 million gain?**

14 A. According to Staff's direct testimony, Laclede advised the Staff that Laclede retired the
15 depreciable assets (buildings and improvements) on the date of the sale of the Forest Park
16 properties. This very questionable action by Laclede inflated the gain on the sale from \$5.8
17 million to \$7.6 million. As Laclede reported in response to Staff data request 392, the Forest
18 Park properties had a net book value of approximately \$1.8 million, for the buildings and
19 improvements combined, at the time of the sale.

20 **Q. Do you believe Laclede erroneously calculated and accounted for its gain on sale of**
21 **Forest Park Properties?**

22 A. Yes. At this time I have serious questions whether Laclede intentionally separated the one
23 transaction – sale of Forest Park utility properties into two separate transactions. The first
24 transaction was to early retire the building and improvements. The second transaction was to
25 boost the gain to be enjoyed by its shareholders by only including the Forest Park utility land

1 in the gain calculation. I will be providing testimony on Laclede's accounting for this
2 transaction in my surrebuttal testimony in this case.

3 **Q. Do you consider Staff's recommendation to split the gain on sale as unreasonable under**
4 **normal circumstances?**

5 A. No. In most gain on sale transactions, Staff's sharing approach would be reasonable and
6 appropriate. For example, in general, since shareholders are the owners of utility property,
7 they should be entitled to some portion of the gain on the sale of normal plant retirements. The
8 Staff's capital structure methodology approach for this calculation, which results in a
9 shareholder/ratepayer sharing, is within a range of reasonable options on how to account for
10 these transaction in a rate proceeding.

11 However, with this specific Forest Park gain on sale transaction, as Staff even noted in its
12 testimony, the ratemaking treatment should reflect the true nature of the transaction, which is
13 to replace an old facility with a new facility. Appropriate ratemaking treatment would require
14 gains from selling the old facility be credited to the construction of the new facility. Staff's
15 adjustment does not fully accomplish that objective.

16 **Q. Please explain.**

17 A. Laclede retired (sold) exiting plant in service (Forest Park properties) that was used and useful
18 to ratepayers for reasons that were not related to utility operations. This sale resulted in
19 Laclede recognizing a gain on the sale. Laclede then replaced the specific property that was
20 sold with higher-cost property, which results in higher utility rates. While the prudence of
21 this decision is certainly appropriate to consider, OPC is not making a prudence
22 recommendation on this issue in this case.

23 However, due to the specific circumstances of this transaction, any gain on sale of the retired
24 property should be used to reduce the cost of the new property. In the alternative, the gain
25 should be used to increase the depreciation reserve of the new property, thereby reduce net

1 book value and net rate base of the new facility, by the amount of the gain. This is the
2 recommendation made by OPC in its direct testimony and that is the position the Commission
3 should adopt for ratemaking purposes in this rate case.

4 **Q. Has Staff correctly identified additional compensation provided to Laclede related to**
5 **the sale of Forest Park utility assets that should also be allocated to the cost of Forest**
6 **Park replacement assets, the newly-constructed Manchester building?**

7 A. Yes. Staff explained in direct testimony that Cortex, the entity that acquired Forest Park,
8 acquired these utility assets in order to serve as the developer for an IKEA retail store. On
9 June 27, 2013, Laclede agreed to sell its Forest Park buildings, structures, and land to Cortex
10 for \$8.3 million. In addition to this \$8.3 million, Laclede was paid an additional \$5.7 million
11 dollars from Cortex explicitly to compensate Laclede for expenses related to relocating its
12 employees and equipment from the Forest Park location to other Laclede facilities, primarily
13 the building (Manchester) that replaced the Forest Park building. In its direct testimony, Staff
14 explained these additional funds received by Laclede as follows:

15 On September 2, 2014, LAC closed on a purchase of land at 5311
16 Manchester, where it built a centrally-located facility to house a
17 portion of the employees and functions that were previously located at
18 the Forest Park facility. The new facility cost approximately \$7 million
19 and was placed into service in November 2016. Since the new facility
20 is a replacement for a portion of the Forest Park properties that were
21 sold to Cortex, Staff recommends that the \$5.7 million of relocation
22 funds received from Cortex, less expenses incurred to relocate Forest
23 Park employees and equipment during the moves, should be used to
24 offset the construction cost of the new Manchester facility. Staff
25 recommends including a regulatory liability to record the rate base
26 offset of the relocation expense and amortizing it over a five year
27 period beginning with the date of new rates in the current case.
28

29 **Q. Do you agree with the Staff's description of this event and how the relocation proceeds**
30 **should be addressed in this rate case?**

1 A. Yes. I agree that Staff's recommendation for the creation of a regulatory liability for the
2 amount of the relocation compensation received by Laclede related to this sale, less direct
3 expenses incurred to move from Forest Park to Manchester, is a reasonable option. However,
4 OPC believes a better approach, as described above with the gain on sale, would be to add
5 these unspent relocation funds, in addition to the gain on sale, to the depreciation reserve for
6 the new Manchester Facility. The depreciation reserve represents that portion of the cost of
7 plant that has been recovered by utility shareholders as it reflects the cumulative payment by
8 ratepayers to Laclede for the depreciation expense on utility plant.

9 OPC's proposed increase to the Manchester depreciation reserve is designed to reflect the
10 dollars charged to the Manchester plant included in Laclede's rate base in this rate case that
11 should not have been charged to the plant account. As describe above, the gain on the sale of
12 a utility asset that is replaced by another similar and related utility asset should be considered
13 one transaction and the gain should be used to reduce the cost of the new utility asset.

14 **Q. If the Staff adopted this OPC recommended approach to the Forest Park gain and**
15 **relocation funds would it then be more closely achieving its desired intent, which is to**
16 **use these gain on sale and relocation funds to "offset the construction cost of the new**
17 **Manchester facility"?**

18 A. Yes.

19 **Q. Does this conclude your discussion of the Forest Park gain on sale and relocation funds?**

20 A. Yes, it does.

21 **Carrying (financing) Cost of Laclede and MGE's Natural Gas Inventories**

22 **Q. Prior to this rate case did Staff and Laclede have an agreed upon method concerning**
23 **the ratemaking treatment of the natural gas inventory carrying or financing costs?**

1 A. Yes. As Staff references in its direct testimony (Cost of Service Report), since 2005 Staff and
2 Laclede have agreed that natural gas inventory financing costs should be recovered through
3 Laclede's PGA surcharge. At page 62 line 12 of its direct testimony Staff describes the
4 ratemaking treatment of natural gas inventories it has supported for the past 12 years:

5 Based upon a review of LAC's tariffs, LAC has been authorized to
6 recover gas inventory carrying costs as part of its PGA since October
7 1, 2005. The tariff that describes the PGA treatment is Sheet No. 28-
8 h, and became effective in LAC Case No. GR-2005-0284.

9
10 The original inclusion of inventory carrying costs in LAC's PGA
11 tariffs was part of a Stipulation and Agreement, and therefore was not
12 a litigated issue.

13
14 In subsequent LAC rate cases, the Gas Inventory Carrying Cost
15 Recovery ("GICCR") tariff remained, and therefore "current" gas
16 inventories were not included in LAC's rate base as they had been
17 prior to 2005.

18
19 Staff is proposing to revert to the ratemaking treatment used for LAC
20 prior to 2005 and therefore include gas and propane inventories in rate
21 base.

22
23 **Q. Is Staff recommending a radical departure from the ratemaking position that both it**
24 **and Laclede recommended to the Commission to approve in 2005?**

25 A. Yes. Staff's position is sponsored by Staff witness David Sommerer and is reflected at
26 pages 60 line 12 through page 63 line 3 of Staff's direct testimony. In this testimony Staff
27 states that as part of this current rate case, Mr. Sommerer is recommending that both the
28 current natural gas and propane inventories that were previously included in the PGA/ACA
29 process now be included as part of rate base in the cost of service calculation.

30 **Q. In its direct testimony in this rate case did Staff provide any evidence of any economic**
31 **or other substantive changes that have occurred since its 2005 ratemaking agreement**

1 **with Laclede that would justify such a departure from the ratemaking position Staff and**
2 **Laclede recommended to the Commission in 2005?**

3 A. No.

4 **Q. Is it appropriate to make a change in a long-term ratemaking policy for a utility**
5 **without considering the impact of the change on that utility's ratepayers?**

6 A. No. But that is exactly what Staff is proposing in this rate case. Staff provided no
7 testimony nor did it even indicate it considered the impact of changing the ratemaking
8 treatment of natural gas inventory carrying cost on Laclede's ratepayers.

9 **Q. Did Staff provide a reason why it is proposing this change in ratemaking treatment**
10 **of Laclede's natural gas and propane inventories?**

11 A. Yes. At page 61 line 23 of its direct testimony Staff testifies that, "[T]hese amounts are
12 included in rate base in order to give LAC and MGE the opportunity to earn a return on its
13 investment for these inventories until those assets have been used."

14 Also, at page 62 line 8 of its direct testimony Staff states, "[T]he inclusion of gas
15 inventories in rate base is a method of addressing the inventory carrying costs associated
16 with paying for the gas or propane prior to its use and related revenue recovery by giving
17 the LDC the opportunity to earn a return on its investment until these inventories are used."

18 **Q. Does Laclede currently recover its carrying costs through a return on rate base in a**
19 **general rate case?**

20 A. No. Staff's new position must be based on a presumption that, under Staff's current
21 preferred method of rate recovery of inventory carrying costs, through Laclede's PGA
22 surcharge, Laclede is not recovering its inventory carrying costs. This supposition by Staff,
23 which it uses as a basis for its new position, has no basis in fact and is just wrong.

1 **Q. Does Laclede currently recover its carrying costs through a PGA surcharge as a**
2 **return on its investment?**

3 A. Yes. Laclede is currently being reimbursed all of its carrying costs to finance its natural
4 gas inventories through its PGA customer surcharge. Laclede is recovering, through the
5 PGA, the short term debt interest expense it incurs to maintain natural gas inventories.

6 In its recommended capital structure in this rate case, Staff is reflecting the fact that Laclede
7 finances its investments in natural gas inventory through Laclede's short-term debt
8 acquisitions. Staff has included short-term debt as a component of its recommended capital
9 structure, which is designed to compensate Laclede for the amount of short-term debt
10 interest expense it incurs in financing its natural gas inventories.

11 Therefore, while Staff appears to be stating in testimony that it has a desire for Laclede to
12 "earn a profit" on its cost to finance natural gas inventories (an opportunity to earn a return
13 on its investment other than the short-term debt return Laclede is currently earning through
14 the PGA). However, in reality, Staff is merely providing for the same recovery of
15 Laclede's short-term debt financing costs as Laclede is currently recovering in its PGA
16 surcharge.

17 **Q. Does Laclede support the Staff's inclusion of short-term debt in Laclede's capital**
18 **structure to finance its natural gas inventories?**

19 A. No. Laclede does not include short-term debt in its proposed capital structure. Laclede's
20 position, which is substantially worse than Staff's position on this issue, is that while it
21 finances its inventories with short-term debt at around 2 percent, its customers should
22 reimburse Laclede at its overall weighted cost of capital, approximately one-half of which
23 is based on a profit level of 10.35 percent.

1 **Q. What will occur if the Commission accepts Staff's rate base treatment for gas**
2 **inventories but does not include a proportionate level of short-term debt in Laclede's**
3 **capital structure in this rate case?**

4 A. Laclede's customers will be harmed. Solely because of Staff's proposed change in
5 ratemaking treatment in this case, Laclede's customers will be forced to pay a profit to
6 Laclede's shareholders on the dollar amount of natural gas costs that are currently being
7 financed through a much lower cost of short-term debt.

8 **Q. What would be the dollar amount of harm to Laclede's rate payers?**

9 A. Laclede's proposed gas inventory rate base amount is \$68,507,994. Multiplying this
10 amount by Laclede's proposed 11.39% weighted average cost of capital (grossed up for
11 taxes on the equity portion) results in an annual cost to ratepayers of approximately \$8
12 million. Applying Laclede's 1.38% short-term debt rate to this inventory balance, as is the
13 rate treatment currently in Laclede's PGA, the annual cost to Laclede ratepayers is
14 approximately \$1 million. Therefore, if Staff's proposed rate base treatment is accepted
15 and the Commission does not reflect a proportionate amount of short-term debt in
16 Laclede's capital structure, ratepayers will be harmed by approximately \$7 million every
17 year until rates are adjusted in the future.

18 **Q. At page 62 line 3 of its direct testimony Staff states that, "MGE has traditionally**
19 **included natural gas inventory in its rate base and so rate base treatment should not**
20 **be considered a change in ratemaking treatment" for Laclede. Is this statement**
21 **correct?**

22 A. No. Changing Laclede's rate recovery of a significant revenue requirement cost
23 component from the PGA back to a rate case is a significant and unusual change in
24 ratemaking treatment. While such a change may be appropriate due to changing
25 economic conditions or other factors, neither the Staff nor Laclede have provided any

1 reasonable or legitimate reasons to make this significant change in ratemaking treatment
2 for natural gas inventory costs.

3 **Q. What is the totality of Staff's justification for proposing this change in ratemaking**
4 **treatment for Laclede?**

5 A. The totality of Staff's reasons for recommending a major change in ratemaking
6 methodology for Laclede's natural gas inventories are listed below.

7 1. Staff wants to provide Laclede with an opportunity to earn a
8 profit on a natural gas inventory investment that Laclede finances
9 through short-term debt.

10
11 2. Staff believes there is a "beneficial effect" of consistent rate
12 treatment between two separate utilities, Laclede and MGE.

13
14 3. Staff believes taking natural gas inventories out of the PGA will
15 make its annual ACA reviews less complex.

16
17 4. At page 62 line 25 of its direct testimony Staff states that it
18 purportedly "had" "a long-standing position that only clear and
19 identifiable "actual gas costs" should be subject to PGA recovery."
20

21 **Q. In direct testimony, did Staff provide any benefit of including natural gas inventory**
22 **carrying costs in the PGA, which is updated annually, as opposed to a rate case, where**
23 **financing costs are not updated for several years?**

24 A. No.

25 **Q. In 2005 did Laclede advise the Commission that including natural gas inventory**
26 **carrying costs in the PGA has the benefit of only charging ratepayers with the actual**
27 **financing costs?**

28 A. Yes. As will be discussed below, Laclede and Staff made a presentation to the Commission
29 of the Stipulation and Agreement reached in Case No. GR-2005-0284. In explaining the

1 benefits of including the inventory carrying costs in the PGA (which is updated annually)
2 as opposed to including in rate base in a rate case (where financing costs are not updated
3 for several years) Laclede advised the Commission:

4 And once again, one of the reasons for doing that, from our
5 perspective, is that you will go ahead and know what those costs are.
6 You will not be charging more or less than what they are, and they're
7 about as intricately related to gas costs as they're already recovered
8 through the PGA, as just about anything else could be. (Page 108,
9 *Transcript of Proceeding , GR-2005-0284, In the Matter of Laclede*
10 *Gas Company's Tariff to Revise Natural Gas Rate Schedules*
11 *Stipulation & Agreement Hearing September 26, 2005, Jefferson*
12 *City, Missouri Volume 7*)(Emphasis added).

13
14
15 **Q. Do you agree with Laclede that one of the main benefits of including inventory costs**
16 **in the PGA is that customers will be charged as a fuel cost and Laclede will receive as**
17 **reimbursement for that cost, a much more current and accurate financing cost?**

18 A. Yes. This benefit described by Laclede to the Commission is a significant benefit of the
19 current ratemaking treatment of Laclede's natural gas inventory carrying costs. However,
20 this ratepayer benefit was not considered by Staff in its recommendation to change from
21 the PGA recovery method to the rate base recovery method.

22 **Q. Do any of the reasons Staff provides in its direct testimony in support of this change**
23 **discuss the impact of Staff's proposed change on Laclede's ratepayers?**

24 A. No. Staff's testimony provides no indication that it even considered the financial impact
25 of this change on Laclede's ratepayers.

26 **Q. Did you earlier address Staff's first reason in support of this change, that it wants**
27 **Laclede's shareholders to earn a profit on natural gas inventories that are financed**
28 **through short-term debt?**

1 A. Yes.

2 **Q. Briefly address Staff’s second reason for this change, that Staff believes there is a**
3 **“beneficial effect” of consistent rate treatment between two separate utilities, Laclede**
4 **and MGE.**

5 A. Staff did not describe nor explain in testimony its basis for why it believes there would be
6 a beneficial effect of changing the ratemaking treatment of Laclede natural gas inventories
7 from the current PGA method. Because it did not explain or describe what it means by this
8 “beneficial effect,” I have to assume, and I believe the Commission should assume, that
9 Staff knows of no beneficial effect. Therefore, there is no substantiating support to Staff’s
10 position.

11 This becomes ever more apparent when considering that Staff’s position provides no
12 discussion of the alternative position: if MGE recovered its carrying costs through a PGA.
13 If the true motivation is a belief that consistent rate treatment is of paramount benefit, then
14 Staff would have presented a balanced analysis showing the impact on the Companies and
15 ratepayers under on both circumstances. Staff provided no such analysis and simply,
16 following Laclede’s request, opted for method (rate base), which will likely result in the
17 higher cost to ratepayers.

18 **Q. What is your opinion of Staff’s third reason for this ratemaking change, that taking**
19 **natural gas inventories out of the PGA will make its annual ACA reviews less**
20 **complex?**

21 A. I will agree that taking a scope of work out of a fuel cost audit will make that fuel cost audit
22 less complex and easier to conduct. However, I will also point out that adding this very
23 same scope of work to a general rate case cost audit will make the general rate case cost
24 audit more complex.

1 Staff did not explain how the ACA audit step of calculating inventory carrying costs is
2 overly complex. Even if it is overly complex, this is an audit step that Staff has been
3 performing in Laclede ACA audits for the past 12 years. Laclede has had several rate cases
4 over the past 12 years and Staff, to my knowledge, has never proposed this change nor
5 provided any indication that its ACA audits are overly complex. Staff never proposed this
6 change until Laclede requested it.

7 **Q. Finally, please state your concerns with Staff’s fourth and final reason in support of**
8 **its proposed change – that Staff’ “had” “a long-standing position that only clear and**
9 **identifiable “actual gas costs” should be subject to PGA recovery**

10 A. First I will emphasize that there is no question that natural gas inventory carrying costs are
11 a pure, clear and identifiable cost of natural gas. The most obvious example of this fact is
12 that if Laclede did not purchase natural gas, it would not have natural gas inventory
13 carrying costs.

14 From an accounting and ratemaking concept, capitalizing financing costs to natural gas
15 inventory is no different than capitalizing financing costs to utility construction projects
16 through the utility’s AFUDC (Allowance for Funds Used During Construction) financing
17 rate. No reasonable person would argue that the construction financing (AFUDC) costs
18 are not a plant in service cost. Similarly, it is a reasonable position that natural gas
19 inventory “financing costs” are as much a natural gas cost as the invoice price of the natural
20 gas commodity that resides in the inventory.

21 **Q. Is hedging against natural gas price volatility a stated reason why utilities’ maintain**
22 **physical natural gas inventories?**

23 A. Yes. Maintaining fuel inventories is a universally-accepted means of hedging price
24 volatility of the natural gas market. In this regard, carrying costs on this inventory can also
25 be considered a hedging cost.

1 **Q. Does Laclede recover its natural gas hedging costs through its PGA surcharge?**

2 A. Yes, it does. This is even an additional reason why inventory carrying costs should be
3 recovered in a PGA. Since Staff expresses concern about consistency among different
4 utilities (such as Laclede and MGE), it should be more concerned with intra-utility
5 consistency. Laclede's intra-utility consistency would require that natural gas inventory
6 hedging costs be recovered from ratepayers in the same manner as other hedging costs,
7 through the PGA.

8 **Q. In 2005 did Laclede indicate the belief that natural gas inventory carrying costs are**
9 **“clear and identifiable “actual gas costs” which should be subject to PGA recovery?**

10 A. Yes. On September 26, 2005, in the Transcript of Proceedings in Case No. GR-2005-0284,
11 Laclede, in response to questions from the Commission, stated that natural gas inventory
12 carrying costs are “about as intricately related to gas costs as they're already recovered
13 through the PGA, as just about anything else could be.”

14 MR. PENDERGAST: “In the past, when we bought all of our gas
15 supplies from interstate pipelines, most, if not all of it, at least the
16 part that's associated with pipeline storage, was bundled up and
17 included in whatever the sales rate was that the interstate pipeline
18 charged the utility.
19

20 After 636 and transportation came, those costs were included for a
21 while up until this point in base rates, and what this would do is have
22 those costs recovered as they used to be, or at least a significant
23 portion of them were, through the PGA mechanism in the future.
24

25 And once again, one of the reasons for doing that, from our
26 perspective, is that you will go ahead and know what those costs are.
27 You will not be charging more or less than what they are, and they're
28 about as intricately related to gas costs as they're already recovered
29 through the PGA, as just about anything else could be.” (Page 107-
30 108, Transcript of Proceeding , GR-2005-0284, In the Matter of
31 Laclede Gas Company's Tariff to Revise Natural Gas Rate

*Schedules Stipulation & Agreement Hearing September 26, 2005,
Jefferson City, Missouri Volume 7)*

1
2
3
4 **Q. During your audit of this rate case did you attempt to gain an understanding of the basis**
5 **and rationale of the Staff's changed ratemaking position on this issue?**

6 A. Yes. I asked several questions of the Staff to obtain this understanding of this change in
7 ratemaking position. Staff refused to answer any of these questions. See attached OPC data
8 requests.

9 **Q. Does this conclude your rebuttal testimony on natural gas inventories?**

10 A. Yes, it does.

11 **Supplemental Executive Retirement Plan Expense ("SERP")**

12 **Q. Do you have concerns with the SERP testimony Staff provided in its Cost of Service**
13 **Report?**

14 A. Yes. I have concerns with the section of Staff's direct testimony titled "SERP and Directors'
15 Dividends" which can be found at Page 105 of the Staff's Cost of Service Report. My
16 concerns are with the following Staff testimony:

17 Included in Staff's revenue requirement recommendations are
18 normalized levels of recurring supplemental executive retirement plan
19 ("SERP") payments and an eight year amortization of large lump-sum
20 SERP payments LAC and MGE have made to their former executives
21 and other highly-compensated former employees.

22
23 In addition to the method Staff used to normalize SERP expense for Laclede, OPC's concerns
24 are that Staff inappropriately assigned Laclede-only SERP expenses to MGE ratepayers and
25 that Staff inappropriately capitalized SERP expenses to Laclede's current construction
26 projects.

1 **Q. Is Staff proposing to include an unreasonable level of SERP expense for Laclede and**
2 **MGE cost of service in this cases?**

3 A. Yes. Staff is recommending a normalized level of SERP expense in excess of \$1 million.
4 This excessive and unreasonable amount is inconsistent with its prior Staff positions on the
5 appropriate ratemaking treatment of SERP expenses in utility rate cases.

6 **Q. Please summarize Staff's previous position on rate recovery of SERP expense.**

7 A. In Case No. ER-2012-0174, Staff recognized that SERP expenses are unique in nature
8 because they are an additional executive pension benefit over and above what is already
9 provided in the regular pension plan. Because of this unique nature, in the past, the Staff
10 treated SERP costs somewhat differently from how it treats normal employee pension costs.
11 The Staff's policy has been that it will recommend SERP costs to be included in cost of service
12 only if they are not significant, are reasonably provided for and able to be quantified under
13 the known and measurable standard.

14 **Q. Under Staff's prior SERP reasonableness standard, did Staff argue large lump sum**
15 **SERP payments to retiring utility executives to be unreasonable and excessive, and**
16 **therefore should not be included in cost of service?**

17 A. Yes. For example, in its testimony in Case No. ER-2012-0174 Staff noted that between 2001
18 and 2011 the utility made lump sum SERP payments ranging from \$700,000 to \$3 million.
19 Staff argued that these lump sum SERP payments, which are in addition to regular pension
20 compensation, were excessive from a ratemaking standpoint and the excessive nature of the
21 lump sum payment alone was one of the reasons why lump sum SERP payments did not meet
22 Staff's SERP test of inclusion in a utility's cost of service.

23 **Q. Did Staff provide an example to the Commission of why including a large dollar lump**
24 **sum SERP payments, as well as converting the large lump sum payment to an annuity**
25 **based payment was unreasonable for ratemaking purposes?**

1 A. Yes. In testimony before the Commission in Case No. ER-2012-0174 Staff testified that if a
2 utility makes a \$3 million SERP payment to a retiring executive, and that executive has a
3 remaining life expectancy of 15 years, then the additional pension compensation to that one
4 retiree would be \$200,000 annually. Staff stated that when one considers that this \$200,000
5 payment is an additional pension payment, an amount over and above the retiree's regular
6 pension annuity, there can be no doubt that it is excessive. (Staff witness Hyneman Surrebuttal
7 ER-2012-0174 page 45 attached as Schedule CRH-R-1).

8 **Staff's Prior Position - Lump Sum SERP payments must be known and measurable**

9 **Q. In the past did Staff argue to exclude annual lump sum SERP payments from a utility's**
10 **cost of service?**

11 A. Yes. Staff based this position, in part, on the fact that lump sum payments are not a known
12 and measurable expense, a fundamental ratemaking principle. Since the Commission has a
13 policy that only expenses that are known to have occurred in a test year and are measurable
14 with a high degree of certainty should be included in a utility's cost of service, Staff did not
15 recommend rate recovery of erratic and irregular lump sum SERP payments.

16 Staff noted in the 2012 Kansas City Power & Light ("KCPL"), (Case No. ER-2012-0174) rate
17 case that lump sum SERP payments made by KCPL were so volatile that no reasonable
18 estimation of future lump sum payments can be made. For example, in the three year period
19 2007 through 2009 KCPL made only one lump sum SERP payment. Over the entire time
20 period KCPL made lump sum SERP payments, the range of payments has been from a low
21 of \$300 to a high of \$3.3 million. KCPL's history of lump sum SERP payments do not meet
22 the basic ratemaking requirement of being known and measurable and thus cannot be
23 quantified accurately enough to be included in cost of service. (Staff witness Hyneman
24 Surrebuttal ER-2012-0174 page 46).

25 **Q. Please continue.**

1 A. Staff further explained its position on the known and measurable standard by explaining that
2 a revenue requirement is the sum of operating and maintenance expenses, depreciation
3 expense, taxes and a fair and reasonable return on the net value of property used and useful in
4 serving its customers. A revenue requirement is based on a test year. In order that the test
5 year reflect conditions existing at the end of the test year as well as significant changes that
6 are known or reasonably certain to occur, it is necessary to make certain “pro forma”
7 adjustments. Lump sum SERP payments are highly irregular both in frequency and amount.
8 There is no reasonable way to quantify this type of payment as they are neither known nor
9 reasonably certain to occur on a recurring basis. (Staff witness Hyneman Surrebuttal ER-
10 2012-0174, page 49).

11 **Q. Are there other concerns about the appropriateness of including lump sum SERP**
12 **payments in a revenue requirement as a reflection of a known and measurable cost?**

13 A. Yes. For example, if a utility executive retires at age 60 and receives a lump sum SERP
14 payment, that lump sum pension payment was designed and intended to represent
15 supplemental pension annuity payments over the life of that executive, which could be 20 or
16 more years. Including all of the cost of the 20-year annuity payment in a single year
17 significantly distorts the true expense level.

18 A more appropriate method of annualizing lump sum SERP payments would be to amortize
19 a reasonable level of lump sum SERP the payment over the remaining life of retired executive.
20 This method would more closely fit the payment of the SERP (annual payment) with the
21 intended employee benefit provided by the SERP, which is a supplemental addition to the
22 regular pension annuity. While this method is more appropriate, it does not address the
23 excessive nature of lump sum payments not the fact that these payments do not meet the
24 known and measurable standard. It is just as common for Laclede as it is with KCPL that the
25 lump sum SERP payments are highly irregular and excessive.

1 **Q. In its 2014 rate case direct testimony did KCPL change its prior SERP ratemaking**
2 **request to convert its lump sum SERP payments to annual annuity payments?**

3 A. Yes, it did. My understanding is that KCPL recognized Staff's concern with lump sum SERP
4 payments and made an attempt to mitigate some of that concern by converting SERP lump
5 sum payments to annuity payments.

6 **Q. In KCPL's 2014 rate case did Staff change its 2012 SERP ratemaking method to accept**
7 **this new KCPL method?**

8 A. Yes. Staff witness Keith Majors described Staff's revised SERP ratemaking position in
9 KCPL's 2014 rate case, ER-2014-0370:

10 SERP payments consist of monthly annuity payments and periodic
11 lump-sum distributions. **Lump-sum payments can be significant**
12 **and are often difficult to predict.**

13
14 As opposed to including a normalized amount of actual lump-sum
15 payments, KCPL used a conversion factor of 14.3 to convert prior
16 lump-sum payments to an amount that approximates the equivalent
17 annuity payments to the qualifying employees as if that lump-sum
18 payment option were not elected. Staff utilized this factor for the
19 calculation of a normalized level of converted lump-sum payments.

20
21 Staff recommends that a three year average of monthly annuity
22 payments, and a three year average of converted lump-sum payments,
23 be used in this rate case to determine allowable SERP expense in rates.
24 This approach is reflected in Staff's revenue requirement
25 recommendation as Adjustment E-204.8 to Account 926, Employee
26 Benefits. Staff Expert/Witness: Keith Majors (page 11 Staff direct
27 testimony ER-2014-0370, April 2, 2015)(emphasis added)

1 **Q. Is the ratemaking approach taken by Staff with KCPL in 2014 an improvement over**
2 **the approach it took in 2012 and prior to 2012?**

3 A. No. In 2014 Staff continued to recognize that SERP lump sum payments are not a known,
4 measurable and recurring expense. Staff's witness on this issue even stated in direct testimony
5 that "Lump-sum payments can be significant and are often difficult to predict". Nevertheless,
6 Staff found a way to incorporate SERP expenses that were significant and which also failed
7 to meet the Commission's known and measurable standard into the utility rates KCPL charged
8 to its customers in 2014.

9 **Q. Is Staff following its 2014 SERP ratemaking method in this case for Laclede?**

10 A. No. In this current Laclede rate case Staff determined that it need not convert lump sum
11 payments into annuity payments as Staff did in KCPL's 2014 rate case. For Laclede, Staff
12 created a new SERP ratemaking method. This new method is just to combine lump sum SERP
13 payments (in excess of \$2 million) with recurring annual SERP payments and calculate a
14 simple 3-year average of the two payment methods. This new Staff approach fails every test
15 of reasonableness, several Commission ratemaking principles, and, in addition, reflects a lack
16 of understanding of the purpose of pension payments and rate case normalization methods.

17 **Staff's Prior Position – SERP Payments must be reasonable and limited**

18 **Q. In Case No. ER-2012-0174 did the Staff further define its "reasonableness standard"**
19 **on SERP expenses by implementing a maximum amount of SERP expenses per retiree**
20 **to include in a utility's cost of service?**

21 A. Yes. The Staff limited the annual amount of SERP expenses per retiree to \$50,000 per year.

22 **Q. What was the basis for the Staff's reasonableness standard?**

1 A. In that rate case Staff indicated that it found that an annual SERP payment of \$50,000 to be
2 in the top 5 percent of all annual SERP payments of former utility employees it reviewed up
3 to that date. (Staff witness Hyneman Surrebuttal ER-2012-0174 page 54).

4 **Q. Based on your review of utility SERP payments from the period 1993 to 2017, how would**
5 **you rank an annual SERP payment of \$50,000 per retiree?**

6 A. I would estimate that this amount is much higher than significantly all annual recurring SERP
7 payments made by Missouri utilities to retirees. This indicates that a \$50,000 SERP limit
8 established by Staff in 2012 is too high and should be reduced to a more reasonable level.

9 **Staff's SERP adjustment for Laclede and MGE in this rate case**

10 **Q. Did Staff describe its current position on SERP in its Cost of Service Report in this case?**

11 A. Yes. Staff's explanation of its SERP cost of service recommendation for Laclede and MGE
12 and its description of how it calculated its recommended level of SERP expense can be found
13 in Staff's Cost of Service Report at page 105.

14 **Q. Does you agree with any of the statements made by Staff in this one paragraph?**

15 A. Yes. OPC agrees with Staff that SERP plans are created primarily to get around the Internal
16 Revenue Service's ("IRS") executive compensation limits on the deductibility of pension
17 benefits to highly-compensated executives. OPC also agrees with the Staff that the IRS
18 compensation limits during 2017 was \$270,000 per year, and awarded benefits calculated on
19 earnings above this level are not tax-deductible.

20 **Q. Based on your review of Staff's direct testimony in this case, does the Staff appear to**
21 **have changed its SERP ratemaking policy that it supported in 2012?**

22 A. Yes. In addition to abandoning its policy on the level of SERP to include in a utility's cost of
23 service, Staff also abandoned a prior position that SERP payments to retired former employees

1 provide no benefit to current utility construction projects, and therefore, should not be
2 capitalized or added to the cost of those plant projects.

3 Staff did not address this issue in its direct testimony, but my review of its SERP expense
4 workpapers indicate that Staff has changed its prior position and now decided that cash SERP
5 payments to retired former employees provide benefit and value to 2017 utility construction
6 projects and therefore should be capitalized to 2017 utility plant construction projects.

7 **Q. Did Staff assert in direct testimony that the “Commission has traditionally included a
8 reasonable amount of SERP expenses in customer rates.”?**

9 A. Yes, it did.

10 **Q. Do you agree with this statement?**

11 A. No. As I noted in my direct testimony, I do not believe the Commission has ever addressed
12 a position on SERP expense in any previous rate case.

13 **Staff no longer applies a known and measurable standard to utility SERP expense**

14 **Q. Did Staff’s decision to include lump sum payments in its SERP cost of service
15 recommendation for Laclede reflect an abandonment of Staff’s application of a known
16 and measurable standard for lump sum SERP payments?**

17 A. Yes. Staff used fiscal years 2014, 2015 and 2016 as the basis of its SERP expense
18 recommendation to include SERP lump sum payments. According to Staff’s work papers, in
19 the three years Laclede only made a large lump sum payment (greater than \$250,000) in one
20 of those years, 2015. No large lump sum payment was made in 2014 and, what is even more
21 of a concern, no large lump sum payment was made in the 2016 test year in this rate case.
22 Despite the fact that no lump sum payments were made in the test year, Staff decided that
23 lump sum SERP payments are a known and measurable expense.

1 **Q. Should a cost that is not incurred within a Commission-ordered test year be classified**
2 **as a test year known and measurable cost?**

3 A. No. Staff's position violates this fundamental tenant of ratemaking.

4 **Q. You stated earlier that Staff is recommending a SERP expense in excess of \$1 million**
5 **yet Laclede's SERP payment averaged \$371,490 over the period 2001 through 2005, and**
6 **averaged \$294,009 over the period 2006 through 2010. Is it reasonable for Staff to ignore**
7 **this 10 years of data when developing a normalized level of SERP expense for Laclede**
8 **in this rate case?**

9 A. No, it is unreasonable. The 2001-2010 amounts reflect actual ongoing levels of SERP
10 expense for Laclede. It was not until the period when Laclede hired a new CEO in early 2012
11 that the SERP expenses began to skyrocket from the \$200,000 to \$400,000 normal levels to
12 \$3.2 million in 2011, \$6.6 million in 2012, and \$2.9 million in 2013.

13 The period 2011-2013 was the period when Laclede was transitioning to a new chief executive
14 officer who was making significant executive changes and embarking on a strong utility
15 growth strategy. This was a unique time for Laclede and it should be considered as
16 extraordinary and nonrecurring. Since the Laclede transition is complete, there is no reason
17 to believe as, apparently Staff believes, that the level of million dollar SERP lump sum
18 payouts will continue.

19 **Staff no longer applies a reasonableness test to utility SERP expense**

20 **Q. Based on your review of Staff's SERP workpapers did Staff appear to abandon the**
21 **"reasonableness test" for SERP expense that you discussed above?**

22 A. Yes. Staff abandoned its reasonableness test developed in prior rate cases. It now appears
23 Staff auditors have adopted a new reasonableness test, not based on ratemaking principles,

1 and not based on levels of similar costs experienced by other utilities, but based on a dictionary
2 definition.

3 In OPC data request 430 OPC asked Staff for its definition of a reasonable SERP expense.
4 Instead of referring to its past SERP ratemaking positions and how Staff determined a SERP
5 expense level to be reasonable, Staff advised OPC that it now has a new reasonableness test
6 based on Black's Law Dictionary.

7 Staff cited to Black's Law Dictionary, 6th Edition, which defines reasonable as "fair, proper,
8 just, moderate, suitable under the circumstances". Staff's position is that it is appropriate for
9 utilities to offer eligible employees a reasonable amount of SERP benefits in order to attract
10 qualified employees and compensate them at competitive levels. Accordingly, Staff is not
11 opposed to inclusion of SERP expenses at an appropriate normalized level in rates. However,
12 Staff would not define what it considers a reasonable SERP expense and could only provide
13 a dictionary definition of the word reasonable.

14 It is apparent that Staff has abandoned its prior maximum \$50,000 annual SERP payment that
15 was based on knowledge of competitive Missouri utility SERP policies and costs. Without
16 brightline standards, like the Staff has supported in the past. Now, any SERP expense sought
17 by a utility can be rationalized as "reasonable" so long as the Staff or the Company
18 manipulates the averages a few years and charges that amount to ratepayers. Under this Staff
19 approach, the cost of the SERP itself will not be subject to the scrutiny of a proper audit.

20 **Q. Did you review the SERP payment data Staff used to develop its SERP expense**
21 **recommendation in this case?**

22 A. Yes, I did.

23 **Q. What were your findings?**

1 A. Staff's three year average (2014, 2015 and 2016) of what it represents as actual cash SERP
2 payments results in an average level of \$ \$1.1 million annual SERP payment. I compared this
3 amount to a five year average of Laclede's SERP payments in 2001 through 2005, which is
4 \$371,490. I also compared this to a five year average of SERP payments made by Laclede
5 from 2006 through 2010 of \$294,000.

6 From a historical perspective, Staff's is recommending Laclede's ratepayers pay in rates in
7 this rate case a level of SERP expense that is three times the size of a normalized level of
8 SERP payments. This is the data that is reflected in Staff's own workpapers and this is the
9 data that Staff ignored by recommending Laclede and MGE's ratepayers reimburse Laclede
10 for an excessive and unreasonable level of SERP expense.

11 **Q. Did Staff explain in testimony any audit procedure it conducted to determine why it is**
12 **reasonable to charge ratepayers an annual level of SERP expense greater than \$1 million**
13 **when, according to Staff's workpapers, Laclede exceeded \$1 million in SERP payments**
14 **in only 4 of the past 16 years?**

15 A. No. It should be obvious to Staff that in at least 3 of those 4 years (2011-2013) SERP
16 payments were materially affected by Laclede's executive reorganization. Laclede's went
17 through a major corporate reorganization in 2011-2013 and possibly extending through 2015.

18 **Q. Based on your understanding did Staff make any attempt to determine if any of the**
19 **SERP payments it included in its cost of service recommendation was reasonable?**

20 A. No. It appears that Staff made no attempt to determine the reasonableness of any SERP
21 payment.

1 **Correction to Staff's SERP calculation**

2 **Q. Based on your review of Staff workpapers do you believe that Staff's calculation of**
3 **SERP expense is based on a conceptual misunderstanding of the data Staff used to**
4 **calculate its SERP expense?**

5 A. Yes. Staff calculated an average SERP expense of \$1,107,826 based on an average of fiscal
6 years 2014 (\$338,610), 2015 (\$2,538,069) and 2016 (\$446,798). From these three fiscal
7 years, Staff calculated an average SERP payment of \$1,107,836. I believe the Staff made this
8 calculation in error based on a lack of understanding of what a lump sum SERP is supposed
9 to represent.

10 The conceptual problem with Staff's calculation is that the 2015 amount includes a lump sum
11 SERP payment to one retiree of \$2,300,743. Simply removing this lump sum payment out of
12 the 2014-2016 average would result in an adjusted average of \$340,911 in annual annuity
13 SERP payments.

14 If you amortized 2015 lump sum SERP payment of \$2,300,743 over an expected remaining
15 life period, the annuity amount would be \$153,383. Adding this \$153,383 to Staff's 2014-
16 2016 average without the lump sum payment would result in a "correct" normalized level of
17 \$494,294 including the lump sum payment. This is the amount that Staff should have
18 calculated using its own methodology instead of the highly excessive and unreasonable level
19 of \$1,107,836.

20 **Q. Is the Staff adjustment methodology for Laclede's SERP in this rate case significantly**
21 **different and inconsistent with Staff's 2014 SERP adjustment for KCPL, as described**
22 **above?**

23 A. Yes, it is.

1 **SERP Capitalization**

2 **Q. Please explain why you disagree with the fact that Staff continues to capitalize SERP**
3 **payments to retirees despite the fact that retired Laclede former employees provide no**
4 **service or benefit to Laclede’s current construction projects, including its ISRS projects.**

5 A. To the extent Staff capitalizes this SERP expense to construction work in progress, account
6 107, which eventually are transferred to account 101, plant in service, Staff intentionally
7 overstates Laclede’s future plant in service costs, including Laclede’s future ISRS costs. Not
8 only is it inconsistent with basic ratemaking principles for Staff to capitalize payments to
9 former employees, this action is against the current position of the Financial Accounting
10 Standards Board (“FASB”) and a recent change to generally accepted accounting principles
11 (“GAAP”) that will go into effect in 2017.

12 **Q. Please continue.**

13 A. The FASB recently changed GAAP accounting rules for pension expense, including SERP.
14 One of the principle changes to pension accounting ruled made by the FASB is that only
15 current pension costs the benefit current construction projects may be capitalized to
16 construction projects. All other pension costs are required to be charged to expense.

17 In its March 14, 2017 edition of “In depth – A look at current financial reporting issues,
18 PricewaterhouseCoopers LLP (PwC”) provided a summary of the new Accounting Standards
19 Update 2017-07, *Compensation-Retirement Benefits (Topic 715): Improving the Presentation*
20 *of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. PwC is one of
21 the “Big Four” auditing firms along with Deloitte, EY and KPMG.

22 What PwC explains below is that the FASB requires that only pension costs which represents
23 employee compensation cost to build or produce utility plant assets are eligible to be
24 capitalized to that plant cost. Since SERP is solely compensation for past services, it is not

1 eligible to be capitalized to plant either under reasonable ratemaking theory or these new
2 GAAP rules. PwC explains this new accounting:

3 Capitalization

4 .7 Under current guidance, since the net benefit cost is considered one
5 aggregate amount, when it is appropriate to capitalize costs (for
6 example, as a cost of inventory or a self-constructed asset), the entire
7 net benefit cost applicable to the pertinent employees for the period is
8 capitalized. However, as described above, this amount includes costs
9 that relate more to financing (i.e., interest cost) or investing (i.e., return
10 on assets), or costs that arose in prior periods and were previously
11 deferred in accumulated other comprehensive income.

12
13 By disaggregating the presentation of net benefit cost on the income
14 statement, the amount eligible for capitalization is now limited to the
15 service cost component of net benefit cost. The FASB believes this
16 more closely reflects the current period compensation cost provided to
17 employees to build or produce inventory or self-constructed assets. It
18 also believes it will improve comparability and reduce the need for
19 additional disclosure requirements around capitalized amounts.

20
21
22 **Q. Was there an effort to exclude regulated utilities from this GAAP requirement?**

23 A. Yes, however the FASB rejected this proposal. Therefore, regulated utility companies are not
24 exempted from these new rules.

25 **Q. Is Staff aware, or should Staffs be aware, that its proposal to capitalize a portion of**
26 **SERP cash payments to retirees to 2017 construction projects is not appropriate**
27 **accounting treatment and is inconsistent with current FASB accounting policy and**
28 **GAAP?**

29 A. In a data request I inquired if the Staff was aware of this new GAAP requirement. However,
30 Staff refused to answer this inquiry and claimed the question was ambiguous. Therefore, I am
31 not aware if Staff is aware of the mandatory requirements of this new GAAP standard.

1 **Q. Did OPC attempt to get an understanding of Staff reasons why decided to capitalize**
2 **SERP expenses.**

3 A. Yes. In OPC data request 430, OPC asked several questions concerning Staff's position in
4 direct testimony on the capitalization of SERP payments. Except for agreeing that costs
5 capitalized to CWIP are designed to allocate to plant the cost of employee services (benefits)
6 in the period, Staff refused to answer any of OPC's questions related to SERP capitalization
7 and why it is proposing to the Commission in this case that SERP costs be capitalized.

8 **Laclede's SERP payments to retired executives provide no benefit to MGE ratepayers**

9 **Q. Did Staff assign Laclede's SERP payments to retired Laclede employees to MGE**
10 **ratepayers?**

11 A. Yes, and this is not appropriate. OPC is not aware of any former MGE retirees who are
12 receiving SERP payments from Laclede. Since all of the current SERP recipients are former
13 Laclede employees, and these former employees only provided services to Laclede and not
14 MGE, no SERP costs should be assigned to MGE's ratepayers. Staff's apparent position is
15 that MGE's ratepayers, who have never received any benefit from retired Laclede employees,
16 should be responsible to pay for services they never received.

17 **Q. Is it possible that MGE ratepayers received some services from Laclede's SERP**
18 **recipients?**

19 A. It is possible, but unlikely. If Laclede's SERP recipients were active employees after MGE
20 was integrated into Laclede, any benefit they would have provided to MGE would be
21 immaterial and inconsequential compared to the service provided to Laclede.

22 Since Laclede acquired MGE late in 2013, no Laclede executive's utility services would have
23 provided any benefits to MGE until 2014 when MGE was integrated in to Laclede. Therefore
24 all SERP retirees who retired in 2014 or before provided no employee services or benefits to

1 MGE ratepayers. Those former Laclede employees who retired after 2014 provided very little,
2 if any benefit to MGE ratepayers.

3 **Q. Does this conclude your rebuttal testimony?**

4 A. Yes, it does.

September 27, 2017

Sent via email

Hampton Williams
Acting Public Counsel
P.O. Box 2230
Jefferson City, MO 65102

RE: Staff objections to OPC data request number 472 to Staff in Case Nos. GR-2017-0215 and GR-2017-0216

Mr. Williams:

On September 20, 2017, Mr. Hyneman of the Office of the Public Counsel submitted identical data request (DR) number 472 to Staff in both Case Nos. GR-2017-0215 and GR-2017-0216. Staff raises the following timely objections to DR 472 in both cases:

Data Request 472 from Mr. Hyneman:

Reference Page 107-108, TRANSCRIPT OF PROCEEDINGS, GR-2005-0284, In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules Stipulation & Agreement Hearing September 26, 2005, Jefferson City, Missouri Volume 7 MR. PENDERGAST: "In the past, when we bought all of our gas supplies from interstate pipelines, most, if not all of it, at least the part that's associated with pipeline storage, was bundled up and included in whatever the sales rate was that the interstate pipeline charged the utility. After 636 and transportation came, those costs were included for a while up until this point in base rates, and what this would do is have those costs recovered as they used to be, or at least a significant portion of them were, through the PGA mechanism in the future. And once again, one of the reasons for doing that, from our perspective, is that you will go ahead and know what those costs are. You will not be charging more or less than what they are, and they're about as intricately related to gas costs as they're already recovered through the PGA, as just about anything else could be." 1. Does Staff disagree with any of the statements made by Laclede? If yes, please state the disagreement and the basis of the disagreement. 2. Laclede states one ratepayer benefit of including inventory costs in the PGA is that Laclede will not be charged more inventory costs than what the actual costs are. Does Staff agree with this statement? If not, why not. If Staff agrees with this statement, why is Staff, in its direct testimony in this case, recommending the Commission eliminate this ratepayer benefit? 3. Laclede states that natural gas inventory costs are "about as intricately related to gas costs as they're already recovered through the PGA, as just about anything else could be." Does Staff disagree with this statement? If yes, why? Regarding the appropriate treatment of gas inventory financing costs, first it was in the PGA, then it went to rate base, then in 2005 at Laclede's request it went back to the PGA. Now in 2016 Laclede wants it out of the PGA, and Staff is recommending it go back to rate base. If the Staff concerned at all about the lack of consistency in its recommendations to the Commission on this issue? If not, why not?

Objection is made to Data Request No. 472 in its entirety in both cases on the following bases:

(i) it is beyond the scope of proper discovery of an expert witness;

(ii) it constitutes an improper use of a data request, as a data request may not be used to ask an expert to prepare an essay on a topic chosen by the requesting party;

(iii) the DR refers to the transcript of a stipulation presentation in which the stipulation being addressed provided in paragraph 17 that “None of the signatories to this Stipulation and Agreement shall be deemed to have approved or acquiesced in any ratemaking or procedural principle, including, without limitation, any method of cost determination or cost allocation, depreciation or revenue related method or any service or payment standard, and none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation in this or any other Commission, judicial review or other proceeding, except as otherwise expressly specified herein. Nothing in this Stipulation and Agreement shall preclude the Staff in future proceedings from providing recommendations as requested by the Commission or limit Staff’s access to information in any other proceedings. Nothing in this Stipulation and Agreement shall be deemed a waiver of any Commission statute or regulation;

(iv) the DR asks Staff to opine as to a hearsay statement, made not by a sworn witness but by an attorney for a party other than Staff in a non-contested stipulation presentation rather than a contested hearing;

(v) the DR mischaracterizes the statement made by Mr. Pendergast of Laclede and the history of gas inventory carrying cost treatment;

(vi) the DR mischaracterizes the history of Staff’s position on the issue;

(vii) the DR is unclear and ambiguous;

(viii) in addition to the above, in Case No. GR-2017-0216, the DR is misleading and mischaracterizes Staff’s position and testimony, since GR-2017-0216 concerns MGE and Staff has not recommended changes to the treatment of MGE gas inventory carrying cost.

Sincerely,

/s/ Jeff Keevil

Jeff Keevil
Deputy Counsel
Missouri Public Service Commission
573-526-4887

Response to OPC Data Request No. 430

Reference Staff COS Report page 105 where it states “The Commission has traditionally included a reasonable amount of SERP expenses in customer rates.”

1) Please list each and every Order and every other document relied upon by the Staff to reach its conclusion that the Commission has traditionally included a reasonable amount of SERP expenses in customer rates.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

2) What is Staff’s definition of a “reasonable” SERP expense?

Black’s Law Dictionary, 6th Edition, defines reasonable as “fair, proper, just, moderate, suitable under the circumstances”. Staff’s position is that it is not inappropriate for utilities to offer eligible employees a reasonable amount of SERP benefits in order to attract qualified employees and compensate them at competitive levels. Accordingly, Staff is not opposed to inclusion of SERP expenses at an appropriate normalized level in rates.

3) Did Staff make a determination that the lump sum SERP payments were reasonable? If yes, what criteria did Staff use to reach this conclusion? If no, why not?

Lump sum payments are an option under the current Laclede Gas Company SERP plan, and the lump sum option is available for SERP plans for other Missouri large utilities. The purpose of the SERP, to Staff’s knowledge, is a restoration plan, that is designed to maintain a level of total retirement benefits which would otherwise be payable under the Laclede Gas Company Cash Balance Retirement Plan, but for the compensation and amount payable limitations imposed by the Internal Revenue Code. The Laclede Gas Company Cash Balance Retirement Plan allows for lump sum payments. To Staff’s knowledge, there are no current pending changes to either the SERP plan or the Retirement Plan. Therefore, it is reasonable to conclude that some form of SERP lump sums will be paid in the future. The criteria Staff used to reach this conclusion was the fact that some amount of lump sums have been paid in the near past, and some amount of lump sums should be paid in the future.

Staff examined the periodic and lump sum SERP payments in total for 16 years (see Staff Direct Workpapers). Staff also examined SERP payments separated between periodic payments and lump sums from 2010 through 2017. In every year during 2011 through 2016, Laclede incurred some form of lump sum SERP payment. Consequently, it is reasonable to conclude that some form of lump sum SERP payments will be incurred in the future. Staff used the payments made from 2014

through 2016 in its three year average. Using this time period for Staff's average excludes any payments made to executives that did not provide services to MGE.

4) Please list and describe each and every reason why Staff chose an 8-year amortization period for lump sum SERP payments?

Staff did not use an 8 year amortization period for lump sum SERP payments. Staff used a three year average of actual payments. Staff did, in error, reference an 8 year amortization in its direct filed cost of service report.

5) List the the dollar amount of SERP Staff is recommending for Laclede in this rate case and state how Staff determined this amount to be reasonable.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR; however, the dollar amount of included O&M expense is \$304,958 and Staff's adjustment can be found in Staff's Accounting Schedules at Schedule 10, adjustment E-91.8.

6) List the dollar amount of SERP Staff is recommending for MGE in this rate case and state how Staff determined this amount to be reasonable.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR; however, the dollar amount of included O&M expense is \$168,842 and Staff's adjustment can be found in Staff's Accounting Schedules at Schedule 10, adjustment E-63.5.

7) Does Staff agree that costs capitalized to CWIP are designed to allocate to plant the cost of employee services (benefits) in the period? If not, why does Staff not agree with this statement?

Yes.

8) If Staff agrees with the statement in #7 above, please list and describe the benefits to accrued plant (CWIP) up to the end of the test year that were the result of service performed by SERP retirees.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

9) Does Staff believe capitalizing SERP cash payments to CWIP is good accounting? If yes, please explain why this is good accounting.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

10) Does Staff believe capitalizing SERP cash payments to CWIP is good ratemaking? If yes, please explain why this is good ratemaking.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

11) Does the Staff understand that capitalizing any part of pension expense with the exception of service cost will be prohibited by FASB in 2017? If no, please explain the basis for the Staff's conclusion.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

12) Does the Staff agree that capitalizing any part of SERP expense is directly contradictory to this new GAAP treatment? If not, please explain how Staff's treatment of SERP is consistent with this new GAAP.

Pursuant to the objection letter sent to OPC September 21, 2017, Staff objects to this portion of the DR.

- DR 429
- Staff COS Report page 60. “Staff witness Dave M. Sommerer is recommending that both the current natural gas and propane inventories that were previously included in the PGA/ACA process now be included as part of rate base in the cost of service calculation.” At page 62 of Staff COS Report Mr. Sommerer states “LAC has been authorized to recover gas inventory carrying costs as part of its PGA since October 1, 2005” under the Inventory Carrying Cost Recovery (“GICCR”) tariff. Mr. Sommerer also states that “Staff is proposing to revert to the ratemaking treatment used for LAC prior to 2005 and therefore include gas and propane inventories in rate base.” 1. Does Staff’s reversion to an old ratemaking treatment for Laclede result in higher utility rates for Laclede’s ratepayers? If no, please explain and demonstrate this belief with calculations. If yes, please quantify this increase in utility rates.
- 2. Mr. Sommerer states this new change in ratemaking treatment of natural gas inventories is justified because this new ratemaking treatment is consistent with how MGE treats gas inventories are treated. He also states an additional benefit is that accounting for gas inventory in a rate case makes Staff’s natural gas cost audit calculation easier. A) Does Mr. Sommerer believe Laclede’s ratepayers would agree that it is a reasonable and prudent Staff action to change a long-term Laclede ratemaking treatment for gas costs and increase utility rates just to be consistent with a different utility and to make audit calculations easier?
- B) Does Mr. Sommerer personally believe it is a reasonable and prudent Staff action to change a long-term Laclede ratemaking treatment for gas costs and increase utility rates just to be consistent with a different utility and to make audit calculations easier?
- 3. At page 62 of the Staff’s COS Report Mr. Sommerer states “Staff has also had a long-standing position that only clear and identifiable “actual gas costs” should be subject to PGA recovery. Does Staff believe the cost to purchase natural gas and place it and maintain it in inventory is a clear and identifiable actual natural gas cost? If not, please list and describe in as much detail as possible each and every reason why Staff does not believe this cost is a “clear” natural gas cost. Also list and describe in as much detail as possible each and every reason why this is not an “identifiable” natural gas cost.
- 4. If Staff believes that natural gas inventory costs are not “clear and identifiable” natural gas costs and only “clear and identifiable” natural gas costs should be included in a PGA,
- A) please list each and every reason why Staff included natural gas inventory costs in Laclede’s PGA for the past 12 years?
- B) Was this a Staff error?
- C) Has Staff changed its definition of a “clear and identifiable” natural gas cost?
- 5. Please list the name(s) of each and every member of Staff who was involved in the decision to change the natural gas inventory ratemaking treatment for Laclede.
- 6. Please list the name of the Staff member who made the decision to change the natural gas inventory ratemaking treatment for Laclede.
 - Due Date: 9/28/2017
 - Requested By: Chuck Hyneman

Staff objects to this data request as irrelevant and misleading because Staff witness David Sommerer’s testimony referenced in the above DR proposes no change to MGE’s current PGA/ACA process from what is currently in effect in MGE’s tariffs. Therefore, the questions

asked in these DRs of MGE are wholly irrelevant and misleading as to Staff's position and mischaracterize Staff witness David Sommerer's testimony.

- **DR 430**
- **Reference Staff COS Report page 105 where it states "The Commission has traditionally included a reasonable amount of SERP expenses in customer rates." 1) Please list each and every Order and every other document relied upon by the Staff to reach its conclusion that the Commission has traditionally included a reasonable amount of SERP expenses in customer rates.**
 - *Staff objects to this question as overbroad and unduly burdensome because it requests every Commission decision in which it permitted a utility to recover a reasonable amount of SERP expense. This would require an intensive amount of research into prior Commission decisions, which Staff cannot perform at the same time as drafting testimony.*
- **2) What is Staff's definition of a "reasonable" SERP expense?**
 - *Staff will provide an answer to this DR prior to the October 26 due date.*
- **3) Did Staff make a determination that the lump sum SERP payments were reasonable? If yes, what criteria did Staff use to reach this conclusion? If no, why not?**
 - *Staff will provide an answer to this DR prior to the October 26 due date.*
- **4) Please list and describe each and every reason why Staff chose an 8-year amortization period for lump sum SERP payments?**
 - *Staff will provide an answer to this DR prior to the October 26 due date.*
- **5) List the the dollar amount of SERP Staff is recommending for Laclede in this rate case and state how Staff determined this amount to be reasonable.**
 - *Staff 's recommendation is outlined in its accounting schedules attached to and as outlined in its direct testimony regarding SERP expense.*
- **6) List the dollar amount of SERP Staff is recommending for MGE in this rate case and state how Staff determined this amount to be reasonable.**
 - *Staff 's recommendation is outlined in its accounting schedules attached to and as outlined in its direct testimony regarding SERP expense.*
- **7) Does Staff agree that costs capitalized to CWIP are designed to allocate to plant the cost of employee services (benefits) in the period? If not, why does Staff not agree with this statement?**
 - *Staff will provide an answer to this DR prior to the October 26 due date.*
- **8) If Staff agrees with the statement in #7 above, please list and describe the benefits to accrued plant (CWIP) up to the end of the test year that were the result of service performed by SERP retirees.**
 - *Staff objects to this DR because OPC requests it of the improper party. This question would be better asked of the company, specifically the MGE witness which filed SERP testimony.*
- **9) Does Staff believe capitalizing SERP cash payments to CWIP is good accounting? If yes, please explain why this is good accounting.**
 - *Staff objects to this DR as vague. The term "good accounting" is ambiguous and Staff would be forced to result to speculation to answer this request.*
- **10) Does Staff believe capitalizing SERP cash payments to CWIP is good ratemaking? If yes, please explain why this is good ratemaking.**
 - *Staff objects to this DR as vague. The term "good ratemaking" is ambiguous and Staff would be forced to result to speculation to answer this request.*

- **11) Does the Staff understand that capitalizing any part of pension expense with the exception of service cost will be prohibited by FASB in 2017? If no, please explain the basis for the Staff's conclusion.**
 - *Staff objects to this DR as ambiguous. Staff as part of its work stays up to date on the current and future FASB provisions. It is unclear from this request how OPC expects Staff to explain that it concluded that a new provision will go into effect under FASB.*
- **12) Does the Staff agree that capitalizing any part of SERP expense is directly contradictory to this new GAAP treatment? If not, please explain how Staff's treatment of SERP is consistent with this new GAAP.**
 - *Staff objects to this DR as vague. The request appears to project a personally held opinion and position onto Staff and then in turn expect Staff to respond. Staff would recommend such a projection is better reserved for rebuttal testimony.*

Due Date: 9/28/2017

Requested By: Chuck Hyneman

In depth

A look at current financial reporting issues



FASB changes the presentation of pension cost

No. US2017-05

March 14, 2017

What's inside:

Background.....1

Key provisions..... 2

Capitalization.....3

No industry exceptions.....4

Not-for-profit presentation.....4

Convergence with IFRS.....6

Other presentation matters.....7

What's next..... 7

At a glance

On March 10, 2017, the FASB issued final guidance on the presentation of net periodic pension and postretirement benefit cost (net benefit cost). Presently, net benefit cost is reported as an employee cost within operating income (or capitalized into assets when appropriate). The amendment requires the bifurcation of net benefit cost. The service cost component will be presented with other employee compensation costs in operating income (or capitalized in assets). The other components will be reported separately outside of operations, and will not be eligible for capitalization.

Background

.1 Net benefit cost on pension and postretirement benefit plans includes multiple components, including current period employee service cost, interest cost on the obligation, expected return on plan assets, and amortization of various amounts deferred from previous periods. Today, these components must be aggregated and reported as a single net employee compensation cost, which is either reported within the operating section of the income statement or capitalized into assets, when appropriate. The various components are disclosed in the footnotes.

.2 The FASB received feedback from some stakeholders that the aggregate presentation of net benefit cost combines elements that are distinctly different in their predictive value, resulting in greater cost and complexity when analyzing financial statements. In response, the FASB issued guidance¹ that changes the presentation of the net benefit cost.

.3 The FASB is not changing the rules related to how benefit costs are measured. The new guidance will, however, impact where the components of net benefit cost are presented within an employer's income statement. It will also impact when certain costs are recognized in the income statement, as the amount of costs that can be capitalized will be limited to service cost only.

¹ Accounting Standards Update 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

Key provisions

.4 Under the new rules, entities that sponsor defined benefit plans will present net benefit cost as follows:

- Service cost will be included with other employee compensation costs within operations, if such a subtotal is presented;
- The other components of net benefit cost will be presented separately (in one or more line items) outside of income from operations, if such a subtotal is presented; and
- Only the service cost component will be capitalized, when applicable (for example, as a cost of inventory, internal-use software, or a self-constructed fixed asset).

.5 If a separate line item is used to present the other components of net benefit cost, it should have an appropriate description. If a separate line item or items is not used, the line item or items in the income statement where the other components of net benefit cost are included must be disclosed.

.6 Gains and losses from curtailments and settlements, and the cost of certain termination benefits accounted for under ASC 715, *Compensation-Retirement Benefits*, will be reported in the same fashion as the other components of net benefit cost.

Example: Statement of Operations (commercial entity)

	20X9
Revenues	\$2,000
Operating expenses (1)	1,500
Income from operations	500
Other income (expenses), net	(100)
Other components of net periodic pension cost	(100)
Net income	\$300

(1) The service cost component is presented in the same line item or items as other employee compensation costs arising from employee services rendered in the period.

Example: Statement of Operations (banking institution)

	20X9
Non-interest revenues	\$1,200
Interest income	800
Interest expense	(600)
Net interest income	200
Non-interest expenses (1)	(900)
Other components of net periodic pension cost	(100)
Income before income tax expense	400
Income tax expense	(100)
Net income	\$300

(1) *The service cost component is presented in the same line item or items as other employee compensation costs arising from employee services rendered in the period.*

Capitalization

.7 Under current guidance, since the net benefit cost is considered one aggregate amount, when it is appropriate to capitalize costs (for example, as a cost of inventory or a self-constructed asset), the entire net benefit cost applicable to the pertinent employees for the period is capitalized. However, as described above, this amount includes costs that relate more to financing (i.e., interest cost) or investing (i.e., return on assets), or costs that arose in prior periods and were previously deferred in accumulated other comprehensive income. By disaggregating the presentation of net benefit cost on the income statement, the amount eligible for capitalization is now limited to the service cost component of net benefit cost. The FASB believes this more closely reflects the current period compensation cost provided to employees to build or produce inventory or self-constructed assets. It also believes it will improve comparability and reduce the need for additional disclosure requirements around capitalized amounts.

PwC observation:

Companies that have elected a policy of immediately recognizing actuarial gains and losses will likely view this change favorably. For these companies, the income statement is subject to more volatility as fluctuations in pension amounts are recognized immediately instead of being deferred and recognized over time. This volatility is captured into inventory or other assets as those amounts may be capitalized, or else reflected in operating income. By presenting only the service cost component within operations and limiting the amount eligible for capitalization to service cost, this will likely reduce volatility within the balance sheet and operations section of the income statement.

For all entities, cost accounting systems, processes and related controls will need to be updated to reflect the new capitalization requirements upon adoption.

No industry exceptions

.8 The FASB considered whether certain industries should be allowed an exception to the new guidance. For example, for rate-regulated entities, these changes would create a difference between US GAAP and regulatory reporting for amounts capitalized into the cost of property, plant and equipment for rate-making purposes. It will also create a mismatch between what is included in operating revenue (as rates charged to customers will reflect recovery of the entire net benefit cost) as compared to what is included in operating expenses. Similarly, certain types of government contractors are reimbursed based on their costs measured under Federal Acquisition Regulations and government cost accounting standards, which do not align with the new FASB guidance. However, the FASB ultimately did not provide any exceptions to the accounting guidance for specific industries.

PwC observation:

The changes to the cost capitalization guidance will impact more than just inventory or self-constructed assets. It will also impact entities in the financial services sector, or any company that is able to capitalize allocated portions of compensation costs. For example, insurance entities may capitalize net benefit costs as part of establishing deferred assets related to acquiring new contracts (deferred acquisition costs). For entities that originate loans, direct loan origination costs (which may include elements relating to pension costs) are required to be deferred as a basis adjustment to the loan or receivable.

While the insurance and receivables guidance was not specifically amended by the new guidance, upon adoption, these entities will need to limit any net benefit costs capitalized to only the service component.

Not-for-profit presentation

.9 The new guidance is applicable to not-for-profit entities. Today, not-for-profit entities (NPOs) are required to provide information about expenses by functional categories (e.g., major programs and supporting activities); additional information regarding expenses by natural classification (e.g., salaries, benefits, occupancy costs) is optional. Once ASU 2016-14, *Not-for-profit entities (Topic 958): Presentation of financial statements of not-for-profit entities*, becomes effective, information about expenses by natural classification will also be required.

.10 When NPOs report expenses by natural classification, the new pension presentation requirements are similar to those for business entities. The service cost component of net benefit cost will be reported together with other compensation costs, and the other components will be reported separately from those amounts and shown outside an intermediate measure of operations, if one is presented². When NPOs report expenses by functional categories (illustrated in the example below), they will continue to apportion net periodic pension costs among the appropriate functional expense categories, as is done today. However, if an intermediate measure of operations is presented, the standard requires that the service cost component be included within operating costs, and that the other components be reported as nonoperating.

.11 If, in addition to reporting net benefit cost, the statement of activities reflects pension- and postretirement-related amounts that would be reported in other comprehensive income (OCI) by business entities (for example, actuarial gains or losses), special reporting considerations apply. Outside of not-for-profit healthcare entities, the NPO financial reporting model does not utilize the concept of other comprehensive income. Today, the pension-related OCI-type amounts are simply reported as an increase or decrease in net assets, displayed in a separate line outside of expenses. Subsequently, the annual reclassification out of this category and into benefit costs is reported in that same separate line item.

.12 The new standard prohibits reporting of the other components of net benefit cost in the same line as the OCI-type items. If the other components are shown as a separate line item (see the example below), the caption used should appropriately differentiate that line from the separate line for the OCI-type amounts. If the NPO reports an intermediate measure of operations, the standard imposes a new requirement that the OCI-type amounts be reflected as nonoperating (consistent with the requirement for reporting the other components of net benefit cost). Thus, the annual “recycling” would occur entirely within nonoperating activity.

² For NPO health care entities within the scope of ASC 954, the other components would be reported above the performance indicator.

Example: ASC 958 Statement of Activities - Not-for-Profit Organization

This example illustrates the reporting by an NPO that presents expenses by functional classification and reports an intermediate measure of operations.

	20X9 (in 000's)		
	Without Donor Restrictions	With Donor Restrictions	Total
Operating:			
Revenues, gains, and other support	\$10,000	\$5,000	\$15,000
Expenses, including pension service cost	7,500		7,500
Increase in net assets from operating activities	2,500		2,500
Nonoperating:			
Other components of net periodic pension cost	(100)		(100)
Pension-related changes other than net periodic pension cost*	50		50
Increase in net assets	2,450	5,000	7,450
Net assets, beginning of year	105,000	52,000	157,000
Net assets, end of year	\$107,450	\$57,000	\$164,450

*Reduction of prior service cost and other gains/losses charged to OCI in prior periods.

Convergence with IFRS

.13 Under IAS 19(R), *Employee Benefits*, service cost and net interest cost can be recognized in the income statement as either a combined amount or as separate line items. Remeasurements of the net benefit liability (asset) are recognized in other comprehensive income and those amounts are not recycled into the income statement. While IFRS allows flexibility in the presentation, the new US GAAP guidance will require the disaggregation of the service cost component from other components of net benefit cost.

.14 In addition, under IFRS, the net funded position is accreted at a single discount rate to determine net interest cost. This is different than the requirements in ASC 715 to independently calculate interest cost based on a discount rate applied to the projected benefit obligation and the expected return on plan assets based on an expected long-term rate of return applied to the market-related value of the plan assets. Further, a new difference will be introduced by the new guidance when companies capitalize costs into inventory or fixed assets. Under the new US GAAP guidance, the cost that can be capitalized will be limited to service cost, while under IFRS, the entire cost of the relevant employees' benefits is capitalizable.

Other presentation matters

.15 For segment reporting, companies should continue to present information based on how management reports costs internally for evaluation purposes, regardless of what is now required for consolidated GAAP reporting. Some companies currently present the service cost component separate from the other components of net benefit cost in the income statement for segment reporting and, therefore, this new guidance may increase consistency between their overall reporting and their segment disclosures. For reporting entities with discontinued operations, the components of net benefit cost presented outside of operations should be allocated appropriately to discontinued operations.

.16 In a multiemployer pension plan, unrelated employers make contributions but the assets are commingled, and therefore these plans are accounted for similar to defined contribution plans, with expense recorded for the required contribution each period. Accounting for multiemployer plans will not change under the new guidance, as benefit cost under these plans is defined by the employer's required contribution for the period, not the various actuarial components of the overall plan. Further, in stand-alone financial statements of a subsidiary, plans in which employees participate in a commingled parent-sponsored pension plan are accounted for in the same manner as if they were multiemployer pension plans. This will also not change under the FASB's guidance.

.17 For the first time, the guidance specifies the presentation for gains and losses on curtailments and settlements, as well as termination benefits paid through retirement plans. As these were not previously considered part of the defined components of periodic net benefit cost, they were not subject to the aggregation guidance of the previous guidance. Accordingly, there was diversity in practice as to how such amounts were historically recorded. Additionally, termination benefits paid outside of retirement plans (such as normal severance) would not be eligible for the specified presentation in the guidance, and would likely still be presented within operating income, if such a subtotal is presented.

What's next

.18 The guidance is effective for public business entities for annual reporting periods beginning after December 15, 2017, and interim periods within that reporting period. For all other entities (including all NPOs), it is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption will be permitted as of the beginning of an annual reporting period for which financial statements have not been issued or made available for issuance. However, early adoption is only allowed in the first interim period presented in a fiscal year; therefore, early adoption is only permitted in the first quarter of 2017 for calendar year-end public companies.

.19 This guidance is required to be applied on a retrospective basis for the presentation of the service cost component and the other components of net benefit cost (including gains and losses on curtailments and settlements, and termination benefits paid through

retirement plans), and on a prospective basis for the capitalization of only the service cost component of net benefit cost. Amounts capitalized into assets prior to the date of adoption should not be adjusted through a cumulative effect adjustment, but should continue to be recognized in the normal course as, for example, inventory is sold or fixed assets are depreciated.

.20 The guidance allows a practical expedient for the retrospective application that permits use of the amounts disclosed for the various components of net benefit cost in the pension and other postretirement benefit plans footnote as the basis for the retrospective application. This would be in lieu of determining how much of the various components of net benefit cost were actually reflected in the income statement each period as a result of capitalization of certain costs into assets and their subsequent amortization. If the practical expedient is elected, this fact must be disclosed.

Questions?

PwC clients who have questions about this *In depth* should contact their engagement team. Engagement teams who have questions should contact the National Professional Services Group.

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Authored by:

Jay Seliber
Partner
Phone: 1-973-236-7277
Email: jay.seliber@pwc.com

Roxanne Fattahi
Senior Manager
Phone: 1-973-236-4290
Email:
roxanne.fattahi@pwc.com

Nicole Berman
Director
Phone: 1-973-236-4202
Email: nicole.s.berman@pwc.com

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MISSOURI PUBLIC SERVICE COMMISSION

STAFF REPORT COST OF SERVICE



SPIRE MISSOURI, INC., d/b/a SPIRE
LACLEDE GAS COMPANY and MISSOURI GAS ENERGY
GENERAL RATE CASE

CASE NOS. GR-2017-0215
and GR-2017-0216

Jefferson City, Missouri
September 2017

**** Denotes Confidential Information ****

1 All of the Staff's expense lag calculations are measured to the point in which the
2 Company makes payment for the goods and services received. LAC and MGE included a bank
3 float for some of its expense lags. A bank float is defined as the time between when LAC and
4 MGE pay for a cost and when the check clears the bank. Staff is opposed to efforts to incorporate
5 "bank float" or similar electronic measurements of when funds are actually removed from the
6 Company's bank accounts in expense lag calculations.

7 In conclusion, the results of the study performed by Staff resulted in a positive CWC
8 requirement. This means that in the aggregate, the shareholders have provided the CWC to the
9 Company during the year. Therefore, the shareholders should be compensated for the CWC that
10 they provide, through an increase to rate base.

11 *Staff Expert/Witness: Karen Lyons*

12 **E. Stored Gas Inventory**

13 **1. Natural Gas and Propane Inventories**

14 Natural gas is purchased and injected into storage facilities during the summer months
15 where it is held until the winter months when that gas is withdrawn and delivered to LAC's and
16 MGE's distribution system for customer use. Propane gas is also purchased and stored to meet
17 peak demand during the winter months. LAC owns propane facilities, but MGE does not.

18 LAC owns the Lange natural gas underground storage field located north of St. Louis.
19 LAC generally fills this storage field in the summer and uses gas from this storage to serve its
20 customers on cold days during the heating season. The storage field and natural gas in the
21 storage field are LAC investments. The natural gas in the storage field is recorded in one of
22 three accounts as required by the Federal Energy Regulatory Commission ("FERC") Uniform
23 System of Accounts ("USOA"). The natural gas that is included in FERC account 164.10 Gas
24 Stored - Current represents attainable natural gas that is used to meet seasonal demand
25 increases.³¹ Prior to this rate case, the balance in account 164.10 and 164.11 was addressed as
26 part of the PGA/ACA process and therefore was not included in rate base. As part of this current
27 rate case, Staff witness Dave M. Sommerer is recommending that both the current natural gas
28 and propane inventories that were previously included in the PGA/ACA process now be

³¹ Some of the gas in the storage field is unrecoverable. Attainable natural gas is that which is able to be recovered and used. It is also referred to as current gas.

1 included as part of rate base in the cost of service calculation, in addition to the natural gas
2 recorded in FERC accounts 117.10 and 352.30, that are already recorded in rate base.
3 The balance of inventory contained in FERC account 117.10 Gas Stored - base gas, also referred
4 to as “cushion gas,” represents the volume of gas that must remain in the storage facility to
5 provide the required pressurization to extract the current gas from the storage facility.
6 The balance reflected in FERC account 352.30 is non-recoverable natural gas that is permanently
7 embedded in the storage field and may never be extracted.

8 LAC also injects and withdraws gas from the Mississippi River Transmission (“MRT”)
9 pipeline as a supplemental source of natural gas to the Lange storage field. This gas, along with
10 the current stored gas discussed above, is now being included in LAC’s rate base.

11 LAC also owns a cavern located adjacent to the Lange natural gas underground storage
12 field that contains propane inventories previously included as part of LAC’s PGA/ACA. Similar
13 to the current natural gas inventories discussed above, Staff recommends that propane inventory
14 should also be included in rate base.

15 MGE has firm capacity³² for access to natural gas storage on the Southern Star Central
16 Gas Pipeline and the Panhandle Eastern Pipeline.

17 For both LAC and MGE, Staff has reviewed all gas inventories for the period of
18 January 2013 through June 30, 2017, and has included a 13-month average ending June 30,
19 2017, as the proper amount of natural gas inventory to include in rate base.

20 For LAC only, Staff has reviewed all propane inventories for the period of January 2013
21 through June 30, 2017, and has included a 13-month average ending June 30, 2017, as the proper
22 amount of propane inventory to include in rate base.

23 These amounts are included in rate base in order to give LAC and MGE the opportunity
24 to earn a return on its investment for these inventories until those assets have been used. Staff
25 will continue to review the natural gas and propane inventory levels through the true-up date in
26 this case.

27 *Staff Expert/Witness: Lisa M. Ferguson*

³² Firm capacity is the amount of gas available for production or transmission which can be, and in many cases must be, guaranteed to be available at a given time.

1 2. LAC Storage Field

2 Staff is including a 13 month average level of natural gas and propane inventories in rate
3 base for both MGE and LAC. MGE has traditionally included natural gas inventory in its rate
4 base and so rate base treatment should not be considered a change in ratemaking treatment.
5 The rationale for including inventory in rate base is that natural gas (or propane) must be injected
6 into storage fields (or caverns in the case of propane) prior to withdrawal. Local Distribution
7 Companies (“LDCs”) must therefore finance the cost of the inventory until the inventory is
8 withdrawn from storage. The inclusion of gas inventories in rate base is a method of addressing
9 the inventory carrying costs associated with paying for the gas or propane prior to its use and
10 related revenue recovery by giving the LDC the opportunity to earn a return on its investment
11 until these inventories are used.

12 Based upon a review of LAC’s tariffs, LAC has been authorized to recover gas inventory
13 carrying costs as part of its PGA since October 1, 2005. The tariff that describes the
14 PGA treatment is Sheet No. 28-h, and became effective in LAC Case No. GR-2005-0284.
15 The original inclusion of inventory carrying costs in LAC’s PGA tariffs was part of a Stipulation
16 and Agreement, and therefore was not a litigated issue. In subsequent LAC rate cases, the Gas
17 Inventory Carrying Cost Recovery (“GICCR”) tariff remained, and therefore “current” gas
18 inventories were not included in LAC’s rate base as they had been prior to 2005. It should be
19 noted that gas inventories associated with cushion gas³³ continued to receive rate base treatment
20 even after the institution of the GICCR in 2005.

21 Staff is proposing to revert to the ratemaking treatment used for LAC prior to 2005 and
22 therefore include gas and propane inventories in rate base. This has the beneficial effect of
23 having consistent ratemaking treatment between the two divisions of LAC and MGE. It further
24 has benefits of reducing complexity resulting from the review of the separate GICCR mechanism
25 in the annual Actual Cost Adjustment (“ACA”) reviews. Staff has also had a long-standing
26 position that only clear and identifiable “actual gas costs” should be subject to PGA recovery.

³³ **Base gas (or cushion gas)** is the volume of natural gas intended as permanent inventory in a storage reservoir to maintain adequate pressure and deliverability rates throughout the withdrawal season. (Energy Information Administration, *The Basics of Underground Natural Gas Storage*).

1 In addition, all other Missouri LDCs have used the “rate base” approach to recover carrying costs
2 associated with gas inventory in their Missouri jurisdictions.

3 *Staff Expert/Witness: David M. Sommerer*

4 **F. Prepayments; Materials and Supplies**

5 **1. Prepayments**

6 Prepayments are the costs a company incurs and pays in advance for various items
7 needed to operate the utility system. Staff’s recommended treatment of prepayments is to
8 examine each prepayment account individually in order to determine an appropriate measure that
9 most accurately reflects the ongoing future investment costs of a particular account, and then
10 include that amount in LAC’s and MGE’s rate bases. LAC and MGE have utilized their own
11 funds for prepaid items such as insurance premiums and rents. Staff examined LAC’s and
12 MGE’s prepayment account balances on a month-by-month basis. Based on this review and the
13 variability in the monthly account balances, Staff determined the prepayment levels to include in
14 LAC’s and MGE’s rate bases (Rate Base, Accounting Schedule 2) by calculating the 13-month
15 average ending June 30, 2017, the update period. A 13-month average of month-ending balances
16 is used to capture the beginning balance and ending balance of the 12-month period ending
17 June 30, 2017. Staff recommends this approach because there was no discernible upward or
18 downward trend in the monthly balances.

19 *Staff Expert/Witness: Wayne Hodges*

20 **2. Materials and Supplies**

21 Materials and supplies consist of natural gas piping, connections for service, main
22 repairs, gas regulators, and spare parts necessary to operate the local distribution natural gas
23 system. Staff’s recommended treatment of materials and supplies is to examine each account
24 individually in order to determine an appropriate measure that most accurately reflects the
25 ongoing future investment costs of a particular account, and that should be included in LAC’s
26 and MGE’s rate base. Staff reviewed the monthly balances for materials and supplies over the
27 last several years and, because the monthly account balances fluctuated with no distinguishable
28 trend, Staff determined that a 13-month average as of June 30, 2017, was appropriate for
29 materials and supplies. Materials and supplies are included in the LAC and MGE rate base
30 (Accounting Schedule 2).

31 *Staff Expert/Witness: Wayne Hodges*