BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

POST-HEARING BRIEF

OF

LACLEDE GAS COMPANY

AND

MISSOURI GAS ENERGY

January 6, 2017

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LACLEDE GAS COMPANY AND MISSOURI GAS ENERGY

COMES NOW Laclede Gas Company ("Laclede") and on behalf of its two Missouri operating units, Laclede Gas (herein so called) and Missouri Gas Energy ("MGE"), files this Post-Hearing Brief, and in support thereof, states as follows:

I. INTRODUCTION

The General Assembly enacted Sections 393.1009-1015 RSMo. (the "ISRS Statute") back in 2003 in large part to encourage utilities to incur costs to expedite safety replacements by reducing regulatory lag and permitting more timely recovery of those expenditures. In effect, the ISRS statute operates primarily as a carrot in which some reduction in regulatory lag is traded for expedited safety.

While OPC sees the ISRS as a cash register for gas utilities, they ignore the other side of the equation, which is that Laclede is accelerating its safety work, and is doing so in an efficient and cost-effective manner. Thanks in large part to the incentives provided by the ISRS legislation, customers are getting a safer system at a much faster pace than before, and at a faster pace than would otherwise be achieved without the ISRS. OPC has

taken it upon itself to frustrate the goal of the legislature and undercut the ISRS. Certainly, we would not argue with OPC's decision to oppose a controversial cost item such as the ISRS eligibility of work done to address third party damage. However, in this case, OPC takes direct aim at the cast iron and steel main replacement programs of Laclede Gas and MGE – programs that form the core of the ISRS statute. Further, OPC seeks to disallow the hydrostatic testing obligations that arose out of the San Bruno tragedy, in which 8 people were killed, 51 injured, and 38 houses destroyed. By opposing more timely recovery under the ISRS Statute for mandated safety investments, OPC inappropriately elevates the payment of ISRS dollars above the safety work incentivized by the legislature.

In this ISRS case, there are three issues:

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

2. (Formerly Issue No. 4)

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

3. (Formerly Issue No. 5)

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

II. DISCUSSION

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

For the reasons stated below, it is neither lawful nor appropriate to allow OPC to raise new issues in this case that could have, and should have, been raised by the 60 day deadline provided in the statute.

A. OPC is subject to the 60 day requirement.

If the 60 day deadline doesn't apply to OPC, than what deadline would apply? The Commission should not be led to believe that the Legislature set up a specific process under which Staff was to submit a report in 60 days, but any other party is free to raise issues and ask for hearings at any time. OPC wants to turn the ISRS statute on its head and argue that the burden was on the other parties and the Commission to create and enforce a procedural schedule that required OPC to act by the 60 day deadline. (See Tr. 18, lines 1-8) But the Legislature already established a schedule. The burden should be on OPC to request a post-60 day late filing from the Commission, and for the Commission to decide if it is even authorized to grant such an extension.

B. OPC has repeatedly acknowledged that it is subject to the 60 day requirement.

In multiple arguments regarding the "Updating" issue,[1] OPC has claimed that it did not have enough time to audit the updated information prior to the end of the 60 day statutory period. OPC's repeated position is that OPC is subject to that 60 day deadline. Its witness, Mr. Hyneman, has testified to that fact in this case; its attorney Mr. Poston, has argued the point to the Commission, the Western District Court of Appeals and the Missouri Supreme Court. Quotes from this testimony and argument are replicated in Attachment 1 to this brief. Now that OPC has raised its issues in this case on day 70, however, OPC suddenly wants the Commission to believe that the statutory mandate does

[1] The Updating issue has been twice decided by the Commission against OPC. OPC raised it for a third time in this case; it was Issue #2 until OPC withdrew it on January 2, the day before the hearing.

not apply at all. OPC cannot have it both ways. Its previous arguments at the Commission and the courts are correct and OPC should live with the 60 day deadline it has repeatedly acknowledged is applicable.

C. OPC failed to comply with the Commission's November 30 order.

While OPC was required to raise new issues by day 60 on November 29, the same day Staff filed its report, the Commission's November 30 order allowed OPC to respond to Staff's Report by December 9. The November 30 order did not allow for OPC to either respond to Staff's Report or raise its own new issues. OPC's response did not address Staff's report at all, but improperly raised its own new issues. If a party can raise anything it wants and call it a "response," then there is no meaning to the term 'respond.' The Commission gave OPC permission to respond to Staff's report, not to raise its own issues. OPC is permitted to raise its own issues, but it must do so by the statutory deadline.

D. The fact that OPC was permitted to violate the 60 day rule in past ISRS cases does not allow it to violate that rule in this case.

OPC has raised issues after the 60 day period in at least one previous ISRS case. Permitting OPC to violate a statutory deadline was unlawful, but as a practical matter, Laclede Gas and MGE were satisfied with the ultimate decision and did not appeal the issue. Given the breadth of the late issues raised by OPC, and the unreasonably short time to explore them, Laclede does not accede to the violation of the statute in this case. In fact, neither of the two ISRS issues in this case involve a consideration of new or unique information; for example, Laclede Gas and MGE have been replacing cast iron and steel with plastic patches for at least the past nine years. (Tr. 112, lines 5-12). On three separate occasions in the past three years, MGE has, at OPC's request, provided

specific information regarding planned ISRS expenditures, including information that its ISRS may include costs of hydrostatic testing. So OPC could have teed up these issues anytime between day 1 and day 60, and has no excuse for failing to do so.

E. OPC's claim that a late DR answer caused it to miss the deadline is a red herring.

OPC claims that it missed the 60 day deadline due to a late answer to a November 8 data request. This 'late DR' argument is a red herring. Out of 63 data requests, this is the only one OPC notes as being late. The data request in question asked three questions about incentive compensation, an issue that is not even in these cases. OPC has no excuse for not raising the two issues that have remained in these cases by the 60 day deadline.[2] For the same reason, OPC's claim that the late DR on incentive compensation released it from its agreement in this case to expedite ISRS cases in exchange for a considerable tax adjustment ($700,000) is just further evidence of OPC's bad faith in its dealings in these ISRS cases.

F. OPC's requirement to issue a report in 60 days is not impacted by the fact that Laclede answered DRs on time.

OPC claims it missed the 60 day deadline because Laclede responds too slowly to its DRs. With the exception of the error in objecting to one DR on a subject that has been removed from this case, OPC admits that Laclede answered all of OPC's DRs on time. OPC complains that Laclede answers Staff's DRs faster. Nothing prohibits Laclede from answering DRs sooner than they are due, or seeking to go above and beyond its legal obligations to provide additional assistance to people who have

[2] With respect to the three late DRs, Laclede had provided information on the first question on November 7, the day before the DRs were even issued. Because the three DRs improperly raised incentive compensation rate case issues, Laclede drafted an objection which it believed had been delivered to OPC, but in fact was never sent. The DR response was late because Laclede did not intend to respond at all to an irrelevant rate case issue. When the error was brought to Laclede's attention, the Company made a good faith effort to answer the question immediately.

demonstrated a good faith effort to honor past agreements and audit ISRS costs in a fair and reasonable manner. It has not been Laclede's experience that OPC personnel have demonstrated those attributes.

Another reason why OPC's late report should be disallowed is the fact that it prevented the parties from properly vetting the issues. For example, prior to the hearing, OPC argued that hydrostatic testing did not improve the line or enhance its integrity, but never raised the issue of whether hydrostatic testing was a capital project. It was not raised in its December 9 motion for hearing, nor in its December 16 direct testimony, nor even in its December 28 position statement. Instead, the first time OPC argues that the hydrostatic testing costs should not be capitalized is in the hearing room. This type of ambush technique is unreasonable and unfair to the other parties, and shortchanges the Commission because it impedes the arguments and evidence from being fully vetted.

For example, the December 9 motion for hearing started by mis-stating the law to the Commission. Section 393.1009(5)(b) (hereinafter referred to as "Section 5(b)") designates ISRS eligibility for the following:

> Main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects **extending the useful life or enhancing the integrity of pipeline system components** undertaken to comply with state or federal safety requirements; (emphasis added)

Section 5(b) clearly states that the project could either extend the useful life ***or*** enhance the integrity of the components. OPC changed the statute by conflating the two options into one in describing Section (5)(b) to the Commission. OPC claimed that projects apply to:

> "**the enhancement of infrastructure to extend its useful life**,"[3]

[3] OPC is entitled to make its own arguments, but it is not entitled to write its own statute.

OPC then bootstrapped the rewritten statute to argue that Section 5(b) required an enhancement to the plant, and that a hydrostatic test alone does not qualify as an enhancement. There was no mention by OPC of whether the costs should be capitalized.

Because of the breadth and depth of the four issues raised by OPC well after the 60 day deadline, those issues could not be properly heard and thus Laclede's rights to due process was violated. OPC's effort in withdrawing two of the issues on a holiday 24 hours before the hearing only highlights the fact that these issues could not be fairly tried.

For this reason, along with the others set forth above, OPC's unlawful and unreasonable effort to raise new issues well after the end of the 60 day statutory period should be rejected.

ISSUE #2: Whether it is appropriate to include "hydrostatic" testing costs in MGE's ISRS revenues.

The hydrostatic testing in this case belongs in an ISRS because it is a capital project; it is similar to the other projects mentioned in Section 5(b); it extended the useful life of a pipeline system component; it was undertaken to comply with state or federal safety requirements; and it meets all other criteria for inclusion in an ISRS.

Capital vs. Expense

ISRS investments include capital items, not expenses such as operating and maintenance expense. In this case, the costs of hydrostatic testing have been properly capitalized. OPC provided evidence and arguments that hydrostatic testing costs should be expensed, but all OPC succeeded in proving is what Staff and MGE already knew and acknowledged: that hydrostatic testing costs to check for leaks as part of a normal integrity management program are properly expensed. (Tr. 145, lines 11-21). All three

parties agree on this; it is the reason why no hydrostatic testing costs were in Laclede or MGE ISRS filings prior to 2010. Neither Laclede nor MGE has or will capitalize hydrostatic testing for integrity management program purposes.

What OPC failed to realize is that there is a second type of hydrostatic test. This second type is not part of a leak testing program, but is a one-time test mandated to establish a maximum allowable operating pressure (MAOP) for a line. The costs of this test are normally capitalized and become part of the property record for that asset. Normally, this is done when a line is first installed; however, the hydrostatic test on MGE's Grain Valley transmission line in this ISRS case was also this second type of test: a one-time pressure test that served to establish the MAOP for that line and keep it fully in service. (Tr. 145, line 22 to 147, line 1).

Since July 1970, pipeline operators have been required to perform a hydrostatic pressure test on a newly constructed transmission line before placing it in service. The cost involved in performing the test is capitalized along with other costs of construction. Prior to 1970, this test was not mandated and was not always performed. (Tr. 146-47; Laclede Exh. 3, p. 4,).

In January 2011, PHMSA issued an advisory bulletin (the "2011 Bulletin") following its investigation of the September 2010 explosion in San Bruno, California, where eight people lost their lives, 51 people were hospitalized, and 38 homes were destroyed. PHMSA's investigation concluded that PG&E did not have adequate records to support its MAOP for the subject transmission line. The 2011 Bulletin provided specific regulatory interpretations that placed a renewed focus on locating and verifying the records of historical hydrostatic tests for pre-1970 transmission pipelines. PHMSA's new interpretations stated that traceable, verifiable and complete records were necessary,

which led MGE to determine that certain hydrostatic testing projects were required, such as the one done on the Grain Valley transmission line. (Laclede Exh. 3, pages 4-5).

Before the 2011 Bulletin, MAOP's were established for pre-1970 lines by either a specific pressure test, operating history, or design requirements, as outlined in 4 CSR 240-40.030(12)(M) [49 CFR part 192.619]. The 2011 bulletin further defined the requirements for that pre-1970 pipe, which resulted in Laclede Gas, MGE and other utility pipeline operators undertaking efforts to verify that these one-time tests are or were completed in compliance with the PHMSA requirements. (*id.*)

In the infrequent situation in which the line does not have sufficient records to verify the original one-time test to establish an MAOP, Laclede must perform the test or take the pipe out of service. Since the original one-time hydrostatic test to set an MAOP for the transmission would have been capitalized, the substitute one-time hydrostatic test to establish an MAOP for the Grain Valley line should also be capitalized. (Laclede Exh. 3, p. 6)

Exhibit No. 5, the 2005 FERC Order on Accounting for Pipeline Assessment Costs (the "2005 FERC Order"), pertained to costs involved in integrity management programs. It generally found, with some exceptions, that the cost to perform hydrostatic tests should be expensed as part of a maintenance program. MGE concurs with this finding. However, as indicated above, the 2005 FERC order focuses on what we are referring to in this Brief as Type 1 hydrostatic testing. The 2005 FERC Order states:

> Pipeline operators must then assess the identified pipeline segments **to locate anomalies such as cracks, dents, and leaks using hydrostatic tests**, smart pigs, or direct assessment activities.
> (OPC Exh. 5, June 30, 2005 FERC Order, par. 5, emphasis added)

The integrity management hydrostatic tests referred to by FERC were performed for the express purpose of finding leaks or potential future leaks. This is the same purpose as OPC witness Hyneman's understanding of hydrostatic tests – "to determine the potential longevity of the pipe for leaks." (Tr. 211, lines 19-24) Even OPC's attorney referred to the Type 1 integrity management type of hydrostatic test in an exchange with MGE witness Lauber:

Mr. Poston: And hydrostatic testing involves filling a segment of pipe with pressurized water, and if it doesn't maintain the pressure, you know the pipe has a leak; is that correct?

Mr. Lauber: That's one of the things, yes, that you identify.
(Tr. 121, lines 12-17)

The FERC, OPC witness Hyneman and OPC attorney Poston are all addressing Type 1 integrity management hydrostatic testing, and all correctly proclaim that the cost of that testing should be expensed. OPC proved the same point yet again in OPC Exhibit 4, the Uniform System of Accounts, where Maintenance is defined as including "Inspecting, testing and reporting on condition of plant specifically to determine the need for repairs… and inspecting and testing the adequacy of repairs which have been made." (OPC Exh. 4, p. 632, under Item No. 2, emphasis removed). As noted above, and as testified to by MGE witness Lauber (Tr.126-27), MGE agrees that such Type 1 maintenance costs should be expensed and are expensed; that's why there has been very little hydrostatic testing costs in ISRS cases.

OPC witness Hyneman claimed to be "absolutely certain" that the cost of hydrotesting should be charged to expense. He insisted that he had done a lot of research on the subject, including reading a lot of FERC orders and discussions, all of which

"absolutely convinced" him of his position that there's only one FERC exception where hydrostatic testing can be capitalized, and that is when the operator is undertaking a major rehabilitation project. Mr. Hyneman further stated that he was curious why Staff witness Oligschlaeger couldn't produce a document to support his testimony that the Grain Valley hydrostatic test could be capitalized. (Tr. 238).

First, it is clear that OPC Witness Hyneman has a bias against the ISRS. At the hearing, he testified that he came up with the idea of bringing forward depreciation and deferred taxes, both of which reduce an ISRS, from the petition date to a date closer to the operation of law date. This procedure appears nowhere in the ISRS statute, but both Laclede and MGE's ISRS in this case include 3½ extra months of depreciation and deferred taxes. At the same time, Mr. Hyneman testified that he strongly opposes the update process, which is the mirror image of Mr. Hyneman's idea, wherein the utility brings forward two months of ISRS investment. In other words, Mr. Hyneman believes it is perfectly fine to update the ISRS with reductions, but not with additions. (Tr. 212, line 19 to 213, line 13). Further, he believes that the ISRS legislation was proposed by the Missouri LDCs and their lobbyists, that its purpose is to protect utility shareholders through the elimination of regulatory lag, and that the ISRS is being forced on Missouri ratepayers.[4] (Tr. 213 to 214, line 12). This brazen opposition to Missouri's ISRS statute should be taken into account in assessing the credibility of Mr. Hyneman's positions on ISRS issues.

Second, it is suspicious that Mr. Hyneman testified on January 3 that he was an expert on accounting for hydrostatic testing, when the accounting argument wasn't even

[4] It is not clear whether Mr. Hyneman believes that a safer gas system is also being forced on Missouri ratepayers.

mentioned in OPC's pleadings challenging the ISRS eligibility of hydrostatic testing filed on December 9 and December 28, nor even in Mr. Hyneman's own direct testimony filed on December 16. (OPC Exh. No. 1)

In contrast, Staff witness Oligschlaeger and MGE witness Lauber both distinguished the special type of hydrostatic test required to establish an MAOP for the Grain Valley line, and testified that the test can and should be capitalized. In supporting capital treatment for MGE's hydrostatic test, Staff Witness Oligschlaeger testified that "FERC accounting guidelines allow for capitalization of hydrostatic testing costs in certain circumstances." (Staff Exh. No. 6, p. 11, lines 16-19). At the hearing, Mr. Oligschlaeger identified one of those circumstances as hydrostatic testing performed to establish an MAOP in the absence of records of an earlier hydrostatic test. (Tr. 198, line 23, to 200, line 4).

A document supporting their position is attached hereto in the form of a November 5, 2004 Notice of Proposed Accounting Release from the FERC Chief Accountant (the "2004 Notice"). It refers to capitalizing rehabilitation projects in paragraph 5, but it also addresses in paragraph 4 the specific situation MGE is faced with in this case, and finds that it is appropriate for an operator to capitalize a hydrostatic test, or retest, when it does not have sufficient records supporting a first test. Specifically, the Chief Accountant of the FERC said:

> The Commission, however, has permitted the capitalization of pipeline testing costs related to existing plant in certain instances…entities were allowed to capitalize retest costs in those instances where initial tests of a constructed pipeline did not meet the requirements of the new legislation, making it necessary to retest so that the full capacities of the pipeline could be utilized."
>
> (Federal Energy Regulatory Commission; Docket No. AI05-1-000, Accounting for Pipeline Assessment Costs; Notice of Proposed Accounting Release, par. 4)

Also attached is a screen shot from the FERC website on Accounting Releases, showing Accounting Release 8 (AR8), which confirms the propriety of capitalizing hydrostatic tests to confirm or establish MAOPs. Although AR8 was released in 1969, it was updated as recently as 2010, well after the 2005 FERC Order.

The hydrostatic test in this case is a Type 2 test, not for the purpose of finding leaks and improving integrity, but for the purpose of setting an MAOP that becomes a part of the records of the asset. MGE witness Lauber testified to the 2011 PHMSA Advisory Bulletin, which also postdates the 2005 FERC Order. The bulletin is broken into two pieces:

> "I. Establishing MAOP or MOP Using Record Evidence"; and
>
> II. Performing Risk Identification, Assessment, Data Accuracy, Prevention, and Mitigation"
> (Federal Register, Vol. 76, No. 6, p. 1506, Advisory Bulletin (ADB-11-01)

The fact that in 2011, PHMSA chose to separate the process of establishing an MAOP from the integrity management activities further supports the points of Staff witness Oligschlaeger and MGE witness Lauber that the hydrostatic tests should be treated differently.

OPC Exhibit 5, the 2005 FERC Order, followed the Chief Accountant's 2004 Notice. The Order does not override the Notice; in fact in footnote 2 on page 1, the Order notes that it is simply addressing a broader range of actions than the 2004 Notice – actions to be taken as part of a pipeline integrity management program. The specific and applicable instance provided in the 2004 Notice, and updated on FERC's website in 2010, remains in force.

Similar Projects and Useful Life

Section 5(b) applies to "Main relining projects, service line insertion projects, joint encapsulation projects 'and other similar projects' extending the useful life" of pipeline system components such as the Grain Valley transmission line. The hydrostatic testing project in Grain Valley is not a main relining project, a service line insertion project, or a joint encapsulation project. However, it is similar to those projects. MGE witness Lauber was the only witness with technical expertise. He testified that the hydrostatic testing project in Grain Valley was similar to the other projects in that they all require work to be performed on a pipeline for the purpose of extending its useful life or enhancing its integrity. (Tr. 147, lines 14-17). Mr. Lauber testified that the hydrostatic testing process required the pipeline to be taken out of service and filled with pressurized water. (Laclede Exh. 3, p.3 line 21, to 4, line 2).

MGE witness Lauber also testified that the three named projects in 5(b) all involve a physical improvement of the line. (Tr. 135, lines 4-6). In other words, all three enhance the physical integrity of the line. (Tr. 148-49). But Section 5(b) does not require that the project always enhance the integrity of the line. It states that the project can either enhance the integrity *or* extend the useful life. OPC would have the Commission believe that there must always be a physical enhancement. This is not true, because the sentence was written with the disjunctive 'or.' There must be situations where the project can extend the useful life of the component without also resulting in a physical enhancement. The hydrostatic test is just such a project. While the integrity management hydrostatic tests would not qualify for ISRS because they are expensed and

do not extend the useful life of the pipe,[5] the 'Type 2' hydrostatic test, done for the purpose of establishing an MAOP, is both capitalizable and extends its useful life. Pre-1970 pipes that do not have a reliable, qualifying MAOP are subject to an expensive replacement. But for the hydrostatic test, the Grain Valley line would have had to be taken out of service, ending its useful life. The hydrostatic test alone created an MAOP and allowed the pipe to remain in service. That was the sole reason that the one-time test was performed. If the Grain Valley line had had a qualifying MAOP, there would have been no hydrostatic test, because it would not have been needed to extend the useful life of the line. (Tr. 147-48). For all of these reasons, the hydrostatic testing expenditures are fully eligible for inclusion in the ISRS.

Issue #3. Laclede's and MGE's strategy when replacing cast iron and steel mains and service lines is to also replace connected plastic mains and service lines at the same time. Can all costs associated with these replacements be recovered through the ISRS?

In its pleadings and testimony in this case, OPC asserts that some of the costs incurred by Laclede and MGE to install new pipeline facilities in connection with replacing cast iron and unprotected steel pipeline facilities – replacement costs that are unquestionably ISRS-eligible – have been made ineligible for ISRS inclusion solely because some plastic pipe also had to be replaced as part of these projects. This proposal by OPC, even if entertained by the Commission, should be rejected because it:

- lacks the kind of critical details necessary for the parties to challenge and the Commission to determine its reasonableness;

[5] Paragraph 21 of OPC Exhibit No. 5, the 2005 Order, states that "Broadly speaking," the information gathered from assessment activities does not by itself increase the useful life of a pipeline asset. Broadly speaking, MGE would agree with this. Specifically speaking, the direct effect of MGE's Type 2 hydrostatic test in this case is to extend the useful life of the Grain Valley transmission line.

- is wildly inconsistent with both the letter and intent of the very ISRS Statute upon which it is presumably based;
- is based on a new method for calculating eligible ISRS costs that is nowhere to be found in the ISRS Statute.

As discussed below, any of these flaws standing alone would be sufficient to justify a rejection of OPC's proposal. Taken together, they affirmatively compel such a result.

A. Failure to Provide Critical Details

Regardless of its merits or lack thereof, OPC's proposal must be rejected by the Commission because it lacks the kind of critical details that are essential for other parties to assess and challenge its reasonableness and for the Commission to determine whether there is any valid basis for adopting it. In fact, OPC's proposal is so unformed and incomplete that it does not even merit being called a proposal.

In effect, OPC has simply observed that in the course of completing various cast iron and steel replacement projects, Laclede and MGE incidentally replaced some plastic pipe that had previously been installed and used to patch these cast iron or steel facilities when leaks, corrosion or other flaws were discovered, thus extending the useful life and enhancing the integrity of these facilities. Based on nothing more than this simple observation, and its assumption that these plastic patches were not in a worn out or deteriorated condition, OPC asserts that some portion of the replacement costs for installing the new plastic pipelines must be declared ineligible for inclusion in the ISRS charges under consideration in this case.

But even if OPC's undefined proposal could somehow be reconciled with the ISRS law, OPC has utterly failed to provide the details and evidence that would be necessary to reasonably evaluate and adopt it. One of the most critical missing pieces is

the absence of any method for determining how the costs of installing new plastic pipe could be adjusted to account for the fact that a portion of the facilities being replaced was comprised of cast iron or steel and another portion of plastic. In his direct testimony, OPC witness Hyneman asserted that "[t]here are very simple methods that could be used to separate the eligible ISRS costs from the ineligible ISRS costs." (OPC Exh. 1, p. 10, lines 5-6). Nowhere in his testimony, however, did Mr. Hyneman actually propose such a method, simple or otherwise.[6] In fact, counsel for OPC spent a significant portion of the hearing in an unsuccessful attempt to get witnesses for *other* parties to devise or endorse a method that could be used to implement its proposal.

Because OPC failed to offer any method for adjusting the costs of newly installed pipe to account for what it claims is a disqualifying replacement of some plastic pipe, it was, of course, also unable to offer any quantification of the dollar value of its proposal. As Staff witness Bolin correctly noted during redirect examination, it is the party sponsoring a particular proposal or adjustment – in this case OPC – that has the responsibility to provide such a quantification, as well as the method used for deriving it. (Tr. 175). In this case, OPC did neither.[7]

OPC's failure to suggest either a method for implementing its proposal or a quantification of its effect has deprived the other parties of any meaningful opportunity to

[6]Mr. Hyneman struggled up to the very end of the evidentiary hearing to articulate some method that could potentially be used to implement OPC's proposal. As his discussion with Chairman Hall demonstrated, however, even when pressed he never could articulate a definitive method that could be reliably and fairly used, especially under circumstances such as those prevailing here where more cast iron and steel pipe have been removed than the amount of new facilities installed. (Tr. 229, line 24 to Tr. 232, line 19).

[7] OPC's failure to articulate a method for implementing its proposals should not result in Laclede and MGE being denied recovery of ISRS amounts just because some plastic was replaced on a project. Obviously, it would be grossly unfair to penalize Laclede and MGE because OPC failed to fulfill its responsibility to develop and present a fully-formed proposal.

assess and rebut the propriety and reasonableness of that proposal. For example, because the cumulative amount of new pipe installed on the projects cited by Mr. Hyneman was *less* than the total amount of cast iron and steel pipe replaced by those projects (Laclede Exh 2, Revised Rebuttal Schedule GWB-1), a party might very well argue that any method which had the effect of excluding any portion of these replacement costs was patently unreasonable and inconsistent with the ISRS Statute, regardless of whether an incidental amount of plastic was also removed. OPC might take a different view regarding the propriety of such a method. But it is impossible to even begin the debate because of OPC's complete failure to specify in its testimony what method it believes should be used and explain why it believes such a method would be appropriate. Of course, this glaring omission also makes it impossible for the Commission to perform its statutory duty to evaluate OPC's proposal and determine whether it is lawful and reasonable.

Fortunately, the Commission's rules of practice and procedure are designed to prevent the kind of unproductive and unfair shadow boxing entailed by OPC's omission of these critical details from its proposal. Specifically, Rule 4 CSR 240-2.130(7)(A) explicitly requires that direct testimony of the kind filed by OPC witness Hyneman in these cases . . . "shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief." Clearly, OPC has failed to meet this requirement by omitting from its direct testimony any description or explanation of the method that it believed should be used to adjust replacement costs in those instances where there is some incidental replacement of plastic pipe.

That such a failure requires rejection of OPC's proposal is confirmed by the Commission's recent decision to reject a proposal by KCPL to include certain projected

costs in its revenue requirement. Because the proposal was not made in KCPL's case-in-chief, but instead raised for the first time in surrebuttal testimony, the Commission determined that it would be unfair and prejudicial to the rights of other parties to consider such a proposal. In affirming the Commission's decision to reject the proposal, the Western District Court of Appeals stated the following.

> In its Report and Order, the PSC also denied KCPL's request to add specific estimated future costs in the calculation of KCPL's revenue requirement. The PSC found the following with regard to each requested expense. First, the requests to add the projected future costs to KCPL's revenue requirement did not come until surrebuttal testimony and as such violated PSC Rule 4 CSR 240-2.130(7)(A), which requires that direct testimony "shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief." The PSC found that KCPL's failure to include its estimates and requests in its case-in-chief prevented other parties from having a sufficient opportunity to conduct discovery or provide testimony on the matters.

See ***In the matter of Kansas City Power and Light Company's Request for Authority to Implement a General Rate Increase for Electric Service v. Public Service Commission,*** WD 79125 consolidated with WD 79143 and WD 79189 (Opinion Issued September 6, 2016).

The deficiencies in OPC's proposal in these cases are even more extreme. At least in the KCPL case, the utility submitted a fully formed proposal, albeit at a late stage in the proceeding. OPC has not even done that in these proceedings and, as a consequence, the Commission should reject in its entirety OPC's proposal relating to the incidental replacement of plastic pipe as part of Laclede's and MGE's cast iron and steel replacement programs.

B. Inconsistency with Letter and Spirit of the ISRS Statute

In addition to falling well short of the kind of fully-formed proposal that can actually be evaluated and addressed by the parties and the Commission, OPC's proposal

should also be rejected because it is fundamentally inconsistent with the letter and spirit of the ISRS Statute. In effect, OPC is asking the Commission to impose a financial penalty on Laclede and MGE because they have done exactly what the ISRS Statute contemplates. Specifically, Laclede and MGE have pursued programs for replacing cast iron and steel facilities that no one disputes should be replaced given their worn out and deteriorated condition. That is exactly the kind of activity that the ISRS Statute was designed to encourage by permitting the contemporaneous recovery of such replacement costs. Moreover, Laclede and MGE have sought to undertake these replacement projects in the manner best calculated to enhance the overall safety and integrity of its distribution system while reducing the overall cost of such replacements to their customers. Again, both of these features are fully consistent with the ISRS Statute's goal that such replacement work enhance safety and be done in a prudent manner.

As discussed below, OPC's assertion that some portion of the replacement costs for installing the new plastic pipelines must be declared ineligible is fundamentally inconsistent with the purpose and language of the ISRS Statute itself. It is also contrary to even a basic understanding of how physical assets are maintained and replaced in the real world. Under OPC's approach to this issue, the amount paid to a contractor to replace a bridge would need to be reduced whenever there was a girder or two that was still in usable condition. Those are not the compensation terms that contractors performing such work would expect or ever agree to, and they are not terms that the ISRS Statute imposes on gas utilities for ISRS work.[8]

[8]As Laclede witness Lauber sensibly noted, when a patch of plastic is connected to a worn out or in deteriorated segment of cast iron or steel that needs to be replaced, the plastic should also be considered to be in a worn out or deteriorated condition. (Tr. 132, lines 12-22). That's exactly

Notably, OPC does not dispute any of these claimed attributes of Laclede's and MGE's replacement programs. Specifically, OPC does not dispute that the sole purpose of these replacement programs, and the specific projects undertaken in connection with them during the ISRS period, was to replace aging cast iron or steel pipeline facilities. Indeed, not one shred of evidence has been presented that would suggest these projects were undertaken for any other purpose. Nor has OPC disputed that all of the projects at issue in these cases were planned, designed and executed in way that would best advance public safety while minimizing costs for the ratepayer, all in accordance with the highest standards of prudence.[9] Instead, OPC is suggesting that Laclede and MGE should be financially penalized *precisely because* they conducted their replacement work in the manner that was best calculated to enhance public safety and prudently minimize costs for its ratepayers – goals that could only be achieved through the incidental replacement of some plastic pipe.

OPC claims that such a result is mandated by the ISRS Statute because it authorizes the recovery of replacement costs under Section 393.1009(5)(a) only for those gas utility plant projects that are undertaken "as replacements for existing facilities that have worn out or are in deteriorated condition." But that is exactly why the replacement projects at issue in these cases were undertaken – i.e. "as replacements for existing [cast iron and steel] facilities that have worn out or are in deteriorated condition." Moreover, that was the exact outcome realized by these projects as evidenced by the fact that the projects resulted in the replacement of more worn out and deteriorated cast iron and steel

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how one would view a usable girder on a failing bridge and there is no basis for force-fitting a different perspective when it comes to gas distribution facilities.

[9]OPC Witness Hyneman testified that he had no questions, comments or concerns with how Laclede operationally is replacing its lines and mains. (Tr. 211, lines 14-16)

facilities than the amount of new pipe that was installed. (Laclede Exh. 2, Revised Rebuttal Schedule GWB-1). Nevertheless, because the prudent completion of these projects also required the incidental replacement of some plastic pipe that may not have been worn out or in deteriorated condition, OPC suggests that under the ISRS Statute these clearly ISRS eligible replacement costs have been partially or fully transformed into ineligible costs.

One of the most elemental rules of statutory construction is that statutes must be construed in a way that avoids unreasonable or absurd results. ***Reichert v. Bd. Of Educ. of St. Louis***, 217 S.W.2d 301, 305 (Mo. Banc 2007). Applying that rule to the issue at hand requires rejection of the clearly absurd and thoroughly unreasonable result that would flow from OPC's interpretation of the ISRS Statute. In effect, OPC's construction of the ISRS Statute presumes that the legislature intended to provide financial incentives that would encourage gas corporations to undertake replacement projects in a way that compromised rather than enhanced the safety of their distribution systems. For example, undertaking these replacement projects in a way that sought to use (rather than replace) the patches of plastic pipe that were scattered through the cast iron and steel facilities would have avoided the exclusion of replacement costs that OPC says are mandated by the ISRS statute. But as Laclede witness Lauber discussed in his rebuttal testimony, such an approach would have also resulted in a significantly less safe distribution system. (Laclede Exh. 3, p. 10, line 14 to p. 11, line 2) Rather than run a continuous line of new pipe in the right-of-way between the street and sidewalks, such an approach would have required the installation of numerous tie-ins, fittings and joints to connect the new pipe to the older plastic pipe that was located at both a greater depth and to the side in the street. (Laclede Exh. 3, pp. 9-10). As Mr. Lauber indicated in his testimony, and in response to

several questions from Chairman Hall, this significant increase in tie-ins, fittings and joints would have made the resulting system less safe and more prone to leakage. (*Id*.; Tr. 135, lines 9-23). Moreover, the creation of a piping system located at different depths and locations along the street, with a patchwork of criss-crossing tie-ins between them, would have seriously compromised the ability to locate such facilities in order to avoid third party damage which remains the single largest cause of natural gas incidents. It is simply preposterous to suggest, as OPC has with its position in this case, that the General Assembly intended the ISRS Statute to incentivize the creation of this kind of Rube Goldberg distribution system that would only serve to frustrate rather than advance the fundamental safety goals of the Statute.

An equally absurd result flowing from OPC's interpretation of the ISRS Statute is the adverse effect it would have on one of the Statute's other major goals, namely to ensure the ISRS work is planned, designed and completed in a prudent manner. The Statute's emphasis on ensuring ISRS work is prudently performed is underscored by the fact that it affirms the Commission's right to review the prudence of ISRS expenditures not just once but twice. *See* subsections (8) and (10) of Section 393.1015. OPC's interpretation of what the ISRS Statute requires, however, would work against this fundamental goal as well. As explained by Mr. Lauber and Laclede witness Glenn Buck, a replacement strategy that tried to use rather than simply replace these plastic patches would have been significantly more expensive than the one chosen by the Company. (Laclede Exh 4, pp. 10-11; Exh. 2, p.11) [10] The additional digging needed to connect the

[10]In fact, OPC witness Hyneman himself illustrated the perverse incentive that adoption of OPC's proposal would have on the cost of replacing facilities. As he indicated in a discussion with Chairman Hall, if a utility was confronted with a segment of main that had developed a leak, the utility could either replace the leaking segment of the main at a lesser cost or the entire main at a

new plastic to the older plastic patches would take considerable time and cost considerable money. There is no tenable basis for concluding that the ISRS Statute was intended to encourage such a result and yet that is exactly where OPC's interpretation, and its gratuitous exclusion of valid replacement costs, would lead. The result would be a replacement program that took more time, is more expensive and is less safe.

Finally, because OPC's interpretation of the ISRS Statute would produce these absurd and unreasonable results, it can be readily distinguished from the Commission's decision in a prior ISRS case to exclude replacement costs relating to certain telemetric equipment because such equipment was not worn out or in a deteriorated condition. In this instance, there is no dispute that the cast iron and steel facilities replaced in these cases were in a worn out or deteriorated condition. Nor is there any dispute that the quantity of these worn out or deteriorated facilities exceeded the quantity of the new facilities installed. In view of these considerations, there is no analogy to be made to the Commission's decision relating to telemetric equipment. In fact, OPC's proposal in this case would be akin to saying that the cost of telemetric equipment could not be included in ISRS charges to the extent that any portion of that equipment was not worn out or in a deteriorated condition. In other words, even if the telemetric equipment could no longer function, OPC's position in this case would suggest that the full cost of replacing it would never be eligible for recovery through the ISRS so long as <u>any</u> component of the equipment was still operable. Laclede submits that such an argument would not have

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greater cost so that it would be ISRS eligible in its entirety. (Tr. 232, line 20 to 233, line 14). Unfortunately, under OPC's interpretation of the Statute, the utility would have an incentive to just replace the entire main, regardless of cost considerations, to avoid the kind of financial penalty that OPC seeks to impose when the time came to replace the remainder of the main. Again, there is no reason or rationale for interpreting the ISRS Statute in a manner that would introduce this kind of perverse incentive.

prevailed had it been the basis for excluding telemetric replacement costs and it should not prevail here as a legitimate basis for excluding the costs at issue in these cases.

C. Lack of Statutory Language Authorizing OPC's Proposed Method

Adoption of OPC's proposal in these cases would be even more inappropriate given the absence of any language in the ISRS Statute that describes or even alludes to the kind of approach OPC has suggested for disallowing valid replacement costs where there is an incidental replacement of plastic pipe as part a valid replacement program. Certainly, the ISRS Statute itself contemplates that plastic pipe would be routinely installed as a remedial measure to replace portions of leaking facilities since it specifically allows ISRS recovery of projects that extend the useful life or enhance the integrity of existing facilities. Section 393.1009(5)(b). In fact, main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects, are specifically mentioned in the Statute as the kind of temporary fixes that may be included in ISRS charges until facilities are replaced in their entirety. (*Id*).[11]

If there had been any intention on the part of the legislature to exclude future replacement costs based on the installation of these temporary, remedial fixes, the ISRS Statute surely would have prescribed a method for doing so. After all, the ISRS Statute takes great pains to describe in detail how ISRS charges are to be calculated and allocated, including the specific ways in which the return on ISRS facilities is to be determined, the cost of service elements that comprise the ISRS revenue requirement and the specific basis for allocating such charges within and between customer classes. The fact that the ISRS Statute says nothing about adjusting replacement costs to account for

[11] These temporary fixes are no different than the temporary road that was constructed to permit the recent rehabilitation of the bridge leading into Jefferson City. The cost of the temporary road as well as the cost of rehabilitating the bridge are both legitimate costs that should be recovered.

previous installations of facilities needed to address a leak or other flaw in a pipeline segment strongly suggests that no such adjustment was contemplated. The absence of such language is especially compelling given the degree to which such adjustments would, as discussed above, serve to frustrate rather than advance the Statute's underlying goal of enhancing safety and ensuring the ISRS work is performed in a prudent and cost effective manner.

For all of these reasons, the fact that Laclede and MGE had to replace some plastic pipe as a necessary and integral part of its cast iron and steel replacement programs is simply irrelevant to the recovery of these valid replacement costs. In fact, if the replacement of such plastic pipe has any relevance at all to these proceedings it lies in the fact that by retiring such facilities, Laclede and MGE were able to reduce the amount of the ISRS revenue sought in these cases thorough the recognition of lower depreciation expense. (Laclede Exh. 2, p. 11, lines 3-13). For just the projects identified by Mr. Hyneman, this depreciation-related reduction in ISRS charges is worth approximately $53,000[12], rising to well over $200,000 when the impact of all retirements is considered. (*Id.*; *see also* Laclede Exh 4, Appendix B, p. 3; Exh 5, Appendix A, p.1; Tr. 97, line 25). OPC's position on this issue should accordingly be rejected by the Commission.

III. CONCLUSION

In conclusion, Laclede Gas and MGE submit that the issue raised by OPC in its pleadings and testimony in this case should not even be considered by the Commission since they have been raised and presented in direct violation of the mandatory timing restrictions set forth in the ISRS Statute – restrictions that OPC itself has represented to the Commission and courts of this state are equally applicable to it. If the Commission

[12]Laclede Exh. 2, p. 11, lines 12 – 14.

nevertheless considers such issues, it should dispose of them in favor of the positions taken by Laclede, MGE and the Commission Staff for all of the reasons set forth herein.

WHEREFORE, Laclede Gas Company and MGE respectfully request that the Commission accept this Brief, and approve their ISRS filings in the amounts recommended by the Commission Staff in its November 29 recommendation, effective on or before January 28, 2017.

Respectfully submitted,

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ATTORNEYS FOR LACLEDE GAS COMPANY AND MISSOURI GAS ENERGY

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing pleading was served on the General Counsel of the Staff of the Missouri Public Service Commission, and the Office of the Public Counsel, on this 6th day of January, 2017 by hand-delivery, fax, electronic mail or by regular mail, postage prepaid.

/s/ Rick Zucker

OPC WITNESS HYNEMAN TESTIMONY TO COMMISSION IN THIS CASE

In addition to being an improper response to Staff Recommendations, the OPC Motion should have raised these new issues by the 60-day statutory deadline. While that deadline is not addressed specifically to OPC, there is no question that the Legislature intended that all issues in an ISRS case be raised by Day 60, so that they can be addressed and decided by the Commission ahead of the 120-day statutory deadline.

Further, OPC knew that it needed to respond by the 60-day deadline. **On page 14 of its Direct Testimony filed on December 16 in these cases, HYNEMAN** testified to the following:

> Q. Did Laclede's decision to provide the supporting documentation so late in the process harm OPC's ability to effectively audit the ISRS petitions?
> A. Yes. The ISRS statute allows only 60 days to audit tens of millions of dollars of ISRS plant work orders…Even with the legally-mandated 60 day audit period, OPC struggles to complete an audit of an ISRS Application.

OPC BRIEF TO COMMISSION IN 2015 ISRS CASES

This difficult situation highlights the fact that, like Staff, OPC must be required to file a report on ISRS issues within the legally-mandated 60 day time period. OPC already knows that this is the case; OPC's repeated opposition to the update process has hinged upon its understanding that the 60 day deadline applies to OPC as well as Staff.

For example, on page 15 of its Brief in ISRS Case Nos. GR-2015-0341 and 0343, OPC states that it "does not oppose the May through June costs because the required detail was provided with the petition, **and Public Counsel was provided the full statutory 60-day period to review these costs. (FN 8: Section 393.1015.1.2(2) RSMo provides for a 60-day review period following the filing of an ISRS petition.)"**

OPC BRIEF TO WESTERN DISTRICT - ISRS 2 APPEAL CASES -10/27/16

As another example, in **OPC's second appeal of the ISRS update issue, OPC filed a BRIEF on October 27, 2016**, stating that "**The ISRS statutes include a sixty-day review process with an additional sixty-days for the PSC to conduct a contested hearing if necessary**." (Case No. WD79830, OPC Brief, p. 28) OPC also stated that the "**Legislature created a mechanism for public participation when it established a sixty-day review period and mandated the petitioning utilities serve OPC with the petition, rate schedules, and supporting documentation**. (Id. at p. 34)

OPC BRIEF TO MISSOURI SUPREME COURT – NOV. 16, 2016

"The PSC allowed Laclede…to wait and provide its supporting documentation for $20 million in costs just 17 days before the statutorily established sixty-day review period ended. Laclede's late submission denied the PSC, the PSC Staff and the public's representative, OPC, the statutorily prescribed opportunity to review such costs."

[Federal Register Volume 69, Number 223 (Friday, November 19, 2004)]
[Notices]
[Pages 67727-67729]
From the Federal Register Online via the Government Publishing Office [www.gpo.gov]
[FR Doc No: E4-3224]

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. AI05-1-000]

Accounting for Pipeline Assessment Costs; Notice of Proposed Accounting Release

November 5, 2004.

Take notice that the Chief Accountant of the Federal Energy Regulatory Commission proposes to issue an Accounting Release (attached) to provide guidance on accounting for pipeline assessment activities. The proposed Accounting Release would require an entity to recognize costs incurred in performing pipeline assessments that are a part of a pipeline integrity management program as maintenance expense and would apply to all Commission jurisdictional entities.

The Commission has reviewed the proposed Accounting Release. At the conclusion of the comment period specified at the end of this notice, the Chief Accountant will consider the comments received, make any necessary changes and circulate the proposed final Accounting Release to the Commission for review. Upon the Commission's approval, a final Accounting Release will be issued by the Chief Accountant.

All interested parties are invited to send electronic or written comments on all matters in this proposed Accounting Release to the Commission. Comments are requested from those who agree with the provisions of the proposed Accounting Release as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph or group of paragraphs to which they relate and clearly explain the problem or question. Those who disagree with provisions of this proposed Accounting Release are asked to describe their suggested alternatives, supported by specific reasoning.

Specifically, responses to the following questions are requested:

1. The Proposed Accounting Release concludes that pipeline assessment activities performed as part of a pipeline integrity management program should be accounted for as maintenance expense. Do you agree or disagree with the conclusion? If you disagree, please provide your alternative view and basis for it.

2. Are there instances, other than in connection with a major pipeline rehabilitation project, where pipeline assessment costs should be capitalized? If so, please provide particulars of the circumstances under which the costs would qualify for capitalization, the applicable Uniform System of Accounts Instruction and/or other authoritative literature that supports such a determination.

3. This proposed Accounting Release contemplates an effective date of January 1, 2005. Should this Accounting Release instead be applied retroactively for all periods? If so, provide a basis for your conclusion.

The Commission encourages electronic submission of comments in lieu of paper using the ``eFiling'' link at http://www.ferc.gov. Persons unable to file electronically should submit an original and 14 copies of their comments to the Federal Energy

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Regulatory Commission, 888 First Street, NE., Washington, DC 20426.

In addition to publishing the full text of this document in the Federal Register, the filing is accessible online at http://www.ferc.gov, using the ``eLibrary'' link and is available for review in the Commission's Public Reference Room in Washington, DC. There is an ``eSubscription'' link on the Web site that enables subscribers to receive e-mail notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please e-mail FERCOnlineSupport@ferc.gov, or call (866) 208-3676 (toll free). For TTY, call (202) 502-8659.

Comment Date: December 20, 2004.

Magalie R. Salas,
Secretary.

Attachment--Federal Energy Regulatory Commission Proposed Accounting Release No. 18 Accounting for Pipeline Assessment Costs

Summary

1. This Accounting Release clarifies that the pipeline assessment costs of a pipeline integrity management program are properly accounted for as maintenance and charged to expense in the period incurred. These costs generally include hydrostatic testing, smart pigging, and direct pipeline assessment techniques.

Reasons for Issuing Accounting Release

2. The Commission has become aware of diverse practices in

accounting for pipeline assessment activities. For example, some entities view pipeline assessments as activities performed specifically for the purpose of testing and reporting on the condition and integrity of the existing pipeline to prevent failure and recognize these costs as maintenance expense. While other entities capitalize some or all pipeline assessment costs where the assessment leads to any property changes that qualify as a capital addition or replacement. These diverse accounting practices reduce the comparability of financial statements among jurisdictional entities and make reviews of existing rates more difficult. This Accounting Release would clarify the proper accounting for pipeline assessment costs, promote comparability of financial information, and reduce uncertainty.

Basis for Conclusion

3. Under the requirements of the Commission's Uniform System of Accounts, costs incurred to inspect, test, and report on the condition of existing plant to determine the need for repairs or replacements and testing the adequacy of repairs made are recognized as maintenance expense.\1\ Additionally, costs incurred for work performed specifically for the purpose of preventing failure or maintaining the life of plant are recognized as maintenance expense.\2\

\1\ See Operating Expense Instruction No. 2, Maintenance, Item No. 2 of 18 CFR parts 101 and 201 (2004).

\2\ See Operating Expense Instruction No. 2, Maintenance, Item No. 3 of 18 CFR parts 101 and 201 (2004).

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4. The Commission, however, has permitted the capitalization of pipeline testing costs related to existing plant in certain instances. In response to pipeline safety legislation in 1968, the Chief Accountant issued Accounting Release No. 8 (AR-8). In AR-8, costs incurred under a planned maintenance program to meet the requirements of the legislation were to be treated as maintenance expense. However, entities were allowed to capitalize retest costs in those instances where initial tests of a constructed pipeline did not meet the requirements of the new legislation, making it necessary to retest so that the full capacities of the pipeline could be utilized. When such costs are capitalized all prior testing costs related to the specific property were to be retired in accordance with Gas Plant Instruction No. 10.

5. The Chief Accountant has also permitted entities to capitalize hydrostatic testing costs when the work was done in connection with major pipeline rehabilitation projects involving significant replacements and modifications of facilities.\3\ These rehabilitation projects extended the overall pipeline system's useful life and serviceability. Capitalization of pipeline assessment costs in these instances was permitted on the conceptual basis that future accounting periods would be benefited.\4\ The pipeline assessment activities in these instances were not, however, associated with any on-going maintenance programs.

\3\ In Docket No. AC94-149-000, Northwest Pipeline Corporation (NPC) was permitted to capitalize the costs of pipeline coating and hydrostatic testing costs incurred to rehabilitate its pipeline system. NPC was also permitted to establish retirement units for pipeline costing and hydrostatic testing. When coating costs and hydrostatic testing costs were capitalized as part of a rehabilitation project, NPC was required to retire all prior coating and testing costs in accordance with Gas Plant Instruction No. 10. Capitalization of pipeline assessment activities in this case was permitted as they were considered part of a one-time rehabilitation project which significantly enhanced and increased the life of NPC's pipeline system as a whole, although the work was spread out over a number of years.

\4\ See Statement of Financial Accounting Concepts No. 6, paragraph 25.

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6. Natural gas and oil pipelines must now comply with new Federal regulations regarding pipeline integrity management programs issued by the Office of Pipeline Safety (OPS) of the U.S. Department of Transportation.\5\ Under these regulations, natural gas pipeline and hazardous liquid pipeline operators are required to develop, implement, and follow an integrity management program for segments of pipeline in high consequence areas. The pipeline integrity management programs require pipeline companies to (a) identify and characterize applicable threats to pipeline segments that could impact a high consequence area; (b) conduct a baseline assessment and periodic re-assessments of these pipeline segments; (c) mitigate significant defects discovered from the assessment; and (d) continually monitor the effectiveness of its integrity program and modify the program as needed to improve its effectiveness. To make initial and subsequent assessments, pipeline companies will use hydrostatic tests, smart pigs, or direct assessment activities.

\5\ 49 CFR part 192, Pipeline Safety: Pipeline Integrity Management in High Consequence Areas (Gas Pipelines); Final Rule

effective January 14, 2004 and 49 CFR part 195, Pipeline Safety: Pipeline Integrity management in High Consequence Areas (Hazardous Liquid Operators with 500 or more miles of Pipeline); Final Rule effective February 15, 2002.

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7. Under OPS's regulations for pipeline integrity management programs, the pipeline assessment activities that pipelines must undertake are to determine the condition of the pipe. If any anomalies are detected, repairs or replacements are then made to maintain and improve pipeline integrity and reliability. The assessment activities required under a pipeline integrity management program constitute steps performed as part of an on-going inspection and testing program.

8. The Commission's accounting rules, as described above, provide that costs incurred to inspect, test and report on the condition of plant to determine the need for repairs or replacements are to be charged to maintenance expense in the period the costs are incurred. We view the various testing techniques that will take place because of the new safety regulations to constitute a work activity falling within our rules for maintenance expense. Further, expenditures for pipeline assessment activities under a pipeline integrity program do not meet the capitalization criteria established by the Commission, as discussed above, as the costs are not incurred as part of a one-time rehabilitation project to extend the useful life of the pipeline system, rather the expenditures are made as part of an on-going inspection and testing or maintenance program.

9. Accordingly, pipeline assessment costs of a pipeline integrity management program are properly accounted for as maintenance and charged to expense in the period incurred. Appendix A includes three examples that illustrate the provisions of this Accounting Release.

10. This Accounting Release shall be effective January 1, 2005.

Appendix A--Illustrative Examples of the Application of the Accounting Release

Example 1

A pipeline company owns and operates a large pipeline system. The company has established 100 foot lengths of pipe as a retirement unit for purposes of determining when the costs of property changes are to be charged to expense or capitalized as a component of pipeline property. During the year, the Company assesses 100 miles using hydrostatic testing and direct assessment of pipe at a cost of $1.5 million. As a result of the assessment, the company replaces a continuous 2 mile segment of the pipe at a cost of $750,000 and replaces or sleeves 3

[[Page 67729]]

other separate sections of the pipeline each being less than 100 feet in length at a total cost of $175,000. At the conclusion of all work, the company hydrostatically tests the affected segments of pipe to appropriate operating pressure at a cost of $150,000.

The assessment activity, regardless of whether hydrostatic testing, direct assessment, or other techniques are utilized constitutes work undertaken specifically for the purpose of determining the condition of existing pipeline facilities. Although the assessment did result in identifying a need to replace a segment of line in excess of the designated property unit of 100 feet, only the direct construction costs of $750,000 and a related portion of the hydrostatic testing costs incurred following completion of the construction work should be capitalized. All of the costs incurred to assess the condition of the existing pipeline should be charged to maintenance expense in the period they are incurred. Also, all of the costs of replacing or sleeving the 3 pipe sections that are each less than a retirement unit, including a portion of the related hydrostatic testing costs incurred after completion of the work should be charged to expense in the period incurred.

Example 2

A pipeline company owns and operates a large pipeline system. Its pipeline system is comprised of segments with different size pipe and different maximum allowable operating pressures (MAOP). The company is experiencing capacity constraints on certain pipeline segments because of increased demand for gas in markets it serves.

The company hydrostatically tests a 5 mile segment of its system to assess its compliance with pipeline safety regulations at a cost of $1,000,000. In conjunction with facility additions of $200,000, the company uses the opportunity provided by the hydrostatic testing to certify an increase in the MAOP of the 5 mile pipeline segment from 750 pounds per square inch gauge (PSIG) to 1000 PSIG. The increased MAOP of the 5 mile segment now equals the MAOP at the upstream and downstream ends of the pipeline segments of which it is interconnected and the company is able to alleviate an operational constraint and increase the available capacity of its pipeline system.

The costs of the hydrostatic test of $1,000,000 should be charged to maintenance expense since they were incurred for the purpose of determining the condition of existing pipeline facilities, a maintenance activity. While a benefit of the

assessment activity was an increase in the capacity of the pipeline segment, the company would have had to incur the costs to hydrostatic test the pipeline segment to comply with pipeline safety requirements regardless whether an increase in MAOP resulted. Thus, the company cannot capitalize any of the hydrostatic test costs in this instance. The company would, however, be allowed to capitalize the $200,000 of facility additions.

Example 3

A pipeline company previously received approval from the Chief Accountant to capitalize hydrostatic test and smart pigging costs when the work was done in connection with a major pipeline rehabilitation project involving significant replacements and modifications of facilities. The rehabilitation project significantly extended the overall pipeline system's useful life.

During 20X1, the Company assesses 50 miles of the eastern leg of its system using hydrostatic testing and smart pigging at a cost of $1.0 million. The assessment was done as part of the pipeline's integrity management program to comply with DOT regulations. As a result of the assessment, the company replaces a continuous 5 mile segment of pipe at a cost of $1.5 million. In addition, the company undertakes a major rehabilitation of the western leg of its system. As a part of the $20 million rehabilitation project, the company incurs $500,000 of hydrostatic test costs to determine the exact nature of replacements to be made, along with incurring $250,000 of hydrostatic test costs to determine that the replacements were adequately made.

The costs of the hydrostatic and smart pigging assessment activities performed on the eastern leg of the system of $1.0 million would be expensed as maintenance, since it was performed as a part of the company's integrity management program. The company would be allowed, however, to capitalize the $1.5 million of direct construction costs it incurred, since they replaced a segment of line in excess of the designated property unit of 100 feet.

In regards to the major rehabilitation project on the western leg of the company's system, the company would be allowed to capitalize assessment related costs, if it has in place appropriate internal controls for distinguishing between costs incurred related to ongoing assessment activities under its pipeline integrity program and those assessment costs that are a part of a rehabilitation project. As a minimum, in order to qualify for capitalization, the company must have controls in place that clearly define the scope of the rehabilitation project, separately budget for the project as a capital item, provides for a projected completion date for the project and adequately sets forth how costs are assigned to construction projects.

If the above capitalization criteria are met, the company would be allowed to capitalize the $500,000 of hydrostatic test costs it incurred to determine the scope of the replacements needed related to the major rehabilitation of the western leg of its system. The company would also be allowed to capitalize the $250,000 of hydrostatic test costs it incurred to determine that the replacements were adequately made. Capitalization of hydrostatic test costs in this instance is appropriate since the rehabilitation project significantly extends the useful life of the western leg of the company's system. Previous testing costs related to the rehabilitated segments would of course be retired in accordance with Gas Plant Instruction No. 10.

[FR Doc. E4-3224 Filed 11-18-04; 8:45 am]
BILLING CODE 6717-01-P

FERC
FEDERAL ENERGY REGULATORY COMMISSION

Hydrostatic Testing of Gas Main and Pipelines

TEXT SIZE S M L

Question: What is the proper accounting treatment for costs incurred in hydrostatic testing of gas mains and pipelines to meet the requirements of the USAS N31.8, 1968 Code, which became Federal standards under legislation passed by Congress August 12, 1968?

Answer: Costs incurred under a planned maintenance program which meet the standards of USAS B31.8, 1968 Code, should be treated as regular maintenance expenses. When a utility had constructed a pipeline and its initial tests did not meet the requirements of the Code making it necessary to retest so that the full capacities could be utilized such costs could be capitalized. When such costs are capitalized all prior testing costs related to the specific property should be retired in accordance with Gas Plan Instruction 10. Testing costs on future construction should be capitalized provided that such testing meets the then prevailing reqired standards.

Arthur L. Litke
Chief Accountant

Effective: March 6, 1969

Updated: June 28, 2010