July 27, 2017

Mayor and City Council
City of Nash
Nash, Texas

Re: Statement of Intent to Increase Rates

Ladies and Gentleman:

CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Arkla ("CenterPoint Arkla" or the "Company") files this Statement of Intent to Increase Rates ("Statement of Intent") within the City of Nash, Texas ("City"), which is a part of CenterPoint Arkla's Texarkana, Texas Service Area. CenterPoint Arkla is a gas utility as defined by the Gas Utility Regulatory Act ("GURA"),[1] and the City has exclusive original jurisdiction to set rates for the Company pursuant to § 103.001 of GURA. CenterPoint Arkla serves approximately 446 residential customers and 56 small commercial customers in the City. By this Statement of Intent, CenterPoint Arkla notifies the City of its intent to increase its rates effective September 1, 2017, which is at least 35 days from the date of this filing.

For many years, CenterPoint Arkla has provided the City with safe, adequate and reliable natural gas service at reasonable rates and has worked hard to control its operating costs while continuing to provide service at these reasonable rates. As a result of those efforts, the Company's operating expenses have remained relatively flat since the Company implemented its last change in base rates almost 10 years ago. However, during that same period, the Company has continued to make substantial capital investments necessary to maintain a safe and reliable system, and those expenditures are continuing to grow due to aging infrastructure and increasingly more stringent pipeline safety and integrity regulations. Without the requested increase, CenterPoint Arkla's current rates for service to customers in the City no longer provide a reasonable opportunity for CenterPoint Arkla to recover its operating costs and earn a fair return on its investment.

Last year, CenterPoint Arkla completed a major rate case in the State of Arkansas. As part of that proceeding, the Arkansas Public Service Commission ("APSC") held public hearings in Little Rock, Texarkana and Jonesboro, Arkansas, and by Order dated September 2, 2016, the APSC approved new rates for the Company. A copy of the Order is attached as Exhibit A.

Consistent with the Company's historical arrangement with the City, CenterPoint Arkla is presenting for consideration by the City rate schedules and tariffs consistent with those approved in Arkansas by the APSC, with the exception of the Gas Supply Rate Rider ("GSR Rider") and certain riders that are expiring in Arkansas. The GSR Rider included in the proposed rates and tariffs is based off the GSR Rider approved by the Arkansas Public Service Commission, but it will specifically align gas costs paid by Nash, Redwater, Texarkana and Wake Village, Texas customers to the cost of the gas supplied to those customers so that customers in these cities do not overpay or underpay for their cost of gas.

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[1] TEX. UTIL. CODE ANN. §§ 101.001, *et seq.*

Accordingly, pursuant to GURA § 104.102, CenterPoint Arkla files this Statement of Intent with attached Rate Schedules containing the proposed revisions to the Company's rates and terms and conditions of service applicable in your City. The proposed Rate Schedules are attached as Exhibit B. Additionally, for convenience, Exhibit C shows a redlined comparison of the proposed rate schedules and tariffs against the current rate schedules and tariffs applicable in your City. The effect of the Company's proposed new rate schedules and tariff changes is to increase CenterPoint Arkla's net annual non-gas revenues in the City by approximately $34,604 per year.

In addition to the proposed increases to rates for the residential, small commercial, and large volume commercial classes, CenterPoint Arkla proposes a new tariff: the Formula Rate Plan ("FRP") Rider. The FRP Rider supports infrastructure investment and adjusts rates annually if the company is over or under recovering costs. This tariff was also approved by the APSC. The FRP Rider will replace the Main Replacement Program tariff currently on file in the City.

If approved, the proposed revisions to the rate schedules amount to an increase per month of approximately $6.16 for the average residential customer in the City. The changes represent a total increase to the Company's revenues for the City of approximately 10.4%, and constitute a "major change" as that term is defined in GURA § 104.101.

Publication of required notice containing information relative to this Statement of Intent will be made in accordance with applicable statutes.

Finally, the Company may request reimbursement of all Company and City rate case expenses as allowed by law. The exact amount will not be known until the case is completed.

If you desire any additional information concerning these changes, we will be available at any time to discuss them with you.

Very truly yours,

Walter L. Bryant

Walter L. Bryant
Vice President – Regional Operations

Attachments

DELIVERED TO:

____, ____________________________________ of
NAME OFFICE (Mayor, City Secretary, etc.)

the City of _____________ on this __________ day of ______________ 2017.

____
SIGNATURE

July 27, 2017

Mayor and City Council
City of Redwater
Redwater, Texas

Re: Statement of Intent to Increase Rates

Ladies and Gentleman:

CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Arkla ("CenterPoint Arkla" or the "Company") files this Statement of Intent to Increase Rates ("Statement of Intent") within the City of Redwater, Texas ("City"), which is a part of CenterPoint Arkla's Texarkana, Texas Service Area. CenterPoint Arkla is a gas utility as defined by the Gas Utility Regulatory Act ("GURA"),[1] and the City has exclusive original jurisdiction to set rates for the Company pursuant to § 103.001 of GURA. CenterPoint Arkla serves approximately 124 residential customers and 24 small commercial customers in the City. By this Statement of Intent, CenterPoint Arkla notifies the City of its intent to increase its rates effective September 1, 2017, which is at least 35 days from the date of this filing.

For many years, CenterPoint Arkla has provided the City with safe, adequate and reliable natural gas service at reasonable rates and has worked hard to control its operating costs while continuing to provide service at these reasonable rates. As a result of those efforts, the Company's operating expenses have remained relatively flat since the Company implemented its last change in base rates almost 10 years ago. However, during that same period, the Company has continued to make substantial capital investments necessary to maintain a safe and reliable system, and those expenditures are continuing to grow due to aging infrastructure and increasingly more stringent pipeline safety and integrity regulations. Without the requested increase, CenterPoint Arkla's current rates for service to customers in the City no longer provide a reasonable opportunity for CenterPoint Arkla to recover its operating costs and earn a fair return on its investment.

Last year, CenterPoint Arkla completed a major rate case in the State of Arkansas. As part of that proceeding, the Arkansas Public Service Commission ("APSC") held public hearings in Little Rock, Texarkana and Jonesboro, Arkansas, and by Order dated September 2, 2016, the APSC approved new rates for the Company. A copy of the Order is attached as Exhibit A.

Consistent with the Company's historical arrangement with the City, CenterPoint Arkla is presenting for consideration by the City rate schedules and tariffs consistent with those approved in Arkansas by the APSC, with the exception of the Gas Supply Rate Rider ("GSR Rider") and certain riders that are expiring in Arkansas. The GSR Rider included in the proposed rates and tariffs is based off the GSR Rider approved by the Arkansas Public Service Commission, but it will specifically align gas costs paid by Nash, Redwater, Texarkana and Wake Village, Texas customers to the cost of the gas supplied to those customers so that customers in these cities do not overpay or underpay for their cost of gas.

[1] TEX. UTIL. CODE ANN. §§ 101.001, *et seq.*

Accordingly, pursuant to GURA § 104.102, CenterPoint Arkla files this Statement of Intent with attached Rate Schedules containing the proposed revisions to the Company's rates and terms and conditions of service applicable in your City. The proposed Rate Schedules are attached as Exhibit B. Additionally, for convenience, Exhibit C shows a redlined comparison of the proposed rate schedules and tariffs against the current rate schedules and tariffs applicable in your City. The effect of the Company's proposed new rate schedules and tariff changes is to increase CenterPoint Arkla's net annual non-gas revenues in the City by approximately $10,331 per year.

In addition to the proposed increases to rates for the residential, small commercial, and large volume commercial classes, CenterPoint Arkla proposes a new tariff: the Formula Rate Plan ("FRP") Rider. The FRP Rider supports infrastructure investment and adjusts rates annually if the company is over or under recovering costs. This tariff was also approved by the APSC. The FRP Rider will replace the Main Replacement Program (MRP) tariff currently on file in the City.

If approved, the proposed revisions to the rate schedules amount to an increase per month of approximately $6.44 for the average residential customer in the City. The changes represent a total increase to the Company's revenues for the City of approximately 7.0%, and constitute a "major change" as that term is defined in GURA § 104.101.

Publication of required notice containing information relative to this Statement of Intent will be made in accordance with applicable statutes.

Finally, the Company may request reimbursement of all Company and City rate case expenses as allowed by law. The exact amount will not be known until the case is completed.

If you desire any additional information concerning these changes, we will be available at any time to discuss them with you.

Very truly yours,

Walter L. Bryant

Walter L. Bryant
Vice President – Regional Operations

Attachments

DELIVERED TO:

____, __________________________________ of
NAME OFFICE (Mayor, City Secretary, etc.)

the City of _____________ on this __________ day of ______________ 2017.

____
SIGNATURE

July 27, 2017

Mayor and City Council
City of Texarkana
Texarkana, Texas

Re: Statement of Intent to Increase Rates

Ladies and Gentleman:

CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Arkla ("CenterPoint Arkla" or the "Company") files this Statement of Intent to Increase Rates ("Statement of Intent") within the City of Texarkana, Texas ("City"), which is a part of CenterPoint Arkla's Texarkana, Texas Service Area. CenterPoint Arkla is a gas utility as defined by the Gas Utility Regulatory Act ("GURA"),[1] and the City has exclusive original jurisdiction to set rates for the Company pursuant to § 103.001 of GURA. CenterPoint Arkla serves approximately 9,394 residential customers, 1,469 small commercial customers and 3 large volume customers in the City. By this Statement of Intent, CenterPoint Arkla notifies the City of its intent to increase its rates effective September 1, 2017, which is at least 35 days from the date of this filing.

For many years, CenterPoint Arkla has provided the City with safe, adequate and reliable natural gas service at reasonable rates and has worked hard to control its operating costs while continuing to provide service at these reasonable rates. As a result of those efforts, the Company's operating expenses have remained relatively flat since the Company implemented its last change in base rates almost 10 years ago. However, during that same period, the Company has continued to make substantial capital investments necessary to maintain a safe and reliable system, and those expenditures are continuing to grow due to aging infrastructure and increasingly more stringent pipeline safety and integrity regulations. Without the requested increase, CenterPoint Arkla's current rates for service to customers in the City no longer provide a reasonable opportunity for CenterPoint Arkla to recover its operating costs and earn a fair return on its investment.

Last year, CenterPoint Arkla completed a major rate case in the State of Arkansas. As part of that proceeding, the Arkansas Public Service Commission ("APSC") held public hearings in Little Rock, Texarkana and Jonesboro, Arkansas, and by Order dated September 2, 2016, the APSC approved new rates for the Company. A copy of the Order is attached as Exhibit A.

Consistent with the Company's historical arrangement with the City, CenterPoint Arkla is presenting for consideration by the City rate schedules and tariffs consistent with those approved in Arkansas by the APSC, with the exception of the Gas Supply Rate Rider ("GSR Rider") and certain riders that are expiring in Arkansas. The GSR Rider included in the proposed rates and tariffs is based off the GSR Rider approved by the Arkansas Public Service Commission, but it will specifically align gas costs paid by Nash, Redwater, Texarkana and Wake Village, Texas customers to the cost of the gas supplied to those customers so that customers in these cities do not overpay or underpay for their cost of gas.

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[1] TEX. UTIL. CODE ANN. §§ 101.001, *et seq.*

Accordingly, pursuant to GURA § 104.102, CenterPoint Arkla files this Statement of Intent with attached Rate Schedules containing the proposed revisions to the Company's rates and terms and conditions of service applicable in your City. The proposed Rate Schedules are attached as Exhibit B. Additionally, for convenience, Exhibit C shows a redlined comparison of the proposed rate schedules and tariffs against the current rate schedules and tariffs applicable in your City. The effect of the Company's proposed new rate schedules and tariff changes is to increase CenterPoint Arkla's net annual non-gas revenues in the City by approximately $886,391 per year.

In addition to the proposed increases to rates for the residential, small commercial, and large volume commercial classes, CenterPoint Arkla proposes a new tariff: the Formula Rate Plan ("FRP") Rider. The FRP Rider supports infrastructure investment and adjusts rates annually if the Company is over or under recovering costs. This tariff was also approved by the APSC. The FRP Rider will replace the Main Replacement Program tariff currently on file in the City.

If approved, the proposed revisions to the rate schedules amount to an increase per month of approximately $7.27 for the average residential customer in the City. The changes represent a total increase to the Company's revenues for the City of approximately 10.1%, and constitute a "major change" as that term is defined in GURA § 104.101.

Publication of required notice containing information relative to this Statement of Intent will be made in accordance with applicable statutes.

Finally, the Company may request reimbursement of all Company and City rate case expenses as allowed by law. The exact amount will not be known until the case is completed.

If you desire any additional information concerning these changes, we will be available at any time to discuss them with you.

Very truly yours,

Walter L. Bryant

Walter L. Bryant
Vice President – Regional Operations

Attachments

DELIVERED TO:

____, ____________________________________ of
NAME OFFICE (Mayor, City Secretary, etc.)

the City of ______________ on this ___________ day of _______________ 2017.

____
SIGNATURE

July 27, 2017

Mayor and City Council
City of Wake Village
Wake Village, Texas

Re: Statement of Intent to Increase Rates

Ladies and Gentleman:

CenterPoint Energy Resources Corp., d/b/a CenterPoint Energy Arkla ("CenterPoint Arkla" or the "Company") files this Statement of Intent to Increase Rates ("Statement of Intent") within the City of Wake Village, Texas ("City"), which is a part of CenterPoint Arkla's Texarkana, Texas Service Area. CenterPoint Arkla is a gas utility as defined by the Gas Utility Regulatory Act ("GURA"),[1] and the City has exclusive original jurisdiction to set rates for the Company pursuant to § 103.001 of GURA. CenterPoint Arkla serves approximately 1,789 residential customers and 85 small commercial customers in the City. By this Statement of Intent, CenterPoint Arkla notifies the City of its intent to increase its rates effective September 1, 2017, which is at least 35 days from the date of this filing.

For many years, CenterPoint Arkla has provided the City with safe, adequate and reliable natural gas service at reasonable rates and has worked hard to control its operating costs while continuing to provide service at these reasonable rates. As a result of those efforts, the Company's operating expenses have remained relatively flat since the Company implemented its last change in base rates almost 10 years ago. However, during that same period, the Company has continued to make substantial capital investments necessary to maintain a safe and reliable system, and those expenditures are continuing to grow due to aging infrastructure and increasingly more stringent pipeline safety and integrity regulations. Without the requested increase, CenterPoint Arkla's current rates for service to customers in the City no longer provide a reasonable opportunity for CenterPoint Arkla to recover its operating costs and earn a fair return on its investment.

Last year, CenterPoint Arkla completed a major rate case in the State of Arkansas. As part of that proceeding, the Arkansas Public Service Commission ("APSC") held public hearings in Little Rock, Texarkana and Jonesboro, Arkansas, and by Order dated September 2, 2016, the APSC approved new rates for the Company. A copy of the Order is attached as Exhibit A.

Consistent with the Company's historical arrangement with the City, CenterPoint Arkla is presenting for consideration by the City rate schedules and tariffs consistent with those approved in Arkansas by the APSC, with the exception of the Gas Supply Rate Rider ("GSR Rider") and certain riders that are expiring in Arkansas. The GSR Rider included in the proposed rates and tariffs is based off the GSR Rider approved by the Arkansas Public Service Commission, but it will specifically align gas costs paid by Nash, Redwater, Texarkana and Wake Village, Texas customers to the cost of the gas supplied to those customers so that customers in these cities do not overpay or underpay for their cost of gas.

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[1] TEX. UTIL. CODE ANN. §§ 101.001, *et seq.*

Accordingly, pursuant to GURA § 104.102, CenterPoint Arkla files this Statement of Intent with attached Rate Schedules containing the proposed revisions to the Company's rates and terms and conditions of service applicable in your City. The proposed Rate Schedules are attached as Exhibit B. Additionally, for convenience, Exhibit C shows a redlined comparison of the proposed rate schedules and tariffs against the current rate schedules and tariffs applicable in your City. The effect of the Company's proposed new rate schedules and tariff changes is to increase CenterPoint Arkla's net annual non-gas revenues in the City by approximately $131,589 per year.

In addition to the proposed increases to rates for the residential, small commercial, and large volume commercial classes, CenterPoint Arkla proposes a new tariff: the Formula Rate Plan ("FRP") Rider. The FRP Rider supports infrastructure investment and adjusts rates annually if the company is over or under recovering costs. This tariff was also approved by the APSC. The FRP Rider will replace the Main Replacement Program tariff currently on file in the City.

If approved, the proposed revisions to the rate schedules amount to an increase per month of approximately $6.03 for the average residential customer in the City. The changes represent a total increase to the Company's revenues for the City of approximately 12.0%, and constitute a "major change" as that term is defined in GURA § 104.101.

Publication of required notice containing information relative to this Statement of Intent will be made in accordance with applicable statutes.

Finally, the Company may request reimbursement of all Company and City rate case expenses as allowed by law. The exact amount will not be known until the case is completed.

If you desire any additional information concerning these changes, we will be available at any time to discuss them with you.

Very truly yours,

Walter L. Bryant

Walter L. Bryant
Vice President – Regional Operations

Attachments

DELIVERED TO:

____, _________________________________ of
NAME OFFICE (Mayor, City Secretary, etc.)

the City of _____________ on this __________ day of ______________ 2017.

____
SIGNATURE

ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF CENTERPOINT ENERGY RESOURCES CORP. D/B/A CENTERPOINT ENERGY ARKANSAS GAS FOR A GENERAL CHANGE OR MODIFICATION IN ITS RATES, CHARGES AND TARIFFS)	DOCKET NO. 15-098-U ORDER NO. 8

ORDER

On November 10, 2015, pursuant to Ark. Code Ann. §§ 23-4-401, *et seq.*, CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Arkansas Gas (CEA) submitted an *Application for Approval of a General Change in Rates and Tariffs* (Application), reflecting a $35.6 million revenue deficiency. CEA stated that its base rate increase is driven primarily by the rising capital expenditures necessary to maintain a safe and reliable system as well as a decline in both the number of residential customers served since 2006 and in use per customer. According to CEA, the impact of the requested rate increase would be an increase on the average residential customer's bill of $6.68, which is approximately a 12.2% increase in the average customer's total bill, including gas costs. CEA also provided notice that it elects to implement a Formula Rate Plan (FRP) pursuant to Act 725 of 2015. In support of its Application, CEA filed the Direct Testimony and Exhibits of the following witnesses: Walter L. Bryant, Jeffrey A. Bish, Beryl Drews, Jane A. George, Lynne Harkel-Rumford, Robert B. Hevert, Mary A. Kirk, Matthew S. Smith, and Dane A. Watson. On January 15, 2016, the Commission approved the interventions of Arkansas Gas Consumers, Inc. (AGC) and the University of Arkansas System (UAS). The General Staff of the Commission (Staff) and the Consumer Utilities Rate Advocacy Division of the Office of the Attorney General (AG) also are parties to the case.

On April 14, 2016, the AG filed Direct Testimonies and Exhibits of August H. Ankum, William Perea Marcus, and David E. Dismukes.; Staff filed the Direct Testimonies and Exhibits of Don Malone, Kim O. Davis, Robert E. Henry, Jerry Keever, Karen L. Wheatley, Rick Dunn, Jeff Hilton, Gail P. Fritchman, Gerrilynn Wolfe, William L. Matthews, Robert Swaim, and Victoria Settles; UAS submitted the Direct Testimonies of Mark Kenneday and Larry Blank; and AGC submitted the Direct Testimonies and Exhibits of Jeffrey Pollock, Billie S. LaConte, and Gregory Hamilton.

On May 11, 2016, CEA submitted the Rebuttal Testimonies of Walter L. Bryant, Jeffrey A. Bish, Beryl Drews, Lynne Harkel-Rumford, Robert B. Hevert, Mary A. Kirk, Matthew S. Smith, and Darren Storey.

On June 7, 2016, the following witnesses filed Surrebuttal Testimony: on behalf of the AG, August H. Ankum, William Perea Marcus, and David E. Dismukes; on behalf of UAS, Mark Kenneday and Larry Blank; on behalf of AGC, Jeffrey Pollock, Billie S. LaConte, and Gregory Hamilton; and on behalf of Staff, Don Malone, Kim O. Davis, Robert E. Henry, Jerry Keever, Karen L. Wheatley, Rick Dunn, Jeff Hilton, Gail P. Fritchman, Gerrilynn Wolfe, William L. Matthews, Robert Swaim, and Victoria Settles.

On June 16, 2016, CEA filed the Sur-surrebuttal Testimonies of Walter L. Bryant, Jeffrey A. Bish, Beryl Drews, Lynne Harkel-Rumford, Robert B. Hevert, Mary A. Kirk, Matthew S. Smith, and Darren Storey, and an updated cost of service study and Minimum Filing Requirement schedules.

On July 1, 2016, CEA, Staff, UAS, and AGC (the Settling Parties) filed a *Joint Motion to Approve Settlement Agreement* (Joint Motion), including a Stipulation and Settlement Agreement (Settlement), and the Settlement Testimonies of Kim O. Davis, Jeff Hilton, and Matthew Klucher for Staff, Jeffrey Bish and Walter Bryant for CEA, Larry Blank for UAS, and Jeffry Pollock for AGC. Also on July 1, 2016, all parties filed a *Joint Issues List*. On July 6, 2016, all parties submitted a *Joint Motion to Excuse Witnesses and Examine Certain Issues on the Joint Issues List Out of Order*, which the Commission approved in part by Order No. 6, excusing CEA witnesses Watson and Harkel-Rumford; Staff witnesses Wolfe, Dunn, and Settles; UAS witnesses Kenneday and Jeffries; and AGC witness LaConte. On July 8, 2016, the AG filed Testimonies and Exhibits of David Dismukes and August Ankum in Opposition to Settlement.

On July 12-13, 2016, the Commission held a public evidentiary hearing at its hearing room in Little Rock, Arkansas. On July 19 and July 21, 2016, respectively, the Commission held hearings for public comment in Texarkana and Jonesboro, Arkansas. No public comments were made at the July 12 hearing; one public comment was made at the July 19 hearing opposing the settlement; and one public comment was made at the July 21 hearing opposing the settlement. In addition, seven public comments, one with approximately 700 signatures, has been received online to date which opposed the proposed rate increase.

<u>Positions of the Parties</u>

I. CenterPoint Application and Direct Case.

CEA submitted an Application reflecting a non-gas revenue requirement of $196.0 million and a revenue deficiency of $35.6 million. Application at Schedule A; T. 5666. The Application seeks a 10.3% return on equity, and a 5.77% overall rate of return. T. 9195-9196. The Application is based upon a test year ending in September 2015, with six months of actual data and six months of forecasted data. T. 5666.

Approval of the Application would increase residential rate class revenue by 34.3% and would decrease revenue from the following commercial rate classes in the percentages indicated: SCS-1: -3.9%; SCS-2: -31.3%; SCS-3: -67.0%; LCS-1: -22.0%. Application Schedule G-1 at 1. The rates proposed in the Application would increase the monthly bill of a typical Residential customer by $6.68, or 12%. T. 4195.

CEA identifies the major driver of the requested retail revenue requirement increase as rising capital expenditures due to aging infrastructure and to natural gas pipeline safety and integrity management regulations. T. 5666. CEA states that new federal and state regulations require capital investments in safety and integrity management that will ensure a safe and reliable system and position the company to serve economic development from new large-volume customers. T. 5669. CEA also notes that its revenue has been impacted by a declining number of customers and use per customer. T. 5537 and 5552-5555.

CEA describes nine programs related to safety and integrity management. Witness Bish describes the following five programs: (1) the Picarro Surveyor™ Program, which employs a new leak detection technology that is more sensitive than the infrared and remote methane technology currently in use; (2) the Vintage Plastic Replacement Program; (3) the Services At-Risk Program, which would relocate services near customer property lines to the side of the customer's primary structure in order to reduce the risk of third-party damage; (4) the Permanent Records Integrity Management Project, which would review every record documenting the construction and repair of the gas delivery system and include such information within CEA's

Geographic Information System (GIS); and (5) the Pipeline Integrity Assessment and Remediation Program. T. 7308.

CEA witness Smith describes the following four programs: (1) the Right of Way (ROW) Maintenance Program, which would proactively clear right of ways every three years; (2) the Regulator Station Maintenance Program, which is proposed to sandblast and paint regulator stations every five years; (3) the Unlocatable Pipeline Detection Program, which would ensure the ability to identify and locate underground facilities within 48 hours of receiving a request to do so; and (4) the Atmospheric Corrosion Inspection Program, which would enable federally-mandated inspections of above-ground facilities. T. 7759. To the degree that these safety and integrity management programs remain contested after the filing of the Settlement, they are further described below.

CEA states that it has managed its Operations and Maintenance (O&M) expenses in such a way that they have stayed relatively constant since rates were implemented following its 2006 rate case, and offers evidence that it has enhanced customer service. T. 5544-5545. CEA states that such service improvements are directly tied to short- and long-term incentive compensation (STIC and LTIC) packages for its employees and proposes full recovery of such incentives. T. 5546-5547.

The Application elects to implement a Formula Rate Plan (FRP) using a forward-looking test year, as authorized by Act 725 of 2015 (Act 725), and including a FRP Rider. T. 5525-5526. The FRP would be periodically reviewed, using a fully projected test year. T. 4218. It would use the same ROE approved in this case and would apportion adjusted rates to the applicable classes in the same percentages as the base rates revenue requirements approved in this case. *Id.* FRP Rider annual rate adjustments would not exceed 4% of each rate class's total revenue including gas revenue for the twelve calendar months preceding the Rider FRP projected test year. T. 4219. Rider FRP would adjust the compared earned return rate for common equity for the projected test year to the target return rate for common equity, which would be the difference between the prior Rider FRP projected test year base revenue adjustment and the actual change in base revenue for that time period, once at least twelve months of data are available. The initial FRP would extend for not more than five years, with the possibility of the Commission approving a five year extension. *Id.*

CEA's Application classifies and allocates distribution plant costs using a minimum system analysis (Minimum System Study, or MSS) which allocates the costs of a minimum sized system as customer-related costs and the remaining costs as demand-related. T. 4196-4197 and 4201-4202. This method, which is specified in Act 725,[1] advances economic efficiency, economic development, and employment opportunities, according to CEA witness Drews, by lowering the revenue requirement for the commercial classes, preventing them from subsidizing other classes, lowering their cost of business, and enhancing the attraction of Arkansas as a place to locate and expand business. T. 4198.

CEA also requests approval of a new Services At-Risk (SAR) Rider to recover SAR program costs. T. 5536. CEA's Application proposes to retain all of its existing riders during the gap in time between implementation of new rates and implementation of the FRP Rider, but then anticipates withdrawing all existing riders (including the new SAR

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[1] *See*, Ark. Code Ann. § 23-4-422 (b)(3).

Rider) except for the Weather Normalization Adjustment Rider (WNA Rider) and other exact recovery riders such as the Gas Supply Rate Rider (GSR Rider), Municipal Tax Adjustment Rider (MTA Rider), and the Energy Efficiency Cost Recovery (EECR) Rider. T. 5536-5537. With regard to the Vintage Plastic Replacement Program, CEA seeks to modify CEA's existing Main Replacement Program (MRP) to recover the costs associated with replacing vintage plastic pipe. T. 7308 and 7320-7327. CEA notes that, if vintage plastic piping is added to the MRP, it will continue to create calculable reductions in leak repair costs that should be included in the MRP rider. T. 7349-7351. The Application proposes to require evaluation of continuance of the Main Replacement Program (MRP) Rider at or before the time of CEA's first FRP filing. T. 5541-5542.

II. Pre-settlement testimony.

In Direct and Surrebuttal rounds of testimony, all other parties contested CEA's overall revenue requirement; its proposed return on equity and capital structure; and the scope and budgets of its proposed safety programs. All other parties except Staff contested its request to include the full amount of short- and long-term employee incentive compensation programs in rates (although Staff recommended slight reductions). The AG opposed approval of an FRP on the basis that it would reduce CEA's incentive to address customer attrition and contested the economic impact of CEA's proposed cost allocation and its potential rate effect on residential customers.

Through these rounds of testimony and CEA's Rebuttal and Sur-surrebuttal testimony, CEA and other parties made limited progress in resolving overall revenue requirement differences. At Rebuttal, CEA agreed to a 1.3% decrease in its originally-requested revenue requirement and at Surrebuttal it agreed to a 2.4% decrease. T. 5616 and 5646. In Direct and Surrebuttal Testimony, Staff sought non-gas revenue reductions from the amount in CEA's Application of $29.5 million and $21 million, respectively. T. 7603 and 7649. At Surrebuttal, the AG recommended a rate increase of no more than $10.0 million. T. 7171.

The AG, UAS, and AGC vigorously opposed CEA's proposal to recover the full amount of short-term incentive compensation (STIC) and long-term incentive compensation (LTIC), but Staff largely supported it. CEA asserted that STIC and LTIC are essential to attract and retain a competent, creative, stable workforce, and that its overall compensation package falls at or below the median compensation needed to attract such a workforce. T. 5654-5644. Staff agreed that such compensation is generally a necessary cost of providing utility service, but recommended disallowing the time-based portion of LTIC (which comprised roughly $179,000 of the $4.8 million total incentive compensation package), characterizing it as simply a bonus not tied to performance. T. 5967 and 5970-6971.

The AG recommended removing 50% of STIC expenditures that benefit both ratepayers and shareholders (a $1.5 million reduction) and eliminating 100%, or $704,000, for stock-based LTIC. T. 6796-6704. UAS recommended disallowance of 50% of STIC plan costs and all LTIC plan costs. T. 4366-4367. AGC similarly testified that, while payment of incentive compensation based on certain operational goals may be reasonable and necessary, amounts paid to achieve certain financial goals only benefit shareholders and should not be charged to ratepayers. T. 4470. AGC recommended on this basis that 55% of STIC be disallowed; AGC also recommended disallowance of all LTIC. T. 4472-4473. UAS noted that the Commission approved similar disallowances in three recent rate cases (Docket Nos. 13-028-U, 15-015-U, and 15-011-U). T. 4366-4367. While, as noted below, the STIC and LTIC issues were settled to the agreement of all parties, the Settlement is non-unanimous with regard to safety and integrity programs, expenses, cost of capital, cost allocation, approval of an FRP, and rate design.

III. Settlement

All Parties except the AG propose a Settlement, which provides for a revenue requirement of $175,438,012, which is a $14.2 million revenue increase over current Rate Schedule Revenues (including revenues currently recovered through riders that prospectively will be included in base rates). T. 4818 and 6294. The Settlement was developed by adjusting Staff's $172,440,007 Surrebuttal Revenue Requirement upward by $2,998,005, in response to CEA's Sur-Surrebuttal Testimony, additional information provided by CEA, and the positions of AGC and UAS. T. 6294. The Settlement uses the billing determinants and resulting revenues from Staff's Surrebuttal testimony. T. 4814.

In response to CEA, and regarding expenses, the Settlement proposes the following increases from Staff's Surrebuttal case for certain expense adjustments included in CEA's proposed safety and integrity programs:

1. A $225,309 increase to Staff's Surrebuttal position for the annualized *pro forma* expense for the Unlocatable Pipe Detection program, for which Staff testifies CEA provided additional invoices, bringing the adjustment to $411,854. T. 6295. CEA originally requested $678,351 for this program, of which $241,676 was a test year cost and $436,675 was a pro-forma adjustment. T. 7778.

2. A $1,140,766 increase to Staff's Surrebuttal recommendation of $1,848,814 for the adjustment to the Pipeline Integrity Program, bringing the total adjustment to $2,989,680. T. 6297-6299. The new adjustment reflects increases in the use of water for pressure tests, inclusion of four additional in-line inspections during 2016, and an increased O&M ratio for validation digs. *Id.* CEA originally requested $4,499,333 to operate this program, of which $535,883 was a test year expense and $3,913,450 was a pro-forma adjustment based on a forward-looking schedule of activities by outside vendors. T. 7348. In Direct Testimony, however, Staff recommended a significant reduction in program expense (reducing the *pro forma* adjustment of $3.9 million by $3.7 million) based on CEA's lower average annual expenditure over the prior seven years. T. 7889. While Staff and CEA resolved some differences by Surrebuttal, prior to the Settlement CEA still opposed normalization of these costs based on normalization over the prior seven years on the basis that it would not reflect future costs. T. 7493.
3. A $1,081,346 increase to Staff's Surrebuttal case for the adjustment to the Picarro Surveyor™ program, bringing the adjustment to $3,272,199. T. 6300-6301. This increase covers an additional software license, additional contractor costs, and additional expense for Type C Leaks. *Id.* CEA originally sought to recover $5,952,837 for this program, including $1,930,442 in test-year expenses and $4,022,395 in adjustments. T. 7319.

Mr. Bish testifies that the program costs included in the Settlement are reasonable and are necessary for CEA to operate its pipeline safety programs to ensure public safety and comply with state and federal requirements. T. 7577-7578.

The Settlement also includes the following increases from Staff's Surrebuttal positions for other expense items:

1. An increase of $86,938 for the Property Tax Adjustment, bringing the annualized adjustment to $834,826 and the total *pro forma* 2016 property tax year amount to $5,134,184. T. 6296.
2. An increase of $809,019 for the Corporate Services Adjustment, bringing it to $2,301,369. T. 6296. This increase includes twelve months of expense ending May 2016, and excludes bonuses and time-based, Long-term Incentive Compensation. *Id.*
3. An increase of $435,707 for the Depreciation and Amortization Expense Adjustment, bringing it to $6,540,107. This increase includes CEA's requested amount of Computer Amortization and accommodates the increase to additions and retirements associated with the Settlement's inclusion of 95% of CEA's capital plan (discussed below). T. 6304.

The Settlement also, in response to AGC and UAS, disallows 100% of performance-based LTIC and 40% of STIC (thereby eliminating 50% of Short Term Incentive Compensation tied to financial performance metrics). These two disallowances reduce expense by $610,918 and $1,575,057, respectively. T. 6302.

While Staff witness Davis continues to view 100% of LTIC and STIC as appropriate for recovery, he testifies that Staff supports this disallowance as part of the negotiated settlement. T. 6193-6194. Mr. Davis notes that these Settlement provisions regarding LTIC and STIC reduce incentive compensation expense by an amount that is $469,992 more than recommended by the AG in Surrebuttal. T. 6191-6192. Mr. Blank states that the Settlement's LTIC and STIC provisions are consistent with UAS recommendations and with past Commission decisions. T. 4436. Mr. Pollock describes LTIC and STIC as a primary issue for AGC and notes that the Settlement provisions on this issue result in a disallowance of approximately $2.2 million. T. 4601.

The Settlement also updates *Pro Forma* Net Plant to reflect 95% of CEA's planned additions, retirements, and related Accumulated Depreciation and Retirement Work-In-Progress. This revision increases rate base by $10,388,961 from Staff's Surrebuttal case and increases Revenue Requirement by $653,320. T. 6303-6304. Staff explains that CEA provided evidence that, while the level of capital spending through May 2016 in the *pro forma* year is below the annual average of its capital budget, expenditures have begun to exceed the monthly average and that the prior three years show the same pattern of increased spending during June through September. T. 6303. Assuming that the same level of June through September spending occurs this year, Staff witness Hilton testifies that CEA will meet its capital budget for the *pro forma* year and that the inclusion in the Settlement of 95% of CEA's capital budget (and related revisions to Gross Plant-in Service, Retirements, Accumulated Depreciation, Retirement Work-in-Progress, and Depreciation Expense) are reasonable. *Id.*

In response to CEA witness Hevert's Sur-surrebuttal Testimony, the Settlement updates certain capital components (Common Equity, Customer Deposits, Accumulated Deferred Income Taxes (ADIT) and Current, Accrued and Other Liabilities (CAOL)) to reflect balances as of February 29, 2016, which were the most recently available. T. 6189. The Settlement adopts the cost rates supported by Staff witness Keever's Surrebuttal Testimony. T. 6190. The Settlement applies a Total Debt to Equity (DTE) ratio of 51.5 to 48.5, based on Staff witness Keever's recommendation, to the resulting external capital total of $566.2 million. AGC witness Pollock explains that the intervenors opposed the DTE ratio of 41% to 59% requested in CEA's Application, because the 59% equity ratio was substantially higher than the equity ratio of other gas delivery companies presented as risk-comparable proxies for CEA. T. 4601.

The Settling Parties accept the 9.5% ROE recommended in Staff witness Keever's Surrebuttal Testimony. T. 6189. Mr. Pollock states that the Settlement's 9.5% ROE is at the upper end of AGC's recommended 8.8% to 9.5% range, but that it is acceptable because the Settlement fixes CEA's equity ratio at 48.5%. T. 4601. Staff witness Davis testifies that the Settlement's updated capital structure increases the Revenue Requirement by $1,076,239 overall, and by $748,813, net of the update to Working Capital Assets. T. 6191.

For the purpose of cost allocation and designing rates, the Settling Parties agree to accept Rate Schedule Revenue Requirements and cost classification and allocation methodologies recommended in Staff witness Karen Wheatley's Surrebuttal Testimony. T. 4814-4815. Mr. Klucher testifies that applying Staff's Cost of Service model to the overall 25.53% Settlement increase in revenue requirement results in the following change from present rate schedule revenues for each class: +35.51% for Residential; -0.35% for Small Commercial Service-1 (SCS-1); -20.02% for SCS-2; -50.18% for SCS-3; and +7.26% for Large Commercial Service-1 (LCS-1). T. 4815-4816.

The Settlement, however, includes the following mitigation to reduce the differential between class revenue increase impacts:

1. Remove the surplus in the SCS classes;

2. Limit the residential class increase to no more than 125% of the system average increase;
3. Increase LCS-1 class to 40% of the system average increase; and
4. Mitigate the remaining residual revenue deficiency by increasing the SCS classes equally. T. 4816-4817.

The mitigated change from present rate schedule revenues for each class under the Settlement is as follows: +31.91% for Residential; +9.60% for SCS-1; +9.60% for SCS-2; +9.60% for SCS-3; and +10.21% for LCS-1. T. 4817. Mr. Klucher testifies that this mitigation achieves a just and reasonable result by tempering the Residential class rate increase while keeping the base rate increase to the other classes below the system average. *Id.* at 7. He states that the mitigation reasonably distributes the increase among the classes and maintains the relationships among the classes consistently with the Settlement COS results. T. 4817-4818. Mr. Blank agrees that the Settlement mitigates residential rate increases while removing what he determined to be negative economic impacts that would result from the class revenue allocation proposed by Staff in Direct Testimony. T. 4437.

Mr. Klucher further states that, when rate schedule revenues are combined with all revenues, including the cost of gas, the Settlement results in a 4.69% increase in Total Revenues. T. 4818. This 4.69% overall revenue increase is distributed as follows among the rate classes on a total bill basis: +7.26% for Residential; -0.90% for SCS-1; -2.53% for SCS-2; -3.73% for SCS-3; and -2.93% for LCS-1. *Id.*

Mr. Pollock testifies that CEA originally proposed a class cost of service study fully reflecting Act 725 and that CEA proposed several changes that the Settling Parties mostly accepted. T. 4601. He states that the Settling Parties agree that the requirements for implementing Act 725 have been met in this proceeding, but that there is disagreement about the interpretation of the Act. *Id.* He testifies that the Settling Parties therefore accept the Settlement class cost of service study as a compromise and do not recommend or endorse a specific cost allocation methodology. T. 4601-4602.

Mr. Pollock testifies, regarding revenue allocation among customer classes, that CEA's Application proposed to eliminate interclass subsidies completely. T. 4602. While AGC supported CEA's proposal, Mr. Pollock states that AGC also proposed that any mitigation of increases among particular classes should be limited to 150% of the system average non-fuel revenue increase. *Id.* He notes that the Settlement Agreement's limitation in residential base rate increase to 125% of system average increase is the mitigation that Staff adopted from the AG in its Surrebuttal Testimony; he states, however, that Staff's proposal excluded present Rider revenues. *Id.* Mr. Pollock asserts that, when restated to include present Rider revenues, the Settlement would result in essentially the same 150% cap that AGC proposed. *Id.*

The Settling Parties also agree to increase the Residential Customer Charge by $1, to $10.75 per month. T. 4819. Mr. Klucher testifies that, on a total bill basis, a typical residential customer consuming 50 CCF per month would see a monthly bill decrease of 0.6%, from $50.63 to $50.35. *Id.* Mr. Klucher's Settlement Testimony Table 4 further indicates that residential customers using more or less during a month than this average usage will see monthly bill increases ranging from 3% to 12%, depending on the amount of usage, and that the overall Class Increase is 7%. T. at 4820. Mr. Klucher states that these total bill impacts do not appear to have a significant adverse effect on the typical residential customer. *Id.* Mr. Klucher adds that no individual LCS customers would receive bill impacts much greater than 10% under the Settlement and that the proposed LCS rates thus avoid adverse customer impacts. T. 4822.

With regard to riders and tariffs, the Settlement accepts the modifications to CEA's tariffs recommended by Staff in Direct and Surrebuttal Testimony and accepted by CEA in Rebuttal and Sur-surrebuttal. T. 6196. The Settlement includes the following additional modifications and understandings:

1. The FRP Rider is modified to reflect the fixed Total Debt to Total Equity Ratio (DTE Ratio) described above at 51.5 to 48.5, with a short term debt proportion of 7.71%. T. 6194. Mr. Davis points out that this agreement eliminates his earlier recommendation that the DTE Ratio vary in a range around a point estimate, and that it is similar to the AG's request for approval of a slightly different point estimate for DTE Ratio. T. 6194-6195.
2. Rider MRP will remain in effect until the effective date of CEA's first Rider FRP rate adjustment, consistent with the recommendation of Staff witnesses Fritchman and Swaim. T. 5671 and 6196.
3. The first Rider MRP filing to recover Plant-in-Service Additions for Eligible Mains and Associated Services (Mains Additions) following the rate case will be made once cumulative actual *pro forma* Mains and associated Services Additions exceed the agreed upon *pro forma* Mains and associated Services Additions, consistent with the recommendation of Staff witness Gail P. Fritchman. T. 6196-6197.

4. The first SAR Rider filing following the rate case will be made once cumulative actual *pro forma* Services and Meters Additions exceed the agreed upon *pro forma* Services and Meters Additions, consistent with the recommendation of Staff witness Gail P. Fritchman. *Id.*

Mr. Pollock testifies that, by adopting Staff's proposed FRP provisions, the Settlement FRP clarifies and improves CEA's initially-proposed FRP, which lacked the necessary structure, procedure, and information necessary to properly adjudicate a filing. T. 4602. He states that the Settlement includes essentially the same structure, protocols, and information requirements adopted in the previous FRP approved for Entergy Arkansas, Inc. *Id.* Mr. Pollock also supports the expiration of certain riders that will accompany implementation of the FRP. *Id.*

Regarding the issue of customer attrition, the Settlement requires CEA to file an annual report that includes:

1. The customer attrition in each rate class for the prior year;
2. A discussion of each program or initiative CEA has implemented to address and mitigate any customer attrition in each customer class;
3. Any changes in customer counts and usage compared to prior years; and
4. An indication of whether counts are improving or declining. T. 6197-6198.

Mr. Davis testifies that CEA has analyzed factors underlying attrition since 2001 and that CEA has taken actions to stem customer attrition that may be having a positive impact, based on recent trends in customer accounts. *Id.* Mr. Davis testifies that the reporting should add transparency to CEA's attrition challenges and efforts, and that many other natural gas companies are facing similar challenges. T. 6198.

The Settling Parties further request that new rates be implemented beginning on September 12, 2016, for bills rendered on September 13, 2016. *Id.* CEA explains that it used September 10, 2016, as the date new rates will go into effect in calculating ADIT for federal tax purposes, and that if rates go into effect earlier, ADIT would need to be recalculated to avoid significant penalties. T. 5673-5674. Because September 10, 2016, is a Saturday, the Settlement provides for implementation of rates on the following Monday, September 12, for bills rendered on and after September 13, 2016. *Id.*

IV. AG opposition to the Settlement.

The AG opposes the Settlement for twelve reasons (AG Opposition at 4), which may be grouped and summarized under the following topics: (1) Safety and Integrity Management Programs; (2) Other expense issues; (3) Cost of Capital Issues; and (4) Cost Allocation, Riders (including the FRP) and Rate Design.

<u>Safety and Integrity Management Programs</u>:

Regarding safety and integrity management programs, the AG opposes the Settlement's provisions regarding the Regulator Station Maintenance program (AG Issue No. 7). T. 7281. AG witness Marcus testifies that, despite CEA accepting Staff's recommendation to slow the program from 5 years to 7 years, CEA proposes to do more work than is necessary to reduce risk. *Id.* Mr. Marcus explains that the Settlement authorizes CEA to spend $419,250 per year for seven years (for a total of $2.93 million) "to fix a 'problem' that has resulted in only ONE SINGLE LEAK in recent history." *Id.* (emphasis in the original). Mr. Marcus adds that CEA would paint regulator stations even if they would be retired within the seven year period, and even if they are new. *Id.* Mr. Marcus recommends disallowing the program in favor of sandblasting and repainting within several years once corrosion is actually found, with actual costs being recovered in the FRP. T. 7281-7282. He recommends, in the alternative, at 10-year program. T.8046.

At the public hearing, Mr. Marcus testified that regulator stations are inspected every year under federal rules, so that problems can be caught quickly when they are found. T. 8046. He testified that, even without a proactive program, the leaks CEA seeks to prevent are extremely rare and corrosion protection pursuant to annual inspection is reasonable. T. 8046 and 8051.

Staff witness Henry, in Surrebuttal, stated that the Regulator Station Maintenance program—as revised by Staff's recommended timeframe—reasonably meets the federal requirement for an atmospheric corrosion control that includes cleaning and coating of each pipeline or portion of pipeline that is exposed to the atmosphere. T. 7732-7733. At the public hearing, Mr. Henry added that a Staff audit report found multiple situations in which atmospheric corrosion was occurring across the state and it came to a point where Staff felt like it needed to be addressed company-wide rather than district by district. T. 8041-8042. He stated that the need to address corrosion applies to any infrastructure above ground, including meter stations, above ground mains, and regulator stations. T. 8042.

The AG also opposes the Settlement's acceptance of a three-year, proactive ROW Maintenance program adjustment $729,949, for a total program cost of $962,907 (AG Issue No. 8). T. 7284.

CEA initially proposed a three-year, $3.3 million ROW Maintenance program on the basis that federal law requires it to consistently patrol, inspect, and maintain approximately 225 miles of right of way. T. 7764-7765. CEA asserts that the program will mitigate third-party damage to its facilities and protect public safety. T. 7768-7772.

The AG responded in Direct Testimony that CEA's proposal represented a greater than $1 million annual increase over test year actual spending; that federal law does not require the program; that CEA indicates it was not violating federal law at prior, lower spending levels for as-needed vegetation management; and that CEA has not provided evidence that the program is needed to avoid serious risks from damage due to third parties or ROW encroachment. T. 6820-6821. The AG recommended denial of any *pro forma* program increase and recommended limiting program spending to an inflation adjustment plus 15% for reasonable annual variances from prior spending levels. T. 6822.

Staff, based on the Direct Testimony of Mr. Henry, found that CEA's program of proactive mowing and clearing of brush and trees would increase public safety and facilitate leakage surveys, prevention, and repair. T. 7717-7718. Staff, however, recommended a $456,143 reduction in costs for bush hogging and large timber removal on the basis of a Staff visits to CEA's proposed projects sites. T. 7719. Staff also recommended that CEA report annually on its ROW maintenance activities. T. 7719-7720.

In Rebuttal, CEA adopted Staff's recommendations, subject to minor adjustments to Staff's proposed costs, and opposed the AG's recommendations on the basis that the ROW program should be operated proactively to ensure safety rather than on the basis of historical leak activity and repair costs. T. 7789 and 7791. Mr. Smith testified for CEA that the company should make judgments to avoid leaks rather than respond to them after experiencing failures, and that the federal requirement for the company to observe surface conditions along its rights-of-way requires a consistent, regular maintenance program. T. 7791 and 7796.

In Surrebuttal, Mr. Henry addressed the AG's assertion that the ROW program is not required by federal law. Mr. Henry detailed eleven items that pipeline operators must inspect for (such as effects of encroachments and potential for gas migration from vaults and pits), which he asserts reasonably require the kind of unencumbered access for continuing surveillance that CEA's proposed program would provide. T. 7734-7735.

The AG maintains, in opposition to the Settlement, that timber removal should be performed, but that it is not the ratepayers' responsibility because they did not make the decision to fail to spend adequate sums of money to prevent tree growth. T. 7283. Mr. Marcus testifies that the most important reason for the Commission to reject the Settlement on this point is to assign the cost of timber removal to shareholders. *Id.* He recommends either a three-year or five-year program without ratepayers funding the excess costs of timber removal. *Id.* These recommendations would reduce ratepayer costs by $171, 949, or $487,663, respectively, from the Settlement amount. *Id.*

At the public hearing, the AG asked Staff witness Malone about Staff's review of CEA's ROW maintenance plan costs. T. 7972. The AG asked whether Staff's determination that only 11.25 percent of ROW designated by CEA as needing large timber removal actually needed large timber removal caused Staff to rethink the overall extent of the ROW program. T. 7973. Mr. Malone answered that Staff's recommended budget reduction, which was accepted by CEA, adequately addressed the identified problem. T. 7973. The AG further asked whether Staff similarly reviewed CEA's small timber removal plan and Mr. Malone said they did not. T. 7974.

Also at the public hearing, Mr. Marcus testified for the AG that timber grew up along CEA's ROW over the last 10 years due to a serious pattern of deferred ROW maintenance in which CEA spent only $66,000 per year from 2007 to 2014. T. 8047. Under questioning, Mr. Marcus acknowledged that the definition of such timber is three inches in diameter, which, he stated, is easier to grow in ten years than in three. T. 8047. Mr. Marcus also testified that the over-reporting of timber found by Staff's review suggests that the program should get less risk-based priority; he recommends, instead, a 5-year program. T. 8048.

Also at the public hearing, CEA witness Bish was asked whether CEA had experienced state or federal audit violations for failing or deferring implementation of safety and integrity regulations. T. 7877. Mr. Bish answered that there have been alleged violations found by Staff audits, which tend to involve problems with continuing surveillance that represents itself in atmospheric corrosion, the regulator station, the meter painting programs, and the right of way maintenance programs. T. 7877-7878. Mr. Bish described a general and significant shift at CEA from reactive integrity management to proactive threat detection and, in response to questioning, stated that CEA has agreed to file annual reports on the SAR program and is prepared to report on other programs if the Commission deems it to be necessary. T. 7899-7880.

Regarding the PRIME program and Pipeline Integrity Program, Mr. Marcus testifies for the AG that the PRIME program is a high priority, but that a small part of its cost should be disallowed on ratemaking grounds because federal rules required records to be kept of all hydro tests post-1970 or 1971, and that ratepayers should not be charged for hydro tests in cases where CEA lacks required records. T. 8049 and 7284. Mr. Marcus testifies that CEA has been violating federal rules for decades by not maintaining records of hydrotesting at certain sites after 1971. T. 6833.

Mr. Marcus also asserts that CEA has performed no hydrotesting to date under the Integrity Program because of missing records, but that CEA plans to do such testing during 2017-2020. T. 6834-6835. Mr. Marcus recommends that, if this hydrotesting occurs at sites with missing records, shareholders, rather than ratepayers should pay for the hydrotesting. T. 6835.

Mr. Bish testifies for CEA that the PRIME program will incorporate all known and applicable attributes of the CEA's natural gas system into its GIS system to facilitate better analysis, reporting, and threat assessment. T. 7492. At Sur-surrebuttal, Mr. Bish noted that CEA accepts Staff's adjustment to payroll and labor expense for PRIME. He responds to the AG that CEA is unaware of any missing records and that Mr. Marcus provides no evidence that hydrostatic testing records are missing. T. 7493-7493. Mr. Bish explains that CEA completed its retrieval of records for transmission lines by 2006, as required under federal Transmission Integrity Management Program (TIMP) rules, and that CEA has no need or plan to retrieve additional transmission hydrotest records as part of the program. T. 7493. He states that Mr. Marcus's recommendation is uninformed and without basis and should be rejected. T. 7493.

At the public hearing, Staff witness Henry indicated that the PRIME program is linked to infrastructure protection. T. 8042. He stated that it is designed to incorporate all known existing records into one location, allowing an operator to look at all records at once, and to evaluate and rank risks. T. 8042. He explained that PRIME also provides field personnel updated information on every piece of pipe they might encounter in the field, and that this is useful in responding to damaged pipes or threats, for example, by indicating the location of such pipe. T. 8043.

Mr. Henry also supports CEA's Integrity Management and Remediation Program as a key component of CEA's efforts to safely operate its system. T. 7709. In Direct Testimony, he describes in some detail the federal TIMP and Distribution Integrity Management Program (DIMP) requirements for periodic assessment and remediation that became effective in 2004. T. 7708. Mr. Henry states that Staff inspected CEA's TIMP during 2011 and 2016 and CEA's DIMP in 2014 and that CEA's plans and activities are consistent with federal code. T. 7709. Mr. Henry agrees with Mr. Bish that removal of pressure testing costs related to CEA's hydrostatic pressure testing records is not appropriate. T. 7731.

Regarding the SAR program, Mr. Marcus testifies that the risk of damage to meters identified by CEA to justify the SAR program is less than half of that reported by Source Gas, which had a similar program authorized. T. 7285. He also asserts that CEA has not prioritized its work so as to focus on the services most at risk and is therefore asking for money first without analyzing how much money it really needs to proceed in a reasonable manner. *Id.* Mr. Marcus recommends rejecting the program, but allowing meters to be moved if they are connected to mains that are being replaced under the Main Replacement Program, provided that funding could later be entertained for areas with the greatest risk once CEA does more analysis. T. 7286. Mr. Marcus also recommends limiting the movement of meters without charge to the customer to 100 feet, rather than 200 feet. *Id.*

At Surrebuttal, Mr. Henry stated that CEA's records showed 367 leaks per year in service lines caused by vehicles and that gas has ignited three times in the last ten years due to vehicle strikes. T. 7730. Mr. Henry characterized CEA's SAR program as a reasonable response to the federal requirement to identify, evaluate, rank, and address risks. T. 7730.

At the public hearing, Mr. Bish and Mr. Henry testified that the AG's recommendation to limit free service replacements to 100 feet from the original location is unreasonable and unworkable. T. 7738. Mr. Henry explained that leaving existing customer lines out of replacement projects would leave CEA with no knowledge of what the existing line is made of, how it was constructed, how it was put in, or the operation and maintenance performed on the line. T. 7738. He testified that the Settlement SAR program is the best workable solution. T. 7738.

Mr. Marcus also proposes an alternative under which CEA would file a report in a new docket by September 1, 2018, identifying areas with higher and lower risks and developing a plan to address high risk sites. He recommends either zero funding or funding at half of CEA's request level (about $2.84 million), pending the filing of the report. T. 7286. At the Public Hearing, Mr. Marcus testified that, compared to other programs such as the Picarro program, the SAR program is not high on the list of priorities for managing risk. T. 8048.

Also, under questioning by the Commission, Mr. Bish testified that CEA has filed an annual report to update the Commission about its Main Replacement Program since its beginning and has agreed to file a similar report for the SAR Program and is prepared to do other integrity management program reports if the Commission deems them to be necessary. T. 7879-7880.

Other expense issues

Regarding other expense issues affecting the overall revenue requirement, Mr. Marcus, for the AG, seeks disallowance of $1.6 million in costs allocated to CEA ratepayers as a result of CenterPoint's spinoff of Enable Midstream Partners (Enable) in 2014. T. 7280. Mr. Marcus states that CenterPoint undertook a spinoff of Enable for the benefit of shareholders, resulting in harm to CEA customers in the form of a 33.5% increase in service company costs allocated to CEA. *Id.*; *see also,* T. 6529. Mr. Marcus recommends instead using a 2.5% inflation rate to define the reasonable rate of increase of costs billed to CEA from CenterPoint's Service Company, which would yield his recommended $1.6 million disallowance. T. 7280.

For CEA, witness Storey testifies that, in general, total Service Company costs increased since 2013 due to a company reorganization, depreciation expense, inflation, and competitive pay adjustments, and not only due to the Enable transaction. T. 9109-9110. He notes that, while total Service Company costs have increased since 2013, the percentage of Service Company costs allocated to Arkansas have only marginally increased. T. 9110. Mr. Story also states that fluctuations in cost allocations are normal and derive from numerous factors and that Mr. Marcus did not argue that any particular Service Company services are unreasonable. T. 9110. Mr. Storey testifies that costs related to governance, which form 78% of Service Company costs allocated to CenterPoint's business units, grew by only 0.3% from 2006 to 2015, demonstrating diligence in Service Company cost management. T. 9111. Mr. Storey calculates that the $1.6 million disallowance recommended by the AG would result in less allocated costs than the Commission found to be reasonable in CEA's 2006 rate case. T. 9152-9152.

Mr. Storey states that Mr. Marcus' argument that CEA governance costs grew by 23% since 2006 and that allocated costs grew 33% since 2013 is misleading because these increases represent compound growth rates of only 2.3% and 2.2%, respectively since the last rate case. T. 9154. Mr. Storey argues that these growth rates are less than the 2.5% growth rate reflected in Mr. Marcus's recommendation and thus cannot be held to have harmed ratepayers. T. 9154. Mr. Storey notes that Staff does not raise concerns related to the spinoff of Enable, even after conducting discovery, on-site meetings, and an in-depth review of an internal audit of the Service Company by a third party. T. 9159.

At the public hearing, the AG asked Mr. Storey whether the 0.3 percent growth rate in governance costs from 2006 to 2015 is low only because those costs declined between 2006 and 2013, and whether he would acknowledge that those cost grew 16.2 percent per year from 2013 to 2015. T. 9174-9175. Mr. Storey confirmed this pattern for governance costs and for allocated Service Company costs in general, but reiterated, on redirect, that the increase in Service Company costs were not related to the Enable spinoff, but instead to depreciation, inflation, and competitive pay adjustments, as well as the reorganization following the Enable spinoff. T. 9176.

Mr. Marcus also recommends a $192,089 reduction below the Settlement level in the *pro forma* year costs for meter reading. T. 7281. The key issue, he states, is how to estimate *pro forma* year costs after full implementation of Automated Meter Reading

(AMR). T. 7281. Mr. Marcus asserts that, while CEA and Staff base the adjustment on costs incurred during the pre-AMR year, it is more reasonable in the case of a change with large impacts on system operations, as he recommends, to annualize the three available months of actual post-AMR costs (January-March 2016). T. 7281.

Staff and CEA respond that, because the AG's recommendation is based upon only three months of actual data, they recommend basing the meter reading adjustment instead upon CEA's known costs of service and actual historical costs. T. 17 and 5879. CEA also indicates that Mr. Marcus's annualization of costs from January through March 2016 includes a datapoint that is a significant outlier that is inappropriate to include. T. 5879.

Cost of Capital

In response to the Settlement, Mr. Marcus maintains the AG's consistent position throughout the proceeding that the ROE should be reduced by 25 basis points to reflect what he characterizes as a significant transfer of financial risk from stockholders to ratepayers if an FRP is approved. T. 7275. He states that this adjustment would reduce the Settlement rate of return by about 7.8 basis points, or 12.8 basis points pre-tax, and that the revenue requirement would be reduced by $890,000. *Id.*

Staff witnesses Davis and Keever testify that the AG's proposed 25 basis point reduction is not warranted because it is inappropriate to make discrete risk adjustments to ROE based on individual, isolated business or financial risks. T. 6188.

Mr. Marcus responds that the FRP is qualitatively different from other mechanisms used by proxy group companies such as weather normalization, decoupling, or specific program cost recovery riders because it shifts virtually all business risks from shareholders to customers. T. 7276. He states that it reduces regulatory lag and leaves customers with most of the risk for rising non-gas costs, including labor, supplies, income and other taxes, bad debts, costs allocated to CEA from its parent company, and other costs. *Id.* He similarly states that the FRP insulates stockholders from the risk of competition with other energy sources, abnormal weather, changing demographics, economic conditions, and every other cause. *Id.* Mr. Marcus states that the FRP dramatically reduces the risk profile of the company and reduces income variability, making CEA materially less risky than its peers. T. 9676-9677.

At the public hearing, Mr. Marcus further acknowledged that some of the revenue stabilization provided by an FRP has become "baked in" to the comparative utility proxy group used to develop a range of acceptable ROEs, because revenue stabilization measures such as the Billing Determinants Adjustment implemented in CEA's 2006 rate case are now more prevalent. T. 9674. He stated that "that's why I'm talking about 25 basis points." T. 9674. He noted that, when CEA first asked for revenue stabilization in Docket No. 01-243-U, "nothing was baked in" and he recommended a 150 basis point adjustment; he speculated that he might have recommended 75 basis points in 2006, when a significant number of companies had decoupling mechanisms. T. 9674-9675.

At the public hearing, Mr. Hevert responded for CEA to AG witness Marcus. Mr. Hevert stated that he was not able to replicate all of Mr. Marcus's calculations, but that his analysis showed an increase in the value of the proxy group of companies of about half of the 19% appreciation found by witness Marcus. T. 9560. Mr. Hevert states that the appreciation over three months was about half this amount, half of which occurred during the one week subsequent to the United Kingdom's vote to leave the European

Union. T. 9561. Mr. Hevert also describes a series of treasury yield, utility stock price, and broader stock market movements as a search by investors for yield that indicates at a more basic level that little weight can be given to this volatile data. T. 9562-9563. Mr. Hevert suggests that, while Mr. Marcus expects treasury yields to reduce the cost of equity, when interest rates fall due to fear of market volatility, investors demand a greater risk premium for equities, offsetting to some degree the effect of decreased treasury yields. T. 9564-9565. Mr. Hevert also suggests that the market period in question is anomalous due to the Brexit vote. T. at 9579.

Mr. Hevert confirmed in response to Commission questioning that in CEA's 2006 rate case he had initially recommended a 35 basis point ROE reduction to account for Commission approval of the Billing Determinants Adjustment (BDA) and later recommended a 25 basis point reduction (prior to the Commission adopting a 10 basis point reduction). T. 9569. Mr. Hevert, however, explained that no similar reduction is warranted in the current case because of the increasing prevalence of riders and decoupling mechanisms in the gas utility business. T. 9570. Mr. Hevert further testifies that he does not think an investor looking at CEA and another company would accept a reduced return on investment—indicating that CEA is materially less risky than its peers—based upon the FRP. T. 9574. Mr. Hevert acknowledges that approval of the FRP will decrease regulatory lag for CEA. T. 9576. Mr. Hevert further asserts that the question of the proportion of a company's revenue that is affected by a revenue stabilization mechanism is secondary to the issue of the extent to which it stabilizes the cost that it's meant to address: stabilization of a less volatile portion of costs through an FRP makes less difference to systemic risk than stabilization of significant, volatile, uncontrollable costs. T. 9577. Mr. Davis, for Staff, stated at the public hearing that he agrees with Mr. Hevert's testimony. T. 9651.

At the public hearing, Mr. Davis added that, while common sense suggests that the FRP lowers risk somewhat and would reduce regulatory lag for CEA, he feels that any ROE adjustment that targets a single element of risk must be both appropriate and quantifiable. T. 9652. He states that he is unaware of any testimony in the docket that explains how the AG arrived at a 25 basis point adjustment, and that, in his opinion, an adjustment is neither appropriate nor quantifiable in this case. T. 9652.

At the public hearing, AGC witness LaConte testified that although she advocated an adjustment to ROE for approval of the FRP in her Direct and Surrebuttal Testimony, AGC agreed to compromise its position on the ROE adjustment in the interest of the Settlement. She testified at the hearing that as a policy issue, absent the Settlement, she still feels the adjustment to ROE would be warranted should the FRP be approved. T. 9649. She testifies, however, that in this case AGC accepts a higher ROE because the Settlement on the equity ratio lowered the weighted cost of capital. T. 9648-9649.

The AG argues that the Settlement departs from the long-standing precedent for the state's major electric utility (Entergy Arkansas, Inc.), under substantially similar facts, by failing to remove a portion of external capital dollars attributable to money pool lending activity between CEA and CERC. T. 48. Staff witness Keever recommends against the AG's proposed money pool adjustment because CEA's money pool does not exhibit the same characteristics as the money pool used by Entergy Arkansas. He states that Arkansas ratepayers are not unduly harmed because the money pool rate for CEA of 5.23% is reflective of actual borrowing costs for CERC as opposed to EAI's money pool rate of .09%. T. 6416. At the public hearing, witness Hevert echoed witness Keever's reasoning, and added that he feels it is inconsistent to impute a capital structure and then make an adjustment based on actual balances. T. 9568.

Mr. Marcus responds that his money pool adjustment is consistent with Entergy Arkansas' Docket No. 06-101-U rate case. T. 9670. Unlike that case, however, he acknowledges that he did not remove short term debt from the calculation of his adjustment. T. 9670-9674. At the hearing, AG witness Marcus noted that while he still feels the adjustment is reasonable, a better way to have made the adjustment would have been if CEA's parent company's actual capital structure were the source of the imputation for CEA. T. 9679-9680.

Cost allocation, FRP, Attrition, and Rate Design

Dr. Dismukes, for the AG, opposes the Settlement because it raises residential base revenues by 35.51 percent while all other rate classes except large commercial service (LCS) are given rate decreases. T. 5168-5169. Dr. Dismukes states that the residential class would be the only class to see an increase in its required natural gas revenues. T. 5169. Even with the Settlement provision limiting the residential base revenue increase to 125% of the system average, Dr. Dismukes observes that residential revenues increase 7.26 percent on a total revenue requirement basis, while all other rate classes would see decreases of between 0.90 percent and 3.73 percent.

Dr. Dismukes notes that the Settlement reduces LCS-1 customer bills by only 0.35 percent rather than the 2.93 percent mentioned in the Settlement because these large customers pay the natural gas portion of their service to upstream suppliers, rather than CEA. T. 5170. Dr. Dismukes thus asserts that the Settlement would provide only marginal benefit to large industrial customers. T. 5170.

Dr. Dismukes asserts that residential revenues per customer have increased by as much as 20 percent over the past 16 years while non-residential customer revenues have fallen by as much as 17 percent. T. 5171. He states that residential customers have borne 97.2 percent to the $87.6 million in revenue requirement increases since 1987, while large industrial customers have seen rate increases in only two of CEA's past seven rate cases. T. 5171-5172. Dr. Dismukes notes that the Commission in one case mitigated increases for commercial and industrial customers by decreasing a determined rate reduction for residential customers. T. 5173.

Dr. Dismukes disagrees with the Settlement's Class Cost of Service (CCOS) allocation on the basis that its proposed Minimum System Study (MSS) is flawed. T. 5174. Dr. Dismukes notes that CEA proposed its MSS in order to meet a requirement in Act 725 that, in the case of an FRP, allocation of costs must be based on a MSS approach if doing so will be "beneficial to economic development or the promotion of employment opportunities." T. 5175, *referencing* Ark. Code Ann. §§ 23-4-22(b), (3)(A) and (3)(B). Dr. Dismukes (and Dr. Ankum, for the AG) argue that CEA did not meet its burden of proof to establish that the MSS benefits economic development, in part because CEA provides no evidence of an economic benefit from prior industrial customer rate decreases, and in part because CEA relies on what the AG characterizes as a flawed study provided in Rebuttal by AGC, rather than on CEA's own evidence. T. 5175-76, *referencing* earlier testimony. Dr. Dismukes maintains that Act 725 does not replace the Commission's role in setting just and reasonable rates and that the Settlement significantly shifts the way CEA's rates are set, reducing rates for industrial customers without evidence that it will assist economic development. T. 5175-5176. Dr. Dismukes also objects to the Settlement's allocation of regulator equipment that he describes as part of CEA's larger system of distribution mains on the basis of demand, and with its allocation of accounts for Gas Stored Underground, Distribution Expense, and Customer Installations. T. 5177-5178.

At the public hearing, Dr. Dismukes testified that, as an alternative to CEA's MSS method of allocating the cost of mains, he proposes a "Seabrook method" (referring to a FERC-jurisdictional pipeline case) that administratively determines an allocation of 50 percent of these costs to customer classifications, 25 percent to volumes, and another 25% to peak. T. 5228-5232. When asked at the public hearing about the basis in substantial evidence for this method, Dr. Dismukes indicated that it produces results consistent with Staff's recommendation in other rate cases and falls within reasonable regulatory discretion to choose within a reasonable range, particularly when choosing among multiple cost of service studies or different approaches. T. 5251-5252.

Dr. Dismukes also emphasizes that the Settlement mitigation proposal covers base rate revenues and not non-fuel revenues, which include rider revenue. T. 5178. He states that actual non-fuel revenue changes thus differ substantially from proposed Settlement mitigation amounts. T. 5179. He asserts that, while non-fuel revenues would increase by 4.69 percent, residential customers would see a rate increase of 7.26 percent, or 155% of the system average increase. T. 5179. Dr. Dismukes states that the Settlement thus violates the previously-applied principle that "no individual customer class [should] receive a rate decrease in the context of an overall system increase" and that it could lead to rate shock. T. 5179. At the public hearing, when Staff suggested through questioning that this principle had been applied to base rates, not including rider revenues, and not to total customer bills, Dr. Dismukes did not recall whether or not that was true. T. 5250-5251.

Dr. Dismukes also generally indicated that mitigation cannot fully address the concerns about class allocation that he has with the MSS study, in part because the MSS creates a significantly different starting point for class allocation. T. 5256. Dr. Dismukes testified, however, that mitigating class revenue allocation differences by reducing residential increases in such a way that no other class gets any decrease would be just and reasonable. T. 5256-5257.

Dr. Dismukes recommends that the Commission reject the Settlement proposal's total revenue distribution (including rider revenues) and instead follow his Surrebuttal proposal to rely upon a Class Cost of Service Study (CCOSS) that does not incorporate MSS allocation of distribution plant facilities. T. 5180. In the alternative, he recommends limiting the revenue increase for any one rate class to 125% of the system average increase, including all non-fuel revenues. T. 5180.

Regarding rate design, Dr. Dismukes recommends maintaining customer charges at current levels and rejecting the Settlement proposal to reduce the first residential rate block from 50 ccf to 15 ccf in favor of the current rate block structure. T. 5180. Dr. Dismukes would increase volumetric rates in accordance with his CCOSS and would reject CEA's proposed changes to overtime fees and direct CEA to provide a CCOSS in the next rate case which evaluates charges based on a flat rate and actual costs incurred. T. 5181. Dr. Dismukes states that his proposals would increase revenue for the residential and small commercial customer class revenues by 3.28 percent and for LCS customers by 4.17 percent. T. 5181.

Also, regarding the FRP, while Dr. Dismukes supports the fixed DTE ratio and short term debt provisions included in the FRP, he disagrees with the Settlement premise that CEA's FRP should follow the same form as that previously approved for Entergy Arkansas, Inc. T. 5182-5183. He argues that, as a gas distribution utility, CEA faces different challenges—such as customer attrition—and also has less diverse opportunities to achieve cost savings (which might offset the effects of attrition) than an electric utility. T. 5183. He asserts that the FRP provisions could make CEA whole for customer losses regardless of the reason for these losses, making CEA indifferent to promoting cost-effective natural gas usage or combating customer attrition. T. 5183-5184. Dr. Dismukes observes that CEA's service territory includes growing areas; that CEA only recently conducted a study, after a decade of attrition, to understand its attrition issues; that its retention team has missed its Arkansas goal in two of the last three years, despite growth in local housing markets; and that despite increasing meter installations in 2015, CEA still ended 2015 with fewer net customers. T. 5185-5188. Dr. Dismukes adds that the FRP may reduce CEA's incentive to keep other expenses in check and recommends rejection of the FRP proposed in the Settlement. T. 5189.

Dr. Dismukes recommends, instead, utilization of a symmetrical earnings sharing mechanism (ESM) within the FRP that would allow CEA to increase its share of excess earnings as those earnings grow and would require CEA to share earnings deficiencies with ratepayers if it misses earnings targets. T. 5189. Under his recommended ESM, shareholders would retain 25%, 50%, or 75% of earnings beyond CEA's allowed ROE for earnings falling between bandwidths of 0 to 50 basis points, 51 to 75 basis points, or 76 to 100 basis points above earnings targets, respectively, with ratepayers benefiting from the remainder. T. 5190. His recommendation includes removing all existing cost riders and capping infrastructure-replacement capital expenditures at CEA's 5-year average infrastructure replacement budget, with an additional rate impact cap; and an automatic review in year four of the five-year FRP. T. 5191. In the alternative, Dr. Dismukes recommends an annual update with CEA's FRP filings describing its efforts to reverse customer attrition, and establishment of current customer counts as a floor for future FRP filings. T. 5192.

Dr. Ankum testifies for the AG that CEA has demonstrated a need for a rate relief and that residential customers—and particularly low-income customers—have demonstrated that they will terminate service if its cost is too high. T. 5454-5455. Dr. Ankum states that the Settlement rate increase will reduce residential customer spending on other goods and services by an amount characterized by a multiplier effect. T. 5455-5456. While other parties contend that lower commercial and industrial bills, driven by the cost allocation methodology tied to Act 725, will offset this reduction by job creation and investment, Dr. Ankum believes that there is no guarantee that the jobs will be created in Arkansas. T. 5456. He views the idea that industrial job creation will perk up due to a 0.35% reduction in overall natural gas service as "just farfetched." T. 5456-5457. He supports this observation with an analysis of the differing multiplier effects for consumer demand and commercial and industrial customers, concluding that, on balance, the Act 725 cost allocation will hinder economic development and job growth. T. 5459. He notes that most witnesses supporting the Act 725 cost allocation method offer conclusions, but not systemic analysis and that the systemic analysis offered by Dr. Hamilton on behalf of AGC is flawed, in that it finds an immaterial benefit and conflicts with another recent study. T. 5459-5461.

Dr. Ankum also responds to a calculation performed by Dr. Blank in which he asserts that the Settlement mitigates his earlier concerns that a deviation from allocation of costs under Act 725 would cause a negative economic impact. T. 5470-5471. Dr. Ankum testifies that Dr. Blank incorrectly used a regional elasticity estimate for employment when gas prices change, and that when this estimate is replaced with an Arkansas-specific estimate, the Settlement produces yet more job losses, exacerbating unemployment in Arkansas due to the burden on residential customers. T. 5474-5475.

At the public hearing, AGC questioned Dr. Ankum's use in his economic impact calculations of national economic multipliers from the Congressional Budget Office (CBO), rather than state-specific multipliers. T. 5489-5495. Dr. Ankum indicated that the CBO multipliers actually are more generous to AGC's case because the chance of dollars being reinvested within the United States is greater than the chance of dollars being reinvested in Arkansas. T. 5500-5501. Dr. Ankum testified that he would be less concerned about the issue of whether increased dollars charged to residential customers return to the Arkansas economy (i.e., economic "leakage") if CEA's proposed cost allocation method resulted in smaller residential ratepayer impacts, or if that impact were mitigated. T. 5513-5514.

CEA witness Drews reiterates that CEA's CCOSS, based on a 2-inch minimum system and rate design specified in Act 725, will enhance economic growth and increase net employment in Arkansas. T. 4306. He urges the Commission to rely on the analyses of Dr. Hamilton and Dr. Blank as superior because, unlike Dr. Ankum's, it is specific to Arkansas and directly estimates the impact of natural gas utility rates. T. 4307. At the public hearing, Mr. Drews reiterated that the Settling Parties endorse no particular cost allocation method, but noted that CenterPoint Energy (which includes CenterPoint Energy Arkansas and similar natural gas distribution utilities in other jurisdictions) uses a 2-inch MSS in all of its jurisdictions. T. 4317 and 4319. He stated that CEA usually does not do an alternative CCOSS, unless ordered to do so, but that that has happened. T. 4320.

Mr. Drews testified at the public hearing that the residential rate increase will not reduce total customer disposable income. Rather, he stated, it will instead shift spending patterns and that if a household's total spending does decrease, the decrease may not impact the Arkansas economy because the affected goods and services may be consumed or produced outside of Arkansas. T. 4308.

Regarding attrition, Mr. Bryant testifies that CEA has developed and implemented a detailed Retention and Acquisition Strategy, despite the fact that it has had a BDA Rider since the last rate case, and cites approval of the BDA as evidence that the Commission determined that attrition was a problem that needed resolution. T. 5656-5657. Mr. Bryant attributes the attrition to a historic shift away from gas during a period of unusually cold winters and high gas prices, followed by a trend across the South towards all-electric homes. T. 5662-5663. He notes that Staff agrees that CEA has reasonably addressed attrition, regardless of the BDA, and that CEA's population growth is less than the national average cited by Dr. Dismukes. T. 5661. Mr. Bryant states that, while it missed its meter goals in 2015, it kept its attrition rate well below its projected 0.50% rate. T. 5662.

Mr. Drews adds that CEA always has an incentive to reduce customer attrition because it is good for CEA and its investors and existing customers. T. 3409. He notes that the bandwidth limiting FRP revenue adjustments for each class means that CEA may not be made whole for customer losses. T. 4309-4310.

At Surrebuttal, for UAS, Dr. Blank opposed the AG's and Staff's recommendations to mitigate rate impacts on the residential class and favored CEA's class CCOSS incorporating its MSS. T. 4380. Dr. Blank estimated that Staff's mitigation of rate increases for residential customers would cause a net loss of 562 jobs in Arkansas, compared to Staff's cost of service model without mitigation, because it would increase rates for large customers. T. 4381. Dr. Blank derives this estimate based in part upon a University of Arkansas Center for Business and Economic Research report (*Examining the Impact of Electricity and Natural Gas Prices on Manufacturing Employment in Arkansas*) and in part by using state-specific data from the U.S. Bureau of Economic Analysis, which he asserts are more appropriate for this purpose than Dr. Ankum's analysis. T. 4382-4387.

For the Settlement, Dr. Blank revises his analysis and finds that mitigation in favor of the residential class results in a much smaller negative impact of only 139 jobs. T. 4438. Because these estimates are subject to a margin of error, Dr. Blank states that the surrebuttal estimate provided strong evidence of job loss, while the Settlement estimate does not. T. 4438. Dr. Blank therefore concludes that the Settlement gives weight to all aspects of Act 725 and generally accepted ratemaking principles and provides well-balanced, just and reasonable rates. T. 4438-4439. Dr. Blank further testifies that Dr. Ankum's substitution of Arkansas-specific elasticity estimates in his critique of Dr. Blank's work is erroneous because, in this case, those state-specific estimates are not statistically significant. T. 4441-4442.

At the public hearing, the AG questioned Mr. Pollock regarding Exhibit JP-5, which demonstrates the effect of cost allocation under the Settlement compared with the cost allocation employed in CEA's prior rate case (Docket No. 06-161-U, which based class allocation on a MSS assuming imputation of one inch mains). T. 4608-4615 and 4620. Mr. Pollock acknowledged that when gas costs are included, industrial customers would receive a 0.35% decrease in total delivered cost of gas. T. 4616-4617 and 4623-4625.

Dr. Hamilton testified for AGC regarding his REMI (Regional Economic Models, Inc.) model analysis estimating positive job gains through the year 2038 as a result of the Settlement rates. T. 4631-4632. His modeling suggested that allocating costs as suggested by Act 725 would promote both economic development and employment opportunities in Arkansas while slightly retarding the growth of real personal income per capita and real disposable income per capita. T. 4659. His summary report notes that it would be very difficult to measure with statistical confidence the policy-induced changes in these economic development indicators because their policy-induced incremental values are extremely small compared to the state totals. T. 4660.

At the public hearing, Dr. Hamilton testified that, on the whole, his findings suggest that it will be possible for "the gainers to compensate the losers and still remain net gainers." T. 4684. He confirmed that the "losers" in his scenario are the residential ratepayers who would get decreased purchasing power, requiring them to adjust their budgets, reducing expenditures in other parts of the economy; and that the "gainers" would be businesses experiencing lower costs of production. T. 4687-4688. To the question of whether residents on fixed incomes would be compensated by gainers, he explained that it is complicated, but that if he were to address which group should get gains, he would enter the realm of distributional judgments and social justice issues, rather than sticking to the facts. T. 4689-4690. To the question of whether the possible compensation to losers is more likely than not, he answered that his is not a probabilistic model. T. 4691.

Dr. Hamilton also testified that beneficiaries of dividends from any improvement in CEA stock are as likely as not to live within CEA territory, in part because of ownership of mutual funds within retirement plans, and that low natural gas utility prices are a significant factor (maybe a 5 on a scale of 1 to 10) in recruiting industrial economic development (Mr. Bryant, for CEA, later rated it a 3). T. 4694-4697 and 5690. He testified that the amount of dollars involved in the economic benefit to GDP is a $40 million over 20 years, constituting a "small impact" within an Arkansas GDP of more than $100 billion. Tr. 4698.

At the public hearing, Mr. Klucher, on behalf of Staff, testified regarding a chart in his Settlement Testimony demonstrating the bill impact of the Settlement on residential ratepayers at different levels of monthly consumption. T. 4825. He testified that in the summer, a customer who uses gas for hot water heating and space heating and probably uses around 20 ccf. T. 4825. He testified that the typical customer in the winter would use 100 to 105 ccf per month and that 175 ccf would be very high. T. 4825-

4826. He testified that the Settlement rate design gives the high end users an incentive to implement energy efficiency measures. T. 4827.

Mr. Klucher also responded to Dr. Dismukes representation that residential customers have borne the brunt of a series of rate increases by presenting a review of present rate revenues versus base rate revenues in rate cases since 2001 (including revenues from riders that will expire and roll into the FRP). T. 4829-4830. Mr. Klucher states that, since 2001, base rates have increased by 26.1% for residential and 25.8% for nonresidential ratepayers. T. 4831. He also states that looking at base rate revenue requirements divided by the number of customers, the average residential class revenue has increased by 35% and average nonresidential class revenues have increased by 36%. T. 4833. He states that the nonresidential class has seen a larger increase in base rates than has the residential class and that the LCS class has seen a substantially larger increase of about 51%. T. 4833-4834.

Mr. Swaim testifies that Dr. Dismukes proposal for revenue sharing FRP is unnecessarily complex and at odds with Act. 725. T. 4911. He also states that Dr. Dismuke's five-year FRP (with its earnings review in year four) would unnecessarily postpone the analysis of CEA's earning reviews and make it divergent with EAI's FRP. *Id.*

Regarding the MSS and potential alternative methods of allocating the cost of mains, at the public hearing, Mr. Swaim testified that Staff does not usually do a zero intercept study as an alternative to the company's study. T. 4919. He states that the Commission has consistently used a MSS for CEA and has used other cost allocation methodologies for other companies, based in part on the predominance of different sizes of pipe in a particular company and the availability of data. T. 4920. He notes that in every instance, the zero intercept method has produced results that are not statistically significant. He states that, if he had to look at an alternative it would be a zero load study, which was used in the SourceGas Arkansas case, but that it was more appropriate in the case of that company. T. 4920.

Regarding cost allocation and mitigation, Mr. Swaim also made general observations in his Direct Testimony, stating that

> ...costs utilized by a CCOSS are historic and static, not dynamic and forward-looking, undermining many experts' cost causation/pricing claims. There is no single correct answer that is revealed in a CCOSS and it is often up to regulators to exercise their appropriate judgment regarding the nature of these costs and the implications they have in setting fair, just, and reasonable rates. This is one of the reasons why many regulators use the results of a CCOSS as a "guide" in setting rates, but are not bounded by the results that are generated from these studies.

T. 5015. Regarding rate design, Mr. Swaim testifies that the Settlement's proposed residential rate design produces lower bill increases than the AG's proposals and that the results are more uniform for LCS customers than any other proposed rates. T. 5702.

At the public hearing, Mr. Bryant, for CEA, responded to questioning by the AG. He confirms that, while he testified that the average residential consumption is 50 ccf per month, and such average usage would yield a slight monthly bill decrease under the Settlement of 29 cents, the Settlement produces an average annual residential increase of $42.29. T. 5681-5684. He confirmed that the difference between the apparent decrease for an average bill described in testimony and the actual bill increase for residential customers is because customers actual usage varies from month to month, falling on either side of the mean. T. 5685. Mr. Drews further confirmed that, despite the slight decrease apparent for customers using 50 ccf per month, it would be extremely unusual under the Settlement for a customer to see annual bills go down. T. 5698.

Mr. Bryant also stated, regarding the Settlement being in the best interest of ratepayers, that very little of the rate increase will be in CEA earnings going into or out of the state, but rather that this case is largely about investments in safety and pipeline integrity that benefit all ratepayers and the public. T. 5690-5691.

Findings and Rulings

After considering all of the pre-filed testimony and exhibits and the testimony of the witnesses who appeared at the hearing on July 12-13, 2016, along with the public comments made in the Docket, the Commission approves the Settlement with one exception: the Commission directs that rates be further mitigated by eliminating decreases for any class on a total bill basis and further mitigating the residential increase on a total bill basis.

Although the Settlement proposes mitigation from the results of the cost of service study, it does leave the residential class bearing an increase of more than $15 million, while other classes receive a rate decrease of approximately $1 million, on a total bill basis. Under the proposed Settlement, on a percentage basis, the Residential class still has a significantly higher increase (7.26%) on the total bill than all other classes and is significantly higher than the system average (4.69%). All the other classes are below the system average.[2] The Commission's policy concerning cost-based rates has been tempered with the desire to avoid unnecessary significant adverse customer impact. The Commission has frequently employed mitigation so as to gradually move a

[2] T. 4818.

class to its cost of service. AG witness Dismukes testified at the hearing that it would be just and reasonable to reduce the increases to the residential class by ensuring that no other class gets a decrease. T. 5267-67. Therefore, the Commission directs that the Settlement be amended by eliminating decreases for any class as considered on a total bill basis and further mitigating the residential revenue requirement increase.

The additional mitigation of the impact to the Residential class can be accomplished without unreasonable adverse impacts to the other classes. On both a rate schedule revenue basis and total bill basis, all classes other than residential will still be receiving an increase significantly below the system average increase or receiving no increase, respectively. The AG also pointed out at the hearing that for the LGS-1 class, the proposed decrease for the class is an even smaller percentage when considering the total bill plus gas costs associated with transportation service.[3] While other mitigation plans could also be reasonable, the Commission finds that this further mitigation results in a more balanced outcome.

On this point, the Commission does not rely on the historical overviews of the impact of rate increases on residential and business classes provided by either the AG or Staff. While historical review can provide valuable context, the more salient issue is the fair allocation of present rate case costs, not rates found to be just and reasonable based on a different record in past cases. In this case, based on the policy considerations outlined above and the total resulting impact of the Settlement on the individual rate classes, it is not equitable for one class to experience a rate increase on a total bill basis while all other classes are experiencing a rate decrease.

[3] T. 9690, 4616.

The remainder of the Settlement is approved. Mr. Bryant correctly characterizes this case as largely concerned with supporting major investments in safety and pipeline integrity which are generally required by federal and state regulation and by the vital public interest in safe and reliable service. Mr. Henry's testimony that Staff has found a need for statewide attention to atmospheric corrosion; that proactive ROW maintenance is needed to meet federal regulations and to support other safety and integrity functions; and that updated and complete records similarly support safe and efficient field work, provide persuasive corroboration of the reasonable need for CEA's proposals, as modified by the Settlement. Similarly, the Commission finds credibility in the recommendations of Mr. Bish and, after significant Staff review, Mr. Henry, that hydrostatic testing associated with records missing after 1971 should not be excluded from cost recovery and that it is more reasonable, in our climate, to allow cost recovery for the necessary removal of trees three inches and above. The Commission also endorses relocation of service lines up to 200 feet, in part because it will improve safety and in part because it facilitates knowledge by CEA of the composition of its service lines.

The Commission does not view this general approval of significant expense and investment for safety as a blank check. Taking Mr. Bish up on his offer to provide reports on integrity management, the Commission directs CEA to provide a comprehensive annual report including each of its integrity management programs that will allow tracking of costs, work completed, estimates of remaining work (where appropriate), challenges for program completion, and opportunities for cost efficiencies. The Commission intends such reporting to provide transparency for itself and for

Parties and to provide a potential basis for consensus during the next rate case regarding the ongoing expenditure levels for these activities. The Commission expects CEA to submit the comprehensive report at the time of filing its annual FRP review, unless the Parties jointly recommend a different schedule.

Regarding the amount of Service Company costs allocated to CEA, the Commission finds that the evidence shows that the increase is Service Company costs is not due merely to the Enable transaction but to a company reorganization, depreciation expense, inflation, and competitive pay adjustments. The Commission notes that Staff raised no concerns related to the spinoff of Enable, even after conducting discovery, on-site meetings, and an in-depth review of an internal audit of the Service Company by a third party. In addition, Mr. Marcus did not argue that any particular Service Company services are unreasonable. Therefore, the Commission approves the Service Company costs contained in the Settlement.

For meter reading costs, the Commission adopts the Settlement proposal based on Staff's and CEA's testimony that the amounts are based on CEA's known costs of service and actual historical costs and that three months of data are insufficient for the establishment of rates implemented over the next five years, in part because of the suggestion that the AG's data includes "outlier" data that might alter the average cost resulting from that data.

Regarding the cost of capital the Commission finds that, despite the stabilizing effect of an FRP on revenue, no reduction in ROE is merited. This finding is consistent with the Commission's adoption of an FRP for Entergy Arkansas without any reduction in the ROE. The Commission agrees that, as Mr. Hevert, Mr. Davis, and even Mr.

Marcus attest, the gas industry has led a trend towards a variety of revenue stabilization mechanisms which have become more prevalent. Mr. Hevert suggests more subtly that it is not the percentage of revenue covered by stabilization mechanism, but the exact and comparative effect of a mechanism on the particular risk being managed that determines whether a company is advantaged relative to its peers. While this argument has significant merit, common sense supports the AG's observation that the FRP provides a qualitatively different level of risk management than less comprehensive rate mechanisms. And it is exactly in such cases of qualitative and significant changes in rate treatment or risk reduction that the Commission may exercise its discretion to adjust and fix just and reasonable rates. In this case, however, the assessments by CEA and Staff witnesses consider the relative risks of CEA versus comparable companies; they recommend no adjustment to the ROE in light of the FRP because the proxy group has similar revenue stabilization mechanisms in place and therefore similar risks. In addition, Ms. LaConte testifies that AGC accepts a higher ROE because the Settlement Agreement on the equity ratio lowered the weighted cost of capital and because it falls within the range of ROEs originally recommended by AGC (T. 9648-9649). The Commission approves the Settlement ROE based on evidence that the Settlement ROE adequately considers the relative risks of CEA to other companies and because the Settlement ROE is specifically balanced against other reductions in the cost of capital; nevertheless, the Commission retains its flexibility to adjust ROE in future rate cases if it can be shown that the FRP operates to manage CEA's revenue risk better than peers.

Regarding the money pool adjustment, the Commission is convinced that this case presents a different set of facts from prior precedent in the Entergy Arkansas, Inc.

rate case. In particular, Mr. Keever points out that the money pool rate for CEA of 5.23% is reflective of actual borrowing costs for CERC as opposed to EAI's money pool rate of .09%. In combination with the other settled cost of capital provisions, such as the fixed capital structure supported by both AGC and the AG, the Commission approves the Settlement money pool provisions.

The Commission approves the Settlement FRP, with its commitment to reporting on customer attrition. The Commission believes Mr. Bryant that CEA seeks to retain customers, in part because the FRP bandwidth still provides an incentive to avoid earnings losses. The record provides abundant evidence that attrition is an issue for the natural gas delivery business as a whole and the Commission is reluctant to put in place, in the alternative, a more complex rate structure based upon multiple earnings bandwidths.

Regarding cost allocation and Act 725, the Commission notes that although the AG continues to argue that use of the MSS approach is not mandated by Act 725, the Settlement specifically does not recommend or endorse a specific cost allocation methodology and does not represent that Act 725 requires the adoption of the MSS approach. The Commission accepts the class revenue requirement allocation embodied in the Settlement, with the further mitigation detailed herein; makes no finding regarding cost allocation methodologies; and makes no finding regarding the applicability and meaning of Act 725 as it pertains to cost allocation for natural gas distribution plant costs. To the extent mitigation is applied to achieve just and reasonable rates, the results necessarily diverge from the cost of service study. Also, the Commission does note that AGC Hearing Exhibit 1 (T. 9703) shows cost differentials for

Residential, Commercial, and Industrial of +2.7%, -1.9%, and -4.1%, respectively, due to using the settlement cost allocation versus that used in CEA's previous rate case (Docket No. 06-161-U). T. 9703, 4609. The Commission finds that the result reached after mitigation is just and reasonable.

The Commission approves the Settlement provisions regarding rate design, including increasing the Residential customer charge by $1.00 to $10.75. CEA's testimony indicates that the increase is based on increases in inflation and that the resulting charge is similar to that of other gas utilities in Arkansas. Staff's indicates that the Settlement rate design produces lower bill increases for residential customers than does the AG's. While the initial CEA proposal establishing a 15 ccf base rate had the potential to work at cross purposes with CEA's energy efficiency efforts, the rate differential improvements offered by Mr. Swaim and accepted in the Settlement preserve an incentive for conservation.

The Commission therefore orders and directs:

1. The Settlement Agreement is approved as modified by the Commission in this Order.

2. The parties shall inform the Commission by a filing no later than noon on September 7, 2016, whether they accept the Commission's proposed modification of the Settlement Agreement or request a full hearing on the issues.

3. The parties shall file the following to reflect the modifications adopted by this Order, no later than noon, September 7, 2016:

a. a revised Settlement COS Summary – Attachment 1 to Settlement;

b. a revised Table 4 – Residential Monthly Customer Impact by Varying Levels of Usage from Staff witness Matthew Klucher's Settlement Testimony; and

c. a revised Table 5 – Customer Impact Analysis from Staff witness Matthew Klucher's Settlement Testimony.

4. CEA shall file compliance tariffs in compliance with the Settlement Agreement, as revised, as soon as possible.

5. Staff shall file, and any other party may file, testimony on the compliance tariffs no later than noon, five days after the compliance tariffs are filed.

6. Rates shall be effective on September 12, 2016, for bills rendered on and after September 13, 2016.

BY ORDER OF THE COMMISSION,

This 2nd day September, 2016.

Ted J. Thomas, Chairman

Elana C. Wills, Commissioner

Lamar B. Davis, Commissioner

Karen Shook, Acting
Michael Sappington, Secretary of the Commission

I hereby certify that this order, issued by the Arkansas Public Service Commission, has been served on all parties of record on this date by the following method:

___ U.S. mail with postage prepaid using the mailing address of each party as indicated in the official docket file, or

X Electronic mail using the email address of each party as indicated in the official docket file.