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LACLEDE GAS COMPANY
MISSOURI GAS ENERGY

GR-2017-0215
GR-2017-0216

REBUTTAL TESTIMONY

OF

THOMAS J. FLAHERTY

OCTOBER 2017

Laclede Exhibit No 047
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1 **REBUTTAL TESTIMONY OF THOMAS J. FLAHERTY**

2 **Q. PLEASE STATE YOUR NAME AND BY WHOM YOU ARE EMPLOYED.**

3 A. My name is Thomas J. Flaherty, and I am now a Senior Advisor to the Power and
4 Utilities Practice of Strategy&, a part of the PwC network. I was an active Partner at
5 the time I prepared my direct testimony, but have since retired, but am still actively
6 working as a consultant with PwC. My business address is 2001 Ross Avenue, Suite
7 1800, Dallas, Texas 75201.

8 **Q. ARE YOU THE SAME THOMAS J. FLAHERTY WHO PREVIOUSLY FILED**
9 **DIRECT TESTIMONY IN THIS PROCEEDING?**

10 A. Yes, I submitted direct testimony on behalf of both Laclede Gas (“LAC”) in Case No.
11 GR-2017-0215 and Missouri Gas Energy (“MGE”) in Case No. GR-2017-0216.

12 **I. PURPOSE OF REBUTTAL TESTIMONY**

13 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
14 **PROCEEDING?**

15 A. The purpose of my rebuttal testimony is to address issues raised by the Staff of the
16 Missouri Public Service Commission (Staff) and the Office of the Public Counsel
17 (OPC) related to two principal areas: 1) the reasonableness and reliability of the cost
18 allocation process utilized by Spire Shared Services, Inc., and; 2) the financial effects
19 of the acquisitions made by Laclede Gas Company (Laclede) and its parent
20 corporation, since 2013. These include Laclede’s acquisition of Missouri Gas Energy
21 (MGE) in 2013, and the acquisition by Spire Inc. (formerly known as The Laclede

1 Group) of Alabama Gas Corporation (Alagasco) and EnergySouth Corporation
2 (EnergySouth) in 2014 and 2016, respectively.

3 With respect to the cost allocations process, I will address a range of
4 assertions and recommendations by Ms. Azad of OPC and Mr. Majors of the Staff
5 related to: conformance with relevant standards; consistency between process design
6 and execution; future cost allocations outcomes; Cost Allocations Manual (CAM)
7 updating; adjustment to the Applicants' level of allocated costs; identified merger cost
8 savings; and adjustment to the level of recognized merger cost savings and costs-to-
9 achieve recovery.

10 With respect to financial outcomes from prior mergers involving MGE,
11 Alagasco and EnergySouth, I will address Mr. Majors' determination regarding
12 certain synergies not being merger-related, and his basis for non-recognition towards
13 Laclede's costs-to-achieve.

14 **II. PRIOR EXPERIENCE WITH UTILITY ACQUISITIONS**

15 **Q. MR. FLAHERTY, IN ADDITION TO YOUR INDICATED EXPERIENCE**
16 **WITH SERVICE COMPANIES AND COST ALLOCATIONS, WOULD YOU**
17 **SUMMARIZE YOUR PRIOR EXPERIENCE WITH UTILITY MERGER AND**
18 **ACQUISITION TRANSACTIONS?**

19 **A.** I have evaluated hundreds of actual, proposed or potential transactions involving
20 electric, electric and gas combination, gas, or water utilities since approximately
21 1988. I have experience working for both buyers and sellers and have assisted client

1 managements in their assessment of a broad range of transactional issues, including
2 the following:

- 3 • Target analysis
- 4 • Strategy comparison
- 5 • Market assessment
- 6 • Competitor review
- 7 • Synergies assessment
- Synergies allocation
- Transaction structuring
- Regulatory strategy
- Expert testimony
- Integration planning

8
9 The publicly announced transactions in which I have been significantly
10 involved, other than the one that is the subject of these proceedings, are: Kansas
11 Power and Light and Kansas Gas and Electric, IPALCO Enterprises and PSI
12 Resources, Entergy and Gulf States Utilities, Southern Union and Western Resources
13 (Missouri gas properties), Washington Water Power and Sierra Pacific Resources,
14 Midwest Resources and Iowa-Illinois Gas & Electric, Northern States Power and
15 Wisconsin Energy, PECO Energy and PPL Resources, Public Service Company of
16 Colorado and Southwestern Public Service, Baltimore Gas & Electric and Potomac
17 Electric Power, Delmarva Power and Atlantic Energy, WPL Holdings, IES Industries
18 and Interstate Power, Puget Sound Power & Light and Washington Energy, TU
19 Electric and ENSERCH, Western Resources and Kansas City Power & Light,
20 Western Resources and ONEOK (Kansas, Oklahoma gas properties), Houston
21 Industries and NORAM Energy, Ohio Edison and Centerior, ENOVA and Pacific
22 Enterprises, Brooklyn Union Gas and Long Island Lighting, Allegheny Energy and
23 DQE, LG&E Energy and KU Energy, NIPSCO Industries and Bay State Gas,
24 American Electric Power and Central and SouthWest, BEC Energy and COM Energy,

1 Northern States Power and New Century Energies, Dynegy and Illinova, DTE Energy
2 and MCN Energy, ConEdison and Northeast Utilities, PECO Energy and Unicom,
3 AGL Resources and Virginia Natural Gas, Energy East and RGE Energy, FPL Group
4 and Entergy, PNM Resources and TNM Enterprises, Exelon and PSEG Enterprises,
5 Duke Energy and Cinergy, USPowerGen and Boston Generating, WPS Resources and
6 Peoples Energy, FirstEnergy and Allegheny Energy, Citizens Energy and Indianapolis
7 Water, Duke Energy and Progress Energy, Laclede Gas and Missouri Gas Energy,
8 AES and DPL, Inc., Exelon and Constellation Energy, TECO Energy and New
9 Mexico Gas, Laclede Gas and Alagasco, NextEra Energy and Hawaiian Electric,
10 United Illuminating and Iberdrola USA (New England gas properties), NextEra
11 Energy and Oncor, Black Hills Energy and SourceGas, Southern Company and AGL
12 Resources, Great Plains Energy and Westar Energy, AltaGas and WGL Resources,
13 and, HydroOne and Avista.

14 **Q. HAVE YOU PREVIOUSLY TESTIFIED ON MERGER TRANSACTION**
15 **TOPICS BEFORE FEDERAL AND STATE REGULATORY AGENCIES?**

16 A. Yes, I have filed direct or rebuttal testimony in numerous regulatory jurisdictions,
17 including: California, Colorado, Connecticut, District of Columbia, Idaho, Illinois,
18 Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota,
19 Missouri, Nevada, New Jersey, New Mexico, North Carolina, South Carolina, Ohio,
20 Oklahoma, Oregon, Pennsylvania, Texas, Washington and, Wisconsin. I have also
21 filed direct and rebuttal testimony before the Federal Energy Regulatory Commission
22 (FERC).

1 Q. HAVE YOU ALSO ASSISTED LACLEDE IN ITS PRIOR TRANSACTIONS
2 WITH MGE AND ALAGASCO?

3 A. Yes, I have. In 2012 I supported Laclede with the evaluation of the MGE acquisition
4 while I was employed at Booz and Company. The scope of this work included
5 assisting Laclede with the identification and quantification of potential synergies
6 areas, the evaluation of the nature and level of these potential synergies, the
7 identification of potential areas of the costs-to-achieve the merger from evaluation
8 through post-close integration, the evaluation of the nature and level of these costs-to-
9 achieve, and the identification of actions to be undertaken by Laclede to enable
10 attainment of identified synergies and minimization of costs-to-achieve. Subsequent
11 to the announcement of this transaction, our team was engaged to support Laclede
12 with the planning, execution and management of the actual integration process
13 between the two companies and provide support to the regulatory process related to
14 achieving approval for the acquisition.

15 For the Alagasco transaction, we were retained for a similar scope of pre-
16 announcement work related to synergies and costs-to-achieve development.

17 **III. REPRISE OF ACQUISITION BENEFITS ALREADY**
18 **RECOGNIZED IN COMPANY'S COST OF SERVICE**

19 Q. COULD YOU BRIEFLY SUMMARIZE WHAT EVIDENCE SPIRE HAS
20 ALREADY SUBMITTED TO STAFF AND OPC REGARDING THE
21 SYNERGIES IT HAS ACHIEVED IN ITS PRIOR MERGER TRANSACTION
22 WITH MGE?

1 A. Spire has provided its 'Post-Close Tracking Model' as part of discovery in this case
2 in response to Staff Data Request No. 0070. Spire provided the details of the
3 synergies captured to-date, along with the business cases that supported synergies
4 estimation.

5 The summary of achieved synergies from the Laclede – MGE merger is
6 provided in the table below.

7 **Table 1**

8 **Realized Merger Synergies**

	FY2014	FY2015	FY2016	FY2017
Labor	\$14,027	\$25,359	\$29,768	\$29,768
Non-labor	\$16,091	\$14,009	\$19,814	\$19,814
O&M	\$22,514	\$29,148	\$36,812	\$36,812
Capital	\$7,287	\$9,444	\$9,291	\$9,291
Customer growth	\$317	\$777	\$3,479	\$3,479
Total	\$30,118	\$39,369	\$49,582	\$49,582

9
10

11 As shown, Spire and Laclede have been successful in realizing synergies and
12 have been achieving them at an annual run-rate of approximately \$50 million per
13 year in total. To-date, these synergies total to more than \$99 million of labor savings
14 and \$70 million of non-labor savings, or more than \$140 million of total savings
15 since 2013. In addition, these savings reflect approximately \$37 million of annual
16 run-rate O&M amounts and \$9 million of capital avoidance or reduction, as well as
17 customer growth of \$3.5 million. It is important to note that these savings are not
18 inflation adjusted, so the benefit of removing these costs from the business are even

1 greater. These amounts, inflation adjusted or not, far exceed Spire's transition costs-
2 to-achieve.

3 The above table reflects actual savings achieved to-date. It should be
4 recognized that these savings will continue into perpetuity and will escalate at a
5 blended inflation rate that reflects differences in composition between labor and non-
6 labor components.

7 Specific comments related to Staff's review of these synergies and their
8 composition will be addressed in the ensuing section.

9 **IV. RESPONSE TO STAFF'S DIRECT TESTIMONY ASSERTIONS**

10 **Q. WHAT HAS THE STAFF ASSERTED RELATED TO THE LEVEL OF**
11 **SYNERGIES AND TRANSITION COSTS-TO-ACHIEVE IN ITS DIRECT**
12 **TESTIMONY?**

13 A. Through Mr. Majors, the Staff has made several recommendations and adjustments
14 related to the sufficiency of supporting information provided by Spire regarding
15 synergies and transition costs, validity of several synergies categories, association of
16 transition costs with achieved synergies, and treatment of multi-year unamortized
17 costs for capital projects associated with integration of LAC and MGE. In the end,
18 Mr. Majors does not recommend inclusion of any amortization or rate base treatment
19 of transition costs because he asserts that Laclede has not demonstrated merger
20 savings sufficient to justify recovery. Mr. Majors ultimately proposes that should the
21 Commission allow amortization of transition costs-to-achieve, approximately \$2.6
22 million should not be allowed for recovery. Finally, he proposes that no rate base

1 treatment of one-time transition costs be allowed.

2 This recommendation results from the Staff's view that Laclede did not: 1)
3 provide information related to how the achieved synergies would be distributed and
4 reflected in FERC divisional accounts; 2) provide a comparison of actual pre-merger
5 costs versus costs of the combined companies during the test year or update period
6 during which transition costs are sought for recovery; 3) allow Staff to independently
7 validate the level of claimed synergies; 4) demonstrate sufficient synergies to justify
8 transition cost recovery, and; 5) limit its transition costs-to-achieve to transition-
9 related items.

10 **Q. FROM YOUR EXPERIENCE, DOES THE STAFF HAVE SUFFICIENT**
11 **INFORMATION TO VALIDATE THE LEVEL OF MERGER SYNERGIES**
12 **ACHIEVED?**

13 A. Yes. The type of material provided by Spire through its 'Post-Close Tracking Model'
14 is consistent with what I am familiar with in prior transactions and our team had
15 direct involvement with the original design of this model. Additionally, I understand
16 that Staff was provided further information on these savings through the data request
17 process.

18 Staff has suggested that Spire has not provided detailed information to show
19 how FERC divisional costs are impacted by the synergies realized, as specified in the
20 Stipulation and Agreement in Case No. GM-2013-0254. In fact, as Mr. Buck
21 demonstrates in his rebuttal testimony, the Company has provided such information to
22 the extent it was practical and possible to do so. Accordingly, my comments will be

1 limited to a discussion of whether such information is really helpful or relevant to the
2 ability to identify and quantify merger synergies.

3 **Q. DOES THE INFORMATION SOUGHT BY THE STAFF PROVIDE A**
4 **NECESSARY LEVEL OF INSIGHT NOT ATTAINABLE FROM THE**
5 **INFORMATION ALREADY PROVIDED BY SPIRE?**

6 A. No. Further, I believe that any supposed shortcoming in the degree to which the
7 Company has been able to tie specific synergies to specific FERC accounts should be
8 viewed as the non-issue that it is. This is simply not an element that we have ever
9 recommended in our prior synergies tracking work. For commissions that are
10 tracking achieved synergies, the value of the actual realized synergies data lies in the
11 nature of the savings itself and in the bases for quantifying that savings by synergies
12 ‘type’, i.e., the cost element affected, e.g., position reduced, insurance or specific
13 capital project, not in the FERC account distribution. The focus is normally on ‘what
14 changed, why and by how much’ rather than to which FERC account the savings were
15 distributed.

16 **Q. PLEASE EXPLAIN WHY AN EVALUATION OF FERC ACCOUNTS FOR**
17 **EVALUATING SYNERGIES IS EXTRANEIOUS AND MISSES THE BIG**
18 **PICTURE.**

19 A. First, the key question to be addressed is whether Spire has produced sufficient
20 synergies to offset the level of transition costs identified as related to the transaction..
21 From my experience, the additional level of detailed information cited as missing
22 does not substantially supplement what has already been provided that already

1 demonstrates this benefit – cost relationship. Second, my experience suggests that use
2 of either primary or divisional FERC data is not insightful to what actually happens
3 with reduced costs due to synergies. The purpose of the tracking and reporting of
4 synergies is to enable review of what business changes have occurred, not which sub-
5 accounts have been affected.

6 Third, my experience also suggests that distribution of savings by FERC
7 primary or divisional account involves a high degree of judgement about how these
8 reduced costs are apportioned by these FERC categories. It is certainly easy to assign
9 direct costs into a FERC primary account, such as customer service or administrative
10 and general (A&G). But it is much more art than science to distribute these savings at
11 a lower level and utilities use a high degree of discretion in how they assign or
12 distribute costs through the FERC accounts.

13 For example, the 900 series of FERC accounts for LAC A&G in 2016
14 contained 12 secondary accounts, net of contra-accounts. When the largest category
15 shown as part of LAC A&G is salaries, no further insight on levels or basis is added
16 by this distribution beyond what Spire has already filed regarding reduced positions at
17 their proscribed value. What would be more valuable is to understand the resource
18 level and cost impact in the affected function, e.g., how finance or distribution
19 operations are affected, rather than a discrete cost level change to a lower level FERC
20 account. Further, the A&G divisional category for insurance is defined as ‘property
21 insurance, which does not capture other addressable insurance categories such as
22 Directors and Officers, Excess and General, Workers Compensation and, Fiduciary,

1 among others. It is also interesting that the Staff would attribute value at a FERC
2 divisional account level with these limitations when it does not attribute any to
3 specific information that identifies the employee and position that have been reduced,
4 which is directly relevant.

5 Perhaps more important is the inherent flawed premise that underlies Mr.
6 Majors concerns about savings identification. It seems that Mr. Majors believes that a
7 simple 'before and after' comparison of costs from pre-merger levels to post-close
8 test year levels yields a deterministic result.

9 Comparing gross costs levels across two time periods can certainly identify
10 very high level outcomes. And for certain types of comparisons, e.g., understanding
11 simple cost trends, that can suffice. However, if the intent is to truly understand the
12 direct impacts of a merger this comparison would be fraught with flaws. First, non-
13 merger related drivers can cause changes in macro-level costs that are independent of
14 items, such as synergies. Second, macro-level costs do not provide sufficient detail to
15 fully understand the 'pluses and minuses' that contribute to a cost change and mask
16 the identification of direct causation. Finally, macro-level cost levels are a poor
17 substitute for direct synergies identification and quantification, which is what Spire
18 has provided to the Staff.

19 For these reasons, it would not be dispositive to ascribe any claims of a lack of
20 sufficient information to Spire and substitute a higher level of comparison than what
21 would be appropriate.

22 **Q. DO YOU HAVE ANY COMMENTS REGARDING STAFF'S OTHER**

1 **ASSERTIONS AS TO WHY IT CANNOT DETERMINE WHETHER THE**
2 **COMPANY HAS ACHIEVED SUFFICIENT SYNERGIES TO COVER ITS**
3 **CLAIMED TRANSITION COSTS?**

4 A. Yes. The Staff also suggests that it cannot compare the level of synergies realized
5 with the level of transition costs to be addressed for recovery. This is also not a
6 problem for Staff, since Spire reports the actual savings and costs by type and timing.
7 Thus, the Staff has the ability to directly compare, by period, savings and costs-to-
8 achieve, so it has the ability to ensure that customers are not charged for..... “any
9 amount of transition costs that exceed the level of cost reductions actually
10 experienced by the Company”. If alignment in a particular format is the issue, then I
11 believe that this is not a direct rate case issue four years after the close of the MGE
12 transaction.

13 Further, while specific eliminated position information is available and was
14 provided to the Staff in other ongoing reports, the Staff suggests that it required
15 specific position salary data to validate the actual savings. This is specious and
16 ignores another fundamental constraint that utilities have. The Staff can work with
17 ranges of salary data to confirm the level of savings actually realized. The range of
18 salary provides a very good indicator of the level of salary (and loaded benefits) for an
19 employee within Spire. With this level of information, the Staff can easily test the
20 results achieved and determine whether the ‘cost per reduced position’ is
21 representative and reasonable. This is especially true given the overwhelming degree
22 to which the value of these employee-related synergies exceed the value of the

1 identified transition costs.

2 However, aligning specific employee information on a named basis with an
3 actual reduction typically creates problems for a utility with respect to maintaining
4 individual confidentiality of personal employee information. This is why companies
5 either use proxies for the salaries, i.e., a range, or ‘blind’ the identity of the employee
6 and simply use position titles. Nonetheless, the Staff has sufficient information
7 between affected employees and functional salary ranges to validate the savings
8 realized without opening Spire to unnecessary claims for violating personal
9 confidentiality commitments.

10 **Q. THE STAFF ALSO IDENTIFIES SEVERAL COST SAVINGS AND**
11 **TRANSITION COSTS IDENTIFIED BY SPIRE THAT IT ASSERTS ARE**
12 **NOT SUFFICIENTLY LINKED TO THE ACQUISITION OF MGE BY LAC.**
13 **ARE THEY CORRECT?**

14 A. No, I believe the Staff is far too limiting in their attribution of savings that have
15 resulted from the merger. Mr. Lobser will address each of the identified savings and
16 transition cost areas suggested as not being ‘merger related’.

17 However, I believe it is important to delineate what typically is merger related
18 and what is achievable by some other means, e.g., adoption of best practices. When I
19 support companies with their synergies analyses, three categories are typically utilized
20 to capture group potential synergies in terms of their relation to the merger: (a)
21 created, (b) enabled and (c) developed. Savings defined as “created” would not exist
22 ‘but for’ the merger, while “enabled” savings can be ‘unlocked’ by the transaction,

1 that is accelerated or harmonized from the combination of the companies. Finally, the
2 “developed” category typically refers to savings that could occur ‘absent’ the merger,
3 i.e., adoption of best practices that would not have needed the transaction to achieve.

4 Mr. Majors identified 11 specific savings areas that he asserts are not related
5 to the MGE transaction. These relate to custodial services outsourcing, security plans,
6 call center outsourcing, field collection outsourcing, I&C synergies, transportation
7 maintenance outsourcing, sales uplift, growth opportunities, Maximo enhancements,
8 sales expansion and, MoNat office closings. If there are common themes in these
9 areas, the first is the adoption of outsourcing as an integrated entity where one
10 company had conducted the activity in-house and the second theme relates to top-line
11 growth in the MGE service territory.

12 **Q. IS OUTSOURCING A LEGITIMATE SOURCE OF MERGER-RELATED**
13 **SAVINGS?**

14 A. Yes, it can be. As I mentioned, there often are differences in how a company
15 determines to best provide a service, i.e. internally or externally. The choice of
16 outsourcing generally reflects some combination of an individual utility’s cost level,
17 scale, performance history and ability to effectively manage an outsourced
18 relationship. If a company believes there is a better and cheaper option available than
19 internal performance, it will outsource. Similarly, when internal performance is
20 viewed as superior to outsourcing it will continue to execute with existing resources,
21 all other things being equal. Each company will have made its determination based on
22 its unique facts as stand-alone companies.

1 When a transaction occurs between two companies with different approaches,
2 it forces the issue of how to integrate these two discrete models. In this situation, a
3 choice is necessary to define a common model that will best meet the combined need
4 of the larger business regardless of the individual starting point. The question is not
5 whether outsourcing could have been accomplished without the merger. Rather it
6 relates to whether the outsourcing situation provides even greater benefits on a
7 combined basis than as a stand-alone entity.

8 When the acquirer is the outsourcer and has larger scale than the acquiree – as
9 is the case with LAC and MGE for field collections – the use of a third-party has a
10 high likelihood of continuing to be relied upon. However, converting the acquirer to
11 the outsourced option also can be merger-related if the combined economics can be
12 improved to a level beyond that enjoyed by the smaller, current outsourcer, as is the
13 case with transportation maintenance and custodial services. And when an outsourced
14 function has higher economies of scale than an external contract, it will make
15 economic sense to outsource, as is true with respect to the call center and how
16 rationalization across multiple companies can occur .

17 **Q. ARE SAVINGS RELATED TO THE AVOIDANCE OF PRIOR OWNER**
18 **JOINT AND COMMON COSTS LEGITIMATE SYNERGIES?**

19 A. Yes, they are. These costs would have been incurred by the prior owner absent the
20 transaction and reflected in the stand-alone financial forecast that Laclede's bid was
21 based upon, i.e., future earnings would have been reduced by this additional O&M.
22 Thus, MGE customers would have borne these costs in the absence of the acquisition.

1 From LAC's (and MGE's) perspective, avoiding these costs creates a direct
2 benefit to MGE customers in lower costs than would have been borne by MGE
3 customers. And as shown in my direct testimony, total Spire Shared Services costs
4 have been significantly reduced from the acquisition, which benefits both LAC and
5 MGE.

6 **Q. ARE GROWTH RELATED REVENUES ALSO A LEGITIMATE**
7 **SYNERGIES SOURCE?**

8 A. Yes, they are. These opportunities particularly arise from LAC's ability to extend its
9 existing sales programs to MGE which did not have similar programs in related areas
10 in place or planned at the time of the acquisition. Thus, LAC brings an enterprise
11 marketing and sales program to MGE which would not have been available absent the
12 transaction as MGE had no plans for these programs and no investment earmarked for
13 program stand-up. Conversely, LAC brought both a top-line focus and the inherent
14 infrastructure, like the Salesforce CRM system to leverage to MGE. In this case,
15 MGE would not have pursued a similar marketing and sales program on a stand-alone
16 basis, and the potential for incremental revenues would have been foregone.

17 **Q. WOULD PROCESS ENHANCEMENTS FROM INCREASED MAXIMO**
18 **FUNCTIONALITY BE LEGITIMATELY CONSIDERED A MERGER**
19 **SYNERGY?**

20 A. Again, yes it would. This would be an enabled savings, since MGE was the
21 beneficiary of Laclede's overall extension of its New Blue system to MGE and its
22 continuing investment in integrated platforms that provide benefit to both entities.

1 These types of benefits resulting from information technology enhancement would
2 not have been available to MGE unless it had definitive plans to conduct such
3 investment for similar functionality on its own - which it didn't.

4 **Q. MR. FLAHERTY, DO CHANGES IN OPERATING MODELS FROM STAND-**
5 **ALONE TO COMBINED AS A RESULT OF AN ACQUISITION CREATE**
6 **MERGER-RELATED SYNERGIES?**

7 A. Yes, they do. The opportunity to realize savings from many operating areas, e.g.,
8 shared services or operations support services, often only arise due to the operating
9 model change. When a combined company elects to operate its system in a different
10 manner on a combined basis that it did before on a stand-alone basis, this has direct
11 impacts to combined cost levels. And, when a company now leverages a transaction
12 to think differently about aligning its total resources over an expanded service
13 territory, this also gives rise to merger-related synergies.

14 **Q. ARE MR. MAJORS' ADJUSTMENTS TO LACLEDE'S COSTS-TO-**
15 **ACHIEVE SIMILARLY UNFOUNDED?**

16 A. Yes, they are. Mr. Majors states that transition costs in the areas of MGE retired
17 software, integration costs for MGE software, branding costs, and the Continuing
18 Service Agreement (CSA) from Southern Union and ETE are not appropriate.

19 First, the unamortized costs of MGE's existing software is a legitimate cost-
20 to-achieve, as it is a necessary and unavoidable expenditure incurred as part of the
21 extension of LAC's information management system to MGE and the resulting
22 integration of the LAC and MGE information technology applications. Second, as

1 e.g., branding, that are necessary expenditures to enable the combined company to
2 operate seamlessly across its service territory. These types of costs are contemplated
3 in the Stipulation and Agreement which states: “Transition Costs are those costs
4 integrate and merge the two entities into one organization, and includes integration
5 planning and execution, and “costs to achieve”.

6 As noted above, transition costs are incurred because the transaction occurred
7 and it is necessary to integrate the companies, not just to enable synergies capture. For
8 example, merging companies will incur costs in areas like customer and vendor
9 communications and information technology environment alignment that may not be
10 related to specific synergies, but are necessary to enable effective business operation.

11 For all the reasons stated above, I do not believe Mr. Majors’ adjustments are
12 valid or well-reasoned and should not be accepted by the Commission.

13 **Q. WHAT IMPACT WOULD ADOPTION OF MR. MAJORS**
14 **RECOMMENDATIONS HAVE TO SPIRE AND LACLEDE AND WOULD**
15 **THESE IMPACTS BE REASONABLE?**

16 **A.** Mr. Major’s adjustments have the effect of understating the level of legitimate savings
17 realized, as well as the level of transition costs-to-achieve actually incurred. More
18 importantly, his adjustments have the impact of reducing the recovery of out-of-
19 pocket transition costs-to-achieve and confiscating value from shareholders in the
20 form of diminished earnings and equity value.

21 It is clear that the level of total realized synergies well-exceeds the level of
22 total transition costs-to- achieve that Spire has incurred. The Stipulation and

1 Agreement also clearly establishes the standard for recognition and recovery of
2 transition costs-to-achieve on page 10 as: “Laclede Gas shall not include in customer
3 rates any amount of transition costs that exceed the level of cost reductions actually
4 experienced by the Company.” As a result of Mr. Majors’ incorrect assertions
5 regarding the legitimacy of identified synergies and incurred costs-to-achieve, Spire is
6 being inappropriately penalized for accomplishing exactly what it agreed to do, i.e.,
7 produce merger synergies at a level that are sufficient to create positive net benefits
8 for customers. This is both bad public policy and an incorrect application of the
9 standards set forth in the Stipulation and Agreement.

10 **V. RESPONSE TO MS. AZAD’S DIRECT TESTIMONY ASSERTIONS**

11 **Q. WOULD YOU PLEASE SUMMARIZE THE ASSERTIONS AND**
12 **RECOMMENDATIONS OF OPC WITNESS AZAD?**

13 A. Ms. Azad makes a number of assertions in her testimony related to: the objectivity of
14 my analysis of Spire’s cost allocations; the sufficiency of evidence related to Spire’s
15 compliance with the Affiliate Transactions Rule (4 CSR 240-40.015) promulgated by
16 the Commission; differences in underlying cost allocations amounts, and; differences
17 in utilized cost allocation factors. She also recommends several actions be required by
18 the Commission of Spire to improve the efficacy of the cost allocation process.
19 Namely, Ms. Azad recommends that Spire be required to update and refile the current
20 CAM with the Commission to reflect the most recent changes to Spire’s business and
21 cost allocations processes; improve the nature and level of training on cost allocation
22 within Spire; and submit to a Commission-sponsored audit of Spire Shared Services

1 Inc.'s cost allocations approach. Finally, she proposes a downward adjustment of the
2 level of allocated costs to be included in the cost of service to reflect prior-observed
3 declining cost trends in underlying Spire Shared Services, Inc. costs.

4 I will respond to several of these assertions and recommendation. My rebuttal
5 testimony should be read in conjunction of that of Mr. Krick and _____.

6 **Q. MS. AZAD SUGGESTS THAT YOUR ANALYSIS DID NOT CONSIDER THE**
7 **AFFILIATE TRANSACTION RULE OF THE COMMISSION (4 CSR 240-**
8 **40.015), (THE "RULE") IS THAT CORRECT?**

9 A. No, it is not. Ms. Azad asked whether I had reviewed the Rule prior to developing my
10 testimony. My response to her data request indicated that while I was aware of this
11 Rule, it had not been the basis for the specific analyses that I conducted in
12 determining whether Spire costs were reasonable and consistent with this Rule. In
13 fact, I conducted analyses of a number of areas not specifically referenced within the
14 Rule and developed defined criteria across five specific areas of review: activity
15 necessity and benefits, activity overlap, cost management, cost levels and trends and,
16 allocation process. In my view, these additional areas provide additional context for
17 evaluation of the reasonableness of Spire's cost allocations and are consistent with its
18 intent. For my analysis, the Rule was simply a starting point and one element of the
19 bases used to develop my analysis regarding the reasonableness of Spire's process and
20 cost allocations.

21 As Ms. Azad is aware, Strategy& had conducted two prior assignments
22 regarding cost allocations within Laclede or Spire. The first focused on comparing

1 Laclede's processes at the time and identifying recommendations for next stage
2 evolution. The second focused more directly on the nature of changes that Spire could
3 consider for adoption.

4 The Rule was reviewed in conjunction with the execution of this first
5 assignment in 2015. Moreover, the Rule is similar to others in states that I have
6 reviewed over the course of my involvement with stand-up or analysis of service
7 company or shared services organizations. It focuses on standards, evidentiary needs
8 and record-keeping requirements, among other areas, for regulated utilities in
9 Missouri. While the Rule obviously has standing in Missouri, it reflects similar
10 standards or requirements that exist in other states and / or have been promulgated by
11 other authoritative agencies and bodies that address similar cost allocation challenges.

12 **Q. WHAT OTHER AGENCIES OR BODIES ARE YOU REFERRING TO AND**
13 **WHY ARE THESE STANDARDS ALSO RELEVANT?**

14 A. Again, the Rule is controlling with respect to this matter, but additional
15 complementary standards also exist that provide further perspective on the
16 determination of the reasonableness of affiliate charges, and specifically, cost
17 allocations. These standards are all relevant to the considerations in this case.

18 The agencies or bodies that I'm referring to include: the National Association
19 of Regulatory Commissioners (NARUC); the Cost Accounting Standards Board
20 (CASB), and; the FERC. Each of these entities has codified their perspectives
21 regarding cost allocation efficacy.

22 These entities all embrace similar standards related to how costs are allocated,

1 e.g., the guiding allocation framework and allocation factor selection, and certain
2 entities address the topic of market tests. For example:

- 3 • **NARUC** – Their “Guidelines for Cost Allocations and Affiliate
4 Transactions” has provided guidance since 1998 on cost allocation
5 principles, CAMs, affiliate transactions, audit requirements, and
6 reporting requirements, among other areas. One of NARUC’s cost
7 allocation principles that I use to guide my assessments includes:
8 *“[Principle 2] The general method for charging indirect costs should*
9 *be on a fully allocated cost basis. Under appropriate circumstances,*
10 *regulatory authorities may consider incremental cost, prevailing*
11 *market pricing or other methods for allocating costs and pricing*
12 *transactions among affiliates.”* Moreover, NARUC provides
13 guidelines for affiliate transactions in that, *“Generally, the price for*
14 *services, products and the use of assets provided by a regulated entity*
15 *to its non-regulated affiliates should be at the higher of fully*
16 *allocated costs or prevailing market prices.”* NARUC defines
17 “prevailing market price” as *“generally accepted market value that*
18 *can be substantiated by clearly comparable transactions, auction or*
19 *appraisal.”* NARUC’s framework for cost allocations and affiliated
20 transactions are complementary to the Rule. Moreover, a method of
21 determining cost reasonableness that NARUC supports is
22 benchmarking. In a “Transactions with Affiliates” overview, NARUC

1 states, *“One way to determine if a cost is reasonable is to benchmark*
2 *it to costs incurred for similar services. Benchmarking between*
3 *utilities is possible because the utilities use the same Uniform System*
4 *of Accounts allowing comparability.”* In my previous testimony
5 (pages 53-56), I note the relevance and importance of benchmarking
6 in determining cost reasonableness and stated that this activity is
7 utilized by Spire already and provides recurring comparability. In
8 addition, Spire already procures a number of services from external
9 parties that are conducted through formal requests for proposal, and
10 also compares its internal wage and salary costs to the market. These
11 processes both provide a direct comparison to what could be available
12 in the market and are actually ‘market tests’ conducted in the normal
13 course of business.

- 14 • **CASB** – The CASB has provided a number of Cost Accounting
15 Standards (CAS) that serve as a basis for cost allocation evaluations.
16 One of the relevant provisions includes CAS 418 “Allocation of
17 Direct and Indirect Costs” which discusses a fundamental
18 requirement that *“Pooled costs shall be allocated to cost objectives in*
19 *reasonable proportion to the beneficial or causal relationship of the*
20 *pooled costs to cost objectives...”* and specifically, *“The pooled cost*
21 *shall be allocated based on the specific identifiability of resource*
22 *consumption with cost objectives by means of one of the following*

1 *allocation bases: (i) A resource consumption measure, (ii) An output*
2 *measure, or (iii) A surrogate that is representative of resources*
3 *consumed.”* This serves as an example from another authoritative
4 body of how it embraces similar cost allocation frameworks and
5 standards. Spire utilizes a framework for cost allocation similar to
6 that framed by the CASB. Moreover, in page 77 (Figure IX-1) of my
7 testimony, I have provided how Spire’s peers use similar cost
8 allocation factors.

- 9 • **FERC** – In addition to the regulations set forth in Energy Policy Act of
10 2005, FERC provided further clarity on affiliate transactions with
11 Order 707 in 2008, “Cross-Subsidization Restrictions on Affiliate
12 Transactions.” FERC highlighted that *“these restrictions will*
13 *supplement other restrictions the Commission has in place to protect*
14 *captive customers of franchised public utilities...from inappropriate*
15 *cross-subsidization of affiliates.”* One of the elements of the
16 proposed rulemaking *“require(s) a franchised public utility with*
17 *captive customers to provide non-power goods and services to a*
18 *market-regulated power sales affiliate or a non-utility affiliate at a*
19 *price that is the higher of cost or market price.”* FERC’s directive is
20 similar to the Rule, which states that an entity *“compensates an*
21 *affiliate entity for goods and services above the lessor of – A. The fair*
22 *market price or B. The fully distributed cost.”* FERC acknowledges

1 that *“...defining a market price for general and administrative*
2 *services is a speculative task,”* and *“As we have previously stated,*
3 *the at-cost pricing standard for transactions for non-power goods*
4 *and services from centralized service companies to franchised public*
5 *utilities with captive customers benefits ratepayers through*
6 *economies of scale, and eliminates the speculative task of defining a*
7 *market price in these instances.”* The rulemaking that has been set in
8 place restricts cross-subsidization while avoiding overly cumbersome
9 cost allocation methods. Another issue that FERC addresses in Order
10 707 is the support of a centralized shared service model, similar to
11 that adopted by Spire. FERC stated in its hearing that, *“we believe*
12 *that centralized service companies can facilitate regulatory oversight*
13 *and generally favor their use”* and further adds, *“The detailed*
14 *accounting and reporting requirements applicable to centralized*
15 *service companies greatly assists the Commission in regulating those*
16 *entities in a multi-state context where individual states may have less*
17 *authority to help oversee affiliate transactions.”* The Commission
18 noted that *“current reporting regulations are adequate to ensure*
19 *compliance with the proposed restrictions on affiliate transactions”*
20 and in the Order 707 rehearing *“that no additional reporting*
21 *requirements are necessary at this time.”*

22 As noted, these entities embrace similar standards for how cost allocations should be

1 designed and executed. They each frame their perspectives in the same principles, i.e.,
2 1) cross subsidization should be avoided; 2) a one-size-fits-all approach to allocations
3 is inappropriate as differences to companies can exist, and 3) fully allocated or
4 distributed costs provide a sound basis for aligning shared services costs with affiliate
5 responsibility. Consequently, the entities recognize that the application of effective
6 standards requires that multiple elements be assessed, which is consistent with my
7 approach and testimony.

8 **Q. HAS YOUR ANALYSIS BEEN CONDUCTED IN A MANNER CONSISTENT**
9 **WITH BOTH THE COMMISSION RULE AND THE PRINCIPLES THESE**
10 **ENTITIES PROSCRIBE?**

11 A. Yes, it has. My analysis is consistent with the standards existing within the Rule and
12 reflects its intent with respect to cost assignment and allocations. However, my
13 analysis extends beyond the Rule as stated and specifically addresses several areas
14 which directly relate to why and how costs are incurred, managed and distributed.
15 From having conducted more than 20 assignments in this area, I believe that my
16 approach provides significant rationale for Spire's Shared Services approach to
17 service need and performance, establishes how shared services costs are planned and
18 managed, compares costs to other similar entities, reviews how costs have been
19 incurred, and reviews how cost allocations are executed. The sum of all of these
20 analyses provides a substantial amount of additional data that both support the intent
21 of the Rule and enable the Commission to view specific assessments that illustrate the
22 reasonableness of Spire's costs.

1 Q. WHAT HAS MS. AZAD ASSERTED ABOUT YOUR OBEJCTIVITY AS AN
2 ANALYST AND WITNESS FOR SPIRE?

3 A. Ms. Azad asserts that my involvement with Spire in the conduct of prior related
4 assignments would suggest a lack of independence with respect to any assessment of
5 related cost allocations in this case. She then attempts to buttress this assertion by
6 suggesting that the lack of adjustment to either Spire's filed costs or in other
7 assignments is somehow indicative of this lack of independence. On both counts she
8 is incorrect and is making a false, inappropriate and unsubstantiated claim.

9 Q. WHAT HAS BEEN THE NATURE OF YOUR PRIOR CONSULTING
10 INVOLVEMENT WITH SPIRE?

11 A. I have previously provided services to Spire or its operating companies in two
12 primary areas: 1) the prior MGE and Alagasco acquisition transactions, and; 2) the
13 conduct of an industry review of other utility shared services practices, and support
14 for the design and development of the current Spire Shared Services, Inc. entity and
15 related processes. In these assignments, Spire was interested in our independent
16 perspective regarding the subject matter of these assignments and our development of
17 recommendations that they could implement.

18 Q. HAVE YOU CONDUCTED SIMILAR REGULATORY ASSIGNMENTS
19 THAT REQUIRED YOUR PROFESSIONAL OPINION ON CLIENT
20 MATTERS WHERE YOU PREVIOUSLY PERFORMED RELATED WORK
21 TO THE SUBJECT OF YOUR TESTIMONY?

22 A. Yes, I have. I have consulted regarding the utilities industry for over 40 years serving

1 regulated companies, as well as state commissions and intervenor groups in earlier
2 years. My prior experience with the provision of testimony has covered work
3 performed on behalf of these clients related to capital project execution, merger
4 transactions and other matters, including shared services organization stand-up and
5 subsequent cost recovery. In each of these situations, the direct or rebuttal testimony I
6 submitted reflected my best judgment and experience given the facts present in the
7 specific matter.

8 **Q. ON WHAT BASIS HAS MS. AZAD ASSERTED THAT YOU ARE NOT**
9 **OBJECTIVE WITH RESPECT TO SPIRE IN THIS MATTER?**

10 A. She has suggested that my prior involvement with Spire precludes my objectivity
11 because I had direct involvement with the Company in design of the present cost
12 allocation system. She then ‘bootstraps’ a passage from the Public Company
13 Accounting Oversight Board (PCAOB) related to independence of an auditor to
14 reinforce this assertion. Finally, she suggests that while I have conducted numerous
15 reviews of shared services organizations and cost allocations, she believes that the
16 absence of service company cost adjustments for inappropriately charged costs in
17 these assignments is not reasonable.

18 **Q. IS MS. AZAD CORRECT IN ANY ASPECT OF HER ASSERTIONS**
19 **REGARDING YOUR OBJECTIVITY?**

20 A. No, she is not. She is factually misinformed and offers a false premise upon which she
21 makes her assertions, namely that prior professional involvement with a client leads
22 to biased advocacy for that client. First, she incorrectly assumes that the work I

1 performed for Spire was related to an analysis of transactions, i.e., an audit. To be
2 clear, the scope of our work did not focus on transactions; rather, it focused on the
3 reasonableness of the overall design and application of the cost allocation process.
4 Ms. Azad thus starts her assessment with a fundamental misperception of what she
5 thinks she is reviewing. Second, Ms. Azad cites a passage that provides an example
6 that is not germane to me. I have no “...obligation to or interest in the client, its
7 management, or its owners...” Strategy& consulted to Spire and has no direct or
8 indirect constraint to our objectivity, like her Board of Director example would imply.
9 Third, we were consultants to Spire, not management, i.e., we were not decision
10 makers and accordingly are not reviewing our own decisions. We objectively
11 provided our recommendations on how Spire could stand-up its shared services
12 organization. Fourth, the services we provided to Spire were focused on *ex ante*
13 shared services design, while my testimony addresses *ex post* adoption, processes and
14 outcomes. These two focuses are uniquely different and individually or together do
15 not create any impacts on objectivity. Fifth, Ms. Azad asserts that the lack of findings
16 regarding inappropriate charges in prior work is illustrative of a further lack of
17 objectivity. We were requested to review the manner in which Spire Shared Services
18 Inc. was operating in support of the various entities within Spire as a whole and the
19 consistency of application of the cost allocation process with its original intent. There
20 should be no expectation that adjustments of that type would result since we were not
21 reviewing ‘charges’ from transactions.

22 More problematic is the presumption that adjustments to affiliated charges

1 should be expected from any review of material filed by a utility, regardless of the
2 merit and structure of the process. While I have reviewed numerous shared services
3 organizations and cost allocations results, my focus – and that of any objective
4 reviewer – is on whether the process is well-defined, is working as it is intended and
5 delivers reasonable results given its intent and application.

6 **Q. DO YOU BELIEVE THAT MS. AZAD SIMPLY ASSUMES THAT COST**
7 **ALLOCATION ADJUSTMENTS SHOULD BE NECESSARY TO SPIRE'S**
8 **COST ALLOCATIONS?**

9 A. The results of my prior cost allocation reviews did not result in the types of
10 adjustments Ms. Azad believes must exist because: 1) utilities have been
11 administering processes that have been consistently reviewed for decades by
12 regulatory commissions and found to be consistent with relevant requirements; 2) the
13 appropriate standard for review is whether the cost allocation process in place is
14 yielding reasonable results in accordance with its design; and 3) Spire's cost
15 allocation approach is similar when compared to that of other utilities and achieves
16 reasonable outcomes

17 Ms. Azad does not appear to recognize or appreciate that utilities have been
18 allocating shared services costs since before the adoption of the Public Utilities
19 Holding Company Act of 1935 (PUHCA). This was a formative event with respect to
20 intra-company alignment and payment for services provided between entities and
21 established guidelines and restrictions on how service company costs should be
22 addressed with subsequent establishment of Cost Allocation Manuals (CAMs) that

1 still stand today.

2 Many state statutes and regulatory commission requirements subsequently
3 reflected the principles within PUHCA in establishment of their own regulatory
4 models. Thus, utilities have been allocating service company or shared services costs
5 under stringent guidelines which reduce the potential for inappropriate charges
6 requiring adjustment.

7 Ms. Azad's testimony – and her underlying bias – incorrectly assume that
8 adjustments to cost allocation amounts are necessary to find that utilities have
9 appropriately reflected their shared services costs.

10 Finally, I would note that after having access for months to hundreds of pages
11 and thousands of rows of data, Ms. Azad has not identified a single adjustment to any
12 transaction charges from Spire Shared Services other than her incorrect reallocation of
13 the New Blue information technology system which is further addressed by Messrs.
14 Krick and Hyman.

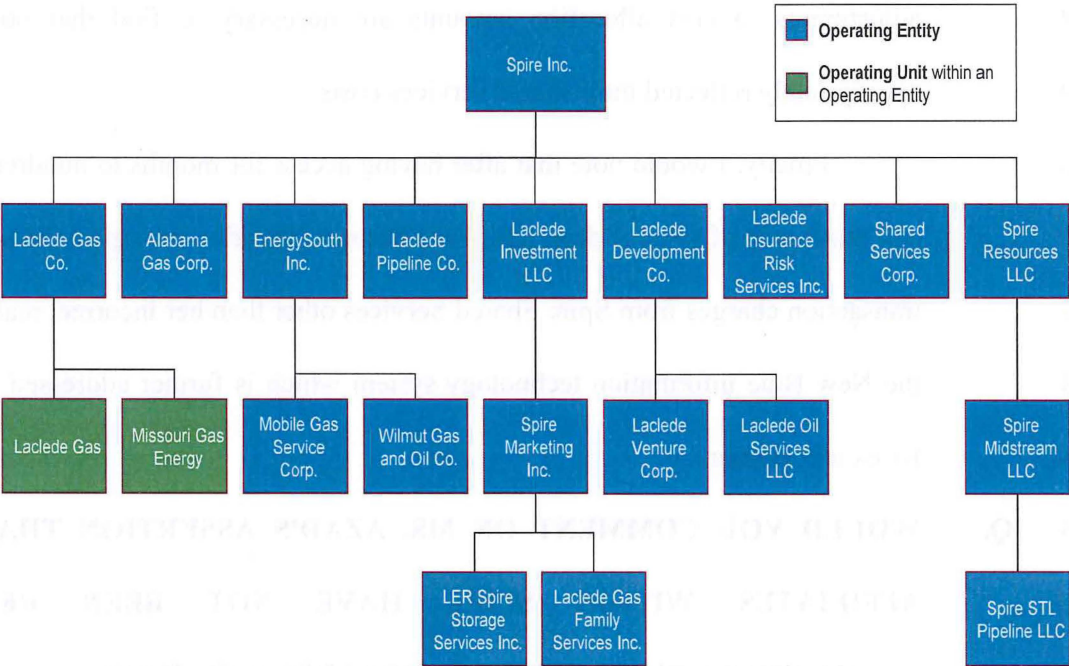
15 **Q. WOULD YOU COMMENT ON MS. AZAD'S ASSERTION THAT MANY**
16 **AFFILIATES WITHIN SPIRE HAVE NOT BEEN RECEIVING**
17 **ALLOCATIONS FROM SPIRE SHARED SERVICES, INC.?**

18 A. Yes. Ms. Azad is both incorrect in her assertion that these affiliates do not receive
19 cost distribution and ignores information available to her that explained Spire's
20 rationale for cost assignment and allocations.

21 The Spire cost assignment and allocation system was established to enable the
22 allocation of shared services costs among the operating utilities and to provide for

1 direct cost capture and assignment to regulated and non-regulated entities, where
 2 appropriate. Ms. Azad notes that 12 of the 21 existing entities within Spire do receive
 3 direct charges or cost allocations and nine do not. We would note that within the
 4 current entity structure of Spire there are 19 entities and two operating units housed
 5 within the Laclede Gas Company entity, not 21 separate entities. Figure 1 below
 6 reflects the proper entity structure for Spire.

7 **Figure 1**



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11 Ms. Azad also incorrectly indicates that Laclede Investment LLC does not
 12 receive any allocations from Spire Shared Services. Allocations to this entity can be
 13 seen in the OPC Calculation Support file on the “New Blue Derp Adj” (sic) tab row
 14 27 (INV is the symbol for Laclede Investment LLC).

1 Of the 19 legal entities and 2 operating companies nine do not receive
2 allocations, these are:

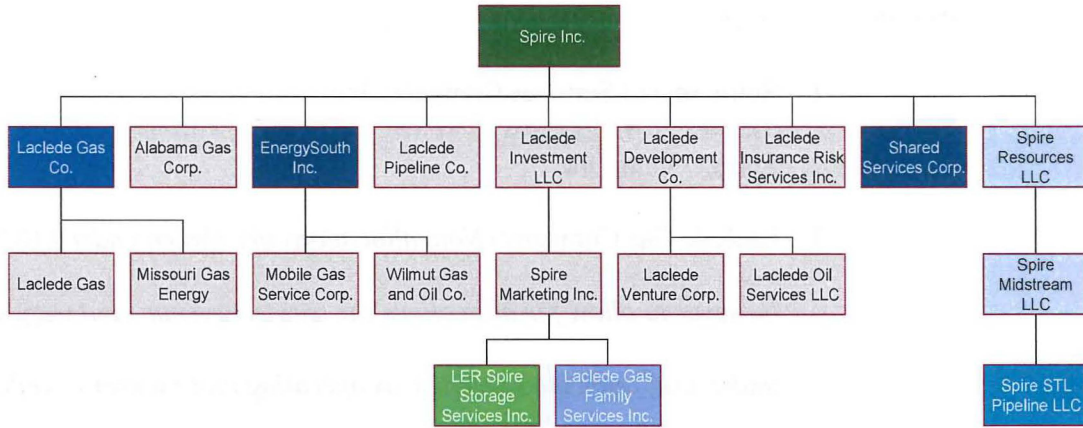
- 3 1. Spire Shared Services Company, Inc
- 4 2. Energy South, Inc
- 5 3. Laclede Gas Company (*Note allocations are shown under LGC*
6 *however to allow for allocations the assets, revenue, and wages listed*
7 *under LGC indicate Laclede Gas operating unit numbers, while MGE*
8 *assets, revenue, and wages under MGE indicate Missouri Gas Energy*
9 *operating unit numbers*)
- 10 4. Laclede Gas Family Services, Inc
- 11 5. Spire STL Pipeline LLC
- 12 6. Spire Inc
- 13 7. Spire Resources, LLC
- 14 8. Spire Midstream, LLC
- 15 9. LER Spire Storage Services, Inc

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17 Figure 2 below provides the rationale for why these nine receive no
18 allocations.

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Figure 2



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- Not intended to be cost centers. All costs are billed out to other entities → receives No shared service allocations. (EnergySouth Inc. and Shared Service Corp)
- For allocation purposes all assets, revenues, and staff are determined at the "Operating Unit" level → all allocations flow to Laclede Gas and Missouri Gas Energy "Operating Units." (Laclede Gas Co.)
- Entity was dissolved in September of 2016 and no longer receives shared service allocations. (Laclede Gas Family Services Inc.)
- Entities hold no assets, revenue or staff → receive not shared services allocations. (Spire Resources LLC and Spire Midstream LLC)
- Shared service costs that originate from or get allocated to the Spire, Inc. holding company are for the benefit of the subsidiaries and are allocated to the subsidiaries via direct charge or allocated through the Shared Services Corp. → No shared services allocations are held by the Spire, Inc. entity, there are however non-shared services costs held within Spire, Inc. (Spire Inc.)
- LER Spire Storage is a sub of Spire Marketing. Its portion of assets, revenues, and staff are held by marketing → shared service allocations charged to marketing. (LER Spire Storage Services Inc.)
- Start-up entity that will begin receiving allocations in FY 2018. Vast majority of costs to date have been direct charged, allocation would be minimal. (Spire STL Pipeline LLC.)
- Receive shared services allocations. (All Others)

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Ms. Azad notes at page 14 of her testimony that almost 100% of Spire’s revenues are generated from its gas utility and gas marketing business segments. These entities do receive allocations and direct charges except where noted above. For those entities not presently receiving cost allocation charges, the asset and resource based businesses, e.g., Spire STL Pipeline LLC, will begin to be allocated costs in FY2018 which will complement other direct costs during 2016. For the remaining entities, they are either shell companies or have no business activity. Ms. Azad’s concern over these entities is misplaced.

1 **Q. IS SPIRE’S APPROACH TO DEVELOPMENT OF ITS ALLOCATED COSTS**
2 **CONSISTENT WITH THE RULE’S STANDARD FOR FULLY**
3 **DISTRIBUTABLE COSTS?**

4 A. Yes, it is. The Rule defines fully distributed costs to include “.... all costs incurred
5 directly or indirectly used to produce a good or service.” While the Rule does not
6 definitively identify how to develop fully distributed costs, it does state that all the
7 costs of the regulated utility should include all costs to complete the transaction,
8 including appropriate allocation of joint and common costs. However, the language in
9 the Rule – and the focus of the Rule itself – clearly is more directed at addressing the
10 regulated entity’s purchase of goods and services from affiliates, rather than the
11 provision of goods and services to an affiliate.

12 In my view, Spire’s cost assignment and allocation methodology is consistent
13 with this standard. First, employees of Spire Shared Services are housed within the
14 regulated utilities and thus original costs for these services initiate from the entity that
15 is providing the service. Second, joint and common costs, i.e., for typical corporate
16 center activities are identified and assigned or allocated to the affiliate that benefits
17 from the activity or spread across the entities comprising the overall business. Third,
18 the labor costs of Spire Shared Services include relevant loaders for benefits which
19 further build total costs of performance. Thus, Spire Shared Services costs are fully
20 distributed.

21 **Q. DOES SPIRE ALSO UTILIZE MARKET INFORMATION TO TEST ITS**
22 **COSTS AGAINST WHAT IS AVAILABLE FROM OTHER PROVIDERS?**

1 A. Yes, it does this through the regular course of business execution. Spire utilizes third-
2 party resources, i.e., market sources, for provision of various activities, such as for
3 audit and tax services, construction management, call centers and, payroll. These
4 outside service entities provide insight into comparative costs for performance and
5 represent a market source for certain activities that best lend themselves to
6 outsourcing.

7 As I mention with respect to Mr. Majors' assertions regarding certain synergies
8 areas, LAC identified additional outsourcing opportunities related to either extending
9 its current third-party arrangements across MGE or adopting existing MGE
10 outsourcing across its similar activities. The use of third-parties in the normal course
11 of business provides a useful view into the market for alternative service providers
12 and therefore market costs.

13 My experience suggests that the incremental costs associated with reviewing
14 internal costs for activities performed through a market comparison far exceeds its
15 value, particularly when the appropriate assignment and allocation of costs captures
16 these expenditures in a more useful manner and Spire already reviews market costs on
17 an ongoing basis. In my view, adequate market test information already exists and
18 Spire has met the requirements of the Rule.

19 The analysis I have conducted suggests that Spire's cost assignment and
20 allocation methodology adequately enable it to effectively respond to the standards
21 with the Rule regarding use of fully distributed costs and a market test.

22 Q. **DO YOU BELIEVE THAT MS. AZAD'S ADJUSTMENT FOR TRENDS IN**

1 **ALLOCATED COSTS TO MISSOURI OPERATIONS IS APPROPRIATE?**

2 A. No, I do not. Ms. Azad is ‘cherry-picking’ a single item for incorporation into the cost
3 of service which amounts to single-issue ratemaking, which is not a generally
4 accepted approach in historical test year rate cases. Further, Ms. Azad has mis-used
5 the cost decline rate that was contained in my testimony and exhibits.

6 Ms. Azad has utilized a 3.3% compound annual growth rate (CAGR) to apply
7 to 2016 shared services costs to the Spire Missouri Operations (including both LAC
8 and MGE) to develop an estimate of what ‘could’ occur in 2017 if this trend
9 continued. This is incorrect from several perspectives: First, the costs in 2017 are
10 outside the test year and it is speculative to assume what those costs would have been,
11 i.e., whether those costs could be higher or lower. Second, she is only addressing a
12 single area of cost impacts in 2017 which ignores the impacts of inflation on all other
13 costs and any changes to costs that occur as a result of non-escalation, e.g., regulatory
14 mandates, new programs, operating requirements, etc. Third, Ms. Azad has assumed
15 that an observed historical trend over three previous years (2014 – 2016) will continue
16 at the same level into a succeeding year. Fourth, the predicate for changes into the
17 cost base that underlies the declining CAGR is based on the impact of synergies from
18 two large prior transactions that are not replicated in 2016 through EnergySouth.
19 Fifth, she is mixing real and nominal dollars in her application of a declining real
20 CAGR, i.e., inflation adjusted dollars to a nominal cost base, i.e., current dollars.

21 The shortcomings in Ms. Azad’s overall approach reflect a flawed logic and
22 cannot be relied upon. But, even if her logic were assumed to be reasonable, her

1 calculation overstates the potential impact of the declining CAGR she observed in my
2 testimony.

3 Ms. Azad utilizes the 2013 to 2016 3.3% CAGR real decline to Missouri
4 operations in shared services charges, i.e., after adjusting for inflation, shown on my
5 Figure VIII – 7 which resulted in a 2016 total of approximately \$213 million. While
6 the percent decline and Missouri operations 2016 baseline figures are correct, she
7 applies an after inflation adjusted CAGR to a nominal dollar, i.e., unadjusted for
8 inflation or actual dollars booked amount. This is an apples and oranges comparison,
9 i.e., actual dollars versus deflated dollars comparison. Ms. Azad overstates the value
10 of any adjustment by more than 100% even if her logic were correct, which it is not.
11 To correct the record, if Ms. Azad were using the correct percent decline CAGR the
12 adjustment would be \$3.0 million, not the \$7 million she proposes. This amount is
13 approximate to the information provided by Spire for its updated results, although the
14 purpose and bases for these calculations are different. But even this adjustment, as it
15 is developed by her, is inappropriate.

16 Nonetheless, her errors do not stop at this calculation itself. The measured
17 decline in shared services charges to Missouri operations reflects a single four year
18 timeframe between 2013 and 2016. This timeframe reflected the realization of
19 significant synergies from the Laclede and MGE transaction and modest synergies
20 from the Laclede and Alagasco transaction. The significant early year impacts of these
21 transactions cannot be assumed to continue at the same rate, particularly when Spire
22 Shared Services costs are escalating overall at a 1.91% real rate, i.e., before inflation.

1 My testimony at pages 63 through 69 identify the changes in cost levels and
 2 types over this period and explains the impact of the mergers and other non-merger
 3 items on functional cost categories, i.e., reduction due to the mergers offset by other
 4 increases to business costs. The rate of decline in service company billings is driven
 5 by the realization rate of merger synergies versus the rate of growth in actual costs,
 6 including inflation. Ms. Azad assumes that the pattern of 2013 – 2016 will continue
 7 through 2017. This is entirely speculative and is incorrect for several reasons: 1) the
 8 merger synergies will be flat rather than growing; 2) the addition of EnergySouth at
 9 its small scale does not alter the shared services charges cost decline path in any
 10 meaningful way like the MGE and Alagasco transactions did; 3) 2017 as a year
 11 cannot be assumed to look like the 2013 – 2016 period, and; 4) escalation continues
 12 to grow at approximately 2% for general inflation, 4% for labor costs and 6% for
 13 medical benefits costs (based on a 30-year average growth rate)

14 These factors referenced above result in a declining rate of change in Spire
 15 Shared Services costs year-over year.

16 **Table 2**

	2013	2014	2015	2016
Total Shared Services Cost	\$374,538,462	\$344,329,196	\$325,141,362	\$322,368,740
Change in Cost Year-on-Year (Reduced Cost)		(\$30,209,267)	(\$19,187,834)	(\$2,772,622)

17
 18 As the table indicates, real costs in 2013 of approximately \$375 million
 19 decline to \$322 million by 2016, but the rate of decline drops as continuing escalation

1 offsets the level of synergies realized. And in fact, these costs are expected to increase
2 in 2017 to approximately \$344 million, which is completely opposite to what Ms.
3 Azad assumes.

4 These factors – individually or taken together – would indicate that Ms.
5 Azad’s premise is false and her adjustment is without merit.

6 **Q. DO YOU BELIEVE IT IS NECESSARY FOR THE COMMISSION TO**
7 **ORDER AN EXTERNAL AUDIT OF SPIRE’S COST ASSIGNMENT AND**
8 **ALLOCATION PROCESSES AND PRACTICES?**

9 A. No, I do not. While the Commission has the prerogative and authority to order and
10 undertake any investigation it considers necessary based on its observation of the facts
11 and conditions, it is not justified in this circumstance.

12 As discussed in my direct testimony and exhibits, Spire Shared Services costs
13 have declined on a real and nominal basis over the last four years which reflects prior
14 expected merger impacts to cost levels. This decline also occurs notwithstanding
15 several years of cost escalation at the levels I indicated above. Thus, there does not
16 appear to be an adverse trend that needs to be investigated.

17 While the CAM could be enhanced by more fully reflecting specifics of the
18 current cost allocation process and the evolution of Spire itself, the approach and
19 processes in use today are still very much aligned with the CAM, but updated, as
20 required, by the major events of needing to add the acquired entities so they are
21 properly allocated costs in accordance with the CAM. The Company itself has
22 acknowledged that the CAM will be enhanced as an outcome of this case and the

1 maturing of its shared services model post-EnergySouth integration. While Ms. Azad
2 calls into question several observed ‘discrepancies’ regarding baseline allocations,
3 Spire entity allocations, and allocation factor utilization, these are directly addressed
4 by Mr. Krick in his rebuttal testimony and would further suggest that an audit would
5 neither be required nor productive in providing additional insight to the Commission
6 regarding the Spire Shared Services model and its allocations process.

7 **Q. WHAT ISSUES HAS MS. AZAD RAISED RELATED TO THE MANNER IN**
8 **WHICH YOU HAVE REVIEWED THE SHARED SERVICES COST FOR**
9 **LAC AND MGE?**

10 A. Ms. Azad has asserted that LAC and MGE should be analyzed separately “...given
11 that the two serve customers in distinct, separate areas of the state, and have their own
12 employees.” This is recommended “...to ensure that the charges recovered from MGE
13 customers and LAC customers justly and reasonably represent the costs for providing
14 services to those particular customers.”

15 **Q. DO YOU BELIEVE THAT MS. AZAD IS CORRECT IN HER BELIEF THAT**
16 **LAC AND MGE SHOULD BE EVALUATED SEPARATELY FOR**
17 **PURPOSES OF ALLOCATIONS?**

18 A. No, I do not. While it is the case that the two utilities have non-contiguous service
19 territories and distinct customer bases, this is not a relevant factor in determining the
20 shared services costs allocated to each respective utility. Furthermore, the allocation
21 of shared services costs to LAC and MGE is an output of the already established
22 guidelines of Spire’s Cost Allocation Manual, which already takes into consideration

1 many of the distinct elements of the customer base and other cost causation drivers
2 utilized for allocations.

3 An additional indication that these two operating units can logically be treated
4 as one utility is the fact the Staff has deemed it appropriate in the past to approve a
5 single CAM for both LAC and MGE, even while normal cost assignment and
6 allocations would continue to apply to each operating entity to support their
7 individual revenue requirements and customer rates. As stated in my testimony, total
8 spend by Laclede dropped by \$9 million in nominal dollars and \$21.8 million in real
9 dollars, representing a 1.4% and 3.3% decline per year, respectively (i.e., Compound
10 Annual Growth Rate (CAGR) from 2013-2016). Overall, the decreases identified in
11 Spire shared services billings represent its commitment to controlling the cost of its
12 services to its affiliates. Further delineation of the utility into LAC and MGE would
13 be of limited to no value in evaluating Spire's overall ability to control shared
14 services costs.

15 Furthermore Ms. Azad offers no precedent or findings to support her assertion
16 that LAC and MGE's allocated costs should be evaluated separately, with respect to
17 the request of Spire. Ms. Azad only states that each operating unit 1) serves two
18 distinct customer bases, without providing any discernable distinction, 2) operates in
19 separate areas of the state, without providing rationale for why this would impact the
20 cost of service, and 3) have their own employees, which while correct ignores the fact
21 that these employees directly charge their costs to the operating unit for which they

1 provide direct benefit or indirectly charge costs, which are then allocated as
2 determined by the aforementioned CAM.

3 Given this lack of cited precedent and supporting rationale I see no
4 meaningful distinction that requires LAC and MGE to be evaluated separately for the
5 purposes of cost assignment and allocations when these costs are sourced from Spire
6 Shared services for both entities.

7 **Q. WHAT HAS MS. AZAD STATED REGARDING WHAT SHE**
8 **CHARACTERIZES AS UNEXPLAINED INCONSISTENCIES AMONG**
9 **SOURCE DOCUMENTS RELATED TO ALLOCATIONS?**

10 A. Ms. Azad has stated that 14 of 25 allocation factors for Laclede, which were utilized
11 during 2016 per the monthly allocations factors reports, were not listed in other sets of
12 documents provided by the company for the same period. Further, Ms. Azad states
13 that several other allocation factors differ yet from the allocation factors the company
14 provided in response to discovery in the information presented to the PSC in the
15 company's presentation in October 2016. And lastly, Ms. Azad asserts that these
16 factors differ from Spire's response to OPC 1021.6. Based on this, Ms. Azad claims
17 that the company's records present an inconsistent and incomplete listing that does
18 not appropriately account for the figures in the testimonies of witnesses.

19 **Q. DO YOU AGREE WITH MS. AZAD'S CONCLUSIONS RELATED TO**
20 **ALLOCATION FACTOR INCONSISTENCIES?**

21 A. No, I do not. We have tried to obtain workpapers or information related to this claim
22 from Ms. Azad; however, at this point have not received any response, so we will

1 reserve our right to circle back to this in surrbuttall. That said, from what I can see
2 having reviewed the same material Ms. Azad used to arrive at this conclusion, it
3 appears that she has taken an overly literal definition of allocation factors to claim
4 there are several independent allocation factors across the documents she reviewed. In
5 the cases where Ms. Azad sees 25 separate and independent allocation factors, I see
6 seven primary factors most with slight variations depending on the scope of Spire
7 business entities they support. This includes, for example, 3-factor allocations; where
8 Ms. Azad sees four independent allocation factors (Corporate Wide (3-factor) Total,
9 Gas Utilities Only (3-factor) Total, MO Gas Utilities (3-factor) Total, and MO Only
10 (3-Factor) Total)¹, I see one allocation factor with four variations.

11
12 Ms. Azad further states that “The lack of unambiguous, consistent figures for
13 the test year is an issue not addressed by Mr. Flaherty. This results in figures that do
14 not appropriately reflect shared services charged and chargeable to Spire companies in
15 the test year or known and measureable changes in charges reasonably anticipated to
16 be allocated to LAC and to MGE for shared services for the period in which new rates
17 would be in place.” Again, the conclusion Ms. Azad reaches is based on an overly
18 specific definition of an “allocation factor”.

19 Ms. Azad also indicates in her tables on pages 32 and 33 that not all allocation
20 factors were used consistently across calendar year 2016 and then uses these
21 occurrences to support her claim of inconsistencies. This claim ignores the fact that

¹ Spire leveraged payroll as a proxy for headcount prior to 2016.

1 five of the 25 allocations factors she notes are new to the shared services organization
2 in FY 2017, therefore there should be no expectation of their consistent use across
3 calendar year 2016. Additional allocation factors show sporadic use over the calendar
4 year; however this is generally due to there being no allocated costs in these months
5 that required allocations. This is at times the case for Field Ops HC related charges
6 (these resources also charge directly when appropriate).

7 Ms. Azad further states at page 30 of her direct testimony that “The lack of
8 unambiguous, consistent figures for the test year is an issue not addressed by Mr.
9 Flaherty. This results in figures that do not appropriately reflect shared services
10 charged and chargeable to Spire companies in the test year or known and measureable
11 changes in charges reasonably anticipated to be allocated to Laclede Gas and to MGE
12 for shared services for the period in which new rates would be in place.” Again, the
13 conclusion Ms. Azad reaches is based on an overly specific definition of the
14 allocation factors that are utilized.

15 Q. **DOES MS. AZAD CITE ANY FURTHER ISSUES WITH YOUR ANALYSIS**
16 **OF ALLOCATION FACTORS WITHIN YOUR TESTIMONY?**

17 A. Yes, Ms. Azad notes that my analysis was not representative of the changes to
18 allocation resulting after to the company’s acquisition of EnergySouth, which took
19 place in 2016. Ms. Azad also cites that in 2016 Spire formed additional entities
20 including Spire Resources LLC, Spire Midstream LLC, and Spire STL Pipeline, and
21 that these entities were not included in my analysis.

22 Q. **WERE THERE REASONS THESE ENTITIES WERE NOT INCLUDED IN**

1 **YOUR ANALYSIS?**

2 A. Yes, these entities were not included due to their limited to no impact on allocated
3 costs in the 2016 calendar year, as well as my focus on shared service related costs
4 and cost trends from 2013 – 2016.

5 Spire Resources LLC and Spire Midstream do not hold any assets, revenues or
6 resources and therefore did not receive direct or allocated shared services costs at any
7 time from 2013 - 2016. For this reason they were not included in the analysis of
8 shared services costs. In general Holding Companies receive no allocated costs from
9 the Spire Shared Service Corp since no assets, revenue, or staff reside within the
10 Holding Company. All costs that accrue to these entities are directly charged and
11 always related to specific project work being conducted on behalf of these Holding
12 Companies, e.g., M&A, special projects, etc. In these cases there are benefits costs
13 that follow the directly charged resource costs, however these too get directly charged
14 to the relevant Holding Company and do not flow through the Share Service Crop.

15 Spire STL Pipeline was excluded from the analysis due to the limited nature
16 of allocated costs in calendar year 2016, Spire STL Pipeline was only included in
17 Spire’s FY2017 allocations and contributed only three months of data to the 2016
18 calendar year. Given the lack of data dating back to 2013 and the limited inclusion of
19 allocated costs in calendar year 2016 these costs were not specifically called out in my
20 analysis and represented limited dollars to allocated shared services cost in the 2016
21 calendar year.

22 Similar to Spire STL Pipeline, EnergySouth was excluded due to the limited

1 impact on the 2016 calendar year shared services costs and the limited insight into
2 historical costs dating back to 2013. At the time of my analysis Spire was still
3 receiving transition services from Sempra who could not provide the required level of
4 detail back to 2013. Furthermore due to inconsistencies between Sempra's and Spire's
5 chart of accounts these costs could not be accurately mapped to Spire's shared
6 services costs, even if they were available. Given this EnergySouth was excluded
7 from my cost trending analysis as well as the overall shared service costs for calendar
8 year 2016.

9 **Q. HAS MS. AZAD NOTED ANY ISSUES WITH THE ALLOCATED COSTS**
10 **IDENTIFIED BY YOU IN YOUR TESTIMONY?**

11 A. Yes, Ms. Azad has noted perceived discrepancies between the allocated shared
12 services costs from my testimony and the numbers provided by Spire through its
13 monthly allocation reports. Specifically, she notes that the \$57.5 million total from
14 the monthly allocation reports represent less than half of the \$121.4 million in
15 allocated costs in my testimony. She further points out that the portion of the charges
16 marked specifically as "shared services allocations" (excluding benefits and
17 insurance) represents a perceived discrepancy of approximately \$11 million between
18 the two sources.

19 **Q. DID MS. AZAD SEEK TO CLARIFY THESE PERCEIVED DISCREPANCIES**
20 **WITH YOU?**

21 A. Partially. Ms. Azad sought to understand the financial model that underpinned my
22 assessment of allocated cost, but primarily focused on attempting to replicate the

1 numbers provided in my testimony, apparently without an understanding of the
2 foundational elements of how my analysis was conducted.

3 **Q. WHAT DRIVES THE DIFFERENCES BETWEEN THE \$57.5 MILLION**
4 **CITED IN MS. AZAD'S TESTIMONY AND THE \$121.4 MILLION CITED IN**
5 **YOUR TESTIMONY?**

6 **A.** It appears Ms. Azad's \$57.5 million value is based on a summation of the allocated
7 costs for LAC and MGE for the 2016 calendar year. In my original analysis, to
8 support cost trending from 2013 – 2016, I separated benefits and insurance into their
9 own distinct elements. The \$121.4 million amount includes insurance and benefits to
10 resources that charge to Spire's Shared Services entity, as well as benefits and
11 insurance to all other resources within the Spire regulated utilities. Only shared
12 service related charges that require allocation flow through Spire Shared Services,
13 with all other costs related to shared services direct charged. For LAC and MGE the
14 total Allocated Shared Services, Allocated Benefits, and Allocated Insurance total
15 \$121.4 million. Ms. Azad's total of \$57.5 is a subset of these costs with the \$63.9
16 million difference being Allocated Benefits and Insurance that are direct charged to
17 LAC and MGE to cover these associated costs for non-shared services related
18 operational staff.

19 **Q. MS. AZAD ALSO NOTES AN APPROXIMATELY \$11 MILLION**
20 **DIFFERENCE BETWEEN THE \$57.5 MILLION IN ALLOCATED**
21 **CHANGES FROM THE MONTHLY REPORTS AND \$46.5 MILLION CITED**
22 **AS ALLOCATED SHARED SERVICES IN YOUR TESTIMONY. WHAT**

1 **EXPLAINS THIS DIFFERENCE?**

2 A. There are two primary drivers for this difference. The first is related to the allocated
3 benefits discussion noted above. Ms. Azad’s \$57.5 million total includes \$8.3 million
4 in benefits. These were included in the Allocated Benefits section my findings, not in
5 the Allocated Shared Services costs Ms. Azad is directly comparing to.

6 An additional \$2.1 million of this difference is related to payroll related
7 clearing accounts Spire only recently incorporated into its allocations in 2016. For the
8 purposes of my cost trending analysis these clearing account dollars were removed to
9 permit an apples-to-apples comparison from 2013 through 2016. While these types of
10 accounts are often used by utilities to capture costs on a temporary basis, they are not
11 always recurring and are ultimately netted against other cost capture accounts.

12 The remaining \$0.6 million is due to additional select eliminations related to
13 indirect payroll items that were not consistently incurred across LAC, MGE, and
14 Alagasco and therefore necessitated separation to ensure an apples-to-apples
15 comparison for 2013 through 2016. These eliminations were maintained when
16 evaluating LAC and MGE to ensure a consistent baseline of Spire Shared Services
17 costs for comparison purposes. A summary reconciliation of cost differences are
18 included in Table 3 below.

19
20
21
22

1

Table 3

Calendar Year Shared Services Total from monthly reports		\$57.5 Million
Adjustment for benefits	–	\$8.3 Million
Adjustment for clearing accounts	–	\$2.1 Million
Adjustment to enable 2013 – 2016 cost comparison	–	\$0.6 Million
Strategy & Allocated – Shared Services		\$46.5 Million

2

3 **Q. SHOULD THE ASSERTIONS AND RECOMMENDATIONS OF MR.**
4 **MAJORS AND MS. AZAD BE ACCEPTED BY THE COMMISSION?**

5 A. No, they should not. Neither Mr. Majors nor Ms. Azad are correct in their assertions
6 and their recommendations are not justified.

7 Mr. Majors is incorrect in his claims that he did not have sufficient
8 information to evaluate the LAC – MGE merger synergies and that LAC has not
9 justified sufficient synergies to enable recovery of the level of costs-to-achieve
10 described in the stipulation and agreement. His adjustments to both synergies and
11 transition costs-to-achieve would adversely financially impact Spire and should not be
12 accepted.

13 Similarly, Ms. Azad’s assertions stem more from misunderstanding the
14 information she reviewed than any incorrect information from Spire. Further, she has
15 not shown that any benefits would be realized from the conduct of a separate audit of
16 Spire shared services costs. Her recommendations should similarly be disregarded by
17 the commission.

18 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

19 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

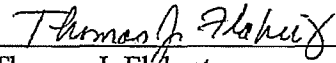
In the Matter of Laclede Gas Company)
d/b/a Missouri Gas Energy's Request to) File No. GR-2017-0216
Increase its Revenues for Gas Service)

AFFIDAVIT

STATE OF MISSOURI)
CITY OF ST. LOUIS) SS.

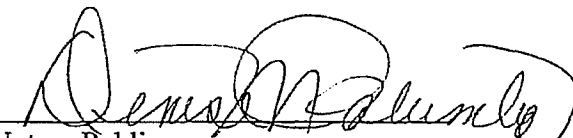
Thomas J. Flaherty, of lawful age, being first duly sworn, deposes and states:

1. My name is Thomas J. Flaherty. My business address is 2001 Ross Avenue, Suite 1800, Dallas, Texas 75201 and I am a Senior Advisor to the Power and Utilities Practice of Strategy&, a part of the PwC network.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony on behalf of Laclede Gas Company and MGE.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.



Thomas J. Flaherty

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



Notary Public

