SURREBUTTAL TESTIMONY

OF

ARA AZAD

LACLEDE GAS COMPANY

MISSOURI GAS ENERGY

GR-2017-0215

GR-2017-0216

Contents

I. INTRODUCTION

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

A. My name is Ara Azad. I am Managing Partner of AzP Consulting, LLC ("AzP"), located at 11614 Tomahawk Creek Parkway, Suite I, Leawood, Kansas 66211.

Q. Are you the same Ara Azad who previously filed direct testimony in this proceeding?

A. Yes, I previously submitted direct testimony on behalf of the Missouri Office of the Public Counsel ("OPC").

Q. What party do you represent?

A. I provide this surrebuttal testimony on behalf of the OPC.

Q. Do you have any corrections to make to your direct testimony at this time?

A. Yes. The title on the tables on pages 36 and 37 of my direct testimony should state "Calendar Year" rather than "Fiscal Year."

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to assertions made in the rebuttal testimonies of Thomas Flaherty, Timothy Krick, Glenn Buck, and Ryan Hyman in response to my direct testimony.

III. RESPONSE TO PROPOSED ADJUSTMENTS

A. <u>New Blue Allocation</u>

Q. Please describe "New Blue."

A. New Blue is an enterprise management software system. Both Laclede Gas Company ("LAC") and Missouri Gas Energy ("MGE") are seeking cost recovery in Case Nos. GR-2017-0215 and GR-2017-0216, respectively.

Q. Did MGE have plans to make investments for similar functionality in its information technology system absent the merger with Laclede?

A. No. Mr. Flaherty testified that MGE did *not* have "plans to conduct such investment for similar functionality on its own."[1]

Q. How did MGE's costs change as a result of the post-merger integration of New Blue?

A. As the table below illustrates, the net book value ("NBV") of MGE's information management system ("IMS") increased approximately tenfold from 2013 to 2016 as a result of integration of the enterprise management system at MGE.

MGE Information Management System Costs

	(A)			(B)
	2011	2012	2013	2016
Plant Balance	$ 32,525,190	$ 33,483,259	$ 33,505,759	$ 67,787,723
Reserve Balance	$ 27,232,246	$ 26,535,431	$ 27,988,830	$ 12,274,769
NBV	$ 5,292,944	$ 6,947,828	$ 5,516,929	$ 55,512,954

(A) Source: Response to Discovery OPC 7132
(B) Source: Response to Discovery, OPC 8504

Q. In your direct testimony, what did you recommend for purposes of the costs related to New Blue?

A. As noted on page 44 of my direct testimony, costs of New Blue are currently not being allocated over the entire enterprise. These costs are, instead, being allocated exclusively to LAC and MGE. Furthermore, as discussed on page 45 of my direct testimony, Spire did not perform a requisite study to assess the proper allocation of these costs. Given that New Blue is an enterprise software system, I believed, and still believe, a reasonable presumption is that the entire Spire enterprise leverages the software's capabilities, which serves the entire corporate structure (i.e., the entire "enterprise"). As such, as discussed on

[1] Flaherty rebuttal, page 17, lines 2-3.

pages 44 through 46 of my direct testimony, I proposed an adjustment that allocates the rate base and depreciation expense of New Blue based on Spire's company-wide 3-factor formula.

Q. Does Spire agree with your proposed adjustment?

A. No. The primary Spire witnesses who addressed this issue, Mr. Hyman and Mr. Buck, argue that my proposed adjustment should not be adopted.

Q. Please summarize Mr. Hyman's and Mr. Buck's statements regarding New Blue.

A. On page 18 of his rebuttal testimony, Mr. Hyman states that New Blue should not be allocated to other Spire entities because, "Alagasco and EnergySouth still maintain their own information management systems and utilize them to support their operations in Alabama and Mississippi…." Mr. Hyman then notes these entities have a "remote connection" to Spire's Missouri utilities.

Mr. Buck states explicitly that my "claim that no study was undertaken related to [cost allocations for the New Blue system] is wrong."[2]

Q. Do you believe the Commission should be persuaded by Mr. Hyman's statements?

A. No. I find Mr. Hyman's explanations more puzzling than illuminating. Mr. Hyman's statements call into question why LAC and MGE ratepayers are individually paying for a system that is designed to serve an entire corporate enterprise. Furthermore, Mr. Hyman states that Alagasco and EnergySouth have a connection to the Missouri utilities, yet maintains that not a single dollar of New Blue costs should be allocated to these entities.

Q. Do you believe the Commission should be persuaded by Mr. Buck's statements?

A. No. On page 25 of Mr. Buck's rebuttal testimony, Mr. Buck states that "[Ms. Azad's] claim that no study was undertaken related to these cost allocations is wrong." In an apparent attempt to support his counterclaim that Spire performed such a study, Mr. Buck

[2] Buck rebuttal, p. 25, line 17.

provides a reference to "workpapers" provided in discovery which clearly do not contain a study such as the one described in Spire's CAM.[3,4] As such, instead of countering my assertion, Mr. Buck's statement further supports my original statement that no such study has been performed.

Q. Should the physical distance between Spire's subsidiaries be an issue in the allocation of New Blue?

A. No. For example, Alagasco's service territory is in the Birmingham, AL area, which is approximately 500 miles from Spire's headquarters in St. Louis. MGE primarily serves Kansas City, MO, which is approximately 250 miles from St. Louis. Both Alagasco and MGE serve remote locations relative to St. Louis, yet only MGE and LAC are allocated costs for New Blue.

Q. Should the fact that LAC purportedly does not use New Blue for its other utility operations be a factor in the Commission's decision on this adjustment?

A. No. The Commission should determine if LAC *should* allocate these enterprise-wide costs to all entities in the enterprise. The Commission should further determine if it is fair and reasonable for MGE and LAC ratepayers to be the sole recipients of these costs.

B. Shared Services Cost Trends

Q. In your direct testimony, what did you recommend for purposes of the costs related to shared services?

[3] I have included Spire's "workpapers" and related data request response as Attachment AA-S-1. I would urge the Commission to review this response and assess for itself whether or not a study, as described in Spire's cost allocation manual, was provided.

[4] Specifically, as noted in LAC/MGE's cost allocation manual: "All costs, including capital costs related to the operation of mainframe systems will be allocated based on a percentage of operating and production time dedicated to routine affiliate activities as compared to the total for each system. ***Such allocations shall be based on a study performed annually***." (emphasis added). Laclede 2016 CAM, p. 17.

A. As noted on pages 42 and 43 of my direct testimony, I recommended an adjustment for shared services costs, which is consistent with the trend observed by the company's witness for the preceding prior three years.

Q. What is the Spire witnesses' position with respect to the proposed shared services costs adjustment sponsored in your testimony?

A. Mr. Flaherty claims that the costs in 2017 are outside the test year and speculative. However, the Spire true-up period extends through September 30, 2017. To the extent Mr. Flaherty's observed shared services cost savings in prior years is a reflection of Spire's success in cost management and anticipated to continue, one would expect that such costs would continue to decline, or at a minimum, stay constant. Instead, as Mr. Flaherty states on page 42 of his rebuttal testimony, the company now claims that shared services costs are expected to *increase* in 2017.

If the Commission chooses to accept Mr. Flaherty's assertion—namely that LAC and MGE shared services costs are rising, not falling—this would also mean that these costs will continue to have an even more significant impact on LAC and MGE ratepayers. This is all the more reason the Commission should order a detailed investigation of Spire's affiliate transactions and shared services costs following the establishment of the SSC and its recent mergers.

Regarding benefits of the merger, Mr. Flaherty states that, "from LAC's (and MGE's) perspective, avoiding [prior owner joint and common] costs creates a **direct benefit to MGE customers in lower costs than would have been borne by MGE customers**. And as shown in my direct testimony, **total Spire** Shared Services costs have been significantly reduced from the acquisition, which benefits both LAC and MGE."[5] (emphasis added) However, if the Commission adopts Mr. Flaherty's testimony regarding the rising shared services costs, as the table below illustrates, any beneficial impact on shared services costs

[5] Flaherty rebuttal, page 16, lines 3-5.

from Spire's acquisitions appears short-lived and shared services costs are now increasing at an alarming rate.

Spire Shared Services Costs

	(A)				(B)
	2013	2014	2015	2016	2017
Total Shared Services Cost	$375	$344	$325	$322	$344
Change in Cost Year-on-Year (Reduced Cost)		(30)	(19)	(3)	$22

(A) Reproduction from Flaherty rebuttal testimony, page 41, Table 2
(B) Added based on Flaherty rebuttal testimony, page 42, line 2

In an apparent attempt to justify why my proposed trend adjustment should not be adopted, on page 42 of his rebuttal testimony, Mr. Flaherty states that Spire Shared Services costs are expected to increase in 2017 by approximately $22 million to $344 million, as shown in the table above. Later on the same page, however, when advocating that no focused audit is necessary, Mr. Flaherty states that, "there does not appear to be an adverse trend [in shared services costs] that needs to be investigated,"[6] with an external audit.

The table above illustrates that, despite continuing anticipated synergy savings, it appears that based on Mr. Flaherty's testimony, in 2017 the increase in shared services costs are anticipated to be enough to net to zero any reduction in shared services savings realized in the previous two years combined. This is further evidence of the need for a thorough investigation of Spire's SSC to determine why shared services costs are increasing drastically, even with the transactions, which should contribute to the reduction of shared services in the years following several mergers.

Mr. Flaherty's second issue with this adjustment is that it is based on a particular area of cost impacts. My review was intended to address the impact of shared services and cost allocations in particular. This is one of the areas impacting revenue requirement sought by the company. Mr. Flaherty's third issue with this adjustment is the expectation that the

[6] Flaherty, Rebuttal, page 42, lines 15-16.

observed historical trend noted in his testimony would continue into a succeeding year. I address this in conjunction with his first issue (earlier) and fourth issue, which is that the trend is based on the impact of synergies from transactions that Mr. Flaherty states "are not replicated in 2016."[7]

Q. Does Mr. Flaherty's assertion regarding prior merger synergies not being reproduceable appear reasonable?

A. No. According to Mr. Flaherty's testimony, Laclede and MGE's annual run-rate merger synergy savings, which represent $50 million of savings in total per year, and $37 million of O&M annually, "will continue into perpetuity and will escalate at a blended inflation rate…"[8] The following table is based on these figures and presented for illustrative purposes regarding the Laclede-MGE transaction, which has since been followed by the Alagasco and EnergySouth acquisitions, the savings from which are not reflected below. This is to put into context the company's presented merger savings relative to shared services costs trends noted in the preceding table (and recognizing the table below focuses on only one of several recent Spire acquisitions).

[7] Flaherty rebuttal, page 39, line18.
[8] Flaherty rebuttal, page 6, lines 11-15 and page 7, lines 3-6.

Realized Merger Synergies
Laclede-MGE
(in million $)

(A)			
FY 2014	FY 2015	FY 2016	Average annual synergies based on prior 3 years
$30	$39	$50	$40

(A)			
FY 2016	FY 2017	FY 2018 +	Average annual synergies based on prior 3 years
$50	$50	$50	$50

Figures are based on Flaherty rebuttal, Table 1, and figures in Flaherty rebuttal, pages 6-7 and represent nominal dollars, unadjusted for inflation.

Assuming an average annual synergy savings of $50 million, from just the Laclede and MGE merger, Spire should be able to at least maintain (rather than experience escalating) costs in its shared services in 2017. As I indicated, this Table only illustrates the potential results of the MGE transaction. The mergers with Alagasco (in 2014) and Energy South (in 2016), are not included in the table above. Both mergers followed the MGE acquisition, and are, thus, in the earlier years following the merger—year 3 for Alagasco, and year 1 for EnergySouth, presumably with still escalating annual synergies as they likely have not yet reached steady state.

For reference, Alagasco and EnergySouth have approximately 524,000 customers and 1,100 employees combined, compared to MGE's approximate 508,000 customers and 560 employees. Given the scale of potential savings to be achieved from the acquisition of Alagasco and EnergySouth, and the synergy savings from the MGE acquisition, the company has not demonstrated why it is unable to maintain the level of shared services cost savings "trend" it purports to have achieved from 2013 to 2016. That the trend does not continue is further evidence that the impact of the newly acquired companies on shared costs should be fully investigated in the recommended audit.

Q. Have you made any modifications to your trend adjustment in response to the information noted in Spire's testimonies?

A. I have. Mr. Flaherty's fifth issue regarding my proposed adjustment for shared services costs is my application of a declining real CAGR, which is adjusted for inflation, to a nominal cost base, that is, current dollars from 2016. I inadvertently used the real rather than nominal rate in my original calculation. I have accordingly modified the adjustment related to the trend in shared services costs, rather than real CAGR rate. The resulting adjustment is an estimated O&M reduction of $2,062,266 to Laclede Gas and $922,081 to MGE.

IV. INDEPENDENCE OF STRATEGY& AND OBJECTIVITY OF FLAHERTY TESTIMONY

Q. Have Mr. Flaherty's comments in his rebuttal testimony addressed the concerns you raised in your direct testimony regarding a lack of independence of Strategy& and objectivity in Mr. Flaherty's review?

A. No. The issues I raised in my direct testimony still stand. That is, Mr. Flaherty's analysis may provide some value, but should not be treated as an independent third-party assessment given Mr. Flaherty's significant involvement in designing and recommending the processes, the effectiveness of which he was engaged to testify. Mr. Flaherty's response in his rebuttal contains a number of misstatements, none of which change these facts. For one, he claims that I "incorrectly assume" he performed an audit at Spire[9] while I explicitly stated in my direct testimony that, "Mr. Flaherty was not performing a financial statement audit" and that nonetheless, "the PCAOB guidance is a useful tool to assess how an

[9] Flaherty rebuttal, page 30, line 22 to page 31, line 1.

established professional organization defines and evaluates independence."[10] Mr. Flaherty's other statements are equally ineffective as a response to my point. For example, he states that he has no obligation to Spire[11] and further states that because he is a consultant to, and not in management at Spire, he and Strategy& would "not be reviewing [their] own decisions."[12] In this engagement, however, he was reviewing the effectiveness of the implementation of Strategy&'s and Mr. Flaherty's own prior recommendations to Spire. The fact that Mr. Flaherty is unable to acknowledge that hiring the consultant who designed a system to evaluate the effectiveness of the system may create a relationship that is not fully independent, at least in appearance if not in fact, is evidence of his lack of objectivity.

Lastly, Mr. Flaherty maintains a position that because cost allocation practices have been in place for years and are generally based on a sound foundation, naturally no issues are likely to exist. It appears consistent with that approach that Mr. Flaherty would testify that Spire's "process is well-defined," "working as intended," and that it "delivers reasonable results"[13] without the need to even review the costs charged to the utilities.[14]

V. INSUFFICIENCY OF EVIDENCE TO SUPPORT CONFORMANCE WITH AFFILIATE TRANSACTIONS RULE

Q. In rebuttal testimony, did Spire's witnesses respond to the company's lack of evidence to support compliance with Missouri's Affiliate Transactions Rule ("the Rule")?

A. Yes. Mr. Flaherty response confirms that his analysis was not tailored to the specific interpretation and requirements of the Missouri affiliate transactions rule, nor was it performed at a level of detail sufficient to conclude the allocation of the shared services and affiliate transactions charges to LAC or MGE were appropriate. Mr. Flaherty stated

[10] Azad direct, footnote 29.
[11] Flaherty rebuttal, p. 31, line 6.
[12] Flaherty rebuttal, p. 31, lines 9-10.
[13] Flaherty rebuttal, p. 31, lines 4-5.
[14] Flaherty rebuttal, p. 31, lines 20-21, Mr. Flaherty states "we were not reviewing 'charges' from transactions.

in his rebuttal testimony, that he was "aware of this Rule," but "it had not been the basis for the specific analyses that [he] conducted in determining whether Spire costs were reasonable and consistent with this Rule"[15] despite the fact that he recognizes "the Rule is controlling with respect to this matter."[16] Furthermore, in his analysis, Mr. Flaherty admits he was "not reviewing 'charges' from transactions."[17] He also sites other authoritative guidance, but does not address the fact the Missouri Affiliate Transaction Rules contain specific guidelines for a utility's recording and reporting practices. Neither the utility or its consultants have discretion to deem deviations from the Rule as appropriate because, in the company's or its consultants' opinion, they "support the intent of the Rule." Nothing presented by Spire or its consultants demonstrates otherwise.

VI. NON-COMPLIANCE WITH COST ALLOCATION MANUAL

Q. On pages 39 and 40 of your testimony, you comment that Spire, in some cases, does not enforce the policies and procedures of its CAM. You then provide an example regarding the utilization of exception time reporting. Did any Spire witnesses respond to your assertion?

A. Yes. On pages 3 and 4 of his testimony, Mr. Krick states that the inconsistency I noted in my direct testimony is a "misunderstanding" on my part.

Q. Do you still believe your original assertion was accurate?

A. Yes. I believe the Commission should disregard Mr. Krick's statements because they are evasive and do not directly address the inconsistency that I noted. Instead, the Commission should simply note the obvious (and explicit) contradiction between Spire's CAM—representing the time reporting policies Spire is claiming it follows—and Spire's data request response—which, in this case, represents the time reporting policy Spire is actually following. As noted in my direct testimony, Spire's CAM explicitly states that, for certain

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[15] Flaherty rebuttal, p. 22, lines 10-12.
[16] Flaherty rebuttal, p. 23, line 14.
[17] Flaherty rebuttal, p. 31, lines 20-21.

departments, "direct labor shall be charged to the service under an exception time reporting methodology…"[18] while in response to discovery, Spire explicitly stated that "exception time reporting isn't used."[19]

Q. Are there additional examples of Spire not following the policies and procedures noted in its CAM?

A. Yes. Mr. Buck's rebuttal testimony regarding New Blue provides an additional example of LAC/MGE not following the policies and procedures noted in its CAM. Specifically, Mr. Buck states that, "CC&B costs were allocated based on the number of customers at each utility whereas Powerplant costs were allocated based on fixed assets." Neither number of customers nor fixed assets are listed as possible allocation bases to allocate costs of information systems in Spire's CAM.[20]

VII. INCONSISTENCY IN COST ALLOCATION INFORMATION PROVIDED BY SPIRE

Q. Have Spire's rebuttal responses resolved the problems with the inconsistency of responses the company has provided with respect to its cost allocations information?

A. No. In fact, these issues are illustrated further in the rebuttal testimonies of Mr. Krick and Mr. Flaherty, who, state that, "Laclede Investment LLC – this entity did receive allocations"[21] and "Ms. Azad … incorrectly indicates that Laclede Investment LLC does not receive any allocations from Spire Shared Services."[22] Spire's response to discovery clearly responds to the contrary. Specifically, in OPC DR 1021.5.1, which requested each

[18] Laclede 2016 CAM, p. 13 and 14.
[19] Response to discovery, OPC Data Request 7126.
[20] Specifically, "Information Systems" allocation bases listed on Laclede's 2016 CAM at p. 17 include: percentage of operating and production time dedicated to routine affiliate activities as compared to the total for each system. Such allocations shall be based on a study performed annually; number of personal computers assigned on a departmental basis; and proportion of direct labor reported by each department for an affiliate.
[21] Krick rebuttal, page 5, line 5.
[22] Flaherty rebuttal, page 34, lines 11-12.

operating company or affiliate that did not receive SSC allocations or charges in the test year, and in OPC DR 1021.5.2, requesting each operating company or affiliate not receiving SSC allocations or charges, Spire lists Laclede Investment LLC in response to both.[23]

Q. Have Spire's witnesses provided a rationale for the inconsistent manner in which Spire has presented its allocation factor data?

A. Mr. Flaherty first makes the false statement that he has: "tried to obtain workpapers or information" from me and that "he has not received any response," claiming that he will thus "reserve the right" to "circle back to this in surrebuttal."[24] He then asserts that I am using "too literal" and "overly specific" definition for allocation factors. Next, he states that the change in the SSC formation resulted in changes in use of allocations—a point I had already identified as one stemming from changes in Spire's business and leading to changes in cost assignments. This change creates a greater need for a detailed review of the before and after cost allocations through an external independent audit. Finally, Mr. Flaherty does admit a "sporadic use" of some of the allocation factors during the test year.[25]

Q. First, please address Mr. Flaherty's statements regarding his attempt to obtain workpapers and information from you.

A. My workpapers were attached to my direct testimony.

Q. Has Mr. Flaherty presented discovery requests to you regarding your assertions?

A. No.

Q. Has Mr. Flaherty contacted you to discuss questions regarding your assertions?

A. No.

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[23] Attachment AA-S-2 for reference.
[24] Flaherty rebuttal, p. 46, line 1.
[25] Flaherty rebuttal, p. 47, line 3.

Q. As of the time of filing his testimony, did you have correspondence with Mr. Flaherty, Strategy&, or Spire?

A. Yes. At the request of Spire, I spoke with Jon Clabault of Strategy& to walk through questions Spire or Strategy& had about my testimony. At the conclusion of the call Mr. Clabault indicated he understood my calculations and that he believed he had the information necessary to replicate the results I included in my direct testimony. The conversation spanned less than 15 minutes and there were no questions on "obtaining" my workpapers, which had been filed with my direct testimony. This teleconference took place on October 4th—approximately two weeks prior to Mr. Flaherty filing his testimony. Mr. Flaherty did not attend the discussion and was not included on Spires's correspondence with OPC and AzP. To the extent Jon Clabault was addressing Mr. Flaherty's questions, it appears there was a lack of internal communication at Strategy&.

Q. Please address Mr. Flaherty's concern with your definition of allocation factor.

A. Mr. Flaherty suggests that because Spire utilizes, for instance, a three-factor formula for allocations to corporate, to the gas utilities, the MO gas utilities, and MO companies, it is appropriate that these factors be collectively considered "three-factor formula" allocators, generally.

Q. What do you believe is the issue with this broader definition of allocation factors?

A. From an accounting perspective, the examples above are used in differing contexts for allocating different types of costs, and can yield widely different results. For example, according to Spire's response to discovery in 2016, the various three-factor formulas—"corporate-wide," "gas utilities only," "MO gas utilities only," and "MO only total"—varied in the percentage charged to LAC from 45.2 percent to 63.2 percent, and in the percent charged to MGE from 23.5 percent to 32.6 percent. These represent ranges of 18 percent and 9.1 percent, respectively.[26] Thus, when reviewing the appropriateness of the

[26] PPT slide in DR 142, slide 19, "Allocations Factors Summary (pre-EnergySouth)", which appears to be the information relied upon by Mr. Flaherty in his direct testimony, p. 34 of 279 in workpapers.

allocations and the impact on utility rates, it is necessary to go beyond Mr. Flaherty's overly-broad definition and assess the reasonableness of the actual percentage—the literal and specific definition—the percentage of costs charged to the utility.

Q. Has Mr. Flaherty responded to your observation that several of the changes that are known and should have been measurable to the company are not adjusted for by Spire or in Mr. Flaherty's direct testimony?

A. Yes. Mr. Flaherty responded regarding the impact of Spire's acquisition of EnergySouth and formation of its new entities. Regarding Spire Resources LLC, Spire Midstream LLC, and Spire STL Pipeline, Mr. Flaherty stated that he did not consider them in his analysis due to their limited impact on 2016 allocations because the first two hold no assets, revenues, or resources, and Spire only started including Pipeline in allocations in FY2017.[27] He states that he excluded EnergySouth because, in 2016 Sempra was still providing Spire transition services, and it "could not provide the required level of detail back to 2013."[28]

Q. Does Mr. Flaherty's response appear reasonable?

A. Mr. Flaherty's explanation regarding the limited effect of the holding companies (Spire Resources and Spire Midstream) on allocations is flawed. In his argument, Mr. Flaherty assumes that the corporate 3-factor formula is an appropriate allocator and thus given the level of assets, revenues, and employees at these entities, it would reasonably follow that they not receive allocations. It is not appropriate to allocate costs on the basis of the Massachusetts / 3-factor formula in this instance. Allocations to non-utility affiliates, which by design often do not hold the same large capital assets, employees, and revenues as utilities do, is not an appropriate means of assigning charges based on cost causation. Certain common and corporate costs such as compliance with SEC filing requirements, or

[27] Flaherty rebuttal, p. 48; however, on page 36 of his testimony, in Figure 2, Mr. Flaherty states this inclusion takes place in FY 2018.
[28] Flaherty rebuttal, p. 49, lines 3-4.

residual corporate overhead costs, such as executive benefits and compensation not directly assignable to a specific entity, should still be allocated to all the entities benefiting from these costs. Thus, the Massachusetts or 3-factor formula Mr. Flaherty uses as the basis for his argument is not appropriate for allocations under these conditions and would lead to the utilities to naturally receive a disproportionately larger—or all—charges, some of which should be charged to all affiliates, including Spire Resources LLC and Spire Midstream LLC. Mr. Flaherty's argument for why these entities did not receive allocations, demonstrates Spire's inappropriate use of an allocator (the Massachusetts or three-factor formula) rather than a legitimate reason to exclude these entities from the pool of companies receiving allocations.

Regarding the impact of EnergySouth and Spire STL Pipeline on allocations, I believe these impacts should be known and measurable at this point, and incorporated into or adjusted for in the revenue requirements of LAC and MGE. It does not appear that Spire and its consultants have made a reasonable effort to quantify and account for the impact of their integration on overall shared services costs and the resulting allocations to LAC and MGE for the rate effective period.

Q. Can you provide any precedent or guidance in support of your discussion on allocations to holding companies?

A. The Commission's March 8, 2017 Order in File No. ER-2016-0285 is a recent illustration of this point. In that Order, the Commission approved KCPL's CAM, adopting a general allocator for assigning residual common costs, such as those I discussed earlier. In this Commission-approved CAM, the Massachusetts formula is reserved for the regulated operations of KCPL. For activities involving non-regulated operations, a general allocator based on "an entity's relative ratio of direct and assigned expenses to total direct and assigned expenses incurred" is used.[29]

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[29] Exhibit B, Page 13 of 113, KCPL CAM ER-2016-0285 Stipulation and Agreement dated February 10, 2017, approved by the Commission on March 8, 2017.

VIII. EXTERNAL AUDIT OF SSC COST ALLOCATION

Q. On pages 5 through 7 of your direct testimony, you recommend that the Commission order an independent audit to "assess the adequacy of Spire's processes and internal controls related to Spire shared services and to make recommendations for an updated and revised CAM for LAC and MGE." Do any other OPC witnesses address the need for such a review?

A. Yes. Mr. Chuck Hyneman also addresses in his surrebuttal testimony the importance and urgency of conducting an independent third-party audit of affiliate transactions and shared services costs. In addition to the reasons detailed in my direct and surrebuttal testimonies, Mr. Hyneman discusses the recent affiliate transactions between Laclede Insurance Risk Services (LIRS) and Spire's Missouri utilities, and Spire's inconsistent presentation of the nature of these transactions in this rate case, which conflicts with the information provided by the company it its Annual Report. Mr. Hyneman also discusses concerns over Spire's lack of transparency and compliance with the affiliate transactions rule since 1993, which has been consistent with the company's current position based on my review of its affiliate transactions practices and deficiencies in record keeping and compliance with the Rule as evidenced in Spire's responses to discovery in the current proceeding.

Q. Mr. Hyneman urges the Commission to rule on this issue in the current case. Do you agree with his recommendation?

A. Yes. I believe Mr. Hyneman's sense of urgency is warranted and I support his position on this issue. In addition, to mitigate any further potential detriments to ratepayers, I highly recommend that the Commission require that Spire fully address and rectify any affiliate transaction and shared services costs issues identified through the recommended audit before filing LAC or MGE's next application for a rate increase.

Q. Do Spire or its witnesses contest the assertion that the Commission has the authority to order this audit?

A. No. In fact, Mr. Flaherty explicitly states that "***the Commission has the prerogative and authority to order and undertake any investigation it considers necessary*** based on its observation of the facts and conditions…"[30] [emphasis added]

Q. Does Mr. Flaherty believe a cost allocation audit is necessary?

A. No. Mr. Flaherty states in his testimony that he does not believe a cost allocation audit is "justified."[31] Mr. Flaherty also states that he believes utilities "have been allocating service company or shared services costs under stringent guidelines" and that this results in a "reduce[d]…potential for inappropriate charges requiring adjustment."[32]

Q. Do you believe the Commission should consider cost allocations and affiliate transactions as having a reduced "potential for inappropriate charges requiring adjustment" as suggested by Mr. Flaherty?

A. No. Since 2005 with the repeal of the original PUHCA, utility holding companies have become increasingly complex. At the risk of stating the obvious, if a utility holding company acquires another company, all else equal, the company becomes more complex, as do its cost allocations and affiliate transactions. When a utility holding company acquires several new subsidiaries in multiple jurisdictions in rapid succession, as Spire has done over the past five years, the additional complexities are amplified, making a thorough review of these affiliate relationships by the Commission even more vital.

Q. Are you familiar with any past cases at the Commission that supports your recommendation that cost allocations and affiliate transactions be viewed by the Commission as a high-risk area?

A. Yes. In a 2013 opinion, the Missouri Supreme Court found that there is an "inherent risk of self-dealing" in affiliate transactions. In its opinion, the Missouri Supreme Court also expressly stated that a "presumption of prudence," similar to the approach Mr. Flaherty

[30] Flaherty rebuttal, page 42, lines 9-10.
[31] Flaherty rebuttal, page 42.
[32] Flaherty rebuttal, page 33.

appears to be recommending, is inappropriate for purposes of reviewing affiliate transactions.[33]

Q. On page 2 of his rebuttal testimony, Mr. Krick states that he does not believe a cost allocations audit is necessary, and also states that "a rate case proceeding does allow the time needed to review the cost allocation procedures…" but it is dependent on "scope, objective, and purpose of the review." Do you know of any other state commissions that review utility cost allocation and affiliate transaction issues outside of rate case proceedings?

A. Yes. Several states perform affiliate transactions audits outside of rate cases. While I did not conduct a comprehensive review of all states, I am aware of several commissions that perform these reviews. California, for example, regularly conducts affiliate transactions audits. Similar to my recommendation from my direct testimony, California utilizes an independent auditing firm to perform these audits.[34] Other states, such as New Jersey and New York, perform affiliate transaction reviews in the course of comprehensive management audits.[35,36]

Q. On page 2 of his rebuttal testimony, Mr. Krick indicates that he is unclear regarding the "scope, objective, and purpose" of your recommended audit.

Can you please provide Mr. Krick and the Commission with additional guidance regarding what you believe an appropriate scope, objective, and purpose would be for your proposed audit?

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[33] Order No. SC92964; Attachment AA-S-3 for a full copy of the Opinion.
[34] Copies of the audit reports from the most recent audits performed are available at: http://www.cpuc.ca.gov/General.aspx?id=1459
[35] For sample audit report from New Jersey, see: http://www.state.nj.us/bpu/pdf/auditpdfs/NorthStar%20NJNG%20Audit%20Final%20Report%206-26-14%20double%20sided.pdf
[36] For sample audit report from New York, see: http://documents.dps.ny.gov/public/MatterManagement/CaseMaster.aspx?MatterCaseNo=14-M-0001&submit=Search

A. Yes. The proposed audit would seek to provide the Commission with an independent, third party auditor's assessment of Spire's compliance with each of the rules laid out in the Affiliate Transactions Rule. For illustration purposes, I have provided a template for the chosen auditor to utilize when performing the audit. This is provided as Attachment AA-S-4. In addition to this compliance checklist, I would also urge the Commission to include as part of the auditor's scope, cost allocation considerations concerning the New Blue system (discussed in additional detail in the *New Blue Allocation* section of this testimony).

Q. Would you like to make any additional statements regarding the proposed audit?

A. Yes. As noted on pages 46 through 48 of my direct testimony, one of the reasons I believe it is necessary and prudent for the Commission to order a cost allocations audit is because of the lack of responsiveness Spire demonstrated throughout the engagement with regard to discovery. As I noted in my testimony, over 80% of data requests were received after the 20-calendar day timeframe established in the procedural schedule for this case.

Q. Did any Spire witnesses respond to your concerns regarding the company's discovery issues during this proceeding?

A. Yes. On pages 1 and 2 of his rebuttal testimony, Mr. Krick includes the following question and answer:

> Q. Were there significant delays and inadequacies in your direct responses (sic) to discovery requests?
>
> A. ***While some of the requests were delayed within the allowed extension period***, I attempted to answer each request by the deadline and provided the level of detail available to satisfy the request. ***I was unaware*** until reading her testimony that Ms. Azad felt there were significant inadequacies in our responses. It seemed to me the level of detail we provided, particularly given the volume of requests we received from her, was more than adequate. (emphasis added)

Mr. Krick's claim that the requests "were delayed within the allowed extension period" is inaccurate, if not disingenuous. Many of Spire's responses exceeded even the extended response period that Spire itself proposed. See Attachment AA-S-5 for email correspondence between OPC and Spire related to this issue. Furthermore, Mr. Krick's claim that he was "unaware" of the discovery deficiencies until reading my testimony is specious. Mr. Krick either knew, or, clearly should have known, about OPC's concerns because OPC had multiple phone and email correspondence regarding these deficiencies with Spire's primary discovery contact, Mr. Buck. See Attachment AA-S-6 for an example of this correspondence.

IX. LAC AND MGE SEPARATION

Q. On page 28 of your direct testimony, you note that Mr. Flaherty, with a few exceptions, analyzed information for LAC and MGE on a combined basis. As such, you note that Mr. Flaherty generally failed to identify and assess the costs to each utility separately. How does Mr. Flaherty respond?

A. Mr. Flaherty agrees on page 43 of his testimony that, "it is the case that the two utilities have non-contiguous service territories and distinct customer bases" but he continues by asserting that "this is not a relevant factor" and that "[f]urther delineation of the utility into LAC and MGE would be of limited to no value in evaluating Spire's ***overall*** ability to control shared services costs." [emphasis added]

Mr. Flaherty's focus on evaluating Spire on an "overall" basis is misguided. As noted in my direct testimony, LAC and MGE have separate customer bases, separate revenue requirements, and, subsequently, pay different rates and follow different tariff schedules. As such, the most proper way to review these two entities' costs is on an individual basis. If the Commission adopts Mr. Flaherty's method of analyzing the costs of two utilities on a combined basis, it will add an unnecessary layer of complexity and decrease transparency. As an illustrative example, consider an individual LAC ratepayer. The LAC ratepayer pays rates based on LAC's individual revenue requirement. As such, the LAC ratepayer has a right to expect that the costs he or she is paying to have been reviewed on an individual basis—not through a review of some hypothetical hybrid entity.

Q. Has Mr. Flaherty provided any precedent as to why the two utilities should not be assessed independently?

A. No.

Q. Does this conclude your surrebuttal testimony?

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 Service	)))	Case No. GR-2017-0215
In the Matter of Laclede Gas Company d/b/a Missouri Gas Energy's Request to Increase Its Revenues for Gas Service	)))	Case No. GR-2017-0216

AFFIDAVIT OF ARA AZAD

STATE OF KANSAS)
) ss
COUNTY OF JOHNSON)

Ara Azad, of lawful age and being first duly sworn, deposes and states:

1. My name is Ara Azad. I am Managing Partner at AzP Consulting, LLC.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached affidavit are true and correct to the best of my knowledge and belief.

Ara Azad

Ara Azad

Subscribed and sworn to me this 21st day of November 2017.

JOY WELSH
Notary Public - State of Kansas
My Appointment Expires 8-10-2020

Joy Welsh

Notary Public