

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

**In the Matter of Spire Missouri, Inc.'s
Request to Increase its Revenues for
Gas Service**

Case No. GR-2017-0215 et al.

**REPLY BRIEF OF
MISSOURI INDUSTRIAL ENERGY CONSUMERS**

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Comes now, the Missouri Industrial Energy Consumers (MIEC) and for its reply brief states as follows:

A. INTRODUCTION

This Brief will address the same issues addressed in the MIEC initial brief (listed in the order addressed herein and as identified in the Motion to Delay the Start of Proceedings, and Amended List of Issues, Order of Witnesses, Order of Cross-Examination and Order of Opening Statements):

B. Cost of Capital (Issue III.a.)

1. Return on Equity (Issue III.a.i.)

2. Capital Structure (Issue III.a.ii.)

C. Revenue Stabilization Mechanism (Issue IV.a.i.)

D. Surveillance (Issue III.i.i.)

E. Trackers (Issue III.h.i.)

This brief will respond to arguments made in the initial brief of Spire Missouri, Inc. The fact that it does not address the arguments made by other parties does not necessarily mean that the MIEC agrees with those arguments.

B. COST OF CAPITAL

1. Return on Equity

As the MIEC explained in its initial brief, the 10.35 percent return on equity proposed by Spire is inconsistent with this Commission's recent history, inconsistent with the testimony of the other cost of capital witnesses, and inconsistent with current company and market data. In its initial brief at page 20, Spire calls its expert's opinion supporting a 10.35 percent "prominent." The dictionary defines prominent as "protuberant," "immediately noticeable" and "conspicuous."¹ It is all that! Spire's proposed 10.35 percent return on equity is a conspicuous outlier in this case. Nothing in Spire's initial brief serves to resuscitate Spire's fatally flawed case for a 10.35 percent return on equity.

At page 24 of its initial brief, Spire explains that Spire witness Pauline Ahern gave the results of her DCF analysis only very limited weight because of high market to book ratios. MIEC/OPC witness Michael Gorman explained that that Ms. Ahern's arguments concerning market to book ratios are misplaced. A market-based DCF study like those performed by all witnesses in this case estimates the incremental or marginal cost of equity to a utility investor. On an incremental or marginal basis, a utility can be faced with the decision of investing in its stock or investing in utility plant investment. Hence, "on the margin," Mr. Gorman observed that the market-to-book ratio is always one, and setting a utility's authorized return on equity consistent with the market cost of equity has supported market-to-book ratios greater than one for an extended period of time.²

In its initial brief at page 28, in footnote 2, Spire provides a laundry list of what it asserts are flaws in Mr. Gorman's cost of equity analysis, but little or discussion of those alleged flaws. Mr. Gorman thoroughly rebutted all of these arguments in his surrebuttal testimony (Exhibit 416),

¹ American Heritage Dictionary, Second College Edition, 1985.

² Exhibit 416, Gorman Surrebuttal, pages 7-9.

so this brief will address just a few of the most overstated claims. First, Spire asserts that Mr. Gorman's use of the 1986-2017 time period in his Equity Risk Premium analysis is inappropriate because it is too short. In making this criticism, Spire witness Ahern fails to recognize that there are two types of equity risk premium studies: those based on actual realized historical investment returns; and expectational equity risk premium studies, which is the type that Mr. Gorman performed. While Ms. Ahern's criticism may have had some validity had Mr. Gorman done a risk premium study based on actual realized historical investment returns, it has no validity as applied to his expectational equity risk premium study.

Spire also claims, in that same footnote, that Mr. Gorman ignores the equity risk premium's strong negative correlation to the level of interest rates. In point of fact, Mr. Gorman did not ignore that correlation, and discussed it at length in his Surrebuttal Testimony.³ Mr. Gorman explained why it is inappropriate to make a specific adjustment based on this correlation:

While a change in interest rates is a factor that can help describe an appropriate equity risk premium, interest rate changes are not the only risk factor that can affect the relative risk differentials between equity and debt securities. Therefore, Ms. Ahern's proposal to measure an equity risk premium based on only changes in nominal interest rates is not accurate and does not produce a useful or accurate estimate of a fair return for Laclede/MGE.⁴

In the same footnote, Spire makes inaccurate characterizations of MIEC/OPC witness Gorman's DCF studies. Specifically, Mr. Gorman's DCF studies are purely based on stock yields based on observable stock prices and current dividend payments expected over the 12 months subsequent to the observable price.⁵ In addition, Mr. Gorman's DCF model reflects consensus analysts' growth rate projections. All of this information is based on investors' demands to invest in a utility stock, which is precisely what drives that utility's cost of equity capital. Mr. Gorman did not apply any market-to-book ratio adjustments to the results of his DCF model. As such,

³ *Ibid.*, pages 11-12.

⁴ *Ibid.*, page 11.

⁵ Exhibit 407, Gorman Direct, pages 23-24.

Spire's arguments are misplaced, and the Commission can and should rely on MIEC/OPC witness Gorman's testimony concerning Spire's cost of equity.

2. Capital Structure

At page 35 of its initial brief, Spire argues that its capital structure at September 30, 2017 is reasonable to use for ratemaking purposes in this case. The first reason it cites is that this capital structure is "based on the actual capital structure that finances the assets and operations of the public utility that is the subject of this rate proceeding." Spire's arguments concerning support for its proposed capital structure are not accurate. Spire's actual capital structure at September 30, 2017 includes a significant amount of common equity that supports a goodwill asset on Spire's balance sheet. This goodwill asset is not an asset that is included in its rate base and is not an asset on which it relies to provide service to its customers. MIEC/OPC witness Gorman explained that a goodwill asset can **only** be supported by common equity, because it is a paper asset with no economic value and produces no cash flows.

Therefore, in order to rely on Spire Missouri's actual September 30, 2017 capital structure, and identify what amount of that capital structure is used to support its utility rate base investments, the amount of common equity supporting the goodwill asset as recorded on Spire's balance sheet at September 30, 2017 **must** be removed from the ratemaking capital structure. Removing the common equity supporting the goodwill asset will produce a ratemaking capital structure that does actually reflect Spire Missouri's capital cost incurred to support its investments in utility rate base assets.⁶

It is critical that the Commission understands that if the common equity supporting the goodwill asset is not removed from the ratemaking capital structure, then Spire's rates to retail customers will increase to support costs associated with the goodwill asset created when Laclede

⁶ Exhibit 414, Gorman Rebuttal, pages 5-8.

Gas bought MGE. This is a direct violation of the agreement that Laclede and MGE entered into with other parties to gain this Commission's approval for Laclede to acquire MGE. Spire committed to not increasing rates to retail customers to recover "directly or indirectly" the costs associated with the goodwill premium embedded in this transaction. In order to meet this obligation, the common equity supporting the goodwill asset created in Laclede's acquisition of MGE must be removed from the capital structure used to set rates for Spire Missouri.⁷ (Transcript cite)

For these reasons, the Commission must remove the \$210 million of common equity capital from Spire's common equity balance to establish a ratemaking capital structure that reflects the ratio of debt and equity actually used to fund investments in the utility rate base assets that provide service to Missouri retail customers.⁸

C. REVENUE STABILIZATION MECHANISM

For the reasons discussed in the MIEC initial brief (as well as those of Staff and OPC), the Revenue Stabilization Mechanism (RSM) should be rejected. So should the late-breaking Weather Normalization Adjustment Rider (WNAR). The WNAR is not a complete coherent proposal that has been vetted through the rounds of testimony in the normal fashion, but rather a desperate attempt by Spire to salvage something because it recognizes the flaws in its RSM proposal.

At page 79 of its initial brief, Spire admits that the WNAR was submitted on the last day of the regular evidentiary hearing. As if that was not bad enough, Spire is not simply asking the Commission to adopt that proposal, but rather to make modifications to it based on an affidavit

⁷ Transcript, page 1393.

⁸ *Ibid.*, at page 5 and Schedule MPG-R-2.

that did not find its way into the record until the true-up hearing on January 3, 2018. There was no significant change in the law, nor even a significant change of facts. Spire simply wants to keep churning in the hopes that it can get any sort of an adjustment mechanism, no matter how quickly it was put together and no matter how late in the proceeding it appeared. This is just not a process that leads to thoughtful and appropriate regulatory policy. The Commission should reject both the RSM and the WNAR.

D. SURVEILLANCE

The question presented here is simple: has Spire made a compelling case for keeping its financial information secret from its customer representatives? The MIEC submits that it has not. Spire offers three vague reasons⁹ why the MIEC should have access to the surveillance data that it has already agreed to provide to Staff and OPC. First, it claims that it does not sufficiently understand the interests that the MIEC represents. Second, it raises vague concerns about confidentiality protections. Third, it argues that the MIEC will be confused because the “surveillance reports are unadjusted.”

First, Spire asserts that it should not be required to provide surveillance data to an entity like the MIEC because it claims to not understand who the MIEC represents. This is a red herring. The Commission has repeatedly recognized the interests of the MIEC in matters involving Spire, including when it recently granted the MIEC intervention in this case. The MIEC has been involved in all significant matters involving Laclede Gas Company, and most involving Missouri Gas Energy, literally for decades. As the Commission has recognized, the MIEC represents the interests of industrial customers in utility matters. Spire offers no logical argument about why that interest must be ramped up only when Spire chooses to file a rate case, and turned off at all other

⁹ Spire Initial Brief, pages 69-70.

times. For the same reasons that it makes sense for Staff and OPC to have ongoing, updated information on Spire's financial picture, it makes sense for the MIEC to have that information. Spire asserts that in between rate cases, industrial customers are not at risk for rate increases. While that is true, it obscures a very important point. In the current environment, Spire enjoys the ISRS and continues to capitalize on cost savings opportunities from the MGE acquisition. These are two of the big drivers that have caused Spire to be over-earning in this case, and caused the over-earnings that led OPC to file an earnings complaint against Laclede in April of 2016. These drivers are still influencing Spire's earnings today, and very likely will in the period following this rate case. Without the surveillance data at issue, the MIEC will be severely handicapped in its ability to understand whether and to what extent Spire's rates need to be decreased.

Spire's second reason for opposing MIEC's request to get the surveillance data that will be provided to Staff and Public Counsel has to do with the confidential nature of some of the data. The confidential information at issue is the very same type of information that Spire willingly provides to MIEC in rate cases. Spire was unable to offer any explanation about why the confidentiality of the information could not be protected just as well when there is not a rate case pending as when there is. Indeed, Spire witness Buck conceded that conceded that "it certainly could be."¹⁰

Spire's final reason for not granting the MIEC access to the surveillance data is both laughable and a bit offensive. Spire claims that because the data to be provided in the surveillance reports will be unadjusted, the MIEC may become "confused" and that such confusion "could lead to a costly and unnecessary investigation or complaint case." The lawyers and experts who represent the MIEC have expertise similar to the lawyers and experts at the Staff and OPC (and generally speaking, longer experience than their counterparts at the state agencies), but Spire seems to have no

¹⁰ Transcript, page 1565.

concern that the Staff and OPC lawyers and experts might become “confused” by unadjusted financial data. It is ridiculous and somewhat offensive for Spire to suggest without any factual basis that the lawyers and experts who represent the MIEC are so much less competent than their counterparts at Staff and OPC that the Commission should ensure that surveillance data is never allowed in their hands.

None of the arguments that Spire raises in its brief are in the least convincing, and the Commission should decide this issue in favor of the MIEC. The Commission can ensure confidentiality by issuing a protective order pursuant to 4 CSR 240-2.135(3) that covers the information to be provided in the surveillance reports.

E. TRACKERS

In its initial brief, the MIEC pointed out that the Commission recognizes that trackers “violate the matching principle, tend to unreasonably skew ratemaking results, and dull the incentives a utility has to operate efficiently and productively...”¹¹ It also pointed out that Spire failed to provide adequate evidentiary support for the need for a tracker for environmental costs. In its initial brief, Spire relies on two sentences from the Surrebuttal Testimony of Eric Lobser as the entire evidentiary support for the need for a tracker. In its entirety, that testimony states:

[T]he Company expects that its environmental liabilities over the next several years **could be** significant, especially in terms of the remediation costs incurred to address the former manufactured gas plants of MGE and LAC. Presently, we anticipate that environmental costs **may be** incurred beginning next year, with the potential for significantly greater costs after that.¹²

That’s it. That is the entirety of the facts on which Spire relies in asking the Commission to implement a mechanism that “violate[s] the matching principle, tend[s] to unreasonably skew

¹¹ ER-2014-0370, *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service*, Report and Order issued September 22, 2015, pages 50-51.

¹² Exhibit 8, Lobser Surrebuttal, page 22; emphasis added.

ratemaking results, and dull[s] the incentives a utility has to operate efficiently and productively....”¹³

Spire also suggests at page 69 of its initial brief that it would be inconvenient to wait for its next rate case in three or four years to implement this tracker. In making this assertion, Spire necessarily admits that it does not expect the environmental costs to have a significant enough impact to require the filing of a rate case. A tracker is simply not appropriate when the requesting utility has done so little to justify it, and has admitted that the costs it seeks to track will not be significant enough to drive a rate case filing.

F. CONCLUSION

For the reasons set forth herein, the Commission should:

- 1) Authorize a return on equity of 9.2 percent;
- 2) Set rates based on a capital structure of 47.2 percent equity and 52.8 percent long term debt;
- 3) Deny Spire’s requests to implement a Revenue Stabilization Mechanism or a Weather Normalization Adjustment Mechanism;
- 4) Order Spire to provide to the MIEC, and other intervenors in this case that request it, the surveillance reports that it has agreed to provide to Staff and OPC subject to the same confidentiality provisions that apply to surveillance reports provided under the Fuel Adjustment Clause regulations; and
- 5) Deny Spire’s request to establish a tracker for environmental compliance costs.

Respectfully submitted,

¹³ ER-2014-0370, *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service*, Report and Order issued September 22, 2015, pages 50-51.

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 17th day of January, 2018, to all counsel of record.

/s/ Lewis Mills

