BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of Spire Missouri Inc.'s d/b/a Spire Request for Authority to Implement a General Rate Increase for Natural Gas Service Provided in the Company's Missouri Service Areas	))))))	Case No. GR-2021-0108

REPLY BRIEF OF THE MISSOURI OFFICE OF THE PUBLIC COUNSEL

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Table of Contents

Table of Contents 2
Introduction 5
Issue 1: Cost of Capital 7
  Response to Return on Equity 7
    Response to Spire's Argument regarding the OPC's Recommendation 8
    Response to argument regarding "Current Inflation" 14
    Response to Business Risk Adjustment 15
    Response to Floatation Costs 16
    Response to the discussion of ROE authorized by other Commissions 20
    General Response to Spire's Capital Structure Argument 22
  Response to Capital Structure 23
    First Factor 24
    Second Factor 25
    Third Factor 26
    Fourth Factor 30
    Summary of the Four Factors 32
    Response to Other Claims 33
    Conclusion 37
  Response to Short-term Debt 38
  Alternative Cost of Capital Discussion 43
    Capital Structure 44
    ROE 46
Issue 8: Cash Working Capital 48
  "Income Tax Component of Cash Working Capital" and "Current Income Tax Expense" are Separate and Distinct Items 48
  Response to Spire 53
  Response to Staff 61
  Conclusion 68

Issue 13: Incentive Compensation 70
Customer Benefit Does not Justify Double Recovery 70
Conclusion 73
Issue 15: Capitalization of Overheads 75
Response to Spire 75
Regarding what is “Arbitrary” 75
Impact on Revenue Requirement 80
Documentation 82
Remedies 83
Issue 16: Net Operating Loss Carryforward Application 85
Response to Spire 85
Understanding the Critical Issue 85
Considering Private Letter Rulings 89
Regarding Normalization Violations 95
Response to Staff 97
Issue 19: Affiliate Transactions 101
The OPC’s argument 101
Response to Staff 102
Response to Spire 121
General Response to Spire’s Executive Summary along with the First and Second Argument Sections 121
Response to “Customer Benefits” 132
Response to “Costs Borne by Spire Inc.” 133
Response to “OPC Adjustment” 141
Issues not raised in Spire’s brief 145
Conclusion 147
Issue 24: Depreciation 149
Response to Staff 149
Response to Spire 150
Choice of Rates 150
General Plant Accounting 151
Cast Iron Mains 154

Enterprise Software ... 155
Ultrasonic Meters ... 156
Conclusion ... 157
Issue 26: Ultrasonic Meters ... 158
Response to Spire ... 158
Spire's claims regarding safety, accuracy, and reliability of ultrasonic meters are overblown and immaterial ... 158
Considering the Many Internal Contradictions in Spire's Case ... 159
Ultrasonic Meter Costs are not "Negligible" ... 168
Conclusion ... 171
Response to Staff ... 172
Issue 30: Weather Normalization Adjustment Rider ... 174
Legal Analysis: the Meaning of Conservation ... 174
RNA Block Breaks ... 178
Problems with the WNAR ... 179
Brief Discussion Regarding Monetary Impact of Adjustments ... 183
Conclusion ... 185

PUBLIC

Introduction

Nothing in the initial briefs filed by either the Staff of the Commission ("Staff") or Spire Missouri ("Spire" or "the Company") have demonstrated any error in the OPC's positions, as they were laid out in its own initial brief. At the same time, this reply brief will demonstrate the abundance of errors, misstatements of fact, and misapplication of legal principles relied upon by both Spire and Staff in support of their respective positions. Before moving on to the discussion of those points, however, the OPC wishes to take one moment to remind the Commission of a legal principle that the Commission will see referenced time and again in this reply brief. The Commission cannot forget that it is **Spire** who bears the burden of proving that its proposed rates are just and reasonable. RSMo. § 393.150.2 ("At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the gas corporation"). This legal detail is paramount to the present case because Spire has entirely failed to meet that burden on multiple issues. Moreover, it is incumbent on the Commission to internalize that point when weighing the evidence presented. Should, at any time, the Commission find itself "on the fence" so to speak, the burden of proof dictates that Commission should err against the utility. *White v. Dir. of Revenue*, 321 S.W.3d 298, 305 (Mo. banc 2010) ("When the burden of proof is placed on a party for a claim that is denied, the trier of fact has the right to believe or disbelieve that party's uncontradicted or uncontroverted evidence. If the trier of fact does not believe the evidence of the party bearing the burden, it properly can find for

the other party. Generally, the party not having the burden of proof on an issue need not offer any evidence concerning it." (internal citations omitted)). With that in mind, let us now turn to the issues.

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Issue 1: Cost of Capital

There are three sub-components to this issue that need to be addressed: (1) return on equity ("ROE"), (2) capital structure, and (3) short term debt. The last two issues are really the same, or, more accurately, the third issue is a subset of the second, but the OPC will consider them separately for clarity of discussion. Because of the difference in position taken by the Spire and Staff with regard to these three issue sub-components, the OPC will break down its response by sub-component as opposed to responding to each party separately.

Response to Return on Equity

As the Staff's brief notes, the OPC and Staff are primarily in agreement on this issue. *Staff Initial Brief*, pg. 9. For this reason, the OPC will constrain its response on this issue exclusively to Spire's brief. Before diving into the merits of the issue, however, the OPC feels it is important to complete the record as to one point. Spire spends considerable time outlining the qualifications of the three experts who provided testimony on this issue. While the OPC does not wish to dwell too much on the concept of witness qualifications, the OPC does wish to address that Spire neglects to mention that OPC witness Mr. David Murray has **also** been designated as a "Certified Rate of Return Analyst (CRRA) by the Society of Utility and Regulatory Financial Analysts (SURFA)." Exhibit 215C, *Direct Testimony of David Murray*, DM-D-1. Mr. Murray was further "authorized in October 2010 to use the Chartered Financial Analyst (CFA) designation." *Id*. To quote Mr. Murray:

> The use of the CFA designation requires the passage of three rigorous examinations addressing many investment related areas such as valuation analysis, portfolio management, statistical analysis, economic analysis, financial statement analysis and ethical standards. In addition to the passage of the examinations a CFA charterholder must have four years of relevant professional work experience.

Id. To the OPC's knowledge, Mr. D'Ascendis has not attained the CFA designation. As previously indicated, though, the OPC would rather the Commission rely on the strength and logic of the underlying arguments presented by the expert witnesses, and not just fall back on their qualifications. With that in mind, let us review the arguments.

Response to Spire's Argument regarding the OPC's Recommendation

The only arguments that Spire can muster to rebut the position of the OPC regarding return on equity is to (1) claim that Mr. Murray's recommended ROE does not match his estimated cost of equity ("COE") and (2) make a weak attempt to discredit Mr. Murray's recommendation on the basis that Mr. Murray has recommended the same ROE in other cases. With regard to the first point, Spire has cited no legal or factual basis to show that a company's ROE and COE must match.[1] Moreover, Mr. Murray acknowledged and explained this point in detail in his testimony:

> **Q. Mr. D'Ascendis claims that you dismissed your COE estimates when recommending a 9.25% ROE for Spire Missouri. Is this accurate?**

[1] The OPC notes that it is also not aware of any legal or factual basis to show that a company's ROE and COE must match. Spire's suggestion that this must occur appears to be purely a figment of the Company's imagination.

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A. No. My recommended authorized ROE of 9.25% takes into consideration many different factors. A fundamental principle of shareholder value creation is for a company to invest in projects that allow the company to at least earn its cost of capital. An allowed ROE of 9.25% allows for a margin of 225 basis points over my estimate of Spire Missouri's COE. **I am aware investors have become accustomed to regulators allowing utility companies returns that are higher than their cost of capital. In fact, some investors, such as Evercore ISI, use investment models that assume that regulators currently allow an ROE to COE spread of approximately 440 basis points (9.75% ROE – 5.35% COE), but will eventually reduce the spread to a range of 225 to 275 basis points as either the COE increases, the allowed ROEs decrease or a combination of both**.

As I discussed in my Direct Testimony, as recently as Spire Missouri's 2017 rate case, I had estimated that the LDC industry's COE was approximately 25 basis points lower than that of the vertically-integrated electric utility industry. Therefore, I suggested that an authorized ROE that is 25 basis points lower than that which the Commission considered reasonable for electric utilities was fair and reasonable. I understood the Commission would apply its zone of reasonableness standard in determining the lowest and highest recommended ROEs it would consider. Knowing that the Commission had applied this standard when deciding a 9.5% allowed ROE was fair and reasonable for Missouri's largest electric utility companies, it was my opinion that the Commission should recognize Spire Missouri's lower risk as compared to Missouri's larger electric utilities. Again, in my opinion, an allowed ROE as low as the cost of capital would be sufficient to attract capital, but if the Commission were to authorize an ROE consistent with such, then Spire's stock price would decline considerably **because investors expect some consistency within how Missouri sets the rates for its utility companies**. Based on my analysis of capital market conditions and consideration of investor communications of the typical relationship between LDCs and the electric utility industry, a 9.25% authorized ROE applied to a reasonable equity ratio is factored into the price investors are willing to pay for Spire's stock.

Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 31 ln. 3 – pg. 32 ln. 5. As one can clearly and plainly see, Mr. Murray's recommended ROE was premised on

very careful consideration of the relevant facts and circumstances surrounding how utility rates are set in Missouri. Further, Mr. Murray's analysis is again shown to be consistent with the investment community's understandings and expectations (as demonstrated in Evercore ISI's investment analysis). *Id.*

The second argument that Spire presents, as already referenced, is to just point out that "Mr. Murray has recommended an ROE of 9.25% in several recent rate cases in Missouri[.]" *Spire Initial Brief*, pg. 86. The fact that this is one of the only two arguments that the Company can produce to rebut Mr. Murray's position shows just how feeble Spire's case is. In particular, Spire sought to draw attention to two cases: "the Empire District Electric case in 2019" and the "Missouri-American Water case that concluded earlier this year[.]" Tr. pg. 813 lns. 7 – 21. Neither of these examples demonstrate any error in Mr. Murray's recommendation. For example, Staff also recommended **<u>the exact same 9.25%</u>** ROE that Mr. Murray recommended in the Empire case (ER-2019-0374). ER-2019-0374, *Amended Report and Order*, pg. 30 ¶ 46 ("Both Staff and OPC's financial analysts agree that a 9.25 percent authorized ROE is reasonable."). More importantly, the Commission agreed with both Staff and the OPC. *Id.* ("The Commission finds this ROE to be reasonable and based upon realistic economic growth."); Tr. pg. 843 lns 16 – 20 ("Q. What was the outcome of that case with regard to the specific recommendation you made? A. The Commission awarded a 9.25 percent and a capital structure of 46 percent equity, 54 percent long-term debt.").

The Missouri American Water case (WR-2020-0344) is different from the Empire District Electric case in that it ultimately settled. Tr. pg. 843 lns. 4 – 5. (Q. What was the outcome of that case? A. That case settled”). The ROE issue was not identified in the settlement and was instead “black-boxed.” *Id.* at lns. 6 – 11. Prior to settling, Mr. Murray filed testimony in that case that stated the following:

> **Q. Based on your analysis and understanding of the utility industry’s current COE, investor expectations on allowed ROEs and the COE for water utilities compared to electric utilities, what would be a fair and reasonable allowed ROE in this case?**
>
> A. 8.25% to 9.25%. However, as I will explain in further detail in the following sections of my testimony, if MAWC’s authorized capital structure is set consistent with the debt capacity it creates, then a 9.25% ROE is justified since the increased financial risk causes MAWC’s cost of equity to be similar to Missouri’s electric utility companies.

WR-2020-0344, *Direct Testimony of David Murray*, pg. 31 lns. 15 – 21.

> While there is significant evidence that suggests that American Water’s water utility subsidiaries, including MAWC, have lower business risk than that of electric utilities, there is also evidence that American Water offsets this lower business risk by employing a larger proportion of debt in their capital structures. Therefore, if the Commission appropriately recognizes American Water’s use of higher leverage in the capital structure it authorizes MAWC, then a 9.25% allowed ROE is consistent with capturing MAWC’s lower overall cost of capital because it results in lower weight being assigned to the equity in the capital structure.

Id. at pg. 38 lns. 16 – 23. The point of this digression is to show that Mr. Murray is not just “randomly picking 9.25%” as Spire would have the Commission believe. Instead, Mr. Murray’s recommendations have been carefully made based on the facts and circumstances specific to each case. Also, it is worth pointing out that Staff’s recommendation in the Missouri American Water case was largely consistent with

the OPC's recommendation. WR-2020-0344, *Staff Cost of Service Report*, pg. 32 lns. 4 – 6 (". . . Staff concludes that an authorized ROE in the 9.3% to 9.8% range is just and reasonable. Staff recommends the Commission authorize a midpoint ROE of 9.55%.").

There are only a handful of other points that the OPC wishes to address regarding Spire's attempt to rebut the OPC's position. First, Spire makes a claim that the Empire District Electric Company is not comparable to Spire and suggest that Mr. Murray recognized this "fact" in testimony. *Spire Initial Brief*, pg. 87. There is no support for this statement. The citation that Spire supplies is to pages two through three of Mr. Murray's direct. The only reference to the Empire District Electric Company on those two pages is this sentence: "[p]erhaps the most relevant consideration for the Commission's assessment of a fair and reasonable allowed ROE for Spire Missouri is whether Spire Missouri's risk profile is significantly different from Missouri's large electric utilities considering the Commission's last authorized ROE was 9.25% for The Empire District Electric Company ("Empire") in Case No. ER-2019-0374." Exhibit 215C, *Direct Testimony of David Murray*, pg. 2 lns. 20 – 24. Mr. Murray clearly did not state that the two utilities were not comparable, but instead suggested the Commission **should** compare them. This is further reflected in the main conclusion that Mr. Murray provided in his direct testimony:

> While the pandemic caused a significant disruption in the capital markets, especially as it related to credit, during the spring of 2020, broader capital markets have since been hitting all-time highs on a regular and consistent basis. This has caused the S&P 500 to trade at a premium to the utility industry, which is more typical of financial markets prior to the financial crisis in 2008/2009. While utility stocks are no longer trading at the all-time high levels they achieved right

> before the pandemic, they are still trading at higher levels due to continued low, long-term interest rates. **<u>My analysis shows that electric utilities and LDCs are beginning to trade at similar valuation levels</u>**. However, this was not the case for much of 2020. **<u>Although I am recommending Spire Missouri be allowed the same ROE as Empire, I recognize the recent discount by recommending an ROE range with a high-end of 9.5%</u>**.

Exhibit 215C, *Direct Testimony of David Murray*, pg. 54 ln. 19 – pg. 55 ln. 4. Spire clearly has no basis for the statements it has made, which is not uncommon for this issue.

Another example of a statement Spire offers with no support appears in the next paragraph. Spire starts by claiming a review of the ROE recommendations offered by Mr. Murray over the last four years will "demonstrate" his ROE is not based on market models. *Spire Initial Brief*, pg. 87. The citation offered to support this position is page twelve of Spire witness Woodard's True-Up Rebuttal. *Id*. Mr. Woodard does not offer any discussion of Mr. Murray's ROE recommendations over the last four years either on page twelve or anywhere else in his true-up rebuttal.[2] *See generally*, Exhibit 62C, *True-Up Rebuttal Testimony of Adam Woodard*. The next line of Spire's brief just states "Mr. Murray routinely recommends an ROE of 9.25, regardless of the model results." There is no support offered for this assertion and there is none to be found. A review of the testimony Mr. Murray filed in this case and other cases shows the Mr. Murray's recommendations are fully supported by his

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[2] Just to be safe, the OPC also checked Mr. Woodard's true-up direct. However, Mr. Woodard's true-up direct does not mention Mr. Murray at all. *See generally*, Exhibit 60C, *True-Up Direct Testimony of Adam Woodard*.

models. *See generally*, Exhibit 215C, *Direct Testimony of David Murray*; WR-2020-0344, *Direct Testimony of David Murray*. It is self-evident that Spire has no substantive response to the OPC's ROE recommendation and the Company's only recourse as a result is to besmirch the OPC's expert by just fabricating problems and not seeking to prove its claims. Between this and the lengthy analysis of Mr. Murray's recommendation the OPC provided in its initial brief, the Commission should order the 9.25% ROE that Mr. Murray proposed.

Response to argument regarding "Current Inflation"

The next segment of Spire's brief claims that the OPC "disregarded inflation" in its ROE analysis. *Spire Initial Brief*, pg. 87. This makes very little sense. Inflation matters in an ROE analysis to the extent that it affects interest rates on bonds. Exhibit 6, *Rebuttal Testimony of Dylan W. D'Ascendis*, pg. 15 lns. 8 – 10 ("**Q. DO YOU AGREE WITH DR. WON THAT INFLATION IS STRONGLY RELATED TO INTEREST RATES?** A. Yes, I do."). Bond rates are important to ROE analyses to the extent that they are used to establish the risk-free rate that gets used in a CAPM model for ROE. *See* Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 17 ln. 19 – pg. 18 ln. 9 ("For the risk-free rate, Staff used the average yield on 30-year U.S. Treasury bonds for the three-month period ending March 31, 2021" (pg. 18 lns. 7 – 8)). The problem with Spire's argument, though, is that bond prices **already reflect investors' expectations regarding inflation**:

> Current bond prices already reflect investors' interest rate expectations over the long-term. If they didn't, then the market would be considered inefficient and investors could make a riskless profit by shorting bonds

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> to capture the certain decline in long-term bond prices when long-term interest rates increased

Exhibit 216C, *Rebuttal Testimony of David Murray*, pg. 27 lns. 12 – 15. This is a fundamental principle in economics and is sometimes known as the "efficient market theory" or "efficient market hypothesis." *Id.* at lns. 9 – 11; *see also* Lucas Downey, *Efficient Market Hypothesis (EMH)*, Investopedia (March 25, 2021), https://www.investopedia.com/terms/e/efficientmarkethypothesis.asp. The OPC thus did not "disregard" inflation since it was already included in the models because it is already built into the bond prices.[3]

Response to Business Risk Adjustment

Spire offers a short paragraph that argues a business risk adjustment should be included due to the Company's small size compared to other utilities in the proxy group. *Spire Initial Brief*, pg. 88. In response, the OPC notes the following testimony offered by its Expert witness Mr. Murray:

> **Q. What is your reaction to Mr. D'Ascendis' proposed increase in his ROE due to Spire Missouri's smaller size?**
>
> A. The small size risk premium is not applied in practice for purposes of determining a fair value of regulated utility assets. ** ________________
> ____
> ____
> ____

[3] The OPC notes that Spire's brief states that the OPC failed to "update" its ROE recommendation for current market conditions. *Spire Initial Brief*, pg. 87. It is not clear what Spire meant by the word "update," but to the extent that Spire meant that the OPC failed to later **<u>change</u>** its ROE then it should be noted that Spire's own witness also never "updated" his ROE to account for inflation. Further, the OPC notes that ROE was explicitly excluded from the list of issues that the parties anticipated would be updated for true-up. GR-2021-0108, *Proposed Procedural Order and Schedule*, pg. 7.

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> However, considering the fact that the LDC industry is mainly comprised of small to mid-cap companies, Mr. D'Ascendis could have simply given more weight to the COE estimates of the smaller companies in his proxy group rather than making an explicit adjustment to his final COE estimate.

Exhibit 216C, *Rebuttal Testimony of David Murray*, pg. 31 ln. 21 – pg. 32 ln. 10. Even if the Commission disregards this point, however, the OPC also notes that Spire's brief argues the following:

> Mr. D'Ascendis then compared Spire to the proxy group of natural gas companies based on size and bond rating and calculated Company-specific flotation costs. In his analysis, Mr. D'Ascendis found that Spire is smaller than the proxy group in several different measures and that Spire has a better bond rating than the average bond rating of the proxy group. The small size of Company relative to the proxy group necessitated an upward adjustment of 0.10% and the Company's less risky bond rating necessitated a downward adjustment of 0.10%.

Spire Initial Brief, pg. 82. As Spire itself points out, the credit risk adjustment and the size adjustment result in equal and opposite modifications, so the two cancel each other out. As such, this discussion is pointless.

Response to Flotation Costs

The next issue that Spire raises concerns a concept known as "flotation costs." *Spire Initial Brief*, pg. 88. The first question to ask is: what are flotation costs? To answer that, the OPC will allow Spire's witness to speak for himself:

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> **Q. WHAT ARE FLOTATION COSTS?**
>
> A. Flotation costs are those costs associated with the sale of new issuances of common stock. They include market pressure and the mandatory unavoidable costs of issuance (e.g., underwriting fees and out-of-pocket costs for printing, legal, registration, etc.). For every dollar raised through debt or equity offerings, the Company receives less than one full dollar in financing.

Exhibit 5, *Direct Testimony of Dylan W. D'Ascendis*, pg. 45 lns. 14 – 19. To put it in the simplest terms, flotation costs are the cost to issue equity into the market. *Id*. The next question is how should they be recovered?

Spire argues that flotation costs should be recovered through the ROE itself. However, this is a subjective method that will allow a potential constant and perpetual recovery of finite costs. If the flotation costs are just included in the ROE, then they will become a constant part of the ROE and never be "paid down" as one would expect of any other cost included in rates. To avoid this problem, flotation costs should instead be *amortized* and recovered directly as an expense:

> **Q. In what situations have OPC and Staff been generally supportive of a company's request to recover equity issuance costs?**
>
> A. In past Missouri rate cases in which a company can show that proceeds from an equity issuance benefited the Missouri utility, **then transaction expenses related to the equity issuance have been allowed to be recovered through an amortization of such expenses**. Consequently, if equity is issued within the test year and there is evidence to support that the issuance benefited Spire Missouri's LDC assets, and therefore its customers, then it is my opinion that **these costs should be recovered through an expense allowance rather than through an adjustment to the ROR**.

Exhibit 216C, *Rebuttal Testimony of David Murray*, pg. 29 lns. 13 – 21. This will prevent the recovery *in perpetuity* problem while still ensuring that the utility is made whole for the cost to issue these equity units. However, there is another, still greater problem with the inclusion of a subjective adjustment for equity transaction costs. That is the simple fact that they are not being used to support **Spire Missouri**.

Returning to the excerpt from the previous page, one of the points Mr. Murray made was that flotation costs should only be included to the extent that they actually benefit the utility. *Id*. Otherwise you are forcing utility customers to pay for something that has no relation to the provision of utility services. This was actually an issue raised in the last Spire rate case:

> **Q. Did you express your concern about the flotation cost adjustment in Spire Missouri's 2017 rate case?**
>
> A. Yes. In that case, I specifically identified that the proceeds raised from the 2013 and 2014 equity issuances were for purposes of raising funds to acquire MGE, Alagasco and EnergySouth. As I explained in that case, it is wholly inappropriate to request recovery of issuance costs associated with these acquisitions as these are considered transaction costs. In the stipulation and agreement executed in the MGE acquisition, the Company specifically agreed not to seek recovery of these costs in subsequent rate cases. If Spire, Inc. had filed applications requesting authority to acquire Alagasco and EnergySouth, the same conditions would have likely been imposed. Considering the fact that Spire Missouri continues to request recovery of equity transaction costs related to funding acquisitions is extremely troubling.

Exhibit 216C, *Rebuttal Testimony of David Murray*, pg. 29 lns. 1 – 12. The same problem Mr. Murray sought to address in the last rate case is now before this Commission again, in that, the flotation costs Spire now seeks to recover are related

to equity issuances that either did not or may not have benefited Spire Missouri to any degree whatsoever:

> **Q. How did Spire Inc. use the proceeds from its common equity issuances in 2016 and 2018?**
>
> A. Spire issued 2.185 million common shares in 2016 to raise $133 million to fund its acquisition of EnergySouth. Spire issued 2.3 million common shares in 2018 to raise $133.2 million to fund investments in Spire St. Louis Pipeline, storage investments, and ongoing infrastructure upgrades.
>
> **Q. Is it possible that some of the proceeds from the 2018 equity issuance were used to make infrastructure upgrades to Spire Missouri's system?**
>
> A. It is possible because according Spire Inc.'s May 7, 2018, Supplemental Prospectus, it indicates the proceeds from the equity issuance were used to redeem Spire Inc.'s commercial paper. To the extent that this commercial paper funded Spire Missouri's infrastructure needs, then transaction costs of this equity issuance could be associated with Spire Missouri's capital needs. However, considering the fungibility of Spire Inc.'s capital management, in which it can simply allow Spire Missouri to retain all of its earnings to fund capital needs, rather than issue commercial paper, **it becomes somewhat futile to attempt to determine the exact amount of proceeds from the equity issuance that supported Spire Missouri's capital needs**.

Exhibit 216C, *Rebuttal Testimony of David Murray*, pg. 29 ln. 22 – pg. 30 ln. 13. The same can be said of the 2019 and 2021 equity issuances. *Id.* at pg. 30 ln. 17 – pg. 31 ln. 4. Because there is no evidence that shows the equity issued by Spire Inc. from 2013 through the present is being used to directly fund Spire Missouri as opposed to the other Spire Inc. entities, the cost to issue that equity (*i.e.* the flotation costs) should not be included in the ROE. Even if the Commission **did** decide to include the cost of equity issuance, those costs should be expensed and amortized and not included directly in the ROE.

Response to the discussion of ROE authorized by other Commissions

Spire's evidence on this point contradicts its own argument. The centerpiece of Spire's discussion here is the S&P Global Market Intelligence report issued on July 27, 2021, which was entered into the record as Exhibit 51.[4] Exhibit 51, *S&P Global RRA Report Dated 7/27/2021*. The Report states as follows: ** ______________________

____

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______________________________ ** *Id.* at pg. 2. Right from the start, we can see that the ** _____ ** that the report cites is very different from the 9.95% that Spire is requesting, which fundamentally undermines the Company's position. In fact it is almost ** ______________________________________ ** This should obviously give the Commission pause.

Spire's brief does try to inflate the average ROE number identified in the S&P report somewhat by attempting to distinguish the average ROE for "the last twelve months ("LTM") ended June 30, 2021" from the average ROE for "the first half of 2021" number. *Spire Initial Brief*, pg. 90. However, Spire is asking the Commission to focus too narrowly on the discrete difference that a few months bring. Instead, the Commission should be looking at the ROE issue on a broad level. Fortunately, the S&P report helps with that by providing this graph: **

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[4] This report was marked as confidential per Spire's request. Tr. pg. 751 ln. 24 – pg. 752 ln. 2. However, Spire's brief cites to it without identifying any portion as confidential. *Spire Initial Brief*, pg. 90. The OPC is unsure how to proceed on this point, but, for the sake of safety and to preserve the confidentially requirements, the OPC will treat this report as confidential for all points not already stated in Spire's brief.

** Exhibit 51, *S&P Global RRA Report Dated 7/27/2021*, pg. 2. What this graph clearly shows is that **

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** *Id*. The point here is that the broad trend does not reflect the immediate data, which is not uncommon when dealing with averages. As the report itself points out, ** ____ ** *Id*. at pg. 1. It would not be unreasonable to assume that, as more cases come in, the average will change to be closer to the total trend. Even if that did not occur, the evidence still shows that Spire should expect capital costs to go down, not up.

There are a few more things that Spire argues in this section, but the OPC will address those in its alternative cost of capital discussion below. The only other point that the OPC does wish to address here is Spire's discussion of the "zone of reasonableness." *Spire Initial Brief*, pg. 91. Specifically, Spire notes that "[t]he Commission generally sets the zone of reasonableness at 100 basis points above and below the national average ROE authorized for similarly-situated utilities." *Id*. Spire goes on to point out that its recommended ROE of 9.95% is within this zone of reasonableness. *Id*. The OPC just wants to point out that **<u>all</u>** the recommendations made by every party who spoke on this issue fall within that zone. Even if you use the higher 9.62% Spire argues for, the zone of reasonableness falls from 8.62% to 10.62%. The OPC's recommendation of 9.25% and Staff's 9.37% are clearly within this range. Thus, the discussion of the "zone of reasonableness" is effectively meaningless.

General Response to Spire's ROE Argument

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Outside the discussion on these specific points related to Spire's initial brief, the OPC sees no reason to rebut the position of Spire's witness Mr. D'Ascendis beyond those points already raised in its initial brief. *See OPC Initial Brief*, pgs. 50 – 59. Therefore, the OPC will conclude its discussion of the ROE issue here and encourage the Commission to review the OPC's initial brief for further details regarding the error of Mr. D'Ascendis ROE recommendation.

Response to Capital Structure

Both Spire and Staff have recommended that the Commission order a capital structure based on Spire Missouri's "actual" stand-alone capital structure, which they define as 54.28% common equity and 45.72% long-term debt. *Spire Initial Brief*, pg. 91; *Staff Initial Brief*, pg. 18. Right from the start, this is a false statement as both parties are ignoring the large percentage of short-term debt that Spire carries on its books at almost all times. However, that is the discussion for the next section. For now, let us focus on the arguments both parties present as to why the Commission should order Spire Missouri's unnecessarily equity-rich capital structure.

Both Staff and Spire cite to the same four factors to support their respective arguments. Before listing them here, the OPC points out that neither party has cited to **any** Commission authority that shows the Commission has relied on these four factors in the past.[5] The OPC is not arguing that the Commission should disregard

[5] Dr. Won identifies that the four factors are "guidelines for determining when to use a parent company's capital structure" that are taken from the guidebook produced by the Society of Utility and Regulatory Financial Analysts that is titled "The Cost of Capital – A Practitioner's Guide." Exhibit 124, *Rebuttal Testimony of Seoung Joun Won, PhD*, pg. 41 lns. 3 – 6.

these factors, but rather, is just seeking to point out that Spire's statement that the Commission **<u>relies</u>** on them is wholly false and unsupported.[6] Regardless, the OPC will still examine these four factors, which are laid out succinctly in Staff's brief as follows:

1. Whether the subsidiary utility obtains all of its capital from its parent, or issues its own debt and preferred stock;
2. Whether the parent guarantees any of the securities issued by the subsidiary;
3. Whether the subsidiary's capital structure is independent of its parent (i.e., existence of double leverage, absence of proper relationship between risk and leverage of utility and non-utility subsidiaries); and,
4. Whether the parent (or consolidated enterprise) is diversified into non-utility operations.

Staff Initial Brief, pg. 19. Both Staff and Spire claim that each of these factors fails to support the OPC's position, so we shall review each in turn.

First Factor

The first factor is "whether the subsidiary utility obtains all of its capital from its parent, or issues its own debt and preferred stock[.]" *Staff Initial Brief*, pg. 19. Staff boldly states that Spire issues its own debt. *Id.* Spire states that it issues its own **<u>long-term</u>** debt. *Spire Initial Brief*, at 92. The difference here is important because the fact that Spire is skirting around, and which Staff just plain gets wrong,

[6] If the OPC were to attempt to respond to every misstatement of fact that Spire engaged in in the course of this issue, it would require a nearly line-by-line analysis. Half of what the Company says is offered with no citation or support and many times the cited support does not actually verify the stated proposition.

is that Spire Missouri does **not** issue its own short-term debt. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 17 lns. 12 – 14. (". . . Spire Missouri relies on Spire Inc. for its short-term capital needs through Spire Inc.'s consolidated commercial paper program."). Spire admits this much in the 10-K form that the Company files with the SEC:

> [Spire Missouri, Spire Alabama and the subsidiaries of Spire EnergySouth] rely on short-term credit and long-term capital markets, as well as cash flows from operations to satisfy their seasonal cash requirements and fund their capital expenditures. The Utilities access the commercial paper market through a program administered by the holding company, **which then loans borrowed funds to the utility**.

Exhibit 237, *10-K Cover Page and Page 30 and Definition Section*, pg. 30 (pg. 7 of the PDF "skinny version") (emphasis added). Spire Missouri relies on Spire Inc. for access for short-term capital funding, which the OPC has shown supports up to 10% of Spire Missouri's capital structure. *Id.*; Exhibit 216, *Rebuttal Testimony of David Murray*, pg. 15 lns. 1 – 3. Because Spire **does** rely on its parent for its short-term capital needs, the first factor partially supports the OPC's position.

Second Factor

Both Staff and the Company accurately state that the parent does not guaranty any of Spire Missouri's long-term debt, but this does not establish that Spire Missouri's capital structure is consistent with its business risk profile. *Staff Initial Brief*, pg. 19; *Spire Initial Brief*, at 92. As the OPC witness's Mr. Murray explained:

> Spire Missouri and its regulated utility affiliates have lower business risk profiles than Spire Inc. and its non-regulated subsidiaries. Spire

> Inc.'s creditworthiness depends on its regulated subsidiaries rather than the opposite. Therefore, creditors/lenders to Spire Missouri do not require credit enhancement. However, Spire Inc.'s other riskier non-regulated subsidiaries do require credit enhancement, which would not be possible but for Spire Inc.'s ownership of low-risk, regulated LDCs, including that of Spire Missouri.

Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 2 – 8. Spire Inc.'s credit quality is enhanced by its ownership of Spire Missouri and its other regulated LDC subsidiaries. *Id.* This enhancement not only allows Spire Inc. to issue holding company debt, but it also allows it to provide parental guarantees for Spire Inc.'s non-regulated subsidiaries' financial transactions. *Id.*

Third Factor

With regard to the third factor, Spire claims "Spire Missouri has an independently determined capital structure" while Staff asserts "[t]here is no double leverage or any other inappropriate entanglement with Spire, Inc." *Spire Initial Brief*, at 93; *Staff Initial Brief*, pg. 19. Neither of these claims represent the true reality of the situation. Beginning with Spire's claim, it is important to understand that "S&P determined that Spire Missouri's hypothetical stand-alone credit profile ("SACP") is 'A+,' but ultimately assigns Spire Missouri an 'A-' credit rating due to Spire Inc.'s more leveraged capital structure." Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 24 – 27. In particular, consider the following quote that Mr. Murray provided from Standard & Poor's ("S&P") Ratings Direct:

> Under our group rating methodology, we assess Spire Inc. as the parent of the group that includes Spire Alabama Inc. and Spire Missouri Inc. We assess the group credit profile as 'A-' which leads to a long-term

> issuer credit rating of 'A-'. **Our view is that the current insulation measures are not sufficient to warrant separation between the parent and its subsidiaries**.

Id. at pg. 6 lns. 15 – 19 (emphasis added). An even more in-depth analysis was provided by the Moody's rating agency in the April 1, 2021, credit report Spire offered in case GF-2020-0334: **

** GF-2020-0334, *GR-2020-0334 - Rating Agency Reports (moody's credit opinion – spire-missouri-inc)*, pg. 6 (emphasis added).[7] The point here is that **both** S&P and Moody's consider Spire Missouri's credit profile to be constrained by Spire Inc., which means that Spire Missouri's equity-rich capital structure does not support the bond rating it could have absent its affiliation with Spire Inc.'s more leveraged capital structure. Further, **both** credit rating agencies acknowledge that there is not sufficient evidence to warrant the separation of these two entities from a credit rating perspective. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 6 lns. 15 – 19 ("Our view is that the current insulation measures are not sufficient to warrant separation between the parent and its subsidiaries. (S&P speaking)); GF-2020-0334, *GR-2020-0334 - Rating Agency Reports (moody's credit opinion – spire-missouri-inc)*, pg. 6 (** ____

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__________ ** (Moody's speaking)). Moody's plainly states that it ** ______________

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[7] The Commission took administrative notice of these filings during the hearing. Tr. pg. 776 ln. 17 – pg. 777 ln. 3.

______________________________________ ** This is literally an example of double-leverage in action, which brings us to Staff's assertion.

"[D]ouble-leverage on a broader level is simply the existence of leverage at the subsidiary and at the holding company, which defines Spire Inc.'s financing strategy." Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 15 – 17. It is this broad definition that ties into the second half of the segment in parentheses found in the third factor, which is the "absence of proper relationship between risk and leverage of utility and non-utility subsidiary" *Id.* at lns. 17 – 19. As Mr. Murray explained:

> If Spire Inc.'s non-regulated subsidiaries could support the debt issued at the holding company, they would not require guarantees from the holding company. Therefore, **it is wholly illogical and inconsistent with the relationship between risk and leverage to conclude that Spire Inc. could issue holding company debt without the cash flow support of its low-risk regulated utility assets**.

Id. at lns. 19- 23 (emphasis added). As we have already seen, ** ______________

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Again, **this is the double-leverage** that Staff claims not to exist in action, as recognized by prominent rating agencies.

Staff and Spire can stubbornly claim that no double-leverage exists, but the reality is that there **is** clearly an absence of proper relationship between risk and

leverage of the utility and non-utility subsidiaries. The safest companies owned by Spire Inc. – Spire Missouri and its other regulated gas utilities – have lower amounts of leverage than either Spire Inc. itself or those used and assumed for its non-regulated subsidiaries. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 9 lns. 11 – 19. Moreover, these other non-regulated entities have been unable to operate without Spire Inc.'s credit support and have required Spire Inc. to provide considerable parental guarantees. *Id*. at lns 4 – 8. This ties back in and feeds off of the OPC's point regarding the second factor. Spire Inc. does not provide parental guarantees to Spire Missouri only because Spire Inc. **relies** on the cash flows **from** Spire Missouri to provide parental guarantees to Spire Inc.'s **other, non-regulated** entities. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 2 – 8. Thus, **the whole second factor has been effectively turned on its head**. It is not that Spire Inc. offers parental guarantees of Spire Missouri, but rather, Spire Missouri is effectively providing the guarantees **to** Spire Inc. *Id.*; GF-2020-0334, *GR-2020-0334 - Rating Agency Reports (moody's credit opinion – spire-missouri-inc)*, pg. 6 (** ____

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__________________ ** (emphasis added)). If the second and third factors are read in **conjunction**, with an effort to follow the logic and reasoning that underlies them, then one will quickly find that **both** actually support the OPC's position.

Fourth Factor

Both Staff and Spire begrudgingly admit that Spire Inc. has diversified into non-utility operations. *Staff Initial Brief*, pg. 19; *Spire Initial Brief*, at 93. Specifically, Spire is engaged in ** ____

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______________________________ ** Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, schedule RES-D-6 part 1, PDF pg. 81. However, Staff and Spire attempt to downplay the importance of this factor by claiming that the diversified business endeavors only make up a small part of Spire's overall business. This is faulty logic for two reasons. First, the factor does not specify an amount or degree of diversification, so there is no justification for arguing that Spire is not diversified because it has not diversified "enough." *See*, *e.g.*, *Staff Initial Brief*, at pg. 19. Second, this argument ignores the central logic of the factor as a whole. To understand this, one must again consider the factors in **conjunction**, as Mr. Murray testified:

> Although Spire Inc. does have some exposure to non-regulated operations, this exposure to non-regulated operations should cause Spire Inc. to have a less leveraged consolidated capital structure than its LDC subsidiaries due to the fact that its non-regulated operations have more business risk. Prior to Spire Inc.'s acquisition-oriented strategy starting in 2013, Spire Inc. (then Laclede Group) was less leveraged than Spire Missouri (then Laclede Gas Company). Laclede Group only issued short-term debt prior to these acquisitions. Therefore, this factor supports the use of Spire, Inc.'s consolidated capital structure because the lower-risk regulated utilities allow Spire Inc. to have a more leveraged capital structure while maintaining a strong investment grade credit rating.

217C, *Surrebuttal Testimony of David Murray*, pg. 19 lns. 10 – 19. Because Spire Inc. has this exposure to non-regulated entities, it has a higher degree of business risk.

Id. Because its business risk would be higher, the Company's debt capacity should be lower and it should have more equity when compared to its relatively safer regulated gas utilities. *Id*. However, Spire Inc. actually has less equity and more debt than its regulated gas utilities, which is backwards. *Id*. This is because Spire Inc. is **using** its regulated utilities, like Spire Missouri, "to have a more leveraged capital structure while maintaining a strong investment grade credit rating." *Id*. The fourth factor therefore ties into the third factor to show how there is an absence of a proper relationship between risk and leverage of utility and non-utility subsidiaries and further supports the OPC's position.

Summary of the Four Factors

To put the problem with Staff and Spire's use of the four factors into simple terms (besides the obvious problem stemming from how they sometimes just ignore facts), Staff and Spire are treating the four factors as an unthinking checklist. The Commission should not just view these four factors as a checklist. Instead, the Commission should strive to **understand** the four factors and how they relate to one another to answer the overarching question: what is the fair and reasonable capital structure to use to set Spire Missouri's rate of return. If one takes the time to evaluate and understand these factors, one will quickly find that they all support the OPC's position. Spire Missouri is dependent on Spire Inc. for its short-term financing. Exhibit 237, *10-K Cover Page and Page 30 and Definition Section*, pg. 30 (pg. 7 of the PDF "skinny version"). Spire Inc. does not make guarantees to Spire Missouri only because the reverse is effectively true in that Spire Inc. is relying on Spire Missouri's

strong and predictable cash flows to support the parental guarantees it made to its nonregulated entities. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 2 – 8; GF-2020-0334, *GR-2020-0334 - Rating Agency Reports (moody's credit opinion – spire-missouri-inc)*, pg. 6. Spire Inc.'s reliance on Spire Missouri to cover its **own** debt issuances is double-leveraging. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 18 lns. 15 – 23. Both S&P and Moody's have acknowledged that Spire Missouri's credit worthiness is constrained by Spire Inc.'s actions. Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 6 lns. 15 – 19; GF-2020-0334, *GR-2020-0334 - Rating Agency Reports (moody's credit opinion – spire-missouri-inc)*, pg. 6. Finally, Spire Inc. is diversified and its diversified holdings exemplify the nature of the double-leveraging that is occurring in this case. 217C, *Surrebuttal Testimony of David Murray*, pg. 19 lns. 10 – 19. Based on these factors, the Commission should order a capital structure based on Spire Inc.'s consolidated capital structure.

Response to Other Claims

There are a handful of other statements made by Spire and Staff that the OPC considers worth discussion. The first is Spire's claims that it will still change its capital structure as business and economic conditions change despite the fact that it targeted the same exact capital structure it was authorized in the 2017 rate case. *Spire Initial Brief, p. 93.* This is a hollow commitment. Spire Inc.'s and the LDC industry's stock prices underwent a fundamental shift in 2020 as it relates to their valuation levels (as measured by price-to-earnings ratios) when compared to the regulated electric utility industry. Exhibit 215C, *Direct Testimony of David Murray*,

pg. 10 ln. 17 – pg. 14 ln. 27. For the five years prior to 2020, the LDC industry traded at a premium to the electric utility industry, but suddenly in 2020, it began trading at a discount. *Id.* at pg. 12 lns. 1 – 8. Mr. Murray testifies specifically as follows:

> As is graphically illustrated, LDC's traded at a significant premium to electric utilities for the five-year period, January 1, 2015 through December 31, 2019. The average P/E multiple was approximately 3x higher over this period. However, beginning in early 2020 and until very recently, LDC's started trading at a discount to electric utilities. LDC's traded at an average P/E that was 1.6x lower than electric utilities for all of 2020. It wasn't until recently that the P/E ratios for LDCs started trading closer to par with electric utilities.

Id. Fundamental principles of capital structure management to preserve shareholder value require companies to limit the amount of common equity they issue when share prices are trading lower. Exhibit 216, *Rebuttal Testimony of David Murray*, pg. 8, ln. 16 – pg. 9, ln. 6, pg. 11 lns. 14 – 28; Exhibit 241, *True-Up Direct Testimony of David Murray*, Schedule DM-TD-1, pgs. 18, 20, 22-29, 34. Otherwise, a company is diluting its existing shareholders because, in order to raise the same amount of common equity before its stock price declined, it has to issue more shares, which divides anticipated earnings among more shareholders. This is simple math. Despite this fact, Spire Missouri is still targeting the same common equity ratio as it had at the time of the 2017 rate case. Exhibit 215C, *Direct Testimony of David Murray*, pg. 40 lns. 15 – 25. However, if one considers that Spire Missouri's equity is wholly-owned by Spire Inc., there is no dilution, just a higher equity ratio for ratemaking purposes. Spire Inc.'s strategy for its regulated subsidiaries' capital structures is thus simply

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——— ** Exhibit 241, *True-Up Direct Testimony of David Murray*, Schedule DM-TD-1, pg. 12. Just the mere fact that Spire Inc.'s 2021 Financing Strategy provided to Spire Inc.'s BOD has ** ————————————————————————

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———————————— ** should be sufficient to counter Spire Missouri's hollow commitment to manage its capital structure for cost efficiency. *Id*. But taking a deeper dive into the 2021 Financing Strategy illustrates Spire Inc.'s ** —————— –

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Id., at Schedule DM-TD-1, pgs. 1 – 46.

The second issue to address is Staff's response of "so what?" to the fact that Spire is targeting the capital structure the Commission approved in the Company's last rate case. *Staff Initial Brief*, pg. 20. The answer to this question is the $28 million **per year** that Spire Missouri customers will be required to pay because of the unnecessarily high equity ratio. Exhibit 147, *True-Up Rebuttal Testimony of Karen Lyons*, Schedule KL-tr2. This is even higher than the OPC's original projections, which is consistent with what Mr. Murray suggested would happen during the hearing:

> Q. I feel like we need to break things down on a most basic level. What is the impact of having a high equity ratio on customer rates?
>
> A. They're higher. It's a higher revenue requirement assuming using the same ROE but it's as high a revenue requirement plus you have a tax gross-up factor on equity which makes it even more magnified.

> Q. How does that factor into your concern regarding maintaining the existing Spire equity to debt ratio?
>
> A. Based on my analysis of Spire Missouri's credit metrics which produce healthy cash flows consistent with apparently a higher economical credit rating, which they don't receive credit for, that customers are paying at least 20 million. With true-up it's going to be even higher. Let's just say in the $20 to $25 million range higher rates per year to achieve credit metrics that they don't get credit for from specifically Standard & Poor's.

Tr. pg. 837 ln. 12 – pg. 838 ln. 5; *see also* Tr. pg. 819 lns. 9 – 11 ("Q. Can you identify any damage to ratepayers? A. Yes, sir. They're being charged too much. Over $20 million a year."). Apparently, Staff just does not care that Spire Missouri customers are paying far more than is necessary because of an inefficient capital structure that is being used to subsidize the Company's non-regulated entities at the ratepayer's expense.

The final point that the OPC wishes to address is the argument made near the end of Spire's brief wherein Spire argues that "utilizing additional leverage, as suggested by OPC, would introduce additional risk, thereby raising the cost of equity while also raising the cost of debt" *Spire Initial Brief*, pg. 94. This is a bogus position because the evidence shows that Spire Inc. does **not** consider this a problem when actively managing its **own** capital structure. Instead, Spire Inc.'s internal financing documentation show ** ____

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** Spire itself clearly does not believe that increasing its leverage or reducing its rating will have any material effect on its capacity or cost of debt, so neither should the Commission.

Conclusion

Spire's brief states: "[t]he assertion by OPC that Spire is in error by following the Commission's prior decision suggests that Spire should not listen to the regulators of Missouri utilities." The OPC believes that this statement is more revealing than Spire considered. The OPC's whole argument is that Spire is purposefully targeting its capital structure to achieve a higher degree of equity than is necessary to artificially boost cash flows to its parent, Spire Inc. The OPC's position is therefore not that "Spire should not listen to the regulators of Missouri utilities[,]" but rather, that Spire should act as a prudent and independent business and actively manage its capital structure to achieve the lowest reasonable cost without jeopardizing financial stability. *See*, *e.g.*, Exhibit 215C, *Direct Testimony of David Murray*, pg. 40 lns. 1 – 14. Spire does not want to act like a prudent and independent business however, nor does it have any interest in actively managing its capital

structure. It has demonstrated that in this case. Instead, Spire wants the **<u>Commission</u>** to be calling the shots and running its business (at least as far as capital structure goes). This is a problem. Because Spire has effectively shown that it is going to just follow whatever capital structure the Commission orders, the Company has effectively forced the Commission into the position of controlling the general management of the Company as to the issue of capital management, which is something that the Commission is not supposed to do. *State ex rel. Laclede Gas Co. v. Pub. Serv. Com.*, 600 S.W.2d 222, 228 (Mo. App. WD 1980) ("It is obvious that the P.S.C. has no authority to take over the general management of any utility."). The Commission should thus reject this invitation and order Spire to **<u>actively manage its own capital structure</u>** and not just target what the Commission sets. The only way to do that in this case is to diverge from the capital structure ordered in Spire's last rate case and instead order a capital structure consistent with Spire Inc.'s actively managed capital structure.

<u>Response to Short-term Debt</u>

Neither Staff nor Company have put much into the issue of short-term debt, which makes the response somewhat difficult. Staff acknowledges that "[i]f the amount of short-term debt exceeded the value of the short-term assets plus Construction Work in Progress ("CWIP"), then Dr. Won would include the excess amount of short-term debt in the ratemaking capital structure." *Staff Initial Brief*, pg. 21. Staff then goes on to state "[t]hat is not the situation here" without citing to anything. *Id*. In reality, the amount of short term assets (including CWIP) exceeded

short-term debt considerably as was demonstrated in the OPC's brief. *See OPC Initial Brief*, pgs. 16 – 19. This can be seen by simply doing the math found in the schedules Spire itself provided and was further testified to by the OPC's witness Mr. Murray. Exhibit 45C, *Surrebuttal Testimony of Adam Woodard,* Schedule AWW SR-2; Exhibit 216, *Rebuttal Testimony of David Murray*, pg. 15 lns. 4 – 7. Moreover, Staff's witness acknowledged that they did not actually check the math on this issue during the hearing. Tr. pg. 783 lns. 5 – 10 ("Q. What would you look for to determine when to recommend a different capital structure? A. So one of the main thing is about the short-term debt. We needed to check that is intentionally Spire Missouri manipulate short-term debt level. I needed to check that." (Dr. Won speaking)). This is all that there is to say regarding Staff's brief.

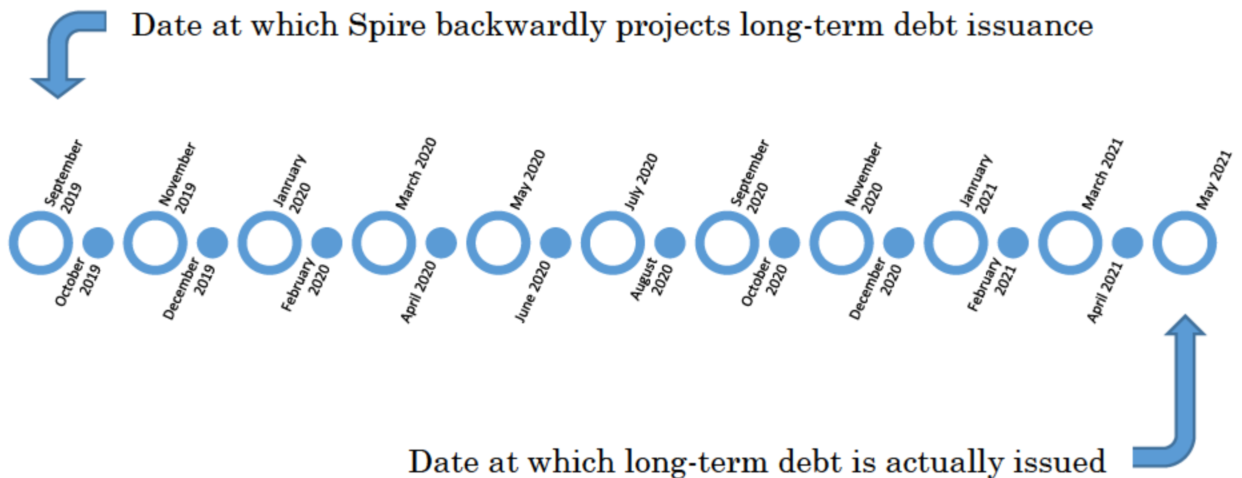
Spire's brief does provide a little more to rebut the OPC's position, but ultimately fails to do so. There are a few minor points to address and then one major point. First, Spire notes that just having short-term debt exceed CWIP should not close the analysis because there are other short-term assets such as "deferred purchased gas costs, unamortized PGA costs, propane inventory, and hedging gains and losses." *Spire Initial Brief*, pgs. 94 – 95. This is an irrelevant point, though, because the schedule in Mr. Woodard's testimony shows that short-term debt exceeded the total of **all** short-term assets after removing the erroneous and misleading backdated long-term debt issuance. *See* Exhibit 45C, *Surrebuttal Testimony of Adam Woodard, Schedule AWW SR-2*; Tr. pg. 839 ln. 3 – pg. 840 ln. 13. Second, Spire mentions Winter Storm Uri. *Spire Initial Brief*, pg. 95. The OPC's

witness already took Winter Storm Uri into account. Exhibit 242, *True-up Rebuttal Testimony of David Murray*, pg. 5 ln. 13 – pg. 6 ln. 4. ("Because Spire Missouri plans to recover [the amounts related to Winter Storm Uri] through its PGA/ACA applications and the atypical nature related to this event, it would be reasonable to simply use the average short-term debt in excess of short-term assets for the period December 31, 2019 through December 31, 2020, as I did in my True-up Direct Testimony."). With those two items out of the way, we may now turn to the big issue: the faulty "point-in-time" analysis.

The OPC already addressed the issues with the so-called "point-in-time" analysis extensively in its initial brief. *OPC Initial Brief*, pgs. 19 – 34. As such, the OPC will offer only a very brief review here. Stated bluntly, the "point-in-time" analysis is nothing but a blatant attempt to manipulate Spire's short-term debt ratios. This can be seen plainly in the schedules of Spire witness Mr. Woodard who has included a backdated long-term debt issuance that occurred on May 21, 2021, in such a matter that the amount appears in every month of the test-year and true-up. Exhibit 242, *True-up Rebuttal Testimony of David Murray*, pg. 4 lns. 1 – 3. ("Mr. Woodard's adjustment to Spire Missouri's average short-term debt balance inaccurately assumes that the $305 million of long-term debt issued on May 21, 2021 had been issued in September [2019]."). Mr. Woodard has "characterized his backdating of the hypothetical replacement of short-term debt with long-term debt as a 'pro forma long-term debt issue.'" *Id.* at lns. 3 – 5. "This characterization is misleading" because "[p]ro-forma adjustments to financial statements are intended

to reflect a company's expected financial position **going-forward**" not backward. *Id.* at lns. 5 – 6 (emphasis added). Moreover, it creates an absurd result wherein the rate case for the **entire test-year and true-up** is being set based exclusively on the last eleven days of May, 2021. This can be seen visually in the figure below:

Figure 1: Spire Capital Time-line



Despite the patent absurdity of Spire's decision to backdate a long-term debt issuance to the beginning of the case, Spire still insists that this is necessary to comply with the so-called "point in time" analysis. *Spire Initial Brief,* pg. 95. However, Spire has **never** offered an explanation of what this "point in time" analysis means, let alone why it is necessary. In fact, the OPC could find no explanation of a "point in time" analysis **anywhere**. This is a major problem for the very simple reason that it will make the "point in time" analysis almost impossible to explain or defend, especially under the standards applied by appellate courts against arbitrary decision-making. If the Commission does agree with Spire, then it would behoove the

Commission to properly state and explain what the "point in time" analysis is, why it is just and reasonable, and how the Commission intends to apply it. Otherwise, it would appear that the rule requires quite literally **and arbitrarily** picking a random point in time during the case to determine the capital structure, which is reversible under Missouri law. *Spire Mo., Inc. v. Pub. Serv. Comm'n*, 618 S.W.3d 225, 231 (Mo. banc 2021) (a Public Service Commission's decision "is reasonable if supported by substantial, competent evidence on the whole record, it **is not arbitrary and capricious**, and is not based on an abuse of discretion." (emphasis added)).

Arbitrary really is the only word for describing the Company's position. To illustrate that, just consider this one little point: what would happen if the long-term debt that issued May 21, 2021, had actually been delayed and was instead issued June 1, 2021? Under that **exact** scenario, there would be no evidence in the record to disallow short-term debt costs excess of CWIP, even if you use Spire's "point in time" analysis. Move a **single** debt issuance by **less than two weeks**, and one has to fundamentally change the equation and expectation of how Spire Missouri is funded as a going concern for the foreseeable future using Spire's "point in time" analysis. This is not consistent with how the Commission regularly operates, nor does it make any logical sense. The Commission should instead order a capital structure (and rates in general) that reflect the actual financial reality of the utility on a continuing basis. Case Nos. 18,433, 18,463, 18,494 and 18,495, 20 Mo. P.S.C. (N.S.) 592, 1976 Mo. PSC LEXIS 31 (April 23, 1976) ("It is hoped that this 'snapshot' will accurately reflect the Company's situation **on a continuing basis** and that rates determined on the basis

of the 'snapshot' will reflect the Company's **continuing situation**." (emphasis added)). In this case, the **only** evidence that pertains to how Spire Missouri is funded on a continuing or normal basis is Mr. Murray's testimony showing that 7.3% of Spire Missouri's capital structure has been supported by short-term debt for the period from September 30, 2017 through September 30, 2020 **after** excluding short-term debt assets (including CWIP). *Rebuttal Testimony of David Murray*, pg. 15 lns. 1 – 7. The Commission should not ignore 19 months of data and base Spire's capital structure on just the last eleven days of May, 2021.

Alternative Cost of Capital Discussion

The OPC fully stands behind its arguments regarding the proper ROE and capital structure for Spire Missouri. During the evidentiary hearing, however, the Commission asked the OPC's expert witness whether he had "any recommendations for an appropriate capital structure outside of the Staff and the Company's proposal." Tr. pg. 826 lns. 16 – 18. Given this, the OPC considers it prudent to offer the following point for consideration. Should the Commission decide to emulate the learned King Solomon and "split the baby" so to speak, the evidence in this case supports an obvious middle ground: a capital structure of 50% common equity, 43% long-term debt, and 7% short-term debt with an ROE of 9.50%. While the OPC does **not** recommend the Commission adopt this capital structure and/or ROE (because the OPC stands behind its previous recommendations) the OPC will now spend a moment to point the Commission to the necessary support for this alternative proposed capital structure and ROE.

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Capital Structure

A capital structure of 50% common equity, 43% long-term debt, and 7% short-term debt is fully supported by the record. First, the OPC's witness provided a response to the Commission's question cited above:

> A. At a bare minimum, STL is a new pipeline, and obviously folks are aware of the issues there and that there's risk to whether or not it even continues. It was a brand new pipeline and they were authorized a higher rate of return as part of getting their certificate. FERC gave them a 50/50 capital structure, 50 percent equity, 50 percent debt. A brand new pipeline versus a company that's been in existence since the late 1800s and has fairly predictable ongoing investments for the foreseeable future within structure replacement, I don't understand how anybody can with a straight face say that Spire Missouri should have an equity ratio that's higher than what's assigned to the FERC STL pipeline. . . .
>
> [. . .]
>
> Q. Okay. Thank you. I'm going to sum up that last answer as it should at least be 50/50 like the STL pipeline and there are other examples within the Spire, Inc. affiliate organization that you could cite. Okay.
>
> A. Yes. When I say "50/50," I mean obviously the 50 percent of debt, my position, OPC's position is that 50 percent of debt should include a proportion of short-term debt if that were something that we were trying to I guess look at other alternatives.

Tr. pg. 826 ln. 19 – pg. 827 ln. 22. Second, the 50/50 split between debt and equity is further supported by the fact that "as it relates to Spire Inc.'s investments in ** ——

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—————— ** Exhibit 217C, *Surrebuttal Testimony of David Murray*, pg. 9 lns. 11 – 13. Third, the S&P Global data that Spire introduced into the record as Exhibit 51 stated: **

** Exhibit 51, *S&P Global RRA Report Dated 7/27/2021*, pgs. 3 – 4. Fourth, the OPC's expert witness Mr. Murray included information in his true-up rebuttal testimony that indicated what Spire's capital structure would be if one eliminated the fallacious "pro forma long term debt issuance" discussed regarding short term debt:

> Using this same period, which was already provided in Mr. Woodard's Schedule AWW-SR2 attached to his surrebuttal testimony indicates Spire Missouri's authorized capital structure should consist of the following ratios assuming no adjustment for goodwill: **49.93% common equity, 42.06% long-term debt, and 8.01% short-term debt**. If goodwill is removed from the common equity balance, then Spire Missouri's capital structure consists of the following ratios: 46.39% common equity, 45.03% long-term debt and 8.58% short-term debt

Exhibit 242, *True-up Rebuttal Testimony of David Murray*, pg. 5 ln. 24 – pg. 6 ln. 4, Schedule DM-TR-1. Finally, it should be noted that the OPC's recommendation of 45.00% common equity and Staff and Spire's recommendation of 54.28% averages out to 49.64%, so 50% equity would be right in the middle.[8] Based on the forgoing, it

[8] There is some legal support for just using an average of the recommendations. In fact, this is the method prescribed by law for an ISRS case if, for whatever reason, the actual numbers are unavailable. RSMo. § 393.1012.2(4)4(7) ("In the event information pursuant to subdivisions (2), (3), and (4) of this

should be easy for the Commission to fully support a capital structure that is 50% common equity, 43% long-term debt, and 7% short-term debt.

ROE

As with capital structure, an ordered ROE of 9.50% is fully supported by the record. First, consider the testimony of the OPC's expert witness Mr. David Murray:

> My analysis shows that electric utilities and LDCs are beginning to trade at similar valuation levels. However, this was not the case for much of 2020. Although I am recommending Spire Missouri be allowed the same ROE as Empire, I recognize the recent discount by recommending an ROE range with a high-end of 9.5%.

Exhibit 215C, *Direct Testimony of David Murray*, pg. 54 ln. 25 – pg. 55 ln. 4. Second note that this falls within Staff's recommend range as well. Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 23 lns. 23 – 25. ("Staff concludes that an authorized ROE of 9.37% is just and reasonable with a range of reasonableness of 9.12% to 9.62%."). Third, note that if one removes the 0.22% flotation adjustment from Spire's calculations, it results in the low end of Spire's recommendation falling to 9.44%, so 9.50% *could* be within Spire's range as well. *Spire Initial Brief*, pg. 82. Fifth, an ROE of 9.50% is very close to the ** ——————————————————

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subsection is unavailable and the commission is not provided with such information on an agreed-upon basis, the commission shall refer to the testimony submitted during the most recent general rate proceeding of the gas corporation and use, in lieu of any such unavailable information, the recommended capital structure, recommended cost rates for debt and preferred stock, and recommended cost of common equity that would produce the average weighted cost of capital based upon the various recommendations contained in such testimony."). The OPC does not argue that this method is **required** in this case, because this is not an ISRS proceeding, nor is the OPC even arguing that the Commission should employ this method. The OPC just notes that using an average of the proposals has at least been contemplated by the legislature if nothing else.

** Exhibit 51, *S&P Global RRA Report Dated 7/27/2021*, pgs. 1 – 2.

Finally, the average of the three proposals (9.25% for the OPC, 9.37% for Staff, and 9.95% for Spire) is 9.52%.[9] For all these reasons, an allowed ROE of 9.50% is fully justified and supported by the record.

[9] See footnote 8 supra.

Issue 8: Cash Working Capital

The arguments presented by both Spire and Staff regarding this issue have sadly added much confusion to this discussion. In order to correct for these problems, we must therefore unfortunately begin with a very brief review of the actual issue in dispute.

"Income Tax Component of Cash Working Capital" and "Current Income Tax Expense" are Separate and Distinct Items

Current Income Tax Expense refers to the amount of money that is included in a utility's rates to pay income taxes. It is literally the amount the utility collects **to actually pay income taxes**. Please consider the following:

> Q. If the Company was going to pay income taxes, the money to pay the income taxes is collected through which, current income tax expense or cash working capital?
>
> A. Current income tax expense.
>
> Q. Thank you. So your adjustment to cash working capital will not affect the amount they are collecting to pay income taxes?
>
> A. No, it will not.

Tr. pg. 524 lns. 7 – 15 (John Riley, CPA Speaking). Current Income Tax Expense is an **expense** item that is included in the company's revenue requirement. In this case, the amount of current income tax expense is calculated in Accounting Schedule 11 of Staff's full accounting schedules, which is titled "Income Tax Calculation." Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 11, pg. 1 of 2. The amount of total income tax expense is found at line 46, which is labeled "TOTAL SUMMARY

OF CURRENT INCOME TAX." *Id.* at ln. 46. This **exact** amount is transferred to the revenue requirement, where it is included at line 7 and labeled "Required Current Income Tax." *Id.* at Accounting Schedule 1, pg. 1 of 1. Please consider the following two figures:

Figure 2: Accounting Schedule 11 Excerpt

42	SUMMARY OF CURRENT INCOME TAX				
43	Federal Income Tax	$23,112,941	$33,040,249	$34,034,791	$35,022,019
44	State Income Tax	$4,104,381	$5,867,266	$6,043,876	$6,219,188
45	City Income Tax	$0	$0	$0	$0
46	TOTAL SUMMARY OF CURRENT INCOME TAX	$27,217,322	$38,907,515	$40,078,667	$41,241,207
47	DEFERRED INCOME TAXES				
48	Deferred Income Taxes - Def. Inc. Tax.	-$7,471,955	-$7,471,955	-$7,471,955	-$7,471,955
49	Amortization of Deferred ITC	-$202,545	-$202,545	-$202,545	-$202,545
50	Amortization of Protected Excess ADIT (TCJA)	-$1,939,752	-$1,939,752	-$1,939,752	-$1,939,752
51	Amortization of Unprotected Excess ADIT (TCJA)	-$6,517,877	-$6,517,877	-$6,517,877	-$6,517,877
52	Amortization of Protected Excess ADIT (MO)	-$372,850	-$372,850	-$372,850	-$372,850

Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 11, pg. 1 of 2 (annotations in red supplied).

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Figure 3: Accounting Schedule 1 Excerpt

Spire Missouri Inc.
Case No. GR-2021-0108
Test Year Ending 09/30/2020
Updated Through 12/31/2020
Revenue Requirement

Line Number	A Description	B 6.78% Return	C 6.91% Return	D 7.05% Return
1	Net Orig Cost Rate Base	$2,751,005,952	$2,751,005,952	$2,751,005,952
2	Rate of Return	6.78%	6.91%	7.05%
3	Net Operating Income Requirement	$186,463,183	$190,204,552	$193,918,409
4	Net Income Available	$149,117,593	$149,117,593	$149,117,593
5	Additional Net Income Required	$37,345,590	$41,086,959	$44,800,816
6	Income Tax Requirement			
7	Required Current Income Tax	$38,907,515	$40,078,667	$41,241,207
8	Current Income Tax Available	$27,217,322	$27,217,322	$27,217,322
9	Additional Current Tax Required	$11,690,193	$12,861,345	$14,023,885
10	Revenue Requirement	$49,035,783	$53,948,304	$58,824,701
11	Allowance for Known and Measureable Changes/True-Up Estimate	$11,100,000	$11,100,000	$11,100,000
12	Miscellaneous (e.g. MEEIA)	$0	$0	$0
13	Gross Revenue Requirement	$60,135,783	$65,048,304	$69,924,701

Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 1, pg. 1 of 1 (annotations in red supplied). Again, current income tax expense is the amount of **expense** included in rates to pay current income taxes (hence the name), as is shown in these two figures.

Cash working capital is not an expense item. It is a component of rate base. Exhibit 209, *Direct Testimony of John S. Riley*, pg. 8 ln. 5. It represents the amount of funds that are needed on average to meet a utility's **day-to-day** expenses:

> Cash Working Capital (CWC) is a rate base component that represents a measurement of the amount of funds, on average, required for the payment of a utility's day-to-day expenses, as well as an identification of whether a utility's customers or its shareholders are responsible for providing these funds in the aggregate.

Id. at lns. 5 – 9.

> Cash Working Capital ("CWC") is the amount of funding necessary for a utility to pay day-to-day expenses incurred in providing the utility services to its customers. Cash inflows from payments received by the Company and cash outflows for expenses paid by the Company are analyzed using a lead/lag study.

Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 33 lns. 14 – 17.

The income tax component of cash working capital reflects the **additional** amount of money that is included in rate base, to compensate either shareholders or customers, for **temporarily** sourcing the funds needed to meet the expense:

> When a utility expends funds in order to pay an expense necessary for the provision of service before its customers provide any corresponding payment, the utility's shareholders are the source of the funds. This shareholder funding represents a portion of each shareholders' total investment in the utility, for which the shareholders are compensated by the inclusion of these funds in rate base. By including these funds in rate base, the shareholders earn a return on the CWC-related funding they have invested.
>
> Customers supply funds when they pay for gas services received before the utility pays expenses incurred in providing that service. Utility customers are compensated for the funds they provide by a reduction to the utility's rate base. By removing these funds from rate base, the utility earns no return on that funding which was supplied by customers.

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Id. at lns. 18 – 27. What is **<u>immensely</u>** important to understand here is this: CWC does not represent the amount needed to pay the expense; CWC only represents the amount needed to cover the **<u>time difference</u>** between when the expense is paid and when the funding is received. This is important because it means that changing the CWC component does not **<u>in any way</u>** effect the amount included in rates to actually pay the expense. Tr. pg. 524 lns. 12 – 15 ("Q. Thank you. So your adjustment to cash working capital will not affect the amount they are collecting to pay income taxes? A. No, it will not. (John Riley Speaking)).

Again, we can see the difference by looking at the actual calculations performed in this case. The amount of cash working capital is included in the calculation of Spire's rate base on Accounting Schedule 2. Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 2, pg. 1 of 1 ln. 5. The cash working capital amount ($10,107,273) flows through to the total rate base amount ($2,751,005,952) at line 35. *Id*. at lns. 5, 35. This total rate base amount is then transferred to the "net Original Rate Base" on line 1 of the revenue requirement. *Id*. at Accounting Schedule 1, pg. 1 of 1 ln. 1. The point here is basic and simple: Current Income Tax Expense and CWC are **<u>different</u>**. The first is an expense item, the second is a rate base item. The first is meant to pay for taxes, the second is meant to account for the temporary source of funding necessary to bridge the time gap between receipt and disbursement of costs and revenue. Because they are different, the two items are accounted for differently in the accounting schedules and revenue requirement calculations. Again, this is a

very basic concept, but one the Commission needs to understand in order to know why Staff and Spire are completely wrong in their respective arguments.

Response to Spire

There are more than a few problems with Spire's argument on this issue, but let us focus on the key points. First, Spire sets out the OPC's position as follows:

> OPC's argument is essentially that because Spire does not expect to make income tax payments in the near future due to recognition of a net operating loss ("NOL"), it should not allocate funds for income tax expenses.

Spire Initial Brief, pg. 53. **This is flat out wrong**. The OPC is **not** taking the position that the amount included for current income tax expense should be modified in **any** way. Instead, the OPC is seeking to change the CWC calculations that deal with income taxes. As was just examined *at length*, CWC and current income tax expense are different. Spire is therefore **completely wrong** to say that the OPC is attempting to argue that Spire "should not allocate funds for income tax expenses." Changing the amount included for cash working capital will not affect the amount included for income tax expense. Tr. pg. 524 lns. 12 – 15 ("Q. Thank you. So your adjustment to cash working capital will not affect the amount they are collecting to pay income taxes? A. No, it will not. (John Riley Speaking)).

The OPC's **real** argument is that the expense lag for purposes of calculating the CWC component regarding income taxes should be set to 365 days to account for the fact that customers are providing funding to pay for income taxes that Spire is

never spending. Let us break this down by looking at Staff's cost of service report. Staff states, "[c]ustomers supply funds when they pay for gas services received before the utility pays expenses incurred in providing that service." Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 33 lns. 24 – 25. In this case, customers are supplying funds to pay an expense (income taxes) because they are paying for gas services before Spire pays the expense (remits the income tax to the State or federal Government). Staff next states:

> Utility customers are compensated for the funds they provide by a reduction to the utility's rate base. By removing these funds from rate base, the utility earns no return on that funding which was supplied by customers.

Id. at lns 25 – 28. Based on this, we see that the income tax portion of CWC should result in "a reduction to the utility's rate base" in order to compensate customers for the funding they are supplying by paying the amount necessary to cover the cost of income tax expense **before** Spire pays out income taxes. *Id*. So far, so simple.

The next step requires figuring out **how much** rate base should be reduced by. To do that we need a "revenue lag" and an "expense lag." *See generally,* Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 34 ln. 25 – pg. 35 ln. 18. In this case, no party has disputed the revenue lag (which "indicates the number of days between the midpoint of the provision of service by Spire East and Spire West and the payment by the ratepayer for such service") so the OPC will ignore this part. *Id*. at pg. 35 lns. 1 – 3. What **is** in dispute is the expense lag. The expense lag "indicates the number of days between the receipt of and payment for the goods and

services (i.e., cash expenditures) used to provide the service to the ratepayer." *Id*. at pg. lns. 5 – 6. In other words, you ask "how much time elapses between when Spire gets money from customers and when Spire has to pay money out?" Therefore, the proper question for this issue is simply: how much time elapses between when Spire gets money to pay income taxes and when Spire actually pays its income taxes? That is literally **all** the Commission has to answer.

Spire and Staff answered the question "how much time elapses between when Spire gets money to pay income taxes and when Spire actually pays its income taxes" by assuming that Spire pays taxes on a quarterly basis. Exhibit 26, *Rebuttal Testimony of Timothy S. Lyons,* pg. 4 lns. 11 – 14; Exhibit 119, *Rebuttal Testimony of Antonija Nieto*, pg. 3 lns. 14 – 17. Spire argues in its brief that this is "to conform with Section 6655 of the Internal Revenue Code." Again, **this is false**. Section 6655 of the Internal Revenue Code includes a specific exception if the tax for the year is less than $500. 26 USC §6655(f) ("No addition to tax shall be imposed under subsection (a) for any taxable year if the tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than $500."). This is reflected in the same IRS publication on which Spire relies so heavily. Exhibit 49, *IRS Publication 542*, pg. 6 ("Generally, a corporation must make installment payments **if it expects its estimated tax for the year to be $500 or more**." (emphasis added)). The unrefuted point is this: you do not assume quarterly tax payments when the taxpayer does not expect to pay more than $500 in taxes.

Spire does not have any reason to assume it will have more than $500 in taxes. Tr. pg. 525 lns. 13 – 21; pg. 624 lns. 12 – 15. "Spire Inc.'s state and federal income tax returns, the Company's annual report filed with the Commission, and the public 10-K reports all indicate that both the parent company and Spire Missouri have not been required to pay income tax in at least the last three years." Exhibit 209, *Direct Testimony of John S. Riley*, pg. 9 lns. 4 – 6. ** ________________________________

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Exhibit 211, *Surrebuttal Testimony of John S. Riley*, JSR-S-03, pg. 11 lns. 1 – 4. Finally, Spire's net operating loss carryforward balance has been steadily increasing, which is consistent with statements made "in the Company['s] most recent 10-K, **which eliminated past and future tax liabilities**." Tr. pg. 647 lns. 6 – 8; Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 11 fn. 10; Exhibit 209, Direct Testimony of John S Riley, JSR-S-03, pg. 9 fn. 7 (emphasis added). Therefore, there is no reason for Spire to assume it will have $500 or more in tax and thus no reason to assume quarterly tax payments. 26 USC §6655(f); Exhibit 49, *IRS Publication 542*, pg. 6.

The proper answer to the question of "how much time elapses between when Spire gets money to pay income taxes and when Spire actually pays its income taxes" is 365 days. This is the proper answer because Spire will not pay income taxes **at all** in the near future. Tr. pg. 525 lns. 13 – 21; pg. 624 lns. 12 – 15. Because Spire collects the funds but does not pay them out, one must use 365 days of expense lag since that

is the maximum value when computing expense on an **annual** basis. This is what Mr. Riley **actually** stated in his rebuttal:

> It is clear that both Spire and Staff do not expect income tax payments to be made to any taxing authorities in the near future due to the recognition of an NOL in the case. A lack of payment should be reflected in the expense lag. That lag should reflect the expected payment date for income tax expenses. **No tax payments in the test year or true-up justifies a 365 day expense lag. An expense lag of a year recognizes the revenue coming in but never being paid out as an expense**.

Exhibit 210, *Rebuttal Testimony of John S Riley*, pg. 5 lns. 13 – 18. **This** is the OPC's argument. The whole point of this digression was to establish **one** thing: the OPC is not asking to modify current income tax expenses as Spire falsely claims. *Spire Initial Brief*, pg. 53. Instead, the OPC is simply and solely asking the Commission to modify the amount of time between when Spire gets money to pay income taxes and when Spire actually pays its income taxes to be 365 days for the purpose of computing CWC, which is necessary to reflect the simple fact that Spire does not actually pay income taxes. That is it.

The next point that merits discussion from Spire's brief follows directly from the first issue and is found on page 54 of Spire's brief. Spire states:

> *If OPC is correct* that Spire should not include any income tax expenses, then zero dollars will be allocated to Spire's cash working capital requirement for income tax. This means that zero dollars will be impacted by an expense lag, rendering the lag time number effectively useless.

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Spire Initial Brief, pg. 54. Again, **the OPC is not arguing that Spire should not include any income tax expenses**. One can hopefully see why the OPC had to spend so much time discussing the first point. It is because Spire is grossly misconstruing the OPC's actual argument.[10] At no point has the OPC **ever** suggested that Spire should allocate zero dollars to Spire's cash working capital requirement for income tax. In fact, the OPC's witness argued the **exact opposite** on the stand:

> Q. This is the same question I asked Ms. Nieto. Why not, for purposes of the cash working capital calculation, why not have the test year adjusted federal and state income tax offset expense be zero? I'll stop there. Why not have it be zero?
>
> A. Well, if you zero you out this entry, it doesn't completely take in the entire calculation. Because of tax normalization rules, and Staff follows those rules, they include an amount for income tax expense in the rate case even though the Company is not paying income taxes [currently]. That's a requirement that we really do not get around, which is completely different than most any other expense built into the case. Even the Staff had mentioned earlier that they did not include earnings tax. So basically they zeroed it out because the Company wasn't paying, it wasn't required to pay any earnings tax. However, that's different with income tax because they have to include them. So what we have is not just the fact that they aren't paying income tax; we have the fact that the money is coming in, which is different than what I said like the earnings tax or some other expenses built into the case. If you don't have an expense, you generally don't include, you know, a payment. But with income tax, we can't get around that.
>
> [. . .]
>
> So to finish that up, if you just zero it out you aren't taking into account that the ratepayer has actually put the money up. So to zero it out doesn't give the credit to the ratepayer.

[10] Whether this is the result of error in understanding or a deliberate attempt to mislead is unclear.

Tr. pg. 510 ln. 13 – pg. 511 24. Instead, the OPC's argument is to increase the expense lag to 365 days, which will drive the net lag negative, which will result in a negative CWC requirement overall. This is demonstrated by the Staff's explanation of how CWC is actually calculated.

Staff explained the CWC calculation in its cost of service report. Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 34 ln. 25 – pg. 35 ln. 18. Just cross-reference this explanation with the actual schedule (Accounting Schedule 8) found in Exhibit 102. Because of the size of the schedule, the OPC has transferred the relevant numbers for discussion to the table below.

Table 1: Select Cash Working Capital Calculations

Line Number	A Description	B Test Year Adj. Expenses	C Revenue Lag	D Expense Lag	E Net Lag	F Factor (Col E / 365)	G CWC Req B x F
27	Property Tax	$20,411,282			- 137.41	- 0.376466	-7,684,154
34	Federal Tax Offset	$34,034,791	49.27[11]	38[12]	11.27	0.030873	$1,050,751

Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 8, pg. 1 of 1. What the OPC is proposing is to change the number in column D for Federal Taxes to 365.

[11] We know the revenue lag is 49.27 despite this value not being in Account Schedule 8 because Spire identifies that the Expense Lag is 38 days and Staff indicates that the Column E Net Lag "results from the subtraction of the Expense Lag (Column D) from the Revenue Lag (Column C)." The math for this calculation is thus: Net Lag (E) = Revenue Lag (C) – Expense Lag (D). In this case, 11.27 = 49.27 – 38.

[12] Spire states that the expense lag is 38 days. *Spire Initial Brief*, pg. 52.

See, *e.g.*, Exhibit 210, *Rebuttal Testimony of John S Riley*, pg. 5 lns. 13 – 18. Based on the numbers in Staff's schedule, this would result in the Net Lag (E) becoming a negative 315.73. This would further result in the Factor (F) becoming negative 0.865017. Finally this would result in the CWC requirement (G) becoming negative $29,440,560.[13] As can be plainly seen, this would **not** result in the zero dollar impact that Spire claims. *Spire Initial Brief*, pg. 54.

The last point that the OPC wishes to respond to is the general idea that "if the OPC is wrong, then Spire will not have the appropriate funds needed to pay income taxes." *See Spire Initial Brief*, pgs. 54 – 55. To this point, the OPC once again observes that it is Spire who has the burden of proving the rates that it seeks are just and reasonable. RSMo. § 393.150.2 ("At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the gas corporation"). The OPC has put forward significant evidence to show that Spire does not and should not expect to pay income taxes in the near future. Tr. pg. 525 lns. 13 – 21, pg. 624 lns. 12 – 15; Exhibit 209, *Direct Testimony of John S. Riley*, pg. 9 lns. 4 – 6, pg. 9 fn. 7; Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 11 fn. 10. Spire has offered **nothing** to refute this point. Staff has offered **nothing** to refute this point. In fact, Staff's

[13] A negative CWC component is not a problem. The property tax CWC component is already negative, for example. Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 8, pg. 1 of 1 ln. 27. On the stand, the OPC's witness Mr. Riley explained that this is because "[p]roperty taxes have -- historically are paid at the end of the year." Tr. pg. 513 lns. 21 – 22. Even if the **whole** CWC calculation goes negative that is still not a problem. As Staff explained in its cost of service report: "[a] negative CWC requirement [just] indicates that, in the aggregate, the utility's customers provide the CWC for the test year." Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 33 ln. 31 – pg. 34 ln. 1.

inclusion of an NOL in rate base **proves** that Staff does not expect Spire to pay income taxes:

> Staff included an NOL in rate base. NOL recognition is indisputable proof that Staff recognizes that Spire will not pay income tax. Obviously, if one includes proof in the calculations that income taxes are not being paid then the lead/lag for income tax payments would need to be adjusted. Specifically, the expense lag would be adjusted to reflect nonpayment.

Exhibit 210, *Rebuttal Testimony of John S. Riley*, pg. 4 lns. 12 – 16. There is **no** evidence in the record **at all** to support the finding that Spire will or is even expected to pay income taxes in the near future. Moreover, Spire **legally** does not get the benefit of the doubt. RSMo. § 393.150.2. Spire's assertion that "[t]here is no magic ball that indicates whether tax law could change" is therefore meaningless. The Commission has to render its decision **based on the evidence presented**. In this case, that means assuming there will be no payment of income taxes. The CWC calculation of income taxes must therefore be adjusted accordingly. Exhibit 210, *Rebuttal Testimony of John S. Riley*, pg. 4 lns. 12 – 16, pg. 5 lns. 13 – 18.

Response to Staff

Much of Staff's brief adds little to the discussion. The background covers issues already discussed above that need not be repeated here. The first real point that merits discussion is the following two lines from page 25:

> Staff has historically recommended or accepted federal and state income tax lags based on the statutory required quarterly equal tax payments. The income tax lag calculation was not based on how much, if any, income tax the Company actually paid.

Staff Initial Brief, pg. 25. With regard to the first sentence, Spire is **not** statutorily required to make quarterly equal tax payments. As explained above, there is an exception built into the law that prevent these payments if the taxpayer has less than $500 in tax. 26 USC §6655(f) ("No addition to tax shall be imposed under subsection (a) for any taxable year if the tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than $500."); Exhibit 49, *IRS Publication 542*, pg. 6 ("Generally, a corporation must make installment payments **if it expects its estimated tax for the year to be $500 or more**." (emphasis added)). As for the second point, the fact that the income tax calculation "was not based on how much, if any, income tax the Company actually paid" is literally the whole problem with this issue. Staff is explicitly acknowledging that it ignored facts and just "did what it usually does." **This is not how regulation is supposed to work**. Staff is not supposed to just ignore facts and calculate CWC for income taxes without bothering to check how much, if any, Spire actually pays in income tax.

The next paragraph of Staff's brief argues that, if the Commission agrees with the OPC, the Commission should order "income tax expense lag be set so the federal and state income tax expense has no impact on the CWC requirement." *Staff Initial Brief*, pg. 25. "In other words, the Staff recommends zeroing out the federal and state income tax expense line item within the CWC requirement calculation." *Id.* Staff **offers** no support for this proposition from either a legal or factual basis, and there **is** no legal support for this proposition from either a legal or factual basis. As

previously discussed, the OPC's witness already explained on the stand why this is wrong. Tr. pg. 510 ln. 13 – pg. 511 24. Staff's position is directly contradicted by the factual record that shows current income tax is built into this case. Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 1, pg. 1 of 1 ln. 46. Spire's customers are going to provide the funding to cover income tax expense, and then Spire is just going to keep those funds. **<u>According to Staff's own cost of service report</u>**, that money should be used to offset rate base. Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 33 lns. 25 – 26 ("Utility customers are compensated for the funds they provide by a reduction to the utility's rate base."). Staff's position amounts to denying customers the benefit of the funds they provided with **<u>no</u>** rationale offered for why.

The last point is sadly one that will add a **<u>lot</u>** of unnecessary complication. Staff attempts to make an argument that the OPC's adjustment will result in a violation of the IRS's normalization rules. It supports that position with reference to a private letter ruling ("PLR"). Staff's argument is **<u>exceptionally</u>** flawed, but it is going to take some work to fully explain it. The OPC will try to keep this brief.

Staff's position is based on a decision and PLR rendered in regards to a case appearing before the Virginia State Corporation Commission that Staff states is "similar to this one." *Staff Initial Brief*, pg. 26. **<u>It is not</u>**. At the time of the Virginia case, Virginia used a future test year with post-hoc true up period, as explained in the PLR:

> The law of State A provides a process under which a utility may recover its costs relating to projects such as new electric generation facilities as a stand-alone rate adjustment added to customers' base rates. As relevant to this ruling request, the process for setting the rates involves two components. First, a taxpayer files estimated projections of all factors, including Accumulated Deferred Federal Income Taxes (ADFIT), relevant to the costs associated with the facility that is the subject of the rate adjustment. Rate base for this purpose is calculated using an average of the thirteen **projected** end of month balances of the components of rate base. The rate adjustment computed using these projections goes into effect at the **beginning of the test period**. The test period is a twelve month period. The anticipated collections from rate payers, **the actual cost incurred with respect to the generating facility and any differences between anticipated amounts and actual amounts are reconciled by a "true-up" mechanism at the end of the test year**. Under this mechanism, the reconciliation amount is either charged to ratepayers (if actual revenues are below estimates) or credited to ratepayers (if actual revenues exceed estimates) as part of the rates established for the forthcoming rate year. For both under and over collections, a carrying charge is imposed.

Exhibit 141, *IRS Private Letter Ruling 201541010*, pg. 2 (emphasis added). This is important, because the PLR turns on the application of a proration methodology that is required by the IRS in the event of a future test year. *Id*. at pg. 2 ("Section 1.167(l)-1(h)(6) of the Income Tax Regulations requires that a proration methodology be used by Taxpayer to calculate its applicable ADFIT balance for future test periods."). However, the Company and Staff of the Virginia Commission began to argue about whether the true-up was a future test year requiring the use of a proration methodology:

> Members of Taxpayer's tax department became concerned about the normalization implications of not using the proration formula during Year A. In filing Case A, Case B, and Case C, Taxpayer incorporated the proration methodology into the calculation of its projected ADFIT balance. In addition, Taxpayer incorporated the proration methodology into the calculation of the true-up in Case B. The staff of Commission A

PUBLIC

> did not agree that the test period used for the rate adjustment ratemaking was a future test period and therefore asserted that the proration methodology was not required.

Id. at pg. 3. The Virginia Commission ultimately decided to approve "the use of the proration methodology in the projected ADFIT balance but denied its use in the true-up." *Id*. What is most important to **our** discussion though, is that "[w]hen Commission A approved the use of the proration methodology for the projected ADFIT balance, it revised a portion of the Taxpayer's cash working capital allowance **to reflect the adoption of the proration methodology**." *Id*. (emphasis added). "Commission A concluded that the item in the cash working capital allowance was **duplicative** of the effect of the proration methodology and was thus unnecessary." *Id*. (emphasis added). This is all very important because the IRS based its decision on the fact that the Commission was adjusting the CWC calculation to account for the use of the proration methodology required because of the future test year:

> In Taxpayer's stand-alone rate adjustment proceedings, Commission A adjusted the already-approved cash working capital allowance **specifically to mitigate the effect of the use of the proration methodology**, finding the effects **duplicative**. In general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. See generally, § 1.46-6(b)(2)(ii) (In determining whether, or to what extent, the investment tax credit has been used to reduce cost of service, reference shall be made to any accounting treatment that affects cost of service); Rev. Proc 88-12, 1988-1 C.B. 637, 638 (It is a violation of the normalization rules for taxpayers to adopt any accounting treatment that, directly or indirectly flows excess tax reserves to ratepayers prior to the time that the amounts in the vintage accounts reverse). Here, Commission A adjusted the cash working capital allowance **specifically to mitigate the effect of the application of the proration methodology**. This is inconsistent with the normalization rules. We do **not** hold that the normalization rules require a similar type of cash working capital adjustment **in all cases**;

> we hold only that, where, **as here**, it is adjusted or removed **in an attempt to mitigate the effects of the application of the proration methodology or similar normalization rule**, that adjustment or removal is not permitted under the normalization rules.

Id. at pgs. 8 – 9. (emphasis added). That was a lot to consider. Let us take a moment to review.

The Virginia case and PLR were based on Virginia's unique future test-year plus historical true-up rate mechanism. Because of this dichotomy, it was unclear whether it was necessary to use the proration methodology to calculate ADIT balances that is required for future test-years by IRS regulation. The Virginia Commission decided to order the proration methodology in the future test-year, but not for the historical true-up. When it ordered the proration methodology, the Virginia Commission decided to adjust the CWC requirements because it considered them **duplicative** of the proration methodology. The IRS said that this adjustment to reflect the duplicative nature was an attempt to mitigate the effect of the proration methodology itself. The IRS concluded that attempting to mitigate the proration methodology was inconsistent with the normalization rules. Now the major question: does any of that have **anything** in common with this case? The answer: no, not one bit.

This case employed a historical test year, not a future test year. No party to this case is claiming, arguing, or even attempting to address a proration method under Section 1.167(l)-1(h)(6) of the Income Tax Regulations. The CWC issue has **nothing** to do with ADIT balances, which are what requires the proration

methodology. Even if there was a requirement to use the proration methodology, no one is attempting to argue that use of the proration method would be duplicative of the CWC calculation. No one is attempting to argue any mitigation of any proration method or similar normalization rule. This case has absolutely nothing in common with the Virginia case. Neither the facts, nor law, nor logic employed by the IRS with regard to the PLR issued in that case have any bearing on this one.

Having gone through that, we come to the conclusion of the Staff's argument, which is a single sentence stating: "[c]learly, the OPC's attempt to use CWC to mitigate or manipulate the effects of income tax expense on Spire's revenue requirement will violate the IRS' normalization rules." *Staff Initial Brief*, pg. 27. To start off, this is offered with no legal or factual support from the record save for the PLR, which the OPC has now shown is completely distinct from the present case. More importantly, though, the real issue here comes back to the phrase "to mitigate or manipulate the effects **of income tax expense**[.]" We thus return to the beginning of the issue: the "income tax component of cash working capital" and "current income tax expense" are separate and distinct items. Fortunately, the OPC already explained this at length, so we do not need to spend long discussing it again. The CWC calculation proposed by the OPC will have **no** effect on the current income tax component of the revenue requirement. Tr. pg. 524 lns. 7 – 15 (John Riley Speaking). CWC literally **cannot** affect current income tax because those two items are calculated separately (also one is an expense item and the other is added to rate base). *See* Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedules 1, 2, and 11.

Because the OPC's adjustment only affects CWC and not current income tax expense, it cannot be said to mitigate or manipulate the effects of income tax expense on Spire's revenue requirement so it would not constitute a normalization violation even if Staff's erroneous application of PLR 201541010 was right.[14]

Conclusion

Both Staff and Spire fall into the trap of confusing current income tax expense with cash working capital. The Commission needs to keep these two things separate.

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[14] Because the issue of normalization violations have been brought up repeatedly throughout this case, it may be best to consider what **exactly** the normalization rules actually require. The rules themselves are defined at 26 USC §168(i)(9). There are effectively two parts. Section 168(i)(9)(A)(i) states:

> the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and

This provision requires the taxpayer to compute the federal income tax **expense** (which is taken into account in setting its rates) using a depreciation method that is the same as the method used to compute the depreciation expense for purposes of computing those rates. *Id.*; *see also* IRS Rev. Proc. 2017-47, pg. 3. So, for example, if the utility elects to use a straight line depreciation method to calculate depreciation expense for the purpose of setting its rates (which is what is done in Missouri) then the utility must also use the straight line depreciation method (as opposed to the accelerated depreciation that the utility can elect for tax purposes) when calculating the depreciation deductions that may be claimed on the utility's tax return for the purpose of determining the utility's federal income tax expense to be included in rates. The second part of the rule, section 168(i)(9)(A)(iI), states:

> if the amount allowable as a deduction under this section with respect to such property (respecting all elections made by the taxpayer under this section) differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Under this provision, a taxpayer must account for any **differenc**e between its federal income tax expense as was included **in its rates** and the **actual federal income tax it pays** as a reserve for **deferred taxes**. *Id.*; *see also* IRS Rev. Proc. 2017-47, pgs. 3 – 4. This means that if the amount the utility pays in taxes to the federal government is less than what it calculated for rates (due to the difference between straight line and accelerated depreciation methods for example), the utility must account for that difference by booking the amount to a deferred tax account. In Missouri, we call that deferred tax account "accumulated deferred income tax" or ADIT for short.

Just remember: current income tax expense is an **expense**, cash working capital is **rate base**. Once you clear that hurdle, the rest is easy. All the evidence in the record shows that Spire will not pay income taxes in the near future. Tr. pg. 525 lns. 13 – 21, pg. 624 lns. 12 – 15; Exhibit 209, *Direct Testimony of John S. Riley*, pg. 9 lns. 4 – 6, pg. 9 fn. 7; Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 11 fn. 10. Therefore, the expense lag for the income tax component of CWC should be adjusted to reflect the non-payment. Exhibit 210, *Rebuttal Testimony of John S. Riley*, pg. 4 lns. 12 – 16, pg. 5 lns. 13 – 18. That adjustment should be 365 days. *Id*. This will result in a negative CWC amount overall. Such an outcome is perfectly fine, however, as it just "indicates that, in the aggregate, the utility's customers provide the CWC for the test year." Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 33 ln. 31 – pg. 34 ln. 1.

Issue 13: Incentive Compensation

As the OPC predicted in its *Initial Brief*, Spire and Staff have based the entirety of their respective cases regarding incentive compensation on the premise that customers will receive a benefit from the proposed incentive compensation programs. Neither party took **<u>any</u>** steps to rebut the argument regarding double-recovery that was raised by the OPC's witness and expounded upon during the evidentiary hearing. As such, both Spire and Staff are effectively arguing that it is permissible for Spire to double-recover the cost of implementing its incentive compensation programs as long as customers see a benefit. There is no fact, law, or logic that supports this position.

<u>Customer Benefit Does not Justify Double Recovery</u>

The OPC knows of no other costs included in Spire's revenue requirement for which the Company is permitted double-recovery. Staff and Spire have offered no example of another cost for which the Company is allowed to double recover. Staff and Spire have offered no explanation, either legal or logical, for why the Company should be allowed to double-recover the cost of its incentive compensation plans. The only thing that Staff and Spire are capable of doing is persistently dwelling on the idea that the incentive plans will generate benefits for customers. *Staff Initial Brief*, pg. 30 ("Since the two new metrics implemented by Spire produce benefits for ratepayers, Staff recommends that both metrics be included in base rates."); *Spire Initial Brief*, pg. 59. Again, **<u>there is no legal basis presented for why customer's</u>**

benefiting from a plan justifies double recovery. The OPC is at a loss to even know how to respond to Staff and Spire on this point because both have effectively just completely ignored the OPC's argument and have failed to address the central point of this dispute.

While Staff's brief just completely ignores the OPC, Spire at least makes an effort to address the OPC. Unfortunately, the Company badly misconstrues the argument when it states "[t]he central tension between OPC's position and Spire and Staff's position is in the difference between strictly monetary benefits to Spire versus non-monetary benefits to customers." *Spire Initial Brief*, pg. 58. **This is not remotely true**. The central tension between OPC's position and Spire and Staff's position is that the OPC is arguing the incentive plans will pay for themselves and thus result in double recovery. This can be seen in the direct testimony of the OPC's witness. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 20 lns. 21 – 23 (** ____

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______________________________ **). It can be further seen in the opening statements the OPC gave during the hearing. Tr. pg. 534 ln. 23 – pg. 535 ln. 1 ("[T]he incentive plan will pay for itself through positive regulatory lag. Because it will pay for itself, it is not necessary to have customers further pay for it by including it in rates."). Finally, it can be seen in the questioning that was done during the hearing itself. *See*, *e.g.*, Tr. pg. 576 lns. 11 – 17. Because Spire does not have a good

answer to the double-recovery problem, the Company has fallen back on attacking pointless straw-man arguments.

The only time where Spire's brief comes even *close* to directly addressing the central premise of the OPC's argument is the following two lines:

> OPC's belief that all non-monetary customer benefits will always result in more profit is not in line with reality. There is no guaranty that Spire's short-term gains will always outpace the short-term costs of this compensation package.

Spire Initial Brief, pg. 59. Naturally, enough, this statement is offered with **no** citation to the record and is, in fact, directly contradicted by Spire's own witness:

> Q. So you don't know if the plan you are proposing might actually end up cost customers an average in the aggregate more than they will see in savings?
>
> A. I would hope not, Mr. Clizer.
>
> Q. You would hope that the cost, the plan in the aggregate would generate cost savings greater than the cost of the plan itself. Right?
>
> A. For O&M reduction, yes.
>
> Q. Right. And for the other one, the utility contribution margin, that should increase company revenues. Right?
>
> A. Correct.
>
> Q. And it should increase revenues by more than the plan costs. Correct?
>
> A. An ideal incentive comp makeup, yes.
>
> Q. You say ideal. Wouldn't it be imprudent to have a plan that doesn't generate more revenues than it costs?
>
> A. That would be a problematic compensation plan.
>
> Q. Right. So we would agree that a prudent compensation plan is going to generate more revenues than it costs to run?
>
> A. Or reduce expenses.

Tr. pg.552 lns. 2 – 25 (Re-cross Examination of Scott Weitzel). Staff, incidentally, stated effectively the same. Tr. pg. 559. lns. 15 – 18 (Cross examination of Jeremy Juliette). A prudently designed incentive compensation plan will generate gains in an amount greater than the compensation package. Tr. pg.552 lns. 2 – 25; Tr. pg. 559. lns. 15 – 18. That is **literally how an incentive compensation plan is designed to operate**. Tr. pg. 576 lns. 11 – 14 ("[I]t is your position that the Company's benefit will be greater than the cost of the plan itself. Right? A. It should be, **by design**.") (Robert Schallenberg Speaking) (emphasis added)). Spire's claim that the OPC is making "massive assumptions about how customer benefits correlate to company profit" is completely false. The correlation **has been established by Spire's own witness**. Tr. pg.552 lns. 2 – 25 (Re-cross Examination of Scott Weitzel); *Id*. at pg. 542 ln. 22 – pg. 543 ln. 1. ("Would you agree me that a prudently designed plan would increase revenues or decrease expenses by an amount greater than the cost of the plan itself? A. Yes. There needs to be -- in designing a plan, there needs to be an ultimate benefit.") (Cross Examination of Scott Weitzel)).

Conclusion

Neither Staff nor Spire offer **any** justification for allowing Spire to double-recover the cost of implementing Spire's incentive compensation programs. There is no such justification. Staff, **in this very case,** sought to disallow recovery of severance expense due, in part, to the need to prevent double recovery. Exhibit 136, *Surrebuttal Testimony of Antonija Nieto*, pg. 6 lns. 19 – 23; pg. 8 lns. 1 – 2. The

evidence is uncontroverted that these programs will pay for themselves, thus resulting in double recovery if included in rates. Tr. pg. 559. lns. 15 – 18, pg. 542 lns. 22 – 25, pg. 552 lns. 2 – 25, pg. 576 lns. 3 – 17. The Commission should therefore not permit the cost of these incentive compensation programs to be recovered in rates and instead just allow Spire to recover their costs through the operation of the programs themselves.

PUBLIC

Issue 15: Capitalization of Overheads

Because the OPC and Staff are largely aligned on this issue, the OPC will forgo responding to Staff and instead respond exclusively to Spire.

Response to Spire

Spire raises several arguments with regard to this issue, each of which will be addressed in turn. As with other issues, there are many points stated in Spire's brief that are inaccurate or misleading but which will not be addressed here so as to not unnecessarily expand this brief. We begin with the examination of Spire's direct response to the fundamental argument that the Company is not complying with the Uniform System of Accounts ("USAO").

Regarding what is "Arbitrary"

Spire centers its analysis of the question of whether it is in compliance with the USOA on the use of a single word from Gas Plant Instruction 4 paragraph B. The word in question is "arbitrary" as used in the sentence "[t]he addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted." *Spire Initial Brief*, pg. 24. Spire presents a definition of the word "arbitrary" from Black's Law Dictionary and argues that, so long as its capitalization policies are "done according to reason and judgment" they are not arbitrary and thus permitted. *Id*. at pg. 25. Spire has missed the point.

The first step to understanding just how badly Spire has gone off the rails on this issue is to read the whole of paragraph B in context. Spire has helpfully provided a copy of the paragraph in its brief for us to consider:

> As far as practicable, the determination of payroll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

Id. at pg. 24. If read in context, it is obvious that the purpose of this rule is to tie the overheads being capitalized to construction projects directly to those projects through a defined relationship. *Id*. ("to the end that only such overhead costs as have a definite relation to construction shall be capitalized"). The prohibition against arbitrary percentages should therefore be read as an injunction against methodologies of assignment that do **not** show the definite relationship, which is further buttressed by the phrase "or amounts to cover **assumed** overhead costs" *Id*. (emphasis added). We do not need to turn to Black's Law Dictionary to understand this. Instead, the Commission needs to ask a simple question: how do we know the dollars being booked to a construction project **were actually incurred because of that construction project**. This is what Spire has failed to prove.

What Spire is doing is prohibited by the USOA (and should not be permitted by this Commission) because the Company is **assuming** the amount of time that its corporate back-office spends on certain construction projects based on a ratio of direct

labor to total labor instead of using actual time-card reporting. This was all laid out in Staff Witness Young's surrebuttal:

> In order to avoid using an arbitrary percentage to account for overhead payroll charges, Spire must examine the time reporting of each employee that does not directly charge their time to construction to find the appropriate amount of indirect construction-related payroll. Rather than examining the time of supervisors, Spire has relied exclusively on an arbitrary relationship between direct and indirect labor to account for overhead payroll costs, and the related payroll benefits that follow payroll.

Exhibit 140, *Surrebuttal Testimony of Matthew R. Young*, pg. 19 lns. 1 – 6 (emphasis in original). In practice, the system works like this: a Spire construction worker directly bills 5% of his or her time to Construction Project A, so Spire allocates 5% of the overhead costs related to employing, say, an engineer who would have supervised that project to Construction Project A. Spire does this **without** looking at the time card reporting of that engineer to see if he or she actually spent that much time on the project. It is **this** practice that renders the exercise arbitrary. There is no correlation between how much time a construction worker spends on a project and how much time the back-room engineer spends, as Mr. Young explained on the witness stand:

> Q. And I think you further explain that Spire has assumed there is a relationship between how construction employees use their time and how a supervisor's time is used?
>
> A. **Yes, and that's what makes it an arbitrary sentence**.
>
> Q. Well, that's my question for you. Doesn't the method used by Spire use reason or judgment? It's just not the reason or judgment that you think they should use?

> A. It's not the -- **<u>it's not reasonable to just assume that the supervisors and their supervisors and all the way up to who knows how far up the hierarchy of the employees, that their time is dictated by how the time is reported by the field employees</u>**.
>
> Q. But let's back up a second. I mean you're making an assumption as to how this plays out down the road. But at the fundamental level, there is reason or judgment in terms of how Spire Missouri approaches these overheads, the capitalization of overheads; correct?
>
> A. **<u>No</u>**. We won't know until we see how their –
>
> COURT REPORTER: (Asked for clarification.)
>
> THE WITNESS: How Spire's reasoning was laid out.

Tr. pg. 148 ln. 21 – pg. 149 ln. 19 (emphasis added). Instead, the USOA says to either (1) use the direct time card for the engineer or (2) conduct a special study to determine the time supervisory employees like the engineer devote to construction activities. *Spire Initial Brief*, pg. 24.

The preceding discussion more or less covers the entirety of Spire's brief as the actual legal argument at issue here. There are just two minor digressions that merit mention. The first is the fact that Spire argues rather fervently that it must be acting appropriately because it has been doing the same thing for years. *Spire Initial Brief*, pgs. 27 – 28. On this point, the OPC notes the testimony of Staff witness Mr. Young:

> Q. Does remaining consistent for the sake of consistency create value for stakeholders?
>
> A. While there is value in consistency, not reflecting changes to Spire's operations may create detrimental effects to ratepayers and shareholders that outweigh the value created by Spire's consistency. According to Mr. Krick, the capitalization of overheads has remained constant while the rest of Spire's operations has changed dramatically. As Mr. Krick shows, Spire Missouri's capital expenditures have more

> than doubled between 2014 and 2020. During the same time period, the Laclede Group Inc., that had recently acquired Missouri Gas Energy, further expanded its state and federal regulated operations, expanded its non-regulated operations, and literally became a new company we now know as Spire Inc.
>
> Q. Does using a consistent approach prove compliance with the USOA?
>
> A. No, maintaining an approach that has been used for decades has no relationship to the issue of compliance with the USOA. It appears Mr. Krick is implying that Spire's capitalization of overheads has been approved by the Commission in the past. However, I am unaware of capitalized overheads being raised as an issue in any Spire, or any of Spire's predecessors, proceeding until Spire's ISRS Case Nos. GO-2019-0115 and GO-2019-0116.

Exhibit 140, *Surrebuttal Testimony of Matthew R. Young*, pg. 12 ln. 20 – pg. 13 ln. 12. That last point brings us to the second digression, which is that Spire argues the Commission approved the capitalization of overheads in cases GO-2019-0356 and GO-2019-03. *Spire Initial Brief*, pg. 27. This is inaccurate:

> Q. Was the issue brought forward after those ISRS cases?
>
> A. Yes. In Spire's next round of ISRS cases, Case Nos. GO-2019-0356 and GO-2019-0357, the issue was raised again. During the second layer of Spire's 2019 ISRS cases, the Commission heard arguments on capitalized overheads and was able to form a decision. **Ultimately, the Commission concluded that a rate case was a more appropriate venue to decide the issue given the time constraints of an ISRS case**.

Exhibit 140, *Surrebuttal Testimony of Matthew R. Young*, pg. 13 ln. 17 – pg. 14 ln. 2 (emphasis added); GO-2019-0356 & GO-2019-0357, *Report and Order*, pg. 42 ("The Commission finds that the shortened time frame of ISRS cases does not allow for in depth analysis of overhead costs. The treatment of overheads by Spire Missouri was consistent with how base rates were set in the most recent general rate cases.

Therefore, the Commission finds that they are appropriately included for recovery in the ISRS. Further, given the expedited nature of an ISRS case and the complexity of determining the appropriate overheads to include in construction costs, decisions varying from the methods in a general rate case are best handled during the course of a rate case when there is more time for a full examination and all rate factors are being reviewed.")

Impact on Revenue Requirement

Spire argues that the Commission should not order the Company to stop capitalizing overheads because this will increase the revenue requirement in the short term. *Spire initial Brief*, pg. 29. The response to this is three fold. First, while there might be an immediate increase to revenue requirement, the long-term effect will be to the benefit of ratepayers:

> However, if the cost is continued to be capitalized into rate base, the increase to depreciation expense and the required rate of return accumulates year after year while the rate reduction from decreased expense remains constant, if all else is held equal. Over time, the incremental increases to the revenue requirement will exceed the decrease in expense, which may not be in the interest of ratepayers.

Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 31 lns. 16 – 20. By removing these costs from rate base, ratepayers will end up paying less overall. *Id*. Spire's argument is the equivalent of saying you should never pay down the principle on your mortgage because it will increase your mortgage payments. While this is true, it also means you will never pay off the mortgage and end up spending far more money.

The second response is to point out that Spire is most likely vastly overestimating the amount of expense that would need to be included. Spire Missouri charged $172,799,199.64 of overheads to its test year construction expenditures, **<u>but only $39,023,977.34 of this amount is the capitalization of general overheads</u>**. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 25 lns. 12 – 13 (emphasis added). *Staff Initial Brief*, pg. 33. It is only these **<u>general</u>** overheads that are in dispute here. Tr. pg. 183 lns. 1 – 9. ("Q. So it's not all overheads, just general overhead? A. Not the overhead for like pensions and payroll taxes and those things, they might not be right, but I haven't studied them enough, and there is a general acceptance that that would be a capitalized cost. General overheads is the area you have the most trouble with in terms of being -- whether they are [compliant] or not, and that's where my focus is in this case."). Therefore, the impact of this issue is not nearly as dire as Spire would have the Commission believe. This is made even truer if the Commission orders any of the other recommendations proposed by the OPC. For example, the OPC's recommendation regarding affiliate transactions would effectively nullify this increase thus allowing the Commission to correct both problems **<u>at the same time</u>** yet leave neither the Company nor Customers with the "rate whiplash" that Spire laments.

Finally, the OPC's expert witness Mr. Robert Schallenberg pointed out that any increase in revenue requirement to account for the cessation of general overhead capitalization moving forward should be offset by the removal from rate base of amounts that were previously inappropriately capitalized: **

** Exhibit 205, *Surrebuttal of Robert E. Schallenberg*, pg. 27 lns. 13 – 24. This offset will reduce the revenue requirement impact.

Documentation

Spire's brief responds to Staff's criticism of its documentation policy by pointing to a witness who stated that the general ledger has sufficient evidence but offers no actual examples to back up that statement. *Spire Initial Brief*, pgs. 29 – 30. Spire then tries to shift the blame to Staff for there not being enough evidence in the record to support its own case. *Id*. Spire appears to be operating under the assumption that it is Staff's job to tell Spire how to keep records or present evidence. It is not. Spire has the burden of proof to support the rates it seeks. RSMo. § 393.150.2 ("At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the

PUBLIC

gas corporation"). This includes providing sufficient evidence to show that compliance exists, not just state that it is compliant and offer nothing substantive as proof. *See* Exhibit 205, *Surrebuttal of Robert E. Schallenberg*, pg. 26 ln. 21 (** ________________ ____ ** (emphasis in original)). If the general ledgers really were sufficient to meet the documentation requirements of the USOA, then Spire should have **actually put examples in the record to support its claim**. The fact that Spire chose not to should lead this Commission to the obvious conclusion that Spire is wrong, as Staff states. Exhibit 140, *Surrebuttal Testimony of Matthew R. Young*, pg. 19 lns. 8 – 18.

Remedies

Spire wrote separate sections for the OPC and Staff; the OPC will respond to both together. As for Staff, Spire's only real response is to reiterate the revenue requirement impact previously discussed. This is not an issue for the reasons above. Regarding the paragraph on demonstrating compliance with the USOA, Spire needs to show the definite relationship to construction that exists for the overhead costs it capitalizes and not just rely on the arbitrary "direct to total labor" ratio method it is using. The USOA even explains how to do this: time cards when applicable, special studies when not. *Spire Initial Brief*, pg. 24.

Turning to the OPC, Spire says that it has appropriate policies, procedures, processes and internal controls over financial reporting – **but it does not produce them**. The Commission should order the Company to make them **or produce them**. Spire basically admits that it can provide the quarterly tracking information related

to overhead capitalization, so the Commission should order it to do so. The Commission should further require Spire to meet the requirements of the USOA by showing the definite relationship to construction that exists between the general overheads it capitalizes and the projects they are capitalized to. The one remaining recommendation is the tracker the OPC has proposed. Spire maintains this is some difficult or complex idea. *Spire Initial Brief*, pgs 32 – 33. It is extremely simple. The goal is literally just to ensure that Spire is not transferring overheads to construction in between rate cases (during an ISRS case for example) by an amount that would cause overhead expense to be less than the amount included in base rates in this case. All that is necessary is that you track ** ____

____

____ ** Exhibit 205, *Surrebuttal of Robert E. Schallenberg*, pg. 27 lns. 2 – 4. This is not something that Spire should have difficulty accomplishing.

Issue 16: Net Operating Loss Carryforward Application

Spire and Staff have provided very different responses to this issue. The Staff's brief is, more or less, just a reiteration of the basic underlying concepts related to this issue without any real discussion of the merits for the central argument presented in this case. As such, there is little to respond to from Staff's brief. Spire's brief, by contrast, actually does engage in a fairly robust analysis of this issue, and so merits significant response. To that end, the OPC will begin with the response to Spire.

Response to Spire

There are a significant number of errors in Spire's brief, but responding to them all would require an unnecessary degree of effort compared to the amount of benefit achieved. To simplify matters and expedite review, the OPC will focus on three areas that deserve the most attention.

Understanding the Critical Issue

On page 67 of Spire's brief, the Company posits that the "OPC is Conflating Regulatory Accounting Concepts with Tax Accounting." *Spire Initial Brief*, pg. 67. There is a great deal of irony to this statement, as we shall soon see. At pages 68 and 69 there is a two sentence statement that effectively establishes the entire problem with Spire's case and this issue. Those two sentences are:

> The use of book-tax differences has allowed the Company to reduce its current tax liability to less than zero, producing a negative current income tax expense, **which reduces total income tax expense in the cost of service calculation**. Thus, contrary to what has been alleged by OPC (that ratepayers are paying for the NOL for which Spire is not

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> currently paying the IRS) **ratepayers are receiving a benefit in the form of lower income tax expense for the NOL**.

Spire Initial Brief, pgs. 68 – 69 (internal citations omitted) (emphasis added). The OPC is now going to (1) explain why this statement is wrong, (2) explain why that is important, and (3) show that it is Spire, not the OPC who is confusing regulatory accounting with tax accounting.

The current income tax expense included in Spire's cost of service calculation is not reduced by the presence of an NOL. This can be seen and verified quite clearly and simply by just looking at the calculation of the current income tax expense. The Commission just needs to look at Accounting Schedule 11 in Staff's full accounting schedules to see that line 46, which is labeled "TOTAL SUMMARY OF CURRENT INCOME TAX" is not reduced by the existence of an NOL listed in any of the previous lines leading to that figure. Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 11, pg. 1 of 2. This point was further explained in the Surrebuttal testimony of OPC witness Mr. John Riley:

> Mr. Felsenthal explains that the Company needs to make a debit to NOL ADIT asset and credit (reduction) to current income tax expense. This may be a necessary point to make for financial reporting, but from a **ratemaking** perspective, there is no deduction in current income tax expense for an NOL. It is crucial to understand this point. Under the existing IRS normalization rules, the income tax expense built into rates is not reduced (credited) by the existence of an NOL ADIT asset. Thus there is a fundamental disconnect between what Mr. Felsenthal is describing for financial reporting and what actually occurs in ratemaking. This is the major point I wish to convey to the Commission. Income tax expense will be built into the rate case at a normalized level, but will not be spent, thus generating interest free money for the Company.

Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 3 ln. 16 – pg. 4 ln. 2 (emphasis in original); *see also Id*. at pg. 4 lns. 4 – 8. Moreover, **<u>Spire's own brief acknowledges this very point</u>**. *Spire Initial Brief*, pg. 68 ("**The existence of an NOL has no bearing on the calculation of income tax expense based on the test year revenue and costs.**" (emphasis in original)). For Spire to turn around and claim that an NOL reduces total income tax expense in the cost of service calculation or that ratepayers are receiving a benefit in the form of lower income tax expense for the NOL is therefore obviously false.

The fact that Spire is so clearly wrong with regard to an NOL offsetting current income tax expense for ratemaking purposes is important because that idea forms the essence of the OPC's position:

> Income tax expense is not like deferred income tax. Current income tax expense does not have a reserve account where the balance is stored and then amortized later. It disappears every year. It is an expense item and is recalculated each rate case. Mr. Felsenthal may claim an NOL journal entry reduces income tax expense, but I'm here to tell you that income tax expense is recalculated based on the Net Operating Income requirement in **<u>every</u>** rate case. The $40 million included in this case represents an annualized amount. That is $40 million the first year, $40 million the second year, $40 million the third year, and so on. $120 million or more never going to the taxing authority.

Exhibit 211, *Surrebuttal Testimony of John S. Riley*, pg. 5 lns. 9 – 17.

> Company and Staff want to focus on the fact that I stated an NOL has no cost, but that is only part of the equation. There is a real cost in income tax expense. Staff includes in its accounting schedules a calculated amount of current income tax as if the Company will be writing checks to the Federal and State governments every quarter. As

> I said, it's about $40 million in this case. Staff has approximately $27 million included in the test year. What is important is that the revenue requirement developed in the last case and the case before that and proposed by Staff in this current case all had income tax money expense included despite the fact that Spire either did not or will not pay taxes. The Company has paid no federal or state income taxes over the last three years, nor is there any indication that it will be paid for the next three. Instead, Spire either has a taxable loss, due to tax timing differences that built up its NOL balance, or it had taxable income and applied the accumulated NOL to the balance to zero out the income line.

Id., at pg. 4 ln. 12 – pg. 5 ln. 5. Spire's claim that the "foundation of OPC's argument (that ratepayers are being charged for the NOL) is not valid" is false for the very reason that an NOL cannot offset for ratemaking purposes, **which, again, Spire's own brief acknowledges**. Spire Initial Brief, pg. 68 ("**The existence of an NOL has no bearing on the calculation of income tax expense based on the test year revenue and costs**." (emphasis in original)).

The greatest irony of this issue lies with the fact that Spire accuses the OPC of confusing regulatory accounting with tax accounting. It is ironic because it is Spire who has actually muddied the waters in this way through the suggestion that an NOL offsets current income tax.[15] This is a general rate proceeding. Tr. pg. 525 ln. 5. Its purpose is to set the rates that Spire will charge customers moving forward. As such, the OPC is only concerned with, and has only raised its arguments from, a ratemaking perspective. It is Spire who has decided to bring the Company's internal

[15] As an aside, the OPC notes that Spire accuse it of confusing two "tax concepts" in its brief. *Spire Initial Brief*, pg. 68. However, the two concepts it goes on to identify are: (1) regulatory accounting, and (2) rate base. *Id*. It is seriously questionable whether one could qualify regulatory accounting as a "tax concept." Rate base, on the other hand, is clearly not a "tax concept" as it is purely a product of regulatory ratemaking.

financial reporting into this case and have thus mixed regulatory accounting with tax accounting. Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 3 lns. 17 – 19 ("[What Mr. Felsenthal states] may be a necessary point to make for financial reporting, but from a **ratemaking** perspective, there is no deduction in current income tax expense for an NOL." (emphasis in original)). The Commission cannot allow itself to become confused on this point. Every party that offered testimony on this issue in this case (including Spire) has agreed at some point that an NOL will not affect the calculation of the current income tax component of Spire's revenue requirement for this case. Exhibit 102, *Full Staff Accounting Schedule*, Accounting Schedule 11, pg. 1 of 2; Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 3 ln. 16 – pg. 4 ln. 2; *Spire Initial Brief*, pg. 68 ("**The existence of an NOL has no bearing on the calculation of income tax expense based on the test year revenue and costs.**" (emphasis in original)). Because of that fact, Spire **will** collect current income tax that will not be remitted to the IRS. Exhibit 210, *Rebuttal Testimony of John S Riley*, pg. 2 ln. 16 – 21. This is a second source of "free" cash that should be used to offset the NOL instead of ADIT. *Id.*

Considering Private Letter Rulings

Much of Spire's brief on this issue concerns itself with a series of private letter rulings issued by the IRS to other utilities. *See Spire Initial Brief*, pgs. 70 – 76. Before delving too deep into this issue, we need to stop for a moment and understand what exactly a private letter ruling ("PLR") is, why it is sought, and what it does. Consider what the IRS itself has to say on the matter:

> A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR is issued to establish with certainty the federal tax consequences of a particular transaction before the transaction is consummated or before the taxpayer's return is filed. A PLR is issued in response to a written request submitted by a taxpayer and is binding on the IRS if the taxpayer fully and accurately described the proposed transaction in the request and carries out the transaction as described. A PLR may not be relied on as precedent by other taxpayers or IRS personnel. PLRs are generally made public after all information has been removed that could identify the taxpayer to whom it was issued.

IRS, *Understanding IRS Guidance - A Brief Primer*, https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer (last visited September 12, 2021). A PLR is a tool that a taxpayer can use to ensure certainty about the tax treatment of a specific transaction. *Id.* To get one, the Taxpayer must provide the IRS with the facts of the transaction and the IRS gives a response **based on those facts** regarding how it would rule. *Id.* PLRs are not considered binding precedent because they are **based on the specific facts of a given transaction**. *Id.* Now, despite this fact, PLRs are sometimes looked to for guidance by courts and other judicial bodies as Spire points out. *See Spire Initial Brief*, pg. 71. **But the critical point that must be understood is this**: to properly use an NOL, one **must** consider and compare the underlying facts of the PLR to the case or issue in question. Let us put that into practice.

In this case, Spire witness Mr. Felsenthal identified that there **was** a PLR that has held it would not be a normalization violation to do as the OPC proposes, but attempted to distinguish that PLR by stating the following at hearing:

> On this issue, there has been one ruling that claims -- that decided not including the ADIT asset, the NOL asset, in rate base was not a violation. And in that case, **<u>that case is different than all of the other ones</u>**, all of the subsequent rulings. And if you look at that first ruling, what the Commission did in that case is it permitted the Company to record the entire amount of book tax difference as a [deferred] tax expense, have it recovered in rates without reducing that expense for the NOL, which is what happens in Spire's case and which is typically the case.
>
> So in that ruling the facts are different. The Commission -- or **<u>the IRS said because you have been able to monetize or realize the entire book tax depreciation difference, is it an interest-free loan, the whole amount[,] and does not have to be reduced by the NOL offset</u>**.

Tr. pg. 632 lns. 2 – 16. Despite what Mr. Felsenthal claims, however, the facts of the present situation **<u>are the same</u>** as those he describes for this PLR. The point that the OPC has been making this entire time is that inclusion of "current income tax" in excess of the ADIT generates a secondary source of free cash that offsets the NOL, thus leaving Spire free to fully monetize the entire book tax depreciation differences. *See* Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 6 lns. 19 – 21 ("No one can claim that the Company is denied use of interest free money when it will be receiving at least three years of unspent income tax expense that will be far greater than the balance of the NOL."). This can be further seen in Spire's fallacious attempt to further distinguish this particular PLR in its brief:

> The IRS found that because the NOL had been taken into account in the commission's setting of rates, the decision not to include the NOL amount was justified. What this says is that in that particular rate case, a state commission allowed the utility to include deferred income taxes expense in cost of service *without* an offset in current income tax expense for the NOL.

Spire Initial Brief pgs 72 – 73 (internal citations omitted). Here we see Spire attempting to focus all attention on the idea that the Commission in this particular PLR "allowed the utility to include deferred income taxes expense in cost of service *without* an offset in current income tax expense for the NOL." *Id*. **That is the very same situation in this case**. Staff has included the amount needed to pay deferred income taxes in Spire's cost of service. Tr. pg. 644 lns. 8 – 10 ("Q. So the amount to pay deferred income taxes is included in the calculation of current income taxes? A. Yes."). At the same time, there is no NOL offset to the current income tax calculations. Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 3 ln. 16 – pg. 4 ln. 2, pg. 4 lns. 4 – 8; *Spire Initial Brief*, pg. 68 ("**The existence of an NOL has no bearing on the calculation of income tax expense based on the test year revenue and costs.**" (emphasis in original)). Thus, Spire itself has more or less acknowledged that the facts of this one PLR are consistent with the present case.

The OPC's witness also undertook an analysis of the same PLR referenced by Mr. Felsenthal. *See* Exhibit 211, *Surrebuttal Testimony of John S Riley*, pg. 7 lns. 1 – pg. 8 ln. 33. As Mr. Riley points out, "The basic overview of the PLR is that the Commission excluded the NOL from the ADIT reserve basing its decision on the premise that the Commission did account for the NOL and did not need to adjust the ADIT any further." *Id*. at pg. 7 lns. 15 – 17. In particular, the PLR states:

> Both Commission and Taxpayer have intended, at all relevant times, to comply with the normalization requirements. Commission has stated that, in setting rates it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC or

> MTCC. **Such a provision allows a utility to collect amounts from ratepayers equal to income taxes that would have been due absent the NOLC and MTCC. Thus, Commission has already taken the NOLC and MTCC into account in setting rates**. Because the NOLC and MTCC have been taken into account, Commission's decision to not reduce the amount of the reserve for deferred taxes by these amounts does not result in the amount of that reserve for the period being used in determining the taxpayer's expense in computing cost of service exceeding the proper amount of the reserve and violate the normalization requirements. We therefore conclude that the reduction of Taxpayer's rate base by the full amount of its ADIT account without regard to the balances in its NOLC-related account and its MTCC-related account was consistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

Id. at JSR-S-02 pg. 6 (emphasis added). Mr. Riley further explained:

> This Commission sets rates based on this scenario because Staff calculates income tax expense **regardless of an NOL**. Due to the NOL, income tax expense does not get paid to a taxing authority. This is a normalized amount of expense in the annualized cost of service **that will be a greater amount than the proposed NOL that would be included in rate base**.

Id. at pg. 8 lns 30 – 33 (emphasis added). Because Staff calculates income tax expense regardless of an NOL, the current income tax expense included in rates is greater than the amount of the NOL that would be included as an offset to ADIT. *Id*. Therefore, that current income tax amount, which Staff acknowledged will generate its own source of free money, should be used to offset the proposed NOL instead of having that NOL included in rates. *Id*. at pg. 6 lns. 19 – 21; Tr. pg. 654 ln. 24 – pg. 655 ln. 14.

Having gone through the analysis offered of the one PLR that we know is consistent with the facts of this case, let us consider the other PLRs on which Spire

relies. Predictably, Spire's brief offers no factual analysis comparing the PLRs it cites to the present case. Instead, Spire just jumps up and down on the fact that all these PLRs state that the utility should use a method called either "with or without" or "with and without." *Spire Initial Brief*, pgs. 75 – 75. The problem, though, is that **none** of the PLRs define that method. Moreover, there is nothing in the record of this case that shows that the OPC's offered solution would **not** be consistent with the "with and without" method. The **only** explanation for that method that the OPC could find was this **one** line from Spire Witness Mr. Kuper's rebuttal testimony:

> The IRS uses a with-and-without concept regarding the NOL offset—if one computes the NOL with accelerated/bonus depreciation and then computes it without accelerated/bonus depreciation, to the extent the accelerated/bonus depreciation created the NOL, it is treated as an offset.

Exhibit 19, *Rebuttal Testimony of Charles J. Kuper*, pg. 6 lns. 7 – 10. All the OPC is arguing for in this case is that the NOL be offset against current income tax expense that is collected and not remitted **before** it is offset against ADIT. In doing so, the NOL will be "taken into account" in a manner consistent with the "with and without" method that these other PLRs refer to. Stated more simply, the OPC's proposal complies with the "with and without" method and is thus consistent with these PLRs.

At the end of the day, the touchstone upon which the Commission should rest its decision on this issue is the actual logic presented in the competing arguments offered by Spire and the OPC, not some blind obedience to PLRs. However, to the extent that the Commission does consider the PLRs, it should be done through

examination of how close those PLRs come to the case at issue. In how many of Spire's PLRs was the exact issue that the OPC raises related to current income tax presented? In how many of Spire's PLRs was the application of the "with and without" method described or explained? In how many of Spire's PLRs was deferred current income tax greater than the deferred income taxes included by the relevant Commission for ratemaking? Unless the Commission can answer these questions, it should not treat the PLRs Spire has built its entire case upon as sacrosanct commandments. Instead, the Commission should see these PLRs for what they are, the IRS's interpretation of specific facts for specific utilities.[16] *See Understanding IRS Guidance - A Brief Primer*, *supra.*

Regarding Normalization Violations

[16] Spire has the audacity to attempt to distinguish the one PLR that supports the OPC's position by noting that the PLR states that all assertions made in the PLR are subject to verification and the ruling "is based on the representations submitted by the Taxpayer and is only valid if those representations are accurate." *Spire Initial Brief*, pg. 73. The OPC considers this audacious only because **<u>all</u>** PLRs state the same. *See* Exhibit 50, *Private Lettering Rulings*, pgs. 3, 9, 10, 16, 18, 23, 24, 30, 31, 36, 37, 43, 44, 50, 52, 56, 58, and 62 – 63. Nearly every single PLR will indicate the facts in the letter are based on what the taxpayer sets forth in their request and will also have some variation of the following boilerplate:

> This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.
>
> Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.
>
> This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Id. To suggest that the one PLR on which the OPC relied is somehow unique in this regard is very disingenuous.

Spire spends a great deal of time attempting to frighten the Commission with the spectral boogeyman that is the IRS normalization violations. *See Spire Initial Brief*, pgs. 69 – 70, 76 – 77. The present situation is not anywhere near as dire as the Company would have the Commission believe. As John Riley explained on the stand:

> Even if you take our argument and look at it and go, yes, we're going to offset this NOL with this extra money, Spire is going to go to the IRS and ask if it is okay. And I think it is, but if the IRS -- you know, if you ever tried to figure out the IRS, if they say it isn't then they're going to come back here and the Commission is going to change it. There's -- even if they say it is a violation you just fix it. Nobody is going to slap them on hand and say, You don't get your accelerated depreciation anymore. They're just going to say you need to fix that and that is what will happen. The way I look at it, which I don't think the IRS has ever had the question posed to them, I don't think it is a violation. If on the other hand, the Commission goes ahead and does what I suggest and the IRS comes back and says that it is a violation, it will just be changed. The specter of death is not going to walk in and kill Spire Incorporated. It's just not going to happen. It is not an end-all thing if the decision is contradictory to what the IRS says.

Tr. pg. 669 lns. 1 – 13. What Mr. Riley states can be verified first hand by examination of the IRS's internal revenue procedure document 2017-47, which sets forth the "Safe Harbor" provisions for inadvertent normalization violations. IRS Rev. Proc. 2017-47. This Commission should not be swayed by such scare tactics. It should instead study this issue closely, review the logic set forth by all parties, and rule consistent with the most persuasive argument based on that logic. Nevertheless, should the Commission ultimately decide that it will offset Spire's ADIT with an NOL out of fear of a normalization violation, it should also order a tracker to record the amount of unspent current income tax included in rates but not in ADIT. Such a tracker will not, in any possible way, result in a normalization violation. Tr. pg. 668 lns. 8 – 12

("Q. So tacking on to that, no risk of a normalization violation whatsoever if you go with a tracker? A. Yeah. That is my -- that would be my understanding as to what the IRS usually does and what ratemaking usually does.").

Response to Staff

The Commission's Staff offered no real analysis of the OPC's position, so the OPC has little to which it can directly respond. Instead, the OPC will seek to address what arguments it suspects Staff might raise. In doing so, the OPC is guided by the fact that it strongly appears that Staff is not trying to disprove the existence of the "pile" of "free" money being generated by the inclusion of "current income tax" in Spire's revenue requirement as explained at length in the OPC's initial brief. *OPC Initial Brief*, pgs. 96 – 106. Instead, Staff's entire response to the OPC's argument appears to center on the idea that the "current income tax" pile of free money is somehow separate from ADIT and therefore cannot be used to offset Spire's NOL. This can be seen most clearly in the surrebuttal of Staff witness Matthew Young:

> It is evident that a misunderstanding regarding these two categories of income tax expense exists when Mr. Riley states, "…there is free cash generated due to the inclusion of income taxes in the revenue requirements that are not being paid to the taxing authorities." The cash obtained by the utility through tax strategy is entirely different from the income tax costs included in rates intended to cover current tax payments. Mr. Riley has confused these two sources of cash in his arguments although they are in fact separate.

Exhibit 140, *Surrebuttal of Matthew R Young*, pg. 8 lns. 3 – 9. The problem with this logic is that, besides the bare statement that the two sources of cash are separate, there is no evidence to support the conclusion. Staff appears to be adopting the

positon that current income tax cannot be used to offset an NOL just because they are "different" for some unspecified reason. In fact, Staff's position opens up a very odd self-contradiction that can be seen by comparing two lines found in Mr. Young's surrebuttal.

In his rebuttal, Staff's witness Mr. Young indicated that ADIT was the measure of the tax savings Spire received due to book/tax timing differences that represent "free" cash to the company. Exhibit 125, *Rebuttal of Matthew R Young*, pg. 6 lns. 12 – 18. This idea is reiterated in his surrebuttal, but Mr. Young then goes on to state quite clearly that any difference between what is collected from customers for current income tax expense but not paid to the IRS does **not** constitute ADIT. Please take a moment to compare:

> The rate base reduction for ADIT, including an offset for NOL, is a measurement of how much free cash a company has been able to generate from the government via tax deductions.
>
> [versus]
>
> The difference between current income tax expense collected from customers and cash paid to the IRS does not factor into the ADIT component of rate base.

Exhibit 140, *Surrebuttal of Matthew R Young*, pg. 7 lns. 13 – 16, pg. 8 lns. 20 – 22. Now, holding both of these statements in mind, please consider the following question: should the "free" cash generated for Spire from the current income tax expense that is collected from customers but not paid to the IRS due to application of book/tax timing differences be included in ADIT? Reading the first line, the answer should be yes because the current income taxes – which are not being paid to the

PUBLIC

taxing authority – are generating free cash, as Mr. Young acknowledged on the stand. Tr. pg. 654 ln. 24 – pg. 655 ln. 14. Therefore, the current income tax should be part of the measure of ADIT. Exhibit 140, *Surrebuttal of Matthew R Young*, pg. 7 lns. 13 – 16. However, if you read the second line, Mr. Young **literall**y states that the answer is no, which he **also** repeated on the stand. Tr. pg. 652 ln. 24 – pg. 653 ln. 23; *see also* Tr. pg. 653 lns. 2 – 5 ("The $40 million that the Company is collecting in income taxes, is that amount being -- is the ADIT reducing rate base being increased by a dollar for dollar by that 40 million? A. No."). This is the fundamental problem with Staff's position.

As with other issues in this case, Staff's unwillingness to even **consider** the idea that current income tax expense can be used to offset Spire's NOL is based on inertia rather than any logical or factual basis. In other words, Staff has never been presented with this argument before and, absent guidance from the Commission, will not recommend a change from previous Commission decisions under any circumstances. The OPC's expert John Riley acknowledged this point in rebuttal:

> **Q. What can Staff do with this issue in the current case?**
>
> A. Staff should make the change I recommend in this testimony and present it to the Commission instead **of waiting for the Commission to give them direction**. The argument that there is "free" money to offset the NOL is unmistakable, **but this issue of unspent income tax expense has not reached the Commission in a general rate case hearing**. Staff should get ahead of the issue in this case by making an adjustment that directly acknowledges the "free" money generated for Spire due to the inclusion of income tax expense in its revenue requirement that is not being paid to the proper taxing authority.

Exhibit 210, *Rebuttal Testimony of John S Riley*, pg. 3 ln. 13 – 20 (emphasis added). Unfortunately, Staff did not heed Mr. Riley's suggestion and instead adopted a position that recognizes the existence of "free" cash money being generated by Spire (due to the current income tax included in Spire's rates but not remitted to a taxing authority), but refuses to equate **<u>that</u>** "free" money to the **<u>other</u>** deferred income taxes on the basis that they are "different" for some completely unspecified reason. This position is illogical and unsound and the Commission should not adopt it.

Issue 19: Affiliate Transactions

It is obvious from their respective initial briefs that neither Staff nor Spire have any good response to the OPC's argument on this issue because both parties have instead resorted to making straw-man style arguments and regurgitating irrelevant information. Unfortunately, however, this means that the OPC now has to spend far more time than should be necessary to explain that the points being raised by Staff and Spire have, for the most part, **nothing to do with the issue at hand**. In order to best accomplish this goal, the OPC will begin with a very brief recitation of the argument and issue in question.

The OPC's argument

The OPC has presented an argument in this case that Spire is violating the Commission's affiliate transaction rule, specifically 20 CSR 4240-40.015(2)(A), by providing its affiliate Spire Inc. a financial advantage. The whole argument can be stated in this single sentence:

> Spire Missouri is providing Spire Inc. a prohibited financial advantage because Spire Missouri is transferring information, assets, goods, and/or services necessary to operate Spire Inc. to Spire Inc. below the greater of the fair market price of those information, assets, goods, and/or services or the fully distributed cost to Spire Missouri to procure/produce those information, assets, goods, and/or services

See, *e.g.*, Exhibit 204C, Rebuttal Testimony of Robert E. Schallenberg, pg. 10 lns. 10 – 13 ("Spire Missouri has developed and implemented a system where rates charged to Spire Missouri's customers include the costs of goods and services provided to Spire

Missouri's parent company, Spire Inc. Spire Missouri is therefore providing financially advantageous and preferential treatment to Spire Inc."). This is a clear and straightforward violation of the rule. 20 CSR 4240-40.015(2)(A); *OPC Initial Brief*, pgs. 110 – 124. The Commission must ensure it is not fooled by Staff and Spire's attempts to divert the topic away from this single central issue.

Having discussed the OPC's argument, let us take one moment to consider what the OPC is **not** arguing. Nothing in the preceding discussion dealt with (or even mentioned) Spire Services. This is because **the OPC is not challenging or in any way arguing for an adjustment based on Spire Services**. This issue is **not** about whether Spire Services should exist or be used. Spire Services is important to understanding **how** the affiliate transaction system works, but neither its existence nor cost is being challenged by the OPC. The importance of the fact that the OPC's argument has **nothing** to do with Spire Services will become very apparent as we move into the discussion of Staff and Spire's respective briefs.

Response to Staff

Staff's discussion of this issue is short enough that the OPC will respond paragraph-by-paragraph starting with the first paragraph on page 44. Staff begins by mischaracterizing this issue under the name "corporate allocations" instead of affiliate transactions, despite acknowledging that "all transactions under what Staff classifies as 'corporate allocations' are allocations among affiliates[.]" *Staff Initial Brief*, pg. 44. The OPC already addressed this issue in its initial brief, so it will move on. *See OPC Initial Brief*, pgs. 110 – 111. Staff's second paragraph just states Staff

performed an audit. *Staff Initial Brief*, pg. 45. The third paragraph states that Staff made some adjustments, but also notes that "Staff recommended that the remaining BOD expense should be allocated using an allocator that approximates the three-factor allocation." *Id*. This, incidentally, is emblematic of the whole affiliate transaction problem in this case. Because the three-factor allocation method Spire uses is specifically designed to ensure no costs are attributed no Spire Inc., Spire Missouri ends up paying for Spire Inc.'s Board of Directors. Exhibit 205C, *Surrebuttal Testimony of Robert E. Schallenberg*, pg. 5 ln. 16 – pg. 6 ln. 2; Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 16 ln. 6 – pg. 17 ln. 1. Because Spire Missouri is paying part of the cost for Spire Inc.'s Board of Directors, Spire Missouri is providing Spire Inc. a financial advantage. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 17 lns. 1 – 3.

The fourth paragraph starts off by giving the Staff's understanding of the OPC's position. The rest of the paragraph discusses the benefits of Spire Services. *Staff Initial Brief*, pg. 46. Specifically, Staff notes that the use of a service company like Spire Services "allows certain services, like human resources services, to be provided centrally to a group of affiliates and the costs of the services are then directly charged or allocated to all of the affiliates, including the regulated utility affiliate." *Id*. Staff goes on to argue that using a shared services company is **probably** less costly. *Id*. All of this is irrelevant. The OPC is not challenging Spire's use of a shared service company nor arguing the shared service company be assigned costs. As the

OPC already explained, this issue has **<u>nothing</u>** to do with the question of whether Spire Missouri should use a shared services company, so this digression is pointless.

The next paragraph requires a much more detailed analysis. The paragraph in question is really only two sentences and states in its entirety:

> The Commission's affiliate transaction rule acknowledges that certain services that may be provided by an affiliate, like Spire, Inc., are likely to provide such economies of scale benefits to its regulated affiliates like Spire Missouri, and, therefore are in certain instances exempt from the "asymmetrical pricing" standards in the rule. Such services are defined as "corporate support services" in 20 CSR 4240-40.015(1)(D), and include joint corporate oversight, governance, support systems and personnel, payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development.

Staff Initial Brief, pgs. 46 – 47. Regarding the second sentence, Staff is correct that "corporate support services" is defined in the affiliate transaction rule and includes many of the items listed. 20 CSR 4240-40.015(1)(D). As for the first sentence, though, there is no legal support for this statement. Staff cites to the transcript, but all this citation entails is a Staff witness explaining what the term "asymmetrical pricing model" means. *Staff Initial Brief*, pg. 46 fn. 210. There is **<u>nothing</u>** in the rule that provides an exception to these standards as they are employed in 20 CSR 4240-40.015(2)(A). Instead, the rule provides a blanket prohibition on the provision of a financial advantage by a regulated utility to an affiliate entity. 20 CSR 4240-40.015(2)(A) ("A regulated gas corporation shall not provide a financial advantage to an affiliated entity."). The first sentence of this paragraph is thus just legally wrong.

The OPC cannot be completely sure exactly what Staff meant by this paragraph, but the OPC does have a suspicion, based on context, that Staff is seeking to invoke 20 CSR 4240-40.015(2)(B). Of course Staff does not actually reference 20 CSR 4240-40.015(2)(B) or cite to it, so this is just an assumption. However, because the OPC suspects that 20 CSR 4240-40.015(2)(B) may come up in the reply brief, the OPC will respond to the argument now. 20 CSR 4240-40.015(2)(B) states:

> Except as necessary to provide corporate support functions, the regulated gas corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time.

The OPC expects that Staff and Spire either are or will attempt to make the assertion that Spire should somehow be allowed to violate the affiliate transaction rule because of this sub-provision. Such an argument is obviously wrong for two major reasons.

First, 20 CSR 4240-40.015(2)(B) can only be read to provide an exception for when a utility may provide "preferential treatment" to an affiliate. This phrase is obviously different from the phrase "financial advantage" used in 20 CSR 4240-40.015(2)(A) where it is **expressly defined and prohibited**. Because 20 CSR 4240-40.015(2)(B) does not use the phrase "financial advantage" that is defined in 20 CSR 4240-40.015(2)(A), it clearly does not impact 20 CSR 4240-40.015(2)(A).

"Administrative regulations are interpreted under the same principles of construction as statutes." *Baker v. Dir. of Revenue for Mo.*, 569 S.W.3d 63, 68 (Mo. App. WD 2019) (quoting *Gallagher v. Dir. of Revenue*, 487 S.W.3d 24, 27 (Mo. App. ED 2016). One such principle of statutory construction is the "Presumption of

Consistent Usage" under which a word or phrase is presumed to bear the same meaning throughout a text and, more importantly to our discussion, **a material variation in terms suggests a variation in meaning**. This has been recognized by the Missouri Supreme Court. *Nelson v. Crane*, 187 S.W.3d 868, 870 (Mo. banc 2006) ("If the legislature intended for the terms 'committed' and 'detention' to have the same meaning, it could have utilized consistent terminology by using one term or the other. Holding that the term 'committed,' as used in section 571.090.1(6), is synonymous with the term 'detention,' as used in section 632.305, would render superfluous the distinct terminology employed by the legislature."); *Cox v. Dir. of Revenue*, 98 S.W.3d 548, 550 (Mo. 2003) ("The legislature's re-enactment of the terms 'driving' and 'operating' in section 577.001 emphasizes that both words have distinct meanings."). Reading the phrase "preferential treatment" as found in 20 CSR 4240-40.015(2)(B) to be synonymous with the term "financial advantage" – which is expressly defined in the immediately preceding subsection – would violate this basic canon of statutory construction.

If the Commission intended the "except as necessary to provide corporate support functions" to create an exception to the prohibition on providing a financial advantage found in 20 CSR 4240-40.015(2)(A) it would have either (1) used the phrase "financial advantage" in 20 CSR 4240-40.015(2)(B) or (2) include that language directly in 20 CSR 4240-40.015(2)(A). The Commission did neither of these things, so, again, 20 CSR 4240-40.015(2)(B) clearly does not impact the blanket prohibition on providing a financial advantage found in 20 CSR 4240-40.15(2)(A).

The second major reason that 20 CSR 4240-40.015(2)(B) is irrelevant is that the exception only applies when it is "**necessary** to provide corporate support functions." 20 CSR 4240-40.015(2)(B) (emphasis added). There is no logical argument that it is **necessary** for Spire Missouri to pay the cost of operating Spire Inc. in order to provide corporate support services. In other words, Spire Missouri could provide corporate support services to Spire Inc. **without having to charge itself for the provision of those services**. Therefore, this exception would not apply regardless of the fact that it exists in a completely separate sub-section. For both of these reasons, 20 CSR 4240-40.015(2)(B) is irrelevant to our discussion.[17]

This brings us to the next paragraph of Staff's brief wherein Staff asserts that "Spire, Inc., does not charge a profit margin for the services it provides its affiliates like Spire Missouri." *Staff Initial Brief*, pgs. 47. The brief does continue past this opening sentence, but we do not need to. The issue at hand is the fact that Spire Missouri is providing goods and services **to** Spire Inc. below their fair market price or fully distributed cost. The fact that Spire Missouri is not charged a "profit margin" for the goods and services that it received **from** Spire Inc. is irrelevant to our discussion. Further, based on the context it seems highly likely that Staff was actually referring to *Spire Services* not charging a profit margin, not Spire Inc. *See Staff Initial Brief*, pg. 47 ("Elimination of profit from service company affiliated

[17] Spire witness Mr. Timothy Krick cites to rule 20 CSR 4240-40.015(3)(D) in his surrebuttal testimony. Exhibit 17, *Surrebuttal Testimony of Timothy W. Krick*, pg. 4. Just in case this issue comes up, the OPC notes that this rule only applies to "transactions involving the purchase of goods or services by the regulated gas corporation **from** an affiliated entity." 20 CSR 4240-40.015(3)(D). The affiliate transaction violations involved in this case stem from Spire improperly supplying goods and services **to** its affiliate Spire Inc., not **from** it. As such, this rule is inapplicable.

transactions . . . "). Even if this is the case, the issue is still immaterial because the OPC is not challenging anything with how Spire Services is operated. Either way, this paragraph adds nothing meaningful to the issue.

Moving on, we now come to the seventh paragraph. It is here, for the first time, that the actual issue in this case is fully addressed. To make things simpler, the OPC will reiterate the whole paragraph for discussion:

> Staff found no basis in its audit to support a large adjustment, such as the one OPC recommends, to Spire, Inc. Based on Staff's review, Spire, Inc., and Spire Services, Inc., do not appear to have a material corporate purpose separate and apart from the operations and lines of businesses of their regulated and non-regulated affiliates. Accordingly, it does not seem unreasonable for the Missouri affiliates to be assigned a bulk of the costs incurred across all Spire, Inc.'s holdings. If Spire, Inc., were involved in substantial merger and acquisition activities, then different allocations procedures that result in Spire, Inc., being assigned more costs could be warranted. But currently, Staff is not aware that Spire, Inc., is substantially engaged in such activities. Simply allocating costs to Spire, Inc., or Spire Services, Inc., or ordering a large adjustment like OPC recommends, is not valid absent evidence that Spire, Inc., or Spire Services, Inc., has incurred such costs, and Staff's audit has found no such evidence.

Staff Initial Brief, pgs. 47 – 48. There are four concepts here that need to be discussed, and we will review them one-by-one. The first is the claim that "Spire, Inc., and Spire Services, Inc., do not appear to have a material corporate purpose separate and apart from the operations and lines of businesses of their regulated and non-regulated affiliates." *Id*. This is false and, more importantly, irrelevant under the Commission's affiliate transactions rules.

Before going too deep into the weeds, let us remove "Spire Services, Inc." from the Staff's sentence. We have already established that Spire Services costs are not being challenged by the OPC, so this is unnecessary and will just add confusion. Having done that, what is the purpose of this sentence? In essence, Staff is attempting to claim that Spire Inc. and Spire Missouri are *effectively* the same entity doing the same thing. This will lead into the next sentence where Staff will argue that Spire Missouri should bear the majority of the cost of operating Spire Inc. because Spire Inc. is *apparently* just a shadow of Spire Missouri. The problem with this theory is that it is simply not true.

The OPC's expert witness Mr. Robert Schallenberg explained why Staff was in error in his surrebuttal testimony. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 20 lns. 4 – 7. He focused primarily on the statements that Spire **itself** made in the 2001 restructuring case wherein Spire Inc. transitioned from being a subsidiary of Spire Missouri to being the parent entity to Spire Missouri. *See* Exhibit 226, Verified Application GM-2001-0342, pgs. 3 – 4. Specifically, Mr. Schallenberg states: **

** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 20 lns. 9 – 20; *see also* Exhibit 226, Verified Application GM-2001-0342. Mr. Schallenberg further reiterated this point several pages later in the same testimony: **

** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 22 lns. 5 – 19. The conclusion to draw from this is simple: Spire Inc. clearly has a line of business that is **separate and distinct** from the regulated gas utility business that is Spire Missouri. *Id*. This separation of activities (between regulated utility management and non-

regulated business management) justifies requiring Spire Inc. to pay for its own operation. In fact, that is literally the very justification that Spire employed for the reorganization of Spire Inc. as a separate parent company in the first place. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 20 lns. 9 – 20; *see also* Exhibit 226, Verified Application GM-2001-0342. This brings us to the next concept.

As already alluded to, the next sentence in this paragraph from Staff's brief is meant to lead on from the first. Staff states that, given the lack of supposed difference between the business operations of Spire Inc. and Spire Missouri, "it does not seem unreasonable for the Missouri affiliates to be assigned a bulk of the costs incurred across **all** Spire, Inc.'s holdings" *Staff Initial Brief*, pg. 48 (emphasis added). What Staff is attempting to argue here is essentially that Spire Inc. does not serve any purpose other than to hold stock of Spire Missouri and thus Spire Missouri should just bear the bulk of the costs incurred for operating Spire Inc. As we just discussed, however, this is wrong because Spire Inc. is not just some shadow puppet of Spire Missouri. Instead, Spire Inc. is its own business entity that is tasked with operating **all** of the Spire enterprise, **including** Spire's non-regulated operations. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 22 lns. 5 – 19. For example, the OPC's witness included as attachments to his surrebuttal the complete minutes of the Board of Directors for Spire Inc. from October 2019 through November of 2020. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, RES-S-1. This constitutes 75 pages of meeting information that shows Spire Inc. heavily involved in the direct operation and management of the entire Spire enterprise. *Id*. these 75 pages utterly

dwarf the roughly 20 pages worth of minutes from Spire Missouri's own, separate Board of Directors over roughly the same period. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, RES-S-2. The implication is obvious, Spire Inc. is, as, it claimed it would be in 2001, an active manager of the Spire enterprise and not the "mere holding company" as Staff now suggests. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 lns. 5 – 9 (** ______________________________

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________________________ **).

The separation of business activities between Spire Inc. and Spire Missouri is more than mere semantics. In fact, these separate business activities result in additional costs being incurred by Spire Inc. These additional costs should be retained by Spire Inc. and not foisted off onto Spire Missouri: **

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** *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 ln. 19 – pg. 22 ln. 2. Consequently, it **would** be "unreasonable for the Missouri affiliates to be assigned a bulk of the costs incurred across **all** Spire, Inc.'s holdings" *Staff Initial Brief*, pg. 48 (emphasis added). Moreover, the Commission's affiliate transaction rules do not recognize Staff's "reasonableness" test regardless.

The affiliate transaction rule does not contain a provision that allows Spire Missouri to provide its majority owning company with a financial advantage regardless of whether that majority controller is considered a "holding" or a "parent" company or otherwise deemed to not serve a "separate corporate purpose." *See* 20 CSR 4240-40.015. In other words, once a separate and distinct legal entity has been created (like Spire Inc.), the affiliate transaction rule prevents Spire Missouri from providing that separate and distinct legal entity a financial advantage. *Id*. This is true **regardless** of the purpose or nature of the affiliate. *Id*. Despite this, Spire and Staff now want the Commission to radically re-write its own affiliate transaction rule to allow Spire Missouri to bear the majority of the cost of operating Spire Inc. "just because." *Staff Initial Brief*, pg. 48. **There is no legal support for this proposition**. In addition to there being no *legal* support, **there is no precedential support for this proposition**. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 19 lns. 14 – 16. This is an unsound position to take, as demonstrated by Mr. Schallenberg: **

** *Id.* at pg. 22 lns. 20 – pg. 23 ln. 2. Mr. Schallenberg is perfectly correct. The Commission should in no way endorse the Staff's assumption that the affiliate transaction rule may be violated because Staff believes "it does not **seem** unreasonable." *Staff Initial Brief*, pg. 48.

We now come to the third concept that needs to be addressed, which is found in the two sentences from Staff's brief that together read:

> If Spire, Inc., were involved in substantial merger and acquisition activities, then different allocations procedures that result in Spire, Inc., being assigned more costs could be warranted. But currently, Staff is not aware that Spire, Inc., is substantially engaged in such activities."

Staff Initial Brief, pg. 48. While not stated explicitly, this is an attempt to invoke the argument raised on page 6 of Staff witness Majors' rebuttal with regard to Aquila Inc., which reads as follows:

> A good example of a corporate structure and function that had a separate purpose and focus from regulated utility operations was that of Aquila, Inc. Aquila, Inc. was the parent of Missouri Public Service which is now doing business as Evergy West and is owned by Evergy, Inc. During the late 1980's and 1990's Aquila Inc. invested in utility properties around the world and in various other industries such as

> home security services and equipment, utility distribution maintenance providers, and regulated utilities in England and New Zealand. During this period, Aquila Inc.'s primary focus was clearly no longer its Missouri regulated utility operations and Staff recommended that Missouri customer rates be calculated assuming substantial retention of costs at the parent level to reflect corporate activities not premised upon or required by Missouri utility operations.

Exhibit 117, *Rebuttal of Keith Majors*, pg. 6 lns. 14 – 23. What is truly bizarre about this discussion is how Staff makes no real effort to distinguish Aquila from Spire. This is a problem because Spire, much like Aquila, has now significantly invested in multiple utilities outside of Missouri as well as several other industries. At present, Spire is engaged in ** ____ ** Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, schedule RES-D-6 part 1, PDF pgs. 81.

Given the number of other business ventures that Spire has engaged in, one seriously questions why Staff thinks that Spire is truly dissimilar to the Aquila example that Staff offered. OPC witness Mr. Robert Schallenberg noted as much in surrebuttal: **

> ____

** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 lns. 2 – 11. The difference that Mr. Schallenberg points out only reinforce the idea that Spire Missouri should **not** be paying the cost for Spire Inc. based on the logic Staff employed in the Aquila case.

For Staff to seriously try to argue that Spire Inc. is not engaged in "substantial merger and acquisition activities" is preposterous. Spire Inc. has regularly engaged in "substantial merger and acquisition activities" related to regulated utilities in other states (like Spire Alabama and Spire Gulf) as well as nonregulated business activities (like Spire Storage and Spire STL Pipeline). *See* Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, schedule RES-D-6 part 1, PDF pgs. 81. OPC witness Mr. Robert Schallenberg again directly addressed this point in surrebuttal: **

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** *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 lns. 13 – 18. Spire Inc. is thus very similar to Aquila Inc. and **<u>is</u>** "involved in substantial merger and acquisition activities." *Id.* at lns. 2 – 13. As Staff's own brief indicates, this warrants the use of different allocations procedures that result in Spire, Inc. being assigned more costs. *Staff Initial Brief*, pg. 48.

The fourth and final concept derived from the seventh paragraph of Staff's brief comes from the sentence "[s]imply allocating costs to Spire, Inc., or Spire Services, Inc., or ordering a large adjustment like OPC recommends, is not valid **<u>absent evidence that Spire, Inc., or Spire Services, Inc., has incurred such costs</u>**, and Staff's audit has found no such evidence." *Staff Initial Brief*, pg. 48. This is plainly refuted by the facts. Spire Inc. filed a tax return. Exhibit 223, *Spire & Subsidiaries Consolidated Federal Tax (Skinny Version)*. Some person had to prepare that return. The preparation of that tax return caused a cost to be incurred. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 16. Spire Inc. likewise had to incur a cost to prepare its 2019 Proxy Statement and its United States Securities and Exchange Commission ("SEC") Form 10-K. *Id.* Spire Inc. incurred a cost for using space in its headquarters at 700 Market St. in St. Louis Missouri. *Id.* Spire Inc. incurred a cost for keeping ** ____

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___________________________________ ** *Id.* Spire's Commission

approved cost allocation manual **literally** lists all the goods and services that were provided to Spire Inc. and its subsidiaries, **all of which would have required a cost to be incurred**. Exhibit 203C, Direct Testimony of Robert E. Schallenberg, schedule RES-D-6 part 1, PDF pgs. 40 – 69. There is thus **overwhelming** evidence that Spire Inc. has incurred costs to operate. For Staff to try to insinuate otherwise is simply nonsensical.

Having wrapped up paragraph seven, we come to the final paragraph in Staff's brief. This is merely a summation and so does not add any new insight. The OPC will not overstate its response by addressing issues already covered. However, the OPC does wish to address one or two points that were not mentioned in Staff's brief. These are issues found in Staff's testimony that the OPC suspects Staff might seek to raise in reply.

The first thing to address is Staff's attempt to compare Spire Missouri to Evergy and Ameren. *See* Exhibit 135, *Surrebuttal of Keith Majors*, pg. 9 lns. 9 – 17. Staff's argument effectively just boils down to this: Evergy and Ameren both also have a services company, so Spire must not be violating the affiliate transaction rule. *Id.* ("All three of these utilities are components of multi-jurisdiction entities which allocate costs between and among their various affiliates. . . . Using Mr. Schallenberg's reasoning, these utilities have been victims of affiliate abuse for the last years."). What Staff fundamentally fails to realize is how different Evergy and Ameren are from Spire's shared service company. Evergy, for example has a shared service company that does not provide any services. Exhibit 225, *FERC Form 60 for*

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Evergy Services (Skinny Version), pg. 2 ("Evergy Services, Inc. did not provide services to Evergy, Inc. or its subsidiaries during 2020."). Ameren, on the other hand, has a shared service company that actually charges significant dollar amounts to its parent company both directly and indirectly. Exhibit 224, *FERC Form 60 for Ameren Services (Skinny Version)*, pg. 2 (showing Ameren Corporation, which is the parent company, was charged over $10 million dollars directly and nearly $2 million indirectly). Thus, we can see that it is not as simple as saying "Evergy and Ameren each have a services company, so Spire must not be violating the affiliate transaction rule." The problem with Spire lies with the fact that **Spire Inc.** is not being charged for the services Spire Missouri provides **through** Spire Services. This is an issue that is **unique** to Spire.

The other issue that the OPC wishes to address is the last question and answer provided by Staff at the end of Mr. Major's surrebuttal:

> Q. On the page 16 of Mr. Schallenberg's testimony, he contends that expenses of non-employee directors of Spire Inc. should not be allocated to Spire Missouri. How do you respond?
>
> A. To my knowledge, every major shareholder-owned utility has non-employee directors, even Raytown Water Company with around 6,000 customers. If Spire Missouri were the holding company with no other affiliates, it would undoubtedly have a board of directors with non-employee directors to represent the interests of shareholders. Prior to its acquisition, The Empire District Electric Company was a standalone utility with no holding company structure. Its former board of directors were comprised in part of non-employee directors.

Exhibit 135, *Surrebuttal of Keith Majors*, pg. 11 ln. 19 – pg. 12 ln. 5. It is important to consider this only to rebut the flawed logic at play here. Staff is clearly attempting

to argue that, "even without the parent company Spire Inc., some of the costs Spire Inc. is not currently paying would still be borne by Spire Missouri." This misses the point. The problem is that there are currently **two** cost drivers (one for Spire Missouri and one for Spire Inc.) and Spire Missouri is currently paying for **both**. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 ln. 19 – pg. 22 ln. 2. The fact that Spire Missouri would still have outside (non-employee) directors even if it was a holding company without subsidiaries does not mean that it makes sense for **Spire Missouri** to pay for its **own** Board of Directors **and** Spire Inc.'s outside directors. When Spire Missouri made the decision to reorganize and make Spire Inc. its parent so that Spire Inc. could oversee the non-regulated activities, it adopted a business structure that is markedly distinct from other utilities like Raytown Water Company. Having that distinct business structure means having to abide by the Commission's affiliate transaction rules.

Staff's brief completely fails to rebut the central premise of the OPC's argument, which, again, is that Spire Missouri is providing part of the cost to operate Spire Inc. In fact, Staff's brief just accepts this as fact and attempts to justify it by writing exceptions into the rule that do not exist and presenting clearly false factual assertions such as the idea that Spire Inc. does not engage in any business that is separate from Spire Missouri or that Spire Inc. is not actively and deeply engaged in merger and acquisitions despite now owning utilities in at least three states and several non-regulated enterprises in several *other* states. The Commission should

thus dismiss Staff's faulty logic, rule correctly that a violation of the affiliate transaction rule has occurred, and order an adjustment to account for this violation.

Response to Spire

Spire's brief contains significantly more discussion of this issue than what was presented by the Staff. Therefore, it would be unwise to attempt to refute the Company's brief in the same paragraph-by-paragraph manner. Fortunately, this is also unnecessary because much of Spires' brief is unnecessary and does not address the central issue at hand.

General Response to Spire's Executive Summary along with the First and Second Argument Sections

Spire begins its brief with a general overview of its Spire Services company and an explanation of its allocation process. *Spire Initial Brief*, pgs. 43 – 47. This section is almost completely irrelevant to the argument that the OPC has raised. As the OPC will soon demonstrate, this is most likely due to the fact that Spire has no legitimate answer to the OPC's actual argument. The Company has consequently chosen to just regurgitate an explanation of its allocation process in an attempt to imply that *it just could not possibly be violating the affiliate transaction rules because of all the steps and review involved.* This logic is flawed, though, because merely having a great deal of procedure involved in violating a rule does not remediate the violation itself. Unfortunately, because this pointless recitation of process has no bearing on the central issue, any attempt to evaluate it in depth would expand this

brief unnecessarily. Therefore, the OPC will restrict its analysis to proving two related points: (1) that Spire is not in compliance with its Commission approved CAM and that this would not settles the issue regardless, and (2) that Spire is not seeking to maximize – to the highest extent possible – its direct allocations. Understanding these two points alone will require sufficient evaluation to make clear why the OPC will refrain from addressing every inaccuracy in Spire's brief.

The OPC admitted a copy of Spire's Commission approved CAM into evidence as OPC exhibit 228. One of the more important things to understand about the CAM is that it employs what is commonly called the "three-step" allocation method. Exhibit 228, *Appendix-1 CAM*, pg. 13. According to the CAM:

> This method begins with the premise that **to the maximum extent practical**, all costs which can be specifically attributed to a business segment **are directly charged to that business segment**. Secondly, indirect costs which cannot be directly charged are allocated to business segments **on the basis of a causal relationship**. In the third step, any remaining costs which **cannot be reasonably associated with a specific, identifiable, causal relationship** shall be allocated using a general allocator as described below.

Id. (emphasis added). What this means is that Spire should first seek to directly assign as much costs as possible and then afterwards seek to indirectly assign costs based on a causal relationship.[18] *Id*. It is **only after these first two steps have**

[18] Spire fully acknowledges this point in its brief. *Spire Initial Brief*, pg. 44. ("This method begins with the premise that to the maximum extent practical, all costs that can be specifically attributed to a business segment are direct charged.").

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failed that Spire should start allocating costs using a general allocator. *Id*. This is not, however, the way Spire is actually operating.

The fact that Spire is not directly assigning costs to the maximum extent possible can be seen in OPC Exhibit 220. This exhibit was examined during the cross of Spire witness Mr. Timothy Krick:

> Q. What I'm trying to indicate here is that you agree with me that for the director and officers insurance, zero percent is directly assigned to non-Missouri entities, a hundred percent is indirectly assigned. Correct?
>
> A. Correct.
>
> Q. And as far as cost assigned to Spire Missouri, again, zero percent is directly assigned and a 100 percent was indirectly assigned; is that correct?
>
> A. Correct
>
> Q. And the same is true for corporate costs with the subheading director fees, expenses, director stock-based --
>
> A. Yes.
>
> Q. -- compensation?
>
> A. Yes, sir.
>
> Q. And, effectively, the same is also true of the outside audit and depreciation furniture and fixtures, again, a 100 percent is indirectly assigned?
>
> A. That's right. We're assigning based on factors approved in the Commission-approved cost allocation manual.
>
> Q. From my point, a 100 percent is indirectly assigned. That's the critical part I'm asking you about right now.
>
> A. Yes, that's very clear by this schedule. Yes.
>
> [. . .]
>
> Q. And, so, according to this, again, a 100 percent of costs are indirectly assigned for general and admin expenses to everyone but for Spire Missouri?

A. As reported in this report, in line with the definitions of this CAM report that was created a long time ago.

[. . .]

Q. It's a 100 percent indirectly assigned. Property and liability insurance, again, a 100 percent indirectly assigned across the board?

A. Yes.

Q. For rent it's a 100 percent indirectly assigned across the board?

2 A. Yes.

Q. Now, personnel costs, we actually do see some break down. We see that 31 percent has been directly assigned to Spire Missouri?

A. That's correct.

Q. But the other 69 percent was indirectly assigned?

A. Yes.

Q. For the EDP system, again, we see Spire Missouri was a 100 percent indirectly assigned. Right?

A. Yes.

Q. And then if we go all the way down to the bottom at total, and I want the total direct versus indirect per CAM at the bottom, the amount indirectly assigned to Spire Missouri was 80 percent. The amount directly assigned was 20 percent?

A. Yes.

Tr. pg. 331 ln. 17 – pg. 334 ln. 18; Exhibit 220, *DR Response*. Despite what Mr. Krick attempts to argue through the course of the cross-examination, the point here is that Spire is **indirectly** assigning nearly **all** of its costs. *Id*. This is the **exact opposite** of how the CAM was designed to work, which was elaborated upon by Mr. Schallenberg:

Q. YOU MENTIONED THAT THE AFFILIATE TRANSACTION RULE HAS A SPECIFIC DEFINITION FOR THE COSTING METHODOLOGY TO BE USED FOR AFFILIATE TRANSACTIONS. CAN YOU PLEASE ELABORATE?

A. The affiliate transaction rule defines the costing methodology to focus on the costs of a good or service produced.

[definition of "Fully Distributed Cost" from ATR]

Therefore, the proper basis for cost allocation methodology for an affiliation transaction is the use of the goods and services produced, i.e. the costs follow the goods or services. **In practice, this is done by charging the cost of a good or service being produced directly to the user of that same good or service**. This method of directly charging costs results in costs being directly assigned to each affiliate based on the goods and services that are actually used by that affiliate. This method of direct charging has a secondary benefit as well, in that, an affiliate recovers its production costs through the number of goods and services sold to individual entities. The purchasing affiliates' costs is determined by the number of produced goods and services it uses. Thus, a purchasing affiliate will have no costs from a good or service produced if it doesn't purchase any such good or service. The purchasing affiliate will only pay for the costs of goods and services that it used in proportion of the amount that was totally used. For example, if the purchasing affiliate purchased 10% of the goods or services produced by an affiliate, then the purchasing affiliate would pay 10% of the producing affiliate's total costs to produce that good or service.

Q. DOES SPIRE RELY MAINLY ON THE DIRECT CHARGING METHODOLOGY YOU JUST DESCRIBED FOR ITS AFFILIATE TRANSACTIONS?

A. No. **Spire does not directly assign costs based on the goods and services that are actually being used by each affiliate**. Spire instead uses the ** ____________________ ** allocation method for assigning the cost of goods and services produced and consumed by its affiliates. **Under this model, Spire seeks to assign costs based on the affiliate entities that it believes have "benefited" from the good or service regardless of whether the affiliate actually used that good or service**. However, **this is not what the Commission's affiliate transaction rules permit or require** so as to prevent a Missouri electric, gas, or steam utility from providing a financial advantage to an affiliate.

The affiliate transaction rule requires cost allocation based on a specific methodology related to goods and services used as opposed to cost charging to affiliates independent of the amount of the good or service used. The ** ____________________ ** formula, which does not assign/allocate costs based on the amount of goods and service used, will thus not comply with the affiliate transaction rule.

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The "benefit" criteria Spire is using, which employs the ** ____________________ ** method, is inappropriate, as the process ignores both the cost causer and the net benefit as the appropriate cost objective. To state it differently, the ** ____________________ ** method does not consider who caused the cost to be incurred or even try to determine whether the cost is actually beneficial to the entity being charged.

Exhibit 204C, *Rebuttal Testimony of Robert E. Schallenberg*, pg. 11 ln. 15 – pg. 13 ln. 7 (emphasis added). This failure by the Company to maximize its direct charging demonstrates how it is not actually following its CAM.

If Spire truly intended to follow its Commission approved CAM, it would be direct charging costs to the maximum amount possible. This would necessarily include charging more costs directly to Spire Inc., as Mr. Schallenberg discusses:

> **Q. SO, TO REITERATE, WHAT SHOULD THE COMPANY BE DOING INSTEAD?**
>
> A. Spire should be direct charging all affiliate transaction costs which are incurred by or on behalf of a specific Spire Inc. entity (including Spire Inc. itself) directly to the entity who has caused the cost to be incurred. For example, Spire Inc. has a number of outside (meaning non-employed) directors on its Board of Directors. Outside directors receive special compensation. The cost of the compensation for Spire Inc.'s outside directors is thus incurred to satisfy a requirement of Spire Inc. to have outside directors on its board. As such, **the cost of this compensation should be directly charged to Spire Inc. and not allocated to Spire Missouri**.

Id. at pg. 13 lns. 17 – 24. The problem is that Spire has no intention of actually following its CAM. Instead, Spire has designed and implanted its corporate organization structure to ensure as much charging as possible (80% of all costs) are done through the least-favored, third-step method in the CAM using a general

allocator. This failure to maximize direct charging forms the fundamental heart of this issue.

Even if one looks past the fact that Spire is not maximizing its direct charging or looking for a causal relationship for indirect charging (like the CAM instructs), the mere fact that it is employing an allocation factor found in the CAM does not prove prudence or compliance. Again, OPC witness Bob Schallenberg explained this point in surrebuttal: **

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** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 6 lns. 14 – 23. There are two parts to this excerpt that we need to examine, starting with the fact that Spire's CAM requires adjustment to ** ____ ______________________________________ **

We return to Exhibit 228, which is the copy of Spire's Commission approved CAM. Turning to page 15, we find the three factor allocation method that Spire has

been relying on throughout the case to justify its affiliate transaction rule violation. Just past that, though, the CAM states:

> These factors should be continuously monitored for fairness, relevance, reasonableness, and appropriateness and, if the business or operational considerations supporting the propriety of the general allocator computation change materially and continued use of the allocation method results in an inequitable allocation of costs, [Spire] immediately change one or more of the component factors to ensure that the costs are being allocated on the most equitable and appropriate basis. [Spire] shall document the reason for the change and the reason for the new factors.

Exhibit 228, *Appendix-1 CAM*, pg. 15. This except verifies the excerpt from Mr. Schallenberg given earlier. Moreover, it demonstrates another fatal flaw with the argument that "just following the CAM" is sufficient to prove prudence or compliance. The CAM **itself** states that when the three factors that make up the general allocator are no longer resulting in an allocation that is fair, relevant, reasonable, or appropriate they need to be changed. *Id*. A general allocator that results in a direct violation of the affiliate transaction rule is one that does not meet the standards of fairness, relevance, reasonableness, and appropriateness. Therefore, once Spire realized that its CAM was going to result in Spire Inc. not being charged **any** of the costs for goods and services it received (such as rent, personnel costs, and administrative or regulatory work), it was under an obligation to change the three factor formula. *Id*. Spire's failure to do so was itself a violation of the CAM.

The second important part of the excerpt from Mr. Schallenberg quoted above is the fact that Spire is being rather dishonest when it claims Spire Inc. has none of

the three assets – "(1) fixed assets and investments, (2) revenue, and (3) direct payroll" – that make up the three factor general allocator. As Mr. Schallenberg elucidates: **

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** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 7 lns. 3 – 14. The officers of Spire Inc. **should** have at least part of their salaries directly charged to Spire Inc. Instead, all of their salaries are indirectly assigned using the three factor general allocator. Further, because none of the officer's salaries has been directly assigned, Spire Inc. **looks** like it has no direct payroll, so it also does not get indirectly assigned anything either. The problem should be clear. First, Spire ignores the mandate to directly assign as much costs as possible by assigning no payroll directly to Spire Inc. Then the Company turns around and indirectly assigns nothing to Spire Inc. as well based on the fact that nothing has been directly assigned to Spire Inc. This is how Spire is abusing its CAM.

PUBLIC

In addition, there is also the problem of Spire's tax returns. ** ________

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Exhibit 223, *Spire & Subsidiaries Consolidated Federal Tax (Skinny Version).* ** ___

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** This tax return thus calls into serious doubt Spire's claim that Spire Inc. has none of the three factors that make up the general allocator used in the CAM. Spire's claim that it was proper that Spire Inc. was not allocated any of these costs should also thus be in doubt. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 15 lns. 17 – 18. (** ____

_____________ **).

As one last point with regard to this argument, the OPC would point out that Spire's CAM explicitly states that the OPC may challenge the three-factor formula contained in it. Exhibit 228, *Appendix-1 CAM*, pg. 16 ("In addition, each party shall be free in subsequent rate cases to propose changes to the calculation of the

components used in [Spire]'s fully distributed cost determination, the financial metrics to be included in the general allocator and in the allocation factors described below."). This is, in essence, what the OPC has done in this case. The OPC is now challenging the three-factor formula on the basis that it is **designed** to not assign costs to Spire Inc. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 5 ln. 16 – pg. 6 ln. 2. As such, Spire cannot rely on its claim that it was just following the three-factor formula found in the CAM because the OPC is directly challenging the three-factor formula found in the CAM.

As we have thus seen, Spire is not following its CAM because it is not directly charging costs to the maximum degree possible as the CAM requires. Exhibit 228, *Appendix-1 CAM*, pg. 13; Exhibit 204C, *Rebuttal Testimony of Robert E. Schallenberg*, pg. 11 ln. 15 – pg. 13 ln. 7. Second, Spire's CAM requires the three-factor allocator it defines to be "continuously monitored for fairness, relevance, reasonableness, and appropriateness[,]" which Spire has not done because it has allowed the three-factor allocator to result in an affiliate transaction rule violation. Exhibit 228, *Appendix-1 CAM*, pg. 15. Third, Spire's application of the three-factor allocator has been called into question because Spire is not recognizing any of the officers who work for Spire Inc. as being on Spire Inc.'s payroll (due to its decision to ignore the mandate to maximize direct allocation) and have thus forced the allocator to exclude Spire Inc. from indirect assignment of any costs. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 7 lns. 3 – 14. Finally, the CAM itself allows the OPC to challenge the three-factor allocator, which is a problem for Spire because the mere fact that the

Company uses the three-factor allocator cannot itself establish the prudency of that same allocator. Exhibit 228, *Appendix-1 CAM*, pg. 16.

As stated at the beginning of this discussion, this analysis was offered primarily to rebut the key assertions of the first five pages of Spire's brief while forgoing the even more extensive discussion that would have been required to refute **everything** Spire stated. So, for example, we know that Spire is misrepresenting its practices when its states "[c]onsistent with its commission-approved CAM, Spire's objective is to directly assign costs to the utility operating companies and affiliates to the extent it is possible and practical to do so." *Spire Initial Brief*, pg. 42. We know this to be a misrepresentation because Spire make no effort to directly assign almost **any** cost categories and ultimately directly assigns only 20% of the over $200 million of costs incurred in this test year. Tr. pg. 331 ln. 17 – pg. 334 ln. 18; Exhibit 220, *DR Response*. We further know that it is utterly false when Spire states "[t]he costs reflected in Spire's filing are consistent with . . . the Company's Commission-approved CAM" for the very same reason (*i.e.* the lack of direct allocation) not to mention the failure to comply with the requirement to modify the CAM when allocation factors result in unjust allocations (such as when they result in a violation of the affiliate transaction rule itself) and other reasons. *See Spire Initial Brief*, pg. 43 Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 6 lns. 14 – 23; Exhibit 228, *Appendix-1 CAM*, pg. 15. With that, we can move on to the next part of Spire's argument.

Response to "Customer Benefits"

Spire argues that the use of a shared service company provides customer benefits. *Spire Initial Brief*, pg. 47. As the OPC laid out at the very beginning of the discussion of affiliate transactions, it is not challenging Spire's use of a shared services company. The only question at issue here is whether Spire Inc. should pay for the costs incurred to operate Spire Inc. as required by the Commission's affiliate transaction rule. Any discussion of the benefits Spire receives from having a shared services company is wholly meaningless.

Response to "Costs Borne by Spire Inc."

The OPC will temporarily skip the fourth argument raised in Spire's brief and move directly to the fifth where, for the first time, Spire directly addresses the OPC's primary contention that the Company is violating the affiliate transaction rule by having Spire Missouri pay for or provide the goods and services necessary to operate Spire Inc. There are two paragraphs here to which the OPC will respond.[19] The first reads as such:

> Additionally, OPC counsel specifically made allegations related to costs associated with the "salary" of Spire Inc.'s president and CEO. These statements ignore the fact that substantial portions of the compensation of executive officers are borne solely by Spire, Inc. and its shareholders. Spire witness Krick explained that as to executive compensation for stock-based compensation, Spire Missouri makes a very large adjustment to its test year numbers to remove approximately $9M from its request. Thus, recovery of those amounts are not sought from Spire Missouri customers and are instead borne by Spire, Inc. and its shareholders.

[19] Technically, there is a two sentence third paragraph at the beginning, but the OPC does not consider this paragraph to merit response beyond what will be addressed with regard to the other two paragraphs.

PUBLIC

Spire Initial Brief, pg. 51 (internal citations omitted). This is a poorly developed straw-man argument. Spire does not refute the **central and integral point**, which is that Spire Inc. does **not** pay any portion of the cost of its own CEO, or any of its other officers, or even its Board of Directors. Instead, Spire just argues that it *could* have had Spire Missouri pay for even more. This should be obvious, but, arguing that you could have had a more egregious affiliate transaction rule violation does not remediate or ameliorate the **initial** affiliate transaction violation. To put this in perspective, just imagine a man who is on trial for robbing a bank. The man's defense attorney stands up in court and argues:

> Sure, the defendant stole $10,000 from the bank's vault, but the prosecution is ignoring the point that the defendant *could* have stolen $1 million dollars. Because he did not steal $1 million dollars, the defendant did nothing wrong.

This is understandably faulty logic. Not stealing $1 million dollars does not excuse the fact that the defendant did steal $10,000 dollars. In the exact same way, the fact that Spire is not seeking recovery of $9 million dollars in stock-based compensation for Spire Inc. executives from Spire Missouri ratepayers does not excuse the fact that they **are** seeking ** ——————————————————————

** Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 17. Asking Spire Missouri to pay the salaries for Spire Inc.'s executive officers (even if it is not their stock-based compensation) is still providing Spire Inc. a financial advantage. *See Id.*

at pg.17 lns. 1 – 3. This is still prohibited by the affiliate transaction rule. 20 CSR 4240-40.015(2)(A).

The second paragraph that Spire offers in response to the OPC's entire argument does at least try to actually address the argument directly. It reads as follows:

> It is true that there are certain categories of cost for which Spire Inc. does not receive an allocation. That is because the CAM specifies that these costs should be allocated based on the three-factor formula, which is comprised of fixed assets, revenues, and direct payroll, of which the Holding Company has none, as it does not produce or consume goods or services. Therefore, it receives no allocation of such costs. This does not mean that Spire Missouri bears all of those costs. Other affiliates are allocated a portion in compliance with the methods described in the CAM. Moreover, in the absence of the Holding Company, the operating company would still have those functions and presumably not be sharing them with other affiliates with the scale that they are today.

Spire Initial Brief, pgs. 51 – 52. There are several points to respond to here. The first is the line "That is because the CAM specifies that these costs should be allocated based on the three-factor formula, which is comprised of fixed assets, revenues, and direct payroll, of which the Holding Company has none, as it does not produce or consume goods or services." The OPC has already addressed the problem with the three-factor formula and Spire's claim that the holding company has no fixed assets, revenues, and direct payroll. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 7 lns. 3 – 14. However, the OPC must now directly refute the idea that Spire Inc. "does not produce or consume goods or services." This is absolutely and completely untrue.

In order to show how ludicrous the claim that Spire Inc. "does not produce or consume goods or services" is, it is best to consider an example. Fortunately, both sides to this case centered their discussion on just such an example, which is the use of Spire Inc.'s headquarters at 700 Market Street in St. Louis Missouri. To illustrate, Spire witness Mr. Timothy W. Krick claimed in his rebuttal testimony that the OPC's witness Mr. Schallenberg was wrong to say that neither Spire Inc. nor Spire Services are charged any part of the cost of obtaining and maintaining this building. Exhibit 16, *Rebuttal Testimony of Timothy W. Krick*, pg. 8 lns. 21 – 27. However, Mr. Krick then went on to immediately admit that neither Spire Inc. nor Spire Services pay any part of the cost of obtaining and maintaining this building.[20] *Id*. at pg. 9 lns. 1 – 8. This is where the violation of the affiliate transaction rule arises, as Mr. Schallenberg explained: **

** Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 19 lns. 7 – 11. Mr. Krick attempts to rebut this by employing the following logic:

> **Q. MR. SCHALLENBERG ALLEGES THAT THIS RESULT INDICATES THE 10 TRANSACTIONS ARE NOT CONSISTENT**

[20] The discrepancy here lies in the fact that Mr. Krick is splitting hairs by arguing that costs **are** "charged" to Spire services but then allocated away to other affiliates, thus leaving Spire services to pay nothing. Exhibit 16, *Rebuttal Testimony of Timothy W. Krick*, pg. 8 ln. 21 – pg. 9 ln. 3. Nothing is ever charged to Spire Inc. *Id*. at pg. 9 lns. 6 – 8.

WITH THE AFFILIATE TRANSACTIONS RULES BECAUSE SPIRE MISSOURI IS PROVIDING GOODS AND SERVICES TO AFFILIATES AT NO COST (SCHALLENBERG DIRECT, PAGE 19). DO YOU AGREE WITH THAT POSITION?

A. No. Because of the nature of their role, neither Spire Inc. nor Spire Services make any use of the building at 700 Market Street. Accordingly, because they receive no "goods or services" associated with the building, there are no costs to be allocated to them.

Exhibit 16, *Rebuttal Testimony of Timothy W. Krick*, pg. 9 lns. 9 – 16. Thus, we can see how Spire's claim that Spire Inc. "does not produce or consume goods or services" ties directly into this argument. The next step is to show how plainly false this idea is.

The fact that Spire Inc. makes use of the building at 700 Market Street is both obvious and easily established. The OPC's witness Robert Schallenberg explained the problem with Mr. Krick's logic at length in surrebuttal: **

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** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 16 ln. 5 – pg. 17 ln. 17. Even more evidence was produced during the evidentiary hearing. This includes the actual floor plan of the 6th floor of the 700 Market street building. Exhibit No. 221, *DR - 1059 and Map*. During the evidentiary hearing, Mr. Krick identified several of key officers of Spire Inc. who work on this floor. Tr. pg. 336 ln. 4 – pg. 338 ln. 1. It is true that Mr. Krick attempted to argue that these individuals were not in fact Spire Inc. employees, but rather worked for some nebulous "Spire Enterprise." *See Id*. In terms of **legal realities**, however, these individuals were shown to be officers of Spire Inc. per the filing Spire Inc. made with the Missouri Secretary of State's office. Exhibit 222, *2020 Annual Report Spire, Inc.*; Tr. pg. 340 ln. 14 – pg. 341 ln. 6. This same exhibit also showed 700 Market Street, St. Louis Missouri as the address of Spire Inc.'s registered agent as well as all of its officers and directors. Exhibit 222, *2020 Annual Report Spire, Inc*. It even showed that Spire Inc. claimed its principle

PUBLIC

place of business or Corporate headquarter as the 6th floor of 700 Market Street, St. Louis, which is consistent with the floor plan showing that is where its principal officers work. *Id.* For Spire Missouri to claim that Spire Inc. is not receiving a benefit from 700 Market Street, St Louis, is simply irrational.

So far, we have contained our examination to the issue of rent and specifically the use of offices at 700 Market Street, St. Louis. However, this is, again, only because the OPC's witness chose to use this as an example. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 18 lns. 1 – 3. The logic of this argument extends well beyond the issue of rent. Spire is receiving many other benefits from the work Spire Missouri performs without providing compensation. Providing the personnel to operate Spire Inc. is one obvious example. *Id.* at pg. 16 ln. 5 – pg. 17 ln. 1; Tr. pg. 385 ln. 3 – pg. 386 ln. 21. Providing administrative and support functions, such as ensuring federal regulatory compliance with the SEC and preparing/filing tax returns, is another. *Id.* In short, there is simply no way that the Company can seriously contend that Spire Inc. "does not produce or consume goods or services."

This argument actually bears many similarities to the last of the four concepts from Staff's paragraph seven discussed above. The answer remains the same now as it was then. Spire Inc. filed a tax return. Exhibit 223, *Spire & Subsidiaries Consolidated Federal Tax (Skinny Version)*. Some person **had** to prepare that return. The creation of that tax return is a service that Spire Inc. obviously "used." Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 16. Spire Inc. likewise had to prepare a Proxy Statement for its investors and an SEC Form 10-K, which were both

also examples of goods or services that Spire Inc. consumed. *Id*. the provision of costs to pay for Spire Inc.'s outside directors and the provision of executive officers to run the company is yet **another** example of a goods or service that Spire Inc. "consumed." *Id*. Spire's Commission approved cost allocation manual **literally** lists all the goods and services that were provided to, **and thus consumed by**, Spire Inc. and its subsidiaries. Exhibit 203C, Direct Testimony of Robert E. Schallenberg, schedule RES-D-6 part 1, PDF pgs. 40 – 69. There is thus **overwhelming** evidence that Spire Inc. has consumed goods and services produced by either Spire Missouri or its affiliates. For Spire to claim otherwise is purely disingenuous.

There are still two more points to address with regard to this second paragraph. The first is the sentence "[o]ther affiliates are allocated a portion in compliance with the methods described in the CAM." *Spire Initial Brief*, pg. 51. This is irrelevant, plain and simple. The fact that other affiliate also pay for Spire Inc.'s costs does not make Spire Missouri paying for those costs any less of an affiliate transaction violation. The second is the line "[m]oreover, in the absence of the Holding Company, the operating company would still have those functions and presumably not be sharing them with other affiliates with the scale that they are today." *Spire Initial Brief*, pgs. 51 – 52. This was also touched upon briefly in the response to Staff. In short, this is a meaningless statement because it ignores the fact that Spire Missouri now has to pay for **duplicative and additional** costs. *See* Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 21 ln. 13 – pg. 22 ln. 2. If Spire **was** a standalone company, it would not be paying the cost for two sets of boards of directors

as it is now (the first being Spire Missouri and the second being Spire Inc.). The same is true for executive officers. Moreover, those costs that Spire Missouri would still have to bear (tax return preparation and SEC filings for example) would be smaller because the overall company would be smaller and simpler. The point is this: the Spire enterprise's non-regulated affiliates add additional cost and complexity to the overall Spire system, which is why Spire Inc. was created to manage those other non-regulated operations. Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 20 lns. 9 – 20; *see also* Exhibit 226, Verified Application GM-2001-0342. Spire Inc. should thus bear the cost of its own operation to reflect the fact that it was created as a separate entity **solely** to allow for these non-regulated business enterprises to exist. Arguing that "Spire Missouri would have to bear the costs anyway" ignores the actual reality behind why Spire Inc. exists at all. *Id.*

Response to "OPC Adjustment"

Spire, for reasons unclear, sought to rebut the OPC proposed adjustment before discussing the merits of the OPC's argument. One could read this to imply that the Company acknowledges the veracity of the OPC's position and is thus more keen to blunt the impact then attempt to confront the argument, but that would just be speculation. Regardless, the last issue to discuss is the Company's response to the OPC's proposed adjustment. There are just three points the OPC wishes to make.

First, Spire's brief makes some rather outlandish claims regarding the "alternative proposal" counsel for the OPC offered at the evidentiary hearing. Specifically, the Company states:

> At the hearing, OPC for the first time made an alternative proposal to its $65,733,945 adjustment. OPC's alternative proposal was to move approximately $2-3 million of board expense, some executive pay, and some office space to Spire Inc. The $60 million swing in recommendations to the Commission at hearing underscores the lack of appropriate foundation for the argument beyond accusation and conjecture. This wide swing should diminish any concerns that Spire is not appropriately allocating costs correctly.

Spire Initial Brief, pg. 48. There is no citation for any of this, because none of it is true. The actual statement that Spire is referring to is this:

> I'm going to throw out there an alternative. If the Commission is unwilling to just put 65 [million] down, and I can fully understand why, the alternative is to say, look, at a minimum, Spire Inc. should bear the cost of its own executive officers and its own board. And then you should have Spire Missouri be reimbursed for the direct services it has provided to Spire Inc. That is a simpler solution. Well, actually, it's not simpler, but it is -- well, it's an alternative. We'll just leave it at that.

Tr. pg. 325 ln. 21 – pg. 326 ln. 4. The basic idea here is straightforward: have Spire Inc. bear the cost of its own executive officers and its own Board of Directors and then order the Commission's Staff to determine a cost for the goods and services that Spire Missouri provided to Spire Inc. (such as rent, tax return preparation, 10K preparation, proxy statement preparation, etc.) and treat that as an adjustment to Spire Missouri's revenue requirement so as to reimburse Spire Missouri for the direct services it has provided to Spire Inc. At no point did **anyone** suggest this amount was just $2-3 million. In fact, the witness for the OPC identified that Spire Missouri incurred costs for ** ____

____ .

____ ** Exhibit 203C, *Direct*

Testimony of Robert E. Schallenberg, pg. 17. That is at least ** ―――――― ** right there. The additional costs that might be incurred to reimburse Spire Missouri for goods and services it produced for Spire Inc. is going to be much more difficult to quantify, but it is only going to drive the number higher.

The second point concerns the so-called "common sense" test that Spire attempts to employ by comparing Spire Inc. to the other Spire regulated gas entities in terms of the number of customers served and miles of pipe. This is an utterly nonsensical argument for one obvious reason: there is no correlation between either of those concepts and the cost of goods and services Spire Missouri provided to Spire Inc. The question to be answered here is very simple: of the costs retained by Spire Missouri for goods and services Spire Missouri produced for affiliates, how much should have been assigned to Spire Inc. To fully answer that question, one would need to know all the services that Spire Missouri provided Spire Inc. and then find the cost Spire Missouri incurred to provide or produce those goods and services. At no point in this process would one have **any** reason to look at either the number of customers or the miles of pipe in the Spire enterprise regulated gas utilities. Consider the preparation of a tax return for example. To determine how much it cost Spire Missouri to prepare Spire Inc.'s tax return you would ask questions like: how many people worked on it, how many hours did they work, and how much were they paid for that time. What you would **not** ask is how many miles of pipe does Spire Missouri have. That has literally **nothing** to do with the cost of preparing a tax return. It is meaningless.

Let us consider another example. This time let us look at rent. How would the Commission determine the proper amount of rent costs that should be allocated to Spire Inc.? The answer is quite simple, as the OPC's expert witness laid out: **

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** Exhibit 205C, *Surrebuttal Testimony of Robert E. Schallenberg*, pg. 18 lns. 1 – 12. Looking at this example, can one find discussion of number of customers or miles of main? No, of course not. These factors have no bearing on the assignment of costs. Spire's whole claim that the OPC's adjustment does not make common sense by comparing to miles of main or numbers of customers is itself completely nonsensical.

The last point that the OPC wants to make is one that is not directly addressed in Spire's brief but which still needs to be pointed out and reinforced. As the OPC has stated before, it is Spire who bears the burden of proving that its rates are just and reasonable. RSMo. § 393.150.2 ("At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased

rate is just and reasonable shall be upon the gas corporation"). This takes on a **particular** importance when dealing with the issue of affiliate transactions because the Missouri Supreme Court has held that "[a] presumption of prudence is inconsistent with the rationale for the affiliate transaction rules and with the PSC's obligation to prevent regulated utilities from subsidizing their non-regulated operations." *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371, 378 (Mo. banc 2013). "Accordingly, the presumption of prudence is inapplicable to affiliate transactions." *Id*. at 379. This makes things crystal clear: Spire has the burden of proving how much of the affiliate transaction costs retained by Spire Missouri were just and reasonable. If Spire cannot meet that burden, **then all the costs should be disallowed**. In this case, Spire's problem stems from the fact that it is not directly charging almost any of its costs and instead is using a general allocator that specifically omits Spire Inc. Exhibit 204C, *Rebuttal Testimony of Robert E. Schallenberg*, pg. 11 ln. 15 – pg. 13 ln. 7; Exhibit 205C, *Surrebuttal Testimony of Robert E. Schallenberg*, pg. 5 ln. 16 – pg. 6 ln. 2. As a result, Spire lacks the evidentiary tools necessary to easily determine the cost of the goods and services that Spire Inc. received from Spire Missouri, and, therefore, would not be able to meet its burden of proof. When considered in that context, the OPC's adjustment is actually quite generous.

Issues not raised in Spire's brief

There is one issue that Spire did not raise in its brief that the OPC suspects might be raised in reply. That is to claim that Spire is just a "holding company" and

thus "does not produce or consume goods or services." Fortunately, the OPC has already shown how this last part is false. For the sake of completeness, though, the OPC will very briefly rebut the argument that Spire Inc. is a holding company.

Spire Inc. is **not** a mere holding company whose sole purpose is to hold stock. Instead, Spire Inc. is the governing head of the overall Spire enterprise and is actively and deeply involved in the management and operation of its subsidiaries including Spire Missouri. The OPC's witness Mr. Schallenberg explained in surrebuttal: **

** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 7 ln. 19 – pg. 8 ln. 6.

Given these factors, it would be more proper to call Spire Inc. a parent company rather than a holding company, again as Mr. Schallenberg explained: **

** Exhibit 205C, *Surrebuttal of Robert E. Schallenberg*, pg. 13 ln. 14 – pg. 14 ln. 11. However, the OPC also cautions the Commission not to get bogged down with the semantics of *what* exactly to call Spire Inc. The ultimate issue here is that Spire Inc. does not "merely own stock" but rather actively engages in the management of its affiliates, **which is something that Spire Inc. was originally intended to do**. However, this point was addressed at length in the response to Staff's positon, so the OPC will go no further with this analysis.

Conclusion

Much like Staff, Spire admits the central contention of the OPC's argument. *Spire Initial Brief*, pg. 51. ("It is true that there are certain categories of cost for which Spire Inc. does not receive an allocation."). These categories of costs represent goods and services that Spire Missouri provides to Spire Inc. without compensation from Spire Inc., which is a clear violation of the Commission's affiliate transaction rule. 20 CSR 4240-40.015(2)(A). All the rest of Spire's brief is an attempt to confuse the issue by pretending that Spire Inc. does not consume goods or services or that Spire Missouri is directly allocating as much as possible, both of which are obviously false. These are hollow distractions. All the Commission needs to concentrate on is the fact that its affiliate transaction rule has been violated. Spire Inc. is receiving goods and services below the greater of fair market price or fully distributed cost, because it is not being assigned **any** cost. The OPC is the **only** party who has offered a manner to correct this. In the face of a clear rule violation, the complete failure of Spire to meet its statutorily imposed burden of proof, and OPC's proposed remedy being the sole offered solution, the Commission should clearly order the OPC's proposed remedy.

Issue 24: Depreciation

The OPC conducted an exhaustive review of the depreciation issue in its initial brief. In doing so, the OPC sought to highlight the myriad issues that arose in this case related to depreciation. At the time, the OPC did not believe that the situation could get worse. It got worse. Fortunately, the groundwork laid in the initial brief should render this discussion relatively short.

Response to Staff

Staff requests the Commission to "order the use of the depreciation rates found in Staff's *Revenue Requirement Cost of Service Report* with the exception of accounts related to Smart Meters and Smart Meter Installation." *Staff Initial Brief*, pg. 49. The OPC has already addressed the problem regarding Staff's general plant accounts and will not re-tread that ground here. *See OPC Initial Brief*, pgs. 130 – 133. However, the OPC does wish to stress that Staff appears to have gotten its recommendation wrong. Staff's witness argued to maintain the current depreciation rate for Account 391.95 Enterprise software, which were ordered in case GO-2012-0363. Exhibit 128, *Surrebuttal of David T. Buttig, PE,* pg. 7 lns. 1 – 5. The rate set in GO-2012-0363 was 7% based on a 15-year average service life.[21] GO-2012-0363, Report and Order, pg. 10 ¶ 2, pg. 8 ¶ 16. However, the depreciation rate for account 391.95 found in Staff's *Revenue Requirement Cost of Service Report* is 10% based on a 10-year average service

[21] It is not stated clearly, but the net salvage percentage must be -5% for the rate to be 7% using a 15 year average service life. This can be seen by applying Staff's calculation for depreciation rate which is: $Depreciation\ Rate = (100\% - Net\ Salvage\%) \div Average\ Service\ Life$. Exhibit 101 C, *Staff's Revenue Requirement Cost of Service Report*, pg. 112 lns. 28 – 29.

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life. Exhibit 101, *Staff Cost of Service Report*, Appendix 3 (Schedule DTB-d1). The OPC presumes this was an oversight on Staff's part and that Staff intended to request the Commission order the use of the depreciation rates found in Staff's *Revenue Requirement Cost of Service Report* with the exception of accounts related to Smart Meters, Smart Meter Installation, *and Enterprise Software*. Regardless, the OPC still argues that the currently ordered rates for Account 391.95 Enterprise software, as set in GO-2012-0363, be maintained for all the reasons set forth in the surrebuttal of Staff's own witness. Exhibit 128, *Surrebuttal of David T. Buttig, PE,* pg. 7 lns. 21 – 22.

Response to Spire

While Spire's brief is rife with inaccuracies and other errors, the time necessary to fully explore them all would most likely exceed the value of the corrections. To that end, the OPC will address only briefly the five points that Spire articulates.

Choice of Rates

Spire spends a considerable part of its brief arguing why the Commission should adopt the depreciation rates found in the depreciation study Spire filed in rebuttal testimony rather than continue the existing rates as offered by OPC witness John Robinett. *See Spire Initial Brief*, pgs. 14 – 18. The OPC explained the rationale behind its recommendation extensively in direct. *See OPC Initial Brief*, pgs. 159 – 165. The basic premise is this: at the time the OPC filed direct testimony, there was

PUBLIC

no evidence **in the record** to support Spire's requested rates, so the OPC did not support them. By the time later testimony became due, the OPC had identified numerous errors with the depreciation study and decided not to support it. The OPC has freely admitted that it did not and could not perform its own study. Exhibit 202, *Surrebuttal Testimony of John A. Robinett*, pg. 19 lns. 17 – 18. ("I did not perform a study, as OPC does not have depreciation software needed to perform a study."). At this point, the OPC is not terribly concerned with *which* set of rates the Commission adopts so long as the Commission fixes the specific problems that the OPC has identified related to accounts 376.2 mains – cast iron, 376.3 mains – plastic, 381.1 smart meters, 382.1 smart meter installation, and 391.95 EMIS as well as the general plant account issue discussed in the OPC's *Initial Brief*. To that end, the OPC reiterates that, if the Commission adopts new rates, it should use the Average Service Life and Net Salvage Percentages found in Appendix 3 of Staff's cost of service report as modified per the OPC's recommendations in its *Initial Brief*. *OPC Initial Brief*, pgs. 168 – 170.

General Plant Accounting

This part of Spire's brief (and the whole case) is immensely confused because Spire does not understand its own depreciation recommendation or what the OPC is recommending. The OPC and Spire are actually almost completely aligned on this issue, but for another of Spire's self-contradictions. First, the rate that should be applied to the accounts under the heading of "general plant" are the rates you will get if you apply the formula in Staff's cost of service report to the Average Service

Life and Net Salvage Percentages found in Appendix 3 of Staff's cost of service report, which is consistent with the result reached in Spire's depreciation study. *Compare* Exhibit 101, *Staff Cost of Service Report*, pg. 112 lns. 28 – 29, Appendix 3 (Schedule DTB-d1); *and* Exhibit 35, *Rebuttal Testimony of John J. Spanos*, Schedule JJS-R2. The **whole** problem here stems from the fact that Spire originally recommended, and Staff adopted, the dollar-weighted rate in Mr. Spanos' depreciation study and not the "amortized" value that Spire is **now** recommending. *See OPC Initial Brief*, pgs. 129 – 138. However, Spire's brief refused to acknowledge the Company's own error and thus compounds it.

The second issue here is how to treat plant that is fully accrued. The OPC's position is fairly straightforward. Plant should continue to accumulate depreciation reserve until it is retired:

> At the time the rates are set, Spire's rates are set with a level of fully accrued plant and depreciation expense built in to rates utilizing the entire plant balance. Ratepayers should receive the benefit of increased reserves **if the utility does not timely retire fully accrued dollars**. If general plant amortization is approved, it is Spire's decision how regularly to retire fully amortized general plant, which could be monthly, quarterly, bi-annually, or annually.

Exhibit 202, *Surrebuttal of John A Robinett*, pg. 9 lns. 6 – 11 (emphasis added). Fully accrued plant should therefore just be retired. This puts the burden on the utility to keep good records and timely manage its depreciation reserves to ensure fully accrued plant is timely retired. Spire has a *similar* recommendation:

> First, it is critical that assets beyond the amortization period have a depreciation rate of zero because they have been theoretically fully

> recovered. Ex. 36 (Spanos Surrebuttal), p. 5. **Second, as part of the application of the 2020 Depreciation Study and proper implementation of amortization accounting (square curve) the assets beyond the amortization period need to be retired**. *Id*.

Spire Initial Brief, pg. 19 (emphasis added). Spire **also** appears to be arguing that fully accrued plant should just be retired. However, Spire also wants to set the depreciation rate of fully accrued plant to zero. **This is contradictory**. When plant is retired, it is removed from the plant and depreciation reserve account balances. Exhibit 101C, *Staff's Revenue Requirement Cost of Service Report*, pg. 25 lns. 14 – 15 (" . . . the actual plant is retired and removed from plant balance and the related reserve"). You do not need to set a rate for fully accrued plant if you are going to retire the fully accrued plant because, once it is retired, the plant will no longer be in the account and there will be nothing to apply the rate to. There is thus **no need** to set rates to 0.00% for fully accrued plant.

"[T]he Commission has not ordered depreciation rates for fully amortized plant to be 0.00% and the Company should be continuing to book depreciation expense for assets as long as they are on the books **and not retired**." Exhibit 201, *Rebuttal Testimony of John A Robinett*, pg. 5 lns. 8 – 11 (emphasis added). Instead of trying to set fully accrued plant to 0.00% and then retire it at some later date, Spire should just retire the plant immediately. This coincides with the OPC's recommendation if the Commission does order general plant amortization:

> If the Commission approves Spire's request for General Plant Amortization, I recommend that the Commission order Spire to continue specifying the original cost and associated retirement units for all

> additions to the accounts where General Plant Amortization accounting treatment will occur. **<u>Additionally, Spire should be placed under a standing order to treat all general plant that exceeds the amortization period as retired for ratemaking purposes</u>**.

Exhibit 202, *Surrebuttal of John A Robinett*, pg. 12 lns. 10 – 15 (emphasis added). The witness for Staff, Mr. David T. Buttig, PE, recommended the exact same thing:

> If the Commission orders the amortized depreciation rates of Mr. Spanos, **<u>I recommend the Commission order Spire to regularly retire all assets that have reached the end of the amortization period</u>**. By ensuring assets are retired at the end of the amortization period, any over-accrual from maintaining assets in rate base past their amortization period will be minimized.

Exhibit 128, *Surrebuttal of David T. Buttig, PE*, pg. 6 lns. 3 – 7 (emphasis added). Spire **<u>now</u>** appears to be recommending the same thing. *Spire Initial Brief*, pg. 19. ("Second, as part of the application of the 2020 Depreciation Study and proper implementation of amortization accounting (square curve) the assets beyond the amortization period need to be retired."). There is literally no reason that Spire needed to make this as complicated as it did. All the Commission needs to do is order **<u>one</u>** set of rates and then have Spire just retire plant from its accounts once it has become fully accrued.

Cast Iron Mains

Spire argues that its cast iron mains account (376.2) should be modified to reflect the expected termination of the cast iron main replacement program in 2030. *Spire Initial Brief*, pg. 20. Spire further states that the "OPC does not reflect this requirement in its proposal." Please consider several points:

1. The OPC's witness Mr. John Robinett was the **first** person to address the need to modify the cast iron mains account to reflect the end of the replacement program. This is because the OPC addressed the issue in direct testimony, while Spire did not broach the subject until rebuttal. Exhibit 200, *Direct Testimony of John A. Robinett*, pg. 3 lns 11 - 12; Exhibit 35, *Rebuttal Testimony of John J Spanos*, pg. 14 ln. 1.
2. The OPC actually spent **longer** discussing cast iron mains than Spire. *Compare* Exhibit 200, *Direct Testimony of John A. Robinett*, pg. 3 ln 11 – pg. 7 ln. 4; and Exhibit 35, *Rebuttal Testimony of John J Spanos*, pg. 14 lns. 1 – 23.
3. The OPC's adjusted rate (35.87%) is **higher** than Spire's adjusted rate (12.35%). *Compare* Exhibit 200, *Direct Testimony of John A. Robinett*, pg. 4 ln. 23; and Exhibit 35, *Rebuttal Testimony of John J Spanos*, Schedule JJS-R2, pg. 38 and 51 of 396.

The OPC has not only "reflect[ed] this requirement in its proposal," the OPC is actually putting forward the argument that Spire should see a larger revenue requirement increase as to this one issue than Spire itself requested. The fact that Spire does not know or understand this is frankly alarming.

Enterprise Software

Spire wants to change the depreciable life for the enterprise software in account 391.95 from 15 years to 10 years. There is no evidence to support this change. Exhibit 128, *Surrebuttal of David T. Buttig, PE*, pg. 7 lns. 21 – 22. In its brief, "Spire contends that it has provided sufficient support for a new rate for this account as part of the 2020 Depreciation Study and which is further explained in Mr. Spanos' testimony." *Spire Initial Brief*, pg. 21. First, the depreciation study performed by Mr. Spanos has **no** discussion of the enterprise system or any other software. *See* Exhibit 35, *Rebuttal Testimony of John J Spanos*, Schedule JJS-R2. The study offers *rates*,

but there is no analysis or evaluation offered with regard to the software system. *Id*. Instead, the only real evidence Spire offers is the following sentence from Mr. Spanos' testimony: " . . . software applications are continually being upgraded and the functionality of each application is being improved to handle more applications." Exhibit 35, *Rebuttal Testimony of John J Spanos*, pg. 16 lns. 13 – 15. There is no discussion about:

1. What modifications, **<u>if any</u>**, have actually been made to the enterprise software;
2. How those modifications would have affected the software;
3. How those modifications would have resulted in the software becoming obsolete **<u>faster</u>** (which is what is implied by the shortening of the life);
4. How the change from 15 to 10 years was determined; or
5. How the enterprise software compares to other systems used by other utilities.

There is, simply put, no evidence to support this change. Exhibit 128, *Surrebuttal of David T. Buttig, PE,* pg. 7 lns. 21 – 22. Moreover, please remember that this is the same witness who failed to realize that the OPC had recommended a change to cast iron mains, who failed to realize that the Company on whose behalf he was testifying had not recommended his proposed rates in direct, and whose study supports a 35 year life for an account that Spire's other witness argues should be 18 to 22 years. *See* Tr. pg. 253 ln. 19 – pg. 255 ln. 12. Mr. Spanos' testimony is plainly not credible and the Commission should not order a change in rates based on one sentence in his rebuttal testimony.

Ultrasonic Meters

As noted in the OPC's initial brief, Spire has conceded the point on this issue and agreed to no change in rates for accounts 381.1 and 382.1. *Spire Initial Brief*, pg. 22. No further analysis of this point is necessary.

Conclusion

The absolute mess that is depreciation has only managed to get worse due to Spire's failure to understand its own case or the recommendations of other parties. The Commission should either (1) order Spire East and West adopt the current depreciation rates of Spire East subject to the modifications to accounts 376.2 Mains – Cast Iron and 376.2 Mains – plastic laid out in the OPC's *Initial Brief*, or (2) order new depreciation rates based on the recommendations proffered in the OPC's *Initial Brief*. *See OPC Initial Brief* pgs. 167 – 169. This includes the OPC's recommendation regarding general plant amortization, which is seconded by the Staff. *Id*.

Issue 26: Ultrasonic Meters

Given the degree of similarity between Staff and the OPC's positions, the OPC will focus its conversation primarily on Spire and return to Staff at the close of this discussion.

Response to Spire

There are several major problems with Spire's argument that merit discussion. The OPC will break its analysis down into parts, beginning with a short reiteration of the OPC's direct response to the supposed "benefits" of ultrasonic meters.

Spire's claims regarding safety, accuracy, and reliability of ultrasonic meters are overblown and immaterial

This issue was covered at length in the OPC's initial brief, so the OPC will keep this examination short. *See OPC Initial Brief*, pgs. 172 – 193. Not a single one of the safety benefits that Spire promotes so fervently are unique to ultrasonic meters. Every single safety feature that Spire lists in its brief, bar none, can be found in competing diaphragm meters currently on the market. Exhibit 219, *Honeywell Spec Sheet for AC 250NXS*. The claim that ultrasonic meters are "twenty times more accurate" than diaphragm meters is wrong. It is based on a false comparison of brand new meters to used diaphragm meters. Tr. pg. 283 ln. 5 – pg. 285 ln. 3. Moreover, if one looks at the **actual** specification sheet produced by Itron, one can see that the **real** accuracy difference between ultrasonic and diaphragm meters is only about 1%.

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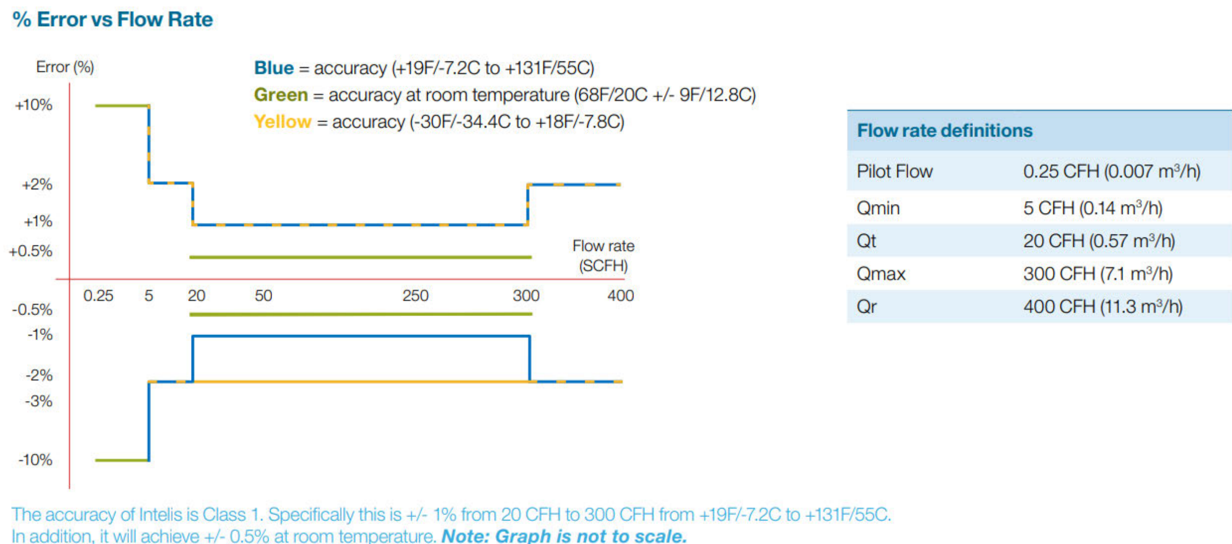
Exhibit 32, *Rebuttal Testimony of James Rieske*, Schedule JAR-R3 pg. 3 of 4. To make sure this is perfectly clear; here is an excerpt from the specification sheet:

Figure 4: Excerpt from Ultrasonic Meter Specification Sheet



Flow rate definitions	
Pilot Flow	0.25 CFH (0.007 m³/h)
Qmin	5 CFH (0.14 m³/h)
Qt	20 CFH (0.57 m³/h)
Qmax	300 CFH (7.1 m³/h)
Qr	400 CFH (11.3 m³/h)

Id. Please note the caption at the bottom of the graph that states "[t]he accuracy of Intellis is Class 1[,]" "[s]pecifically this is +/- 1% from 20 CFH to 300 CFH from +19F/-7.2C to +131F/55C." This means that the ultrasonic meters are already nearly in line with the +/- 2.0% of diaphragm meters. *Spire Initial Brief*, pg. 36. The last issue, reliability, is something that we will consider in depth in a moment, so we shall return to it later. In the end, all of the championed "benefits" of ultrasonic meters Spire offers are either immaterial because diaphragm meters can accomplish the same or overblown because the difference between diaphragm and ultrasonic meters is overstated. These errors do not and should not justify Spire's decision to switch meter technology.

Considering the Many Internal Contradictions in Spire's Case

Spire's argument on this issue is rife with internal contradictions, some of which have already been pointed out in the OPC's initial brief. However, in responding to the position Spire has taken, it is necessary to catalog and consider many of these contradictions. To that end, the OPC has prepared the following table:

Spire Internal Contradictions	
Position A	**Position B**
Spire argues that the stranded investment issue can be mitigated by "simply pacing the Installation of ultrasonic meters appropriately" *Spire Initial Brief*, pg. 41.	Spire argues that its service contract with Landis+Gyr ends on April 1, 2025, "with no possibility of further extension" and further states that "This decision will require Spire to, **at a minimum**, physically change all Spire East metering equipment" *Spire Initial Brief*, pg. 37 (emphasis added).
Spire argues that it did not consider meters built by competing manufacturers like the Honeywell meter the OPC offered because those meters "could not fit within the metering system used by Spire." *Spire Initial Brief*, pg. 40.	Spire asserts that "in Spire East, network meter reading services are provided . . . by Landis & Gyr," but that "Landis & Gyr's proprietary system is built on hardware and software that is obsolete and troublesome to continue to keep operational, **so their intent is to retire the entire system**." *Spire Initial Brief*, pg. 37 (emphasis added); *see also* the row above.

Spire argues that Commission rules require replacement of meters after ten years. *See* Exhibit 32, *Rebuttal Testimony of James Rieske*, pg. 16 lns. 4 – 5 ("Presently, across Missouri, more than 60% of all residential meters are more than 10 years old, and should be replaced pursuant to Commission rules.")	Spire acknowledges that it has "obtained a variance from this rule in 1996, which allows for statistical sampling to determine the accuracy of groups of meters (grouped by size and type) that are ten years old or older." *Spire Initial Brief*, pg. 37.
Spire's brief insinuates that the Company is only replacing meters that are shown to be faulty per statistical sampling. *See Spire Initial Brief*, pg. 37 ("These meters required replacement, regardless of the type of replacement meter installed, whether it be diaphragm or ultrasonic."); *see also* Tr. pg. 253 lns. 14 – 18 (" Q. So you're not just replacing the meter because it is ten years old. You are relying on some historical analysis to say this falls under the population that needs to be replaced. Correct? A. Yes." (re-cross examination of James Rieske)	Spire has indicated that it is currently replacing meters whenever the opportunity arises **regardless of age or condition** and intends to continue with this method. Exhibit 115C, *Rebuttal Testimony of J Luebbert*, pg. 5 lns. 5 – 6 ("When a meter is off and customer service needs to be re-stablished, the meter is being replaced regardless of age." (quoting Spire response to Staff DR 0293)); Exhibit 202, *Surrebuttal Testimony of John A. Robinett*, pg. 14 lns. 9 – 10 ("Spire has been retiring most existing diaphragm meters that were removed for testing and met the accuracy standard for years." (quoting Spire response to Staff DR 0443)); Exhibit 32, *Rebuttal Testimony of James Rieske*, pg. 16 lns. 8 – 10 ("In Missouri West Territory, we plan to continue replacing diaphragm meters with ultrasonic meters when we are already at a customer premises for another purpose . . . .").

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Spire's brief claims that the Company's decision to implement ultrasonic meters was based on "studies evaluating meter technology beginning in the fall of 2018" *Spire Initial Brief*, pg. 39.	Spire's response to OPC DR-2047, asking if Spire performed a cost benefit analysis for switching to ultrasonic meters, indicated that the Company had not performed any such analysis. Exhibit 206, *Direct Testimony of Geoff Marke*, pg. 2 ln. 17 – pg. 3 ln. 5.
Spire insists that its studies show that diaphragm meters "have increasing mechanical failures" and that "[s]ignificant numbers of meter replacements are meters that have been in service for less than 10 years."	Spire's witness testified that "[a]t the end of the day, our experience tells us a diaphragm meter last **almost exactly what an ultrasonic meter will last**, again, 18.8 years, 22.1 years[;] [t]he ultrasonic meter is 20 years." Tr. pg. 232 ln. 23 – pg. 233 ln. 1 (emphasis added).
Spire's witness testified that "[a]t the end of the day, our experience tells us a diaphragm meter last almost exactly what an ultrasonic meter will last, again, 18.8 years, 22.1 years." Tr. pg. 232 ln. 23 – pg. 233 ln. 1	Spire presented a depreciation study in the record that determined Spire's diaphragm meter account should have an average service life of 35 years. Exhibit 35, *Rebuttal Testimony of John J. Spanos*, Schedule JJS-R2 pg. 51 of 396.

PUBLIC

Spire's witness testified that the average service life of its new ultrasonic meters should be about 20 years. Tr. pg. 233 ln. 1.	Spire presented a depreciation study in the record that determined Spire's ultrasonic meter accounts should have an average service life of 15 years. Exhibit 35, *Rebuttal Testimony of John J. Spanos*, Schedule JJS-R2 pg. 51 of 396; s*ee also Spire's Initial Brief*, pg. 22 ("While Spire's 2020 Depreciation Study supports a depreciation rate change for accounts 381.1 and 382.1 . . .").

The table speaks for itself. Spire simply cannot keep its story straight. The Company's position and testimony changes and shifts depending on the argument Spire wishes to make at any one given point with the result being a record and argument that refutes itself multiple times. This persistent self-repudiation not only demonstrate the complete lack of credibility that should be given to Spire's witnesses, it also shows how terribly flawed Spire's case for ultrasonic meters is overall.

Spire wants the Commission to believe that the Company is not just actively replacing every meter it can find. Spire want the Commission to instead think that it "is merely introducing ultrasonic metering technology as the new residential standard in Spire operating areas" and that "[t]his new technology is being used to replace aging and underperforming meter populations as identified by the inspection and testing of meters during the annual testing program." *Spire Initial Brief*, pg. 41. This is flat out false. Spire's response to Staff data requests and its own witness's pre-filed testimony shows that Spire is currently replacing meters whenever the

opportunity arises **regardless of age or condition** and that the Company fully intends to continue with this method moving forward. Exhibit 115C, *Rebuttal Testimony of J Luebbert*, pg. 5 lns. 5 – 6 ("When a meter is off and customer service needs to be re-stablished, the meter is being replaced regardless of age." (quoting Spire response to Staff DR 0293)); Exhibit 202, *Surrebuttal Testimony of John A. Robinett*, pg. 14 lns. 9 – 10 ("Spire has been retiring most existing diaphragm meters that were removed for testing and met the accuracy standard for years." (quoting Spire response to Staff DR 0443)); Exhibit 32, *Rebuttal Testimony of James Rieske*, pg. 16 lns. 8 – 10 ("In Missouri West Territory, we plan to continue replacing diaphragm meters with ultrasonic meters when we are already at a customer premises for another purpose . . . ."). Contrary to what Spire is now trying to pretend, the Company has made it quite clear that this is the beginning of a full-scale replacement program that Spire intends will **increase** in pace. Tr. pg. 253 ln. 21 – pg. 254 ln. 7. In fact, Spire is arguing that it **needs** to increase the rate of replacements because it is going to lose support for its meter reading system in the East with the expiration of the Landis+Gyr contract. *Spire Initial Brief*, pg. 37. This raises several new problems with Spire's argument.

First, Spire boldly tries to counter the OPC's argument that the Company should have considered other alternatives (such as the diaphragm meter produced by Honeywell) before switching to ultrasonic meters by arguing that those meters would be incompatible with Spire's meter reading system. *Spire Initial Brief*, pg. 40. But Spire is **also** arguing that the meter reading system it is currently using will cease

being supported, which is why the Company claims is **needs** to switch meters. *Spire Initial Brief*, pg. 37. **Spire obviously cannot have it both ways**. If the termination of the meter reading system is a legitimate reason for why Spire **needs** to replace all the meters in the East service territory, then Spire cannot also rely on that very same meter reading system to justify why it did not investigate meters produced by other manufacturers. Instead, Spire should have used the expiration of its service contract with Landis+Gyr to investigate other potential meter manufacturers and find the most cost-effective solution. Spire, however, decided it had been given a golden ticket to just build rate base, so the Company never put any effort into performing a cost-benefit analysis or similar due diligence. Exhibit 206, *Direct Testimony of Geoff Marke*, pg. 2 ln. 17 – pg. 3 ln. 5. By doing so, Spire has locked itself into path-dependent decisions that feed off one another to ensure a constant future uptick in rates. Tr. pg. 299 lns. 16 – 19 (OPC witness Dr. Marke Speaking). Spire has created "a cheat code to increase [its] rate base off of each of these investments and make it larger." *Id.* at lns. 20 – 21. Moreover, the Company has exacerbated its already serious stranded investment problem, which brings us to the second problem with the expiration of the Landis+Gyr contract.

Spire is trying to placate the Commission regarding the serious issue that the OPC raised related to the stranding of Spire's current diaphragm meter technology by stating "the 'stranded asset' concern can be mitigated by simply pacing the installation of ultrasonic meters appropriately and continuing to target meter populations that are subject to mandatory testing and that are non-performing or

under-performing." *Spire Initial Brief*, pg. 41. At the offset, the OPC notes that Spire is **not** just targeting meters that are "non-performing or under-performing," but rather is replacing all meters regardless of age or condition as explained above. More importantly, though, Spire's claim that it can "mitigate" the stranded investment problem by "pacing" the installation of ultrasonic meters is **obviously false** if the Commission believes Spire's other statement that the decision of Landis+Gyr not to support Spire East's existing meter infrastructure "will require Spire to, **at a minimum**, physically change all Spire East metering equipment" by April 1, 2025. *Spire Initial Brief*, pg. 37 (emphasis added). If Spire intends to meet **this** deadline, then it will have to retire a large number of diaphragm meters **before** the end of their useful life, which may be anywhere from 18 to 35 years depending on which Spire witness you believe. *See* Tr. pg. 253 ln. 19 – pg. 255 ln. 12. The OPC has already spoken about that issue at length, so it will not reiterate itself here. However, this also raises yet another issue, which is the whole problem with reliability.

Spire's brief lays out six bullet points on page 39 that are aimed at convincing the Commission that diaphragm meters are completely unreliable because they are constantly breaking down. *Spire Initial Brief*, pg. 39. The way Spire describes diaphragm meters one would be forgiven from assuming they were made from paper and string and could be destroyed by a stiff breeze. The conclusion that Spire would obviously like the Commission to reach is to assume that ultrasonic meters will last longer and thus be more reliable than the existing diaphragm meters. However, we know this is not true. How do we know? Because Spire's own witness testified to that

point. Tr. pg. 232 ln. 23 – pg. 233 ln. 1 ("At the end of the day, our experience tells us a diaphragm meter last **almost exactly what an ultrasonic meter will last**, again, 18.8 years, 22.1 years[;] [t]he ultrasonic meter is 20 years." (emphasis added)). Despite Spire's big talk about diaphragm meters being "prone to breakage regardless of age[,]" the ultimate fact is that these meters are still lasting **as long as** an ultrasonic meter (if not longer depending on which Spire witness you believe). Moreover, Spire's depreciation study filed in this case argued that ultrasonic meters should actually have an even **shorter** life of 15 years. Exhibit 35, *Rebuttal Testimony of John J. Spanos*, Schedule JJS-R2 pg. 51 of 396; s*ee also Spire's Initial Brief*, pg. 22 ("While Spire's 2020 Depreciation Study supports a depreciation rate change for accounts 381.1 and 382.1 . . .").

Stop and think about the implications of this issue. Spire is actively seeking to convince the Commission that ultrasonic meters will save money because they break down less than diaphragm meters, but, at the same time, Spire is also arguing that ultrasonic meters will have to be replaced either as often or sooner than diaphragm meters. Again, the Company cannot have it both ways. Based on the evidence that **Spire alone has presented**, one could easily reach the conclusion that diaphragm meters are still the better alternative to ultrasonic meters even if they **are** more prone to breakage because they will **still** last longer. Moreover, if the Commission finds Mr. Spanos (Spire's depreciation expert) more credible than Mr. Rieske (Spire's meter expert) as to the average depreciable service life of a meter, then the situation somehow gets even worse because you are now comparing a 35 year average service

life diaphragm meter to a 15 year average service life ultrasonic meter. No matter how one looks at the situation, Spire's entire argument regarding meter reliability, just as with all the other issues we have now discussed, is completely contradicted by the Company's own evidence. As previously stated, the Commission should carefully consider these contradictions and ultimately determine that Spire's witness on meters is not credible and its argument for prudency of switching meter technology is inherently flawed.

Ultrasonic Meter Costs are not "Negligible"

Spire's brief posits that the cost of an ultrasonic meter is only incrementally $25 more than a diaphragm meter. *Spire Initial Brief*, pg. 36. Based on this, the Company argues that the cost of installing the ultrasonic meters that it seeks recovery for in this case is negligible compared to replacing those diaphragm meters. The problem with this theory is that Spire **assumes** that the replacement of the diaphragm meters was necessary. In particular, Spire states "Of the ultrasonic meters that were installed to replace an existing meter through May 20, 2021, 74% of the meters replaced were over ten years old, underperforming, and already mandated for replacement by Commission rules." *Spire Initial Brief*, pg. 37. There is no citation for this statement and it is also not true. This is a very important point that needs to be broken down.

First, the 74% number that Spire references is coming from the testimony of Spire witness Mr. James Rieske. Specifically, Mr. Rieske states: "Of the 41,373 ultrasonic meters we have installed to date, 74% of replacements were meters that

were already mandated for replacement by Commission rules." Exhibit 32, *Rebuttal Testimony of James Rieske*, pg. 16 lns. 2 – 4. It is important to understand that Mr. Rieske does **not** state the meters were underperforming. That is a point that we will get back to shortly. Before that, we need to address the idea that these meters "were already mandated for replacement by Commission rules." This is simply false. The rule Mr. Rieske is relying on is 20 CSR 4240-10.030(19). As the OPC pointed out in its initial brief, this rule does **not** require replacement of meters every ten years. *OPC Initial Brief*, pg. 194; 20 CSR 4240-10.030(19) ("Unless otherwise ordered by the Commission, each gas service meter installed shall be periodically removed, inspected and tested at least once every one hundred twenty (120) months"). Further, Spire has already acknowledged that it received a waiver form this rule so Spire cannot claim that these meter replacements were "mandated" regardless. *Spire Initial Brief*, pg. 37. Therefore, **all** this phrase from Mr. Rieske really means is that of the 41,373 ultrasonic meters Spire installed to date, 74% of replacements were of meters that were more than 10 years old.

The second issue comes from the fact that these meters were not "underperforming" as mentioned in the last paragraph. To understand why we once again must come back to the answer that Spire provided in response to a Staff data requests that indicated that Spire is replacing meters **regardless of age or condition**. Exhibit 115C, *Rebuttal Testimony of J Luebbert*, pg. 5 lns. 5 – 6 ("When a meter is off and customer service needs to be re-stablished, the meter is being replaced regardless of age." (quoting Spire response to Staff DR 0293)); Exhibit 202,

Surrebuttal Testimony of John A. Robinett, pg. 14 lns. 9 – 10 ("Spire has been retiring most existing diaphragm meters that were removed for testing and met the accuracy standard for years." (quoting Spire response to Staff DR 0443)). This means that there is no guarantee that **<u>any</u>** of the 74% of meters Spire replaced that were more than 10 years old were actually "underperforming." There is thus nothing in the record to substantiate the claim that "[o]f the ultrasonic meters that were installed to replace an existing meter through May 20, 2021, 74% of the meters replaced were over ten years old, underperforming, and already mandated for replacement by Commission rules." *Spire Initial Brief*, pg. 37. At best, only the first part of this sentence (that 74% of the meters replaced were over ten years old) can be supported. This is what leads to the problem with Spire's claim that the costs were negligible.

It is only because Spire has expanded the testimony of its witness to assume that all or almost all the meters that it replaced "had" to be replaced that Spire can possibly claim the cost of the ultrasonic meters was "negligible." Once you remove that factor, you must compare the **<u>full</u>** cost of the ultrasonic meter against the cost of leaving the diaphragm meter in place (which would obviously cost nothing). If, as an extreme example, none of the 74% of meters Spire replaced that were over ten years old were actually required to be replaced and had instead just been replaced because the customer was establishing service or the meter had been turned off due to maintenance (which is not completely unlikely given the number of potential replacements that might have occurred due to ISRS work), the cost comparison would

be $9,813,750 versus $0. *Spire Initial Brief*, pg. 36. The OPC considers it a rather absurd stretch to call nearly $10 million "negligible."

Conclusion

As explained in the OPC's initial brief and reiterated here, Spire's argument has changed considerably over the course of this case. When is Spire replacing its diaphragm meters? It would appear at every opportunity the Company gets, despite what Spire now seeks to argue. Exhibit 115C, *Rebuttal Testimony of J Luebbert*, pg. 5 lns. 5 – 6 ("When a meter is off and customer service needs to be re-stablished, the meter is being replaced regardless of age." (quoting Spire response to Staff DR 0293)); Exhibit 202, *Surrebuttal Testimony of John A. Robinett*, pg. 14 lns. 9 – 10 ("Spire has been retiring most existing diaphragm meters that were removed for testing and met the accuracy standard for years." (quoting Spire response to Staff DR 0443)). How long do meters (diaphragm or ultrasonic) last? Hard to tell at this point. *See* Tr. pg. 253 ln. 19 – pg. 255 ln. 12. What is Spire's plan regarding meter replacements moving forward? Not even Spire could tell you. Exhibit 208, *Surrebuttal Testimony of Geoff Marke*, pg. 5 ln. 20 – pg. 6 ln. 1; Tr. pg. 285 lns. 9 – 16, pg. 286 ln. 12 – pg. 287 ln. 3. The only question that **is** easy to answer is why Spire is doing this. The answer to that question is simple: because Spire has a perverse incentive to do so. Tr. Pg. 300 lns. 8 – 9 ("there is a perverse incentive for this company to build out rate base. This is a platform to do it."). This is gold plating; a basic attempt by Spire to justify a major overhaul of its distribution system that will result in hundreds of millions of dollars of cost in future cases. The Commission needs to take action now to force Spire to

address the issues and problems the OPC has identified because, if it does not, these same exact issues and problems will return and there will be even more money at stake.

Response to Staff

For the most part, the OPC and Staff are in agreement on this issue. The one major point that the OPC chooses to respond to from Staff's brief is the following paragraph:

> Staff does not object to the Commission allowing Spire Missouri to include the costs of new ultrasonic meters in instances where the service was already disconnected, the existing meter needed to be replaced, and/or the alternative replacement option would be to purchase and install a new diaphragm meter. But importantly, not every existing meter Spire Missouri has replaced with an ultrasonic meter was replaced for the reasons stated above, and, therefore, Staff recommends the Commission disallow the cost of meters and installation (booked in FERC subaccounts 381.1 and 382.2) that were not replaced consistent with the Staff's recommended instances listed above.

Staff Initial Brief, pg. 51. The OPC simply wishes to reiterate the point raised in its own initial brief, and referenced in this brief, which is that "the cost of meters and installation (booked in FERC subaccounts 381.1 and 382.2) that were not replaced consistent with" situations "where the service was already disconnected, the existing meter needed to be replaced, and/or the alternative replacement option would be to purchase and install a new diaphragm meter" may be much greater than the 26% disallowance that Staff proposes. This is because Staff has presupposed that all meters older than 10 years "needed to be replaced." *See* Tr. pg. 263 ln. 24 – pg. 264 ln. 19. If the Commission does adopt Staff's proposal, then it should order the amount

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disallowed re-calculated to disallow either every meter retired that was less than 18.8 years old in Spire East and 22.1 in Spire West or less than 35 years old regardless of service territory, again depending on which Spire witness one finds credible. *OPC Initial Brief*, pg. 203.

Issue 30: Weather Normalization Adjustment Rider

Neither Spire nor Staff have presented much if anything in the way of legal analysis to establish why the proposed RNA complies with, and is thus authorized under, RSMo. section 386.266.3. Because it expects that these arguments will be made for the first time in reply briefs, the OPC will reiterate and reinforce the legal arguments presented in its *Initial Brief*. Beyond that, the only other issues discussed by Staff and Spire are the proper block break points for the proposed RNA and supposed problems with the WNAR. The OPC will address each in turn.

Legal Analysis: the Meaning of Conservation

Staff begins its *Brief* with an analysis of the word "conservation" in relation to its use by Spire. *Staff Initial Brief*, pg. 53. In short, Staff argues that Spire's definition is too broad. Of particular interest is the following two lines:

> The Company's proposed definition is overly broad, encompassing not only the adoption of energy efficiency measures, but "any other factor inducing changes to the volumes of gas sold." Adopting the Company's proposed definition of conservation to include "any other factor" exceeds the plain language and meaning of the statute, which is limited to the two factors of weather and conservation.

Id. That Staff would make this argument is extremely perplexing, because the RNA that Staff is supporting **would** encompass "any other factor inducing changes to the volumes of gas sold." *Id*. Exhibit 104, *Staff Class Cost of Service Report*, pg. 39 lns. 16 – 18; Exhibit 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 14 lns. 8 – 16. That if effectively the whole problem with this issue.

Because of the way that the RNA is designed, any change in the volume of gas sold in the relevant block (block 2 for residential, block 1b for SGS customers) when compared to the presumed volume used in the rate case will affect the RNA bill amount. Exhibit 104, *Staff Class Cost of Service Report*, pg. 39 lns. 16 – 18 ("An adjustment to the RNA rate would be filed annually by the utility based on changes, if any, in actual volumetric sales compared to the level of volumetric sales, by block, used in establishing rates in the rate case."); *Id.* at pg. 42 fn. 19 ("Staff acknowledges that the departure or addition of a customer does have an impact on second block sales; however the intent of the RNA mechanism is to insulate the company from **all** sales variations in the second block." (emphasis added)); Spire *Initial Brief*, pg. 61 ("The RNA is designed to . . . insulate Spire in Block 2 to the benefits or risks of variations between actual and normal usage and revenues.").

As a result, the RNA mechanism "accounts for ***all*** changes in revenue in this second block, regardless of the reason for the change." Exhibit 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 14 lns. 10 – 11; *see also* Exhibit 104, *Staff Class Cost of Service Report*, pg. 42 fn. 19 ("Staff acknowledges that the departure or addition of a customer does have an impact on second block sales; however the intent of the RNA mechanism is to insulate the company from **all** sales variations in the second block." (emphasis added)). This would include accounting "for fuel switching, rate class switching, and economic factors that impact usage in the second block[.]" Exhibit 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 14 lns. 14 – 15; *see also* Tr. pg. 441 ln. 10 – pg. 442 ln. 17 (Cross-examination of Spire Witness Scott Weitzel); Tr.

pg. 455 ln. 14 – pg. 456 ln. 12 (cross-examination of Staff Witness Michael L. Stahlman).

Because Staff's proposed RNA has effectively expanded the definition of conservation to include "any other factor inducing changes to the volumes of gas sold[,]" Staff's **own** definition of conservation "exceeds the plain language and meaning of the statute, which is limited to the two factors of weather and conservation." *Staff Initial Brief*, pg. 53. Staff's proposed RNA (which is based on its own definition of conservation) should thus be rejected **for the very same reason** that Staff argues Spire's definition of conservation should be rejected. Exhibit 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 14 lns. 8 – 16.

The OPC should be able to stop there, but, for the sake of completeness, let us talk for a moment about "blocks." Staff has built its entire case on the idea that by only looking at usage within certain "blocks" (above 50 ccfs for residential and between 300 to 599 ccfs for SGS customers) only changes due to weather or conservation will be captured. *Staff Initial Brief*, pg. 55. However, this is purely an **assumption**. As Staff notes in its brief: The Company's usage numbers indicate that 50 Ccfs is not unreasonable as the break-point for sales **assumed** to vary largely with the number of customers taking service compared to sales **assumed** to vary largely due to weather, conservation, or both. *Id*. On the stand, though, both Staff and Company's witness **admitted** that other changes to customer behavior (such as fuel switching, rate switching, or customer growth) could also affect these blocks. Tr. pg. 441 ln. 10 – pg. 442 ln. 17 (Cross-examination of Spire Witness Scott Weitzel); Tr. pg.

455 ln. 14 – pg. 456 ln. 12 (cross-examination of Staff Witness Michael L. Stahlman). Therefore, this RNA is legally no different than the RSM mechanism that this Commission previously found was beyond its statutory authority to grant. GR-2017-0215, *Report and Order*, pg. 83.

Because Staff actually knows that its blocks will account for **all** variations in usage, regardless of source, its witness attempted in testimony and on the stand to **change** the definition of "conservation" in the exact same manner that Spire did in direct testimony. *See* Tr. pg. 466 lns. 13 – 19 ("Q. Yes, a consumer decision either not to take natural gas at that their new home construction or some consumer switched to another energy product? A. And part of that could be still seen under the broader conservation definition that they are making a decision to choose which one -- which form of fuel, you know, that best suits them. "). However, this attempt to broaden the definition of "conservation" is wrong for all the reasons the OPC laid out in its *Initial Brief*. *OPC Initial Brief*, pgs. 220 – 225. Moreover, Staff **apparently agrees** because it concluded that adopting a "proposed definition of conservation to include 'any other factor' exceeds the plain language and meaning of the statute." *Staff Initial Brief*, pg. 53. Adopting the "broad" definition of conservation that Staff's own witness advocates for **would be the same as** adopting the "any other factor" definition of conservation that Staff argues – and the OPC agrees – would exceed the plain language of section 393.150.2. *See OPC Initial Brief*, pgs. 220 – 225.

The OPC laid out the basic problem in its *Initial Brief*: the RNA will account for all sales variations in the second block including fuel switching, rate class

switching, and any other economic factors that impact usage. Exhibit 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 14 lns. 8 – 16; Exhibit 104, *Staff Class Cost of Service Report*, pg. 42 fn. 19 (" . . . the intent of the RNA mechanism is to insulate the company from **all** sales variations in the second block." (emphasis added)); Tr. pg. 441 ln. 10 – pg. 442 ln. 17 (Cross-examination of Spire Witness Scott Weitzel); Tr. pg. 455 ln. 14 – pg. 456 ln. 12 (cross-examination of Staff Witness Michael L. Stahlman). Consequently, "[t]he Commission cannot approve Spire Missouri's proposed [RNA] because the [RNA] would make adjustments for all variations in [] usage per customer (such as, fuel switching, rate class switching, [customer growth], and economic factors) and not just those limited to weather or conservation." GR-2017-0215, *Report and Order*, pg. 83.[22] Neither Staff nor Spire have offered any response to this basic argument in their initial briefs.

RNA Block Breaks

Because the OPC argues that the Commission does not have the authority to issue the RNA, it will not dwell long on what that RNA should look like. Between the two options, the OPC supports the block breaks proposed by Staff. "The revenue requirement that would be guaranteed is smaller the higher the block break." 213C, *Rebuttal Testimony of Lena M. Mantle*, pg. 30 lns. 10 – 11. "Using Staff's block . . .

[22] Consider also Exhibit 214, *Surrebuttal of Lena M. Mantle*, pg. 12 lns. 18 – 23 ("While there are some differences, what the RSM and RNA have in common is they both would change customers' bills not based on weather or conservation, but based on a comparison of the actual revenues billed to a predetermined amount. The Commission should find in this case, as it did in Spire's last rate case, that a mechanism that adjusts rates for all changes, not just weather and/or conservation, is not consistent with state statute.").

would guarantee less revenue than Spire's proposed block." *Id.* at lns. 16 – 17. "Staff's segment of usage would also result in less double recovery of revenues for customers that switch rates." *Id.* at 17 – 19. Spire's entire argument is basically just "we should get what Ameren got." *Spire Initial Brief*, pg. 62 ("A 30 Ccf block break was approved by the Commission for Ameren and should be approved for Spire."). This is not sufficient to meet Spire's burden of proof to show that its proposed rates are just and reasonable. The Ameren mechanism resulted from a stipulation that, by its own terms, cannot be used or cited to as precedent. Exhibit 232, *Attachment A to Order in GR-2019-0077*, pg. 9 ("Except as explicitly provided herein, **none of the signatories shall be prejudice or bound in any manner** by the terms of this agreement in this **or any other proceeding** regardless of whether this agreement is approved" (Emphasis added)); *see also* Tr. pg. 459 ln. 23 – pg. 460 ln. 2. Spire and Ameren are different utilities. Spire has the burden to prove that its own rates (including the proposed RNA) are just and reasonable for **it** and cannot just cling to Ameren as a drowning sailor clings to driftwood. RSMo. § 393.150.2

Problems with the WNAR

Both Spire and Staff cite to problems with the WNAR in their briefs. For example, Spire states that "[t]he RNA proposal would [] reduce or eliminate the reliance on third party data from local weather stations . . . ." *Spire Initial Brief*, pg. 61. Staff stated a similar point in their brief:

> For example, one advantage of the RNA is that the Company already possesses the information it needs and does not have to go to a third party. When a weather station in Kirksville stopped recording data

necessary to calculate **another** company's WNAR, it took several months of research trying to find a substitute.

Staff Initial Brief, pg. 58 (emphasis added). This is a completely meaningless issue, as the OPC's expert witness explained in testimony:

> **Q. Mr. Stahlman's final response to the WNAR was that there have been problems with another utility's weather data. Is this a concern?**
>
> A. Mr. Stahlman was referring to Case No. ET-2021-0047. In this case, Liberty Utilities Gas filed a tariff sheet with a 30-day effective date to change the weather station used for its WNAR. **The utility had known for months this was a problem, yet waited until right before the change to its WNAR rate to address the change from the Kirksville weather station to the Chillicothe weather station**. Despite the short amount of time given it, Staff worked diligently to make sure that this switch was done appropriately. **The closing of the weather station created a situation that was exasperated by Liberty's procrastination and last minute filing, and had nothing to do with the design of the WNAR**.
>
> As I addressed in my rebuttal testimony, **problems with the weather data should not be a concern for Spire's WNAR since it uses weather from the Kansas City and St. Louis Lambert International airports**. **These major reporting stations have been around for many decades and are not likely to discontinue recording measures of weather**.
>
> **The Commission should not expect this to occur again nor should it approve a mechanism that is not authorized by statute to prevent this unlikely circumstance from occurring again**.

Exhibit 214, *Surrebuttal Testimony of Lena M. Mantle*, pg. 15 ln. 12 – pg. 16 ln. 5 (emphasis added). There is no threat that the two largest airports in the State are going to stop tracking weather any time soon. *Id*. This is not a problem.

In addition to the spurious claim regarding weather reporting, Staff also offered the following as a "problem" with the WNAR:

> While the issues experienced by the WNAR are not necessarily a result of the design of the WNAR itself, there have in fact been issues in actually implementing the WNAR. For example, there have been issues getting source data, reconciling prior and current rates, missed calculations, issues calculating and ranking weather, and difficulty being able to clearly explain differences between calendar months and billing cycle months.

Staff Initial Brief, pg. 58. These issues are not problems with the WNAR, they are problems with Spire's ability to competently operate its utility business. Tr. pg. 467 lns. 21 – 25 ("Q. Are the issues you addressed issues with the WNAR mechanism itself or with Spire's understanding of the WNAR mechanism and how it works? A. **I think it was Spire's understanding and implementation of the mechanism**." (emphasis added)); *See also* Exhibit 123, *Rebuttal Testimony of Michael L. Stahlman*, pg. 4 lns. 13 – 14 ("I do agree Ms. Mantle's characterization that the six issues identified are not really issues with the WNAR."). In case there is any doubt as to the fact that these so-called "issues" are actually the result of Spire's own incompetency, please consider this:

> Q. On page 22 of Ms. Mantle's Rebuttal Testimony, she says, "Computer programs can be written that quickly do the matching of actual and normal heating degree days to each billing cycle. This should have already been done with Spire's current WNAR." Has a computer program been developed that does this?
>
> A. Yes. During the course of GO-2019-0058 and GO-2019-0059, **I developed and provided Spire with an Excel program that does such**. It requires the user to input the actual and normal heating degree days, the meter read dates, and the number of customer charges, and

will provide the monthly adjustment both in terms of ccf/therms and in dollars.

Q. Does Spire utilize this program in its WNAR filings?

A. **No**. The typical excel files we receive from Spire are accounting entries that don't show the daily weather or meter read dates. In order to check the weather, **I look at the weather values in the worksheets and see if I can come up with reasonable meter read dates for the bill cycle and check that the actual and normal weather would have the same meter read dates**.

Exhibit 138, *Surrebuttal of Michael L. Stahlman*, pg.4 lns. 1 – 13 (emphasis added).

Staff literally gave Spire a program that would perform the calculation necessary to operate the WNAR, Spire just does not use it. That is why there are "issues." It has nothing to do with the WNAR, and everything to do with Spire not keeping adequate records and not using the tools Staff has provided. The Commission should not reward incompetent behavior by gifting Spire a statutorily unauthorized decoupling mechanism.[23]

[23] In addition to the issues already discussed, the OPC notes that Spire's brief states: "[t]he current WNAR only insulates the Company from weather fluctuations, not conservation." *Spire Initial Brief*, pgs. 60 – 61. This is wrong. The OPC's witness Ms. Lena Mantle explained at length how the WNAR does account for some conservation. Exhibit 212, *Direct Testimony of Lena M. Mantle*, pg. 6 ln. 1 – pg. 10 ln. 11. Staff's witness further agreed with the OPC. Exhibit 123, *Rebuttal Testimony of Michael L. Stahlman*, pg. 4 lns. 5 – 7 ("Do you agree with Ms. Mantle that the WNAR accounts for conservation? A. I agree that there is interplay between weather and conservation in the WNAR, but it is unclear on how much conservation would actually be accounted for in the WNAR."). This point is somewhat irrelevant, however, because section 386.266.3 allows for a mechanism to account for "weather, conservation, **or both**." RSMo. § 386.266.3 (emphasis added). Thus, there is absolutely no **need** for the WNAR to account for conservation even if it did not already do so (and it does).

Brief Discussion Regarding Monetary Impact of Adjustments

It is uncertain at times as to whether and to what extent the Commission considers the overall dollar amount of a rate increase or decrease when reaching a conclusion on the merits. However, should the Commission grow concerned regarding the scope or scale of the OPC's proposed adjustments, then the OPC would like the Commission to consider that it is possible these adjustments may negate one another in a manner that would result in Spire still receiving a considerable increase to operating revenue while, at the same time, being forced to change bad business practices. For example, the true-up revenue requirement reconciliations filed by Staff show that the adoption of the depreciation rates the OPC has proposed would result in an approximate $17 million dollar increase in revenue requirement for the Company. Exhibit 147, *True-Up Rebuttal Testimony of Karen Lyons*, Schedule KL-tr2. The adjustment that the OPC recommends for capital structure would be a negative $30 million. *Id.* This number would obviously go down if the Commission went with the alternative that was discussed at the end of the capital structure section. It should be easy to see, therefore, that these two numbers will likely offset one another resulting in only a minimal impact to the Company's revenue requirement overall. Further, the largest adjustment that the OPC proposes is a negative $65 million related to the affiliate transactions issue. However, as previously discussed, this could easily be offset if the Commission orders an adjustment to move the roughly $40 million in capitalized general overheads into expenses. Exhibit 203C, *Direct Testimony of Robert E. Schallenberg*, pg. 25 lns. 12 –

13 (emphasis added). *Staff Initial Brief*, pg. 33. Given that Staff's current true-up revenue requirement reconciliations suggest a revenue requirement increase of nearly $86 million dollars, it is possible that the Commission could order all the OPC's proposed adjustments while still ordering a rate increase to Spire in excess of the $47 million of re-based ISRS projects the Company indicated in its initial request. The Commission should therefore see this case as a golden opportunity to correct the myriad problems that the OPC has demonstrated related to Spire's business operations while at the same time giving Spire a boost to revenue and ensuring the Company remains economically healthy. The OPC hopes the Commission will thus seize the initiative and order the adjustments that the OPC has proposed.

Conclusion

The OPC stands by the arguments presented in its initial brief. Nothing argued by either Staff or Spire has shown any flaw in these arguments. The Commission should therefore order the adjustments proposed by the OPC.

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission accept this *Reply Brief* and rule in the Office of the Public Counsel's favor on all matters addressed herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this seventeenth day of September, 2021.

/s/ John Clizer