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**

STAFF'S POST-HEARING BRIEF

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COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Post-Hearing Brief,* states as follows:

INTRODUCTION

In this general rate case, the Commission exercises its delegated, quasi-legislative authority to set prospective rates for Spire Missouri, Inc. ("Spire"), a major Missouri public utility.[1] This decision will affect the lives of thousands of Missourians who live and work within Spire's service areas. It will affect the profitability and viability of numerous small businesses and determine, in part, how much of the family budget will be available for other needs and wants. The Commission's lodestar is the "just and reasonable" rate, which is a rate that produces sufficient revenue to cover Spire's costs in providing gas service, allows its shareholders a reasonable opportunity to earn a fair return on their investment, and yet is as affordable as possible for the rate-paying public.[2]

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[1] Although ratemaking occurs via contested case procedures, and so seems to be a judicial or quasi-judicial act, it is an exercise of legislative power, as all commentators have recognized; *e.g.,* "[w]hen the Commission fixes rates or otherwise promulgates for prospective effect a standard addressed to the public or regulated industry generally, it acts like a lawmaker, and so exercises quasi-legislative power." ***State ex rel. Gulf Transport Co. v. Public Service Com'n,*** 658 S.W.2d 448, 465-466 (Mo. App., W.D. 1983) (Shangler, J., dissenting).

[2] Sections 393.130 and 393.140, RSMo.

The Company:

Spire is local distribution company ("LDC")[3] providing natural gas service to approximately 1,192,976 customers in two service areas, Spire East, formerly Laclede Gas Company, in the St. Louis area, and Spire West, formerly Missouri Gas Energy, on the western side of the state.[4] Spire East's service territory includes St. Louis City and parts of 10 eastern Missouri counties; Spire West's service area includes Kansas City, St. Joseph, Warrensburg, Joplin, and 29 western Missouri counties.[5] Spire is the largest natural gas utility in Missouri[6] and employs about 2,424 persons.[7]

Spire is a wholly-owned subsidiary of Spire, Inc.,[8] which also owns three other LDCs: Spire Alabama, Spire Gulf, Inc., and Spire Mississippi; as well as certain gas-related enterprises not regulated by the State of Missouri: Spire Marketing,[9] Spire STL Pipeline,[10] and Spire Storage.[11] In its 2020 10-K report to the United States Securities

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[3] A local distribution company ("LDC") is a public utility offering natural gas service at retail.

[4] Staff's Revenue Requirement Cost of Service Report, p. 2, ll. 15-21 ("RR Report").

[5] *Id.*

[6] Spire, Inc., 10-K, November 18, 2020, p. 4.

[7] *Id.*

[8] Formerly The Laclede Group.

[9] Spire Marketing provides natural gas purchasing, sales, transportation, and storage services to power generators, utilities, municipalities, and schools; www.spireenergy.com/spire-marketing, accessed July 14, 2021.

[10] "The STL Pipeline is a 65-mile interstate pipeline connected to the Rockies Express Pipeline in Illinois and various points east in Missouri, including to Spire Missouri, the MoGas Pipeline and the Enable MRT Pipeline"; www.spireenergy.com/spire-stl-pipeline, accessed July 14, 2021. Spire STL Pipeline is regulated by the Federal Energy Regulatory Commission ("FERC"). "Spire STL Pipeline, a wholly owned subsidiary of Spire, is capable of delivering up to 4 million therms per day of natural gas into eastern Missouri, of which Spire Missouri is the foundation shipper with a contractual commitment of 3.5 million therms per day." Spire, Inc., 10-K, November 18, 2020.

[11] *Id.;* www.spireenergy.com/about-spire, accessed July 14, 2021. Spire Storage is described as follows: "Located in the southwestern corner of Wyoming, our natural gas storage facilities are connected to five interstate pipelines including the Kern River, Ruby, Questar, Overthrust and Northwest pipelines. We are also strategically located near the liquid Opal Hub and have access to the Rockies Express to

and Exchange Commission ("SEC"), Spire, Inc., stated, "The Company has two key business segments: Gas Utility and Gas Marketing."[12]

In fiscal year 2020, Spire purchased 121.10 billion cubic feet ("Bcf") of natural gas from 27 different suppliers to meet its obligations in its service areas; additionally, Spire transported 45.9 Bcf through its distribution system to certain of its industrial and commercial customers that had purchased their own gas.[13] The fiscal year 2020 peak day send out of natural gas to Spire's customers, including transportation customers, occurred on February 13, 2020; the average temperature was 11 degrees Fahrenheit in St. Louis and 13 degrees Fahrenheit in Kansas City.[14] On that day, Spire's customers consumed 1.56 Bcf of natural gas.[15] Spire states that its "fundamental gas supply strategy is to meet the two-fold objective of 1) ensuring [that] a dependable gas supply is available for delivery when needed and 2) insofar as is compatible with that dependability, purchasing gas that is economically priced."[16]

Ratemaking:

The Commission's statutory duty is, after due consideration of all relevant factors,[17] to set "just and reasonable" rates.[18] A "just and reasonable" rate is one that

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serve customers across the country. We help customers move gas out of the Rocky Mountains area to multiple regions and customer bases"; www.spireenergy.com/spire-storage, accessed July 14, 2021.

[12] Spire, Inc., 10-K, November 18, 2020, p. 4.

[13] *Id.,* p. 5.

[14] *Id.*

[15] *Id.*

[16] *Id.*.

[17] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("Even under the file and suspend method, by which a utility's rates may be increased without requirement of a public hearing, the commission must of course consider all relevant factors including all operating expenses and the utility's rate of return, in determining that no hearing is required and that the filed rate should not be suspended.").

balances the interests of the various stakeholders in the light of the public interest.[19] A just and reasonable rate is fair to both the utility and to its customers[20] and is no more than is necessary to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[21] A just and reasonable rate is not one penny more than is required to cover the utility's necessary and prudent operation and maintenance expenses and to allow a reasonable opportunity of earning a fair profit to the shareholders.

The Commission sets just and reasonable rates via a two-step process using traditional cost-of-service ratemaking.[22] The two steps are (1) the determination of the "revenue requirement," that is, the amount of income the utility needs on an annual basis going forward, and (2) the design of rates that, given the usage characteristics of the utility's customers, will produce the necessary revenue. "Under cost-of-service ratemaking, rates are designed based on a [utility's] cost of providing service including an opportunity for the [utility] to earn a reasonable return on its investment."[23] The Missouri Court of Appeals has described cost-of-service ratemaking as follows: "The Commission [considers the] expenses and revenues, to establish a rate that will allow

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[18] Sections 393.130 and 393.140, RSMo.

[19] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").

[20] ***St. ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

[21] ***St. ex rel. Washington University et al. v. Public Service Commission,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[22] Also known as "rate-of-return" ratemaking. *See* L.E. Alt, ***Energy Utility Rate Setting,*** 18 (2006).

[23] FERC, ***Cost-of-Service Rates Manual,*** 1 (1999) [available electronically at www.ferc.gov].

the company to recover its cost of service from its customers."[24] Elsewhere, the court noted:

> The determination of utility rates focuses on four factors. These factors include: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The revenue allowed a utility is the total of approved operating expenses plus a reasonable rate of return on the rate base. The rate of return is calculated by applying a rate of return to the cost of property less depreciation. The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.[25]

This ratemaking recipe is often expressed by the following formula:

$$\mathbf{COS = C + (V - D)\,R}$$

where:

COS	=	Cost of Service;
C	=	Prudent Operating Costs, including Depreciation Expense and Taxes;
V	=	Gross Value of Utility Plant in Service;
D	=	Accumulated Depreciation; and
R	=	Overall Rate of Return or Weighted Average Cost of Capital (WACC).

To summarize, cost-of-service ratemaking establishes the utility's cost of providing service on an annual basis based upon annualized and normalized test year expenses[26] and adds to that amount a reasonable allowance for a profit to the shareholders on the value of their investment. The profit allowance, in turn, is calculated by multiplying the value of the utility's plant-in-service less accumulated

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[24] ***State ex rel. Laclede Gas Company v. Public Service Commission,*** 328 S.W.3d 316, 317 (Mo. App., W.D. 2010).

[25] ***Union Electric Co.,*** *supra,* 765 S.W.2d at 622.

[26] The test year in this case is the twelve months ending September 30, 2020; the test year update period for this case is December 31, 2020; a true-up audit was performed through May 31, 2021.

depreciation by a rate of return. This sum is the revenue requirement, that is, the amount of money the company must earn annually to cover its cost of service and provide a reasonable return to its investors. Determining the revenue requirement is the first half of the ratemaking process.[27]

In considering the Company's test year expenditures, the Commission should consider whether they are reasonable, necessary and beneficial to ratepayers. Unreasonable and unnecessary expenditures should be excluded from rates and charged to the shareholders. An expenditure is reasonable if the value received is commensurate to the amount paid. An expenditure is necessary if, without it, the utility's ability to provide safe and adequate services to its customers would be impaired. Likewise, expenditures that provide no benefits to the ratepayers should be excluded from rates and charged to the shareholders.

Likewise, the Commission should consider whether the Company's expenditures are lawful and prudent. Unlawful and imprudent expenditures should also be excluded from rates. An expenditure is unlawful if it violates a statute or regulation or a Commission order or decision. An expenditure is imprudent if it is deleterious to ratepayers and, viewed in the context of what was known or should have been known to the Company's officers at the time the expenditure was made, a reasonably prudent person would not have made it.

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[27] Edison Electric Institute (EEI), ***Rate Shock Mitigation*** (June, 2007) p. 5 ("In simple terms, a utility's cost of service or revenue requirement consists of three primary elements: (1) operating costs, such as fuel costs, purchased power costs, operations and maintenance (O&M) costs and customer service costs; (2) a return of capital cost, otherwise known as depreciation expense; and (3) a return on capital cost, including applicable income taxes.")

The second half of the ratemaking process is rate design, that is, the development of rate schedules designed to produce the target revenue requirement. The two steps of rate design are, first, determining the revenue requirement responsibility of each customer class and, second, adjusting or designing the class rate schedules to produce the necessary revenue requirement. Customers, large and small, are classified based on their usage characteristics and on the cost of serving them.

Rate design may be driven by considerations additional to recovering the necessary revenue requirement in a fair and equitable manner. Learned commentators on the rate design process refer to "objectives" including fairness, simplicity, stability, avoidance of undue discrimination or preferences, efficiency, and conservation.[28] Another consideration in rate design is the avoidance of "rate shock," that is, an increase that is simply too large to be readily accepted by ratepayers.

Fair rates match costs to cost causers, so that similarly-situated customers will pay the same rate. Simple rates are easy to understand and administer. Stable rates will generate revenue that tracks costs, so that as costs go up, revenues will too. Discrimination and preferences are the two sides of the subsidization coin. All utility rates involve some degree of subsidization because the actual cost of serving each customer is necessarily slightly different based on unique circumstances, such as the distance of each customer from the utility plant. An important goal in rate design is keeping these subsidies as limited as possible. Efficiency and conservation mean that

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[28] Alt, *supra,* 58-60; J.C. Bonbright *et al.,* ***Principles of Public Utility Rates,*** 85-179 (PUR: Arlington, VA, 2nd ed. 1988).

prices send appropriate cost signals to the customers to safeguard society's scarce resources and to avoid waste.

In summary, Staff urges the Commission to set just and reasonable rates for Spire, after due consideration of all relevant factors, by adopting Staff's recommendations as further discussed herein.

--Kevin A. Thompson.

ARGUMENT

1. Cost of Capital Issues:

What Rate of Return ("ROR") should the Commission allow Spire Missouri?

Cost of capital is generally one of the largest issues in a rate case. Cost of capital is ultimately about calculating the rate of return ("ROR"), by which the rate base is multiplied in order to calculate the return on investment that is part of the revenue requirement. The Commission must at least afford the utility's owners an opportunity to recover a reasonable return on the private assets devoted to the public service.[29] The ROR is the weighted average cost of capital and the Commission sets it indirectly by setting the inputs from which it is calculated, including the return on equity ("ROE"), the capital structure, and the cost of debt.

Typically, these are the three areas of dispute within the cost of capital issue. First, the return on equity ("ROE"), which must be calculated by expert financial analysts using various complex calculation methods and inputs selected through the exercise of professional judgment. Second, the capital structure, which is the ratio of equity to debt

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[29] ***St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("UCCM").

comprising the company's financing. Equity is more expensive than debt by its nature, and so the more equity in the capital structure, the more the ratepayers must pay to sustain it.[30] Third, the cost of long-term debt, which is embedded and therefore, theoretically, not subject to dispute. “Embedded” means that it is a matter of record because the cost of debt can be determined by examination of the debt indentures. The present case includes another, less frequently encountered issue relating to debt, that is, whether or not short-term debt should be included in the ratemaking capital structure.

This rate case is unusual. Staff is aligned with the Company on the issues of capital structure, the cost of long-term debt, and the exclusion of short-term debt. However, Staff is aligned with OPC on the issue of ROE.

Return on Equity:

Staff's expert financial analyst, Dr. Seoung Joun Won, recommends a ROE of 9.37%, within a range of 9.12% to 9.62%. David Murray, the OPC expert, recommends a ROE of 9.25%, within a range of 8.50% to 9.50%. Because OPC's point recommendation is within the range recommended by Dr. Won, Staff is aligned with OPC on the issue of ROE. Spire's expert, Dylan D’Ascendis, on the other hand, recommends a ROE of 9.95%, within a range of 9.94% to 12.07%. That recommendation is outside of Dr. Won's range and is frankly too high.[31] Dr. Won testified that Spire’s expert obtained his overly high recommendation by selecting inputs that, when used in his calculations, would necessarily produce high results:[32]

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[30] Investopedia, “How do cost of equity and cost of debt capital differ?,” retrieved August 26, 2021.

[31] David Murray at Tr. vol. 14, p. 808, ll. 2-5.

[32] Won Rebuttal, p. 2, l. 12, to p. 3, l. 5.

During the review process, Staff discerned that Mr. D'Ascendis introduced a series of biased estimates for his cost of equity ("COE")[33] to recommend his overstated ROE. Mr. D'Ascendis overestimated COE by using inflated input data and improper estimation methods in his direct testimony. …

The overview of Mr. D'Ascendis' overestimation methods is following. First, Mr. D'Ascendis inadequately applied COE estimation methods to his gas company proxy group. When he applied the single-stage constant growth form of the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model ("CAPM"), and the Risk Premium Model ("RPM") to his utility proxy group, Mr. D'Ascendis used unreasonable upward-biased input data for each estimation model. Second, Mr. D'Ascendis unconventionally utilized non-price regulated proxy group data to his DCF, RPM and CAPM analysis resulting in overstated COE estimation of 11.87%. Using a non-price regulated proxy group is fundamentally against the consensus of the regulated utility COE estimation methodologies. Third, Staff's analysis also found that Mr. D'Ascendis made some unsuitable company-specific adjustments, which introduced more upward bias for his COE estimation. …

This sort of result-driven input selection by the Company ROE witness is familiar to Staff from many other rate cases.

Dr. Won went on to testify:[34]

… Mr. D'Ascendis' recommended ROE of 9.95% is too high compared to the average authorized ROE of 9.44% in fully litigated gas utility rate cases completed in 2020. Mr. D'Ascendis' recommended ROE is based on overstated COE estimates. Mr. D'Ascendis presented unreasonable COE estimation procedures using exaggerated input values for his COE estimation models. Mr. D'Ascendis utilized a variety of data sources and analysis methods to produce inflated input values in complex procedures that gave an illusion of supporting his COE estimation, to conceal his unreasonably overvalued inputs.

In his discounted cash flow ("DCF") model, in which a dividend factor is added to a growth rate to obtain a result, Spire's expert used inappropriately high growth rates, as

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[33] Staff, unlike the Company, distinguishes between the COE, which is the minimum return required by investors to invest in the Company rather than an alternative investment, and ROE, which is a value set by a utility regulatory commission.

[34] Won Rebuttal, p. 6, ll. 2-8.

have many company experts in the past.[35] Spire used an average short-term analysts' growth rate of 6.16%, which significantly exceeds the realistic projected long-term Gross Domestic Product ("GDP")[36] growth rate of 3.8%.[37] The single-stage DCF used by Mr. D'Ascendis purportedly describes the growth of the security into perpetuity. As Dr. Won testified, no security can grow at a rate in excess of the economy as a whole in perpetuity.[38] Dr. Won testified, "reasonable DCF COE results should be much lower than Mr. D'Ascendis' estimation."[39]

OPC's expert witness, David Murray, agreed with Dr. Won and testified, "Mr. D'Ascendis' DCF-supported COE estimate is based on irrational assumptions."[40] Mr. Murray further commented, "Obviously with South Jersey Industries, he used a -- he assumed that the dividends of South Jersey Industries can grow in perpetuity at a 10.44 percent compound annual growth rate on a year over year basis forever into the future and that's very irrational. That's higher than the return on the S&P 500 over the long term."[41] Mr. Murray went on, "dividends are never compounded in perpetuity at the five-year earnings per share compound annual growth rate, the consensus equity analysts' compound annual growth rate. So that's irrational in and of itself."[42] Murray further testified that he had "never observed a DCF analysis that assumes a

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[35] Won Rebuttal, p. 11, ll. 11-12.

[36] The GDP is the total monetary or market value of all finished goods and services produced within a country's borders within a given period of time, typically one year. Investopedia, "Gross Domestic Product (GDP)," retrieved August 26, 2021.

[37] Won Rebuttal, p. 12, ll. 4-5.

[38] Won Rebuttal, p. 11, l. 15, to p. 12, l. 5.

[39] Won Rebuttal, p. 14, ll. 12-13.

[40] Murray Rebuttal, p. 19, l. 3; Tr. vol 14, p. 806, l. 13, to p. 807, l. 10.

[41] Tr. vol 14, p. 807, ll. 10-16.

[42] *Id.,* ll. 21-25.

company's cash flows will grow in perpetuity at the same rate as equity analysts' consensus 5-year CAGR [compound annual growth rate] in EPS [earnings per share]."[43]

In the risk premium model ("RPM"), in which an equity risk premium ("ERP") is added to a risk-free rate[44] to obtain a result, Spire's expert, Mr. D'Ascendis, used two different equity risk premiums, both of which were described by Dr. Won as inappropriately high.[45]

Dr. Won testified:

> Based on general U.S. capital-market experience and regulated utilities, the typical ERP is in the 3% to 5% range. Most research results indicated ERP to be nothing higher than 7%. According to Mr. D'Ascendis' GARCH model, among the eight companies in the natural gas utility proxy group, three companies have ERPs greater than 9%. That is unreasonably high. Estimated risk premiums for Mr. D'Ascendis' gas proxy utility group are unstable and vary widely, even though natural gas utilities have relatively similar risk. If the unreasonable ERPs are excluded from Mr. D'Ascendis' PRPM estimation, the mean of PRPM COE estimate would be 8.67%, the median, 9.26%, and the average of the two would be 8.97%. In addition, Mr. D'Ascendis' risk free rate, the consensus forecast 30-year Treasury yield, is also too high compared to current market risk-free rate. Mr. D'Ascendis used the 30-year U.S. Treasury bond yield consensus forecast derived from Blue Chip Financial Services ("Blue Chip") of 2.11%. The average yield on 30-year U.S. Treasury bonds for the three-month period ending December 31, 2020 is 1.62%, 49 basis points lower. Because of his use of a higher projected risk free rate, Mr. D'Ascendis' PRPM COE is inflated by an additional 49 basis points.[46]

Thus, Spire's expert added an inflated ERP to an inflated risk-free rate and obtained an inflated result.

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[43] Murray Rebuttal, p. 21, ll. 1-4; Tr. vol. 14, p. 808, ll. 8-12.

[44] Generally embodied by a long-term government bond.

[45] Won Rebuttal, p. 15, l. 20, to p. 16, l. 1.

[46] Won Rebuttal, p. 16, ll. 1-14.

Additionally, Dr. Won demonstrated that the statistical methodology employed by Mr. D'Ascendis, the GARCH model, produced unreliable results due to insufficient data points.[47] Dr. Won pointed out, "Mr. D'Ascendis' ERP estimates calculated by GARCH model are not statistically reliable. Using natural gas proxy companies' ERP based on Betas of Value Line and Bloomberg, PRPM [predictive risk premium model] COE estimates should be 7.16% and 7.72%, respectively. Therefore, with Mr. D'Ascendis' risk free rate of 2.11%, Staff's recalculated PRPM COE estimate is 7.44%."[48]

Dr. Won testified that Mr. D'Ascendis' second risk premium analysis also used ERPs that are too high.[49] Dr. Won explained, "Staff found that five out of six of Mr. D'Ascendis' ERP results are unreasonably too high. The only reasonable ERP estimate is the . . . Ibbotson ERP [of 5.78%]. Staff found significant flaws in the methodology used by Mr. D'Ascendis to arrive at his inflated ERPs."[50] Dr. Won concluded, after scrutinizing Mr. D'Ascendis' flawed analyses, "Therefore, Mr. D'Ascendis' TMA RPM [total market approach risk premium model] COE estimate of 10.28% is overstated."[51]

OPC's expert witness, David Murray, agreed with Dr. Won.[52] Mr. Murray characterized Mr. D'Ascendis' risk premiums as "far outside of any consensus of risk premiums used by Spire, Incorporated itself for purposes of its own internal valuation

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[47] Won Rebuttal, p. 17, l. 10, to p. 18, l. 3, and Figure 5.

[48] Won Rebuttal, p. 18, ll. 5-8.

[49] Won Rebuttal, p. 18, ll. 16-17.

[50] Won Rebuttal, p. 19, ll. 3-5.

[51] Won Rebuttal, p. 25, ll. 13-14.

[52] Murray Rebuttal, p. 23, ll. 1-4; Tr. vol 14, p. 808, ll. 18-21.

analysis. It's far outside of anything used by utility investors."[53] Mr. Murray commented that the use of such unreasonably high inputs would result in unreasonably high results.[54]

Mr. Murray further testified:[55]

> . . . There's 18 different risk premium estimates in Mr. D'Ascendis' cost of capital analysis, and I think some may have been a little more reasonable, maybe about 7 percent are still higher than mine but some may go as high as -- I'd have to look at his testimony, but 11, 12 percent might be close to the range as to where some of his high ends are and he gives them all equal weight, and I just don't think that that is taken into consideration what's going on with the equity markets with consistently breaking all-time high valuation levels recently.
>
> Q. As a result, would you consider the results of his calculations using those numbers to be unreliable?
>
> A. Yes.

In the capital asset pricing model ("CAPM"), in which a market-risk premium is added to a risk-free rate, and then multiplied by Beta to obtain a result, Spire's expert Mr. D'Ascendis used an inappropriately high market risk premium ("MRP") of 10.45%, compared to the financial services industry's standard estimate of 4.00% to 7.00%. Dr. Won testified:

> Mr. D'Ascendis' CAPM COE estimate of 11.58% is too high even compared to his other COE estimates of 9.74% and 10.04% using DCF and RPM, respectively. Staff found that Mr. D'Ascendis' CAPM COE estimate is too high because he used unreasonably high MRPs. Mr. D'Ascendis' MRP of 10.45%, on average, is much higher than regular US financial service industry's MRP estimates of around 4.00% to 7.00%. Mr. D'Ascendis' MRP is an average of his six MRP estimates. Like his ERP, only one of Mr. D'Ascendis' MRP estimate is close to the range of

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[53] Tr. vol. 14, p. 808, l. 23, to p. 809, l. 1.

[54] Tr. vol. 14, p. 809, ll. 2-5.

[55] Tr. vol. 14, p. 810, ll. 11-24; and see Murray Rebuttal, p. 26, l. 23.

the reasonable MRPs used by US financial service industry. The other five estimates are unreasonably high.[56]

Mr. Murray agreed and testified that Mr. D'Ascendis' MRP was double his own and was unreasonable.[57] The same critical weakness is found in Spire's empirical CAPM.[58] The results of both of Mr. D'Ascendis' CAPM's are therefore unrealistically high and should be discarded.[59]

All of these input manipulations, intended to obtain an inflated result, have been seen before in other rate cases. Each analytical method, the DCF, RPM and CAPM, requires inputs that the expert must select in the exercise of sound professional judgment. Each of these inputs, therefore, is vulnerable to manipulation in order to obtain a pre-selected result. No other consideration can explain the fact that the company expert always comes up with unrealistically high results.

The constitutional parameters that guide the setting of the ROR require a comparative analysis in order to discern a result commensurate with alternative investments of similar risk.[60] For that reason, experts usually use a proxy group of utility companies in the same line of business, which necessarily face the same business risks. However, Spire's expert came up with a new manipulation, one that has not been

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[56] Won Rebuttal, p. 26, ll. 4-11.

[57] Murray Rebuttal, p. 24, ll. 1-3; Tr. vol. 14, p. 809, ll. 6-16.

[58] Won Rebuttal, p. 34, ll. 13-16.

[59] Murray, Tr. vol. 14, p. 809, ll. 17-20.

[60] In a pair of frequently-cited cases, the United States Supreme Court held that the ROR authorized by the Commission must be "commensurate" with the return realized from other investments of comparable risk and sufficient to preserve the company's financial integrity and to allow it to attract necessary capital. ***Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia,*** 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); ***Federal Power Commission v. Hope Natural Gas Co.,*** 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943).

seen before, namely, the use of an inappropriate, non-regulated proxy group, consisting of 41 unregulated companies.[61]

Spire's expert, Dylan D'Ascendis, contends that because his regulated gas utility proxy group and his non-price regulated proxy group share similar Betas, they have the same business risk and are comparable for purposes of ROE analysis.[62] Dr. Won disputed this claim, stating, "Mr. D'Ascendis' non-price regulated proxy group is not reasonably comparable to Spire Missouri or price regulated natural gas utilities and, therefore should not be used for estimating the COE of a natural gas utility. Because non-price regulated companies are included in Mr. D'Ascendis COE estimates, his COE estimates are significantly overstated compared to regular natural gas utilities' COEs."[63] Beta is defined as the volatility of a security compared to the volatility of the market as a whole; as mentioned, it is a component of the CAPM analytical method. Dr. Won testified that Beta alone cannot explain all business risks.[64] Dr. Won testified that the EPS [earnings per share] growth rates and ERPs [equity risk premiums] for D'Ascendis' non-price regulated companies are significantly higher than the growth rates and equity risk premiums for the price-regulated natural gas utilities, by 348 basis points and 193 basis points, respectively.[65] Dr. Won thereby demonstrated that the non-price regulated companies and the regulated natural gas utilities are not reasonably

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[61] Won Rebuttal, p. 7, ll. 2-4.

[62] Mr. Murray disagreed: "It's just impossible to find an industry that has the same risk profile as monopolies. It's a worthwhile endeavor, but it just doesn't – the characteristics are just too different. I mean, you could have really high growth companies, not dividend yield investing companies. You know, the risk differentials are just too disparate in my opinion." Tr. vol. 14, p. 811, ll. 4-10.

[63] Won Rebuttal, p. 7, ll. 6-10.

[64] Won Rebuttal, p. 7, ll. 13-16.

[65] Won Rebuttal, p. 8, ll. 9-21.

comparable for purposes of estimating the cost of equity, despite having identical betas. These purportedly comparable companies are not actually comparable at all and their use led to an inappropriate, upwardly biased result.[66] OPC's expert, David Murray, agreed with Dr. Won that the results of Mr. D'Ascendis' analysis of the non-regulated proxy group should be discarded.[67]

Spire's expert also applied unnecessary and unsupported adjustments to raise his recommendation by another 20 basis points. These adjustments are for size, credit risk and flotation costs. While it is true that Spire Missouri is smaller than the average of Spire's regulated natural gas proxy group, it is also true that Spire Missouri's long-term issuer rating from Moody's Investors Services is greater than the average long-term issuer ratings for Spire's regulated gas utility proxy group.[68] It is understood in the financial services industry that a higher bond rating brings a lower risk premium.[69] Consequently, Spire's proposed small size adjustment is unnecessary because the bond rating agency has already considered overall financial and business risks when awarding the higher rating.[70] Mr. D'Ascendis has also has improperly attributed Spire, Inc.'s flotation costs to Spire Missouri, so the proposed flotation costs adjustment is also seen to be bogus.[71] Mr. Murray testified, "That's definitely very improper. I take specific

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[66] Won Rebuttal, p. 9, *passim.*

[67] Tr. vol. 14, p. 810, l. 25, to p. 811, l. 14.

[68] Won Rebuttal, p. 36, ll. 10-13.

[69] Won Rebuttal, p. 36, ll. 13-14.

[70] Won Rebuttal, p. 36, ll. 14-16; Murray, Tr. vol. 14, p. 812, ll. 22-24.

[71] Won Rebuttal, p. 36, ll. 18-19.

issue with the flotation cost adjustment."[72] All of Spire's proposed adjustments are inappropriate and should be rejected.

Dr. Won's testimony revealed that Mr. D'Ascendis' ROE recommendation is the result of an inappropriate and intellectually-bankrupt methodology, in which inputs were purposefully selected in order to produce unduly high results. Dr. Won's testimony also demonstrated that Mr. D'Ascendis' proposed adjustments are without merit. Mr. Murray agreed with Dr. Won on these points. For these reasons, Spire's proposed ROE range and recommendation must be rejected in favor of the reasonable recommendations offered by Dr. Won and Mr. Murray.

Capital Structure:

In the area of capital structure, Dr. Won recommended the use of Spire Missouri's own capital structure, consisting of 54.28% equity and 45.72% long-term debt. This is the same capital structure recommended by Spire's expert, Adam Woodard. Mr. D'Ascendis testified, "What Mr. Woodard correctly did and what Dr. Won correctly did was they looked at what finances the rate base and that is the actual capital structure of Spire Missouri."[73] OPC, on the other hand, recommended the use of the capital structure of Spire Missouri's corporate parent, Spire, Inc., consisting of 45.37% equity 45.35% long-term debt and 7.28% short term debt.

OPC's recommendation is entirely inappropriate, as Dr. Won testified. While there are situations in which Staff believes the use of the parent's capital structure is

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[72] Tr. vol. 14, p. 811, ll. 18-19.

[73] Tr. vol. 14, p. 709, ll. 15-18.

appropriate for ratemaking, this is not one of them.[74] There are four factors that are considered in determining whether to use the parent's capital structure for ratemaking, as follows:[75]

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.

None of these factors supports OPC's position.[76] Spire Missouri issues its own debt, which is not guaranteed by Spire, Inc.[77] There is no double leverage or any other inappropriate entanglement with Spire, Inc.[78] While the Spire family of companies is engaged in a small amount of non-regulated activity, it cannot be said to have diversified into non-utility operations.[79]

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[74] Won Rebuttal, p. 41, ll. 1-3.

[75] Won Rebuttal, p. 41, ll. 7-15.

[76] Won Rebuttal, p. 41, ll. 16-17.

[77] Won Rebuttal, p. 41, ll. 17-20.

[78] Won Rebuttal, p. 41, l. 21, to p. 42, l. 1.

[79] Won Rebuttal, p. 42, ll. 1-2.

Dr. Won testified that Spire Missouri raises its own debt capital and so its own capital structure is the one that should be used for ratemaking.[80] Mr. Murray testified that Spire, Inc., manages the capital structure of Spire Missouri in order to reflect the ratio approved by the Commission in Spire Missouri's last rate case. Staff disagrees[81] and also responds, "So what?" That is no reason to penalize Spire Missouri. The Company has simply complied with the Commission's most recent ratemaking order. It is Staff's position that Spire Missouri's Commission-approved capital structure is entirely just and reasonable.

Staff does not agree with OPC that Spire, Inc., the parent company of Spire Missouri, manages Spire Missouri for purposes of taking advantage of the debt capacity afforded by Spire, Inc.'s low-risk regulated utility subsidiaries.[82] Staff notes that Spire Missouri's capital structure is consistent with the capital structure ratios maintained by, or authorized for, other natural gas utilities,[83] while OPC's recommended common equity ratio of 47.36 percent is much lower than the average of its natural gas proxy group's common equity ratio of approximately 51 percent.[84] OPC's position is unreasonable and unsupported and must be rejected.

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[80] Won Rebuttal, p. 40, ll. 15-16; Adam Woodard at Tr., vol. 14, p. 715, ll. 16-20.

[81] Won Rebuttal, p. 40, ll. 8-12.

[82] Won Rebuttal, p. 40, ll. 8-12.

[83] Won Rebuttal, p. 40, ll. 17-18.

[84] Won Rebuttal. P. 40, ll. 18-20.

Cost of Debt and Short-Term Debt:

Spire Missouri's cost of long-term debt is 3.99%.[85] Staff and the Company do not agree with OPC's recommendation that short-term debt should be included in the ratemaking capital structure. This Commission does not generally include short-term debt in the ratemaking capital structures. Dr. Won testified that Staff would only recommend its inclusion in certain circumstances, which do not apply here.[86] If 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.[87] That is not the situation here. Company witness Adam Woodard agreed that short-term debts should not be included in the ratemaking capital structure and that its inclusion would result in a lower revenue requirement, making it more difficult for the Company to achieve its authorized ROR and depriving the Company of needed revenue.[88]

Conclusion:

Staff urges the Commission to adopt the thoughtful and well-supported recommendations of Staff's expert financial analyst, Dr. Seoungjoun Won. Staff urges the Commission to reject the bloated ROE recommendation offered by the Company's expert, including the several patently unnecessary adjustments proposed by Spire solely for the purpose of further inflating the ROE. Staff also urges the Commission to reject the capital structure recommendation offered by OPC's expert, which is intended

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[85] Lyons True-up Direct, p. 3, l. 2.

[86] Tr. vol. 14, p. 796, l. 19, to p. 797, l. 24.

[87] *Id.*

[88] Tr. vol. 14, p. 713, l. 23, to p. 714, l. 13.

to significantly reduce the revenue requirement and thereby deprive the Company's shareholders of the opportunity to earn a fair return on the value of their private property committed to the public service. Finally, Staff urges the Commission to exclude short-term debt from the ratemaking capital structure.

--Kevin A. Thompson.

8. Cash Working Capital:

Should the Commission follow the Office of Public Counsel's income tax calculation in Cash Working Capital?

No. By adjusting the income tax working capital requirement by a negative $13,089,822, the Office of Public Counsel ("OPC") is attempting to circumvent the Internal Revenue Service ("IRS") normalization rules, which requires certain income tax amounts to be included in Spire's revenue requirement. Not only is the rationale behind OPC's calculation incorrect, but there is a case and a Private Letter Ruling ("PLR") which indicate that any attempt to evade the required inclusion of income taxes in a utility's revenue requirement will violate the IRS's normalization rules.

<u>Background</u>

Cash Working Capital ("CWC") is the net funds required by Spire Missouri, Inc., to finance goods and services used to provide service to customers from the time those goods and services are paid for by the Company to the time that payment for those services is received from customers.[89] In order to determine the proper net CWC, Spire Missouri, Inc. ("Spire" or "Company") conducted a lead-lag study. A lead-lag study compares the differences between the Company's revenue lag and expense

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[89] Ex. 25, Direct Testimony of Timothy S. Lyons, p. 3.

lead.[90] Revenue lag is the number of days from the time customers receive service to the time customers pay for their services.[91] Expense lead represents the number of days from the time the Spire receives goods and services used to provide service to the time payments are made for those goods and services.[92] The longer the revenue lag, the more funds the Company needs to finance its day-to-day operations and, conversely, the longer the expense lead, the less money Company needs to finance its day-to-day operations.

Income Tax Lead:

Lead days for federal and state income taxes were measured as the number of days from the midpoint of the taxing period to the IRS payment dates.[93] For Spire East, Staff's lead-lag study calculated a CWC requirement of $9,346,801 with an income tax expense lag at 38 days, requiring CWC in the amount of $728,102 for federal and state income tax expense.[94] For Spire West, Staff's lead-lag study calculated a CWC requirement of $941,494 with the same income tax expense lag of 38 days requiring CWC in the amount of $636,510 for federal and state income tax expense.[95]

During testimony, Spire acknowledged that, due to accumulated previous years' Net Operating Losses ("NOL"), the Company has not paid either federal or state income taxes the past three years and does not anticipate paying taxes in the next three years.

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[90] Id.

[91] Id.

[92] Id. P. 4.

[93] Id. P. 9.

[94] Ex. 146. Staff True-Up Accounting Schedules East and West, Spire Missouri East Schedule 08.

[95] Ex. 146. Staff True-Up Accounting Schedules East and West, Spire Missouri West Schedule 08.

Even though Spire has not paid income taxes in the past three years and does not anticipate paying taxes in the next three years, this creates an issue for the Commission to decide.

a. Sub Issue 1: Should Spire's federal and state tax expense be accounted for in calculating Cash Working Capital?

Yes. Spire must account for Federal and State Income Tax Expense when determining the Company's revenue requirement.[96] As discussed by OPC witness John S. Riley: "It is necessary to include income taxes in the CWC calculation because income taxes are already an expense item built into the Company's revenue requirement. In fact, income tax has to be included in Spire's revenue requirement due to the normalization rules established by the IRS.[97] However, the way the OPC and the way Spire and Staff determined the expense lag and CWC requirement for federal and state income taxes differs.

OPC Approach to Cash Working Capital:

The Staff adopted Spire's calculated expense lag based on IRS and state statutory required, equal payments.[98] OPC witness, John S. Riley, believes that this approach was incorrect. Mr. Riley's rationale is that since Spire did not pay income taxes the previous three years, the expense lag should be 365 days rather than 38 days.[99] The effect of using a 365-day expense lag rather than a 38-day expense lag would change Spire's income tax working capital requirement from a

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[96] Ex 209 Direct Testimony of John S. Riley. P. 9.

[97] Ex 209 Direct Testimony of John S. Riley. P. 9.

[98] Ex 136. Surrebuttal Testimony of Antonija Nieto. P. 3.

[99] Ex. 209. John S. Riley P. 9.

positive $446,136 to a negative $12,643,686 and reduce the total CWC in rate base from a positive $12,672,247 to a negative $417,575.[100]

Staff Approach to Cash Working Capital:

Staff witness Antonija Nieto accepted Spire's calculated federal and state income tax expense lag of 38 days, which is consistent with the Internal Revenue Code requirement for filing and paying corporate income taxes on a quarterly basis.[101] The Company's tax year ends September 30, making estimated tax payments due January 15th, April 15th, June 15th, and September 15th. 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.

If the Commission decides that OPC's argument has merit, the Staff recommends treating federal and state income tax expense within CWC similar to other non-cash items (i.e. bad debt expense). Staff recommends income tax expense lag be set so the federal and state income tax expense has no impact on the CWC requirement. In other words, the Staff recommends zeroing out the federal and state income tax expense line item within the CWC requirement calculation.

b. Sub Issue 2: Even though Spire did not pay federal or state income taxes the past three years and does not anticipate paying income taxes the next three years, should the Commission follow the IRS's rule on normalization?

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[100] Id. P. 10.

[101] Ex. 136. Surrebuttal Testimony of Antonija Nieto. P. 3.

Yes. Whether Spire paid federal and state income taxes is irrelevant to the IRS normalization rules, and OPC's attempt to evade these rules by adjusting CWC violates those rules.

IRS Normalization Rules:

Due to the IRS's normalization rules, income tax expense must be accounted for in calculating CWC. As OPC witness Mr. Riley stated:

> It is necessary to include income taxes in CWC calculation because income taxes are already an expense item built into the Company's revenue requirement. In fact, income tax has to be included in Spire's revenue requirement due to the normalization rules established by the Internal Revenue Service ("IRS"). Simply put, the IRS requires income taxes to be calculated and included in rates (as if the utility is going to pay those taxes to the federal government) regardless of whether any such taxes are actually paid.[102]

Normalization rules are designed to incentives the Company to invest into capital projects.[103] The IRS dictates to some extent the Commission's cash working capital treatment in a rate case, and failure to follow normalization rules could result in a punishment by the IRS.[104]

Application of Virginia Electric and Power Company Case:

In a case similar to this one, the Virginia State Corporation Commission adjusted the CWC of the Virginia Electric and Power Company d/b/a Dominion Virginia Power ("Dominion Virginia Power" or "Company") to account for Liberalized Depreciation Accumulated Deferred Income Taxes ("ADIT") balances to prevent the utility cash

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[102] Ex 209. Riley P. 9-10.

[103] Tr. 522:16-19 (Riley Cross)

[104] Tr. 511:25-512:13; Tr. 530:3-8.

requirements from being overstated.[105] Staff reduced the Company's CWC to account for the accelerated depreciation treatment. The Hearing Examiner ordered Staff and Dominion to request a Private Letter Ruling ("PLR") from the IRS concerning this treatment.[106]

In the PLR, the IRS found that the type of adjustment the Virginia State Corporation Commission made to CWC was inconsistent with its normalization rules. In the PLR, the IRS indicated that "[the] purpose of the proration formula is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers."[107] The IRS stated, "[i]n general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules."[108] In the PLR, the IRS further stated:

> 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 [emphasis added].[109]

Clearly, 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.

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[105] Exhibits 142 at 7 (pdf 8), 143 at 26 (pdf 27) (App. Of Va. Elec. & Power Co., Hearing Examiner Report at *18, PUE-2013-00061, 2014 WL 10191322 (Va. S.C.C., Jan. 31, 2014)).

[106] Exhibit 142 at 11 (pdf 12).

[107] Exhibit 141 at 8-9 (pdf 9-10) (IRS PLR 201541010, 2015 WL 5895848 (Oct. 9, 2015)). While PLRs are not legal precedent, a reasonable accountant would "definitely" read and rely on them in advising a tax client, because the IRS "huddle[s]" on this before releasing them, they are published, and they are the agency's interpretation of the regulations. Tr. at 630:3-12 (Felsenthal Cross).

[108] Exhibit 141 at 8-9 (citing 26 C.F.R. § 1.46-6).

[109] *Id.*

Conclusion

The OPC's adjustment to CWC is an obvious attempt to offset income tax expense in the Company's revenue requirement. Calculating the income tax expense effect on CWC the way OPC intends to calculate it is incorrect. Additionally, OPC's method would violate the IRS' normalization rules, which OPC admits.

--Ron Irving.

13. Incentive Compensation:

To what extent should incentive compensation be included in rates?

Spire's Annual Incentive Plans ("AIP") is an incentive compensation program that provides an annual cash payout to eligible union and non-union employees, based upon the following four components: corporate performance, business unit performance, individual performance, and team unit performance.[110] In this proceeding, the Commission faces two questions regarding Spire's incentive compensation: (1) Should the cost of Spire's AIP be included in base rates, and (2) Should the two new metrics Spire implemented in the fall of 2018, utility contribution margin and utility adjusted O&M per customer, be included in base rates? It is Staff's recommendation that the Commission include the cost of Spire's AIP in base rates as well as the two new metrics, minus the cost of the corporate performance component.

a. Should the cost of Spire's AIP be included in base rates?

Staff's recommendation is to include non-earnings based costs of Spire's AIP in base rates.[111] However, as noted above, Spire's bases its AIP upon four components.

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[110] Ex. 101, Staff's Revenue Requirement Cost of Service Report (Public and Confidential), pg. 66, ln. 18-21.

[111] *Id*, ln. 12-17.

Of these four components, it is Staff's recommendation that costs associated with the corporate performance component be removed because it is earnings based.

The Commission has a history of disallowing earnings based incentive compensation.[112] In this proceeding, Spire's corporate performance metric is measured with the financial metric of Net Economic Earning Per Share ("NEEPS").[113] Because NEEPS is earnings based and focuses on earnings per share and benefits to shareholders, Staff has removed the corporate performance component to be consistent with past Commission orders.[114]

On the other hand, the Commission has consistently allowed the inclusion of incentive compensation based on customer and operation metrics.[115] Following its review, Staff concluded that business unit performance, individual performance, and team unit performance components are not earnings based, and should be included in base rates.[116]

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[112] *Id*, ln. 28-30. *See also* File No. GR-2004-0209, In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area, *Report and Order*, September 21, 2004, pg. 43 ("Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed, some actions…might have an adverse effect on ratepayers."); File No. ER-2006-0314, In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of Its Regulatory Plan, *Report and Order*, December 21, 2006, pg. 58 ("[I]f the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service."); and File No. ER-2007-0291, In the Matter of the Application of Kansas City Power and Light Company for Approval to Make Certain Changes in its Charges for Electric Service To Implement Its Regulatory Plan, *Report and Order*, December 6, 2007, pg. 49 ("…because maximizing EPS could compromise service to ratepayers, such as by reducing maintenance, the ratepayers should not have to bear that expense.").

[113] Ex. 101, pg. 66, ln. 24-25.

[114] *Id*, pg. 76, ln. 18-19.

[115] Ex. 131, Surrebuttal Testimony of Jeremy Juliette, pg. 9, ln. 1-3.

[116] Ex. 101, pg. 67-68.

b. Should the two new metrics Spire implemented in the fall of 2018, utility contribution margin and utility adjusted O&M per customer, be included in base rates?

Staff recommends the two new metrics implemented by Spire, utility contribution margin and utility adjusted O&M per customers, be included in base rates.[117] These objectives fall under Spire's AIP component covering business unit performance.[118] Staff sees both of these metrics as "provid[ing] benefits to ratepayers as they incentivize employees to reduce expenses or increase revenues while providing safe and reliable service."[119] While it is also true that reducing expenses or increasing revenues would increase Spire's bottom line and benefit shareholders, it is Staff's conclusion that the methods Spire employees use to achieve these goals would benefit ratepayers.[120] Such methods include repairing leaks, reducing the duration of outages, shorter response times, and increased customer safety.[121] OPC witness Bob Schallenberg agreed that such methods would benefit ratepayers.[122]

Since the two new metrics implemented by Spire produce benefits for ratepayers, Staff recommends that both metrics be included in base rates.[123]

--*Travis Pringle.*

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[117] *Id*, pg. 67, ln. 28-30.

[118] *Id*, ln. 23-25.

[119] Ex. 131, pg. 10, ln. 6-7.

[120] *Id*, ln. 10-11.

[121] *Id*, ln. 12-13. *See also* Transcript Vol. 12 (Evidentiary Hearing – Jefferson City, MO via WebEx – August 4, 2021), pg. 565, ln. 11-13.

[122] Transcript Vol. 12, pg. 570, ln. 11-21.

[123] Ex. 101, pg. 67, ln. 20-30.

15. Capitalized Overheads:

Capitalized overheads are costs that are indirectly related to a capital project that the utility has elected to capitalize rather than to expense.[124] Overheads of this type are allocated to construction work orders and are ultimately reflected in the plant-in-service component of rate base.[125] Some examples of capitalized overheads are provided by the Uniform System of Accounts ("USOA"), which identifies engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pension, taxes, and interest as costs eligible for capitalization as indirect capital costs.[126] Capitalized overheads are recorded as a rate base asset and amortized over a period of time, generally the life of the associated capital asset. If expensed instead, the full amount of these costs is charged immediately to operating and maintenance expenses.

In ISRS case nos.GO-2019-0356 and GO-2019-0357, OPC raised a concern that the amount of overheads included in the surcharge was inappropriate and should not be recovered through the surcharge.[127] Spire Missouri and Staff contended that the issue should not be considered in an ISRS case but should be addressed in Spire's next rate case.[128] The Commission adopted the latter position and the issue was deferred to this

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[124] Young Rebuttal, p. 1, ll. 23-24.

[125] *Id.,* p. 1, l. 24, to p. 2, l. 1.

[126] *Id.,* p. 2, ll. 1-5.

[127] Schallenberg Direct, p. 22, ll. 9-16.

[128] *Id.*

rate case.[129] Staff raises a somewhat different issue now than what was brought forward by OPC in previous ISRS cases, namely, that Staff has been unable to audit Spire's capitalized overheads due to the complexity of Spire's accounting system and therefore cannot determine whether or not Spire is in compliance with the Commission's governing regulations. Neither Staff nor OPC challenges the prudence of the expenditures in question or seeks to change the accounting treatment of any amounts already booked to plant in service as of May 31, 2021.[130]

The Commission has adopted the USOA for gas utilities under its jurisdiction that contains guidance as to items that are eligible to be treated as construction costs, see Commission Regulations 20 CSR 4240-40.040.[131] The USOA identifies overheads as a component of construction costs and provides the requirements for how Spire Missouri is to record them and maintain its books and records.[132] Spire Missouri also includes certain construction components in its treatment of overheads.[133]

The USOA provides:

4. Overhead construction costs.

> A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that

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[129] *Id.*

[130] Tr. Vol. 10, p. 146, ll. 16-24; p. 147, ll. 18-22; p. 170, l. 25, to p. 171, l. 10 (Young).

[131] Schallenberg Direct, p. 22, ll. 20-25.

[132] *Id.*

[133] *Id.*

> the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.
>
> B. As far as practicable, the determination of pay roll 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.**
>
> C. The record supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each utility plant account, and the bases of distribution of such costs.

Staff's responsibility is to audit Spire and determine whether it is in compliance with the Commission's rules. Additionally, OPC has made certain allegations concerning Spire's capitalization of construction overheads. OPC alleges that Spire Missouri is over-charging its projects by capitalizing overheads in excess of the amount allowed to be recorded as plant investment as specified by the Commission rules adopting the USOA.[134] OPC further alleges that Spire Missouri is not capitalizing its overhead based on specific time reports or cost studies required for such accounting by the USOA.[135] Spire Missouri charged $172,799,199.64 of overheads to its test year construction expenditures; $39,023,977.34 of this amount is the capitalization of general overheads.[136] As remedies, OPC proposed:

1. That a tracker be established to ensure that Spire Missouri's general overhead is not allowed to be over-recovered by transferring overheads to

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[134] Schallenberg Direct, p. 25, ll. 5-8, Schallenberg Surrebuttal, p. 25, ll. 13-20.

[135] Schallenberg Direct, p. 25, ll. 5-8.

[136] Schallenberg Direct, p. 25, ll. 12-13.

construction by an amount causing overhead expense to be less than the amount included in base rates in this case.[137]

2. That Spire Missouri be ordered to create policies and procedures that track in the greatest detail the Company's practice for selection of overheads for capitalization, the criteria needed to prove a definite relationship, and why the basis of the relationship is not being used to assign costs. These policies and procedures will examine cost assignment based on hours worked vs salary/wages costs that support the use of the method utilized.[138]

3. That Spire Missouri be required to report quarterly information regarding overhead capitalization to allow monitoring of the dollar impact of Spire Missouri's practices.[139]

4. Finally, that Spire Missouri be required to report each fiscal year the amount of overhead capitalization for which the Company cannot show the definitive relationship to construction and that will consequently not be included in any future ISRS.[140]

The Company responds that its approach to determine what overheads are eligible for capitalization is compliant with the requirements of the USOA, that it is a reasonable and acceptable approach, consistent with historical practice and widely used.[141] The Company asserts that it has not changed its underlying methodology,

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[137] Schallenberg Direct, p. 25, ll. 19-21.

[138] Schallenberg Direct, p. 25, ll. 22-26.

[139] Schallenberg Direct, p. 26, ll. 1-2.

[140] Schallenberg Direct, p. 26, ll. 3-5.

[141] Krick Rebuttal, p. 10, ll. 10-12, 17-19.

which has been found to be acceptable in prior cases.[142] Spire's witness expressed surprise at Staff's inability to audit its capitalization practices.[143]

Staff generally agrees with OPC's allegations. Staff states that it is unable to audit Spire's overheads capitalizations and recommends that, on a going-forward basis, the Commission order Spire to cease capitalizing non-operational overhead costs, or as an alternative, order Spire to cease capitalizing costs received from Spire Services, until such time that Spire can demonstrate its compliance with the USOA.[144]

This is a straightforward issue from Staff's perspective. Staff attempted to audit the capitalized overheads and was unable to do so. Mr. Young, Staff's expert, testified:[145]

> In response to a data request asking for test year overhead employee costs and the related benefits that are capitalized, Spire stated it does not maintain records of such information. Furthermore, Spire states that the allocation of costs to capital orders has dozens of steps, and is a complex systematic process. Consequently, Staff cannot accurately discern the origin of overhead costs that Spire is booking to its capital projects and including in its rate base. … Staff is unable to affirm that Spire is in compliance with USOA requirements found in Gas Plant Instructions 3 and 4 …. Additionally, there are costs currently capitalized by Spire that appear to conflict with the guidance set forth in the USOA.

It is intolerable that Spire maintains its records in such a manner that the Commission's Staff, the investigative arm of the Commission, is unable to audit them. This situation cannot be allowed to continue and, until it is rectified and Spire is able to demonstrate its compliance with the USOA, Staff urges the Commission to order

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[142] Krick Rebuttal, p. 10, l. 20, to p. 11, l. 24.

[143] Tr. Vol. 10, p. 139, ll. 11-17 (Krick).

[144] Young Rebuttal, p. 5, ll. 7-10; Young Surrebuttal, pp. 12-21.

[145] Staff's Revenue Requirement Class Cost of Service Report, p. 32, l. 19, to p. 33, l. 2.

Spire to cease capitalizing non-operational overhead costs; alternatively, to order Spire to cease capitalizing costs received from Spire Services.

Spire is a subsidiary of a publicly-traded corporation and therefore must adhere to Generally Accepted Accounting Principles ("GAAP").[146] Spire is also a Commission-regulated natural gas utility, and therefore must comply with Missouri statutes and Commission regulations, which require that it adhere to the FERC Uniform System of Accounts ("USOA").[147] Both forms of authoritative guidance include a basis for assigning costs either to expense (i.e., included in the income statement) or to capital expenditures (i.e., included in the balance sheet).[148] While some costs are clearly either expenses or capital expenditures in nature, Spire has discretion to assign many costs either to capital or expense as it chooses.[149] With respect to costs related to construction, Gas Plant Instruction 3 includes a list of indirect costs eligible for capitalization, while Gas Plant Instruction 4 limits such capitalization to reasonable amounts.[150] Such costs must be charged to particular jobs or units in amounts reasonably applicable thereto. Mr. Young testified, "Instruction 4 has paragraphs A, B, and C, and Spire has not shown compliance with any of them."[151]

Spire's capitalization of overheads has greatly increased[152] and now constitutes many millions of dollars of rate base. Mr. Young testified, "It is Spire's own testimony

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[146] Staff's Revenue Requirement Cost of Service Report, p. 31.

[147] *Id.*

[148] *Id.*

[149] *Id.*

[150] *Id.*

[151] Young Surrebuttal, p 16, ll. 3-4.

[152] *Id.,* p. 13, ll. 2-3.

that nearly a billion dollars of investment has been made since Spire's last rate case."[153] Staff noted several deficiencies in Spire's accounting methods, primarily insufficient recordkeeping.[154]

Instruction 4, paragraph A, limits overhead construction costs to appropriate amounts by requiring the overheads, "shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs…"[155] Spire's responses to Staff's inquiries give general overviews of how overhead costs are capitalized but do not attempt to explain why any particular overhead is applicable to a construction job or unit or why the end result is an equitable allocation of overheads.[156] Instead, Spire comes to the conclusion that costs are not unique in nature and are equally eligible for capitalization.[157] For example, Spire applies the same capital transfer rate to injuries and damages insurance, nearly the entire office supplies account, and directors and officers insurance despite the varying relationship of those costs to construction.[158]

Instruction 4, part B, prohibits the use of arbitrary percentages to cover assumed overhead.[159] Yet Mr. Krick testified, "one of the primary methods used to allocate overhead is the ratio of direct labor to total labor…."[160] Instead of conducting studies of

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[153] *Id.,* p. 19, ll. 20-21.

[154] Tr. Vol 10, p. 156, l. 19, to p. 157, l. 6.

[155] Young Surrebuttal, p. 16, ll. 6-16.

[156] *Id.*

[157] *Id.*

[158] *Id.*

[159] *Id.,* p. 18, ll. 11-12.

[160] *Id.,* p. 17, ll. 18-19.

the time charged to clearing accounts by its employees, Spire uses the direct labor charges as the basis of distributing overhead payroll costs.[161] While direct labor charges are based on time card distributions, the USOA intended the time reporting of the supervisory labor to be the basis of distribution, not the time cards of their direct reports.[162] Spire has assumed there is a relationship between how construction employees use their time and how a supervisor's time is used.[163] However, the USOA intended each supervisor's time reporting to be the basis of capitalizing overhead payroll, or when that is not practicable, supervisory time reports should be studied to make an appropriate allocation.[164]

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.[165] Rather than examining the time of supervisors, Spire has relied exclusively on an assumed arbitrary relationship between direct and indirect labor to account for overhead payroll costs, and the related payroll benefits that follow payroll.[166]

Instruction 4, Part C, requires records of construction work orders and utility plant accounts to be maintained so that the nature and quantity of each overhead that is charged to each work order and each plant account, as well as the bases of distributing

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[161] *Id.,* ll. 8-16.

[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] *Id,* p. 19, ll. 1-6.

[166] *Id.;* Tr. Vol. 10, p. 148, l. 5, to p. 149, l. 10.

the overhead costs, can be shown.[167] To track the amount and nature of overheads, Spire uses a concept called 'cost elements' to charge work orders.[168] Unfortunately, by the time construction work-in progress is unitized to the FERC plant accounts, those cost elements are lost.[169] Accordingly, Staff concludes that Spire does not keep records sufficient to show each overhead cost in its utility plant account and also has not provided support to show the bases used to distribute its overheads.[170] Staff concludes that Spire is unable to show how costs are recorded so that each job or unit is charged overheads that are reasonably applicable to the construction so that the job or unit will bear an equitable proportion of the overheads.[171]

Neither does Spire comply with Instruction 3. Gas Plant Instruction 3(A)(8) describes the injuries and damages transactions that are eligible for capitalization. Injuries to a person or damages to property that occur in connection with construction work is includable in the gas plant accounts and related insurance recoveries "shall be" credited to the accounts charged with the cost.[172] However, Spire books the loss from the injury or damage to construction accounts but, contrary to the USOA guidance, books the related insurance proceeds to the income statement accounts.[173]

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167 *Id.,* ll. 8-18.

168 *Id.*

169 *Id.*

170 *Id.*

171 *Id.*

172 *Id.,* p. 15, ll. 7-14.

173 *Id.*

Spire's method improperly inflates rate base and increases its earnings through reduced expense.[174]

Gas Plant Instruction 3(A)(19) describes the training costs that are eligible for capitalization.[175] This instruction provides for capital eligibility of training costs related to construction with the provision that the related facilities must be unconventional in nature or new to the company's operations.[176] However, Spire makes no such distinction in training activities and improperly charges its construction projects for generic training activities.[177] The effect of this accounting method inflates rate base and increases earnings when compared to the USOA's guidance.[178]

To the extent that the USOA requires studies to support capitalization accounting, Spire has not performed them.[179] In fact, Mr. Krick did not appear to even understand that studies are required by the USOA:[180]

> Q You got a bench question that asked about I think required studies if I heard correctly. Do you necessarily agree that studies are required by the USOA?
>
> A. If you read it black-and-white, and I think there's -- there's -- I feel like this part of the USOA is somewhat vague.· There's terms in there, reasonably applicable, equitable proportion as far as

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[174] *Id.*

[175] *Id.,* ll. 15-21.

[176] *Id.*

[177] *Id.*

[178] *Id.*

[179] Tr. Vol. 10, p. 136, l. 23, to p. 137, l. 2 (Krick).

[180] *Id.,* p. 141, ll. 13-22.

> practical. So again, I think a study is one way of doing that, but I also think a reasonable method is to, you know, use a causal relationship such as we did.

In the absence of a study of the supervisor timecard distributions, there is no way to determine an appropriate capital transfer rate based on the USOA requirements.[181]

In conclusion, based upon the limited audit it was able to conduct, Staff has found that Spire is not in compliance with the USOA in its capitalization of overheads. The nature of its recordkeeping, such that a thorough audit is not possible, is yet another violation. For these reasons, Staff recommends that, on a going-forward basis, the Commission order Spire to cease capitalizing non-operational overhead costs,[182] or as an alternative, order Spire to cease capitalizing costs received from Spire Services, until such time that Spire can demonstrate its compliance with the USOA.[183]

--Kevin A. Thompson.

16. Net Operating Loss ("NOL") Carry-forward:

How should Spire's Net Operating Loss ("NOL") carry-forward be treated?

OPC's witness recommends excluding Spire Missouri's Net Operating Loss ("NOL") Asset balance from rate base calculation of Accumulated Deferred Income Taxes ("ADIT") and the amortization of Spire Missouri's excess ADIT.[184] OPC's position is based in the mistaken believe that a NOL does not have a true cost attributable to it,

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[181] *Id.,* p. 161, ll. 16-24.

[182] Non-operational overhead costs are employee benefits, shared service, and administrative and general costs. Tr. Vol 10, p. 162, l. 21, to p. 163, l. 4.

[183] Young Rebuttal, p. 5, ll. 7-10; Young Surrebuttal, pp. 12-21.

[184] Ex. 209.

has no cash consequence to the utility, and therefore, no amount of a NOL Asset should be included in the calculation of ADIT.[185] Staff disagrees.[186]

A good description of a NOL is contained in the Commission's Report and Order issued in Case No. WO-2020-0190, where the Commission states:

> The term 'net operating loss' is defined as the "excess of operating expenses over revenues." An NOL results when a utility does not have enough taxable income to utilize all of the tax deductions to which it would otherwise be entitled. When this situation occurs, the amount of the unused deductions is referred to as an NOL and is booked to a deferred asset account.[187]

And further, a NOL Asset is simply the balance of all the accumulation of all prior NOLs.[188] As noted by both Spire Missouri's and Staff's witnesses at the evidentiary hearing on August 5, 2021, NOLs are not unique in the utility industry[189] or for Missouri utilities.[190]

In ratemaking terms, ADIT is a measurement of the tax savings Spire Missouri has received from the Internal Revenue Service ("IRS") but has not passed onto ratepayers through the ratemaking process.[191] Total ADIT is the summation of the normalized book-to-tax timing differences (caused by tax deductions) that are temporary in nature and will become a tax liability to Spire Missouri in future periods.[192] Spire Missouri is able to use book-to-tax timing differences to avoid paying current

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[185] Id.

[186] Exs. 125 & 140.

[187] Report and Order, Case No. WO-2020-0190, p. 6.

[188] Ex. 125, p. 7.

[189] Tr. Vol. 13, pp. 614-615.

[190] Tr. Vol. 13, pp. 657-658. "Q. Mr. Young, are you aware of other Missouri utilities in general realizing [net] operating losses due to bonus [deprecation]? A. It's my understanding that nearly all of them had a net operating losses for bonus [depreciation], the large utilities I should say."

[191] Ex. 125, p. 6.

[192] Id.

income taxes, which means the ADIT balance represents the amount of cash Spire Missouri has avoided spending on its past income tax liabilities and is considered a cost-free loan from the federal government.[193]

Excess ADIT is the balance of book-to-tax timing differences that is due to the federal income tax rate reduction, among other changes, resulting from the Tax Cuts and Jobs Act of 2017.[194] Additional excess ADIT was also created when Missouri reduced its corporate income tax rate from 6.25% to 4%.[195] Typically, tax-to-book timing differences are temporary in nature, but Spire Missouri's excess ADIT timing differences, because of federal and state tax rate changes, are permanent.[196]

Staff's recommended calculation of ADIT represents the accumulated cash consequences of the tax benefits Spire Missouri has realized from its book-to-tax timing differences as of December 31, 2020.[197] Staff also included Spire Missouri's NOL Asset in its recommended calculation of ADIT because the NOL Asset represents a tax benefit Spire Missouri has not yet realized, and therefore, is appropriate to include as an offset to total ADIT.[198] Staff also agrees with Spire Missouri's calculation of excess ADIT related to certain method/life timing differences that includes a NOL offset.[199]

Staff's position on this is straightforward. Staff acknowledges that Spire Missouri has a NOL Asset and recommends that Spire Missouri's NOL Asset balance should be

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[193] Id.

[194] Id., p. 8.

[195] Id.

[196] Id.

[197] Id.

[198] Id. pp. 7-8.

[199] Id.

included in Spire Missouri's ADIT and excess ADIT. Staff also acknowledges that recognition of a NOL tax asset in rate base is, in some circumstances, mandated by the IRS's normalization requirements.[200] Staff's calculated ADIT balance for Spire Missouri represents the accumulated cash consequences of tax benefits Spire Missouri has realized from book-to-tax timing differences. Because the NOL Asset represents a tax benefit that Spire Missouri has not realized, it is appropriate to include this tax asset as an offset to Spire Missouri's total ADIT and excess ADIT.

--*Jamie Myers.*

19. Corporate Allocations and Affiliate Transactions:

Should a significant portion of Spire Missouri's test year operating expenses be disallowed on the grounds that they should properly be charged to Spire Missouri's corporate parent and affiliates?

First, it is important to note that when Staff refers to corporate allocations in this case, Staff is referring to the allocations of costs to Spire Missouri and/or Spire Missouri affiliates. Due to Spire, Inc.'s corporate structure, all transactions under what Staff classifies as "corporate allocations" are allocations among affiliates, and are, therefore, subject to the Commission's rule regarding affiliate transactions of gas utilities, which is contained in 20 CSR 4240-40.015. Consistent with the Commission's affiliate transaction rule, Spire Missouri also has a Commission-approved Cost Allocation Manual ("CAM") document[201] that details Spire Missouri's cost allocation, market valuation and internal cost methods.

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[200] Ex. 140, p. 8.

[201] Ex. 228.

In the course of any general rate case, Staff performs an audit of the costs incurred by or allocated to the Missouri-regulated utility and the methods used to allocate those costs. Staff then makes recommended adjustments to costs that are incurred or allocated. In the instance of Spire Missouri, and specifically this case, Staff reviewed all costs allocated to Spire Missouri and all costs incurred by Spire Missouri, reviewed Spire Missouri's CAM, and in some instances, made adjustments that allocated a portion of those costs to other affiliates.

Staff witness Keith Majors' rebuttal testimony describes some of the adjustments Staff recommended and the portion of costs Staff recommended be allocated to other Spire, Inc., affiliates.[202] Mr. Majors notes that through Staff's recommended payroll annualization, a substantial portion of the salaries and wages of Spire Missouri employees were allocated to various Spire, Inc., affiliates using a three-factor allocator that uses an average of fixed assets, revenue, and wages.[203] For Spire, Inc., Board of Director ("BOD") costs, Staff recommended adjustments to disallow discrete BOD expenses and the elimination of any stock-based compensation that had been charged to Spire Missouri. Staff recommended that the remaining BOD expense should be allocated using an allocator that approximates the three-factor allocation.[204] For internal labor services performed by Spire Missouri employees or employees of other Spire, Inc., affiliates, Staff recommended salary and wage allocations that charge salary and wages to various regulated and non-regulated affiliates.[205]

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[202] Ex. 117.

[203] Id. pp. 3-4.

[204] Id. pp. 4-5.

[205] Id. p. 5

OPC's witness has stated in testimony that Spire, Inc., and Spire Services, Inc., are not being allocated their fair share of costs. OPC's remedy for this alleged unfairness is that the Commission should order a negative adjustment of $84 million or $65 million to Spire Missouri's revenue requirement.[206] Spire, Inc., is the holding company for all Spire Missouri affiliates. Spire Services, Inc., functions as a clearinghouse to properly allocate and charge costs for goods and services between the Spire, Inc., subsidiaries.[207] This particular corporate structure 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.[208] It is highly likely that it is less costly to each affiliate to be charged or allocated a portion of the centralized human resources services costs than if each affiliate, like Spire Missouri, had to provide the human resources services for themselves in-house, or attempt to receive these services from an unaffiliated third party.[209]

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.[210]

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[206] Exs. 203, 204, and 205.

[207] Ex.135, p. 9.

[208] Id. p. 10.

[209] Id.

[210] Tr. Vol. 11, pp. 409-410. "Q. Mr. Majors, in response to some questions from the Bench, you referred to the asymmetrical pricing model and the Commission rules. What exactly were you referring to there? A. It would be in the Affiliate Transaction Rule. I have a copy of it right here." "Q. Are you referring to what is known as Number 2, the standards? A. Yes. Number 2, supbara – subparagraph a –

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.

Further, Spire, Inc., does not charge a profit margin for the services it provides its affiliates like Spire Missouri.[211] The Federal Energy Regulatory Commission ("FERC") currently prohibits centralized service companies under its jurisdiction from charging a profit for corporate support services to affiliated entities.[212] Although the current corporate structure of Spire, Inc., does not include a service company, Spire Missouri does not charge a profit on the services provided to affiliates nor does it pay a mark-up on services received similar to the service company structure.[213] Elimination of profit from service company affiliated transactions, or in this case, quasi-service companies, tends to make receipt of goods or services from a service company, or holding company, more economical to utilities than obtaining the same good or service from an unaffiliated, profit-seeking entity, all other things being equal.[214]

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

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subparagraph one, the rule compensates an affiliated entity for goods or services above the lesser of the fair market price or the fully distributed costs to the regulated gas corporation to provide the goods or services for itself, and it goes on. It's called the asymmetrical pricing – asymmetrical pricing model." See also 20 CSR 4240-40.015(2)(A) & (B).

[211] Ex. 135, p. 10.

[212] Id.

[213] Id.

[214] Id. pp. 10-11.

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.[215] 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.[216] 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.[217] 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 found no evidence in the course of its audit during this general rate case that Spire, Inc., or Spire Services, Inc., have a material purpose separate and apart from the operations and lines of businesses of their regulated and non-regulated affiliates, and no full-time employees or assets are assigned to either entity.[218] As such, Staff believes it would be inappropriate to require that Spire, Inc., or Spire Services, Inc., should be arbitrarily assigned to retain some level of corporate costs beyond the discrete adjustments Staff has recommended in the course of its audit. It is Staff's position that the current costs assignment and allocation procedures in effect for

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[215] Ex. 117, p. 6.

[216] Id.

[217] Id.

[218] Id.

Spire Missouri and its affiliates are reasonable and result in equitable compensation to Spire Missouri for affiliated services it provides.[219]

--Jamie Myers.

24. Depreciation:

What depreciation rates should the Commission order?

The Commission should 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.

Using the depreciation rates proposed by Staff will prevent an over-recovery of assets. Since the Company regularly maintains assets in the general plant accounts past their amortization period, an over-recovery can occur and has occurred in the past.[220] Staff will review the amortization of these accounts in each future rate case to avoid both over- and under-recovery.[221]

If the Commission orders the depreciation rates proposed by Spire witness Mr. Spanos, the Company should also be ordered to regularly retire any assets at the end of their amortization period.[222] Mr. Spanos states that Staff does not incorporate various factors of his depreciation study into their recommendation.[223]

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[219] Id. p. 7. See also Ex. 228.

[220] Ex. 128, Buttig Surrebuttal, p. 5, ll. 9-11, 17-19.

[221] *Id.* at p. 5, ll. 19-22.

[222] *Id.* at p. 6, ll. 3-7.

[223] Ex. 35, Spanos Rebuttal, p. 7, ll. 19-28.

However, companies are not required to use a depreciation study to support their recommended depreciation.[224]

For Accounts 381.1 and 382.2 (Smart Meters and Smart Meter Installation), Staff recommends the use of the depreciation rates included in the surrebuttal testimony of David Buttig. These rates were ordered by the Commission in Case No. GO-2020-0416.[225] There has been no new evidence supporting the change of these depreciation rates since they became effective on October 16, 2020.

--*Casi Aslin.*

26. Ultrasonic Meter Infrastructure:

What amounts should the Commission allow Spire to book to FERC accounts 381.1 and 381.2?

Spire Missouri has incurred costs by replacing some of its existing metering infrastructure with new ultrasonic meters. As noted in the rebuttal testimony of Staff witness J Luebbert,[226] Staff's recommendation was that the Commission not permit Spire Missouri to include the costs of the new ultrasonic meters in FERC subaccount 381.1, and further not permit Spire Missouri to include the costs of the ultrasonic meter installations in FERC subaccount 382.2.

However, after the June 9th technical conference in this case, where Spire Missouri provided all parties additional information regarding the replacements of existing meters with ultrasonic meters, and in view of additional information Staff gathered through the discovery process, Staff refined its recommendation regarding

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[224] Ex. 128 Surrebuttal of David T. Buttig, p. 4, l. 1-5.

[225] *Id.* at p. 8, l. 4-5.

[226] Ex. No. 115.

Spire Missouri's replacement of its existing metering infrastructure, as presented in the surrebuttal testimony of Staff witness J Luebbert.[227]

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.[228] 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.

Specifically, Staff recommends the Commission disallow 26% of the costs of the meters and the associated replacement costs. Based on Spire witness Mr. Rieske's rebuttal testimony, 26% of the existing meters Spire Missouri replaced with ultrasonic meters were less than 10 years old,[229] and thus, had not been required to be tested in accordance with Commission Rule 20 CSR 4240-10.030(19).

Additionally, Staff and OPC noted in testimony concerns that both parties have with the lack of information and justification Spire Missouri has provided for its meter replacements.[230] To address this going forward, Staff recommends the Commission order Spire Missouri to file quarterly reports that detail and describe the changes to

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[227] Ex. No. 133.

[228] Id. p. 4.

[229] Id.

[230] See Ex. Nos. 115, 133, 350, 352.

Spire Missouri's meter replacement strategy for each Missouri service area as well as justification for any changes in replacement strategy. Staff further recommends the justification should include, but certainly not be limited to, cost benefit analyses for changes in replacement strategy, alternative approaches Spire Missouri considered, and potential customer impacts of changes. When asked at the evidentiary hearing on Tuesday, August 3, 2021, Spire's witness Rieske stated that Spire would be willing to provide the Commission, and parties, with additional information on its meter replacements.[231]

--Jamie Myers.

30. Rate Adjustments to Account for Weather, Conservation, or Both ("WNAR/RNA"):

The Commission should adopt Staff's proposed Rate Normalization Adjustment ("RNA").

The Commission is authorized to approve, for Spire's residential class and small general service (SGS) class, "rate schedules authorizing periodic rate adjustments outside of general rate proceedings to adjust rates of customers in eligible customer classes to account for the impact on utility revenues of increases or decreased in residential and commercial customer usage due to variations in either weather,

[231] See Tr. Vol 11, pp. 251-252. "Q: Mr. Rieske, in response to several different questions from the Bench, you provided information stating that Spire had done various data collection or looked at different information. Is this the type of information that Spire would be willing to file with the Commission going forward? A: So much of the information we have already provided as part of data requests in this case. But I certainly think that we will be willing to have a dialogue around the data that we used to evaluate and make decisions about our meter equipment. Q: So you think Spire would be open to the idea of a quarterly report that would be filed with this Commission? A: I would support the idea of having a quarterly report because I think one of the issues I see here is that we have not had enough dialogue around this matter, and I think it would be an improvement for us to have it."

conservation, or both."[232] "Absent a statutory definition, words used in statutes are given their plain and ordinary meaning with help, as needed, from the dictionary."[233]

"Conservation" is not defined by statute.[234] Webster's Third New International Dictionary defines conservation as "[t]he wise utilization of a natural product especially by a manufacturer so as to prevent waste and insure future use of resources that have been depleted."[235] The Company's proposed definition of "conservation" cites no authority.[236] 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."[237] 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.[238] Accordingly, the Commission should adopt Staff's definition of "conservation," which is based on Webster's Third New International Dictionary and is sufficiently broad to capture many examples of conservation efforts.[239]

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[232] § 386.266.3, RSMo (Supp. 2020).

[233] *In Matter of Verified Application and Petition of Liberty Energy (Midstates) Corp.*, 464 S.W.3d 520, 525 (Mo. banc 2015) (quoting *Balloons Over the Rainbow, Inc. v. Dir. of Revenue*, 427 S.W.3d 815, 825 (Mo. Banc 2014)).

[234] § 386.266, RSMo (Supp. 2020).

[235] Webster's Third New International Dictionary 483 (1986); Exhibit 104 at 38 n.15 (Staff report Class Cost of Service).

[236] Exhibit 34 at 29:11-14 (Selinger Direct) (adopted by Weitzel Revenue Requirement Rebuttal, Exhibit 41 at 23).

[237] Exhibit 34 at 29:11-14 (Selinger Direct) (adopted by Weitzel Revenue Requirement Rebuttal, Exhibit 41 at 23).

[238] § 386.266.3, RSMo (Supp. 2020).

[239] Transcript 464-466; 471:12-20.

a. The Commission should adopt Staff's Proposed RNA and proposed usage blocks.

Under Section 386.266.3, RSMo (Supp. 2020), Staff proposes a Rate Normalization Adjustment ("RNA") designed to insulate the company from fluctuations in the residential and SGS classes' customer usage due to weather and conservation.[240] Spire's current mechanism, called the Weather Normalization Adjustment Rider ("WNAR"), is limited to weather fluctuations.[241] Staff's proposed RNA does not distinguish between conservation efforts initiated by the utility, such as the promotion of ratepayer-funded energy efficiency measures, and conservation efforts initiated by residential and SGS customers to wisely utilize natural gas and minimize waste.[242]

Staff's proposed RNA accomplishes its designed purpose of insulating the company from fluctuations in residential and SGS customer usage due to weather and conservation by dividing usage into blocks.[243] While the RNA is designed to adjust for weather and conservation, it is not possible to design a mechanism that completely avoids being affected by other incidental factors.[244] Even the currently effective WNAR is not immune from customer growth or customer attrition.[245] Staff's proposed usage blocks are necessary to find a dividing line between usage that varies due to weather

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[240] Exhibit 104 at 38 (Staff Report Class Cost of Service).

[241] Exhibit 104 at 38 (Staff Report Class Cost of Service).

[242] Exhibit 104 at 38-39 (Staff Report Class Cost of Service).

[243] Exhibit 104 at 38-39 (Staff Report Class Cost of Service).

[244] Transcript 473:13-16.

[245] Transcript 475:15-19. A customer leaving the system will offset a customer joining the system. Transcript 474:24-475:2.

and conservation and usage that varies due to the number of customers taking service.[246]

For residential customers, Staff's proposed RNA divides usage into two blocks. Block 1 encompasses all usage from 0 to 50 Ccf, and Block 2 encompasses all usage in excess of this amount.[247] 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.[248] For instance, as indicated in the tables on page 40 of Staff's Class Cost of Service Report, one percent (1%) of residential customers in the Company's West service area and one to two percent (1%-2%) of residential customers in the Company's East service area exceeded 50 Ccfs of usage in July, August, and September of 2020.[249]

For SGS customers, Staff's proposed RNA divides usage into three blocks. Block 1a encompasses all usage from 0 to 299 Ccf, Block 1b encompasses all usage from 300 to 599 Ccf, and Block 2 encompasses all usage in excess of those amounts.[250] Because customers can change between the SGS and Large Gas Service (LGS) customer classes, and because the LGS class is not subject to a weather and conservation adjustment mechanism under Section 386.266.3, it is more difficult to

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[246] Exhibit 104 at 40-41 (Staff Report Class Cost of Service).

[247] Exhibit 104 at 40 (Staff Report Class Cost of Service). The conversion of Therms to CCf is not expected to have a meaningful impact. *Id.*

[248] Exhibit 104 at 40-41 (Staff Report Class Cost of Service).

[249] Exhibit 104 at 40 (Staff Report Class Cost of Service).

[250] Exhibit 104 at 41-42 (Staff Report Class Cost of Service).

determine the break-points for the SGS class.[251] However, based on Staff's proposed realignment of SGS and LGS rate structures,[252] usage from 300 to 599 Ccf per month appears to reasonably capture the Spire SGS class's weather-sensitive usage by encompassing approximately forty to sixty percent (40%-60%) of SGS customers in heating months.[253] These blocks ensure the RNA accounts for weather and conservation, and not SGS customers switching rate classes.[254]

Staff's proposed RNA insulates the Company from fluctuations in Block 2 for residential customers and Block 1b for SGS customers.[255] Sales in these blocks are reconciled to rate case billing determinants.[256] The company retains the risk in Blocks 1 for residential customers and Blocks 1a and 2 for SGS customers.[257] The Company retains the opportunity to increase its return by increasing the number of customers taking service, but it retains the risk derived from decreases to its return by customers leaving the system.[258] For ratepayers, the RNA limits the degree to which residential ratepayers collectively under- or over-contribute, and passes along to residential ratepayers the benefit (or detriment) of increases (or decreases) in sales associated with customer growth (or loss).[259]

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[251] Exhibit 104 at 41 (Staff Report Class Cost of Service).

[252] Staff's proposal at page 28-35 of its Class Cost of Service Report is largely consistent with the parties' Partial Stipulation, paragraphs 40 and 41, filed on July 30, 2021. *Compare* Exhibit 104 at 28-35; *and* Partial Stipulation and Agreement at 14 ¶¶ 40-41 (EFIS No. 213, Jul. 30, 2021).

[253] Exhibit 104 at 41 (Staff Report Class Cost of Service);

[254] Transcript 466:1-13. Residential customers do not generally switch classes. *Id.*

[255] Exhibit 104 at 38-41 (Staff Report Class Cost of Service).

[256] Exhibit 104 at 39 (Staff Report Class Cost of Service).

[257] Exhibit 104 at 39-41 (Staff Report Class Cost of Service).

[258] Exhibit 104 at 29 (Staff Report Class Cost of Service).

[259] Exhibit 104 at 39 (Staff Report Class Cost of Service).

Compared to Staff's break points, which are based on the usage patterns of the Company and reasonably differentiate between usage that fluctuates due to weather and conservation and usage that fluctuates due to the numbers of customers taking service, the Company's proposed blocks are too low.[260] The Company's break points suffer several deficiencies. The Company's direct testimony is unclear how it developed breaking points of 30 Ccf for Residential customers and 100 Ccf for SGS customers.[261] For residential customers, the Company's attempts to justify its break point in its rebuttal testimony never backs away from the Company's unlawful definition of "conservation."[262] Lowering the usage blocks too much creates the risk that adjustments will account for factors other than weather and conservation, such as the number of customers taking service.[263] For SGS customers, to the extent the Company's breaking points were based on Ameren Missouri's DCA mechanism, there are differences in Ameren Missouri's general service rate classes, and Ameren Missouri's DCA was developed through an analysis of those classes.[264] Finally, the Company's proposed breaking point of 30 Ccf for Residential customers is intended to "minimize[] the Block 1 sales that would be subject to fluctuations due to weather and conservation."[265] Nothing in Section 386.266.3 requires the Commission to insulate the Company from all variations in usage due to weather or conservation.[266]

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[260] Exhibit 104 at 40-41 (Staff Report Class Cost of Service).

[261] Exhibit 123 at 3:5-4:3 (Stahlman Rebuttal).

[262] Exhibit 26 at 24-25 (T. Lyons Rebuttal Class Cost of Service).

[263] Exhibit 104 at 41:1-4 (Staff Report Class Cost of Service).

[264] Exhibit 123 at 3:5-4:3 (Stahlman Rebuttal); Transcript 470:15-24.

[265] Exhibit 26 at 24 (T. Lyons Rebuttal Class Cost of Service).

[266] § 386.266.3, RSMo (Supp.2020).

b. Staff's Proposed RNA avoids design issues present in the currently-effective WNAR.

Because Staff's proposed RNA is based on changes in actual sales, it does not depend on speculative deemed savings or generic load shapes based on general assumptions of how customers conserve energy.[267]

Staff's proposed RNA avoids design issues associated with the WNAR.[268] 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.[269] 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.[270]

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.[271] 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.[272]

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[267] Exhibit 104 at 40 (Staff Report Class Cost of Service); Transcript 473:6-8.

[268] Exhibit 104 at 40 (Staff Report Class Cost of Service); Exhibit 123 at 5:1-4 (Stahlman Rebuttal). Weather data came from the Midwest Regional Climate Center, which is associated with the National Oceanic and Atmospheric Administration (NOAA). Transcript 468:8-12.

[269] Exhibit 123 at 5:1-4 (Stahlman Rebuttal).

[270] Transcript at 463:1-5; 472:14-21

[271] Exhibit 123 at 4:10-20 (Stahlman Rebuttal); Transcript 461:11-17..

[272] Transcript at 461:11-17; 461:21-462:14.

Under Staff's proposal, adjustments under the RNA would be filed once per year, as opposed to the Company's currently-effective WNAR, which is filed twice per year.[273] By filing once per year, with rates to take effect prior to October 1, rates will be in effect for essentially all customers' winter usage.[274]

In contrast to the RNA, the Company's current WNAR is intended to adjust for weather only and not for conservation.[275] While there is interplay between weather and conservation, it is unclear how much conservation is actually accounted for in the WNAR.[276] For instance, in the example provided in the direct testimony of the Office of Public Counsel's witness, the size of the WNAR adjustment is larger than the actual change in usage under the conservation scenario.[277]

c. In the alternative, if the Commission were to adopt a WNAR or revised WNAR, Staff asks for WNAR filings that allow for sixty (60) days to review proposed tariff sheets instead of the current thirty (30) days for review.

While Staff recommends the Commission order the adoption of Staff's proposed RNA, if the Commission were to continue with a WNAR, Staff asks that the Commission require the Company to file updated WNAR tariff sheets sixty (60) days in advance of their proposed effective date.[278] The current thirty (30) days results in a Staff recommendation due within ten (10) to fifteen (15) days at the latest, and Staff has

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[273] Exhibit 104 at 40 (Staff Report Class Cost of Service).

[274] Exhibit 104 at 42 (Staff Report Class Cost of Service).

[275] Exhibit 104 at 38:20-21 (Staff Report Class Cost of Service).

[276] Exhibt 123 at 4:5-9 (Stahlman Rebuttal); Exhibit 138 at 3:8-23 (Stahlman Surrebuttal).

[277] Exhibit 138 at 3:17-21 (Stahlman Surrebuttal).

[278] Exhibit 123 at 4:16-20 (Stahlman Rebuttal).

found that it is difficult to complete its initial review and receive and review substitute tariffs in those ten to fifteen days.[279]

--Curtis Stokes.

CONCLUSION

In conclusion, on account of all the foregoing, Staff recommends that the Commission grant Spire Missouri a general rate increase amounting to approximately $31,324,406 for Spire East and $57,281,213 for Spire West, resolving each contested issue as Staff has recommended. In this way, just and reasonable rates will be set and all relevant factors considered, with due regard to the interests of the various parties and to the public interest.

WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law, determining just and reasonable rates and charges for Ameren Missouri as recommended by the Staff herein; and granting such other and further relief as is just in the circumstances.

Respectfully submitted,

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[279] Exhibit 123 at 4:16-20 (Stahlman Rebuttal).

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **7st day of September, 2021,** to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson