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	)	Case No. GR-2021-0108
Service Provided in the Company's	)	
Missouri Service Areas.	)	

SPIRE'S INITIAL POST-HEARING BRIEF

Spire Missouri Inc. (referred to herein as "Spire" or the "Company") respectfully submits its Initial Post-Hearing Brief in accordance with the Commission's February 3, 2021 *Order Setting Procedural Schedule*. This Initial Post-Hearing Brief will address the remaining contested issues to be resolved by the Commission using the same numerical sequence appearing in the Updated Schedule of Issues and Witnesses filed by the Staff of the Commission ("Staff") on July 30, 2021.

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I. Introduction and Executive Summary

This case represents the first time Spire has filed one rate case for both service territories in recognition that Spire is and intends to remain one Company. The Commission's approval of Spire's rate increase request would represent the first increase to the Company's base rates outside of Infrastructure System Replacement Surcharge ("ISRS") investments since 2013. In this case the Company has requested a base rate increase of approximately $111 million, of which $47 million is already being recovered in the Company's current ISRS rider. Taking these ISRS dollars into account, the Company's requested net increase is approximately $64 million. This translates into approximately a $3.28 per month increase to residential customers' bills, or a 5.5% increase. The Company's modest rate increase request was purposeful and sensitive to the fact that this filing was made during a pandemic. By contrast, other utilities have filed substantially higher increases during this period from 12%-33%. Even with this modest per customer increase, Spire's customers' bills still remain lower than they were fifteen years ago.

Since the Company's last rate case filing in 2017, Spire has invested nearly $1 billion to improve its distribution system infrastructure so that it may continue to provide the safe and reliable service that Spire's customers depend upon. For example, in fiscal year 2020 alone, Spire invested $311 million to replace 318 miles of aging infrastructure. These crucial investments must be considered in setting rates in this case.

An indispensable component of the regulatory compact is the setting of just and reasonable rates that permit Spire the opportunity to earn a fair rate of return that allows the Company to attract the capital necessary to make these crucial investments. The Commission is vested with the state's police power to set just and reasonable rates for utility services. Mo. Rev. Stat. 393.190.

A just and reasonable rate is one that is fair to both the utility and its customers. *State ex rel. Valley Sewage Co. v. PSC*, 515 S.W. 2d 845, 851 (Mo.App. K. C. 1974). In 1925, the Missouri Supreme Court summarized the balancing of competing interests in setting rates as follows:

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. *** These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors. *State ex rel. Washington University et al v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-5, 272 S.W. 971, 973 (Mo. Banc. 1925).

The infrastructure improvements completed by Spire not only enhance the safety and reliability of natural gas service, but also reduce leaks and greenhouse gas emissions. In fact, Spire has already reduced its methane emissions by more than 43% since 2005 and projects a nearly 57% reduction by 2025. Over the last five years, Spire's infrastructure replacement program has reduced leaks per 1,000 system miles by 66%. In addition to ensuring years of improved reliability, this new infrastructure has reduced the Company's maintenance costs. This accelerated infrastructure replacement is made possible by the ISRS statute, which requires the Company to file a general rate case once every three years in order to continue to utilize the ISRS mechanism. The mechanism is also subject to a statutory expenditure cap. Since the Company has already reached the statutory ISRS cap on the west side of the state, Spire filed this case to ensure the continuation of this critical program.

The Company has requested that the Commission set a return on equity ("ROE") at 9.95%, and maintain the Spire Missouri subsidiary capital structure similar to the one ordered in Spire's last rate case, consisting of 45.72% long term debt and 54.28 % common equity.

While recovery of the Company's capital investment is important, Spire also developed its case in consideration of feedback the Company received directly from its customers through Spire's Fresh Perspectives Program. The Company has held listening labs and focus groups throughout the state, allowing Spire to directly engage with customers about what is important to them and what they expect from Spire.

Through the Fresh Perspectives Program, Spire learned that in addition to reliable, safe, and affordable service, customers care about how they are served by Spire, and they care about the environment and our communities. Based on feedback received from Spire's customers, the Company sought to enhance the customer experience. Subsequent to the Company's last rate case Spire launched MyAccount, a 24/7 online portal used by nearly 700,000 of Spire's customers to manage their service online. MyAccount allows customers to access current and prior bills, make payments, view usage history, and obtain tips on ways to reduce their bills. Spire also learned that customers are interested in their energy usage and associated costs. As a result, in May of 2021 Spire launched a free online energy efficiency assessment tool for its residential customers. This new tool provides customers with insights on how to save energy and money through an interactive home energy report.

To minimize customer disruption, Spire also began offering two-hour appointment windows for service visits. Spire has steadily increased the availability of these convenient appointments, with the goal to have 20% of all appointment windows being two hours by the end

of 2021. The investment in programs, systems, service applications and employees are being noticed by our customers. As a result, Spire has seen improved customer service levels and fewer complaints.

It is apparent from the Company's direct filing that Spire is looking at additional ways to reduce its environmental footprint through voluntary customer participation, including through a carbon neutral program and a renewable natural gas initiative, which Spire will continue to pursue separately following the conclusion of this case.

One of Spire's primary objectives is to keep searching for ways to keep costs low for customers, as evidenced by the fact that customer bills are currently lower than they were 15 years ago. Spire is mindful that the COVID-19 pandemic has created hard times for some customers, and Spire responded to this global crisis in several ways. Near the onset of the pandemic, the Company voluntarily halted customer disconnects and suspended late fees. Spire also committed to contribute up to $1 million in shareholder dollars, assisting over 8,000 of Spire's customers impacted by COVID-19. Spire also assisted small businesses struggling during the shut-down, such as restaurants, by making $500,000 in unspent program funding available to eligible businesses to be used towards monthly bill payments. Spire will continue to assist its most vulnerable customers. To that end, in this proceeding Spire proposed improvements to the Payment Partner Program, which is designed to assist eligible customers in paying down their monthly bills. Spire also proposed to increase the customer assistance eligibility threshold from 185% to 200% above the Federal Poverty Level. Spire has also agreed, by virtue of the August 5, 2021 stipulation and agreement filed in this case, to several other program improvements that will directly benefit customers, including an annual Company contribution of $650,000 to the Payment

Partner Program. The improvements to the Payment Partner Program and increase in eligibility threshold are also part of the August 5, 2021 stipulation and agreement .

Additionally, the Company is proud of the collaboration among the parties in this proceeding that resulted in the resolution of 45 of the 54 issues included in the filed Joint List of Issues. While the Company had hoped to resolve all issues in this case, there remain nine critical issues for the Commission's determination. Spire will address them in the order the Commission heard the issues during the evidentiary hearing:

Depreciation. The first issue the Commission must determine is the appropriate depreciation rates. Spire has proposed new depreciation rates that are reflective of the assets in each of its respective service territories. The Company's depreciation rates have not been updated in nearly a decade and the rates fail to account for the current replacement program and technology improvements. Spire's 2020 Depreciation Study calculates the annual accrual rates for Spire's assets by account as of September 30, 2020, based on the most up-to-date service life and net salvage parameters. The Company asks the Commission to update Spire's depreciation rates as described in the depreciation study submitted as part of this case.

Capitalized Overheads. The Commission must also determine the appropriate amount of overheads to be capitalized to construction. This issue pertains to how much of the Company's general and administrative overhead supports capital projects. The Company's longstanding practice for calculating its overhead capitalization rates is performed in accordance with the FERC Uniform System of Accounts ("USOA"). Spire provides detailed O&M expense information both as part of its quarterly surveillance reporting and annual FERC Form 2. In the context of a rate case, additional information is provided to the parties in the Company's detailed general ledger.

However, Staff and the Office of Public Counsel ("OPC") now argue that despite the detailed information already provided, that they do not have enough information to determine the Company's compliance with the USOA. The solution proposed by Staff and OPC—to stop capitalizing overheads all together—is extreme and concerning. If the Commission were to order the Company to stop capitalizing overheads associated with its construction projects, those overheads would instead need to be expensed and recovered on an annual basis instead of over the life of the assets. This would more than double the revenue requirement, resulting in significantly higher customer rates. Given that the Company continues to be in compliance with the USOA, along with the extreme rate impacts that would result from the Company discontinuing the capitalization of overheads, Spire urges the Commission to find that the Company's methodology continues to be appropriate.

Ultrasonic Metering. Spire is also asking the Commission to approve Spire's investment in new metering technology, the ultrasonic meter. Technology is available to significantly improve upon the conventional meter design from the 1800's. In fact, the industry is moving away from producing these legacy gas meters. The evidence shows the incredible safety and accuracy benefits offered by the ultrasonic meter, at a minimal increase in cost. The Company has just begun installing these devices, and requests that the Commission allow the Company to recover the modest costs of installing these next generation devices that provide transformational safety benefits to customers and employees.

Corporate Allocations/Affiliate Transactions. The Commission must also make a determination regarding affiliate transactions. Spire and Staff agree that the Company's accounting allocations have been performed in compliance with its Commission-approved Cost Allocation

Manual, also known as the Company's "CAM", which governs transactions between Spire and its parent company and affiliates. However, OPC has questioned the Company's treatment of its affiliate transactions and has proposed massive cost disallowances as a result. The Company and Staff agree that there has been no harm to Missouri customers, and the Company's allocations should not be adjusted. In fact, Spire's ability to share the cost with other utilities results in lower costs for Missouri customers.

Cash Working Capital. The Company and Staff also agree that the appropriate lag time for cash working capital as it relates to income tax payments is 38 days based on the Internal Revenue Service's payment schedule.

Incentive Compensation. Consistent with Commission precedent, the Company and Staff have removed all earnings-based incentive compensation as part of this case, and agree that Spire should be permitted to implement two new incentive compensation metrics with a customer focus. OPC challenges both the proposed metrics and the inclusion of any incentive compensation expense in Spire's rates. The Company asks the Commission to include the two incentive compensation metrics in this case.

Rate Normalization Adjustment Rider ("RNA")/Weather Normalization Adjustment Rider ("WNAR"). Staff and the Company support an RNA rider mechanism that is currently being used by another Missouri regulated utility. The Company asks the Commission to approve Spire's proposed RNA with a residential block of 30 Ccf and a 100 Ccf breakpoint for small general service ("SGS") customers as the appropriate mechanism to adjust revenue for the effects of weather and conservation.

Net Operating Losses ("NOL"). Spire and Staff agree that the Company should continue to include in rate base its calculation of the Company's Net Operating Loss Carryforward ("NOL") as an offset to Accumulated Deferred Income Tax ("ADIT").

Cost of Capital. The Commission should set rates using a 7.23% weighted average cost of capital using Spire's actual capital structure consisting of 45.72% long-term debt at an embedded debt cost rate and 54.28% equity at a return on common equity ("ROE") of 9.95%. The Commission should reject OPC's extreme position on capital structure because it is contrary to Commission precedent and would destabilize Spire's credit rating during a period of inflation and widespread uncertainty in the financial markets. The ROE recommended by Staff and OPC are not supported by models and are inadequate relative to the national average of ROEs established for natural gas utilities. In setting the ROE, the Commission must rely on market models, and Spire is the only party that presented an ROE analysis based on the results of established modelling criteria.

Summary. Spire respectfully requests that the Commission set rates that allow the Company to recover its investments in the infrastructure crucial to providing essential natural gas service, and to set rates that permit the Company to earn a fair return on its investment, so that the Company may continue to attract that capital necessary to provide safe and reliable service to its customers. Spire requests that the Commission (1) find that the updated depreciation rates as proposed by Spire are appropriate; (2) find that the Company's methods are consistent with the USOA in capitalizing overheads, and allow the Company to continue this method; (3) acknowledge the significant safety benefits of ultrasonic meters and include those incurred costs in rates; (4) find that the Company is following its Commission approved CAM for affiliated transactions; (5) find that the appropriate Cash Working Capital lag day for income expense is 38

days; (6) find that the two incentive compensation metrics proposed by the Company are appropriate; (7) find that the RNA mechanism proposed by Spire is the best means of accounting for weather and conservation; (8) allow the Company to continue its practice of including NOLs in rate base as an offset to ADIT; and (9) maintain Spire Missouri's capital structure consisting of 45.72% long term debt and 54.28 % common equity and to set the Company's return on equity at 9.95%.

II. **Legal Standard**

In determining the rates Spire may charge its customers, the Commission is required to determine that the proposed rates are just and reasonable. Mo. Rev. Stat. 393.150.2. Spire has the burden of proving its proposed rates are just and reasonable. *Id.* In order to carry its burden of proof, Spire must meet the preponderance of the evidence standard.[1] In order to meet this standard, Spire must convince the Commission it is "more likely than not" that Spire's proposed rate increase is just and reasonable.[2]

In determining whether the rates proposed by Spire are just and reasonable, the Commission must balance the interests of the investor and the consumer. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

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[1] *Bonney v. Environmental Engineering, Inc.*, 224 S.W.3d 109, 120 (Mo. App. 2007); *State ex rel. Amrine v. Roper*, 102 S.W.3d 541, 548 (Mo. banc 2003); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 110 (Mo. banc 1996), *citing to Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979).

[2] *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez*, 936 S.W.2d at 109-111; *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).

In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.

Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia, 262 U.S. 679, 690 (1923).

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Id. at 692-93. The Supreme Court has further indicated:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient

> to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. at 603 (citations omitted).

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said: "[a]gencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances." *Federal Power Commission v. Natural Gas Pipeline Co.,* 315 U.S. 575, 586 (1942).

Further, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' ... Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.

State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

III. **Litigated Issues**

A. Issue No. 24- Depreciation

Executive Summary:

All Parties agree on one aspect of depreciation in this case—that one set of Spire depreciation rates should apply for both Spire East and Spire West. The primary issue before the Commission, then, is what depreciation rates the Company should use. The purpose of depreciation rates is to match the full service value of an asset, with the utilization of that asset over its useful life. In order to do this, a study must be undertaken that analyzes the life characteristics of the Company's assets, including drivers for replacement and retirements of those assets, as well as many other factors. The Company, through Gannett Fleming Valuation and Rate Consultants, LLC, conducted a depreciation study, which is included as Schedule JJS-R2 to Exhibit 35, Company witness John Spanos's Rebuttal Testimony. This study was provided to the parties to the case on December 28, 2020, shortly after the Company filed its direct testimony. The depreciation study calculates the annual accrual rates for Spire's assets by account as of September 30, 2020, based on the most up-to-date service life and net salvage parameters. The Company's current depreciation rates have not been updated since 2012 and as a result are no longer valid for the current plant in service.

Argument:

Spire filed a depreciation study in this case in Schedule JJS-R2 of John Spanos' Rebuttal Testimony (Exhibit 35) ("2020 Depreciation Study"). This is the best evidence before the Commission as to appropriate depreciation rates, as no other party has conducted a depreciation

study in this case. Current depreciation rates were set in 2012 and are long overdue for revision in order to align with proper recovery of the assets to which they are being applied over their useful life.

There are several disagreements between Spire, Staff, and OPC within the broad topic of depreciation. These disagreements include: a) whether the Commission should rely on the complete and most current set of depreciation data for Spire East and Spire West included in Schedule JJS-R2, or only outdated data compiled from Spire East; b) whether the Commission should approve the full implementation of general plant amortization for Spire's accounts; c) what rate the Commission should adopt for Spire's main accounts; d) whether the Commission should change the amortization period relating to the Enterprise Information Management System; e) whether the Commission should change the depreciation rate for ultrasonic meters and meter installations. These issues will be addressed in turn below. One issue that is resolved amongst the parties is that Spire East and Spire West should move to one consolidated set of depreciation rates for both Spire East and Spire West. *See, e.g.,* Ex. 200 (Robinett Direct), p. 1.

1. The Commission should rely on the depreciation study completed by Mr. Spanos in Setting Depreciation Rates for Spire East and Spire West.

The 2020 Depreciation Study analyzed historical data from Spire East and Spire West's records to determine recommended depreciation rates for all Spire assets. OPC proposes that Spire East's current depreciation rates from 2012 should be adopted for both Spire East and Spire West, subject to certain modifications discussed in subsections 2 through 5 of this issue. OPC's proposal disregards Spire's 2020 Depreciation Study in this case and ignores all historical evidence from Spire West. This is contrary to the established practice of matching depreciation rates to assets in

service. Ignoring the available historic data and experience from an entire division of Spire that will be governed by these rates is both illogical and contrary to accepted practices for the determination of depreciation rates. Therefore, the Commission should reject OPC's recommendation in favor of Spire's proposed depreciation rates.

Depreciation rates are based on the nature of the assets, the age of the assets, an understanding of the condition of the assets, the expected remaining life of the assets, the past recovery of the assets and the overall life cycle of the assets. Ex. 36 (Spanos Surrebuttal), p. 6. Although there are some similarities between Spire East and Spire West, it is not appropriate to ignore the factors of one entity in the determination of depreciation rates and instead rely only on factors of the other entity. *Id.* Therefore, the depreciation rates of Spire's assets should reflect all the factors of all the assets by class. *Id.*

The 2020 Depreciation Study contains historical data obtained from Spire West, including transaction entries from 1994 through 2020. Ex. 35 (Spanos Rebuttal Testimony), p. 3. The 2020 Depreciation Study also utilizes statistical components from Spire East and Spire West, including all forces of retirement and drivers for replacement at that time. The appropriate development of service life or net salvage estimates must include different practices or policies if they existed. *Id.* The 2020 Depreciation Study also incorporates consideration of past and future practices, type of assets in each account, Company plans, industry trends, estimates of other gas companies, and interpretation of the combined transactional data. OPC has no support for its recommendation that the 2020 Depreciation Study should be rejected; it is simple conjecture. OPC did not perform its own depreciation study. Ex. 202 (Robinett Surrebuttal), pp. 19-20. Mr. Robinett did not use informed judgment based on Spire East and Spire West's data—instead he relied on his experience

working on other depreciation cases since 2010. *Id.* This led him to recommend using Spire East's 2012 depreciation rates as the proposed combined depreciation rates for Spire East and Spire West in 2021. *Id.* In support of his selective use of Spire East's numbers, Mr. Robinett claims that he had "comfort" with the historical data from Spire East that goes back over 150 years. *Id.*

Regarding the 26 years of available data from Spire West, Mr. Robinett points to the fact that Summit Natural Gas of Missouri ("Summit") requested waivers from the depreciation study rule for lack of historical retirements in Docket Nos. GE-2014-0010 and GE-2020-0009. This is a red herring.[3]

In Summit's Application for Waivers Concerning Depreciation Study and Notice from GE-2020-0009 (Dkt. No. 1), Summit stated that its assets were "relatively new for gas utility property" and that it lacked a sufficient amount of "Company-specific historical information" such that a depreciation study would add expense without a corresponding benefit to Summit or its customers. *Id.* at 3. Summit had apparently kept records from 2010 and 2007 for its two operating divisions. *Id.* at 4. As an alternative, Summit offered to provide:

> a non-statistical depreciation review, preferably conducted by an experienced depreciation professional for the utility industry. The review by the depreciation professional would preferably include a tour of the [Summit's] physical plants, a

[3] OPC makes another weak argument that Spire did not "file" their depreciation study, but instead only supplied the study. Tr. Vol. X, p. 98. This apparently caused OPC to decide that it would not review the depreciation study until it was formally filed as schedule to Mr. Spanos' Rebuttal Testimony. *Id.* This argument is easy to dismiss. 20 CSR 4240-40.090 provides that a gas utility "shall submit a depreciation study, database, and property unit catalog to the manager of the commission's engineering analysis unit and to the Office of the Public Counsel." *Id.* at -(1) *and* -(1)(B). Nowhere in the regulation does it state that the depreciation study must be filed. As OPC readily admits that, Spire did "supply" the study to OPC. Tr. Vol. X, p. 98 ("It did supply its deprecation [*sic*] study, I will acknowledge that, but again, nothing was actually put into the record to support what it wanted."). Given that there is no formal filing requirement in the regulation, Spire's supply of the study was sufficient.

> review of current accruals and accumulated reserves, a review of retirement practices and records, and a review to justify or recommend changes to the depreciation rates currently in use by Summit. For the MGU and SMNG divisions, the review should provide a specific justification for each recommendation to adjust the FERC USOA plant account current depreciation rate or accumulated reserve amounts.

Id. at 4. The Commission granted the application, waiving the depreciation study for five years, provided that Summit file a non-statistical depreciation review. *See* Order Granting Waiver of Depreciation Study for Five Years, GE-2020-0009 (Dkt. No. 15).

The Summit case is an inapposite comparison to Spire's current case in several ways. The first and most obvious is that Summit made the decision to apply for a waiver instead of complying with a rule. Spire made the decision to comply with the Commission's rule, 20 CSR 4240-40.090. Next, Summit sought the waiver because it only had 9 years and 14 years, respectively, of divisional historic data. Notably, this only bought Summit 5 years—meaning Summit is required to file a depreciation study with 14 years and 19 years of data. Spire West *already* has 26 years of complete records, in addition to the 150 years of Spire East data. While Spire East and Spire West were different enterprises, they are now a part of one company, meaning that Spire West traditions, experience, and planning can be used to inform the Company's depreciation data. Finally, the Commission ordered Summit to file a proxy for a depreciation study that included a review by a depreciation professional who would investigate plant-specific data and file a report on findings from that investigation. Spire *did* take those steps, and its 2020 Depreciation Study incorporated all the non-statistical depreciation review elements that were ordered in the Summit case and more. OPC offers no support for its suggestion that the Commission ignore a portion of the available statistical data as provided in the 2020 Depreciation Study.

The Commission should rely on Spire's 2020 Depreciation Study to set depreciation rates in this case because it is the best, most complete, and only source to incorporate all available and relevant data for both Spire East and Spire West, the entities to which the depreciation rates will be applied.

2. The Commission should approve an amortization for Spire's general plant accounts.

The Commission should approve the rates provided in the 2020 Depreciation Study, which includes rates for general plant accounts that are designed to eliminate reserve deficiency or surplus and ensure future assets are properly recovered at a stable rate. Staff proposes an amortization of the Company's general plant accounts in a manner that supports the under-recovery of new assets placed in service. OPC disagrees with Spire's proposed amortization methodology, particularly Spire's proposed practice of setting the depreciation rate to 0% for vintage assets that are fully accrued but are not yet retired until approval of the practice is confirmed. Ex. 201 (Robinett Rebuttal), pp. 4-5.

Amortized general plant accounts are not depreciated in the same manner as other accounts because they do not utilize a mortality curve (survivor curve) and general plant account assets are all retired at the same age. Ex. 35 (Spanos Rebuttal), p. 18. The asset's age is consistent with the amortization period. *Id.* Therefore, when assets reach the end of the amortization period they need to be retired, or if they remain on the books then they must have a depreciation rate of 0%. *Id.*

Spire and Staff differ with respect to Accounts 391.00, 391.10, 391.20, 391.30, 393.00, 394.00, 395.00, 397.00, 397.10, 397.20 and 398.00. Based on Mr. Spanos' analysis, Staff did not properly segregate assets into vintage age groups reflecting i) not-fully-recovered assets, ii)

amortized-and-retired assets, and iii) assets that are amortized but not off the books that should have a depreciation rate of zero. *Id.* at 17. This method leads Staff to propose rates that will cause new assets to be under-recovered. *Id.* at 18-19. This under-recovery will cause a reserve deficiency and should be avoided. *Id.* at 19.

OPC disagrees with Spire's proposed practice of setting a 0% depreciation rate for all assets within an account that are fully accrued but are not retired. Ex. 201 (Robinett Rebuttal), pp. 4-5. OPC suggests that Spire should continue to book depreciation expense for assets as long as they are on the books and not retired. *Id.* at 5. OPC believes that this methodology will result in under-recovery of new assets as old assets are retired because the new depreciation rates do not reflect the full life of the assets since it is being weighted and reduced by assets that have been fully recovered by Spire. *Id.*

First, it is critical that assets beyond the amortization period have a depreciation rate of zero because they have been theoretically fully recovered. Ex. 36 (Spanos Surrebuttal), p. 5. Second, as part of the application of the 2020 Depreciation Study and proper implementation of amortization accounting (square curve) the assets beyond the amortization period need to be retired. *Id.* The assets that are within the amortization period by vintage should maintain the amortization rate as set forth in the 2020 Depreciation Study. *Id.* This process ensures full recovery of the existing assets and that future assets in each asset class will be placed in service with the proper recovery rate. *Id.*

The underlying goal of amortization accounting is to avoid any over- or under-recovery. *Id.* at 5-6. The manner in which the accounts are subdivided in the 2020 Depreciation Study allows for the appropriate rates to be determined and addresses the concerns that OPC raises. *Id.* The

Company's presentation of depreciation rates is consistent with the amortization period and segregating the assets in order to ensure full recovery, no more and no less, has been established. *Id.* Under the Company's proposal, new investment will specifically be recovered consistent with the amortization period and while the assets are in service. *Id.*

3. The Commission should adopt Spire's depreciation rates for Spire's mains accounts.

As shown in the 2020 Depreciation Study, the proper recovery of all cast iron main related assets can be achieved by the end of 2030 based on the requirements of the cast iron main replacement program. OPC does not reflect this requirement in its proposal.

During the completion of the Company's depreciation study, Mr. Spanos met with Company employees to ask questions about future plans, particularly those related to the main replacement program. The 12.35% depreciation rate for cast iron mains includes both the Company's historical experience as well as future planning. This provides the most accurate rate with the least impact to Spire's customers.

4. The Commission should change the amortization period relating to the Enterprise Information Management System to ten years.

The Enterprise Information Management System is a software system that Laclede Gas Company developed from 2011 to 2012 and was designed to provide enhanced accounting tools, cross-functional communication, data tracking and analyses, and other essential business processes in the areas of customer service, billing and information, financial performance, supply

chain/inventory, human resources and asset management.[4] When Spire first applied for a depreciation rate for this account, it was assigned a 15-year life based on Spire's plans at the time, as well as projections for the viable useful life of the software. *See* Report and Order, GO-2012-0363 (Dkt. No. 49) *and see Id*. at 7 ("The most commonly utilized life for purposes of establishing depreciation rates for those new systems has been 12-15 years."). Staff recommends maintaining the current 15-year rate, stating that Spire does not provide evidence for a shortened average life for these assets. Ex. 128 (Buttig Surrebuttal), p. 7.

Spire contends that it has provided sufficient support for a new rate for this account as part of the 2020 Depreciation Study and which is further explained in Mr. Spanos' testimony. Mr. Spanos points out that software applications are continually being upgraded, in the utility and many other modern industries, and the functionality of each application is being improved to handle more applications. Ex. 35 (Spanos Rebuttal), p. 16. Therefore, the service life for the original and subsequent applications is not reaching the 15-year threshold that was originally planned. *Id.* Spanos recommended an average life of 10 years as depreciation should match recovery to utilization of an asset systematically and rationally. *Id.* at 16-17.

[4] "Verified Application for an Order Establishing a Depreciation Rate for the Company's New Enterprise Information Management System," GO-2012-0363 (Dkt. No. 5).

5. The Commission should maintain the depreciation rates for ultrasonic meters (Account 381.1) and meter installations (Account 382.1) established in Case No. GO-2021-0416.

A forecasted life of 20 years and resulting depreciation rate of 5 percent was initiated by Spire in its Depreciation Authority Application in Case No. GO-2021-0416 in order to have a more appropriate depreciation rate in place until an analysis of the Ultrasonic Meters and Installations was conducted. Without the Depreciation Authority order for Ultrasonic (Smart) Meter assets, the Company would be forced to use a rate for plant accounts that had already been authorized but contained assets with dissimilar characteristics to those of the new Ultrasonic Meter assets. While Spire's 2020 Depreciation Study supports a depreciation rate change for accounts 381.1 and 382.1, the Company can accept depreciation rates consistent with Case No. GO-2021-0416, until such further analysis of the life of ultrasonic meters and installations have been conducted.

B. Issue No. 15 - Capitalized Overheads

Executive Summary:

OPC and Staff allege that the methodology and process used by Spire to calculate its capitalized overheads is not in accordance with the Uniform System of Accounts ("USOA") provisions that apply to such calculations.

The Company disagrees. Spire calculates its overhead capitalization in accordance with the USOA, using a reasonable and acceptable approach that is consistent with its historical practice and charges overheads that are "reasonably applicable" to its projects.

Further, as noted by past Commission cases, Paragraph (4) of 20 CSR 4240-40.040 allows the Commission to issue orders contrary to the USOA where appropriate:

> (4) In prescribing this system of accounts the commission does not commit itself to the approval or acceptance of any item set out in any account, for the purpose of fixing rates or in determining other matters before the commission. This rule shall not be construed as waiving any recordkeeping requirement in effect prior to 1994.

Thus, the Commission may deviate from the USOA where it believes appropriate without the need for a formal waiver or variance.

As explained in further detail below, the context of this issue is critical. A Commission finding in favor of the OPC and Staff position would likely result in a substantial increase to Spire's revenue requirement, either in this case or in future cases. Thus, utilizing a known and consistent method of overhead assignment provides for not only the use of a reasonable assignment methods, but also rate stability for Spire customers.

Argument:

1. Nature of Costs

In analyzing this issue, it is important to understand the nature of the costs at issue. First, the USOA contemplates capitalizing certain costs that would otherwise be expenses. Staff witness Young stated that "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 indirect capital costs." Ex. 125 (Young Rebuttal), p. 2.

Second, the costs at issue are those that have been incurred by Spire itself or have flowed through Spire Services to Spire. Tr. Vol. X, p. 145. No witness challenges the prudence of Spire's costs that form the basis for the capitalized overheads. Tr. Vol. X, p. 147. This is not a question

about the prudence of expenses, only whether they are recovered as part of construction overheads or as O&M expense. Ex. 17 (Krick Surrebuttal), p. 7.

Again, the Commission's decision is not whether to allow or disallow the subject costs. The question is whether those costs should be capitalized or expensed. Tr. Vol. X, p. 145.

2. USOA Gas Plant Instruction 4

USOA Gas Plant Instruction 4 is the USOA provision that is relevant to this matter. USOA Gas Plant Instruction 4 states as follows:

> 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 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 payroll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. ***The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.***
>
> C. For Major utilities, the records 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 electric plant account, and the bases of distribution of such costs.

Ex. 140 (Young Surrebuttal), Sch. MRY-S3, pp. 563-564 (emphasis added).

As an initial requirement, the USOA requires only that the expenses at issue be "charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto."

The Staff and OPC witnesses focus on those aspects of USOA Gas Plant Instruction 4 B that discuss direct time assignment and special studies. However, what the USOA prohibits in the last sentence of USOA Gas Plant Instruction 4 B is the use of "arbitrary percentages or amounts." Tr. Vol. X, p. 148 (emphasis added).

3. Not Arbitrary and Reasonably Applicable

"Arbitrary" is defined as follows:

> Not done according to reason or judgment; depending on will alone; absolutely in power; capriciously; tyrannical; despotic. Without fair, solid, and substantial cause; That is, without cause based upon the law, not governed by any fixed rules or standard. Ordinarily, arbitrary is synonymous with bad faith or failure to exercise honest judgment and an arbitrary act would be one performed without adequate determination of principle and one not founded in nature of things.

Black's Law Dictionary 55 (Ab. 5th Ed. 1983) (emphasis added).

Spire capitalizes overheads using a systematic and consistent approach that primarily relies on cost causation factors to estimate the relationship of certain overhead costs to construction activities in lieu of studies. Tr. Vol. X, pp. 136-137. The methods utilized by Spire to capitalize overheads are very common and are widely used throughout many industries. Ex. 16 (Krick Rebuttal), p. 10. These methods are based on "reason and judgment" and are not arbitrary.

Staff witness Young described the Spire process as using "the direct labor charges as the basis of distributing overhead payroll costs." Ex. 140 (Young Surrebuttal), p. 17. He further

explained that "Spire has assumed there is a relationship between how construction employees use their time and how a supervisor's time is used." *Id*.

Spire witness Krick acknowledged that one of the primary relationships the Company uses is field direct labor as a percentage of total field labor. Tr. Vol. XI, p. 40. That drives a lot of activity to the Company as it relates to construction activity. *Id*. Spire also has various causal factors within the operation—vehicle usage is one, and other types of overheads that get consumed in the construction process. *Id*. While the Company uses direct labor for a lot of its A&G costs, there are other overheads that are addressed through other types of cost causation drivers. *Id*.

Mr. Krick further described this process as follows:

> . . . direct labor is one of the key variables that is used to allocate a part of the overheads, both direct and indirect in nature, that have a relationship to construction and capital spend activities, including Administrative and General (A&G) expenses. In my opinion, the ratio of direct labor is a reasonable method to determine and estimate the costs associated with construction activity for certain A&G expenses.

Ex. 17 (Krick Surrebuttal), p. 9, l. 19 – p. 10, l. 2.

The Company maintains records of time charged by each employee within the Company's time keeping system and there are areas where cost studies are performed, such as square footage allocations. Ex. 17 (Krick Surrebuttal), p. 11.

The factors used are not fixed, but rather, are updated monthly, as the level of construction activities vary throughout the year and seasons. Spire updates the causal relationship at least annually in the budgeting process. Tr. Vol. X, pp. 140-141. However, when it comes to allocating overheads to capital, Spire reviews and adjusts the overheads on a monthly basis. Tr. Vol. X, p. 141.

Spire's process is based on reason and judgment and, therefore, is not "arbitrary." This Commission made a similar finding in its *Report and Order*, in the case *In the Matter of the Application of Spire Missouri, Inc., et al.*, Case No. GO-2019-0356 and GO-2019-0357 (October 30, 2019), p. 29:

> P. Since Spire Missouri allocated overhead costs consistently with how these costs were allocated in its last general rate cases, it did not add arbitrary percentages or amounts to its overhead costs. ***The Commission concludes that Spire Missouri's treatment of overheads for purposes of these cases is allowable according to the USOA.*** Further, Section (4) of 20 CSR 4240-40.040 allows the Commission to vary from the USOA where appropriate.

(emphasis added).

Spire's process for assigning overheads to capital investment has not fundamentally changed since that time. Spire witness Krick confirmed that "[a]lthough the process and systems used to capitalize overheads has changed in recent years, the underlying and fundamental approach is consistent with the practice used for decades." Ex. 16 (Krick Rebuttal), p. 10. The referenced changes concern only the enhancement of systems to provide more transparency that took place in fiscal year 2020. Tr. Vol. X, pp. 135-136.

The methods are also consistent with how cost of service was determined by the Company in filing the current case and the 2017 rate case and for cases going back for many years. *Id*. at p. 10, l. 25 – p. 11, l. 1-2. Also, because the Company has fundamentally used the same methods for many years, there have also been no changes to methodologies for the purpose of altering net income. Ex. 17 (Krick Surrebuttal), p. 12.

In the ISRS case referenced above, the Commission indicated that "decisions varying from the methods in a general rate case are best handled during the course of a rate case when there is

more time for a full examination and all rate factors are being reviewed." *In the Matter of the Application of Spire Missouri, Inc., et al.*, Case No. GO-2019-0356 and GO-2019-0357, *Report and Order*, p. 42 (October 30, 2019). This current rate case is that opportunity for a full examination and the Commission's answer should be the same—"Spire Missouri's treatment of overheads for purposes of these cases is allowable according to the USOA."

4. Revenue Requirement Impact

In this case, the amounts at issue have been capitalized and no provision is made in Staff's revenue requirement for treatment of any of the previously capitalized amounts as expense going forward. Tr. Vol. X, p. 146.

Any restriction as to Spire's ability to capitalize overheads would necessitate a substantial immediate increase to Spire's revenue requirement. This is because costs that are currently being allocated to capital and recovered over the life of those assets would instead be shifted to expense and recovered on an annual basis. Ex. 16 (Krick Rebuttal), p. 14. Staff explained this relationship as follows:

> The impact of reflecting these discretionary decisions for ratemaking purposes is a trade-off from the ratepayer's perspective. In the ratemaking process, choosing to charge customers for a cost through rate base instead of the income statement will generally cause three changes to the revenue requirement; 1) overall expenses will be reduced, 2) depreciation expense will increase and, 3) the calculated rate of return will increase. In this circumstance, the net impact would likely be an immediate reduction to the revenue requirement, which would appear to be a ratepayer benefit. However, if the cost is continued to be capitalized into rate base, the increase to depreciation expense and the required rate of return accumulates year after year while the rate reduction from decreased expense remains constant, if all else is held equal. Over time, the incremental increases to the revenue requirement will exceed the decrease in expense, which may not be in the interest of ratepayers.

Ex. 101 (Staff Rep. COS), p. 31.

All else being equal, shifting amounts from capital to expense, in the near term, will increase Spire's revenue requirement and therefore increase future customer rates. Ex. 17 (Krick Surrebuttal), p. 12. This is because a high-level, "back of the envelope" estimate for the revenue requirement impact of capitalized amounts is about 10%. Tr. Vol. X, p. 150. Thus, for example, if $100 million is capitalized, all else being equal, you would expect an increase in annual revenue requirement of about $10 million. Tr. Vol. X, pp. 150-151. Reasonable expenses are generally recovered dollar for dollar. Thus, if that $100 million in the above example is not capitalized, but instead expensed, Staff witness Young would expect a net increase to annual revenue requirement in the range of $70 million to $80 million. *Id.*

Company witness Krick calculates that the change suggested by Staff and OPC could result in an increase of as much as $115 million in the Spire's annual revenue requirement. Ex. 17 (Krick Surrebuttal), pp. 7-8. This type of rate "whiplash" is neither good for the customers, nor the Company.

OPC witness Schallenberg also recognized this relationship. He stated that the adjustment he proposed "will result in an increase in expense if not offset by other issues . . ." Ex. 205 (Schallenberg Surrebuttal), p.2. Mr. Schallenberg further stated that he would "estimate the amount to be <u>significant</u>." *Id.* (emphasis added).

5. Documentation

The general ledger contains transaction level support for these costs. The general ledger maintains each and every detail of every transaction that could be in the form of an invoice by a third party. Tr. Vol. X, p. 139. That could be a time record of an employee, and that could be a

general ledger of entry. *Id*. Within general ledger, the Company also has subledgers that maintain additional details of each and every one of those transactions. *Id*.

In spite of this detail, Staff witness Young suggested that the documentation of capitalized overheads was not sufficient for him to audit those amounts. Ex. 101 (Staff Rep. COS), p. 32. Spire proactively worked with all parties throughout this proceeding, especially on this matter, and even had a technical conference to provide clarity. Ex. 16 (Krick Rebuttal), p. 13. Spire Exhibit 46 makes it clear that Spire was working with Mr. Young prior to the filing of the Staff Report – Cost of Service in an attempt to provide additional information. Among other things, it was explained to Mr. Young via email on May 3, 2021 that Spire could provide detail by Costs Element on the work order, but that "there are a few thousand of these and that would take some time and work to pull." Spire Ex. 46, p. 2.

Mr. Young responded on May 4, 2021 as follows:

> Regarding the cost element by work order, I think that would help me but if it includes mounds of data, I likely wouldn't have time to process it before Staff files anyway. Let's come back to this after our filing and see what is needed to clear up some confusion.

Spire Ex. 46, p. 1; *see also* Tr. Vol. X, p. 167. During the hearing, Mr. Young indicated that he never followed up with Spire after this exchange. Tr. Vol. X, pp. 167-168.

As mentioned above, Spire had a technical conference in attempt to further address the allegation that capital overheads are not readily identifiable in Spire's books and records. Ex. 17 (Krick Surrebuttal), p. 9. That technical conference was held on June 9, 2021. *Id*. Similar to the e-mail exchange found in Spire Exhibit 46, no further data requests were submitted by Mr. Young after that June 9, 2021 meeting. *Id*.

Capital overheads are readily identifiable in Spire's books and records. Ex. 17, (Krick Surrebuttal), p. 8, l. 12 – p. 9, l. 8. The general ledger, of which the Company provided a copy during this case, contains transaction level support for all of these costs. *Id*. at p. 9, l. 3-5.

6. Staff Proposed Remedy

As a consequence of its position, Staff recommends, that "the Commission should 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 a time that Spire can demonstrate its compliance with the USOA." Ex. 125 (Young Rebuttal), p. 5; Ex. 101 (Staff Rep. COS), pp. 31-33.

This proposal is unworkable for several reasons. First, as indicated above, Staff has made no provision in its revenue requirement for any currently capitalized amounts to be recovered as expenses. The costs at issue have been prudently incurred and are reasonable. They must be addressed as either capital or expense. "Neither" is not an appropriate answer.

Second, it is unclear when or how Spire will decide that Spire has "demonstrated its compliance with the USOA" to Staff's satisfaction such that Spire can return to the capitalization of overheads. Staff witness Young indicated that he "had envisioned that Spire and Staff and Public Counsel would cooperate and provide status reports to Commission, and decide how to implement that in Spire's general rate cases." Tr. Vol. X, p. 153.

If Spire has "ceased capitalizing non-operational overhead costs," this is not an issue that can just wait until the next rate case for determination. It will have a profound and immediate impact on financial statements.

Thus, if the Commission were to consider the Staff recommendation, at a minimum, it should also consider authorizing the establishment of a regulatory asset/liability to address the treatment of those expenses in the next general rate case. OPC witness Schallenberg suggested something similar in his Rebuttal Testimony when he stated that "[i]f the matter should be addressed in this case then a regulatory asset/liability should be formed capturing the amount of overhead that has not been appropriately included in revenue requirement offset by the amount of overhead that would been recorded as expense in this case." Ex. 204 (Schallenberg Rebuttal), p. 22.

7. OPC Tracker

OPC witness Schallenberg proposed that 1) "a tracker be authorized to ensure that Spire's general overhead is not allowed to be over-recovered. . ."; 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"; 3) "Spire Missouri report quarterly information regarding overhead capitalization to allow monitoring of the dollar impact of Spire Missouri's practices"; and, 4) "that Spire Missouri report each fiscal year the amount of overhead capitalization that the Company cannot show the definitive relationship to construction . . ." Ex. 203 (Schallenberg Direct), p. 25, l. 19 – p. 26, l. 5.

In terms of the proposed tracker, the amount of overhead included in cost of service is measured by the test year and any applicable items through the true-up period. It is not clear how a tracker for overheads would be applicable to this situation or could be reasonably measured and

implemented. Ex. 16 (Krick Rebuttal), p. 14. It was further clear during the hearing that Mr. Schallenberg also did not have a good explanation for how this tracker might work. *See* Tr. Vol. X, pp. 180-181.

As to the policies and procedures, Spire witness Krick notes that the Company already has appropriate policies, procedures, processes and internal controls over financial reporting. Further, the Company's general ledger already tracks these processes in "the greatest detail." Ex. 16 (Krick Rebuttal), p. 14.

As to additional quarterly reporting, Spire already provides a surveillance report quarterly that includes financial information of a similar nature. The Company would consider any reasonable requests for changes to that report that better meet OPC's needs. *Id.*

As to the annual reporting, the Company believes that the identified reporting is unnecessary. Any amounts not considered to have a definitive relationship to construction are expensed as part of O&M. The Company provides a summary of O&M expenses in quarterly surveillance reporting and FERC Form 2. Moreover, a copy of the general ledger that has each detail that comprises O&M is also provided to the parties within each rate case. *Id.*

8. Conclusion

Spire's approach to the capitalization of overheads has provided stability for its customers and the Company in terms of rate impacts over many years. No changes are necessary to the overhead capitalization amounts. However, if on a going forward basis the Commission believes that a special study, or studies, are necessary or desirable, Spire is very much willing to conduct such studies, share those results with the parties, and modify its procedures when rates are next set, if appropriate. Ex. 17 (Krick Surrebuttal), p. 10.

C. Issue No. 26- Ultrasonic Meter Recovery

Executive Summary:

Spire has begun installing the next generation of residential gas meters that measures gas ultrasonically, rather than by the operation of a conventional diaphragm. These devices deliver exceptional benefits to Spire's customers right out of the box. These benefits primarily fall into four categories: (1) customer safety, (2) employee safety, (3) accuracy, and (4) reliability. Importantly, customers receive these benefits immediately when an ultrasonic meter is installed at their home or business—no network is required. All parties agree that Spire has not yet incurred any network costs, and none are at issue in this case. Tr. Vol. XI, p. 274, l. 25 – p. 275, l. 6.

Argument:

1. Ultrasonic Meters Deliver Safety and Other Customer Benefits

The primary benefit of ultrasonic meters is safety. The device continuously measures the flow of natural gas into the home and contains a valve that automatically shuts off the flow of gas to a home when the meter senses an open fuel run. This automatic shut off prevents the home from filling with gas and will prevent explosions and fires from incidents such as copper theft from an unoccupied home. The ultrasonic meter is the first device Spire has ever been able to utilize to proactively manage the safety of customer side piping beyond the meter.

The automatic shutoff valve is also triggered when the device senses other conditions that present a safety concern. For example, the ultrasonic meter contains a temperature sensor which will automatically shut off the flow of natural gas when it detects a temperature of 176 degrees. The 176 degrees threshold was arrived at through careful study, as 176 degrees is the approximate

temperature a meter would reach when a house fire is in close proximity to the meter. Tr. Vol. XI, p. 235. The activation of the automatic shutoff valve at this temperature will prevent fires from being fueled by natural gas. The Itron 400 series meters, which Spire will soon begin deploying for some customer applications, also contain an inlet pressure sensor which will activate the automatic shutoff valve when a system overpressure event is detected. Tr. Vol. XI, p. 216, l. 20 - p. 217, l. 6. This feature may help prevent incidents such as the Merrimack Valley explosions.

The safety benefits of the ultrasonic meters cannot be undervalued. For an incremental cost of merely $25 per meter, or just over a dollar a year over the life of the asset, the new ultrasonic technology has the capacity to save the life of a Spire customer or employee. When questioned as to his professional opinion as an economist, regarding the value of a life, OPC witness Geoff Marke cited a U.S. government standard of between $2 million and $10 million. Tr. Vol. XI, p. 278, l. 25 - p. 279, l. 18. While Spire is mindful of the grim reality in quantifying the benefit to avoid a fatality, the small incremental cost associated with an ultrasonic meter must be recognized. The ultrasonic meter also has the capability to be turned off via a remote control that will be deployed to Spire field technicians. This will allow them to make buildings gas safe without needing to approach the structure to physically turn off the meter valve. Spire's current diaphragm meters do not have a remote shutoff feature. Tr. Vol. XI, p. 217.

Spire's customers deserve reliable, accurate, and consistent meter readings. The ultrasonic meter also delivers game-changing measurement accuracy to Spire's customers. The device uses ultrasonic measurement technology in place of the diaphragm technology invented in the 1800's. The old technology relies on a series of moving parts, which tend to degrade and break over time. When this happens, accuracy suffers. By contrast, the ultrasonic meter has no moving parts, and

delivers incredible accuracy both out of the box, and for the entirety of its service life. Ultrasonic meters are twenty times more accurate than diaphragm metering technology, and this accuracy does not degrade over time. Ex. 33 (Rieske Surrebuttal), p. 8. An ultrasonic meter is delivered with accuracy to +/- 0.1% versus the accuracy of +/- 2.0% in diaphragm meter technology. Ex. 32 (Rieske Rebuttal), p. 11.

2. Incremental Cost of Ultrasonic Meters Are Negligible

The meter itself costs just $25 more than a traditional diaphragm meter and will have a 20-year service life. That means that Spire can deliver all of these benefits for just $1.35 per year of incremental cost. Ex. 33 (Rieske Surrebuttal), p. 9.

To place these incremental costs into context, had Spire utilized diaphragm replacement meters for every residential ultrasonic meter installed during the test year in this case, the cost would have been $8,488,900 (Account 381.1) versus the $9,813,750 spent for the ultrasonic meters. Installation costs in Account 382.2 would have remained the same. Spire believes the compelling safety benefits and superior accuracy of the ultrasonic meters absolutely justifies the incremental costs.

3. External Factors Require a Change in Metering Equipment Now

Even if Spire was not convinced of the incredible benefit and value of transitioning to ultrasonic meters, changes in technology would have pushed the Company to the same result.

Spire's current diaphragm meter supplier has advised the Company that, by the end of 2021, it will cease all production of METRIS and I-250 gas meters. Ex. 32 (Rieske Rebuttal), Schedule JAR-R2. While the Company could continue to pursue other antiquated diaphragm

meters from small, unproven manufacturers going forward, given the enhanced benefits associated with ultrasonic meters, this path is simply illogical. Ex. 32 (Rieske Rebuttal), p. 13.

Further, in Spire East, network meter reading services are provided to Spire by Landis & Gyr, a third-party meter reading service. Landis & Gyr has advised the Company in writing that it will terminate Spire's network meter reading service contract effective April 1, 2025, with no possibility of further extension. Landis & Gyr's proprietary system is built on hardware and software that is obsolete and troublesome to continue to keep operational, so their intent is to retire the entire system. Tr. Vol. XI, p. 248, l. 23 - p. 249, l. 5. This decision will require Spire to, at a minimum, physically change all Spire East metering equipment. Ex. 33 (Rieske Surrebuttal Testimony), Schedule JAR-SR2. This presents a unique opportunity to bring major safety and accuracy enhancements to customers at little marginal cost.

4. Staff and OPC Recommendations Are Not Appropriate

20 CSR 4240-10.030(19) requires meters over ten years old to be removed and tested for accuracy. Spire obtained a variance from this rule in 1996, which allows for statistical sampling to determine the accuracy of groups of meters (grouped by size and type) that are ten years old or older. At ten years, Spire begins pulling out a military statistical sample of every meter vintage year for testing. Once tested, based upon the accuracy of a particular group, Spire targets underperforming groups of meters for more accelerated replacement. Tr. Vol. XI, p. 230. Of the ultrasonic meters that were installed to replace an existing meter through May 20, 2021, 74% of the meters replaced were over ten years old, underperforming, and already mandated for replacement by Commission rules. These meters required replacement, regardless of the type of replacement meter installed, whether it be diaphragm or ultrasonic.

As Spire witness Mr. Rieske testified at the evidentiary hearing, it costs Spire $221 per meter to refurbish an existing diaphragm meter and return it to service. Tr. Vol. XI, p. 230, l. 24 - p. 231, l. 2. Conversely, replacing a meter with a new ultrasonic meter is less costly than refurbishing a substandard meter that lacks the outstanding safety benefits of the ultrasonic meter. It makes no sense to spend more money to deliver an inferior device to customers.

Staff recommends that the Commission disallow 26% of the costs Spire booked in FERC subaccounts 381.1 and 382.2. Ex. 133 (Luebbert Surrebuttal), pp. 4-5. Staff's recommendation appears to be based upon an inaccurate interpretation of Mr. Rieske's statement that "of the 41,373 ultrasonic meters we have installed to date, 74% of replacements were meters that were already mandated for replacement by Commission rules." Ex. 32 (Rieske Rebuttal), p. 16. Staff wrongly assumes that if 74% of meters were mandated for replacement, 26% of meters should not have been replaced by Spire. Staff's overly simplistic mathematical assumption is deeply flawed. In the normal course of business, Spire has meters that break or have operational problems. Spire witness Jim Rieske testified that historically, about 20% of the replacements Spire has performed were of meters less than ten years old that had an operational issue. Tr. Vol. XI, p. 243. On cross examination, Staff witness Luebbert admitted that he did not know how many of the 26% of the replaced diaphragm meters that were less than ten years old were replaced because they were damaged, broken, or otherwise not functioning properly. Tr. Vol. XI, p. 265. Yet, Mr. Luebbert did concede that some of those meters would have needed to have been replaced prior to ten years. *Id.*

Staff and OPC criticized the Company at hearing for not having conducted a cost-benefit study or formal analysis of new metering options. However, the decision to implement ultrasonic

meters as the residential meter standard, with the benefits described above, came from a series of studies evaluating meter technology beginning in the fall of 2018. Ex. 33 (Rieske Surrebuttal), pp 5-8. These studies found the following factors around existing diaphragm metering:

- Testing records confirmed that the overall metering accuracy degrades as the population of meter ages.
- Aging meter populations have increasing mechanical failures that have resulted in extensive field maintenance programs.
- The increase in mechanical failures results in increased effort and expense required to acquire monthly billing reads.
- The mechanical meter components are prone to breakage regardless of age. Significant numbers of meter replacements are meters that have been in service for less than 10 years.
- The combination of all these factors expands the back-office effort required to confirm the accuracy of reads to use for billing.
- The practice of refurbishing a diaphragm meter at a cost of $221 a meter is not a cost-effective practice. Ex. 33 (Rieske Surrebuttal), pp. 5-8.

These studies led Spire to the conclusion that the existing diaphragm meter populations needed to be replaced at a more aggressive rate. These studies demonstrated that it did not make financial sense to refurbish a diaphragm meter at a cost far in excess of what it cost to buy a new one. It was also clear that operationally it made no sense to reinstall used but refurbished diaphragm technology that is already exhibiting significant operational issues.

OPC has criticized Spire, alleging that Spire failed to perform any cost-comparison analyses of various standalone safety devices. This is contrary to the testimony of Spire witness

James Rieske, who credibly testified at the hearing that Spire did investigate ancillary devices to add to existing diaphragm meters. Tr. Vol. XI, p. 259. Spire ultimately concluded that the capability of these add-on devices was limited to merely shutting the gas off, and that the safety features in the ultrasonic meter far exceed the capabilities of an ancillary device. *Id.*

In an effort to demonstrate the existence of other alternative meters to the Itron ultrasonic meter utilized by Spire, at the evidentiary hearing, OPC offered OPC Ex. 219, the spec sheet for a Honeywell American meter. Tr. Vol. XI, p. 220. As Spire witness James Rieske testified, multiple factors impact Spire's ability to utilize a specific meter, and in particular whether Spire's meter reading system is compatible with a given meter. Tr. Vol. XI, p. 221. Stated another way, Spire did not compare products that could not fit within the metering system used by Spire. *Id.* On cross-examination, OPC witness Geoff Marke admitted that he did not know whether any of the standalone safety devices touted by OPC were even compatible with Spire's system, nor what the purchase and installation costs might be. Tr. Vol. XI, p. 276.

At hearing, there was some discussion of the actual service life of diaphragm meters as compared to their depreciation schedule. It is clear that the actual life of a diaphragm meter has been approximately between 18.8 years and 22.1 years, for an average of 20 years, and has been for quite some time. Tr. Vol. XI, p. 232, l. 21 - p. 233, l. 1. This fact has not risen to the attention of the parties in previous rate cases but was discovered in this case due to the introduction of new ultrasonic meter technology. The appropriate recovery of new meter technology should not be challenged by the lingering disconnect of the physical age and depreciation life of existing metering technology that must be addressed regardless of the technology used to replace it.

OPC has also criticized the introduction of ultrasonic meters as an effort by Spire to "gold plate" its system and has suggested that Spire is engaged in a wholesale meter replacement campaign. However, as Staff correctly noted at hearing, Spire has not instituted a full-scale meter replacement program. Spire is merely introducing ultrasonic metering technology as the new residential standard in Spire operating areas. This new technology is being used to replace aging and underperforming meter populations as identified by the inspection and testing of meters during the annual testing program. As noted above, these devices deliver real customer benefits. Those benefits, and the limitations of current metering systems, have driven Spire's decision to begin introducing a new generation of metering technology. The Company has no intention of artificially boosting its rate base, and there is no evidence in the record that any such considerations informed Spire's decisions regarding ultrasonic meters.

OPC also opposes the introduction of ultrasonic metering technology based on the assertion that the cost of some legacy meters will be stranded if they are replaced prior to the end of their service lives. While cost is an important consideration, it is secondary to safety. If the Company can save the life of a customer or employee for just pennies a month, Spire believes it has the obligation to do so. Nevertheless, the "stranded asset" concern can be mitigated by simply pacing the installation of ultrasonic meters appropriately and continuing to target meter populations that are subject to mandatory testing and that are non-performing or under-performing.

5. Conclusion

Spire maintains that it is critical that the Commission recognize the value of this new measurement technology and include in rates the modest costs incurred so far to begin the

transition to these next generation devices. Spire believes strongly that the additional investment is not only financially prudent but feels compelled to provide the ultrasonic safety features to customers when installing a new meter.

D. Issue No. 19- Corporate Allocations and Affiliate Transactions

Executive Summary:

The Commission's affiliate transaction rule, among other things, calls for a "commission-approved CAM," or cost allocation manual. 20 CSR 4240-40.015(3)(D) ("In transactions involving the purchase of goods or services by the regulated gas corporation from an affiliated entity, the regulated gas corporation will use a commission-approved CAM which sets forth cost allocation, market valuation and internal cost methods."). Spire has a "commission-approved CAM," as approved by the Commission in Case No. GC-2011-0098. Spire utilizes its CAM to support Spire's compliance with the Commission's Affiliate Transactions Rules as established in 20 CSR 4240-40.015 and 4240-40.016, which are intended to prevent regulated utilities from subsidizing their nonregulated operations and provide the public assurances their rates are not adversely impacted by non-regulated activities. Ex. 15 (Krick Direct), p. 3. Such methods and requirements are designed to ensure no financial advantage or preferential treatment occurs between Spire and its un-regulated affiliates. *Id*.

Consistent with its commission-approved CAM, Spire's objective is to directly assign costs to the utility operating companies and affiliates to the extent it is possible and practical to do so. *Id.* at 4. For costs that are not direct charged to a specific entity, Spire utilizes cost causation factors that most closely align with the business driver of the costs and the benefiting entities. In

the absence of direct charge or cost causation, Spire commonly uses a general allocator widely used by utilities known as the Modified Massachusetts Formula ("MMF"), which allocates costs based on an average of fixed assets, revenue, and payroll. *Id*.

Staff reviewed Spire's affiliate transactions as a part of this case, to include its corporate allocations, and found that the Company allocates shared service costs in a way that is consistent with its CAM. Tr. Vol. XI, pp. 394-395.

The costs reflected in Spire's filing are consistent with the Missouri affiliate transactions rule and the Company's Commission-approved CAM. Spire's customers are protected by the Company's adherence to the methodologies reflected in that CAM.

Argument:

1. Spire Services

Currently, costs are transferred to a separate entity, Spire Services Inc. (Spire Services), for allocation to its affiliates, to include Spire Missouri. Spire Services was created in July of 2015 as the result of the Company's growth and the need for a formal platform to efficiently execute the allocation of shared services costs to affiliates. Ex. 15 (Krick Direct), p. 4; Ex. 16 (Krick Rebuttal), p. 2. The initial purpose of the entity was to adopt a shared services model for three primary reasons: to facilitate, simplify, and provide transparency to the allocation of shared costs between operating companies and affiliates. Ex. 15 (Krick Direct), p. 4. This was the first step of an ongoing, longer-term initiative to evaluate, design, and implement a mature shared service model. *Id*. Spire Services has no net income, and all costs charged and allocated to Spire Services are re-

allocated to other affiliates. In short, Spire Services is primarily used as an accounting vehicle to ensure costs are properly tracked and allocated to each entity in an appropriate manner. *Id*.

Moreover, over time, Spire Services has been used to consolidate contracts under one entity and consolidate certain benefit plans. Ex. 15 (Krick Direct), p. 5. This structure allows vendors to provide services to numerous Spire entities under one master agreement in lieu of multiple separate agreements between the vendor and each Spire entity. *Id*. The charges for the services are then direct charged to the entity receiving the service or allocated in accordance with applicable rules if the service is being provided for the benefit of multiple entities. *Id*.

2. Allocations Process

The CAM provides for the "three step" method. Ex. 17 (Krick Surrebuttal), p. 2. This method begins with the premise that to the maximum extent practical, all costs that can be specifically attributed to a business segment are direct charged. *Id*. Secondly, indirect costs that cannot be directly charged are allocated to business segments on the basis of a causal relationship. *Id*. In the third step, any remaining costs that cannot be reasonably associated with a specific, identifiable, causal relationship shall be allocated using the general allocator outlined in the CAM. *Id*. at 3. Spire Missouri believes that it has struck the right balance in regard to direct assignment of costs. Tr. Vol. XI, p. 359.

Functions that utilize Spire Services generally fall into two categories: Company Wide shared services and Gas Utility shared services. Ex. 15 (Krick Direct), p. 6. A listing and description of each shared function is found in the Direct Testimony of Spire witness Krick. *Id.*; *Id*. at Sched. TWK-1. However, not all of these functions are charged through Spire Services. Most functions utilize some combination of direct charge and allocation through causal and general

factors. *Id.* at 6. The company-wide shared services departments tend to use more causal and general factors instead of direct charge as they support multiple affiliates. The Gas Utility shared functions typically use a higher percentage of direct charge since their support tends to be more discrete. *Id*. at 6-7.

When costs flow through Spire Services and are allocated between affiliates the Company uses projects (or work orders) in Oracle to systematically collect costs. Ex. 15 (Krick Direct), p. 6. Currently, there are approximately 200 projects established that are associated with a pre-defined allocation method. *Id*. Employees use projects to charge their time/payroll, travel expenses, and procurement of certain goods and services. When a shared service project is charged, costs are collected in Shared Services from the affiliates throughout the month. *Id*. As part of the financial close each month, a company-wide process within the allocation subledger Oracle Profitability and Cost Management (PCM) is generated that calculates the allocation of those costs to each affiliate, based on the pre-defined allocation percentage defined at the project level. *Id*. The percentage is derived based on the causal factor used and the companies that benefit from the costs incurred. *Id*. Projects generally fall into an aggregated subset of cost pools, such as those that impact all entities, utilities only, or region (e.g., Missouri or Southeast), and then further broken down into pools by causal factors. *Id*. at 6-7. A journal entry is recorded (from the allocations subledger PCM) that allocates all the costs in Shared Services back out to the affiliates each month, and the associated net inter-company accounts receivable or payable with Shared Services is settled in the subsequent month. *Id*. at 7. During the financial closing of each month the accounting teams reconcile the amounts due from and payable to Shared Services. *Id*.

The Company continues to analyze when costs will be defined as direct or allocated. Each year during the budgeting process the Company evaluates actual results for the current year and plans for the next year with department heads. *Id.* at 8. During this review it is determined if any department functions or activities have significantly changed and whether the allocation factors and approach are appropriate for the following year. *Id*. Based on this review, a summary of projects typically used for each department is updated annually and communicated to employees in each department. *Id*. The employees are provided this guide and are instructed on what projects to use to charge their time, expenses, and for the procurement of goods and services. *Id*. The project used defines the allocation method, including direct charges. *Id*.

Spire Missouri further monitors costs to ensure individuals are charging the correct projects so that expenses are not being erroneously allocated. Spire Missouri provides instruction to employees on how to code time and expenses so that time is charged to the proper allocator or operating unit. Supervisors and/or approvers of time and expenditures are responsible for verifying that charges are accurate. *Id.* at 9. In addition, payroll and other expenses are budgeted at the project level, and, as part of the budget, the Company runs through the allocations process in a similar way to the actual process, which sets the primary basis for comparison and variance analysis throughout the year. *Id*. Each month a process is performed to review expenses incurred to date versus budget, forecast, and prior year for all shared service functions with department heads in coordination with the Financial Planning & Analysis and Operations Analytics teams. *Id*.

The allocation process used by Spire Missouri is done in a similar way to how such allocations are performed at many Missouri utilities. Ex. 135 (Majors Surrebuttal), p. 9. Staff witness Majors concluded "that the current cost assignment and allocation procedures in effect for

Spire Missouri and its affiliates are reasonable and result in equitable compensation to Spire Missouri for affiliate services provided." Ex. 117 (Majors Rebuttal), p. 7.

3. Customer Benefits

Missouri customers benefit from the way Spire's costs are shared by other affiliates. "Providing corporate services to a number of affiliates on a centralized basis, . . . is inherently more cost-effective than having each regulated affiliate provide the services for themselves." *In the Matter of The Empire District Electric Company, et al.*, Case No. ER-2019-0374, Amended Report and Order, p. 131 (July 23, 2020). Staff witness Majors explained that "use of service companies to obtain necessary corporate support services for multiple entities under a holding company structure is a common practice for utilities, and it is believed to be an economical approach for provision of these services." Ex. 135 (Majors Surrebuttal), p. 9.

If Spire were a stand-alone utility the expenses included in rates would increase. *Id.* at 11. For example, if the amounts of shared services payroll were not allocated to other Spire Inc. entities, it is reasonable to assume that Spire would still incur a large portion of the payroll costs it now assigns to its affiliates. *Id*.

4. OPC Adjustment

In its Direct Testimony, OPC proposed that $84,027,898.01 "be charged to Spire, Inc." and "removed from Spire Missouri's revenue requirement." Ex. 203 (Schallenberg Direct), p. 14. In its Surrebuttal Testimony, OPC refined this calculation to suggest that $63,499,339 of O&M should be removed from Spire's revenue requirement and $20,884,169 should be removed from rate base. Ex. 205 (Schallenberg Surrebuttal), pp. 24-25. The revenue requirement impact of the rate base removal was said to be $2,234,606.08. *Id*. Adding that to the $63,499,339 of O&M

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

Whether the costs at issue have been capitalized or expensed, the bottom line is that there are approximately $84 million in shared costs assigned to Spire Missouri that OPC proposes instead be assigned to Spire, Inc. – the organization's holding company that has no customers, no pipelines, no natural gas, and no operations, regulated or unregulated, independent of its subsidiaries. There is no basis for such an adjustment and no explanation as to why the $84M figure is appropriate under any circumstance.

Staff witness Majors provided a calculation of the approximate $84 million that forms the basis for the OPC adjustment. Ex. 117 (Majors Rebuttal), p. 5. Mr. Majors calculated this amount as follows:

A	Total Amount of Common Allocated Spire Missouri Costs Incurred at Spire Missouri	$221,088,881
B	Total Costs Charged to Spire Missouri Affiliates	$52,321,863
C=A+B	Residual Costs Retained at Spire Missouri	$168,767,018
D=C*50%	50% of Residual Costs Retained at Spire Missouri	$84,383,509
E	Costs Retained at Spire Inc. in Fiscal Year 2020	$355,611
F=D-E	Schallenberg Adjustment	$84,027,898

Id.

The proposed adjustment assumes, without explanation, that 50% of all retained costs at Spire Missouri, less the amount of costs allocated to Spire Inc., should be charged to Spire Inc. *Id*. The testimony identifies no study, allegations of imprudence or any other basis for the 50% allocation to Spire Missouri's holding company, Spire Inc.

The result would be that equal shared services costs would be borne by Spire Missouri and the holding company. In fact, a pie chart provided in OPC witness Schallenberg's Surrebuttal Testimony represents that the impact of OPC's proposal would result in the assignment of 38% of such costs to Spire Missouri, 38% to Spire Inc. and 24% to all other affiliates combined. Ex. 205 (Schallenberg Surrebuttal), p. 24.

A review of the characteristics of these entities shows that OPC's proposal does not pass the commonsense test. For example, the following are the natural gas <u>customers served</u> by various entities:

Spire Missouri	Spire Alabama	Spire Gulf	Spire Mississippi	Spire, Inc.
1,186,500	424,800	84,400	18,400	0

Ex. 47.

Spire Missouri accounts for nearly 70% of the utility customers. Tr. Vol. XI, p. 362. The percentage of the shared costs OPC would shift to Spire Inc. (38%) would greatly exceed the 24% of such costs allocated to all other affiliates, to include the above regulated affiliates that serve well over 500,000 customers between them.

A review of employee numbers also shows why a substantial amount of costs are borne by Spire Missouri. As of September 30, 2020, Spire had 3,583 employees, including 2,424 for Spire Missouri, 947 for Spire Alabama, 123 for Spire Gulf, 34 for Spire Mississippi, 27 for Spire Marketing, and 28 for Spire Storage West. Ex. 16 (Krick Rebuttal), p. 6; *see also* Spire Ex. 47. In other words, approximately 68% of the employees are employed by Spire Missouri.

A similar imbalance can be seen in pipeline miles (of which Spire, Inc. has none):

Spire Missouri	Spire Alabama	Spire Gulf	Spire Mississippi	Spire, Inc.
~31,100	~24,300	~4,300	~1,200	0

Ex. 47.

Spire, Inc. conducts no regulated, or unregulated, business of its own. There is no explanation and no justification for it to bear the same amount of shared services costs as Spire

Missouri, and substantially more than Spire Alabama, Spire Gulf, Spire Mississippi, and others combined.

5. Costs Borne by Spire Inc.

It is misleading to suggest that Spire, Inc. bears no costs based on the shared services allocations. The Holding Company is direct-charged for joint and common costs that are determined to provide no direct or indirect benefit to affiliates. Ex. 16 (Krick Rebuttal), p. 8.

Additionally, OPC counsel specifically made allegations related to costs associated with the "salary" of Spire Inc.'s president and CEO. These statements ignore the fact that substantial portions of the compensation of executive officers are borne solely by Spire, Inc. and its shareholders. Spire witness Krick explained that as to executive compensation for stock-based compensation, Spire Missouri makes a very large adjustment to its test year numbers to remove approximately $9M from its request. Tr. Vol. XI, pp. 358-359. Thus, recovery of those amounts are not sought from Spire Missouri customers and are instead borne by Spire, Inc. and its shareholders.

It is true that there are certain categories of cost for which Spire Inc. does not receive an allocation. Ex. 16 (Krick Rebuttal), p. 8. That is because the CAM specifies that these costs should be allocated based on the three-factor formula, which is comprised of fixed assets, revenues, and direct payroll, of which the Holding Company has none, as it does not produce or consume goods or services. *Id*. at 9-13. Therefore, it receives no allocation of such costs. *Id*. This does not mean that Spire Missouri bears all of those costs. Other affiliates are allocated a portion in compliance with the methods described in the CAM. *Id*. at 8. Moreover, in the absence of the

Holding Company, the operating company would still have those functions and presumably not be sharing them with other affiliates with the scale that they are today. Tr. Vol. XI, p. 356.

6. Conclusion

The allocation process used by Spire Missouri is reasonable, consistent with its commission-approved CAM, and provides for an equitable distribution of shared costs. Further, it ultimately provides for a lower cost of service to Spire Missouri's customers than they would experience in the absence of the sharing and cost allocation of services. Tr. Vol. XI, p. 395.

There is no basis for any adjustment related to this issue and, specifically, no justification for the approximately $84M reallocation of costs from Spire Missouri to Spire, Inc. proposed by OPC. As in prior cases, Staff has fully audited these transactions and agrees with the Company's position that no adjustment is warranted.

E. Issue No. 8- Cash Working Capital

Executive Summary:

Under the Internal Revenue Code ("IRC") § 6655, corporations are required to make quarterly estimated payments for income taxes. In keeping with this simple statute, Spire requests that the Commission decide that the appropriate lead days for income tax payments in calculating the cash working capital ("CWC") requirement is 38.00 days, as reflected in Schedule TSL-D2 (Lead-Lag Study) of Exhibit 25, Spire witness Timothy Lyons' Direct Testimony. Spire calculated, and Staff accepted, a 38-day limit in recognition of the lag time needed to pay income taxes on a quarterly basis when owed. Staff agrees with Spire on this issue, arguing that it has historically

assigned or accepted federal and state income lags based on the statutorily-required, quarterly, equal tax payments. Ex. 119 (Nieto Rebuttal), p. 3, l. 12 - p. 4, l. 12.

Argument:

Cash Working Capital refers to the net funds required by the Company 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 is received from customers. A lead-lag study compares the differences between the Company's revenue lag and expense lead. The revenue lag represents the number of days from the time customers receive service to the time customers pay for their service. The longer the revenue lag, the more cash the Company needs to finance its day-to-day operations.

OPC takes the position that historic compliance with IRS policy and federal law should be ignored by the Commission because Spire does not forecast that it will owe income tax, and that, instead, the lag should be negative 365 days. Ex. 210 (Riley Rebuttal), p. 4, l. 2 - p. 5, l. 18.

OPC conflates the issue of allotted payment amounts and timing of those payments. OPC is wrapped up in the former, but is seeking to cure it with changes to the latter. OPC's argument is essentially that because Spire does not expect to make income tax payments in the near future due to recognition of a net operating loss ("NOL"), it should not allocate funds for income tax expenses. *Id.* at 5. Moreover, OPC argues that the requirement should not be reflected in the expense lag, but that it should be assigned a negative 365-day lag. This last point indicates a misinterpretation of why the expense lag should be left alone. OPC's position, if adopted by the

Commission, leaves a gap in the event that Spire is required to pay income taxes before it comes in for a new rate case and that result is unlawful and unreasonable. Tr. Vol. XII, p. 517.

As Staff and Spire identify, the purpose of the 38-day expense lag is to conform with Section 6655 of the Internal Revenue Code ("IRC"), and, relatedly, IRS Publication 542. Spire Ex. 49 *and see* Ex. 27 (Lyons Rebuttal), p. 4, l. 9 - p. 5, l. 5. The IRS Publication 542 at 6 states, "a corporation must make installment payments if it expects its estimated tax for the year to be $500 or more." Spire Ex. 49. "If the corporation does not pay the installments when they are due, it could be subject to an underpayment penalty." *Id.* "Installment payments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the corporation's tax year." *Id.*

For Spire's tax year ending September 30, estimated tax payments are due January 15th, March 15th, June 15th, and September 15th. Ex. 210 (Riley Rebuttal), p. 4. These payment dates were used to develop Spire's lead days for income tax payments in this lead lag study filed in this case proceeding. *Id. and see* Ex. 25 (Lyons Direct), Schedule TSL-D2 (Lead-Lag Study). Staff agrees with Spire's calculation and has historically and traditionally used this method to develop the expense lag for income taxes. Tr. Vol. XII, p. 493.

Separate and apart from this timing issue is the Commission's determination of whether Spire should include any income tax expenses in its cash working capital requirement. *If OPC is correct* that Spire should not include any income tax expenses, then zero dollars will be allocated to Spire's cash working capital requirement for income tax. This means that zero dollars will be impacted by an expense lag, rendering the lag time number effectively useless. *If OPC is not correct*, and Spire does owe some amount of income tax beyond $500 due to any reason including a change in federal tax policy or exhaustion of its NOL, it would be required by federal law to pay

those taxes on a quarterly basis. This means that those dollars paid would be impacted by an expense lag and the lag day number, rendering the lag time number extremely meaningful. *Id.* at p. 4, l. 19 - p. 5, l. 5. OPC agrees that if the Company has a tax liability they are subject to the IRS timeline. Tr. Vol. XII, p. 509.

To summarize, if OPC is correct that no amount of money should be assigned to Spire's cash working capital requirement for income tax, no money is impacted by any expense lag adjustment. But if money is allocated to income tax, to align with federal tax law, Spire and Staff's 38-day expense lag adjustment is proper and provides certainty that Spire can cover its income tax expenses in the event it must pay taxes. Even OPC witness Riley agreed that if income taxes were paid, a 38-day expense lag would be correct. Tr. Vol. XII, p. 522.

Given that Spire and Staff's 38-day expense lag conforms with tax law and the historic treatment of federal and state income tax lags, the Commission should find this number appropriate. To find otherwise would put the Company at risk of not having the appropriate mechanism or funds available when the Company does have to pay income tax. There is no magic ball that indicates whether tax law could change, thereby impacting the Company's income tax liability. OPC's arguments do not align with its proposed solution and should be rejected.

F. Issue No. 13- Incentive Compensation

<u>Executive Summary:</u>

Spire believes that incentive compensation plans are an integral part of its total compensation package. Base salary, short-term incentives, long-term incentives, health and wellness programs, as well as retirement and savings plans are all important tools to recruit, motivate, incent, and retain a talented and qualified workforce.

In the fall of 2018, Spire's management conducted a detailed review of the Company's current annual incentive plan design ("AIP"). The review focused on the utility's then-current business unit metric, which was Utility Operating Income. After considerable review and discussion by Spire management, the decision was to eliminate this metric for all non-officer plan participants and establish two new metrics as described below:

1. Utility Contribution Margin ("Non-Gas Revenue")

   * Contribution Margin = Gross Utility Revenue – Gas Costs – Gross Receipt Taxes

2. Utility Adjusted O & M per Customer

   * Adjusted O&M per Customer = [O&M Expenses + Property Taxes] /12 Mo. Avg. Customers

Spire believes that these metrics reinforce the Company's commitment to continuous improvement and create better lines of sight for our employees to our customers. These two metrics incentivize employees to reduce expenses or increase revenues while providing safe and reliable service.

Staff agrees that Spire's two proposed metrics should be implemented. In its Cost of Service Report, Staff also included a level of non-earnings-based AIP expense that Staff believes

will be representative of Spire's incentive compensation expense for the year following this rate case. OPC asserts that no amount of incentive compensation expense should be included in Spire's cost of service.

Argument:

Spire's two new proposed metrics offer benefits that impact both Spire customers and employees. The customers receive a direct benefit from increasing the Contribution Margin and reducing O & M expenses. An increased Contribution Margin provides a benefit because by adding customers (*i.e.* more "burning tips"), the distribution of the cost structure is over a larger pool of customers, thereby lowering the cost per customer. An adjusted O & M Expenses per customer is also beneficial because by striving to lower the O & M and property tax costs, the overall cost structure applied to all customers is lower. These customer-focused metrics contribute to more affordable rates for our customers while aligning and complimenting Spire's customer satisfaction and safety metrics.

The new metrics also benefit Spire employees. The metrics allow every employee to have a clear "line of sight" and better understanding how their day-to-day efforts can contribute to Contribution Margin and/or impact O & M per customer, which ultimately allows them to see benefits to the customers. Additionally, only a few employees could directly impact the old matrix of the operating income measure.

While Staff and Spire recommend recovery of Spire's two new metrics (Ex. 104 (Staff's Cost of Service Report), p. 66), OPC argues that Spire's incentive programs provide Spire Missouri employees the incentive to further Spire Inc.'s financial interests at the expense of the rates paid

by its customers. Ex. 203 (Schallenberg Direct), pp. 20-21. OPC's position is not supported by any evidence and is contrary to the Commission's long-standing precedent of allowing inclusion of non-earnings-based incentive compensation to be recovered in a regulated utility's cost of service. Tr. Vol. XII, pp. 556-57 (Staff witness Juliette confirming that the Commission has historically removed earnings-based compensation but that the Commission routinely approves of incentive compensation based upon consumer or operational metrics). Further, OPC appears to reduce the term "benefits" to signify benefits that only impact dollars and cents. This short-changes the value of improving customer service, customer experience, and customer and employee safety, each of which may or may not actually affect overall profit.

The central tension between OPC's position and Spire and Staff's position is in the difference between strictly monetary benefits to Spire versus non-monetary benefits to customers. As Staff witness Juliette stated, Spire's incentive compensation plan results in nonmonetary benefits to customers, including customer safety and response lead times. Tr. Vol. XII, p. 565. These benefits specifically do not "provide a monetary value, but [they] help[] ensure that the customer is safe." *Id.* While non-monetary benefits may lead to monetary benefits, there is no guaranty that earnings and profit to the Company will always increase. *Id.* at 567. Because these customer benefits will be felt by the customer, it is thus fair that the incentive plans be included in cost of service because customers are generally required to pay costs associated with benefits they receive. *Id.* at 566.

OPC's argument starts from the premise that Spire is seeking to pass off monetary benefits accrued by Spire onto the customer. Ex. 203 (Schallenberg Direct), p. 20. OPC witness Schallenberg states that programs like Spire's should be recovered only out of returns to Spire

from the successes of the compensation program. *Id.* But during cross examination, OPC witness Schallenberg acknowledged that the incentive plan does result in customer benefits, like reduction of response time to leaks, increasing the customer satisfaction score, and improving service call quality. Tr. Vol. XII, p. 570. OPC speculates that even these purely non-monetary customer benefits will always improve Company profit through increased revenue or decreased expenses. *Id.* at 576.

OPC's belief that all non-monetary customer benefits will always result in more profit is not in line with reality. There is no guaranty that Spire's short-term gains will always outpace the short-term costs of this compensation package. Limiting utilities to sponsor only incentive compensation plans that can be paid for in benefits to the utility would lead to exclusion of any plan—like this one—that is aimed to benefit the customer, both in how the customer experiences the utility's service and the knock-on financial benefits the customer receives from better, more efficient services. Increasing the quality of service is an important component of what the customer should pay for, especially where, as in here, a long-term goal of the program is to reduce customer rates through increased revenue and decreased cost—even if those may not align with positive net profit in the short term.

In sum, Spire requests the Commission include, in the cost of service, the non-monetary components of Spire's incentive compensation plan. Doing so properly aligns the added customer benefits to costs assigned to the customer, with the upshot that plan success will eventually lead to lower rates in future years. OPC's counterarguments are not persuasive because they ignore the exact customer benefits that are tied into the incentive plan, make massive assumptions about how customer benefits correlate to company profit and contradict Commission precedent.

G. Issue No. 30- WNAR/RNA

<u>Executive Summary:</u>

In this proceeding, Spire proposed a Rate Normalization Adjustment Rider ("RNA") to replace its current Weather Normalization Adjustment Rider ("WNAR"). Spire's proposed RNA was prepared and submitted in accordance with Mo. Rev. Stat. 386.366(3), which permits a utility to file a tariff to account for the impact on utility revenues of increases or decreases in residential and commercial customer usage due to variations in either weather, conservation, or both.

As discussed by Spire witnesses Scott Weitzel and Tim Lyons, Spire's proposed RNA is designed as a two-block rate mechanism: where Block 1 represents monthly customer usage and revenues up to a set threshold, and Block 2 represents the remaining monthly customer usage and revenues. The primary difference between Spire and Staff's RNA proposal is where to set the breakpoint of the block break between Blocks 1 and 2 for the Residential class, and similarly where to set the breakpoint for the Small General Service (SGS) class. OPC sets forth several arguments in an attempt to resurrect and revise the WNAR, which both Staff and Spire agree is outdated and inefficient.

<u>Argument:</u>

The RNA has two primary benefits: (1) to limit the degree to which customers collectively under- or over-contribute to Spire's revenue requirement; and (2) to pass to customers the benefits (or detriments) of increases (or decreases) in usage associated with customer growth. In the absence of such a mechanism customers would be at risk for higher-than-normal gas bills during cold weather years without any offsetting adjustment. Ex. 41 (Weitzel Rebuttal), p. 20. The current

WNAR only insulates the Company from weather fluctuations, not conservation. *Id.* and Ex. 214 (Mantle Surrebuttal), p. 10. Staff and Spire agree that an RNA addresses the interplay between weather and conservation. Ex. 123 (Stahlman Rebuttal), p. 4 and Ex. 43 (Weitzel Surrebuttal), p. 25. The RNA proposal would also reduce or eliminate the reliance on third party data from local weather stations to compute the RNA since Staff would have the information available to them directly from Spire. Ex. 123 (Stahlman Rebuttal), p. 5. Spire's proposed RNA should be approved in this case and should be the next step for Missouri public policy. Ex. 43 (Weitzel Surrebuttal), p. 26.

The RNA is designed to expose Spire to the benefits or risks of variations between actual and normal usage and revenues, and to insulate Spire in Block 2 to the benefits or risks of variations between actual and normal usage and revenues.

As noted above, the RNA is designed as a two-block rate design; the primary difference between Spire and Staff's proposal is where to set the breakpoint of the block break between Blocks 1 and 2 for the Residential class, and similarly where to set the breakpoint for the Small General Service (SGS) class. For residential customers, Spire is proposing a block break at 30 Ccf, and Staff is proposing a block break at 50 Ccf. As noted in the Rebuttal Testimony of Timothy Lyons, Staff's recommendation is based on their review of residential customer bills exceeding 50 Ccf per month, whereas Spire's recommendation is based on a review of all residential bills, taking into account actual usage over each month. Spire's review shows that a block break of 30 Ccf would best align with the intent of the RNA, which is to minimize revenue fluctuations due to weather and conservation. Ex. 27 (Lyons Rebuttal), p. 24. Ameren Missouri ("Ameren"), an electric/gas utility that overlaps service territory with Spire, also has a very similar weather and

conservation rider. Spire Ex. 48. At hearing, Staff witness Stahlman recognized that Ameren's Delivery Charge Adjustment Rider (DCA) was similar to Spire's proposed RNA, noting a first block break of 30 Ccf for Ameren residential customers. Tr. Vol. XII, p. 452. Spire continues to assert that a first block break at 30 Ccf for the residential class is also most appropriate in this case.

Staff's recommendation of a 50 Ccf block for Spire is much greater than the Commision-approved 30 Ccf block for Ameren gas. Staff is proposing a block that is 66% higher than Ameren's. Spire's customers may have a slightly higher usage than Ameren's, but it is not 66% greater. The Company and Staff analyzed customer usage and bill analysis to establish their positions. Both Ameren and Spire serve parts of eastern Missouri and south regions. There is no logical reason why one gas utility would have such a larger and different block than another gas utility operating in the same or similar regions of the state. A 30 Ccf block break was approved by the Commission for Ameren and should be approved for Spire.

For the SGS class, Spire is proposing a breakpoint of 100 Ccf for the SGS class, as compared to the range of 300-500 Ccf proposed by Staff. As with the Company's evaluation of the residential class, Spire based its review on SGS monthly bills to determine an appropriate block break that is best aligned with the intent and purpose of the RNA. Ex. 27 (Lyons Rebuttal), p. 24. 100 Ccf is also consistent and near the low range with the block break utilized in Ameren's DCA tariff for its general service customers which is comparable to Spire's SGS class. Ameren's general service class is between 101 and 400 Ccf. Spire Ex. 48. Ameren just has one general service gas class that serves commercial and industrial customers with varying loads and volumes. Spire has a small general service class that is capped at 10,000 Ccf. Since Spire's has specific volume requirements within the SGS class, there is no need to have a range. The range was established in

the Ameren case since there is a single general commercial and industrial class. Once again, Staff is proposing a much larger block rate than what was approved in the Ameren case. A 100 Ccf block is more appropriate for a smaller commercial customer and within a range of a previous Commission approved weather and conservation rider.

OPC sets forth several proposals in an attempt to modify the Company's current WNAR to require an annual filing, rather than semi-annual filings, and proposes changes to the accumulation periods as ways to simplify the WNAR. These changes are neither necessary nor appropriate because the RNA mechanisms proposed by Spire and Staff factor weather and conservation into the analysis and are consistent with the statute that allows consideration for weather, conservation, or both.

Spire's proposed RNA is the appropriate rider to implement. The 30 Ccf block for residential customers and 100 Ccf block for the SGS class are fully supported by the record and should be implemented as part of this case because they minimize the Block 1 sales that would be subject to fluctuations due to weather and conservation by the residential and SGS customer classes.

H. Issue No. 16-Net Operating Loss Carryforward

Executive Summary:

In keeping with bedrock IRS policy and regulation (Treas. Reg. § 1.167(1)-1(h)(1)(iii)), as well as the policies of FERC and virtually every state regulatory commission in the United States, Spire included in its rate base its calculation of the Accumulated Deferred Income Tax ("ADIT") Asset. The calculation reflects the Company's Net Operating Loss Carryforward ("NOL")[5] as an offset to the ADIT Liability it has recorded for book-tax differences. For example, one book-tax difference would include the difference between straight-line depreciation used to determine book depreciation expense used for financial reporting and ratemaking purposes and accelerated depreciation used to calculate the depreciation deduction used to determine taxable income on the Company's income tax return.

Spire and Staff agree that it is proper for an NOL to be included as an offset to the rate base, reducing ADIT Liability. This is because the NOL represents the quantification of ADIT that Spire has not realized and is required as an offset to the ADIT Liability recorded assuming the ADIT Liability **has been realized**. Ratepayers should benefit from the realized ADIT as it represents an interest-free loan from the U.S. Treasury. In this case, this NOL represents a rate base offset reduction of approximately $56 million. When an NOL exists, that interest-free loan has not been monetized, as the Company has not realized the benefit of the NOL yet. Further, and importantly, tax law requires its inclusion.

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[5] An NOL occurs when company's tax deductions exceed its taxable income within a given tax period. The NOL can then be carried forward to a future year to offset taxable income owed in the future.

OPC disagrees with inclusion of NOL as an offset to ADIT. OPC's position is concerning because it is not only inconsistent with what the IRS requires, but if adopted, would create a normalization violation, which would have significant repercussions to not only Spire but customers who will no longer receive the benefits created by current tax law.

Argument:

1. Spire's Method of Accounting for ADIT and NOL is Sound.

The methodology that Spire used in including the total NOL with total ADIT is called the "with or without"[6] methodology. Ex. 19 (Kuper Rebuttal) at p. 5. Simply put, this methodology means that if one computes the NOL with accelerated/bonus depreciation and then computes it without accelerated/bonus depreciation, to the extent the accelerated/bonus depreciation created the NOL, it is treated as an offset. *Id.*

On its regulatory books, Spire normalizes the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that Spire would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to Spire. To normalize these differences, Spire maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. In this manner, the total income tax expense "matches" the non-tax components of the revenue requirement. This reserve is the ADIT Liability account. *See generally* Ex. 10 (Felsenthal Direct), pp. 30-32.

[6] Also referred to as "with-and-without."

Spire also maintains an offsetting series of entries—a “deferred tax asset” and a “deferred tax expense”—that reflect that portion of those ‘tax losses’ which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOL. Under accounting and regulatory rules, the ADIT NOL Asset and ADIT Liability must be shown broadly. They cannot be netted to only show the “net” realized amount. In a rate case, rate base is typically reduced for the ADIT Liability representing an interest free loan from the U.S. Treasury as a zero cost source of capital. When a portion of that ADIT Liability has not been realized, it must be offset by the unrealized portion, which is the ADIT NOL Asset. In this manner, the ratepayers receive the benefit of the actual interest free loan the Company has realized. *See generally* Ex. 10 (Felsenthal Direct), pp. 30-32.

Treas. Reg. § 1.167(1)-1(h)(1)(iii) provides that if an NOL carryforward would not have arisen (or increased), but for the use of accelerated tax depreciation, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the IRS. This rule recognizes that depreciation-related deferred tax liabilities are interest-free loans from the government extended via the reduction of current tax liability due to the use of accelerated tax depreciation, and should not reduce the rate base unless the depreciation related deferred tax liabilities result in a reduction of cash taxes. Tr. Vol. XIII, p. 650, l. 17 – p. 651, l. 2; Ex. 10 (Felsenthal Direct), p. 26.

As part of this rate case, Spire calculated its rate base by offsetting the rate base with its ADIT Liability balance. Spire reduced its ADIT Liability balance by including the ADIT NOL Asset that represents Spire’s NOL. Essentially, this inclusion recognizes that a portion of ADIT will be offset by the application of a loss that is carried forward from a previous year. *See* Ex. 10

(Felsenthal Direct), p. 32. This represents the true measure of income taxes that are actually deferred by Spire claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to the Company. *Id.*

2. OPC is Conflating Regulatory Accounting Concepts with Tax Accounting

OPC asserts that it is fundamentally unfair that the net result of the treatment of NOLs within ADIT is that Spire receives an unrecognized benefit in the form of unspent income taxes. Ex. 211 (Riley Surrebuttal), pp. 4-5. OPC further suggests that ratepayers should not be charged for current income taxes because the Company has an NOL. *Id.* at 10.

OPC recognizes that federal law requires Spire to collect income taxes. In OPC counsel's recross-examination of OPC witness Riley during the Cash Working Capital section of the hearing, Mr. Riley agreed with OPC counsel that federal "income taxes have to be collected" because of IRS normalization rules. Tr. Vol. XII, p. 529. But OPC argues that while Spire has collected those taxes and earmarked them as income tax expenses, Spire or the Commission should decide that at least some of those funds should not be currently considered "owed to the U.S. government" because OPC speculates that those funds will be offset by net operating losses at some time in the future. Tr. Vol. XIII, p. 660, l. 1 - p. 662, l. 7. This influences OPC's position on Cash Working Capital and this NOL issue. In the Cash Working Capital context, OPC does not believe Spire should prospectively align collection of income tax expenses from customers with scheduled payments to the IRS because OPC guesses that no income tax will be owed. Ex. 210 (Riley Rebuttal), p. 4, l. 2 - p. 5, l. 18. And in the NOL context, OPC believes that Spire should have to

offset the portion of the collected federal income tax that OPC speculates will never be owed against the NOL. *See* Ex. 211 (Riley Surrebuttal), p. 2.

OPC is confusing two tax concepts. The first concept is that of regulatory accounting. The income tax expense computed on the test year revenue requirement and cost of service is based on the concept under regulatory accounting that the income and expense used for ratemaking purposes to determine the appropriate return to be earned by the utility includes an income tax component which matches the pre-tax operating income (all revenue and non-income tax cost of service components). *See* Ex. 10 (Felsenthal Direct), pp. 32-33. In this manner, the income tax expense is computed using regulatory depreciation and regulatory accounting. *Id.* There is no accelerated tax depreciation or other book-tax difference included in this calculation. *Id.* It is strictly a regulatory accounting computation. *Id.* **The existence of an NOL has no bearing on the calculation of income tax expense based on the test year revenue and costs.** *Id.*

The second concept is the rate base. Within the rate base calculation, the ADIT Liability is used as an offset to rate base. *Id.* at 46-48. This offset provides a benefit to ratepayers as the rate base is reduced by ADIT created by utilizing accelerated depreciation and other book-tax differences to reduce taxable income. *Id.* In Spire's case, these accelerated depreciation deductions for tax purposes have reduced the regulatory income to zero and has created a loss in excess of income. *Id.* at 30-32. **This excess loss, or NOL, is a tax concept and not a regulatory concept.** *Id.* The use of book-tax differences has allowed the Company to reduce its current tax liability to less than zero, producing a negative current income tax expense, which reduces total income tax expense in the cost of service calculation. *Id.*

Thus, contrary to what has been alleged by OPC (that ratepayers are paying for the NOL for which Spire is not currently paying the IRS) ratepayers are receiving a benefit in the form of lower income tax expense for the NOL. Ex. 12 (Felsenthal Surrebuttal), p. 8, l. 20 – p.10, l. 19. The foundation of OPC's argument (that ratepayers are being charged for the NOL) is not valid. *Id.* However, this tax liability computed based on the regulatory income from the test year is not forgiven by the IRS or the state taxing authorities. *Id.* As virtually every pre-tax component of test year revenue, income and expense has an income tax impact, to the extent that current income taxes are reduced/increased for book-tax differences, such as accelerated depreciation, a deferred income tax expense and ADIT is recorded. *Id.* This ADIT will be due and payable in future tax periods when the book-tax differences reverse. *Id.* As such, the income tax is required to be collected based on the ratemaking principles applied to the test year.

3. Failure to Include the NOL as an Offset to ADIT Results in a Normalization Violation.

Whether OPC believes the law is fair, philosophically or politically, it is still the law, and failure to recognize an NOL as an offset to ADIT would be a normalization violation and is prohibited by the IRS. A normalization violation would have severe consequences for the ratepayers, as the Company would be forbidden in perpetuity from claiming accelerated depreciation on every future income tax return, which means that ratepayers will no longer receive the benefit of significant, rate base reducing, interest free loans from the U.S. Treasury for ADIT. *See* Ex. 10 (Felsenthal Direct), p. 48; Treas. Reg. § 1.46-6(f)(4).

Spire has claimed accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation is available. Ex. 19 (Kuper Rebuttal), p. 6; *See* Ex. 10

(Felsenthal Direct), pp. 30-32. By doing this, Spire has reduced its current income tax expense to less than zero (a negative expense) and has recorded an ADIT NOL Asset representing the deductions claimed on income tax returns that did not produce a reduction of cash taxes (the reduction that caused the income tax expense to be less than zero). *Id.* This NOL carryforward will be able to be utilized against future taxable income. *See* Ex. 10 (Felsenthal Direct), pp. 30-32. The cumulative NOL available to reduce future taxable income is represented by this ADIT NOL Asset. *See* Ex. 10 (Felsenthal Direct), pp. 30-32.

4. The "With or Without" Methodology Used by Spire is Endorsed by the IRS

Spire's chosen methodology is a standard practice that the IRS has universally accepted in cases such as these. As described by the IRS in Private Letter Ruling ("PLR")-201436037 (included in Spire's Ex. 50),

> the "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC [('Net Operating Loss Carryforward")] attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. <u>This methodology provides certainty</u> and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers.

Spire Ex. 50, PLR-201436037 at 6 (emphasis added).

Staff also points out that this methodology is in keeping with this Commission's historic treatment of this issue. *See* Ex. 140 (Young Surrebuttal), p. 6, *citing* Report and Order in Case No. ER-2014-0258. This is among the reasons why Staff supports inclusion of the ADIT NOL Asset in the ADIT component of rate base. *Id.* at 8.

OPC and Spire start from the same place of agreement that the IRS states that an NOL must be taken into account in calculating the reserve for deferred taxes. *See* Ex. 211, (Riley Surrebuttal), p. 7; Ex. 11 (Felsenthal Rebuttal) at p. 12, l. 13 - p. 13, l. 7. This language appears in every PLR included in Spire Ex. 50—a combined list of all PLRs cited by Spire Witnesses Kuper and Felsenthal.[7] While PLRs are explicitly non-binding, some jurisdictions—including the 8th Circuit—acknowledge their use as persuasive authority. *Thom v. United States*, 283 F.3d 939, 943 fn. 6 (8th Cir. 2002) ("Although private letter rulings have no precedential value and do not in any way bind this court, 26 U.S.C. § 6110(k)(3), we believe they are an instructive tool that we have at our disposal.").[8] Given that both Spire and OPC rely on the IRS' language in these PLRs, it is important to discuss their contents.

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[7] PLR 201438003 at 6 ("§ 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes."); PLR 201436037 at 6 (Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.); PLR 201436038 at ("Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.); etc.

[8] As stated in Mr. Felsenthal's testimony, although PLRs only apply to the taxpayer requesting it, PLRs clearly show the thinking of the IRS with respect to interpreting the IRC and the related regulations. Ex. 12 (Felsenthal Surrebuttal) at p. 11, l. 10 – p. 12, l. 6. In addition, the IRS strives to achieve consistency in its interpretations of the tax statute and regulations. *Id.* All PLRs are published and made available to tax professionals and the taxpaying public. *Id.* The process of publishing the rulings assists other taxpayers with similar fact patterns, avoids the requirement to prepare a ruling request and avoids the need for additional effort by the IRS to respond to such requests when there is a clear interpretation of the IRS position expressed in the PLRs. *Id.* The fact that a PLR is binding only on the taxpayer requesting it does not mean that the IRS does not use a reasoned and consistent approach to support its decision. *Id.* Because the IRS is the administrative agency that interprets the tax rules, published PLRs clearly reveal the agency's interpretation of the tax rules. *Id.* As such, PLRs can be instructive to other taxpayers, such as the case here. *Id.*

In all but one of the PLRs listed in Spire Exhibit 50, the IRS consistently concludes that the proper method to take an NOL into account is to use the "with or without" method. *See* Ex. 50, PLR 201438003 at 7, PLR 201436037 at 7, PLR 201436038 at 6-7, PLR 201519021 at 7, PLR 201534001 at 5-6, PLR 201548017 at 6, PLR 201709008 at 6-7, and PLR 201842001 at 6. Notably, in PLR 201709008, the IRS states that:

> "[i]n order to avoid a violation of the normalization requirements of § 168(i)(9) and Treasury Regulation § 1.167(l)-1, it is necessary to include in rate base the Accumulated Deferred Income Tax (ADIT) asset resulting from the Net Operating Loss Carryforward (NOLC), given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.

Id. at 6-7.

OPC takes a semantic approach to the guidance of these PLRs, stating that while most PLRs state that an NOL must be *taken into account* in calculating the reserve for deferred taxes, these statements do not say that the NOL must be *included*. Ex. 211 (Riley Surrebuttal), p. 7. In support of this distinction, OPC lists a single PLR where the IRS came to a slightly different conclusion than in the eight PLRs cited by Spire—PLR 2014418024. While the facts of the PLR relied on by the OPC are not the clearest, it appears that during a rate case, the reviewing commission set rates using a provision "for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC." *Id.* at 6. Despite this treatment, the utility appealed and advocated that the commission should have included balances in its NOL-related account. *Id.* The IRS found that because the NOL had been

taken into account in the commission's setting of rates, the decision not to include the NOL amount was justified. *Id.* What this says is that in that particular rate case, a state commission allowed the utility to include deferred income taxes expense in cost of service ***without*** an offset in current income tax expense for the NOL. Thus, the IRS concluded that in such a case the entire ADIT was realized in the ratemaking process, compared to the traditional approach used by Spire and this Commission of including both the deferred income tax expense offset by the negative current income tax expense (because of the NOL). There is a key caveat to this opinion cited by OPC that is not present in any of the other listed PLRs:

> [e]xcept as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above. In particular, while we accept as true for purposes of this ruling Commission's assertions that it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC or AMT, we do not conclude that it has done so and those assertions are subject to verification on audit.

Id.

This ruling includes the additional caveat that: "[t]his ruling is based on the representations submitted by the Taxpayer and is only valid if those representations are accurate." Essentially, this means the IRS expressly assumed the alternative method the commission used was adequate based on its limited description but did not verify the alternative method was actually used in that rate case.

As that PLR states, "[t]here is little guidance on exactly how an NOLC [] must be taken into account in calculating the reserve for deferred taxes under §§ 1.167(l)-1(h)(1)(iii) and

56(a)(1)(D).” *Id.* In that sense, there is a kernel of truth in OPC’s position that, theoretically, one could account for NOLs in an alternative manner. But the problem inherent in every solution *other than the “with or without” method*, is that there are no alternatives that are without substantial risk of violating normalization rules.

In PLR 201438003, the IRS states that the “with or without” method is:

> specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of “flow through” of the benefits of accelerated depreciation to ratepayers.

Id. at 6. The IRS went on to say that under the facts presented (which are similar to the instant case) “**any method other than the “with and without” method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.**” *Id.* (emphasis added). This exact language is repeated in PLR 201436037 (at 6), PLR 201436038 (at 6), PLR 201519021 (at 6-7), PLR 201534001 (at 6), PLR 201548017 (at 6), and PLR 201709008 (at 6). This is because accounting for total ADIT and total NOL is the only method of ensuring that the utility is counting every dollar. Attempting to divine a year-to-year partially qualifying NOL opens the door for potential errors and normalization violations.

OPC offers no precedent or persuasive authority that its chosen alternatives are viable and would be accepted by the IRS. In PLR 2014418024, the IRS accepts, by fiat, that the commission’s method of accounting for the NOL was accurate, but does not describe the methodology in any detail, or formally bless that the accounting was correct in form or substance. In Spire’s review of other PLRs, and in the PLRs discussed by the other parties, there are no other examples of viable alternatives to the “with or without” method that the IRS formally accepts. In fact, the PLRs

supporting the "with or without" method read as a graveyard for other potential options. *See*, for example:

- PLR 201438003 at 7 (reduction of rate base by the full amount of ADIT unreduced by the balance of the NOL account, in whole or in part, violates normalization rules; assignment of a zero rate of return to the NOL account violates normalization rules);
- PLR 201436037 at 6 (reduction of rate base by the full amount of ADIT unreduced by the balance of the NOL account, in part, violates normalization rules; imputation of incremental ADIT on account of the reliability plant addition adjustments violates normalization rules; reduction in utility's tax expense element of cost of service to reflect the tax benefit of its NOLC violates normalization rules);
- PLR 201436038 at 6-7 (reduction of rate base by the full amount of ADIT offset by a portion of the NOL account that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis violates normalization rules; ADIT on account of the reliability plant addition adjustments violates normalization rules);
- PLR 201519021 at 6-7 (reduction of rate base by the full amount of ADIT unreduced by the balance of the NOL account, in whole or by a portion of the NOL account that is less than that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis violates normalization rules; assignment of a zero rate of return to the NOL account violates normalization rules);
- PLR 201534001 at 5-6 (conclusions similar to those above),
- PLR 201548017 at 6 (conclusions similar to those above); and
- PLR 201709008 at 6-7 (conclusions similar to those above).

Note also that these PLRs **clearly** state that if the ADIT NOL Asset is not included in rate base to offset the ADIT Liability, a normalization violation will occur. These PLRs are, in effect, defining what "take into account" means—that the ADIT NOL Asset must be included in rate base.

5. If OPC's Proposed Alternative is Viewed as a Normalization Violation, the impacts to Spire and its Customers are Costly.

The consequences of being wrong on this issue are severe. Tr. Vol. XIII, pp. 633-35. The penalty for a normalization violation is the inability of the utility to ever claim accelerated depreciation for income tax purposes. *Id. and see* Treas. Reg. § 1.46-6(f)(4). The IRS has granted relief in the form of "fixing" normalization violations when such violations are inadvertent or unintentional. IRS Revenue Procedure 2017-47. Here, given the amount of attention that has been paid to this issue, any decision to adopt a practice or procedure that is inconsistent with the normalization rules would be far from inadvertent or unintentional. It would be considered intentional, deliberate and willful. It would not be able to be "fixed" and the consequences would be permanent. The result of such a penalty would have an immediate negative impact on the ratepayers and the utility. Tr. Vol. XIII, pp. 633-35. Specifically, if Spire could no longer use the rate base reducing effect of the $190-200 million in ADIT, this would have an approximately $20 million impact on revenue requirement. *Id.*

In light of the many indications from the IRS that the "with or without" method is the only certain approach to account for Spire's ADIT and NOL accounts, Spire and Staff agree that the Commission should adopt Spire's accounting schedules on this issue. OPC's position that the Commission should adopt an avant-garde approach to accounting is not justified in light of the

IRS's consistent language on this issue, and OPC's lack of precedent justifying and supporting the alternatives. OPC's position that the Commission should break with foundational IRS practices and the Commission's historic treatment of other regulated utilities for treating NOLs simply because it is theoretically conceivable that the Commission can do so is not worth the risk to the ratepayers and the utility if the alternative fails to conform with normalization rules and Spire is forbidden from taking accelerated depreciation on any income tax return in the future. Due to the extreme consequences of a potential normalization rule violation, if the Commission is inclined to entertain OPC's erroneous position, Spire would request the Commission order a private letter ruling from the IRS to be requested by Spire to allow the IRS to weigh in on the matter.

Spire asks that the Commission follow IRS protocol and its own precedent and include the ADIT NOL asset as an offset in rate base calculations, and to deny OPC's suggestion that the Commission break with that protocol.

I. Issue No. 1- Cost of Capital

<u>Executive Summary:</u>

In this proceeding, the Company is requesting a 7.23% weighted average cost of capital using a capital structure consisting of 45.72% long-term debt at an embedded debt cost rate and 54.28% equity at a return on common equity ("ROE") of 9.95%. Currently the Company has an approved weighted average cost of capital of 7.20% and a Commission approved ROE at 9.8%. Staff is recommending an ROE of 9.37% within the range of 9.12% to 9.62%. Ex. 101 (Staff Cost of Service Report), p. 5. OPC is recommending an ROE of 9.25% in the range of 8.50% to 9.50%. Ex. 215 (Murray Direct), p. 3) However, as discussed below, the Commission must reject the

recommendations of Staff and OPC and adopt the recommendation of the Company, which is based on generally accepted and reliable estimates of the returns that investors require.

Company witness Dylan W. D'Ascendis conducted an ROE analysis which applied several market-based models such as the discounted cash flow ("DCF"), risk premium model ("RPM"), and capital asset pricing model ("CAPM") to a proxy group of natural gas distribution companies and a non-regulated proxy group similar in total risk to the utility proxy group. After applying the DCF, PRM, and CAPM to both groups, Mr. D'Ascendis adjusted the indicated proxy group results for risk differences between Spire and the proxy group.

Staff witness Seoung Joun Won, PhD derived indicated DCF and CAPM cost rates of 8.10% and 6.40% respectively. Realizing that those indicated cost rates are not reasonable measures of Spire's ROE, Dr. Won conducted a benchmark methodology based on Spire's last authorized ROE, which was based on the results of market models.

OPC witness David Murray testified that he believed the actual market cost of common equity for Spire was in the range of 6.50% to 7.50%. Ex. 215 (Murray Direct), p. 5. Instead of recommending the ROE range that he believed to be the actual cost of common equity for Spire, Mr. Murray looked at the ROE that the Commission authorized in an Empire District Electric Company ("EDE") rate case and adjusted it for his perceived risk differential between natural gas companies and vertically integrated electric companies. For the reasons stated below, this novel approach should be rejected by the Commission, as it has rejected Mr. Murray's recommendations in the past.

The Commission should also reject OPC's extreme positions regarding capital structure. Spire is financially independent from its parent company according to the same factors that the

Commission reviewed in 2017 when determining to use Spire's own capital structure. Further, there is no merit to OPC's arguments for including short-term debt in the capital structure, as the average of all short-term assets exceeded short-term debt when adhering to the Commission's established "point in time" method.

Argument:

1. Governing Legal Principles for ROE

As the Commission has recognized many times in the past, the United States Supreme Court established requirements for determining the reasonable rate of return in *Bluefield Waterworks & Improvement Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679, 692 (1923) ("*Bluefield*") and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("*Hope*"). In short, the fixing of "just and reasonable" rates involves a balancing of investor and consumer interests. *Hope,* 320 U.S. at 603. "What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts." *Bluefield*, 262 U.S. at 692.

A reasonable rate of return is one that closely approximates the profits upon capital invested in other undertakings where the risk involved and other conditions are similar. *Bluefield*, 262 U.S. at 689-90. "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties . . . ." *Bluefield*, 262 U.S. at 692.

In the *Report & Order* in *Re: Kansas City Power & Light Company*, Case No. ER-2010-0355 (April 12, 2011), pp. 120-24, the Commission described its role in determining the return on equity as follows:

> The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions. Pursuant to those decisions, returns for [Great Plains Energy's ("GPE's")] shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a quantification of risk.
> ***
> Investor expectations are not the sole determiners of ROE under *Hope* and *Bluefield*; we must also look to the performance of other companies that are similar to [Kansas City Power & Light ("KCP&L")] in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.
> ***
> The Commission cannot simply find a rate of return on equity that is "correct"; a "correct" rate does not exist. However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. The Commission stated that it does not believe that its return on equity finding should 'unthinkingly mirror the national average.' Nevertheless, the national average is an indicator of the capital market in which [Missouri Gas Energy ("MGE")] will have to compete for necessary capital.
> ***
> The Commission has described a 'zone of reasonableness' extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations. Because the evidence shows the recent national average ROE for electric utilities is 10.34%, that 'zone of reasonableness' for this case is 9.34% to 11.34%. (emphasis in original) (*footnotes omitted*).

The Commission should follow a similar approach for the establishment of Spire's return on equity in this proceeding and adopt the recommendations of the Company related to cost of capital issues.

2. The Company's Recommendation: Witness Dylan W. D'Ascendis

Spire witness Dylan W. D'Ascendis is a well-qualified economic and financial consultant who has provided testimony on strategic and financial matters before twenty state regulatory commissions in the United States and Canada. Ex 5 (D'Ascendis Direct), p. 4. Mr. D'Ascendis holds a Bachelor of Arts degree in Economic History from the University of Pennsylvania and a Master of Business Administration with high honors and concentrations in finance and international business from Rutgers University. *Id*. at 5.

Mr. D'Ascendis calculates the American Gas Association ("AGA") Gas Index, which serves as the benchmark against which the performance of the American Gas Index Fund ("AGIF") is measured on a monthly basis. The AGA Gas Index and AGIF are a market capitalization weighted index and mutual fund, respectively, comprised of the common stocks of the publicly traded corporate members of the AGA. *Id*. at 4. He is a member of the Society of Utility and Regulatory Financial Analysts ("SURFA") and was awarded the professional designation "Certified Rate of Return Analyst" by SURFA, which is based on education, experience and successful completion of a comprehensive written examination. *Id*. at 4-5. He is also a member of the National Association of Certified Valuation Analysts ("NACVA") and was awarded the professional designation "Certified Valuation 5 Analyst" by the NACVA. *Id*. at 5.

To develop his cost of equity recommendation, Mr. D'Ascendis applied several well-recognized cost of common equity models (*i.e.*, the DCF, the RPM and the CAPM) to the market data of a Natural Gas Proxy Group as well as a Non-Price Regulated Proxy Group.

The results of Mr. D'Ascendis' analyses, set forth on the table below, support his recommended ROE point recommendation of 9.95%.

Summary of Common Equity Cost Rate

Natural Gas Proxy Group	
Discounted Cash Flow Model ("DCF")	9.44%
Risk Premium Model ("RPM")	10.79%
Capital Asset Pricing Model ("CAPM")	11.89%
Cost of Equity Models Applied to Comparable Risk, Non-Price Regulated Cos.	12.53%
Range of Common Equity Results Before Adjustment	9.44% - 12.53%
Size Adjustment	0.10%
Credit Risk Adjustment	-0.10%
Flotation Cost Adjustment	0.22%
Range of Common Equity Cost Rates After Adjustment	9.66% - 12.75%
Recommended Common Equity Cost Rate	9.95%

Ex. 6 (D'Ascendis Rebuttal), Schedule DWD R-1, p. 2.

Based on the above, the indicated range of model results was between 9.44% and 12.53%, which was applicable to the Natural Gas Proxy Group before any adjustments for Spire's smaller size, less risky bond rating, or flotation costs.

Mr. D'Ascendis then compared Spire to the proxy group of natural gas companies based on size and bond rating and calculated Company-specific flotation costs. In his analysis, Mr. D'Ascendis found that Spire is smaller than the proxy group in several different measures and that Spire has a better bond rating than the average bond rating of the proxy group. The small size of Company relative to the proxy group necessitated an upward adjustment of 0.10% and the Company's less risky bond rating necessitated a downward adjustment of 0.10%. Ex. 5

(D'Ascendis Direct), p. 7; Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-1, p. 2. Regarding flotation costs, Mr. D'Ascendis found that an adjustment of 0.22% (*i.e.*, 22 basis points) reasonably represents flotation costs for the Company. Without such an adjustment, there is no way for the Company to recover these legitimate costs under the current regulatory model used in Missouri. Ex. 5 (D'Ascendis Direct), pp. 45-48; Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-1, p. 2. Based upon this analysis, Mr. D'Ascendis concluded that the range of reasonable ROEs applicable to Spire is between 9.66% and 12.75%. From that range, Mr. D'Ascendis recommends an ROE of 9.95% Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-1, p. 2.

3. Staff's Recommendation: Witness Seoung Joun Won, PhD

Seoung Joun Won, PhD is currently the Utility Regulatory Manager of the Financial Analysis Unit, Commission Staff Division for the Commission. Dr. Won received his Bachelor of Arts, Master of Arts, and Doctor of Philosophy in Mathematics from Yonsei University and his Bachelor of Business Administration in Financial Accounting from Seoul Digital University in Seoul, South Korea, and earned his Doctor of Philosophy in Economics from the University of Missouri – Columbia. Dr. Won has been employed at the Commission since May 2010. Ex. 101 (Staff Cost of Service Report), Appendix 1, pp. 59-62.

Dr. Won presents his analyses as of March 31, 2021 and June 30, 2017, the earlier date corresponding to Staff's analysis in Spire's last rate case. Dr. Won uses the 9.80% authorized ROE in that case as a benchmark, and then adjusts that benchmark return based on changes in his model results from that case to this one, to form his recommendation. Dr. Won calculates relative changes of negative 0.52% and negative 0.34% based on his DCF model and CAPM results, respectively, averaging negative 0.43%. Subtracting 0.43% from the 9.80% benchmark ROE

results in a point estimate of 9.37%, within a range of 9.12% and 9.62%. While Dr. Won's recommended range is from 9.12% to 9.62%, his analytical results of his models range from 6.40% to 8.10%. Ex. 101 (Staff Cost of Service Report), Schedules SJW-13 and SJW-14.

4. Rearview Mirror Analysis of Staff

Staff's analysis is less credible than Spire's evidence. The method in which Dr. Won derived his recommendation indicates he misunderstands the relationship between the cost of common equity and the authorized ROE. For regulated utilities, the ROE equals the investor-required ROE which equals the allowed ROE, as reflected in the *Hope* and *Bluefield* Supreme Court decisions cited above.

Dr. Won rejected his own conclusion of an appropriate range of common equity cost rate for the Company of 6.40% to 8.10%, implicitly recognizing that this range is woefully inadequate and would provide an insufficient achieved return on the book common equity of the Company. Instead, Dr. Won uses a benchmarking approach, which is essentially a rearview mirror approach looking back at economic conditions that existed in 2017 (test year in the last Spire rate case) and ignoring current market conditions. *See* Tr. Vol. XIIII, p. 752; Ex. 101 (Staff Cost of Service Report), Schedule SJW-15.

In addition, the data used in several of Dr. Won's models are mismatched. For example, Dr. Won uses price data for the period of January through March 2021 for his DCF analysis (Ex. 101, Schedule SJW-12, as corrected at Tr. Vol. XIIII, p. 745), but uses *Value Line* data as of August 28, 2020 for his dividends per share, which is approximately six months earlier than his price data. Tr. Vol. XIIII, p. 756; Ex. 5 (D'Ascendis Direct), Schedule DWD-D-3. Further, the August 28, 2020 dividend per share data was superseded by *Value Line* data published in November 2020,

and in February 2021. *See* Spire Ex. 54 (2/26/21 Value Line Report). Dr. Won divides the dividend per share (from August 2020) by the stock price (from January-March 2021) to obtain the dividend yields used in his DCF calculation. Ex. 101, Schedule SJW-13. Using mismatched data in this calculation results in skewed and unreliable results.

Additional errors are contained in Dr. Won's CAPM analysis. In applying the CAPM, Dr. Won claims that he calculated Beta coefficients using the *Value Line* methodology. Ex. 101 (Staff Cost of Service Report), p. 8, n.37 ("Staff still believes Value Line's beta calculation methodology is proper to use a CAPM analysis. Staff's beta is consistent with Value Line's beta calculation methodology.") However, Dr. Won's calculated betas are *not consistent with* published Betas from *Value Line* and serve to bias his CAPM result downward. *Compare* Ex. 101, Schedule SJW-14, column 2 *with* Spire Ex. 54 (2/26/21 Value Line Report). Simply put, Staff identified specific inputs to be included in its models but did not populate the models with these specific inputs. Tr. Vol. XIIII, p. 764 (Dr. Won: "We didn't directly use printed version of Value Line"). Thus, the models offered by Staff to support its position are simply wrong. As shown at Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-6, using the correct *Value Line* data would show that the ROE based on Dr. Won's application of the CAPM has **increased** from the last Spire rate case, materially changing his recommendation in this proceeding.

Because Staff's recommended ROE is not based on market-based models, and as such, is not in compliance with the governing legal principles mentioned above, the Commission should dismiss its analysis.

5. OPC's Recommendation: Witness David Murray

David Murray is currently a Utility Regulatory Manager for the OPC. In May 1995, Mr. Murray earned a Bachelor of Science degree in Business Administration with an emphasis in Finance and Banking, and Real Estate from the University of Missouri-Columbia. He also earned a Masters in Business Administration from Lincoln University in December 2003. Mr. Murray was formerly the Utility Regulatory Manager of the Financial Analysis Unit, Commission Staff Division for the Commission. Ex. 215 (Murray Direct), Schedule DM-D-1.

In this proceeding, Mr. Murray testified that he believes the cost of equity for Spire "is in the range of 6.50% to 7.50%." *Id.* at 5. However, he quickly walked away from this range, and instead recommended an ROE range of 8.50% to 9.50, based upon his perceived risk differential between natural gas companies and EDE, ultimately recommending an ROE of 9.25%. *Id.* at 2-3, 4-5. It should be noted that Mr. Murray has recommended an ROE of 9.25% in several recent rate cases in Missouri, regardless of the type of utility service (*e.g.,* electric, gas, or water) or economic conditions. Tr. Vol. XIIII, pp. 813-14.

6. Rearview Mirror Analysis of OPC

Like Staff, OPC's analysis is less credible than Spire's evidence. Mr. Murray rejected his own conclusion of an appropriate range of common equity cost rate for the Company of 6.50% to 7.50%, implicitly recognizing that this range is completely inadequate and would provide an insufficient achieved return on the book common equity of the Company. Instead, he recommended a range of common equity cost rates between 8.50% to 9.50%, with a point estimate of 9.25%, based on his review of the return authorized in EDE's last rate case. Ex. 215 (Murray Direct), pp. 2-3, 4-5. Like Staff's approach, OPC's approach is essentially a rearview mirror

approach looking back at economic conditions that existed during the EDE rate case. Additionally, in view of the governing legal principles above, especially the "corresponding risk" mandate, EDE, a vertically integrated electric utility, is not comparable to Spire, a natural gas distribution utility, a fact acknowledged by Mr. Murray in his testimony. *Id.* at 2-3.

The fact that OPC's ROE recommendation is not based on market models is further demonstrated when reviewing the ROEs recommended by Mr. Murray in rate cases over the last four years. Ex. 62 (Woodard True-Up Rebuttal), p.12. Mr. Murray routinely recommends an ROE of 9.25, regardless of the model results. Similar to Staff's analysis, OPC's analysis does not rely on market models to determine the ROE for Spire, and is also not in compliance with the governing legal principles stated above. As such, the Commission should dismiss OPC's recommended ROE for Spire.

7. Rearview Mirror Analyses Fail to Account for Current Inflation

Staff and OPC's failure to update their ROE recommendations for current market conditions is evident in their disregard of inflation. One major factor that impacts returns that has arisen since Spire originally filed its rate case is the emergence of significant inflation in the economy. Dr. Won recognizes the strong relationship between interest rates and the gross domestic product ("GDP") with the inflation rate. Dr. Won references the Congressional Budget Office's ("CBO") inflation data and forecast for 2021 in Staff's Cost of Service Report. Ex. 101, pp. 8-9. Won's reference to the CBO's February 2021 forecast relates to information before rising inflation became evident. Inflation had already started trending higher by the time Staff offered its Cost of Service Report in May. Ex. 6 (D'Ascendis Rebuttal) p. 13. Current inflation, as

measured by the Consumer Price index or Producer Price Indexes, is higher than in any period in the last ten years. Ex. 6 (D'Ascendis Rebuttal), pp. 13-14.

8. Business Risk Adjustment Should Be Included

Empirical evidence demonstrates that there is increased risk due to the small size of Spire compared to the Natural Gas Proxy Groups used by Mr. D'Ascendis, Staff and OPC. Spire's estimated market capitalization of $2.7 billion is lower than the average market capitalization of the Natural Gas Proxy Group, $4.6 billion, or 1.7 times greater than Spire's as of May 28, 2021. Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-1 p. 35. Mr. D'Ascendis also compared Spire's relative size to the proxy groups using seven other measures (average book value, five-year average net income, market value of invested capital, total assets, five-year average EBITDA, total sales, and number of employees), indicating size adjustments ranging from 0.27% to 0.59%. Ex. 7 (D'Ascendis Surrebuttal), pp. 25-26, Schedule DWD-SR-4. The Company has greater relative business risk, because, all else being equal, size has a bearing on risk. Because investors demand a higher return as compensation for assuming greater risk, this greater relative risk of Spire must be reflected in the recommended cost of common equity derived from the market data of any less risky business included in the Natural Gas Proxy Group. Mr. D'Ascendis has quantified this business risk differential as 0.10%, which should be reflected in Spire's authorized ROE in this proceeding. Ex. 6 (D'Ascendis Rebuttal), Schedule DWD-R-1, p. 2.

9. Flotation Costs Should Be Reflected in the ROE Authorized in this Proceeding

As noted by Mr. D'Ascendis, there is no mechanism through which such costs can be captured in the ratemaking paradigm other than an adjustment to the allowed common equity cost

rate to reflect the costs associated with the sale of new issuances of common stock. Ex. 5 (D'Ascendis Direct), p. 46. These costs include market pressure and the essential costs of issuance (e.g., underwriting fees and out-of-pocket costs for printing, legal, registration, etc.). *Id*. at 48, Schedule DWD-D-9. Flotation costs are charged to capital accounts and are not expensed on a utility's income statement. As such, flotation costs are analogous to capital investments, albeit negative, reflected on the balance sheet. *Id*. at 46. Recovery of capital investments relates to the expected useful lives of the investment. *Id*. Since common equity has a very long and indefinite life (assumed to be infinity in the standard regulatory DCF model), flotation costs should be recovered through an adjustment to common equity cost rate even when there has not been an issuance during the test year nor in the absence of an expected imminent issuance of additional shares of common stock. *Id*.

The various cost of common equity models (DCF, RPM and CAPM) assume no transaction costs, and therefore flotation costs are not reflected in the results of the application of these models. The Commission should therefore include flotation costs in the authorized ROE in this proceeding.

10. ROEs Authorized by Other Public Utility Commissions

This Commission has always compared its ROE analysis with those of other commissions to make certain that it was not out of the mainstream. Although it does not "slavishly follow the national average in awarding a return on equity" or "unthinkingly mirror the national average," the Commission has concluded that "the national average is an indicator of the capital market" in which a utility "will have to compete for necessary capital." *See Report and Order*, *Re Kansas City Power & Light Co*., Case No. ER-2010-0355, p. 122 (Apr. 12, 2011); *Report and Order*, *Re*

KCP&L Greater Mo. Operations Co., Case No. ER-2010- 0356, p. 148 (May 4, 2011); *Report and Order*, *Re Union Elec. Co.*, Case No. ER-2011-0028, p. 67 (July 13, 2011); *Report and Order*, *Re Missouri Gas Energy*, Case No. GR-2004-0209, p. 19 (September 21, 2004).

The United States Supreme Court has advised commissions to examine the returns being earned by companies "at the same time and in the same general part of the country" as the utility appearing before it. *Bluefield*, 262 U.S. at 692.

S&P Global Market Intelligence publishes average authorized ROEs for gas utilities nation-wide. **The most recent report from S&P Global Market Intelligence indicates that the average authorized ROEs for gas utilities in the first half of 2021 is 9.62%. Spire Ex. 51, p. 1. This is an increase from the average ROE of 9.46% in 2020.**

There is no support for Dr. Won's suggestion at hearing that a lower average over the last twelve months ("LTM") ended June 30, 2021 indicates that the second quarter 2021 numbers are lower than the first quarter 2021 numbers. Tr. Vol. XIIII, p. 751. The reason the LTM number is lower than the first half of 2021 number is because the LTM number includes older data from the second half of 2020. The most recent, statistically significant average authorized ROE for gas utilities is 9.62%. Spire Ex. 51, p. 1.

This ROE is more consistent with the testimony in Ameren Missouri's recent gas case (GR-2021-0241), Staff proposed a midpoint ROE of 9.5%, less than 30 days after Staff's ability to update the ROE in Spire's case in True-up direct filed on August 6, 2021. The Staff recommended ROE of 9.5% for Ameren Missouri is also within the true up period of Spire's case, and should be considered. The 9.5% ROE was for Ameren's test year ending December 31, 2020, while Spire's true up period ended May 31, 2021.

The Commission generally sets the zone of reasonableness at 100 basis points above and below the national average ROE authorized for similarly-situated utilities. See *State ex rel. Public Counsel v. PSC*, 274 S.W.3d 569, 574 (Mo. App. W.D. 2009). This methodology for setting the zone of reasonableness was upheld by the Missouri Court of Appeals as recently as 2012, holding as reasonable an ROE that "falls within the zone of reasonableness for returns on equity based on the national average authorized return on equity for gas utilities." *State ex rel. Office of the Public Counsel v. PSC*, 367 S.W.3d 91, 110-11 (Mo. App. S.D. 2012).

The Commission should adopt the Company's recommended ROE of 9.95% which is clearly within the zone of reasonableness. Given the small size and business risk of Spire and the average ROE in the nation, this ROE authorization is appropriate for purposes of this case. As discussed previously, both Staff's and OPC's recommended ROEs are not market-based and should be rejected by the Commission. If the Commission is not persuaded by the Company's position, then the most recent national gas utility ROE of 9.62% should be considered as an alternative.

11. The Commission Should Use Spire's Actual Capital Structure to Set the Rate of Return

In 2017, the Commission found that Spire's own capital structure should be used to set the rate of return. In this case, Spire's actual capital structure consists of 45.72% long-term debt and 54.28% equity. OPC takes the extreme position that Spire, Inc.'s capital structure should be used, even though Spire is financially independent from its parent company. As was the case in 2017, Spire issues its own debt which supports its own bond rating. Spire's assets do not guarantee the debt of Spire Inc., its other utilities, or its unregulated operations. Spire, Inc. holds five utilities in

three different states, a FERC regulated interstate pipeline and other businesses not under regulation by this Commission. These are the same facts that lead the Commission to use Spire's own capital structure in the 2017 Report and Order. Amended Report and Order, *Re Laclede Gas Co.*, Case Nos. GR-2017-0215 and GR-2017-0216, p. 43 (March 7, 2018).

Staff agrees that utilizing Spire's capital structure is the correct approach. Ex. 101 (Staff Cost of Service Report), pp. 5-6. OPC's approach is extreme and would destabilize Spire's credit rating, increase the cost of equity, increase the cost of debt, and reduce Spire's access to short-term financing. Ex. 45 (Woodard Surrebuttal), p. 6. The result of OPC's approach would be to increase the cost to Spire's customers. For these reasons, the Commission should be consistent and use Spire's actual capital structure, as recommended by both Staff and the Company and as decided by the Commission in the 2017 Report and Order.

As summarized by Dr. Won, the Commission relies on four factors to determine when a parent company's capital structure should be used:

1. Whether the subsidiary utility obtains all of its capital from the 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 the parent;
4. Whether the parent is diversified into non-utility operations.

Ex. 124 (Won Rebuttal), p. 41 (referencing Society of Utility & Regulatory Financial Analysis ("SURFA") Guidebook, The Cost of Capital, a Practitioner's Guide).

None of these factors support OPC's position when applied to the facts presented in this case. Regarding the first factor, Spire issues its own long-term debt secured by its own assets. Ex. 44 (Woodard Rebuttal), p. 6. Regarding the second factor, no obligation of Spire Missouri is guaranteed by Spire Inc. (or vice versa). Ex. 45 (Woodard Surrebuttal), p. 11. Regarding the third

factor, Spire Missouri has an independently determined capital structure. Ex. 44 (Woodward Rebuttal), p. 6; Ex. 45 (Woodard Surrebuttal), p. 11. Regarding the fourth factor, Spire Inc. is diversified into non-utility operations, which comprise just under 10% of Spire Inc.'s businesses. These non-utility operations include Spire Marketing, Spire Storage, Spire STL Pipeline, and other business segments which are not under regulation by the Commission. Ex. 44 (Woodard Rebuttal), p. 6.

OPC's claim that Spire has ceded management of its capital structure to the Commission is not true. As business and economic conditions change, Spire can and will alter its capital structure in response. Tr. Vol. XIIII, p. 715. However, it is generally appropriate to follow the guidance and capital structure that the Commission approved in the previous rate case. Ex. 45 (Woodard Surrebuttal), pp. 5-6. In the previous rate case, the Commission set rates based on a capital structure of 54.20% common equity and 45.80% long-term debt. In the absence of compelling business or economic changes, if Spire suddenly increased its long-term debt between rate cases (thereby temporarily lowering its overall cost of capital), OPC would likely complain that Spire is over-earning. By managing its capital structure to generally track the Commission's guidance, Spire keeps its cost of capital in line with the cost of capital reflected in rates. The assertion by OPC that Spire is in error by following the Commission's prior decision suggests that Spire should not listen to the regulators of Missouri utilities.

OPC proposed an alternative capital structure in the hearing room. OPC stated that the Commission should use Spire STL pipeline's capital structure of 50% equity and 50% debt. Tr. Vol. XIIII, p. 826-827. This is another flawed alternative proposal by OPC. Spire STL pipeline is a FERC regulated pipeline that is an interstate pipeline and not a state regulated gas local

distribution company. FERC ROE's trend to be much higher than state regulated gas LDCs. OPC did not disclose that with a 50/50 capital structure, Spire STL pipeline could earn a ROE up to 14%. Spire STL pipeline is a small part of Spire Inc.'s overall business portfolio. The Commission should take a measured approach and use the actual capital structure of Spire for establishing rates.

Furthermore, utilizing additional leverage, as suggested by OPC, would introduce additional risk, thereby raising the cost of equity while also raising the cost of debt. Ex. 45 (Woodard Surrebuttal), p. 6. There has been significant market volatility over the last few years and current market signals around inflation and interest rates suggest that this uncertainty will persist. *Id*. This volatility supports a more robust equity layer, not a diminished one. *Id*. The best interest of ratepayers is served not only with an efficient low-cost capital structure, but also a resilient one. *Id*.

12. Short-Term Debt Should Be Excluded from the Capital Structure

OPC advocates for including short-term debt in the capital structure used to set the rate of return on Spire's rate base. This is contrary to the Commission's long-standing practice of excluding short-term debt from major utilities' capital structure. Short-term debt is excluded from the capital structure because it is not used to finance the long-term assets in Spire's rate base. *See* Tr. Vol. XIIII, p. 741.

OPC claims that Spire's short-term debt exceeds the amount of construction work in progress ("CWIP") on Spire's books. Tr. Vol. XIIII, p. 702. However, this should not be the end of the analysis because CWIP is not the only category of short-term assets. Short term debt is also used to finance deferred purchased gas costs, unamortized PGA costs, propane inventory, and

hedging gains and losses. Ex. 44 (Woodward Rebuttal), p. 9. Winter Storm Uri cover gas cost provides a recent example of such short-term debt costs outside of CWIP. In this case, the average of all short-term assets exceeded short-term debt after taking into consideration the funding of $250 million of new long-term debt during the test year. Ex. 45 (Woodard Surrebuttal), p. 17. This is consistent with the "point in time" analysis adopted by the Commission and relied upon in the 2017 Report and Order, in which the Commission excluded short term debt from the capital structure. Amended Report and Order, *Re Laclede Gas Co.*, Case Nos. GR-2017-0215 and GR-2017-0216, p. 42 (March 7, 2018).

In 2017, the Commission found, "The average level of construction work in progress and other short-term assets exceeds the amount of short-term debt outstanding during the true-up period *after taking into consideration a September 15, 2017 funding of $170 million of long-term debt instruments*." *Id*. (emphasis added).

OPC is asking the Commission to ignore the long-term debt issuance during the test year, which is contrary to the generally accepted "point-in-time" analysis, contrary to Staff's position in this case, contrary to the Commission's approach in 2017, and contrary to financial realities. The common and beneficial practice of using short-term debt as a bridge to long-term financing does not indicate that short-term debt is financing rate base, as OPC would have the Commission believe. To the contrary, using short-term debt as a bridge to long-term financing indicates that short-term debt is being used as intended—to fund short term assets, not rate base. *See* Tr. Vol. XIIII, p. 713, ln. 18-22; p. 740, ln. 25 to p. 741, p. 10. Accordingly, the Commission should exclude short-term debt from the capital structure, consistent with the positions of Staff and Spire.

IV. **Conclusion**

For all of the foregoing reasons, Spire respectfully requests that the Commission resolve the remaining disputed issues in this proceeding in accordance with the positions taken and recommendations made by the Company in this Initial Post-Hearing Brief.

Spire specifically requests that the Commission:

1. Rely on Spire's 2020 Depreciation Study to set depreciation rates in this case because it is the only source to incorporate all available and relevant data for both Spire East and Spire West, the entities to which the depreciation rates will be applied;
2. Approve the rates provided in the 2020 Depreciation Study, including rates for general plant accounts, mains, Enterprise Information Management System, and ultrasonic meters;
3. Find that no changes are necessary to the overhead capitalization amounts and that the Company's methods are consistent with the USOA;
4. Find that the Company is following its Commission approved CAM for affiliated transactions;
5. Acknowledge the significant safety benefits of ultrasonic meters and include those incurred costs in rates;
6. Find that the appropriate Cash Working Capital lag day for income expense is 38 days;
7. Find that the two non-earnings-based incentive compensation metrics proposed by the Company should be included in cost of service calculations;
8. Find that the RNA mechanism proposed by Spire is adopted as the best means of accounting for weather and conservation;

9. Allow Spire to continue its practice of including NOLs in rate base as an offset to ADIT; and
10. Maintain Spire's capital structure similar to the one ordered in Spire's last rate case, consisting of 45.72% long term debt and 54.28 % common equity and to set the Company's return on equity at 9.95%.

To the extent an issue was settled in the Partial Stipulations and Agreements, Spire also requests the Commission adopt the proposals included in those documents.

Dated: September 7, 2021

/s/Goldie T. Bockstruck

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ATTORNEYS FOR SPIRE MISSOURI INC.

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing was served electronically, or hand-delivered, or via First Class United States Mail, postage prepaid, on all parties of record herein on this 7th day of September, 2021.

/s/ _Lew Keathley_________________