BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

SPIRE'S POST-HEARING REPLY BRIEF

Spire Missouri Inc. (referred to herein as "Spire" or the "Company") respectfully submits its Post-Hearing Reply Brief in accordance with the Commission's February 3, 2021 Order Setting Procedural Schedule. This Post-Hearing Reply 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

Staff and the Office of the Public Counsel ("OPC") also filed Initial Briefs in this matter on September 7, 2021. Staff and Spire are aligned on many of the disputed issues of corporate allocations and affiliate transactions, cash working capital, incentive compensation and net operating loss and accumulated deferred income taxes. Additionally, Spire and Staff have each proposed to eliminate the Company's current Weather Normalization Adjustment Rider and instead propose a Rate Normalization Adjustment or "RNA" in this case that considers both weather and conservation. Unfortunately, these parties differ on the appropriate breaking point to include in the RNA. Spire's breaking points are based on analysis of customer bills for its residential and small general services ("SGS") customers and therefore asserts that the appropriate breaking points are 30 Ccf and 100 Ccf, respectively. Staff's position differs from the Company's position on the issues of depreciation, capitalization of overheads, ultrasonic meter recovery and cost of capital. For reasons stated herein, Spire asks the Commission to agree with Spire's position based on the evidence presented in this case.

Before responding to the specific arguments made by Staff and the OPC on specific issues, the Company believes it is necessary to comment briefly on the cumulative impact of the positions advanced by OPC in its Initial Brief. During its opening statement in this case, OPC asserted that it is "not out to bankrupt the Company" since it knows that Spire is providing "an important public service". OPC went on to state that it is nevertheless recommending no increase in base rates because in its view such a result "balances the needs of the Company to collect its capital investments" with the supposed need to relieve customers of what OPC considers to be the costs of inappropriate subsidization. Tr. Vol. X, pp 88-89.

Whatever OPC's intentions may be, however, it is clear that any material acceptance of the various positions it seeks to defend in its Initial Brief would in fact inflict substantial financial harm on the Company and seriously impair its ability to provide what OPC itself acknowledges is an "important public service". In essence, OPC is proposing that in response to the roughly one billion dollars in utility investments Spire has made since its last rate case, the Commission should issue an order that would not only deny Spire *any* new revenue to recover the cost of such investments, but also take away all of the ISRS revenues the Company is *currently* collecting for that purpose. It is simply untenable for OPC to claim that this is a result that fairly "balances the needs of the Company to collect its capital investments", when OPC's treats those needs as a matter of so little consequence that it completely ignores them in its overall revenue requirement recommendation.

As discussed below, this obviously untenable result is simply the natural byproduct of the equally unsound and even extreme adjustments that OPC seeks to justify in its Initial Brief. The extreme nature of these adjustments is demonstrated by the degree to which the Commission would need to depart from existing ratemaking principles and practices to adopt them. Specifically, acceptance of such adjustments would require the Commission to:

(1) reverse the capital structure principles and criteria it recently endorsed in the Company's last rate case;

(2) reject the guidance it has provided in multiple cases for determining when incentive compensation costs may be included in rates;

(3) take ratemaking actions that would almost certainly violate IRS normalization requirements and, in the process, jeopardize the Company's ability to use, on behalf of its customers, tens of millions of dollars in accelerated depreciation benefits;

(4) reverse its historical acceptance – over literally decades of prior cases – of how the Company capitalizes overheads to construction;

(5) reject partial or full cost recovery for an ongoing initiative designed to significantly improve the accuracy of the Company's metering process and its capabilities to save lives and property from potentially catastrophic gas leaks,

(6) completely eliminate any adjustment mechanism for addressing the impact of weather fluctuations and other factors on utility revenues and customer bills; and

(7) sanction proposed allocations of costs between the Company and its affiliates that bear no relationship to the cost allocation principles previously approved by the Commission for such transactions or to the actual employee, rate base, revenues and activities of the affiliated companies.

Spire certainly understands that parties are free, under appropriate circumstances, to suggest changes to the Commission's policies and practices. It has done so itself. But OPC's wholesale and unjustified abandonment of so many of them in a single case has led to a cumulative result that cannot be reconciled with any recognizable concept of what constitutes just and reasonable rates. As discussed below, OPC has presented nothing in its Brief to cure this foundational flaw.

II. <u>Litigated Issues</u>

A. Issue No. 24 - Depreciation

The Company's depreciation study should be used to set depreciation rates because it is the best evidence of what those rates should be.

In its Initial Brief, Staff summarizes its position on what course of action the Commission should take with respect to the depreciation issues in this case but does not explain in any detail why the Commission should adopt its recommendations. (Staff's Initial Br., pp. 49-50). OPC, on the other hand, goes into great detail on various minutia relating to the evolution – but not the substance – of this issue. This includes whether the Company should have filed its 2020 Depreciation Study at the beginning of the case (rather than simply submit it to the parties as required by Commission rule 20 CSR 4240-40.090); inconsistencies between the depreciation rates recommended in the Company's study versus those referenced in the direct testimony of a Company witness; and supposed discrepancies between Staff's depreciation recommendations and its description of how those rates were calculated. (OPC's Initial Br., pp. 128–169).

None of this background noise, however, can obscure the decisive fact that Spire is the *only* party to this case to have performed a comprehensive depreciation study based on an evaluation of historical and updated plant data from both Spire East and Spire West. It is also the only study presented in this case that reflects application of all the tools commonly used by depreciation professionals to formulate valid depreciation rates, including informed judgment, site visits and discussions with managerial personnel with knowledge of the Company's activities.

Notably, while Staff and OPC object to several recommendations set forth in the 2020 Depreciation Study on a few selected accounts, neither party has referenced any evidence in their briefs that would cast doubt on the validity of the Company's 2020 Depreciation Study and its results. In fact, the most that Staff can say in that regard is that "companies are not required to use a depreciation study to support their recommended depreciation rates" – an observation that obviously does nothing to cast doubt on the validity or reliability of a study that has been presented. (Staff's Initial Br., p.50).

For its part, OPC's main concerns center on the supposed confusion that was caused when a Company witness who was sponsoring direct testimony on a number of issues referred only to the composite depreciation rates (versus specific rates) for its general plant assets from the Company's 2020 depreciation study. These general plant composite depreciation rates were not representative of the depreciation rates requested in the Company's 2020 Depreciation Study. The Company admits failure to explain the intent behind the Company's use of the composite rates in its direct filing has caused some confusion, and regrets this oversight. This depreciation study was submitted to the parties as part of the Company's workpapers within days of when the Company filed its direct case. (OPC's Initial Br., pp. 136-138). That said, any confusion could have been easily explained and corrected had OPC simply reviewed the 2020 Depreciation Study when it was sent to them early in the rate case process (December 2020) and then sent an email, data request or just made a telephone call asking for a clarification. The Company is not casting aspersions on OPC's failure to do so, but such an approach would have been preferable and more productive than OPC's current efforts to exaggerate the significance of this error in its Initial Brief and pretend that it has some relevance to the issue of what depreciation rates are appropriate.

In any event, any clarifications that may have been needed on this matter were provided when the author of the study submitted rebuttal testimony and schedules that included the same depreciation study that had been in Staff and OPC's possession for over 5 months. *See* Ex. 35 (Spanos Rebuttal), Sch. JJS-R2. As a result, both Staff and OPC were accorded a second opportunity to review it and then file surrebuttal testimony.

The Company's comprehensive 2020 Depreciation Study and the depreciation rates resulting therefrom are clearly the best evidence on this issue, especially in light of the fact that OPC performed no depreciation study, while Staff formulated its depreciation recommendation based on a formula that it did not follow. (See OPC's Initial Br., pp. 131-134). The Company's study, as noted above, was based on an evaluation of updated data for both Spire East and Spire

West, as opposed to the stale data underlying the older depreciation rates for Spire East. OPC not only proposes to rely on this stale data for Spire East, but also proposes to arbitrarily extend depreciation rates based on that data to Spire West without regard to the differences between those two service territories.

The depreciation rate for Account 376.2 Mains-Cast Iron should be increased to the 12.35% recommended by the Company, not the 35.87% recommended by OPC.

With that in mind, the Commission should reject OPC's proposal for a ten-fold increase in the depreciation rate for Account 376.2 Mains - Cast Iron from the current 3.12% to 35.87% to, in part, address the impact that joint encapsulations have had on this account. (OPC's Initial Br., pp. 141-144). As OPC noted, this recommendation alone would require a revenue requirement increase of approximately $23.2 million – a figure that is apparently factored into OPC's recommendation that there be no base rate increase at all. *Id.* While the Company believes a significant adjustment to this account is appropriate, it does not consider such an extraordinary one to be necessary or appropriate. Instead, based on the results of his depreciation study and discussions with Company personnel familiar with such facilities, the Company's depreciation expert has recommended that the depreciation rate for this account be increased to 12.35%. Ex. 35 (Spanos Surrebuttal), p. 4. His more moderate recommendation is more reliable and, unlike OPC's, is not being made with an unrelated agenda in mind.[1]

[1]*See* Tr. Vol X, p. 87 in which OPC advised the Commission during its opening statement that the revenue requirement increase from its proposed depreciation rate change on this account would mostly offset the revenue requirement decrease relating to its capital structure adjustments. In other words, OPC indicated approval of the adjustments would be a "wash" to Company (except for a remaining $3 million or so difference. OPC did not include in its advisory to the Commission, however, the critical caveats needed to understand the true nature of this "wash". Specifically, OPC did not explain that its proposed depreciation rate change would only increase the level of *non-earnings cash* received by the Company while its proposed capital structure adjustments would directly reduce the Company earnings. As a result, such an illusory "offset" or "wash" would still have a significantly adverse impact on the Company's financial situation. Spire does not know, of course, whether OPC's fairly enormous depreciation rate change proposal for cast

The depreciation rate for Account 376.3 Mains-Plastic and Copper should be based on a 60-year average service life as recommended by the Company, not the 75 year average service life recommended by OPC.

Having just proposed a more than 1000% increase in the depreciation rate for cast iron mains, OPC goes on its brief to oppose the Company's recommendation to apply a consistent 60 year average service life to calculate depreciation rates for the Company's plastic mains. (OPC's Initial Br., pp. 154-157). Such a reduction in the average service life for plastic mains would move the resulting depreciation rate for that account in the same upward direction as those being recommended for cast iron mains, albeit at a much smaller pace. There are many forces of retirement on mains that are driving the change in recommended average service lives and in particular the plastic mains that are approaching a more mature life cycle to help understand future expectations.

OPC's arguments for opposing this recommendation, however, just confirm why it is appropriate to utilize the Company's 2020 Depreciation Study with more current analysis and depreciation rates for resolving this issue. First, OPC cites the service lives reflected for this account in prior depreciation studies from 4 to 18 years ago. *Id*. at 155. But that only underscores why it is important to use updated information for determining depreciation rates, as the Company has, and not to simply rely on data from prior depreciation studies that has grown stale. Second, OPC asserts that the Company's service life recommendation unreasonably reflects the

iron mains was motivated by a desire to create the appearance of such a "wash" in the hope that it would make it easier for the Commission to adopt its capital structure adjustments, but it was OPC that explicitly linked the two. At the very least, such a possibility is yet another reason to approve Spire's more moderate and better supported recommendation on this issue.

"premature" replacement of plastic mains connected to the Company's accelerated replacement program for cast iron mains. OPC never explains, however, in what way these replacements are "premature" or why they should not be considered in setting depreciation rates in this case. Indeed, such a criticism is especially misplaced when OPC itself is taking the same kind of accelerated plant replacement factors into consideration in developing its own depreciation recommendations for cast iron mains and explicitly relying on them to propose a depreciation rate increase for that account that is orders-of-magnitude greater than what the Company is recommending for plastic mains. Finally, OPC argues that the Company's proposed reduction in average service life for plastic mains is inconsistent with what other witnesses have said in other contexts about the long-term durability of plastic mains and services. (OPC's Initial Br., pp. 156-157). But as OPC well knows, the Company's recommendation is not being driven primarily by the need to replace plastic mains because of a perceived problem with their condition, but because their replacement is necessary to accommodate the replacement of cast iron mains which do have problematic characteristic. Indeed, given this interdependent relationship, the better question would be how OPC can simultaneously propose a huge increase in the depreciation rate for cast iron mains but a reduction in the depreciation rate for plastic mains. For all of these reasons, Spire's service life recommendation and resulting depreciation rate for this account should be approved by the Commission as the service lives and resulting rates are based on the most up to date information.

The Commission should approve Spire's general plant amortization proposal without the conditions proposed OPC.

In their Initial Briefs, both Staff and OPC continue to oppose the Company's recommendation that the Company be permitted to properly implement general plant amortization for certain accounts consisting of relatively small items so that they are amortized by vintage year without the need to individually track certain data for each item. (OPC's Initial Br., pp. 165 – 166; Staff's Initial Br., p. 50). As proposed by Company witness Spanos, the rate for each general plant account would have an amortization percentage that would be applied to items that are still in service and a zero percentage rate for items that have been in service long enough to exceed the amortization period. Ex. 36 (Spanos Surrebuttal), pp. 4–6. Both Staff and OPC have expressed concerns about this proposal but it is still unclear to the Company why those concerns have any validity. As Staff witness Buttig recognized, general plant amortization is used by other utilities. Tr. Vol. X, pp. 112-113. It is a way to reduce administrative burdens and costs (which are ultimately reflected in rates) for recording certain data on such items in a manner that has been explicitly sanctioned by FERC for small value, high volume items assuming certain criteria are met. https://www.ferc.gov/enforcement-legal/enforcement/accounting-matters/vintage-year-accounting-general-plant-accounts.[2]

To suggest that such data does have some value, OPC argues about its ability to conduct prudence audits of these accounts being potentially compromised, but points to no previous instance where such an audit has been done. The Company should not be required to continue accumulating voluminous information where doing so serves no regulatory purpose.

The Company also has no idea why OPC and Staff oppose the application of a zero percentage rate to those items that have exceeded the period of amortization. The purpose of including the zero percentage rate is to eliminate recovery on items that have or will be retired or have exceeded the amortization period. This consumer protection is a good thing and will ensure that a representative level of assets with these characteristics are excluded from rate recovery in the future. Upon Commission approval of general plant amortization, the Company will retire all

[2] Notably, no party has alleged that Spire's proposal is inconsistent with these FERC requirements.

general plant assets that exceed the amortization period and have a net plant balance of zero. Ex. 36 (Spanos Surrebuttal), pp. 4–6. Additionally, Staff and OPC do not state any reason why Spire should not utilize amortization accounting for these assets in a consistent manner to other utilities in Missouri or others in the industry.

Finally, the Commission should reject the recording, tracking and other conditions proposed by Staff and OPC. Implementation of these conditions would simply eviscerate the administrate benefits of moving to such a system by replacing one set of unneeded and costly administrative burdens with another.

For all of these reasons, Spire respectfully requests that the Commission approve the depreciation rates consistent with the Company's 2020 Depreciation Study.

B. Issue No. 15 - Capitalized Overheads

Introduction:

Spire explained in its Initial Brief that its approach to capitalizing overheads is based on reason and judgement, is not arbitrary, and is in accordance with the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) and, further, why this Commission has the authority to continue that approach pursuant to Commission Rule 20 CSR 4240-40.040.

The Staff and OPC's initial briefs take a different approach to this issue in arguing that the method of capitalizing overheads that has been used by Spire over the prior decades is "arbitrary" and, therefore, not in accordance with the FERC USOA. As described below those arguments fail and the Commission should adopt Spire's position.

i. Process Not Arbitrary

Staff, without support in the applicable USOA provisions, alleges that studies are required by the USOA Gas Plant Instruction 4 B. (Staff's Initial Br., p. 40). As acknowledged by Staff witness Young, while USOA Gas Plant Instruction 4 B identifies direct time reporting and special studies as *permitted*, what the USOA *prohibits* is found in the last sentence of USOA Gas Plant Instruction 4 B -- the use of "arbitrary percentages or amounts." Tr. Vol. X, p. 148 (emphasis added). This sentence of the USOA does not specify a particular method or approach that is arbitrary. It can be assumed, therefore, that this requirement may be addressed in various ways.

The only support that Staff offered for its position was a 1988 document created by the National Association of Regulatory Commissioners (NARUC) interpreting this portion of the FERC USOA. Tr. Vol. X, pp. 151-152. That document has not been updated by NARUC since 1988. *Id*. at p. 152. Moreover, if that document were persuasive and determinative, it is unclear why it has not been cited or used for support in the over 32-year period since its issuance. Staff witness Young, in fact, stated that he is not aware of any instance since 1988 where the interpretation of Gas Plant Instructions 3 and 4 has even been considered in a rate case. Tr. Vol. X, p. 153.

We are left with the fact that Spire has consistently applied its process for capitalizing overheads for many years. As explained by Company witness Tim Krick at the evidentiary hearing, the Company's longstanding process uses "reason and judgment" to set and adjust capitalization rates. This process also has the benefit of stabilizing rates for customers and providing a consistent and predictable result.

ii. Interaction with Accounting Principles

Staff's Initial Brief recognizes that Spire must also comply with Generally Accepted Accounting Principles in addition to the USOA, and that "[b]oth forms of authoritative guidance include a basis for assigning costs either to expense . . . or to capital expenditures. . . ." (Staff's Initial Br., p. 36). Spire notes that guidance is also provided by the Financial Accounting Standards

Board (FASB), which requires adherence to the consistency principle with the objective of limiting management's ability to manipulate financial statements by inconsistently applying or changing certain policies. Ex. 16 (Krick Rebuttal), p. 11.

The underlying and fundamental approaches used by Spire to capitalize overheads is consistent with the practice used for decades. Ex. 16 (Krick Rebuttal), p. 10. If anything, the dramatic change suggested by Staff and OPC (as further described below) violates the FASB requirement for consistency and will serve to disrupt and provide unpredictable results for the Company's financial statements. Such an outcome is neither required nor advisable.

iii. Increase in Capitalization of Overheads Due to Construction Activities

Staff's Initial Brief correctly observes that Spire's capitalization of overheads has greatly increased over the years. (Staff's Initial Br., p. 36). This is neither unexpected nor a reason to embark on a different process for capitalizing overheads.

It is no mystery why Spire's capitalization of overheads has increased over the years. This increase is because there has been a higher level of construction activity, driven in large part by Spire's field operations workforce. Ex. 16 (Krick Rebuttal), pp. 11-12. It therefore makes sense that the level of overheads that support construction and capital investment has increased. *Id*. This is not indicative of any deficiency with the current process for the assignment of overheads.

iv. Ability to Audit

Staff's Initial Brief alleges that it was unable to audit Spire's overhead capitalization. (Staff's Initial Br., p. 35). Spire very much disagrees with this assertion. As explained in Spire's Initial Brief, the Company attempted to provide additional information to assist Staff in its audit of the Company's overhead capitalization. (Spire's Initial Br., pp 30-31). However, Staff did not accept or pursue these offers.

Further, Spire witness Krick believes that communications between the parties were not clear on these issues. One example is OPC Data Request 1009-2 that asked for "the Spire Missouri employee, title, and position description **<u>for each position</u>** that capitalize a portion of their time and benefits as construction overheads during this period." Ex. 16 (Krick Rebuttal), p. 12-13. The response was that "we do not maintain such information in the format requested but will work with OPC to provide further explanation and, if appropriate, a representative sampling of the requested employee information." *Id*. at p. 13. Mr. Krick reiterated that it *is* possible to provide this level of detail for each employee, but that the Company's response was meant to imply it is not practical to provide the information as broadly as requested through this data request. *Id*. The Company tried to proactively work with the parties throughout this proceeding to provide such information in a way that could be audited by the parties. *Id*. However, the audit process necessarily requires communication and as could be seen by the responses of Staff witness Young and his e-mail exchange with the Company, Staff decided it did not want to continue those communications.

v. Proposed Remedies/Consequences

Staff recommends that "the Commission order Spire to cease capitalizing non-operational overhead costs, or an alternative, order Spire to cease capitalizing costs received from Spire Services, until such time that Spire can demonstrate its compliance with the USOA." (Staff's Initial Br., p. 35). In form, this approach is unworkable as it is unclear how Spire would proceed to "demonstrate its compliance." Staff witness Young testified that he "envisioned that Spire and Staff and Public Counsel would *cooperate and provide status reports* to [the] Commission. (emphasis added). And decide how to implement that in Spire's general rate case." Tr. Vol. X, p. 153. Past experiences with Staff, OPC, and the Company cooperating and providing status reports, does not bode well for an expeditious agreement among the parties or unanimous agreement as to what Spire Missouri may, or may not, have "demonstrated."

In addition to the OPC recommendations addressed by Spire in its Initial Brief, OPC rehashed a prior recommendation that any "order should be effective October 1, 2019, the beginning of the test year." (OPC's Initial Br., p. 92). This is contrary to the OPC's position, as restated by the Regulatory Judge Hatcher, that "we're going to leave alone the capital overheads that exist, and going forward we're going to have a tracker, or have a new system or have an order." Tr. Vol. X, p. 181. Mr. Schallenberg's testimony at the hearing appeared to confirm that the OPC's tracker recommendation was not designed to track amounts from the last year, only to track going forward once put into effect. *Id*. This distinction is extremely important, as a retrospective order regarding capitalized amounts going back to October 1, 2019, could result in a write-off of overhead costs capitalized to plant in service during the test year of approximately $87 million. Ex. 17 (Krick Surrebuttal), p. 12. While it is easy for OPC to suggest a "tracker" the implementation of such mechanism requires much detail and specificity as to what items are being tracked, how such tracked items are to be treated, what the future implications are for such tracked items and how records of tracked items are to be kept. OPC's proposal lacks the detail required to effectively and appropriately put such a tracker in place, and the benefit of such a tracker is unclear at best. *See* Tr. Vol. X, pp. 180-181. However, if Spire were ordered to cease capitalizing overheads, at a minimum, such order should be accompanied by the establishment of a regulatory asset/liability to capture those otherwise prudent and reasonable costs.

vi. Potential Increase to Revenue Requirement

What neither Staff, nor OPC, specifically address in their Initial Briefs is the immediate revenue requirement increase that would be a necessary consequence of their recommendations.

There is no challenge to the prudence or the recoverability of the costs at issue. (Spire's Initial Br., p. 26, citing Tr. Vol. X, p. 147). The issue is whether these costs are recovered over a period of time as capital, or over the next year as expense. *See* Staff 's Initial Br., p. 31 ("If expensed instead, the full amount of these costs is charged immediately to operating and maintenance expense.").

The historic test year is used for the purpose of setting rates on a prospective basis. "Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses. . . ." *Spire Mo., Inc. v. Pub. Serv. Comm'n*, 618 S.W.3d 225, 232 (Mo. 2021), quoting *State ex rel. Utility Consumers Council, Inc. v. Public Service Com.*, 585 S.W.2d 41, 58-59 (Mo. banc 1979). Thus, if Spire is ordered to not capitalize overheads, those costs must instead be treated as expenses and a reasonable amount of which must be added to Spire's annual revenue requirement in order to make a reasonable approximation of Spire's expenses on a going forward basis. Failure to include revenues for the purposes of recovering such prudent and reasonable expenses would guarantee that Spire would not have an opportunity to earn a reasonable rate of return on its investment.

Spire witness Krick has estimated that the amount necessary for addition to the annual revenue requirement to be as much as $114.9 million on an annual basis. Ex. 17 (Krick Surrebuttal), p. 7-8. On the other end, OPC witness Schallenberg estimated the amount to be $39,023,977.34. Ex. 25 (Schallenberg Direct), p. 25. Staff did not provide an estimate. Given the estimates provided, if the Commission follows the recommendations of Staff or OPC, it should add a minimum of $39,023,977.34 to the Company's annual revenue requirement to address this issue.

Conclusion

Spire calculates its overhead capitalization in accordance with the USOA, using a reasonable and acceptable approach that is consistent with its historical practice, is not "arbitrary," and charges overheads that are "reasonably applicable" to its projects.

Spire's approach has provided stability for its customers and the Company in terms of rate impacts over many years. As has always been the case, the Company is always open to providing additional information to Staff and OPC to aide them in understanding how its overheads are capitalized. 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

Both OPC, and to a lesser extent Staff, oppose full rate recovery of the costs associated with the Company's program to replace its aging and soon to be obsolete diaphragm meters with ultrasonic meters that are more accurate, only marginally more expensive and that have critical safety features that can better protect the lives and property of the Company's customers. The Company believes that it anticipated and addressed arguments of the other parties sufficiently in its Initial Post Hearing Brief (Spire's Initial Br., pp. 52-56), however there are certain points made by OPC that cannot be ignored.

First, OPC calls into question the prudency of the Company's decision to replace its diaphragm meters based on safety, accuracy, and reliability. OPC tries to distract the Commission regarding the importance of these points by attempting to show that diaphragm meters can provide the same benefits as ultrasonic meters. To support this argument, OPC relies on Exhibit 219 which is a spec sheet for a Honeywell product. (OPC'S Initial Br., pp 173-176). However, at hearing OPC's own witness verified that OPC was not aware of the purchase cost or whether this product is compatible with Spire's current metering systems (it's not). (Spire's Initial Br., p 40; Trans. Vol XI, p. 276). Regardless, the Company's current diaphragm meters do not provide the same safety, accuracy, and reliability enhancements offered by the ultrasonic meters. These benefits, such as more accurate billing and the protection of life, are important. Nowhere does the OPC dispute that the ultrasonic meters the Company is utilizing are not capable of delivering these benefits – it merely claims that perhaps another meter can, too. This is a classic business decision, and should not be the basis for disallowing costs associated with this important enhancement to the Company's system.

Second, OPC raises the issue of the appropriate service life of the Company's current diaphragm meters. In its initial brief, OPC includes specific transcript excerpts of OPC counsel's cross examination of Spire witness James Rieske, wherein Mr. Rieske states that the average service life of diaphragm meters is 18.8 for Spire East and 22.1 for Spire West. (OPC's Initial Br., p. 149-152). Mr. Rieske also testified that he was unaware that Spire witness John Spanos had recommended an average 35-year life for the meters. *Id.* OPC then attempts to argue that the Commission has no other choice but to find one of Spire's witnesses not credible. *Id.* This assertion is false and the argument should fail. At hearing, Spire witness Rieske confirmed that he is an expert in meter technology. Tr. Vol XI, pp. 254-256. He went on to state that he is not familiar with the details of the financial management of the depreciation of assets, and that he does not set or manage the depreciation of the Company's assets. *Id.* Additionally, Company witness Spanos testified that he has 35 years of utility depreciation experience and he performed the Company's 2020 Depreciation Study which was provided to the parties of this case in December

2020 and filed as Schedule JJS-R2. Ex. 35 (Spanos Rebuttal), pp 1-2. Both of these expert witnesses provided credible testimony in their subject matter and any attempt to say otherwise should be ignored. Each witness looked at the life of the meters from a different perspective, based on their respective functional expertise resulting in disparate conclusions. If the Commission would like the Company to analyze this issue further, rather than have the Commission entertain on the fly depreciation adjustments based on a very limited record on the matter, the Company is willing to conduct an analysis on the appropriate service life for its diaphragm meters and submit such an analysis to the Commission as the Commission deems appropriate. However, the disparate conclusions should not distract the Commission from the real issue—whether or not the Company should be allowed to recover costs associated with ultrasonic meters in rates.

Third, the OPC alleges that the Company's replacement strategy results in a significant stranded investment by replacing meters before the end of their useful life. As noted in the testimony of Spire witness Rieske, the Company is targeting those meters that do not meet testing standards or otherwise need to be replaced. While the Company is also replacing meters in other scenarios where the opportunity to replace has arisen organically, regardless of age, this strategy reduces or eliminates the cost of having to come to the residence again in the future to conduct the replacement, while ultimately delivering benefits to customers sooner. Regardless, the issue in this case is not about what replacement strategy the Company should pursue in the future. Rather, it is about the demonstrated prudence of the limited amount of ultrasonic metering assets placed in service during the test year.

Nevertheless, Staff proposes that Spire should file quarterly reports on Spire's meter replacement strategy, including justification for any changes in replacement strategy. (Staff's Initial Br., pp. 51-52). Staff goes on to assert that the justification should include a cost benefit analysis for changes in replacement strategy and alternative approaches Spire considered, along with the potential customer impacts. *Id.* Spire has provided substantial information on its process to the parties involved in this proceeding through testimony and data request responses, including studies Spire conducted that lead to its decision that ultrasonic meters were the appropriate meters for Spire and its customers.

Additionally, Spire is required to file updates with the Commission every six months which includes an update on meters as part of Case No. GO-2020-0182 so Staff's recommendation is redundant. Since the information is already shared and filed in an open case before the Commission, Spire proposes to continue to file the updated information in Case No. GO-2020-0182 bi-annually until that case closes. When that case closes, Spire can provide additional updates and information on ultrasonic meter deployment to Staff and OPC annually. As always, Spire is willing to meet with Staff and OPC at any time to discuss any matter, including meters and meter replacement.

Spire believes that, far from the assertions made by Staff and OPC, its decision to introduce ultrasonic meters to its system and its approach to rolling out these devices is an example of a utility pursuing and implementing a significant customer service improvement in a thoughtful, affordable and cost-effective manner. Such actions by utilities regulated by the Commission should be encouraged and not penalized as OPC's and Staff's adjustments would do. The Commission should permit the full costs of the Company's ultrasonic meters in rates for the reasons previously articulated by the Company.

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

<u>Introduction:</u>

Staff's Initial Brief concludes that "the current costs 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 it provides." (Staff's Initial Br., pp. 48-49). Spire agrees. In contrast, OPC primarily argues that Spire Missouri is providing a financial advantage to Spire Inc. The OPC brief largely does not concern itself with transactions between Spire Missouri and any affiliate other than Spire Inc.

Spire Missouri's conduct is consistent with the affiliated transaction rule and its commission-approved Cost Allocation Manual (CAM). Further, an examination of the transactions at issue reveals that shared costs are borne in an amount and percentage as would be expected given the size and activities of the entities involved. There is no basis for an adjustment related to this issue and certainly no basis for an adjustment in the amount recommended by the OPC.

i. Types of Spire Inc. Costs at Issue

OPC provides a list of goods or services provided to Spire, Inc. for which it alleges there are no costs charged. (OPC's Initial Br., p. 116-117). In reviewing these items, it must be remembered, as acknowledged by Staff, that the affiliate transaction rule treats "corporate support services" differently from other types of affiliate transactions. (Staff's Initial Br., p. 46-47).

Commission Rule 20 CSR 4240-40.015(2)(B) provides that corporate support functions may be provided to an affiliate without regard to preferential treatment:

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

"Corporate support" is defined as "joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities." 20 CSR 4240-40.015(1)(D); Ex. 17 (Krick Surrebuttal), p. 5.

Many of the Spire Inc. items identified by the OPC as being problematic fit into "corporate services" as defined by the affiliate transaction rule, including proxy statements, income tax returns, SEC financial reporting, cash management financing decisions accounting services, risk analysis initial audit, governance, and strategic planning. Notably, Spire Missouri (and its customers) would incur the full cost of these activities on its own in the absence of a shared services structure.

The remaining items on OPC's list are expenses related to executive officer compensation, Board of Director expenses, and rent associated with buildings located at 700 and 800 Market Street in St. Louis, Missouri. As discussed in Spire Missouri's Initial Brief and below, expenses related to executive officer compensation and Board of Director expenses are borne by Spire Inc. and its shareholders. Additionally, expenses related to the buildings are treated in accordance with the Commission-approved CAM.

ii. Costs Borne by Spire Inc.

OPC erroneously alleges that "Spire Missouri is providing a financial advantage in the form of 'information, assets, goods or services' for which Spire Inc. is paying **<u>nothing</u>**" and that Spire Inc. is receiving goods and services without providing "just compensation (or really any compensation)." (OPC's Initial Br., p. 113-114, 124). These allegations are fundamentally untrue.

First, as indicated in Spire Missouri's Initial Brief, the allegations ignore that *<u>substantial</u>* costs are borne by Spire Inc. and its shareholders as to executive compensation and other costs. Additionally, OPC itself identified amounts that are allocated to Spire Missouri by Spire Services. (OPC's Initial Br., p. 115). To say that bears "nothing" and does not provide "really any compensation" for these services is just wrong.

For example, substantial portions of the compensation of executive officers allocated to Spire Missouri are excluded from cost of service. Spire Missouri made a very large adjustment to its test year numbers to remove approximately $9M from its cost of service request. Tr. Vol. XI, pp. 358-359. Similarly, Staff recommended, and *Spire Missouri agreed with*, adjustments to exclude discrete Board of Director expenses in the revenue requirement. (Staff's Initial Br., p. 45). Recovery of those amounts is not sought from Spire Missouri customers, and those costs are instead borne by Spire Inc. and its shareholders. Additionally, the largest component of executive pay is equity awards, which are not included in the revenue requirement, and are instead borne by shareholders. Moreover, Spire Inc. 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.

Contrary to OPC's allegations (OPC's Initial Br., p. 122), Spire Inc., and its shareholders do pay for costs associated with Spire Inc.

iii. Spire Missouri Bears a Proportionate Share of Costs

OPC alleges that the use of Spire Services is ". . . designed to ensure the *disproportionate allocation* of costs to Spire Missouri. . . ." (OPC's Initial Br., p. 124). OPC's only basis for this allegation appears to be its pie chart showing the percentage of "Shared Services Dollars Charged to Spire Missouri vs All Other Spire Inc. Entities." *Id. at* 123.

The pie chart represented that Spire Missouri bore 76.33% of those shared services dollars. However, it should first be noted that examining only "shared services dollars" does not provide a full picture of the costs borne by the various entities. Above, Spire Missouri explained the fact that other costs are direct-charged and removed from the rate making process such that they are borne by Spire Inc. OPC's pie chart does not take into account these expenses.

More importantly, in its Initial Brief, Spire Missouri provided several measurements to test the idea that these shared service allocations are somehow "disproportionate." For example, it was shown that Spire Missouri provides service to nearly 70% of the Spire Inc. utility customers and employs 68% of the Spire Inc. employees. (Spire's Initial Br., p. 50). Given these numbers, the allocation of shared services dollars to Spire Missouri identified by OPC is not surprising and represents a *proportionate* allocation of costs to Spire Missouri.

iv. OPC Adjustment

OPC's Initial Brief does nothing to explain the origin or justification of its recommendation that $84 million of shared services be removed from Spire Missouri's revenue requirement and allocated to Spire Inc. While OPC brazenly alleges that this adjustment would represent Spire Inc.'s "fair share" (OPC's Initial Br., p. 125), there is no analysis of why this "fair share" equals $84 million and conveniently equals 50% of the shared costs otherwise allocated to Spire Missouri.

For context, it may also be an interesting side light to remember that the costs at issue are slightly different in nature from normal service company charges that the Commission might encounter. Spire Services has no employees. Thus, while the issue is being analyzed as an affiliate transaction, the majority of costs that have been allocated by Spire Services to Spire Missouri originated at Spire Missouri. They are Spire Missouri's own costs. Therefore, but for the allocation process that directs some of Spire Missouri's costs to other affiliates, what remains are costs that were incurred by Spire Missouri itself (and not affiliate transactions) and which would carry a presumption of prudence (and which no party has alleged to be imprudent).

OPC has provided no explanation and no justification for why Spire Inc. should bear $84 million of shared services costs, an equal amount of shared services costs as Spire Missouri, and substantially more than all other Spire Inc. affiliates combined.

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.

As in prior cases, Staff has audited these transactions and agrees with the Company's position that no adjustment is warranted. 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.

E. Issue No. 8 - Cash Working Capital

The issue involving Cash Working Capital ("CWC") is the difference in proposed lag days for the income taxes between the Company and Staff's proposal of a 38 day lag time and OPC's vastly different recommendation to include a negative 365 day lag time. As described in more detail below, this issue is linked to the issue of Net Operating Losses and Accumulated Deferred Income Taxes but the issues are separate. The Commission should adopt Staff and the Company's position on this issue as it is supported by the Internal Revenue Code and Internal Revenue Service Publication 542 (Ex. 49). OPC's position should be rejected by the Commission. However, if the Commission accepts OPC's position, the Company supports Staff's alternative proposal that the Commission consider zero lag, which would have zero effect on cash working capital requirement for this line item. Tr. Vol. XII, p. 499.

In its brief, OPC argues that the uncontroverted evidence shows that Spire has not and will not pay income taxes on a quarterly basis, therefore Staff and Spire's proposal to include a 38 day lag period in its Cash Working Capital is "clear error". (OPC's Initial Br., p. 69). This argument suggests that following the law and Commission precedent is "clear error", which the Commission should not accept. OPC acknowledged at hearing that federal tax laws are subject to change. Tr. Vol. XII, p. 522. OPC argues that the likelihood of such a change is "extremely small" and that Spire could come back in for a rate case should that change occur. (OPC's Initial Br., p. 68). "Extremely small" is still a possibility. Rate cases require eleven months to process, require considerable regulatory resources from Staff, OPC as well as additional expense for the Company. This burden and the "extremely small" risk referenced by OPC can be eliminated if the Commission accepts Staff and Spire's proposals to include a 38 day lag period for the income tax expense included in the Company's CWC. This result is consistent with Section 6655 of the Internal Revenue Code and the IRS Publication (Ex. 49) and past Commission practice.

In its Initial Brief, OPC continues to assert that the Commission should make ratemaking adjustments – in this instance to the Company's cash working capital calculation – to account for the fact that the Company had a net operating loss ("NOL") during the test year and as a result did not pay federal income taxes. (OPC's Initial Br., pp. 63-69). In making this argument, OPC commits the same errors that underlie its flawed proposal to not recognize the associated NOL asset as an offset to the Company's Accumulated Deferred Income Taxes (ADIT) balance. (*See* Section H, Issue No. 16 below relating to NOL Carryforward).

The most basic error is that OPC continues to view this issue (as well as the NOL Carryforward issue) through the prism of cash accounting rather than accrual accounting. Ex. 12 (Felsenthal Surrebuttal), p. 9, lines 5-7. But the use of accrual accounting applies to all items of revenue, income and expense involved in the ratemaking process, not just income taxes. *Id*. at p. 10, lines 10-12. Given this, OPC's repeated claims of astonishment that a level of federal income tax is being recognized in the cash working capital calculation despite the absence of cash payments is difficult to understand. Spire could just as easily express surprise every time it makes a capital investment and only receives 10% to 15% of the actual cash outlay back when a revenue requirement is established, because the rest is being deferred and collected over many years as a rate base item. Even though this accumulated difference between the Company's actual cash outlays and the revenue requirements has been authorized by the Commission in rate case and ISRS proceedings which now approaches approximately $1.65 billion for Spire East and approximately $1.29 billion for Spire West (*See* Staff's Notice of Corrected Revenue Requirement filed September 1, EFIS item 409), Spire understands that this is how the accrual-based ratemaking system works. So too does OPC despite its assertions on this and the NOL Carryforward issue.

The second major error is that OPC continues to propose ratemaking adjustments that threaten a violation of IRS normalization requirements. As OPC witness Riley acknowledged during cross examination, the IRS requires Staff to calculate the income tax allowance it has made and include it in the case, regardless of whether those income taxes are being paid to the federal government currently. Tr. Vol. X, Tr. p. 660, lines 22-24. Mr. Riley also knows (or should know) that the IRS requires that the Net Operating Loss carryforward which created the difference between the federal income tax allowance included in rates and the zero cash payments made by the Company should, according to multiple IRS Private Letter Rulings addressing this issue, be treated as a deferred tax asset and included as an offset to the Company's ADIT liability balance. (*See* Spire's Initial Br., pp. 64-77). Otherwise, there is significant risk of a normalization violation that would jeopardize the Company's ability to ever use accelerated depreciation going forward which has been used to generate tens of millions of dollars of cash free "loans" for the Company's ratepayers. Given that requirement, OPC's proposed adjustment to the cash working capital requirement appears to be a poorly disguised attempt to reduce the NOL carryforward offset by other means. As pointed out in footnote 8 on page 67 of its Initial Brief, OPC's proposal to include a negative 365-day lag in the cash working capital calculation to account for this difference between taxes built into rates and taxes paid by the Company would result in a net reduction to rate base of more than $13 million. (*See* also, Ex. 119 (Nieto Rebuttal), p. 4). Given the magnitude of OPC's adjustment the Company is very concerned that it would be viewed as a partial run around the requirement to reflect the NOL Carryforward as an offset to ADIT liability balance. In other words, inclusion of the NOL Carryforward in the ADIT balance reduces the ADIT offset to rate base by approximately $56 million, but then OPC reduces rate base anyway by changing cash working capital based on the same tax event. This is another reason why OPC's adjustment should be rejected.

F. Issue No. 13 - Incentive Compensation

Staff appropriately recognizes that the new incentive compensation metrics developed by the Company after its last rate case satisfy the criteria that the Commission has previously enunciated to include such compensation in rates in that those metrics focus on margin revenues and O&M reductions that benefit customers rather than utility earnings. (Staff's Initial Br., pp. 27-28). Despite these revisions, OPC argues that the Commission should not include these compensation amounts in rates. (OPC's Initial Br., pp. 70 -71). Notably, OPC does not base its opposition on any perceived deficiency in the design or operation of metrics themselves or their effectiveness in creating net benefits for the Company's customers. To the contrary, the arguments presented in OPC's brief affirmatively assume, consistent with the statements of multiple witnesses, that such incentive metrics will work as advertised and produce net benefits, "through increased revenue or decreased expenses … for the utility in an amount greater than the cost to operate the plan itself." *Id.* at 71.

Instead, OPC's opposition to rate inclusion appears to be based entirely on the unsubstantiated claim that the Company will "double recover" these amounts, once through their inclusion in rates now and again when they produce financial benefits during what OPC calls "positive regulatory lag period" between rates. *Id.* at 70-78. As discussed below, OPC's "double recovery" argument is deeply flawed, and should not be permitted to derail approval of a sound incentive compensation feature that both Spire and the Staff have recognized is consistent with recent Commission guidance and will produce tangible benefits for the Company's customers.

First, OPC's "double recovery concern" seems to be based on nothing more than mere assumptions regarding when initiatives resulting from these incentive metrics will be implemented, when the resulting benefits will be flowed through to customers, and the period of time it will take for a particular initiative to produce enough cost savings or increased margin revenues to pay for the costs of the incentive awards. Specifically, OPC appears to have simply assumed that the Company would pay out incentive awards and launch the related initiatives at or very close to the very beginning of a regulatory lag period and then have three or four years to retain any associated financial benefits before they are included in rates and shifted to customers. Moreover, OPC has assumed that the amount of the benefits retained by the utility during this three or four year period would be sufficient to cover the incentive award and other costs the utility has incurred to produce them.

These assumptions are not supported by any record evidence, because OPC did not bother to go beyond the simple proposition that prudently designed incentive plans should pay for themselves – a principle that is easy to agree to in the abstract. For example, OPC made no inquiries and provided no evidence on such critical factors such as the timeframes over which particular initiatives are likely to generate cost savings or revenue margins that are sufficient to pay for the cost of the initiative. OPC made no inquiries and produced no evidence on the pace at which an initiative is likely to produce benefits (i.e. will the benefits grow, decline or remain the same over time). OPC made no inquiries and provided no evidence on what the impact of launching an initiative early versus late in the regulatory lag period will have on the utility's ability to realize savings or margin revenues sufficient to pay for incentive costs. There is no evidentiary support for OPC's position and it should be rejected.

But even if one accepts OPC's assumptions as true, that is still no reason for excluding the cost of incentive awards from rates. Customers as well as the utility would still benefit during the regulatory lag period to the extent a particular initiative produced benefits in excess of the initiative's cost over that limited period of time. Moreover, the customers' share of these benefits would continue to grow once new rates are established since the financial benefits of those reduced costs or added revenues would be shifted entirely to customers at such time. For an incentive initiative that produced an equal level of benefits over a ten-year period, this means that the utility would realize at most 30% to 40% of the total benefits (depending on the duration of the regulatory lag period) while customers would receive at least 60% to 70% of those benefits over the three-year regulatory lag period and then all of the benefits over the next seven years. Such a division of benefits is certainly in line with the sharing percentages that have previously been approved by the Commission under other incentive programs. Nevertheless, such considerations are completely ignored by OPC's "double recovery" argument.

OPC did not provide any evidence to support its assumption that incentive-based initiatives can or will be developed and implemented in a manner that permits the utility to recover the full cost of any incentive awards. For example, what if an incentive initiative was implemented in the final year of a regulatory lag period but has a three year "payback" period before the resulting savings or added revenues are sufficient to cover the cost of the incentive awards? Even though this particular initiative might provide benefits to customers for many years into the future, OPC's approach would only permit the utility to recover a third of the incentive costs since new rates shifting all of these benefits to customers would be in effect in years 2 and 3 of the payback period. The utility's recovery of its incentive award costs would be further diminished to the extent the payback period was longer.

A utility could, of course, always try and manage its incentive programs in a way designed to avoid these results. For example, it could try and launch its incentive initiatives only after a rate case has concluded so it has a full three or four years to capture for its shareholders the largest possible share of the resulting savings or revenues. Or it could reject sound incentive initiatives that have a payback period that exceeds the expiration of the regulatory lag period. Spire has always attempted to do what its right for its customers over the long term regardless of such considerations, but would respectfully suggests that it would be poor public policy for the Commission to facilitate the kind of perverse incentives and regulatory/operational manipulations that would be encouraged by acceptance of OPC's flawed "double recovery" argument.

Finally, the Company would again note that these metrics are only one part of the Company's Annual Incentive Plan. As discussed in the Company's initial brief, Spire's incentive plan also places a strong emphasis on initiatives that are designed to enhance customer service and advance safety. (Spire's Initial Br., p. 58). OPC's "double recovery" argument places a myopic focus only on the financial aspects of the Company's incentive plan to the exclusion of these equally important considerations. (OPC's Initial Br., p. 71). OPC's position should be rejected and the Commission should permit recovery of these incentive compensation costs consistent with the criteria it has adopted for permitting such costs to be included in rates as supported by Staff and the Company.

G. Issue No. 30. WNAR/RNA

Both Spire and Staff have proposed that the Commission replace the Company's existing Weather Normalization Adjustment Rider ("WNAR") with a Rate Normalization Adjustment Mechanism ("RNA") for the Company's Residential and Small General Service ("SGS") customers. The main area of disagreement between Staff and the Company centers on where the first usage block for Residential and SGS customers should be set, with Spire proposing 30 Ccf and 100 Ccf, respectively, and Staff proposing 50 Ccf for Residential and a range of 300 – 500 Ccf for SGS. For its part, OPC opposes the RNA in its entirety, and even suggests the Company's current WNAR should be eliminated, but in the alternative proposes changes to the Company's current WNAR. (OPC's Initial Br., pp. 209- 232).

Turning to OPC's arguments first, it is emblematic of OPC's entire approach to this case that it is proposing elimination of even the Company's current WNAR because the Company has supposedly failed to show the need for such a mechanism to achieve its revenue requirement or to incentivize conservation. (*Id*. at p. 210). Adjustment mechanisms designed to mitigate the impact of weather on the revenues received by the Company and the bills charged to customers began with the Commission's approval of the Company's previous Weather Mitigation Rate Design ("WMRD) in the Company's 2002 rate case proceeding, *See* ***Re: Laclede Gas Company***, Case No. GR-2002-356, Order issued November 8, 2002. The WMRD remained in effect in one form or another for more than 15 years (subject to review in multiple rate cases) until it was replaced by the current WNAR in the Company last rate case. Given the existence and operation of these mechanisms for nearly two decades and OPC's active participation in the numerous regulatory proceedings which repeatedly approved or renewed such mechanisms, OPC's argument that the program should be eliminated should be given no weight by this Commission.

As an alternative to its position to eliminate the WNAR entirely, OPC proposed six modifications to the current WNAR including updated beta coefficients and volumetric rates, which would be reset anyway with any rate case or billing determinant update, as well as changes to the filing and review processes. (OPC's Initial Br., pp. 214-215). None of these alternatives change the fact that the current WNAR does not consider conservation, therefore they are not necessary or appropriate. OPC's alternative proposal to amend the current WNAR should also be rejected.

Likewise, the Commission should not give any weight to OPC's arguments that the RNA mechanism that Staff and Spire have proposed, albeit in slightly different forms, is unlawful because it supposedly addresses more than just weather and conservation. (OPC's Initial Br., 215-225). OPC mentions a variety of items, including rate switching and usage reductions due to an act of nature that might incidentally be reconciled through the alternative RNA, even though they go beyond OPC's strict definition of what constitutes weather or conservation. The Company believes that by structuring the RNA with two blocks, with differing adjustment criteria, the proposed RNA mechanism appropriately accounts for adjustments due to weather or conservation. The Company also believes that the RNA Staff proposes in this case is Staff's attempt to resolve the objection it had to Spire's proposals in the Company's last case. As stated in Spire's brief, the RNA is currently a Commission approved and active rider for Ameren UE gas. (Spire's Initial Br., pp. 61-62).

At the same time, the Company does not believe that OPC's recitation of certain items that might incidentally be addressed by the mechanism provides a compelling justification for rejecting it. Mo. Rev. Stat 386.366(3) 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. The current WNAR only addresses weather variations. In approving this adjustment clause, the General Assembly should be deemed to have had an understanding of how the Commission works, specifically that rates are set based on the application of general averages and principles that cannot possibly address every situation. For example, while rates may be developed for customer classes based on cost causation principles, the Commission does not attempt to take those principles to the extreme to where customers are charged more or less in their rates depending on the specific length of the main serving the customer from the distribution company's gas supply feeder. It would simply be impossible to design, implement and administer such individually-determined rates and charges and a legislature that understands the ratemaking process would not be deemed to have required that the Commission undertake such an impossible, customer specific exercise simply by saying that the rates for each customer should be based on cost causation principles.

Similarly, by providing the Commission with the authority to implement an adjustment mechanism that adjusts to reflect the impact of weather or conservation on customer usage, it is reasonable to assume that it didn't expect the Commission to ferret out and make provision for each and every circumstance, no matter how small an impact, that could incidentally affect customer usage in some way. Such a construction is hardly a reasonable construction of what was intended by a law drafter with a practical understanding of how the ratemaking process works. OPC's attempt to subvert what the legislature did attempt by enacting a customer usage adjustment should accordingly be rejected.

In terms of where the block should be set in the proposed RNA's, Spire would simply note that its proposed 30 Ccf ceiling for the first block is not being proposed simply because that is what the Commission recently approved for Ameren's gas properties. For nearly 15 years prior to that approval, 30 Ccf (or its thermal equivalent) was also used for purposes of setting the first block in Spire's WMRD. As a result, 30 Ccf is a longstanding demarcation point for establishing usage relevant rate blocks in a customer usage adjustment mechanism, reflecting as it does the usage characteristics of Spire's customers over many years. The Company's recommendation is based on review of residential and SGS monthly bills. Specifically, the Company's review notes that under Staff's breakpoint proposal the Company's Block 1 sales would be subject to fluctuations due to weather and conservation by the residential and SGS classes. By comparison, the Company's breakpoint proposal minimizes the Block 1 sales that would be subject to fluctuations due to weather and conservation by the residential and SGS classes. Ex. 26 (Lyons Rebuttal), p. 24. Moreover, as Mr. Weitzel pointed out in his Surrebuttal Testimony, more recent analysis by Company witness Lyons, shows that the 30 Ccf set point for Residential and the first block set point Spire is recommending for SGS customers of 100 Ccf are the appropriate set points for establishing such blocks. Ex. 43 (Weitzel Surrebuttal), p. 24.

H. Issue No. 16 - Net Operating Loss Carryforward

As previously discussed, this issue involves many of the same considerations at the heart of the cash working capital issue. (*See* the Company's Reply Brief on Issue No. 8, Section E above). The Company has addressed in extensive detail in its Initial Post-Hearing Brief why OPC's proposal to not include the NOL Carryforward asset as an offset to the Company's ADIT liability balance would almost certainly produce a disastrous normalization violation. In doing so, the Company fully anticipated and rebutted each of the arguments made by OPC on this issue in its Initial Brief. Spire observes that OPC made virtually no effort in its Initial Brief to provide any authority that would suggest the Company's and Staff's analysis on this issue, including what is necessary to avoid a normalization violation, is incorrect or otherwise in error. Spire can only conclude that OPC has conceded that the Company is correct on this decisive issue and either just does not care or is saving whatever analysis it has for its Reply Brief where Spire will not have an opportunity to respond to it.

The Company will also note that OPC incorrectly claims as fact that there are two "piles" or "buckets" of money at issue. (OPC's Initial Br., p. 96). OPC's first "cash income tax pile" suggests that Spire's customers have been charged for the NOL. This is not the case. An NOL produces a negative current income tax expense recognizing that, on the tax return, current year deductions exceed current year revenues. This negative current income tax expense reduces cost of service and revenue requirement thereby reducing customer rates, not providing a "pile" of cash. Ex. 10 (Felsenthal Direct), p. 32. To put it simply, this first "pile" of cash that the OPC alludes to does not exist with the Company as it is a benefit attributed to Spire's customers as a reduction to revenue requirement that would not otherwise exist absent the NOL. Thus, the OPC argument on this issue is flawed and should be disregarded. Revenue requirements also include a deferred income tax component for book-tax differences such as using accelerated depreciation to determine taxable income on the income tax return versus using book depreciation for financial reporting and rate case/regulatory purposes. The IRC normalization rules require such deferred income taxes for the depreciation book-tax difference to avoid a normalization violation (OPC agrees with this requirement).

In addition, there is no need to establish a tracker as the NOL Carryforward deferred tax asset is already being accounted for as part of the ADIT offset calculation in rate base. Staff's accounting schedule reflects the Company's cost of service items during the test year from a regulatory accounting methodology and builds in a return to establish the revenue requirement needed to produce that return. One component of that cost is income taxes. Income tax is based on a certain predetermined percentage (federal and state tax rates) of the revenues that exceed pre-tax expenses. The utility needs to collect this in order to have the cash available when the taxes are due and payable in the future. From a regulatory accounting perspective, this is the end of the story for the test year revenue requirement. Income taxes are part of that calculation and must be collected. Without any tax return adjustments for accelerated depreciation or other items, tax would be due and payable for this amount. If an NOL exists, an NOL deferred tax asset from a prior period would be utilized against this tax due. This would reduce the NOL which would cause the rate base offset to increase as the NOL would not exist as an adjustment to ADIT. This is strictly a rate base impact for the NOL, it in no way impacts the test year income tax expense. Having a tracker for income taxes does not make sense as income taxes do not have an independent existence. Ex. 10, (Felsenthal Direct), p. 41. Income tax expense is based on the other components of cost of service, revenues and expenses (matching), and to single out income taxes for tracking without also tracking the revenues and expenses affecting such income tax expense, will produce an inconsistent and illogical outcome.

The NOL issue is not a new concept or approach Spire and other regulated utilities in the state are accounting for it. At the hearing, Staff witness Young was asked if he was aware of other Missouri utilities in general that were realizing operating losses due to bonus depreciation. Mr. Young's response was "It's my understanding that nearly all of them had a net operating losses (NOL) for bonus depreciation, the large utilities I should say" Tr. Vol XIII, pp. 657-658, lines 21-25, 1-3.

The law, IRS guidance, and Commission precedent on this issue supports the Company and Staff's position and the OPC's proposed treatment of the NOL Carryforward asset should be rejected.

I. Issue No. 1 Cost of Capital

<u>Summary:</u>

In their Initial Briefs, Staff and OPC pursue positions that would result in an overall rate of return on investment ("ROI") that is lower than required by the *Hope* and *Bluefield* decisions. While Staff supports a reasonable capital structure that is consistent with Spire's position in this case and with the Commission's decision in Spire's last 2017 rate case, it also recommends a return on equity ("ROE") below that required to produce just and reasonable rates. OPC's position is more extreme on the capital structure issue, and includes an ROE recommendation that is even lower than Staff's proposal. Either of the Staff and OPC's positions, if adopted in full by the Commission, would result in rates below those required to give the Company a reasonable opportunity to earn a fair return on its investment, as required by law.

Spire's proposed return on common equity should be used to determine the rate of return

Staff and OPC criticized the methodologies used by the expert witness for the public utility in this case. (Staff's Initial Brief, pp. 9-18; OPC's Initial Brief, pp. 53-59) Spire's expert witness Mr. Dylan D'Ascendis applied several well-recognized cost of common equity models (i.e., the Discounted Cash Flow("DCF"), the Risk Premium Model ("RPM") and the Capital Asset Pricing Model ("CAPM") to the market data of the Natural Gas Proxy Group as well as a Non-Price Regulated Proxy Group. Ex. 5 (D'Ascendis Direct), pp. 14-48. There is no factual basis for such criticisms. Ex. 7C (D'Ascendis Surrebuttal), pp. 1-40.

Mr. D'Ascendis has addressed each of the criticisms of Staff and OPC at length in his Surrebuttal Testimony, and it is unnecessary to re-iterate those arguments herein. Ex. 7C (D'Ascendis Surrebuttal), pp. 2-40. It is sufficient to reiterate here that both Staff and OPC rejected their own analyses. Additionally, the Staff and OPC recommendations are below the average authorized return on gas distribution utilities for 2021 and are inaccurately based on outdated market circumstances. 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%. (Ex. 51C), which is similar to the bottom of Mr. D'Ascendis' updated range (9.66%). This is an increase from the average ROE of 9.46% in 2020. Recognizing the increasing trend in authorized ROEs across the country in these changing times, the Commission should slightly increase Spire's existing authorized ROE of 9.80% to 9.95% as recommended by Spire in this proceeding. The Commission certainly should not lower Spire's currently authorized ROE of 9.80% as inflationary pressures have emerged in the economy over the last several months and the economy is growing again.

A flotation adjustment should be included.

Staff also continues to challenge Mr. D'Ascendis' inclusion of a flotation cost adjustment in his analysis. (Staff's Initial Br., p. 17). Staff's criticisms are without merit. In Spire's 2017 rate case, the Commission itself recognized the legitimacy of a flotation cost adjustment when it determined that an 9.80% ROE was appropriate for Spire. See *Amended Report and Order*, p. 31, Case No. GR-2017-0215/0216. ("When appropriately adjusted for business risk and <u>flotation cost adjustments</u>, and other corrections suggested by [Spire witness] Ms. Ahern, [OPC witness] Gorman's common equity cost rates would be 9.89 percent, also very close to the national average.")(emphasis added).

Contrary to the arguments of Staff that Spire Inc.'s flotation costs are improperly being attributed to Spire Missouri (Staff's Initial Br., p. 17), since equity flotation costs are permanent capital, and were raised by Spire Inc. to the benefit of the entire consolidated company including Spire Missouri, it's inclusion here is nothing short of appropriate. Ex. 45 C (Woodard Surrebuttal) p. 5. It is appropriate to consider flotation costs on equity issuances because even indirectly owned subsidiaries receive equity capital from their parent company, and provide returns on the capital that roll up to the parent company. To deny recovery of issuance costs associated with the capital that is provided to the subsidiaries would ultimately penalize the investors that fund utility operations, and would inhibit the utility's ability to obtain new equity capital at a reasonable cost. Ex. 7C (D'Ascendis Surrebuttal), p. 27.

The fact remains that the Company's shareholders are entitled to receive recovery of its flotation costs, as the Commission has previously recognized, just as Spire Missouri is entitled to receive recovery of debt issuance expenses, as there is no other mechanism in the ratemaking paradigm to recover such costs.

A business risk adjustment should be included.

While Staff recognized that Spire Missouri is smaller than the average of Spire's regulated natural gas proxy group, it argued that a small size adjustment is unnecessary because Spire has a better than average bond rating. (Staff's Initial Br., p. 17). As Mr. D'Ascendis explained, 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 and that rating agencies do not account for company size in their rating methodologies. Spire's estimated market capitalization of $2.7 billion is lower than the average market capitalization of the Natural Gas Proxy Group, which is $4.6 billion (or 1.7 times greater than Spire's) as of May 28, 2021. Ex. 6 (D'Ascendis Rebuttal), Sch. 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 Earnings Before Interest, Taxes, Depreciation, and Amortization (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, Sch DWD-SR-4.

The fact that Spire Missouri also has a better bond rating than some other natural gas companies does not mitigate the need to make a business risk or size adjustment in the determination of the appropriate ROE for Spire Missouri. Ex. 7C (D'Ascendis Surrebuttal), pp. 23-24. The competent and substantial evidence in the record demonstrates that rating agencies do not account for size in their ratings.

In summary, the Commission should recognize in its ROE determination that Spire has increased business risk since it is a relatively small natural gas company compared to its peer group used to assess the appropriate return on common equity. The Commission should adopt the Company's recommended return on equity of 9.95% which is clearly within the zone of reasonableness, given the national average authorized returns of 9.62%. It is only slightly higher than the previously authorized ROE of 9.80% for Spire in 2017, which is appropriate since national average ROEs are increasing as the country comes out of the Covid-related downturns and inflationary pressures are emerging. This ROE authorization is appropriate for purposes of this case and meets the tests of *Hope* and *Bluefield*.

The Commission should use the capital structure proposed by Spire and Staff.

Spire and Staff strongly agree that the Commission's previous decision in its last rate case should be retained and utilized in this case. (Spire's Initial Br., pp. 91-95; Staff's Initial Br., pp.

18-22). In Spire's last general rate case, the Commission made the following findings and conclusions on the capital structure issue:

> The Commission finds that the capital structure of Spire Missouri without short-term debt is the reasonable capital structure for ratemaking purposes in this case. Similarly, the Commission determines that the cost of debt should be the cost of Spire Missouri's cost of long-term debt.
>
> The Commission's decision on capital structure is supported by the facts set out above including that Spire Missouri has an independently determined capital structure with its own long-term debt issuances secured by its own assets that are the subject of this rate case. These assets do not secure the debt of the parent or its other utilities or unregulated operations. In addition, while the Commission previously used the consolidated capital structure of the parent, Laclede Gas Company, it made up almost the entire holding company. Thus, a consolidated capital structure was basically the utility specific capital structure. Currently, however, the parent, Spire Inc., holds five utilities in three different states and is applying to build an interstate pipeline that will be subject to the FERC oversight. Thus, if the parent company's capital structure were used, regulatory policies employed by commissions in other two other states and at FERC, and financing practices followed by utilities or entities not regulated by the Commission, would affect the rates customers pay in Missouri. The changes to the company and the other facts set out above make it reasonable to use the utility-specific capital structure in this case, and not the consolidated capital structure.
>
> The Commission finds that the capital structure of Spire Missouri without short-term debt is the reasonable capital structure for ratemaking purposes in this case. Similarly, the Commission determines that the cost of debt should be the cost of Spire Missouri's cost of long-term debt. The Commission's decision on capital structure is supported by the facts set out above including that Spire Missouri has an independently determined capital structure with its own long-term debt issuances secured by its own assets that are the subject of this rate case. These assets do not secure the debt of the parent or its other utilities or unregulated operations. In addition, while the Commission previously used the consolidated capital structure of the parent, Laclede Gas Company, it made up almost the entire holding company.
> ***

These considerations are as salient today as they were in 2017. As was the case then, Spire Missouri issues its own debt which supports its own bond rating. Spire Missouri's assets do not guarantee the debt of Spire Inc., its other utilities, or its unregulated operations. Spire Inc. owns five utilities in three different states, a FERC regulated interstate pipeline and other businesses not under regulation by this Commission. Ex. 45 C (Woodard Surrebuttal), pp. 10-11. These are the same facts that lead the Commission to use Spire Missouri's own capital structure in the 2017 Amended Report and Order. See *Amended Report and Order*, Re Laclede Gas Co., Case Nos. GR-2017-0215 and GR-2017-0216, p. 43 (March 7, 2018).

Nevertheless, in its capital structure recommendations, OPC has proposed to arbitrarily reduce the equity component of the Company's capital structure well below its actual equity component of 54.28%. (OPC's Initial Br., p. 14). This inappropriate proposal would not allow the Company to recover the actual costs of the capital it has invested in the utility.

Importantly, Staff concluded that "OPC's recommendation is entirely inappropriate, as Dr. Won testified." (Staff's Initial Br. p. 18). Contrary to the recommendation of OPC to use the parent company's capital structure, Staff noted that none of the four factors that the Commission has used in the past for supporting the use of a parent's capital structure for ratemaking are present in this case. (Staff's Initial Br., pp. 18-19). Accordingly, Staff did not agree with OPC that Spire Inc., the parent company of Spire Missouri, manages Spire Missouri for purposes of taking advantage of the debt capacity afforded by Spire, Inc.'s low-risk regulated utility subsidiaries. (Staff's Initial Br., p. 20). Staff also noted that Spire Missouri's capital structure is consistent with the capital structure ratios maintained by, or authorized for, other natural gas utilities. In fact, Dr. Won's Rebuttal Testimony demonstrates that other natural gas utilities have common equity ratios much higher than those recommended by OPC in this case. Ex. 124 (Won Rebuttal), p. 40. OPC's recommendation of a 47.36% common equity ratio, on the other hand, "is much lower than the average of its natural gas proxy group's common equity ratio . . ." (Initial Br., p. 20). Staff therefore concluded unequivocally that "OPC's position is unreasonable and unsupported and must be rejected." *Id.* Spire agrees.

OPC failed to articulate a legitimate reason in its Initial Brief as to why the Commission should depart in this case from its well-reasoned decision on capital structure in Spire's 2017 rate case. In fact, the best the OPC could do is to assert that the Company is "targeting" the capital structure previously authorized by the Commission and that approval of the Company and Staff's capital structure recommendation would therefore lead to a perpetual scheme where Spire will always seek to achieve this capital structure regardless of changed circumstances. (OPC's Initial Br., pp. 34-47). This is a complete red-herring in that there is no evidence to suggest that the Company intends to "target" such a capital structure in the future even though there may be changed circumstances that warrant a different one. Because the circumstances relevant to this issue have not materially changed since Company's last rate case, it was entirely reasonable for the Company to pursue a capital structure similar to what both the Company and the Commission had deemed appropriate just a few years ago. If circumstances in the capital markets do change sufficiently to warrant the pursuit of a different capital structure the Company will be the first to propose such changes and OPC will have a full opportunity to challenge the Company if it does not.

3.99% is the appropriate cost of debt to include in the Company's capital structure.

As Staff pointed out in its Brief at page 21, Spire Missouri's cost of long-term debt is 3.99%. Ex. 145 (Lyons True-Up Direct), p. 3. This fact is not disputed by the parties. (Staff's Initial Br., p. 21; OPC's Initial Br., p. 8). The Commission should therefore utilize 3.99% as the cost of long-term debt in the capital structure in this case.

Short-term debt should not be included in the capital structure.

As explained in the Company's initial brief, short-term debt should not be included in the capital structure used for ratemaking in this case. (Spire's Initial Br., pp. 94-95). The Company's short-term borrowings are fully utilized to finance its short-term assets that are not included in rate base, so such debt should not be in the Company's permanent capital structure. Additionally, short term debt should not be included in the capital structure because the average level of construction work in progress and other short-term assets (including propane, margin calls on multi-year hedging programs and deferred gas costs subject to the PGA carrying costs) exceeds the average level of short-term debt outstanding after taking into consideration the funding of $250 million of new long-term debt instruments during test year. Ex. 45 C (Woodard Surrebuttal), p. 17.

Staff and Company do not agree with OPC's recommendation that short-term debt should be included in the ratemaking capital structure. Staff correctly noted that this Commission does not generally include short-term debt in the ratemaking capital structure. (Staff's Initial Br., p. 21). Dr. Won himself testified that Staff would only recommend its inclusion in certain circumstances, which do not apply here. Tr. Vol. XIIII, pp. 796-97.

As noted by the Company's Initial Brief, short term debt is used to finance deferred purchased gas costs, unamortized PGA costs, propane inventory, and hedging gains and losses. Ex. 44 (Woodard 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 his Surrebuttal Testimony, Spire witness Adam Woodard explained the Commission's usual approach to assessing the level of short-term debt used by a public utility. Mr. Woodard explained that "[t]he average level of construction work in process and other short-term assets is examined against the amount of short-term debt outstanding during the true-up period after taking into consideration long-term debt funding during the true-up period. If the short-term debt net of any long-term debt issuance during the true-up period primarily serves as funding for short term assets it should be excluded from the capital structure." Ex 45C (Woodard Surrebuttal), pp. 8-9.[3] The Commission has followed this approach in the past and should not depart from it in this case.

At one point in its argument, OPC makes an attempt to discredit the Commission's traditional analysis used in the 2017 Spire rate case by pointing to several cases that do not involve capital structure issues at all, but instead address issues related to nuclear fuel inventory (Case No. EO-85-185), cash working capital (Case No. TR-80-235), and depreciation reserves (Case No. 18,433). (OPC's Initial Br., pp. 20-26). These cases may contain a reference to "point in time" or related concepts, but these cases are totally inapposite to the case at hand. The Commission should not rely upon these old cases involving subjects that are not related to short-term debt and are totally inapplicable to the case at hand.

In summary, the Commission should continue to follow its traditional practices to exclude short term debt from the public utility's capital structure. For all of these reasons, the Commission should reject OPC's attempt to depart from its decision in the 2017 Spire rate case and to change the Commission's practice of excluding short-term debt from the capital structures of major public utilities.

III. Conclusion

[3] During the hearings, Mr. Woodard also specifically disputed OPC's contention that short-term debt is used by Spire to finance rate base. Tr. Vol. XIIII, p. 713.

The Company has shown throughout the rate case process that its rate case proposal is not only just and reasonable, but *required* to insure that the Company has the appropriate rates in place to continue to provide the safe and adequate service that our customers expect. It is crucial that the Commission not get distracted by the 232 page show put on by the OPC, an organization that is derived to serve the public yet spends pages arguing against processes and initiatives that benefit the very customers they claim to represent. The Company's filing was made with the goal of ensuring the Company can provide the best service to its customers at rates adequate to attract the capital necessary to provide such service. Spire requests that the Commission consider and accept its proposal as to all remaining issues before the Commission.

WHEREFORE, Spire Missouri respectfully requests that the Commission accepts Spire's Post-Hearing Reply Brief and issue an order determining just and reasonable rates for the Company, consistent with the Company's position as outlined herein and in the Company's Initial Post-Hearing Brief.

/s/Goldie T. Bockstruck

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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 17th day of September, 2021.

/s/ _Lew Keathley_________________