BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Spire Missouri, Inc.'s d/b/a Spire Application for Approval of a Revised Cost Allocation Manual	))))	Case No. GO-2022-0327

RESPONSE TO SPIRE MISSOURI'S DRAFT COST ALLOCATION MANUAL

COMES NOW the Office of the Public Counsel ("OPC") and for its *Response to Spire Missouri's Draft Cost Allocation Manual*, states as follows:

Introduction

The Cover pleading accompanying the draft cost allocation manual ("CAM") filed by Spire Missouri ("Spire" or "the Company") states that the draft CAM "reflects language agreed upon by both Spire and Staff." *Spire Missouri's Draft Cost Allocation Manual Cover Pleading* at 1, GO-2022-0327. The cover pleading goes on to state that "[t]he OPC has been working with Spire and Staff on the CAM re-write, but were not able to reach a consensus as to all changes in the draft CAM." *Id*. While the OPC is reluctant to publicly air its grievances, it does feel it is important to establish that the OPC was afforded little to no opportunity to actually work with either Spire or Staff on the draft CAM following the conclusion of Spire's last general rate case. While it is true that Spire and the OPC had discussed elements of its CAM revision in the past, the OPC is presently unaware of any efforts the Company made to discuss its proposed CAM re-vision during the six month period between the filing of the Commission's November 12, 2021, Amended Report and Order in Case No. GR-2021-

0108 and the Company's filing of the proposed CAM on May 24, 2022. Nor, for that matter, has Spire reached out to the OPC to address any potential concerns regarding the draft CAM in the month since it was filed. The OPC believes that this unfortunate breakdown in communication has contributed significantly to the problems now found in Spire's draft CAM.

Given the lack of communication, it is presently unclear how many of the problems identified by the OPC in Spire's draft CAM actually represent irreconcilable differences between the parties and how many may be issues that could be resolved amicably. Unfortunately, the OPC considers its only recourse at this point to be outlining the numerous problems with the draft CAM in this pleading. The OPC hopes by doing so that either the Company or the Commission will agree to or order the necessary changes laid out in this pleading, respectively.

In order to facilitate better understanding of the problems with Spire's draft CAM, the OPC has divided the issues into two categories. The first is the major concerns, of which there are four. These four have been outlined in the body of this pleading. The remainder are the minor concerns that are addressed in comments and "redline" style edits made to Spire's draft CAM. This edited version of Spire's draft CAM is included as Attachment A to this filing. Please note that the major edits are not included in Attachment A, though there are some comments included in the attachment to highlight where major changes would need to occur. Therefore, the OPC asks the Commission to consider both the redline edits found in Attachment A

and the four major issues outlined in this pleading **<u>together</u>** when ordering any changes to Spire's draft CAM.

<u>Recommendation</u>

The Commission should not approve the draft CAM proposed by Spire. The proposed CAM is faulty for numerous reasons. These include four major issues that are outlined below. These issues notwithstanding, there are also a number of minor issues and revisions that should be made to the proposed CAM. These minor issues and revisions are highlighted in Attachment A to this filing. The OPC thus asks that the Commission to deny Spire's proposed CAM and instead order Spire to draft and adopt a CAM that addresses the issues and revision indicated in Attachment A as well as the four major issues identified in this pleading, which are:

1. <u>The unacceptable and unsupported "Asymmetric Pricing" variance request</u>

Spire's CAM identifies four variances under the heading titled "Variances." One of the OPC's biggest concerns with Spire's proposed CAM is the requested variance to the "cost methodology for corporate support services provided by Spire Services Inc." Specifically, the CAM states: "As such, use of FDC as described in this CAM and a waiver of the asymmetric pricing requirements should be granted to reduce administrative requirements that would simply add cost and provide little if no benefit." *Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1* at 24 - 25, GO-2022-0327. There are several problems with this requested variance.

First and foremost, the term "asymmetric pricing" does not actually appear anywhere in the Commission's affiliate transaction rule. Spire has also failed to identify any particular subheading within the rule that relates to the "asymmetric pricing" requirement. As such, there is no means to determine what *exactly* the Company is asking a variance for. As best as the OPC can determine, this request appears to be for a variance from 20 CSR 4240-40.015(2)(A), which requires that "[a] regulated gas corporation shall not provide a financial advantage to an affiliated entity." In particular, it appears that Spire is seeking Commission approval to give its affiliate, Spire Services, Inc. ("Spire Services"), a financial advantage by allowing Spire to purchases goods or services from Spire Services above fair market price or to sell goods or services to Spire Services below fair market price. This is a direct contradiction of the very purpose of the affiliate transaction rule.

Again, it is somewhat difficult to determine the exact extent of Spire's suggested variance owing to the vague nature of the Company's request. It may be that Spire is only seeking a variance from the evidentiary standards for meeting the requirements of 20 CSR 4240-40.015(2)(A). However, this still poses a significant problem, in that, Spire would then be attempting to write into its CAM a version of the presumption of prudence that the Missouri Supreme Court explicitly stated was not applicable to affiliate transactions. *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371, 378 (Mo. banc 2013). In either event, the Commission should not grant such a variance.

To better illustrate the issue, please consider an example. Assume that Spire chooses to acquire legal services through its affiliate Spire Services. Under the existing affiliate transaction rule 20 CSR 4240-40.015(2)(A), Spire would need to prove that the price it paid to Spire Services for those legal services is the lesser of either the fully distributed cost to Spire to perform those legal services itself or the fair market price for those services. By all appearances, Spire is now seeking to remove the fair market price factor (*i.e.* eliminate the "asymmetric pricing" requirement) in this determination and ask the Commission to just assume that whatever price the Company paid to Spire Services for legal service *is* Spire's fully distributed cost to provide those services for itself. Spire seeks to justify this position by arguing that Spire Services provides support services "without any additional margin on top of the costs, whether an operating or capital-related cost." *Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1* at 25, GO-2022-0327. The questionable veracity of this statement notwithstanding, this argument misses the point. Even if the Commission does just assume that whatever price the Company paid to Spire Services for legal service *is* Spire's fully distributed cost to provide those services for itself, the Company should still be required to check to see if there is a cheaper, non-affiliate provider for legal services before transacting with its affiliate. If an outside, non-affiliate firm can provide legal services to Spire at a lower cost than it would require for Spire Services to provide those same services, then Spire should not be transacting with Spire Services and thereby giving Spire Services a financial advantage over the outside, non-affiliate firm.

Spire's entire justification for having a shared support services company is the claim that this will allow Spire "to save on joint or common administrative costs[.]" *Id.* at 24. However, if it is still cheaper to hire an outside firm to provide the services that Spire Services is now meant to provide, then this justification is rendered meaningless. It is therefore essential that the Commission continue to require that Spire prove that the services being provided by its affiliate cost an amount equal to or less than the fair market price that Spire would incur without the affiliate. This means maintaining the "asymmetric pricing" requirement. Moreover, the justification that Spire offers for not applying the "asymmetric pricing" requirement makes absolutely no sense.

Spire claims that the "asymmetric pricing" requirement should be eliminated "to reduce administrative requirements that would simply add cost and provide little if no benefit." *Id.* at 24 – 25. This statement is made without any support and is obviously false. The benefit provided by the asymmetric pricing requirement is that it forces Spire to show that it is not giving its affiliate Spire Services a financial advantage by contracting with the affiliate despite the availability of cheaper market alternatives (thereby effectively allowing Spire Services to overcharge). Again, the importance of this benefit has been recognized by the Missouri Supreme Court itself:

> [W]henever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions. ... One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.

Office of the Pub. Counsel, 409 S.W.3d at 377 (Mo. banc 2013). What is truly perplexing, though, is the two sentences immediately following the CAM's claim that this variance will reduce administrative requirements:

> However, Spire MO will use available market related information to the extent possible to verify the reasonableness of its FDC calculations for shared services. This market information is to be obtained through use of competitive bidding or benchmarking as feasible.

Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1 at 25, GO-2022-0327. This assertion entirely undermines the offered rationale for eliminating the "asymmetric pricing" requirement because Spire is effectively claiming that it intends to undertake the "administrative requirements" obligated by the "asymmetric pricing" requirement regardless of the waiver.

To reiterate, the "asymmetric pricing" requirement means that Spire needs to show that it is procuring goods and services from Spire Services at or below the fair market value for those goods and services. 20 CSR 4240-40.015(2)(A). In order to accomplish this feat, Spire would need to undertake competitive bidding or benchmarking, as outlined in the rule, to establish the fair market values for those goods or services. 20 CSR 4240-40.015(3)(A),(D). Spire states that eliminating the "asymmetric pricing" requirement would "reduce administrative requirements that would simply add cost and provide little if no benefit" which seems to be referring to the competitive bidding or benchmarking required to establish fair market value. *Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1* at 25, GO-2022-0327.

However, Spire then immediately goes on to state that it *still* intends to undertake competitive bidding or benchmarking. *Id.* This begs two important questions: (1) what "administrative requirements" associated with the "asymmetric pricing" requirement are actually being eliminated, and (2) how much of a cost-savings benefit does the elimination of the asymmetric pricing" requirement actually produce. The presence of both of these questions only reinforces the fact that the Commission should not be granting this variance.

For all the reasons already laid out, the Commission should not grant the requested variance to the "asymmetric pricing" requirement. It is not presently clear what exactly this variance would do, nor has Spire offered any real evidence that there is good cause for this variance or that it would be in the public interest to grant. All Spire seems to have is a vague assertion that not requiring "asymmetric pricing" will "reduce administrative requirements." However, the Company still indicates that it intends to seek competitive bid or benchmark pricing, which are precisely what the "asymmetric pricing" standard requires (assuming that the OPC is correct in its interpretation of Spire's request). The only thing this variance would actually do, therefore, is to lower the evidentiary standard for Spire to show compliance with the Commission's affiliate transaction rules and thereby make it much easier for Spire to provide its affiliates a financial advantage. This is not an acceptable outcome and the Commission should consequently deny this variance request.

2. <u>The application of the Massachusetts Formula (or Three-Factor Formula) as a general allocator</u>

As Spire's CAM points out, "The actual application of FDC cost allocations occurs through what is commonly called the 'three-step' allocation method." *Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1* at 12, GO-2022-0327. The first step is direct allocation, wherein costs that can be directly assigned to a particular good or service are directly assigned to that good or service. Again, Spire's CAM correctly points out that costs should be directly allocated to the highest degree possible. *Id*. ("This method begins with the premise that to the maximum extent practical, all costs which can be specifically attributed to a business segment are directly charged to that business segment."). After direct allocation comes indirect allocation, wherein costs that cannot be directly assigned to a particular good or service are indirectly assigned based on a causal relationship. *Id*. The third and final step is general allocation, where any costs that cannot be directly tied to a specific good or service or indirectly tied through a causal relationship are allocated to all business segments based on general factors. *Id*. Spire's CAM proposes to use a general allocator comprised of three factors: (1) fixed assets and investments, (2) revenues, and (3) direct payroll. *Id*. at 17. This is commonly known as the "Massachusetts" or "Three-Factor" Formula. *Id*. The use of this formula and Spire's approach to general allocation is a problem.

First, the Massachusetts formula is open to sever manipulation owing to the means by which Spire operates its shared services company. As Spire itself notes, Spire Services presently has no employees or assets and instead is just a "pass-through" accounting mechanism. *Id*. at 4. Therefore, all the goods and services that

Spire Services actually produces are in reality being produced by employees on the payroll of other Spire entities using fixed assets and investments owned by other Spire entities. In particular, the vast majority of the work performed by Spire Services is done by employees of Spire Missouri using fixed assets and investments owned by Spire Missouri. As a result, any costs related to shared services performed by Spire Services that are generally allocated are disproportionally allocated to Spire Missouri. Again, this is not because Spire Missouri caused the costs to be incurred,[1] but simply because Spire Missouri happens to be the entity who employs the people and owns the assets necessary to perform the work. Further, the formula also under allocates costs to other entities in the larger Spire family of affiliates. The ultimate parent company of Spire Missouri (Spire Inc.), for example, is not generally allocated **any** costs because Spire maintains Spire Inc. has no assets, revenues, or payroll. Questions regarding the veracity of this statement notwithstanding, this system thus means that none of the costs incurred directly by Spire Inc. (including, for example, the monetary compensation paid to its Board of Directors or any portion of the floor space for the building wherein its Board of Directors meets) can be generally allocated to Spire Inc. This is a problem, or at least, has the potential to become one.

The problems thus outlined with the Massachusetts formula are in large part dependent on a failure by Spire to actually follow its own three step allocation method. The point about Spire Inc.'s board of directors, for example, is only a problem

[1] If it had, the costs would be directly or indirectly assigned to Spire Missouri and not left to be generally allocated.

to the extent those cost referenced are generally allocated instead of being allocated directly or indirectly. Unfortunately, the evidence presented during the last Spire general rate case demonstrated that Spire is relying on general allocations for the majority of its costs. *See* Tr. pg. 331 ln. 17 – pg. 334 ln. 18, GR-2021-0108. This exponentially exacerbates the underlying problem with Spire's proposed use of the Massachusetts formula described previously. To summarize, there are two primary problems at issue: (1) Spire is vastly over-using general allocation as opposed to direct and indirect allocations, and (2) Spire is proposing a general allocator that disproportionately assigns common costs to Spire's regulated utility operations (Spire Missouri in particular) and purposefully excludes other, non-regulated entities. The OPC offers solutions to both of these problems.

As to the issue of overusing general allocation as opposed to direct and indirect allocation, the OPC proposes that Spire include in its annual CAM report filing a breakdown of its total cost allocations by the percentage of costs directly, indirectly, and generally allocated. The OPC proposes further that if Spire's breakdown demonstrates that more than 25% of the total dollars allocated are being generally allocated using the Massachusetts formula, the Company immediately amend their business practices so as to reduce the volume of costs being generally allocated. This is a simple and cost-effective method to ensure that Spire is operating in compliance with its own three step allocation method, which, again, requires "that to the maximum extent practical, all costs which can be specifically attributed to a business

segment are directly charged to that business segment." *Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1* at 12, GO-2022-0327.

Regarding the second issue, which is the disproportionate allocation of costs to Spire's regulated utility operations under the Massachusetts formula, the OPC proposes replacing the Massachusetts formula with a better alternative for general allocation. Specifically, the OPC recommends that costs to be allocated generally are allocated to each business entity based on the average percentage of costs directly and indirectly allocated to that entity weighted by the dollar amounts directly and indirectly allocated. Stated differently, costs that cannot be allocated directly or indirectly should be generally allocated based on the weighted average ratio of allocated direct and indirect costs.

3. The elimination of Indirect Allocation Methodologies

Spire's current CAM includes allocation methodologies for the following cost items: Administrative & General Expenses, Annual Report & SEC Reporting Costs, Board of Director Fees, Depreciation, Employee-Related Costs, Information Systems, Insurance, Outside Audit Fees, Rent, and Vehicle Costs. *See* Exhibit 228, Appendix-1 CAM, Gr-2021-0108. Spire's proposed CAM does not include cost allocation methodologies for any of these items. Instead, Spire's proposed CAM simply states:

> A current list of services shall be included as an appendix to the SFA, and a list of current functions providing shared services and specific allocation factors for their services shall be provided with each Annual CAM report.

Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1 at 18, GO-2022-0327. As such, Spire's new cost allocation manual does not actually contain cost allocation methodologies for a large number of services, meaning the Commission has no oversight over these allocation methodologies. Moreover, Spire has failed to file a copy of the referenced "appendix to the SFA" for the Commission's review. In fact, it is not even clear at this point that the Commission's Staff has reviewed the cost allocation methodologies referenced in "appendix to the SFA." For all these reasons, the Commission should not accept Spire's current proposed CAM. Instead, the Commission should order Spire to either (1) include at least those specific cost allocation methodologies included in its previous CAM in this new version, or (2) include at least those specific cost allocation methodologies included in its previous CAM in an appendix to be affixed to, and referenced by, the CAM itself. In short, the Commission should at least review the individual cost allocation methodologies that Spire intends to use as part of its review of Spire's overall cost allocation manual.

4. <u>The effort to make the CAM modifiable at will without Commission oversight</u>

The last major issue with Spire's proposed CAM may or may not be an actual issue as the CAM appears inconsistent on how freely it can be changed. In its "Purpose and Background" section, the CAM states as follows:

> Typical changes in ongoing business operations may add or subtract affiliates, impact the need for a function to provide a certain service to an entity, or revise how a specific factor should be calculated, which will adjust how shared costs are allocated as a matter of "standard business". Such changes should be accommodated provided they are identified in Spire MO's annual CAM report and Service & Facilities Agreement (SFA), together with an explanation of why such changes were made, so Staff and OPC are afforded the opportunity to

> review the appropriateness of any such routine update. However, more fundamental shifts in the business, market conditions or other factors may affect the continuing appropriateness or usefulness of a particular method or principle and require a change in the CAM itself. If such changes occur and are in compliance with the standards set forth in the Rules, then Spire MO may make appropriate adjustments to the allocation guidelines and costing principles in its CAM. In such event Spire MO will provide Staff and OPC with immediate notice of the change to afford them the opportunity to challenge the appropriateness of any such change.

Spire Missouri's Draft Cost Allocation Manual Exhibit No. 1 at 2 – 3, GO-2022-0327.

In its "Overview" section, meanwhile, the CAM also states as follows:

> This CAM is appropriately considered a living document designed to adapt with the Company as it pursues opportunities to provide benefits to customers through growth and the sharing of relatively fixed costs with the allocation of common goods and services. **Any changes to the Commission-approved CAM or the SFA will be filed with the Commission for approval.** This CAM, including all Appendices, and associated CAM Reports, will be submitted through the Commission's EFIS filing system in accordance with the timelines outlined in the Rules, including any waivers or variances to the Rules approved for Spire MO by the Commission. Upon official Commission approval of the CAM, any changes to the CAM will be submitted to Commission Staff ("Staff") and the Missouri Office of Public Counsel ("OPC"), with full explanation and any associated supporting documentation.

Id. at 6 (emphasis added). Based on these two excerpts, it difficult to determine to what extent the Company's CAM or the accompanying Service & Facilities Agreement ("SFA") can be changed without Commission authorization. This is an issue because the CAM, SFA, and any other accompanying documentation should only be changed by Commission order and only given proper procedure.

By its own acknowledgment, the CAM is meant "to support Spire Missouri Inc.'s . . . compliance with the Missouri Public Service Commission . . . Affiliate

Transactions Rules . . . ." *Id*. at 2. This is done by having the CAM state "the criteria, guidelines and procedures Spire MO will follow to be in compliance with the Rules, including cost allocation, market valuation and internal cost methods related to its transactions with affiliates . . . ." *Id*. If the Commission approves the CAM and Spire follows it, then the Company should, in theory, be compliant with the Commission's affiliate transaction rules. However, this whole arrangement is immediately lost if Spire is able to change its CAM (or the necessary associated documentation like the SFA) without Commission approval. Once the CAM is changed without Commission approval, the resulting document is no longer a "Commission approved CAM" and thus can no longer be relied upon to establish compliance with the Commission's rules. Therefore, the process for changing the CAM should include a method for the Company to seek Commission approval for the change so that the resulting document can still be considered a "Commission approved CAM."

As stated previously, it is presently unclear whether Spire's proposed CAM actually requires changes to the CAM and associated documentation to receive Commission approval. At one point the CAM clearly states "Any changes to the Commission-approved CAM or the SFA will be filed with the Commission for approval[,]" which would appear to establish the matter rather plainly. However, the CAM also attempts to draw a distinction between "[t]ypical changes in ongoing business operations" and "more fundamental shifts in the business" that suggests the former may be changed without Commission approval while the latter would need a more formal approval process. Given these apparent discrepancies, a specific section

detailing the means and methods for changing the CAM and related documents should be added to the CAM to specifically highlight exactly when and how the CAM can be altered. Moreover, the Commission should not approve the current draft version of the CAM to the extent that it would allow Spire to unilaterally change aspects of its CAM or SFA without first seeking Commission approval.

Conclusion

There are numerous problems with the draft CAM proposed by Spire ranging from the minor changes identified in Attachment A to the major issues addressed in this pleading. The natural result is a CAM that ultimately fails to achieve its stated objectives. Instead of ensuring compliance with the Commission's affiliate transaction rules, this CAM does everything it can to circumvent, undermine, and ultimately abandon those rules. All of this is being done so that Spire can provide its affiliates a financial advantage by constructing a vehicle (Spire Services) which will allow Spire Missouri employee's to do work on behalf of these affiliates while simultaneously allocating the majority of the costs back to Spire Missouri. Approval of this draft CAM by the Commission will therefore only serve to harm Spire's customers to the benefit of Spire's affiliate partners. Thus, the Commission should not approve of Spire's draft CAM.

WHEREFORE, the Office of the Public Counsel respectfully requests the Commission deny Spire's request for approval of its draft CAM and provided all such other relief as is just and reasonable under the circumstances.

Respectfully submitted,

By: /s/ John Clizer

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CERTIFICATE OF SERVICE

I hereby certify that copies of the forgoing have been mailed, emailed, or hand-delivered to all counsel of record this twenty first day of June, 2022.

/s/ John Clizer