

# Exhibit No. 217

**Exhibit No.:**  
**Issue(s):** Rate of Return (ROR)/ Capital Structure  
**Witness/Type of Exhibit:** Murray/Surrebuttal  
**Sponsoring Party:** Public Counsel  
**Case No.:** GR-2021-0108

**SURREBUTTAL TESTIMONY**  
**OF**  
**DAVID MURRAY**

Submitted on Behalf of the Office of the Public Counsel

**SPIRE MISSOURI, INC.**

CASE NO. GR-2021-0108

\*\*

\*\*

**Denotes Confidential Information  
that has been Redacted**

July 14, 2021

**PUBLIC**



## TABLE OF CONTENTS

<b>Testimony</b>	<b>Page</b>
Capital Structure	2
Response to Dylan D'Ascendis' Rebuttal Testimony	19
Summary and Conclusions	38

**SURREBUTTAL TESTIMONY**

**OF**

**DAVID MURRAY**

**SPIRE MISSOURI INC.**

**FILE NO. GR-2021-0108**

1 **Q. Please state your name and business address.**

2 A. My name is David Murray and my business address is P.O. Box 2230, Jefferson City,  
3 Missouri 65102.

4 **Q. Are you the same David Murray who filed direct and rebuttal testimony in this case?**

5 A. Yes.

6 **Q. What is the purpose of your testimony?**

7 A. I will respond to the rebuttal testimonies of Spire Missouri Inc.'s ("Spire Missouri")  
8 witnesses, Dylan W. D'Ascendis and Adam Woodard. I will also respond to Staff witness,  
9 Seoung Joun Won, PhD (Dr. Won), rebuttal testimony addressing capital structure.

10 **Q. What primary issue does Mr. D'Ascendis address in his rebuttal testimony?**

11 A. Mr. D'Ascendis mainly addresses the appropriate return on common equity ("ROE") to  
12 allow Spire Missouri in this rate case. However, he also briefly discusses his opinion as to  
13 the reasonableness of Spire Missouri's requested capital structure as it relates to capital  
14 structures underlying his proxy group.

15 **Q. What issue does Mr. Woodard address?**

16 A. Mr. Woodard mainly addresses capital structure.

17 **Q. What issues does Dr. Won address?**

18 A. Dr. Won addresses the appropriate ROE in this case as well as the capital structure to which  
19 the ROE should be applied. Dr. Won's main disagreement with my recommended rate of

1 return (“ROR”) relates to my recommended capital structure. He supports the  
2 Commission’s decision in Spire Missouri’s 2017 rate case, Case No. GR-2017-0215,  
3 adopting Spire Missouri’s capital structure.

4 **Q. What issue will you address first?**

5 A. Capital structure.

6 **CAPITAL STRUCTURE**

7 **Q. What is your general reaction to Mr. Woodard’s response to your direct testimony?**

8 A. Mr. Woodard does not address the details of my direct testimony. Mr. Woodard’s response  
9 is fairly general and just reasserts his view that the Commission made the right decision in  
10 Spire Missouri’s 2017 rate case. While I did not expect Mr. Woodard to disagree with the  
11 Commission’s 2017 decision authorizing Spire Missouri a 54.2% common equity ratio, I  
12 did expect Mr. Woodard to specifically address why he believes this is the most cost  
13 efficient capital structure for Spire Missouri’s ratepayers. Mr. Woodard states the  
14 following about maintaining a common equity ratio of approximately 54.2%:

15 Spire Missouri has continued to manage its capital structure in a  
16 conservative manner that provides ratepayers with affordable and  
17 sustainable service while **adhering to the guidance provided by the**  
18 **Commission in the last rate proceeding.**<sup>1</sup> (emphasis added)

19 Therefore, the Company is placing responsibility on the Commission to set a cost efficient  
20 capital structure and the Company will manage Spire Missouri’s balance sheet to this  
21 capital structure.

22 **Q. Does Mr. Woodard claim that nothing has changed to cause the Commission to**  
23 **reconsider Spire Missouri’s authorized capital structure?**

24 A. Yes. This is a main theme to Mr. Woodard’s rebuttal testimony. Mr. Woodard indicates  
25 the following about my capital structure position:

---

<sup>1</sup> Woodard Rebuttal, p. 7, ll. 15-17.

1 He [David Murray] also insists on re-litigating issues that were fully decided  
2 in the last rate case proceeding, including offering up the inclusion of short-  
3 term debt with little to no support and without recognition of the  
4 Commission's long held exclusion of short-term debt from major utility's  
5 capital structures and its customary "point in time" analysis.<sup>2</sup>

6 **Q. Are you insisting on relitigating the capital structure issue?**

7 A. Yes.

8 **Q. Why?**

9 A. Because not only do I continue to assert that the facts and circumstances in the 2017 rate  
10 case justified the Commission adopting a capital structure that is guided by the cost  
11 efficient management of Spire Inc.'s capital structure, but new evidence, which includes  
12 direct admissions by the Company in this case, prove that Spire Missouri's capital structure  
13 is not managed for cost efficiency, but rather for ratemaking.

14 On a more general level, I would also point out that capital structure and cost of capital are  
15 issues that arise in all companies' general rate cases. Business, economic and capital  
16 markets are dynamic, which should cause companies to manage their capital structures  
17 accordingly. It is unreasonable to expect that a company, such as Spire Missouri, would  
18 maintain static capital structures without consideration for these changes.

19 **Q. You mentioned additional evidence that Spire Missouri's capital structure is not  
20 managed for cost efficiency, but rather for ratemaking. Have you already offered  
21 much of this evidence in this case?**

22 A. Yes, but I'll offer additional evidence in this testimony by responding to Mr. Woodard's  
23 rebuttal testimony.

---

<sup>2</sup> *Id.*, p. 8, ll. 16-19.

1 **Q. What capital structure does Mr. Woodard recommend the Commission use to set**  
2 **Spire Missouri’s authorized ROR?**

3 A. Spire Missouri’s capital structure as of the true-up date, May 31, 2021, which he maintains  
4 consists of 54.28% common equity and 45.72% long-term debt.<sup>3</sup>

5 **Q. What capital structure ratios did the Commission authorize in Spire Missouri’s 2017**  
6 **rate cases, Case No. GR-2017-0215 and GR-2017-0216 (hereinafter referred to as the**  
7 **“2017 rate case”)?**

8 A. 54.2% common equity and 45.8% long-term debt.<sup>4</sup>

9 **Q. On pages six through seven of his rebuttal testimony, Mr. Woodard cites the factors**  
10 **the Commission considered in the 2017 rate case to support its decision to adopt Spire**  
11 **Missouri’s capital structure to set Spire Missouri’s ROR. Did you address your**  
12 **disagreement with the Commission’s rationale for its decision in your rebuttal**  
13 **testimony?**

14 A. Yes. I addressed this on pages four through seven of my rebuttal testimony.

15 **Q. Would you like to provide additional testimony on these issues?**

16 A. Yes. Mr. Woodard claims that the fact that Spire Missouri issued secured bonds in May  
17 2021 supports the facts the Commission cited in the last rate case. While I agree it is a fact  
18 that Spire Missouri issued these bonds and they are secured by a first mortgage on Spire  
19 Missouri’s assets, I do not agree that this fact supports the adoption of Spire Missouri’s  
20 cost inefficient capital structure.

---

<sup>3</sup> *Id.*, p. 6, ll. 1-2.

<sup>4</sup> Case Nos. GR-2017-0215 and GR-2017-0216, Report and Order, March 7, 2018, , p. 45



1 **Q. How was Spire Inc. able to ensure Spire Missouri’s long-term (common equity and**  
2 **long-term debt) capital structure ratios as of the true-up date, May 31, 2021,**  
3 **approximated the Commission’s authorized capital structure ratios in the 2017 rate**  
4 **case?**

5 A. Because this is Spire Inc.’s strategy for managing Spire Missouri’s capital structure. Spire  
6 Missouri freely admitted as much in its response to Staff Data Request No. 0115 in this  
7 case:

8 Spire Missouri manages its capital structure to represent the capital structure  
9 that was approved by the Commission in the last rate case (GR-2017-0215  
10 and GR-2015-0216) (*sic*).

11 **Q. Did Spire Missouri have the need to issue more long-term debt than the \$305 million**  
12 **it issued?**

13 A. It certainly could have. As of May 31, 2021, Spire Missouri had \*\* \_\_\_\_\_ \*\*  
14 of affiliate notes payable outstanding to Spire Inc. and \*\* \_\_\_\_\_ \*\* outstanding to  
15 third-parties on a short-term credit facility. Considering the fact that Spire Missouri should  
16 have received most of its customers’ bill payments from the winter of 2020/2021 by May  
17 31, 2021, there is no reason to expect much additional internal cash flow from operations  
18 to allow for further reduction in short-term debt balances. Additionally, as I discussed in  
19 my direct and rebuttal testimonies, if Spire Missouri provided a consistent dividend to Spire  
20 Inc., it would need to issue more capital to support its cash needs.

21 **Q. Why does Spire Missouri have two forms of short-term debt outstanding on its**  
22 **balance sheet?**

23 A. The credit facility was drawn due to cash needs associated with winter storm Uri. Although  
24 I am only aware of an additional \*\* \_\_\_\_\_ \*\*<sup>5</sup> of excess gas costs associated with  
25 gas purchases during the gas price spike associated with Uri, Spire Inc. decided to borrow  
26 \$250 million.

---

<sup>5</sup> Spire Missouri response to Staff Data Request No. 414.

1 **Q. Do you know how the other \*\* \_\_\_\_\_ \*\* was used?**

2 A. No. But I imagine this reduced the amount of borrowings needed from Spire Inc. and was  
3 likely used to fund general operational needs, which likely included investment in plant.

4 **Q. Do these events/decisions counter the position that Spire Missouri's capital structure**  
5 **is managed independently?**

6 A. Yes.

7 **Q. Is Spire Inc.'s and Spire Missouri's corporate governance and management structure**  
8 **organized to allow Spire Missouri's capital structure to be managed for the best**  
9 **interests of Spire Missouri and its customers?**

10 A. No. For a more thorough discussion on conflicts of interest related to management  
11 decisions that are counter to Spire Missouri's interests, see OPC witness Robert  
12 Schallenberg's testimony. In addition, Standard & Poor's ("S&P") Ratings Direct  
13 indicated the following about Spire Missouri's lack of sufficient separation from Spire Inc.  
14 to justify being rated based on its own stand-alone credit quality:

15 Under our group rating methodology, we assess Spire Inc. as the parent of  
16 the group that includes Spire Alabama Inc. and Spire Missouri Inc. We  
17 assess the group credit profile as 'A-' which leads to a long-term issuer credit  
18 rating of 'A-'. Our view is that the current insulation measures are not  
19 sufficient to warrant separation between the parent and its subsidiaries.<sup>6</sup>

20 **Q. Does S&P's opinion discredit Mr. Woodard's rebuttal testimony?**

21 A. Yes. Mr. Woodard indicates the following in his rebuttal testimony:

22 Moody's and S&P both assign Spire Missouri bond ratings supported by its  
23 stand-alone capital structure.<sup>7</sup>

---

<sup>6</sup> Gabe Grosberg and Evan Harris, "Spire Inc. Ratings Affirmed; Subsidiaries No Longer Under Criteria Observation; Outlook Stable," S&P Global Ratings – RatingsDirect, August 19, 2019.

<sup>7</sup> Woodard Rebuttal, p. 7, ll. 7-8.

1 At least as it relates to S&P's assigned rating to Spire Missouri, Mr. Woodard's testimony  
2 is wrong.

3 **Q. Mr. Woodard maintains that because Spire Missouri's targeted common equity ratio**  
4 **of 54.2% is within the range of the equity ratios of Mr. D'Ascendis' proxy group, this**  
5 **supports the Commission authorizing the same common equity ratio again in this**  
6 **case. Is this a valid reason for the Commission to authorize this ratio?**

7 A. No. The Commission should heavily scrutinize this logic and consider its fallacy due to  
8 Spire Inc. being a constituent of this proxy group. Mr. D'Ascendis, Dr. Won, and I  
9 analyzed a proxy group of companies that included Spire Inc. As shown in Mr.  
10 D'Ascendis' Schedule R-8 attached to his rebuttal testimony, Spire Inc.'s 5-quarter average  
11 common equity ratio for the quarter-ended March 31, 2021 was 45.69%. The range of 5-  
12 quarter average common equity ratios for Mr. D'Ascendis' original eight proxy companies  
13 is 33.10% to 57.63%. Mr. D'Ascendis eliminated NiSource from his proxy group for  
14 purpose of his rebuttal testimony, which had the lowest common equity ratio of his eight  
15 companies. However, even after eliminating NiSource, the lowest common equity ratio  
16 was 36.93% for South Jersey Industries ("SJI"). Therefore, based on Mr. D'Ascendis' test  
17 of reasonableness based on the range of average common equity ratios of his proxy groups,  
18 both Spire Inc.'s and Spire Missouri's common equity ratios could be considered  
19 reasonable for ratemaking.

20 **Q. Did Mr. D'Ascendis also compare Spire Missouri's common equity ratio to his proxy**  
21 **group's subsidiaries?**

22 A. Yes. This information is shown on page 2 of Schedule R-8. The 5-quarter average  
23 common equity ratio range for his original proxy group was 33.1% to 62.14%. The low-  
24 end was based on NiSource's average with the high-end based on Spire Alabama. After  
25 eliminating NiSource, the range is 47.91% to 62.14%. Although I do not agree with using  
26 the subsidiary capital structures to test the reasonableness of a market-tested capital  
27 structure, even on this basis, Spire Inc.'s common equity ratio would be reasonable based  
28 on the fact cited in the Commission's order.

1 **Q. Why don't you agree with the use of subsidiary capital structures to test the**  
2 **reasonableness of a recommended capital structure?**

3 A. Because each ROR witness in this case determined a reasonable recommended ROE based  
4 on his analysis of the publicly-traded parent companies of the subsidiaries (in the case of  
5 Atmos and ONE Gas Inc. the utility assets are owned directly by the publicly-traded parent  
6 company rather than indirectly through subsidiaries). Therefore, each witnesses'  
7 recommended ROEs are based on the total risk inherent in the publicly-traded companies,  
8 which encompasses additional business risks from non-regulated assets, as well as  
9 additional financial risk from debt issued by the holding companies. Therefore, because  
10 the COE is estimated based on the consolidated capital structures, the tests of  
11 reasonableness of the corresponding capital structures should be based on each company's  
12 consolidated capital structure, which captures the total financial risk evaluated by equity  
13 investors.

14 **Q. Mr. Woodard claims that your capital structure recommendation is based on your**  
15 **"theory that Spire Missouri should receive credit for the debt capacity its assets**  
16 **support."<sup>8</sup> Is this theory?**

17 A. No. This is reality. It is a fact that lower business risk assets can support more financial  
18 risk, i.e. debt. Spire Missouri, Spire Alabama and Spire Gulf have low business risk as  
19 demonstrated by the rating agencies' evaluation of such. This is also supported by Spire's  
20 own internal evaluations of events likely to have caused a decline in Spire Inc.'s equity  
21 value and the volatility of its stock, which was not its regulated utilities.<sup>9</sup>

22 **Q. Considering Spire Inc.'s operations other than its regulated LDC operations have**  
23 **more business risk, would it not be prudent for Spire Inc.'s consolidated capital**  
24 **structure to have less leverage than its regulated utility subsidiaries?**

25 A. Yes. Actually, this is how Spire Inc. managed its capital structure prior to the  
26 commencement of its acquisition strategy. Prior to Spire's acquisition of Alagasco, Spire

---

<sup>8</sup> Woodard Rebuttal, p. 8, ll. 6-8.

<sup>9</sup> Spire Inc. and Spire Missouri Inc. Interim Goodwill Impairment Testing, December 31, 2020.

1 Inc. typically had a higher common equity ratio in its consolidated capital structure as  
2 compared to the common equity ratio at its regulated utility subsidiary, Laclede Gas  
3 Company (assets now known as Spire Missouri East).

4 The only assets Spire Inc. owns are its subsidiaries. Spire Inc.'s other subsidiaries have  
5 not been able to operate without Spire Inc.'s credit support. The only assets that provided  
6 significant and dependable cash flows to allow Spire Inc. to provide parental guarantees of  
7 up to \*\* \_\_\_\_\_ \*\*<sup>10</sup> are those of its regulated utilities. This is not  
8 theory. This is fact.

9 **Q. Does Spire Inc.'s own internal analysis demonstrate that its LDCs should be**  
10 **supported by a more economical capital structure?**

11 A. Yes. As it relates to Spire Inc.'s investments in \*\* \_\_\_\_\_

12 \_\_\_\_\_  
13 \_\_\_\_\_ \*\* Considering the fact  
14 that Spire Inc. had to write-down its Spire Storage investment by \$140.8 million last year,<sup>12</sup>  
15 it is illogical to assume Spire Storage's business risk can allow a higher proportion of  
16 leverage than Spire Missouri. As I will explain when addressing Dr. Won's discussion of  
17 the four factors to consider when evaluating a fair and reasonable capital structure, this  
18 demonstrates the lack of a logical relationship between business risk and financial risk (i.e.  
19 the use of a higher proportion of debt to finance lower-risk assets).

20 **Q. Does Spire Inc. consider Spire Missouri's FFO/debt of around 20% over the last**  
21 **several years to be optimal for a cost efficient capital structure?**

22 A. No. Spire Inc. communicates to its investors that it targets an FFO/debt ratio of 15% to  
23 16%. \*\* \_\_\_\_\_

24 \_\_\_\_\_ \*\*

<sup>10</sup> Spire Inc. Board of Directors Meeting, March 4, 2020, p. 60.

<sup>11</sup> Spire Inc. Strategy Committee Meeting, April 24, 2019, p. 103 of 227.

<sup>12</sup> Spire Inc. SEC Form 10-K Filing, September 30, 2020, p. 48.

<sup>13</sup> Spire Inc. Strategy Committee Meeting, January 27, 2021, p. 32 of 88.

1 **Q. Mr. Woodard testifies that you suggest Spire Missouri “incur additional leverage and**  
2 **trigger rating agency downgrades.”<sup>14</sup> Is this an accurate representation of your**  
3 **testimony?**

4 A. No. Mr. Woodard did not cite my specific testimony as it relates to his representation.  
5 However, I gather his representation is based on my direct testimony beginning on page  
6 50, line 14 through page 52, line 2. In this testimony I discuss my specific quantifications  
7 of the additional leverage I determined Spire Missouri could carry and still maintain a  
8 credit rating at least consistent with the group credit rating S&P currently assigns to Spire  
9 Missouri.

10 **Q. Did Mr. Woodard, or any other Spire Missouri witness, refute your specific**  
11 **calculations and corresponding estimated impacts on Spire Missouri’s**  
12 **creditworthiness?**

13 A. No. Neither Mr. Woodard nor Mr. D’Ascendis addressed my pro forma calculations and  
14 the potential impact such additional leverage may have on Spire Missouri’s or Spire Inc.’s  
15 credit rating.

16 **Q. Did you analyze a scenario in which it was your opinion that Spire Missouri’s and**  
17 **Spire Inc.’s credit ratings may be downgraded if it were adopted by the Commission?**

18 A. Yes. I discussed this scenario on page 51, lines 5-22 of my direct testimony.

19 **Q. Are there any LDCs in the proxy group used by the ROR witnesses in this case that**  
20 **have a similar financial risk profile as you estimated in this scenario?**

21 A. Yes. South Jersey Industries (“SJI”) has financial risk consistent with the pro forma  
22 scenario I determined.

---

<sup>14</sup> Woodard Rebuttal, p. 8, ll. 15-16.

1 **Q. What are SJI’s credit ratings?**

2 A. Moody’s does not rate SJI. S&P assigns a ‘BBB’ rating to SJI.

3 **Q. Are you advocating for Spire Missouri’s capital structure to be managed to a ‘BBB’**  
4 **rating?**

5 A. No. I provide this information to illustrate the fact that even with this additional financial  
6 risk, SJI still maintains an investment-grade credit rating. SJI is able to maintain an  
7 investment-grade credit rating at this level of financial risk, despite the fact that it is  
8 exposed to more business risk than Spire Inc. because of its significant exposure to non-  
9 regulated operations and an activist, anti-carbon environment in New Jersey.

10 **Q. What credit rating does Spire Inc. consider to be most cost efficient?**

11 A. \*\*—————\*\*<sup>15</sup>

12 **Q. Mr. Woodard asserts that you include short-term debt in your recommended capital**  
13 **structure with “little to no support and without recognition of the Commission’s long**  
14 **held exclusion of short-term debt from major public utility’s capital structures and**  
15 **its customary ‘point in time’ analysis.”<sup>16</sup> What is your understanding of Mr.**  
16 **Woodard’s testimony as it relates to the Commission’s customary “point in time”**  
17 **analysis?**

18 A. Mr. Woodard’s statement refers to the Commission’s evaluation of the reasonableness of  
19 a company’s rate levels as of the test year and any potential updates of this test year.  
20 However, an audit of a company’s books and records should never be restricted to  
21 accepting a company’s financial position as of a “point in time” as being representative of  
22 a company’s potential earnings during the period rates will be in effect. A test year should  
23 not cause regulators to put on “blindlers” and ignore a company’s typical financial position  
24 over a ratemaking cycle. This is especially true for a company such as Spire Missouri that

---

<sup>15</sup> Spire Strategy Committee Meeting, October 16, 2019, p. 78.

<sup>16</sup> *Id.*, p. 8, ll. 17-19.

1 is allowed to collect surcharges on investments between rate cases. Therefore, the capital  
2 structure should be examined over the rate case cycle to determine how Spire Missouri  
3 typically finances its infrastructure investments. Spire Missouri's capitalization of its  
4 infrastructure investments includes a significant proportion of short-term debt. I estimated  
5 this proportion to be approximately 7.28% of Spire Missouri's capital structure.

6 **Q. What is your response to Mr. Woodard's testimony about the "Commission's long  
7 held exclusion of short-term debt from major public utility's capital structures..."<sup>17</sup>?**

8 A. While Mr. Woodard is correct that most major electric utilities in Missouri have had short-  
9 term debt excluded from their capital structures because levels of construction work in  
10 progress ("CWIP") have consistently exceeded short-term debt, this has not been the case  
11 for other utility subsectors such as LDCs and water utility companies. Specifically, before  
12 Spire Missouri acquired the Missouri Gas Energy assets (now Spire Missouri West) from  
13 Southern Union, MGE's authorized capital structure in Case No. GR-2009-0355 included  
14 a ratio of 3.26% short-term debt as well as a common equity ratio of 38.66%.<sup>18</sup>  
15 Additionally, before Laclede Gas Company began recovering carrying costs on its gas  
16 inventories through PGA/ACA applications starting after 2002, Laclede Gas Company  
17 regularly included short-term debt in its recommended ratemaking capital structure for  
18 purposes of setting its ROR.<sup>19</sup>

19 **Q. Mr. Woodard claims that as of the true-up period, May 31, 2021, because Spire  
20 Missouri's short-term debt balance was reduced by a \$305 million long-term bond  
21 issued on May 20, 2021, this justifies not including short-term debt in Spire Missouri's  
22 authorized ROR because this complies with "the 'point-in-time' rule."<sup>20</sup> Does this  
23 justify not including short-term debt for purposes of setting Spire Missouri's ROR?**

24 A. No. Again, Mr. Woodard implies the Commission should put on "blinders" and ignore the  
25 reality of how Spire Missouri routinely and consistently finances its investments. In fact,

---

<sup>17</sup> *Id.*

<sup>18</sup> Case No. GR-2014-0007, Glenn W. Buck Direct Testimony, Schedule GWB-2.

<sup>19</sup> Case No. GR-2002-356, Glenn W. Buck Direct Testimony, pp. 10-11 and Case No. GR-2001-629, Glenn W. Buck Direct Testimony, pp. 9-10.

<sup>20</sup> Woodard Rebuttal, p. 9, l. 7.



1 Mr. Woodard admits that Spire Missouri “utilized short-term debt (“STD”) during the test  
2 year for its replacement program.”<sup>21</sup> But Mr. Woodard claims that because this short-term  
3 debt was refinanced with \$305 million of long-term debt, it should be ignored in setting  
4 the ROR that consistently supports Spire Missouri’s rate base.

5 **Q. Mr. Woodard claims that you “offer[ed] up the inclusion of short-term debt with little  
6 to no support...”<sup>22</sup> What support/analysis did you perform to determine the  
7 proportion of short-term debt to include in your recommended capital structure?**

8 A. I explain my findings on page 54, lines 1 through 9 of my direct testimony. Although I did  
9 not specifically reference the schedules in my testimony, Schedules DM-D-9-1 through  
10 DM-D-10-2 show the analysis I performed to determine first, whether it is appropriate to  
11 include short-term debt in the capital structure used to set Spire Missouri’s authorized  
12 ROR, and second, if so, what proportion of short-term debt to include.

13 **Q. Can you explain your findings from these schedules?**

14 A. Yes. As shown on Schedule 9-1, both Spire Inc.’s and Spire Missouri’s capital structures  
15 have consisted of at least 11% short-term debt, on average, for the last 3 to 5 years. I used  
16 Spire Inc.’s and Spire Missouri’s fiscal year (FY) ended balance sheet information (shown  
17 on Schedules DM-D-9-2 and DM-D-9-3) to determine the proportion of their capital  
18 structures supported by short-term debt.

19 Although this information shows Spire Inc.’s and Spire Missouri’s propensity to use a  
20 significant amount of short-term debt over several years, I recognized that this yearly  
21 information was a “snapshot,” or “point-in-time” as Mr. Woodard characterizes such,  
22 based on FY-ending balances for each year over the last several years. For this reason, for  
23 purposes of determining whether and how much short-term debt to include in my  
24 recommended capital structure, I analyzed Spire Inc.’s and Spire Missouri’s average  
25 quarterly short-term debt balances over the entire test year (9/30/2019 through 9/30/2020).

26 This approach allowed me to evaluate the decline in short-term debt balances that should

---

<sup>21</sup> *Id.*, p. 9, ll. 7-10.

<sup>22</sup> *Id.*, p. 8, l. 17.

1 occur due to receipt of payments from customers after the 2019/2020 heating season. My  
2 findings from this analysis are shown on Schedules DM-D-10-1 and Schedule DM-D-10-  
3 2. As can be seen on Schedule DM-D-10-1, both Spire Inc.'s and Spire Missouri's  
4 quarterly-average capital structures for the test year consisted of at least 10% short-term  
5 debt. Even after excluding construction work in progress ("CWIP") from the short-term  
6 debt balances, over 7% of each company's capital structures was supported by short-term  
7 debt.

8 **Q. How did you approach the proportion of short-term debt you recommended be used**  
9 **to set Spire Missouri's ROR in Case No. GR-2017-0215?**

10 A. In that case, I recommended the ratio of short-term debt be based on the average ratio of  
11 short-term debt over Spire Missouri's typical rate case cycle, which is usually in the range  
12 of 3-4 years due to the statutory requirement for Spire Missouri to file within 3 years of the  
13 implementation of its first ISRS surcharge if it wants to continue to collect revenues based  
14 on additional investments.<sup>23</sup> I determined Spire Inc.'s average quarterly proportion of  
15 short-term debt, net of CWIP, for the period September 30, 2014 through September 30,  
16 2017. This analysis indicated an average proportion of short-term debt, net of CWIP, of  
17 6.47% for this period.

18 **Q. If you had approached your recommended proportion of short-term debt using your**  
19 **same approach in the last rate case, what proportion of short-term debt would you**  
20 **recommend be included in Spire Missouri's authorized ROR?**

21 A. 7.05% based on my analysis of Spire Missouri's average CWIP and short-term debt  
22 balances for the period December 31, 2017 through December 31, 2020.

23 **Q. Why didn't you include the most recent quarterly period, March 31, 2021?**

24 A. Because of the anomalous amount of short-term debt caused by higher gas prices from  
25 winter storm Uri.

---

<sup>23</sup> Section 393.1012.2 and 393.1012.3, RSMo.

1 **Q. How does this compare to the proportion of short-term debt you recommended based**  
2 **on the average quarterly period covering the test year?**

3 A. It is slightly lower. I recommended a short-term debt ratio of 7.28%.

4 **Q. Are you changing your recommended proportion of short-term debt based on your**  
5 **analysis of the full rate case cycle?**

6 A. No. Spire Inc. and Spire Missouri have shown a willingness to carry a higher proportion  
7 of short-term or shorter-term debt in its capital structure in between rate cases in order to  
8 capture additional margin. As I indicated in prior testimony, this was the rationale for Spire  
9 Missouri issuing a 3-year term loan after Spire Missouri's last rate case.

10 **Q. Did Spire Missouri time its long-term debt issuance in the last rate case during the**  
11 **final month of the true-up period?**

12 A. Yes. Spire Missouri's true-up period in its 2017 rate case was September 30, 2017. Spire  
13 Missouri issued \$170 million of long-term debt on September 15, 2017. Spire Missouri's  
14 capital structure witness in that case, Glenn Buck, claimed that if this pro forma amount of  
15 long-term debt were deducted from short-term debt for the prior 13-months to the true-up  
16 date, the net balance would be less than short-term asset balances for the same 13-months,  
17 which he testified justified the exclusion of short-term debt from the authorized ROR.

18 **Q. Do these transactions demonstrate the error of relying on "snapshot" or "point-in-**  
19 **time" analysis for purposes of setting fair and reasonable rates over the rate case**  
20 **cycle?**

21 A. Yes. Not only does this result in an unreasonable ROR for rates set in the general rate case,  
22 but this unreasonable ROR is then allowed to be applied to ISRS related investments, which  
23 are funded by lower cost capital not reflected in the ROR used to set the ISRS surcharges.

1 **Q. Does Staff disagree with your recommended capital structure?**

2 A. Yes. Dr. Won provides his response to my capital structure recommendation on pages 39  
3 to 42 of his rebuttal testimony.

4 **Q. What is the basis for Dr. Won’s disagreement with your capital structure**  
5 **recommendation?**

6 A. Dr. Won cites several of the Commission’s reasons from the 2017 rate case and maintains  
7 that the use of Spire Missouri’s capital structure is “supported by the facts in this  
8 proceeding including that Spire Missouri has an independently determined capital structure  
9 with its own long-term debt issuances secured by its own assets.”<sup>24</sup>

10 **Q. Do you agree with Dr. Won’s conclusion that Spire Missouri has an “independently**  
11 **determined capital structure?”**

12 A. It depends on the identity of the subject. Dr. Won does not identify the entity that  
13 “independently” determines Spire Missouri’s capital structure. However, because Spire  
14 Inc. has decided to manage Spire Missouri’s capital structure to target the ratios the  
15 Commission authorized in the 2017 rate case, it is clear that the Commission is the defacto  
16 manager of Spire Missouri’s capital structure. Therefore, I do not agree Spire Missouri nor  
17 any of Spire Missouri’s affiliates are managing Spire Missouri’s capital structure  
18 independent of outside influences.

19 **Q. Does Dr. Won discuss any other factors he considers supportive of adopting Spire**  
20 **Missouri’s capital structure?**

21 A. Yes. Dr. Won cites four factors identified in “The Cost of Capital – A Practitioner’s  
22 Guide,” by David C. Parcell, to support his position that the Commission was correct in  
23 adopting Spire Missouri’s capital structure for purpose of determining its authorized  
24 ROR.<sup>25</sup>

---

<sup>24</sup> Won Rebuttal, p. 42, ll. 14-16.

<sup>25</sup> *Id.*, p. 41, ll. 7-15.

1 **Q. Are you familiar with these factors and this curriculum?**

2 A. Yes. I have reviewed and debated these factors in several cases over my career.

3 **Q. Did you debate these factors in Spire Missouri's 2017 rate case?**

4 A. Yes. Spire Missouri's ROR witness, Pauline Ahern, in Case No. GR-2017-0215, cited  
5 these factors in defending the use of Spire Missouri's capital structure.

6 **Q. Will you discuss these factors again and update your arguments for any changes in  
7 circumstances and/or financial data?**

8 A. Yes.

9 The first factor is:

10 Whether the subsidiary utility obtains all of its capital from its parent, or  
11 issues its own debt and preferred stock.

12 Spire Missouri still issues long-term debt to third-party investors. However, Spire Missouri  
13 relies on Spire Inc. for its short-term capital needs through Spire Inc.'s consolidated  
14 commercial paper program. Spire Inc. last made a direct equity infusion into Spire Missouri  
15 in 2012. As I have discussed in my direct and rebuttal testimonies, because Spire Missouri  
16 has retained 100% of its cash flows in several quarters over the last several years, Spire  
17 Inc. has strategically funded its cash deficiencies for dividends by raising capital at the  
18 holding company. Spire Inc. has raised capital from other sources to fund \$100 million of  
19 dividends during the past several years. Although I discussed this aspect of Spire Inc.'s  
20 financial management of its family of companies in my direct testimony,<sup>26</sup> Spire Missouri  
21 did not respond to this part of my testimony.

22 The second factor is:

23 Whether the parent guarantees any of the securities issued by the subsidiary.

---

<sup>26</sup> Murray Direct, pp. 52-53.

1 Spire Inc. still does not guarantee any of Spire Missouri’s securities. However, as I  
2 discussed in other areas of my testimony, Spire Missouri and its regulated utility affiliates  
3 have lower business risk profiles than Spire Inc. and its non-regulated subsidiaries. Spire  
4 Inc.’s creditworthiness depends on its regulated subsidiaries rather than the opposite.  
5 Therefore, creditors/lenders to Spire Missouri do not require credit enhancement.  
6 However, Spire Inc.’s other riskier non-regulated subsidiaries do require credit  
7 enhancement, which would not be possible but for Spire Inc.’s ownership of low-risk,  
8 regulated LDCs, including that of Spire Missouri.

9 The third factor is:

10 Whether the subsidiary’s capital structure is independent of its parent (i.e.  
11 existence of double leverage, absence of proper relationship between risk  
12 and leverage of utility and non-utility subsidiaries).

13 As I indicated when discussing the first factor, Spire Inc. last issued debt to make a direct  
14 equity infusion into Spire Missouri in 2012. This circumstance/situation is the most direct  
15 form of double-leverage. However, double-leverage on a broader level is simply the  
16 existence of leverage at the subsidiary and at the holding company, which defines Spire  
17 Inc.’s financing strategy. It is this broader definition that feeds into the logic provided in  
18 the quoted parenthesis, which is the absence of the proper relationship between risk and  
19 leverage of the utility and non-utility subsidiaries. If Spire Inc.’s non-regulated  
20 subsidiaries could support the debt issued at the holding company, they would not require  
21 guarantees from the holding company. Therefore, it is wholly illogical and inconsistent  
22 with the relationship between risk and leverage to conclude that Spire Inc. could issue  
23 holding company debt without the cash flow support of its low-risk regulated utility assets.  
24 The absence of a proper relationship is supported by the fact that S&P determined that  
25 Spire Missouri’s hypothetical stand-alone credit profile (“SACP”) is ‘A+,’ but ultimately  
26 assigns Spire Missouri an ‘A-’ credit rating due to Spire Inc.’s more leveraged capital  
27 structure.<sup>27</sup> This two-notch differential is even greater than the one-notch differential that  
28 existed at the time of the 2017 rate case. Additionally, as \*\*

---

<sup>27</sup> Beverly R. Gantt and Matthew L. O’Neill, “Spire Missouri Inc.,” S&P Global RatingsDirect, March 23, 2020.

1 \_\_\_\_\_  
2 \_\_\_\_\_ \*\* Therefore, the third factor  
3 does not support setting Spire Missouri's ROR based on its cost inefficient capital  
4 structure.

5 The fourth factor is:

6           Whether the parent (or consolidated enterprise) is diversified into non-  
7           utility operations.

8 The fourth factor is mainly concerned with whether one would reasonably expect the parent  
9 consolidated capital structure to be significantly different than that of its subsidiaries due  
10 to business risks that are widely diverse. Although Spire Inc. does have some exposure to  
11 non-regulated operations, this exposure to non-regulated operations should cause Spire Inc.  
12 to have a less leveraged consolidated capital structure than its LDC subsidiaries due to the  
13 fact that its non-regulated operations have more business risk. Prior to Spire Inc.'s  
14 acquisition-oriented strategy starting in 2013, Spire Inc. (then Laclede Group) was less  
15 leveraged than Spire Missouri (then Laclede Gas Company). Laclede Group only issued  
16 short-term debt prior to these acquisitions. Therefore, this factor supports the use of Spire,  
17 Inc.'s consolidated capital structure because the lower-risk regulated utilities allow Spire  
18 Inc. to have a more leveraged capital structure while maintaining a strong investment grade  
19 credit rating.

20 **RESPONSE TO DYLAN D'ASCENDIS' REBUTTAL TESTIMONY**

21 **Q. What is Mr. D'Ascendis primary focus in his rebuttal testimony?**

22 A. Mr. D'Ascendis is primarily addressing my and Dr. Won's ROE recommendations. He  
23 briefly discusses Spire Missouri's recommended capital structure as it relates to his proxy  
24 companies' capital structures.

28 Spire Strategy Committee Meeting, October 16, 2019, p. 78.

1 **Q. What is your general reaction to Mr. D’Ascendis’ rebuttal testimony?**

2 A. Mr. D’Ascendis did not provide any testimony in response to my direct testimony  
3 comparing and contrasting the electric utility and local natural gas distribution (“LDC”)  
4 capital market conditions. In my opinion (and in most equity analysts’ opinions over most  
5 of the past year), this has been one of the most remarkable and debated dynamics that has  
6 changed within the utility sector. This has also been of great interest and concern to Spire  
7 Inc. It is this type of information that should be closely examined and understood in  
8 determining a fair and reasonable allowed ROR in this case. This information is also  
9 important for understanding whether Spire Inc. should be pursuing a more conservative  
10 capital structure for purposes of ensuring financial flexibility to ensure Spire Missouri’s  
11 credit profile is not even more unfairly constrained by Spire Inc.’s additional business and  
12 financial risk. This certainly is one of the primary issues that has caused Spire Inc. to  
13 reevaluate the types and amounts of capital it issues in order to ensure financial stability at  
14 reasonable costs. However, Spire Inc. has not been as concerned with ensuring the same  
15 for Spire Missouri’s security issuances. Instead, Spire Inc. has targeted the same equity-  
16 rich capital structure for Spire Missouri as it was authorized in the 2017 rate case. This  
17 fact in and of itself should be sufficient to dismiss Spire Missouri’s requested ROR as too  
18 high.

19 **Q. What is your general reaction to Mr. D’Ascendis’ conclusions as it relates to change**  
20 **in cost of capital environment?**

21 A. Mr. D’Ascendis concludes that investor-required returns have increased since he filed his  
22 Direct Testimony on December 11, 2020.<sup>29</sup> Mr. D’Ascendis conclusion is at odds with the  
23 continued upward climb in broader stock market valuations and the decrease in yields on  
24 junk bonds. His conclusion is also at odds with \*\* \_\_\_\_\_  
25 \_\_\_\_\_  
26 \_\_\_\_\_

---

<sup>29</sup> D’Ascendis Rebuttal, p. 8, ll. 4-6.



- 1 • \_\_\_\_\_
- 2 \_\_\_\_\_
- 3 • \_\_\_\_\_
- 4 \_\_\_\_\_
- 5 • \_\_\_\_\_
- 6 \_\_\_\_\_ \*\*30

7 **Q. Mr. D’Ascendis indicates that he does not agree that utility stock investments are**  
8 **“akin to bond investments.”<sup>31</sup> Who does he disagree with?**

9 A. Investors. Mr. D’Ascendis claims that equity analysts greatly influence investor decisions  
10 as it relates to making stock investments. These same equity analysts consistently compare  
11 the valuation of utility stocks to changes in bond yields due to the fact that they consider  
12 regulated utility stocks to be bond surrogates/substitutes.<sup>32</sup> While there certainly are  
13 periods in which the historical ~71% correlation of utility stocks with interest rates are not  
14 as strong, analyzing utilities’ P/E ratios as they relate to current interest rates routinely  
15 forms the basis for whether these equity analysts consider utility stocks to be expensive or  
16 inexpensive.<sup>33</sup>

17 **Q. Mr. D’Ascendis concludes that low interest rates during 2020 were due to a**  
18 **“volatility-driven ‘flight to safety’ as opposed to a systematic lowering of capital**  
19 **costs.”<sup>34</sup> Do you agree that there has been a “flight to safety?”**

20 A. No. As is evident by consistently increasing valuation levels for the broader markets and  
21 a significant decline in junk bond yields and the declining spread of junk bond yields over  
22 United States Treasury (UST) bonds, the opposite has occurred. Although this illustrates  
23 the decline in required market risk premium, this does not necessarily imply that the  
24 required risk premium to invest in utilities has decreased since shortly prior to the onset of  
25 the COVID pandemic. However, as I discussed extensively in my testimony in Ameren  
26 Missouri’s and Empire’s 2019 rate cases, Case No. ER-2019-0335 and ER-2019-0374,

---

<sup>30</sup> Spire Inc. Strategy Committee Meeting, January 27, 2021, p. 34.  
<sup>31</sup> *Id.*, p. 10, ll. 14-15.  
<sup>32</sup> Shahriar Pourreza, CFA, et. al., “21 Utilities Outlook: Getting Ready for Another Bumpy Ride,” Guggenheim Securities LLC, January 21, 2021, p. 14.  
<sup>33</sup> *Id.*, p. 27.  
<sup>34</sup> D’Ascendis Rebuttal, p. 10, ll. 20-21.

1 respectively, utilities' COE were at all-time lows at that time. As shown in the below  
2 graph, electric utilities' and LDCs' P/E ratios are trading at similar levels versus the  
3 discount that LDCs traded at during most of 2020:



5

6 **Q. Mr. D'Ascendis provides his rationale as to why utility stock investments should not**  
7 **be considered analogous to bond investments by comparing utility dividend yields to**  
8 **'A'-rated utility bond yields on page 19 of his rebuttal testimony. In this chart he**  
9 **focuses on the fact that the 'A'-rated utility bond yields are historically higher than**  
10 **utility dividend yields. Does this surprise you?**

11 **A. No. Part of the expected return from investing in utility stocks is an expected growth in**  
12 **dividends over the long-term. Bond coupons do not grow based on a company's underlying**  
13 **fundamentals. However, if long-term interest rates decline (assuming no change in**  
14 **companies' risk profiles), then the value of higher historical bonds' coupons increase,**  
15 **causing the price of the outstanding bonds to increase. As discount rates (i.e. the cost of**

1 capital) decrease, the value of the higher coupons increase, resulting in a higher market  
2 value of the bonds. This same relationship holds true for utility stocks.

3 **Q. Does Mr. D’Ascendis’ computation of capital gains for utility stocks for the period**  
4 **2010 through 2020 prove that the characteristics of utility stocks are very much like**  
5 **bonds?**

6 A. Yes. UST bonds over the same period achieved over 60% of their total returns from price  
7 appreciation. The price appreciation in bonds was not caused by expected growth in  
8 coupons because coupons are fixed when the bonds are issued. The price appreciation in  
9 bonds occurred because the cost of capital declined (the rate used to discount the higher  
10 coupons declined causing the value of the bonds to increase). The same holds true for  
11 utility stocks. Therefore, Mr. D’Ascendis’ analysis of capital gains for utility stocks during  
12 the period of generally declining interest rates supports the fact that utility stocks have  
13 investment characteristics similar to bond/fixed-income securities.

14 **Q. Mr. D’Ascendis claims that a multi-stage DCF method is “not applicable to utility**  
15 **companies.”<sup>35</sup> Is his position correct?**

16 A. No. Mr. D’Ascendis’ testimony is based on his view that utility companies are in the  
17 mature stage of their growth cycle. While I appreciate the fact that the utility industry is  
18 generally considered to be a mature industry, Mr. D’Ascendis position is not supported by  
19 practical evidence. As I explained in my direct testimony, a multi-stage DCF approach  
20 was appropriate because this is in fact how utility investment analysts determine a fair  
21 value for utility stock investments. I have first-hand knowledge of at least two investment  
22 firms that use multi-stage DDM/DCF to estimate a fair price to pay for utility stocks.  
23 There are likely several others that perform such methods, but not all analysts publish the  
24 specifics of their models in their research reports.

---

<sup>35</sup> *Id.*, p. 27, ll. 19-21.

1 **Q. Mr. D’Ascendis indicates that it is better to use earnings growth rates in a DCF**  
2 **analysis because earnings expectations have a more significant influence on market**  
3 **prices than dividend expectations.<sup>36</sup> Does Spire Inc. agree with Mr. D’Ascendis?**

4 A. No. In evaluating its dividend payment policies, Spire Inc. recognized that utility investors  
5 are focused on dividends and the growth in dividends. This is because this is a fundamental  
6 characteristic of utility stock investments and investors’ expectations for their investments  
7 in utility stocks.

8 **Q. Mr. D’Ascendis indicates Value Line is the only source he is aware of that publishes**  
9 **projected dividend per share (DPS) growth rates.<sup>37</sup> Do equity analysts provide**  
10 **projected DPS information for the companies that they follow?**

11 A. Yes. This information was the basis for the projected DPS information I used in my multi-  
12 stage DCF analysis in my testimony. I obtained this information from S&P Global Market  
13 Intelligence’s database. As I explained in my rebuttal testimony, investors are primarily  
14 interested in long-term growth rates in earnings per share (EPS) because this allows them  
15 to determine whether a particular company’s P/E ratio (a relative valuation method)  
16 deserves a premium or discount to its peers. The long-term growth in EPS is not used as a  
17 proxy for perpetual dividend growth in a constant-growth DCF analysis.

18 **Q. Mr. D’Ascendis claims it is “well-established in the financial literature that projected**  
19 **growth in EPS is the superior measure of dividend growth in the DCF model.”<sup>38</sup> Is**  
20 **he correct?**

21 A. No. Mr. D’Ascendis concludes that because security analysts’ recommendations affect  
22 stock prices, this proves that investors use the security analysts’ projected 5-year compound  
23 annual growth rate (CAGR) in EPS as the constant growth rate in a single-stage DCF  
24 analysis. This was not the conclusion of the seminal study by Cragg and Malkiel,<sup>39</sup> which

---

<sup>36</sup> *Id.*, p. 28, ll. 3-7.

<sup>37</sup> *Id.*, p. 30, ll. 1-7.

<sup>38</sup> *Id.*, p. 31, l. 27 – p. 32, l. 1

<sup>39</sup> Malkiel, Burton G., and John G. Cragg. “Expectations and the Structure of Share Prices.” *The American Economic Review*, vol. 60, no. 4, 1970, pp. 601–617.

1 most subsequent studies have cited as support for the influence of equity analysts'  
2 recommendations on stock prices.

3 The conclusion of this academic study was that equity analysts' expectations had a  
4 greater influence on stock prices compared to simple extrapolations of historical financial  
5 data. This conclusion is logical considering the vast amounts of resources dedicated to the  
6 discipline of securities analysis. This does not translate into proof that investors use  
7 projected five-year CAGR in EPS as a constant growth rate in the single-stage DCF  
8 methodology. In fact, the Cragg and Malkiel study did not even use the DCF valuation  
9 model when testing their hypothesis regarding the influence of analysts' projections on  
10 stock prices. It is more plausible to conclude that, because investors rely on equity  
11 analysts' expectations, they rely on their investment recommendations (e.g. buy, sell or  
12 hold), which is exactly how \*\*

13 

---

\*\*40

14 Equity analysts' investment recommendations are based on their assessment of the intrinsic  
15 value of a given stock. Analysts' methodologies for estimating a fair price varies, but most  
16 at least assess the current price-to-forward earnings ratios both on a consensus basis and  
17 on the analyst's own estimates. If the analyst believes the company can grow its earnings  
18 faster than the consensus and/or the company deserves a higher price-to-earnings ("P/E")  
19 ratio than the consensus, then the analyst will expect a higher return than the consensus. In  
20 my experience, this is the primary purpose for providing both discrete EPS forecasts and  
21 EPS growth rate forecasts. It allows investors to estimate a potential justified P/E multiple.

22 Cragg and Malkiel specifically indicated the following in their study:

23 We would not argue that these estimates necessarily give an accurate picture  
24 of general market expectations. It would, however, seem reasonable to  
25 suggest that they are representative of opinions of some of the largest  
26 professional investment institutions and that they may not be wholly  
27 unrepresentative of more general expectations. **Since investors consult**  
28 **professional investment institutions in forming their own expectations,**  
29 **individuals' expectations may be strongly influenced—and so reflect—**  
30 **those of their advisers.** That several of our participating firms find it  
31 worthwhile to publish these projections and provide them to their customers

---

<sup>40</sup> Spire Inc. Board of Director Meeting, April 30, 2020, p. 7.

1 provides prima facie evidence that a certain segment of the market places  
2 some reliance on such information in forming its own expectations. Also,  
3 insofar as other security analysts and investors follow the same sorts of  
4 procedures as those used by our sample analysts in forming expectations,  
5 general investors' expectations would resemble those of the analysts.  
6 Consequently, these predictions may well serve as acceptable proxies for  
7 general expectations and surely seem worthy of detailed analysis.<sup>41</sup>  
8 (emphasis added)

9 Considering the above information, in which the foundation for the study concludes  
10 that investors rely and depend on their investment advisors, and therefore, stock prices  
11 reflect these expectations, it is imperative for ROR witnesses to understand how these  
12 advisors perform their investment analyses rather than using their growth rates without  
13 understanding the context in which they are used. In my experience analyzing investment  
14 analysts' research reports, I have *NEVER* seen an investment analyst assume a utility stock  
15 will grow at a constant rate in perpetuity consistent with the analyst's projected 5-year  
16 CAGR in EPS. To assume that investors utilize the information provided by equity analysts  
17 in a way that is wholly inconsistent with how the very analysts that provide them use them,  
18 is not supported by practical evidence.

19 Equity analysts often use the dividend discount model ("DDM") to estimate a fair  
20 price to pay for the stock. The DDM is synonymous with the DCF in utility ratemaking  
21 settings. The DCF in utility ratemaking is simply solving for the required return/cost of  
22 equity variable. In valuation, the goal is to solve for the fair price of the stock.  
23 Consequently, if equity analysts are of value to their clients, then the stock prices will  
24 reflect their estimates of future dividends and the required return on these dividends.  
25 Consequently, if one accepts the studies that security analysts' expectations influence  
26 investors, which is the conclusion made by Malkiel and Cragg, then this means that stock  
27 prices reflect the cost of equity used by these very same analysts. My experience has been  
28 that these equity discount rates are usually much lower than cost of equity estimates  
29 provided by ROR witnesses in utility rate cases. I have provided many examples in this  
30 case and in past rate cases, which proves that equity analysts use equity discount rates as  
31 low as in the 5% range, with very few as high as 7%. This clearly refutes Mr. D'Ascendis'

---

<sup>41</sup> *Id.*

1 constant-growth DCF COE estimates in the 9% range, which assumes that dividends will  
2 grow perpetuity at the equity analysts' projected 5-year CAGR in EPS.

3 Consequently, Mr. D'Ascendis' testimony is wrong as it relates to his statement  
4 that it is "well-established in the financial literature that projected growth in EPS is the  
5 superior measure of dividend growth in the DCF model."<sup>42</sup>

6 **Q. Mr. D'Ascendis claims that the GDP information he provided on Schedule DWD R-  
7 4 proves that the utility industry can be expected to grow at a rate faster than the  
8 overall economy.<sup>43</sup> What does he fail to recognize in his analysis?**

9 A. The fact that the utility industry has become a shrinking portion of the economy over the  
10 last 20+ years. As can be seen in the following graph, the utility industry increased as a  
11 contribution to GDP from the years 1947 through approximately the mid-1980s. However,  
12 since this time, the utility industry has become a shrinking part of the economy with a  
13 leveling off of its contribution since around the turn of the century. If utilities were to  
14 continue to contribute approximately 1.5% to the economy, then it may be rational to  
15 expect utilities to grow at the same rate of the economy for the foreseeable future.  
16 However, this would be based on the aggregate growth of the industry, rather than growth  
17 of the earnings of the industry. In fact, history has shown that because utility companies  
18 need to issue external equity (additional common shares), the expected growth in

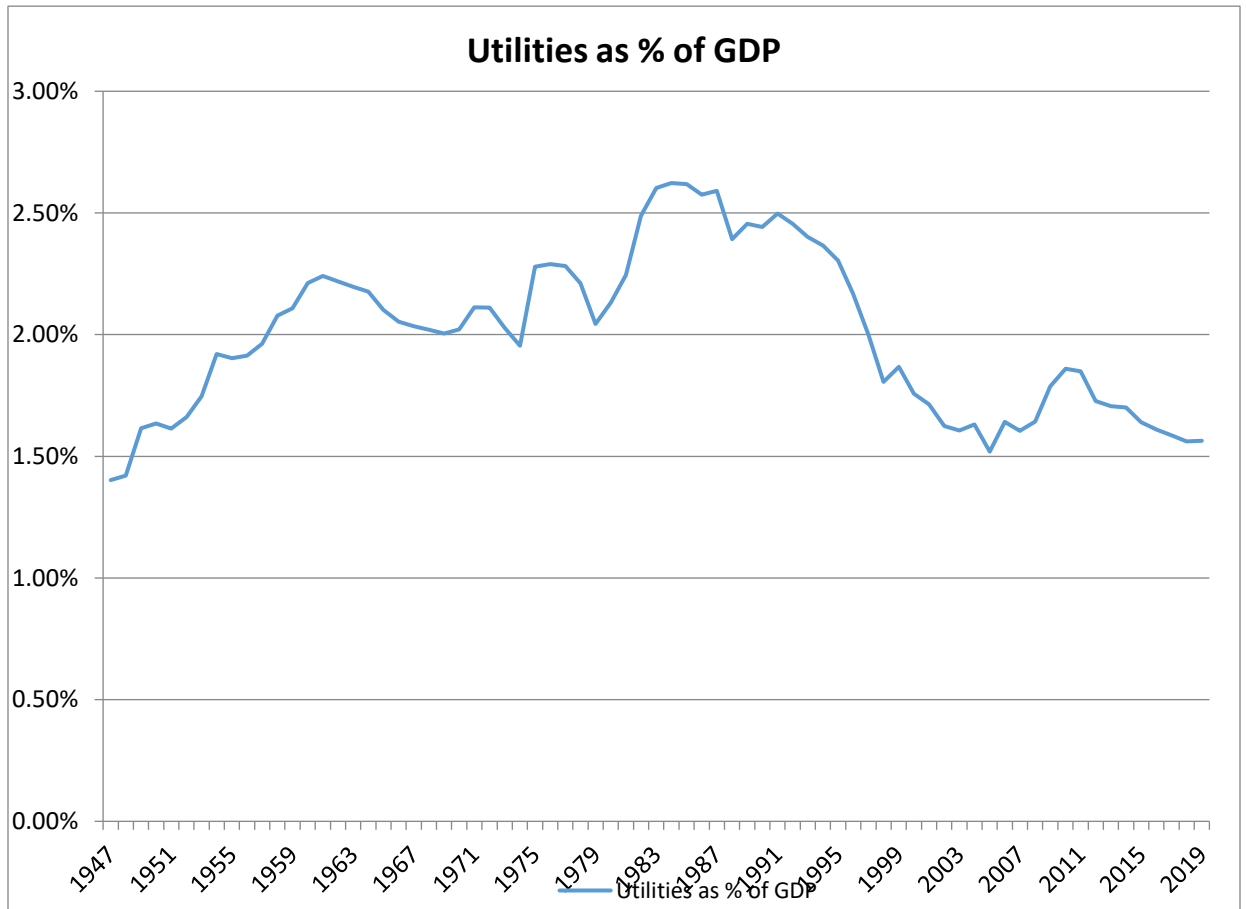
---

<sup>42</sup> D'Ascendis Rebuttal, p. 31, l. 27 – p. 32, l. 1

<sup>43</sup> *Id.*, p. 32, ll. 3-5.

1

earnings/dividends per share is less than an aggregate expected earnings growth rate.



2

3

**Q. What is your response to Mr. D’Ascendis’ suggestion that cost of capital estimation methods such as the CAPM or risk premium analyses should use projected interest rates?**

4

5

6

A. This defies the efficiency of capital markets that Mr. D’Ascendis embraces when discussing the use of published betas and equity analysts’ earnings growth rates. Mr. D’Ascendis is correct that investors take all of this information into consideration when determining a fair price to pay for stocks in utility companies. Investors also consider the forward expectations of interest rates when deciding on a fair price to pay for their investments, whether it is an investment in utility stocks or an investment in bonds. If it is investors’ consensus that long-term interest rates will increase over the next year, then this is factored into the price they are willing to pay for bonds. Mr. D’Ascendis’ suggestion that the cost of capital should be based on higher forward interest rate estimates implies

7

8

9

10

11

12

13

14



1 that investors in bonds today do so with the expectation that bond prices will decrease when  
2 interest rates increase. This is not the case. The current price of long-term bonds reflect  
3 investors' expectations of an average return over the life of the bond.

4 Additionally, as I will discuss later in my testimony, Spire Inc.'s own cost of capital  
5 analysis, performed for purposes of ensuring the carrying value of its LDC assets are fairly  
6 reported on its balance sheet, used current interest rates rather than projected interest rates.

7 **Q. Mr. D'Ascendis indicates that you are incorrect in your position that "market-based**  
8 **ROE analyses are not equal to the authorized ROE..."<sup>44</sup> Does Mr. D'Ascendis**  
9 **disagree with others besides you on this matter?**

10 A. Yes. He disagrees with investors and Spire Inc. Equity analysts have become accustomed  
11 to commissions allowing ROEs higher than the COE. In fact, influential equity research  
12 analysts, such as Evercore ISI, that publish CAGRs in EPS, determine a final terminal  
13 allowed ROE to COE spread of 2.25% when determining a fair price to pay for utility  
14 stocks. Additionally, Spire Inc. estimates a much lower COE when determining a  
15 reasonable fair value for its utility assets. I provided this information in my rebuttal  
16 testimony. I found that Spire Inc. uses reasonable market risk premium of approximately  
17 \*\* — \*\* when making its own investment and valuation assessments.

18 **Q. Mr. D'Ascendis takes issue with your comparison of Spire Missouri to the Empire**  
19 **District Electric Company for purposes of determining a fair and reasonable allowed**  
20 **ROE in this case.<sup>45</sup> How do you respond?**

21 A. My comparison of the LDC subsector of the utility sector to the electric utility subsector  
22 of the utility sector is a routine aspect of investors' evaluations of the attractiveness or  
23 unattractiveness of potential investments in utilities at any given time. The inversion of  
24 LDCs trading at a premium to the electric utility subsector to trading at a discount to the  
25 electric utility subsector has been the subject of much debate by investors and the analysts  
26 advising such investors through their published research. In fact, equity research analysts

---

<sup>44</sup> *Id.*, p. 46, l. 19, through p. 47, l. 3.

<sup>45</sup> *Id.*, p. 48.

1 covering the utility sector have been evaluating potential justifications for LDCs trading at  
2 discounts to electric utilities as opposed to premiums. To the extent that such a change in  
3 relationship is due to a higher COE relevant to the electric utility industry, the Commission  
4 should consider such in determining a fair and reasonable allowed ROE for Spire Missouri.  
5 In my direct testimony, I decided such uncertainty justified recommending the high-end of  
6 my recommended ROE range exceed the 9.25% allowed ROE for Empire. However, due  
7 to the fact that a significant aspect of the debate on the decline in LDC stock prices involved  
8 a potential decline in the industry, a lower terminal value/perpetual growth rate for the  
9 industry would also explain the decline in the LDC subsectors' stock prices (i.e. same COE  
10 applied to lower expected future cash flows causes a lower fair price for a share of LDC  
11 stock).

12 Consequently, this is the type of comparison investors routinely make when  
13 deciding which subsectors of the utility industry are attractive investments in the current  
14 market environment. In the recent MAWC rate case, I analyzed the valuation levels of the  
15 electric, gas and water subsectors of the utility industry in order to provide some context  
16 as to why the water utility industry traded at valuation levels that often exceeded the electric  
17 and gas industries by at least 10x P/E in recent periods. I concluded that the higher P/E  
18 ratios in for the water utility subsector could be explained by a lower overall discount rate  
19 (cost of capital including the debt used in the capital structure) and a higher expected  
20 terminal value/perpetual growth rate because of the confidence in the need for safe and  
21 reliable water and sewer utility service in perpetuity.

22 **Q. Mr. D'Ascendis indicates that you did not consider your CAPM and Bond Yield Plus**  
23 **Risk Premium results in determining your ROE recommendation.<sup>46</sup> Is this an**  
24 **accurate representation of your testimony?**

25 **A.** No. As Mr. D'Ascendis notes in his testimony, I performed a CAPM and Bond Yield Plus  
26 Risk Premium analysis to test my DCF estimates. Because my COE estimates using these

---

<sup>46</sup> *Id.* p. 51, ll. 3-9.

1 methods indicate that my multi-stage DCF are likely too high, I used these lower estimates  
2 to establish the lower-end of my COE range, which was 6.5%.

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

5 A. No. My recommended authorized ROE of 9.25% takes into consideration many different  
6 factors. A fundamental principle of shareholder value creation is for a company to invest  
7 in projects that allow the company to at least earn its cost of capital. An allowed ROE of  
8 9.25% allows for a margin of 225 basis points over my estimate of Spire Missouri’s COE.  
9 I am aware investors have become accustomed to regulators allowing utility companies  
10 returns that are higher than their cost of capital. In fact, some investors, such as Evercore  
11 ISI, use investment models that assume that regulators currently allow an ROE to COE  
12 spread of approximately 440 basis points (9.75% ROE – 5.35% COE), but will eventually  
13 reduce the spread to a range of 225 to 275 basis points as either the COE increases, the  
14 allowed ROEs decrease or a combination of both.<sup>47</sup>

15 As I discussed in my Direct Testimony, as recently as Spire Missouri’s 2017 rate case, I  
16 had estimated that the LDC industry’s COE was approximately 25 basis points lower than  
17 that of the vertically-integrated electric utility industry. Therefore, I suggested that an  
18 authorized ROE that is 25 basis points lower than that which the Commission considered  
19 reasonable for electric utilities was fair and reasonable. I understood the Commission  
20 would apply its zone of reasonableness standard in determining the lowest and highest  
21 recommended ROEs it would consider. Knowing that the Commission had applied this  
22 standard when deciding a 9.5% allowed ROE was fair and reasonable for Missouri’s largest  
23 electric utility companies, it was my opinion that the Commission should recognize Spire  
24 Missouri’s lower risk as compared to Missouri’s larger electric utilities. Again, in my  
25 opinion, an allowed ROE as low as the cost of capital would be sufficient to attract capital,  
26 but if the Commission were to authorize an ROE consistent with such, then Spire’s stock  
27 price would decline considerably because investors expect some consistency within how

---

<sup>47</sup> Durgesh Chopra and Michael Lonegan, “Utes Mid-Year Quick Update,” Evercore ISI, July 5, 2021, p. 6.

1 Missouri sets the rates for its utility companies. Based on my analysis of capital market  
2 conditions and consideration of investor communications of the typical relationship  
3 between LDCs and the electric utility industry, a 9.25% authorized ROE applied to a  
4 reasonable equity ratio is factored into the price investors are willing to pay for Spire's  
5 stock.

6 **Q. Mr. D'Ascendis takes issue with the betas, interest rates, and market risk premium**  
7 **estimates you used in your COE analysis.<sup>48</sup> What issue does he raise about the beta**  
8 **and market risk premiums ("MRP") you use?**

9 A. He indicates that the information I used is not published by a "widely available source"  
10 and the MRP as estimated by Duff & Phelps is "not transparent."

11 **Q. Does his criticism make any sense considering the eighteen risk premium estimates**  
12 **he used to estimate the cost of equity for Spire Missouri?**

13 A No. Of the 18 different risk premium estimates Mr. D'Ascendis provides to estimate Spire  
14 Missouri's COE, only one of these estimates is published and widely available, which is  
15 the 7.01% market risk premium he shows on page 2 of Schedule DWD-D5.<sup>49</sup> The  
16 remainder of Mr. D'Ascendis risk premium estimates are determined through his misuse  
17 of financial and market data provided by Value Line and Bloomberg. Although Value Line  
18 and Bloomberg are reputable sources for financial and market data, they do not advise  
19 investors as to appropriate market risk premiums. There are no reputable "widely available  
20 sources" that estimate market risk premium estimates anywhere close to the 10.45% Mr.  
21 D'Ascendis estimates based on his use of data from these sources. As I indicated on page  
22 24 of my rebuttal testimony, Spire Inc. itself used a \*\* — \*\* market risk premium for  
23 purposes of determining if the value of its regulated utility assets are fairly reported on its  
24 balance sheet.

---

<sup>48</sup> *Id.*, p. 51-53.

<sup>49</sup> *Id.*, Schedules DWD-D4, pp. 8, 12 and 13; and DWD-D5, p. 2

1 **Q. What source does Spire Inc. use for purposes of determining a fair and reasonable**  
2 **market risk premium?**

3 A. Spire Inc. has used many different sources to determine a \*\* \_\_\_\_\_ \*\* market risk premium  
4 is reasonable. According to its December 10, 2018, Impairment of Analysis of Goodwill,  
5 this market risk premium was based on the following information considered by  
6 PricewaterhouseCoopers: \*\* \_\_\_\_\_

7 \_\_\_\_\_  
8 \_\_\_\_\_  
9 \_\_\_\_\_ \*\* In an internal memorandum regarding its own assessment  
10 of the value of its regulated LDC assets, Spire Inc. indicated the following about the sources  
11 it relied on for a \*\* \_\_\_\_\_

12 \_\_\_\_\_  
13 \_\_\_\_\_  
14 \_\_\_\_\_  
15 \_\_\_\_\_  
16 \_\_\_\_\_

- 17 • \_\_\_\_\_
- 18 \_\_\_\_\_
- 19 • \_\_\_\_\_
- 20 \_\_\_\_\_
- 21 \_\_\_\_\_ \*\*

22 As indicated in Spire Inc.'s memorandum, this market risk premium is consistent with  
23 those it uses for other valuations. I confirmed such when I analyzed the inputs Spire Inc.  
24 used for purposes assessing the value of its Spire Storage business segment. For purposes  
25 of determining this value, Spire Inc. used a market risk premium of \*\* \_\_\_\_\_  
26 \_\_\_\_\_ \*\*

<sup>50</sup> Spire Inc. Board of Directors Meeting, April 24, 2019, p. 103 of 227.

1 **Q. What company publishes the Ibbotson Associates, Inc.’s Stock, Bonds, Bills and**  
2 **Inflation (“SBBI”) data?**

3 A. Duff & Phelps. Duff & Phelps has been publishing this data for approximately the last five  
4 years.

5 **Q. Does the CFA Institute make this data available to its members?**

6 A. Yes. This data is updated monthly and made available to all CFA members in good  
7 standing.

8 **Q. Is this how you accessed this data?**

9 A. Yes.

10 **Q. Mr. D’Ascendis also takes issue with your use of a 20-year risk-free rate in addition**  
11 **to your use of a 30-year risk-free rate when estimating the cost of equity.<sup>51</sup> Why did**  
12 **you show a CAPM analysis with a 20-year risk-free rate?**

13 A. Because the historical earned return spread between returns on large company stocks and  
14 returns on long-term government bonds is based on 20-year UST bonds. Although I agree  
15 with Mr. D’Ascendis that it is desirable to use the longer 30-year UST bonds for the risk-  
16 free rate for the first variable in the CAPM, if so, it should also should be used to determine  
17 the earned return to subtract from large company stocks. Ibbotson’s database of returns on  
18 long-term government bonds is based on the return on 20-year UST bonds. Therefore, the  
19 return spread is based on realized returns on 20-year UST bonds, not 30-year UST bonds.  
20 Shorter-term UST bonds provided lower returns than longer-term UST bonds over the  
21 long-term. Therefore, adding the higher earned return spread to the higher yield of the 30-  
22 year UST bond causes an upward bias.

---

<sup>51</sup> D’Ascendis Rebuttal, p. 52, l. 4 through p. 53, l. 2

1 **Q. Can you provide an example to illustrate your position?**

2 A. Yes. The arithmetic total return on 30-day UST bills for the period 1926 through 2020 was  
3 3.34%. Subtracting this total return from the arithmetic total return from large company  
4 stocks of 12.16% results in an earned return spread of 8.82%. It is not proper to add this  
5 earned return spread to a current 30-year UST bond of approximately 1.5% to project a  
6 10.32% return going forward. This 8.82% return spread would be added to a current 30-  
7 day UST bill yield of 0.05% to arrive at an expected return of 8.87%.

8 **Q. Are you familiar with the first source used by Spire Inc. in its goodwill impairment**  
9 **analysis?**

10 A. Yes. This is the website maintained by Dr. Aswath Damadoran, PhD, New York  
11 University Stern School of Business. Dr. Damadoran's treatises have historically been  
12 used as part of the curriculum for the CFA Program administered by the CFA Institute.

13 **Q. What does Dr. Damadoran estimate as the current market risk premium?**

14 A. 4.72% as of the end of 2020.<sup>52</sup>

15 **Q. Are you familiar with the second source used by Spire Inc.?**

16 A. I am familiar with KPMG, but I have not regularly reviewed their published market risk  
17 premiums.

18 **Q. What is the most recent market risk premium estimate you could find from KPMG?**

19 A. The most recent market risk premium I could find published by KPMG was as of March  
20 31, 2021, which was 5.75%.<sup>53</sup>

---

<sup>52</sup> <http://pages.stern.nyu.edu/~adamodar/>

<sup>53</sup> <https://home.kpmg/nl/nl/home/insights/2020/04/equity-market-risk-premium-2020.html>

1 **Q. Considering Mr. D’Ascendis’ emphasis on the efficient market hypothesis and his**  
2 **view that investors use widely-available information that is easy to understand, does**  
3 **it make sense that he suggests estimating the risk premium using the “Predictive Risk**  
4 **Premium Method?”**

5 A. No. I have never observed the Predictive Risk Premium Method (“PRPM”) being used to  
6 estimate the COE in utility cost of capital proceedings other than by Mr. D’Ascendis’  
7 colleague, Spire Missouri’s ROR witness from the 2017 rate case, Ms. Pauline Ahern. I  
8 have yet to see the PRPM used by utility equity analysts to estimate a fair price to pay for  
9 utility equities. Based on Mr. D’Ascendis emphasis that only straightforward, transparent  
10 information is reflected in utility stock prices, it is illogical to assume an obscure method  
11 that requires users to purchase Eviews<sup>®</sup> statistical software to validate and also have ready  
12 access to the University of Chicago’s Center for Research in Security Prices (“CRSP”)  
13 database, would accurately measure the COE. Of course, there is no reason to do so for  
14 purposes of estimating an investors’ COE because Mr. D’Ascendis could not provide a  
15 practical example of any investors using this method because apparently he does not track  
16 this type of information.<sup>54</sup>

17 **Q. Mr. D’Ascendis compares expected returns to actual returns on page 55 of his**  
18 **testimony. Does this information illustrate the fact that investors have realized**  
19 **unexpected returns due to the continued decline in costs of capital?**

20 A. Yes. Mr. D’Ascendis claims that it is inappropriate to subtract total returns (both yield and  
21 capital gains) for UST bonds from total returns for stocks to estimate a required equity risk  
22 premium because the only true risk-less return on bonds is that of the coupon.<sup>55</sup> This fact  
23 illustrates the fallacy of comparing actual realized returns to projected returns and  
24 concluding that this proves investors’ projections are inconsistent with their required  
25 returns. Fama and French studied the period from 1950 through 2000 and determined that  
26 investors realized an extra 2.55% to 4.32% additional compound annual return over their  
27 expected/required returns, which was especially pronounced during the last 20 years of the

---

<sup>54</sup> Dylan W. D’Ascendis’ response to OPC DR No. 3020.

<sup>55</sup> D’Ascendis Rebuttal, p. 40, l. 13 through p. 41, l. 13.



1 20<sup>th</sup> century (1980 – 2000).<sup>56</sup> Fama and French attributed the unexpected returns to the  
2 decline in the discount rate (cost of capital), which caused not only bond investors to realize  
3 unexpected returns, but also stock investors.

4 **Q. Mr. D’Ascendis claims that your Bond Yield Plus Risk Premium analysis is premised**  
5 **on the notion that utility stocks are “bond-like” investments. Is he correct?**

6 A. No. I relied on the CFA Program curriculum for purposes of this simple and  
7 straightforward test of reasonableness. The specific language from the CFA Program  
8 curriculum is as follows:

9 **4.3.2 Bond Yield Plus Risk Premium**

10 For companies with publicly traded debt, the **bond yield plus risk**  
11 **premium method** [bold in original] provides a quick estimate of the cost  
12 of equity. The estimate is

$$13 \text{BYPRP cost of equity} = \text{YTM on the company's long-term debt} +$$
$$14 \text{Risk premium}$$

15 The YTM on the company’s long-term debt includes

- 16 ■ a real interest rate and a premium for expected inflation, which are also
- 17 factors embodied in a government bond yield; and
- 18 ■ a default risk premium.

19 The default risk premium captures factors such as profitability, the  
20 sensitivity of profitability to the business cycle, and leverage (operating and  
21 financial) that also affect the returns to equity. The **risk premium** in  
22 Equation 13 [above] **is the premium that compensates for the additional**  
23 **risk of the equity issue compared with the debt issue** (recognizing that  
24 debt has a prior claim on the cash flows of the company). In US markets,  
25 the typical risk premium added is 3%–4%, based on experience.<sup>57</sup>  
26 (emphasis added)

27 As is clear from the above language (especially that which I emphasized), the risk premium  
28 added to a company’s yield on its long-term debt is not dependent on the company’s equity  
29 having bond-like characteristics. In fact, this test of reasonableness can be applied to any

---

<sup>56</sup> Eugene F. Fama and Kenneth R. French, “The Equity Premium,” *The Journal of Finance*, April 2002, pp. 637-659.

<sup>57</sup> Refresher Reading, 2021 CFA Program, Level II, Reading 25, p. 35.

1 company that has publicly-traded debt, whether it is a growth company that does not pay a  
2 dividend because it is retaining capital for reinvestment, or a company in financial distress  
3 that does not pay a dividend because it is required to retain cash to pay its debt service. As  
4 is clear from the quoted language, bond investors are subject to all of the same business  
5 risk factors as equity investors, but they have first claim to cash flows. My testimony  
6 simply emphasized that utility equity investors' required risk premium would be at the low-  
7 end (3%) because of the fact that utility investors do consider the dividend to be fairly safe.  
8 The main uncertainty to the utility equity investor is estimating the expected growth rate  
9 of the dividend.

## 10 **SUMMARY AND CONCLUSIONS**

11 **Q. Can you summarize your surrebuttal testimony?**

12 A. Yes. The way in which Spire Inc. has managed Spire Missouri's capital structure since the  
13 2017 rate case confirms the appropriateness of using Spire Inc.'s capitalization policies and  
14 strategies as a guide to determining a fair and reasonable capital structure to which to apply  
15 the authorized ROE in this case. As Spire Inc. has demonstrated through its own strategic  
16 decisions on the types of capital to issue to maintain financial soundness, but also not dilute  
17 existing shareholder value, Spire Inc.'s capital structure is not managed for the primary  
18 purpose of achieving a higher equity ratio for ratemaking. The same is not true for Spire  
19 Missouri. Spire Missouri has relinquished the responsibility for managing its capital  
20 structure on a cost efficient basis to the Commission. If Spire Inc. desires to be authorized  
21 a higher equity ratio for ratemaking for Spire Missouri, it should manage itself to a more  
22 conservative capital structure, which will result in a family of companies that has a stronger  
23 and more flexible financial position.

24 The Commission should also ensure that the authorized capital structure recognizes Spire  
25 Inc.'s and Spire Missouri's consistent and significant use of short-term debt to fund its rate  
26 base and its investments that are allowed surcharges through ISRS applications in between  
27 general rate cases. Spire Inc.'s financial management of Spire Missouri's security  
28 issuances shows that it attempts to lower its cost of capital in between rate cases, but have

1 its authorized ROR set based on higher costs associated with long-term capital. The  
2 Commission can rectify this manipulation by including this low cost short-term debt in the  
3 authorized capital structure.

4 A 9.25% allowed ROE is fair and reasonable considering it allows for at least a 225 basis  
5 point margin over Spire Missouri's COE. My own analysis, corroborating information  
6 from equity analyst, internal information from Spire Inc. and common sense tests of  
7 reasonableness prove that Spire Missouri's COE is likely not higher than 7%.

8 **Q. Does this conclude your testimony?**

9 A. Yes.