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DIRECT TESTIMONY

OF

ARA AZAD

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS COMPANY
MISSOURI GAS ENERGY

CASE NO. GR-2017-0215
CASE NO. GR-2017-0216

** **

Denotes Highly Confidential Information that has been Redacted

September 8, 2017

PUBLIC

OPC Exhibit No. 401
Date 12-13-17 Reporter Becca
File No GR-2017-0215; GR-2017-0216

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Request to Increase Its Revenues for Gas Service	)))	Case No. GR-2017-0215
In the Matter of Laclede Gas Company d/b/a Missouri Gas Energy's Request to Increase Its Revenues for Gas Service	)))	Case No. GR-2017-0216

AFFIDAVIT OF ARA AZAD

STATE OF KANSAS)
) ss
COUNTY OF JOHNSON)

Ara Azad, of lawful age and being first duly sworn, deposes and states:

1. My name is Ara Azad. I am Managing Partner at AzP Consulting, LLC.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached affidavit are true and correct to the best of my knowledge and belief.

Ara Azad

Subscribed and sworn to me this 8th day of September 2017.

Notary Public

STACEY L. TERRY
Notary Public
State of Kansas
My Commission Expires 04/08/2018

DIRECT TESTIMONY

OF

ARA AZAD

LACLEDE GAS COMPANY

MISSOURI GAS ENERGY

GR-2017-0215

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Contents

I. INTRODUCTION

Q. Please state your name, title and business address.

A. My name is Ara Azad. I am Managing Partner of AzP Consulting, LLC ("AzP"), located at 11614 Tomahawk Creek Parkway, Suite I, Leawood, Kansas 66211.

Q. Please describe your education and employment background.

A. I received my Bachelor of Science in Molecular Biosciences from the University of Kansas and my Master of Science in Accounting from the University of Missouri-Kansas City. I began my career as a financial statement auditor with the international public accounting firm, PricewaterhouseCoopers. Prior to cofounding AzP, I was a Senior Consultant at the regulatory consulting firm, Overland Consulting.

During the course of my career as a financial statement auditor and regulatory consultant, I have participated in a number of auditing and consulting engagements in the utility industry. These engagements include financial statement audits, affiliate transactions reviews, public interest merger reviews, property tax valuations, and focused management audits. My former clients include the public service commission staffs of Delaware, Maryland, New York, Utah, and Virginia. Particularly germane to this proceeding was my work in the prudency and affiliate transaction review of Questar Gas Company, a local distribution company headquartered in Utah, and Wexpro, its unregulated affiliate supplier of natural gas. As part of this review, I investigated costs charged by affiliates to the regulated distribution company to ensure costs were accurate and in compliance with the regulatory requirements previously approved by the Utah Public Service Commission.

Q. Do you have any professional designations?

A. Yes. I am a Certified Public Accountant licensed in the state of Missouri.

Q. Have you previously served as an expert consultant in a utility rate case proceeding?

A. Yes. Most recently I served as the expert consultant assisting the Public Service Commission technical staff of Delaware in its review of Delmarva Power's application for an increase in natural gas and electric base rates. In those proceedings, I served as Delaware staff's primary witness addressing the post-merger impacts of the 2015 acquisition of PHI (Delmarva Power's parent company) by Exelon, and testified regarding the revenue requirement impact of the allocation of merger savings and costs to achieve merger synergies to Delmarva Delaware customers. I also provided rebuttal testimony to the Missouri Public Service Commission (the "Commission") in Case No. EM-2016-0213, *In the Matter of The Empire District Electric Company, Liberty Utilities (Central) Co. And Liberty Sub Corp. Concerning an Agreement and Plan of Merger and Certain Related Transactions*. As part of this rebuttal testimony, I performed a review of affiliate transactions and cost allocation matters.

Q. What party do you represent?

A. I provide this testimony on behalf of the Missouri Office of the Public Counsel ("OPC").

Q. What is the purpose of your direct testimony?

A. The purpose of this testimony is to address the Laclede Gas ("LAC") and Missouri Gas Energy ("MGE") (collectively, "LAC/MGE") cost allocation issues. My evaluation of the utilities' cost allocation processes for purposes of this testimony included a review of the applicable Missouri rule regarding affiliate transactions, an examination of LAC/MGE's compliance with this rule, a review of the direct testimonies of Thomas Flaherty and Timothy Krick,[1] and a review of LAC/MGE's cost allocation procedures.

Q. What is the relevant rule for affiliate transactions in Missouri?

[1] My review of these testimonies primarily focused on the section titled *Allocation Process* found in Mr. Flaherty's testimony and the section titled *Cost Allocation Mechanics* found in Mr. Krick's testimony.

A. The relevant rule guiding affiliate transactions for gas utilities in Missouri is outlined in Title 4 - Rules of Department of Economic Development, Division 240 – Public Service Commission, Chapter 40 – Gas Utilities and Gas Safety Standards, Section 15 – Affiliate Transactions (4 CSR 240-40.015 or "Affiliate Transactions Rule").

II. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. What are the findings and recommendations presented in your testimony?

A. A summary of my primary findings and recommendations are as follows:

SUMMARY OF FINDINGS

Spire has recently undergone significant changes to its corporate organizational structure.

- Since September 2013, Spire has acquired four gas utilities, three of them in non-Missouri jurisdictions, increasing the complexity of its organization, as well as more than doubling its customer base.2 In addition to the changes resulting from its acquisitions, Spire also formed three new entities and dissolved one entity in 2016.

In 2015, Spire, based on recommendations from the consulting firm Strategy&, performed a major overhaul of its cost allocation processes.

- These changes included the creation of a separate shared services legal entity, as well as a redesign of Spire's allocation process and modifications to its allocation process, which it is still in the process of modifying.

Spire was unwilling and/or unable to adequately support its compliance with the Commission's Affiliate Transactions Rule.

[2] "End of period customers" per Spire's 2016 annual report and 2012 annual report. Customers increased from 628 thousand customers at end of fiscal year 2012 to 1,679 thousand customers at end of fiscal year 2016, representing an increase of 167%.

Spire's written cost allocation training materials are inadequate and its cost allocation manual ("CAM") is not enforced.

The information Laclede provides in its annual CAM reports does not adequately address the reporting requirements set forth in its CAM or the Commission's Affiliate Transactions Rule.

Laclede Gas and MGE failed to modify their cost of service to reflect the shared services ongoing cost reductions identified by the companies' own witness.

Spire failed to allocate the cost of New Blue, the company's enterprise management system, among all the entities that do and reasonably should benefit from the system.

During this review, there were significant delays and inadequacies in responses to discovery requests, as well as overuse of confidentiality designations by Spire.

- 113 of 137 data requests submitted in the cost allocation area were responded to after the 20-day timeframe
- Many data request responses provided by Spire referenced responses to other data requests with no narrative clarification regarding why, how, or where the company believed the requested information was provided in the referenced data request.

SUMMARY OF RECOMMENDATIONS

Recommendation 1 - Given the substantial changes that Spire has instituted regarding its shared services, the Commission should order an independent audit to assess the adequacy of Spire's processes and internal controls related to Spire shared services and to make recommendations for an updated and revised CAM for LAC and MGE.

- This audit should be conducted before the end of 2019.

- While AzP is proposing adjustments related to issues in this rate case, an affiliate transactions/shared services audit would/should address issues related to costs at a greater level of detail than is appropriate or feasible in the course of a rate case proceeding. This is due in part to the limitations posed by the problems in the company's responses to discovery in the course of the current proceeding, as well as the timeline and level of detail and resources required for a full audit.

- In order to circumvent discovery issues that occurred in this proceeding, the specific timing of this audit should be determined in conjunction with Spire to assure that Spire has sufficient resources to respond to data requests to ensure that the audit can be performed in a timely manner.

- As part of this audit, a comprehensive review should be performed to ensure that the policies and procedures noted in the LAC/MGE CAM are the policies and procedures employed by LAC/MGE personnel.

- The chosen independent auditor should be selected by OPC and Staff.

- Spire should designate a specific company contact who will be available to coordinate discovery, and other administrative issues for the duration of the audit. And, if the designated individual is on leave for an extended period of time, Spire should designate another individual to ensure that progress of the audit is not stalled.[3,4]

- One of the issues that should be specifically addressed by this audit is the allocation of Spire's enterprise information management system known as "New

[3] Delays in the company's responses to discovery in this proceeding were due, in part, to Spire's primary contact being unavailable for an extended period of time (See page 27 of August 9, 2017 discovery conference transcript).
[4] When asked to address the delays in responses to discovery at the August 9, 2017 discovery conference, Mr. Pendergast stated that Spire was "doing the best [it] can" and that "this has been a pretty extraordinary case." Allowing Spire to have input into the timing of the audit, and, specifically, allowing the audit to be scheduled at a time when Spire's resources will be most available, should help resolve this issue (Pages 26 and 27 of August 9, 2017 discovery conference transcript).

Blue." Responses to discovery show that this asset is being held entirely on the books of Laclede Gas Company with the costs allocated to LAC and MGE. (OPC Data Requests 7128, 7129, 7130 and 7131). This audit should include a detailed review of the extent to which any other entities within Spire aside from LAC/MGE are benefitting, or should be benefitting, directly or indirectly, from this system.

Recommendation 2 - For any future Spire acquisitions, mergers and/or divestitures Spire should provide an analysis with its application to the Commission to address how the event is anticipated to impact the costs assigned to Missouri-jurisdiction utilities. This analysis should include a minimum five-year estimate of the future costs to be apportioned to Missouri-jurisdiction ratepayers, with a comparison and contrast to prior five-year equivalent data for all Missouri utilities involved.

Recommendation 3 - LAC/MGE should file for a new commission-approved CAM to reflect changes that have occurred at Spire, including the creation of Spire Shared Service Company.

- Given the importance of cost allocation on LAC/MGE ratepayers, I recommend that the company require employees who charge costs that directly or indirectly impact Missouri-jurisdictional utilities to take an annual training course to help ensure that these employees are receiving an adequate level of up-to-date training. I also recommend that these training materials discuss the potentially deleterious impact of improper cost allocations on all stakeholders, including LAC/MGE's regulated utility customers. I recommend that the details of this requirement be outlined in the new revised CAM.

Recommendation 4 - LAC/MGE should report information in an annual CAM report at a level sufficient to address the reporting requirements outlined in its CAM and the Commission's Affiliate Transactions Rule.

- At a minimum, this information should include, but not be limited to, each of the items outlined on pages 2-4 of the company's 2016 CAM. The company's current noncompliance with these specifications includes numerous examples such as missing information related to basis used (e.g., FMV, FDC, etc.) to record each type of affiliate transaction, amount of all affiliate transactions by entity and account charged, full and complete list of all contracts with affiliates, and figures that are not presented appropriately[5].

- I also recommend that the company's CAM reports include the allocation factor calculations for every factor utilized during the year, and document any changes to these factors made during the year.

<u>Recommendation 5 – I recommend adjustments to the company's proposed revenue requirement related to the following:</u>

- An adjustment to reduce the O&M expenses of Laclede Gas and MGE by $4.9 million and $2.2 million, respectively to account for the trend in O&M billings/shared services costs anticipated through the true-up period and the periods in which rates will be in effect.

- An adjustment to reduce the rate base and depreciation expense of MGE by $33.4 million and $2.8 million, respectively for MGE and an adjustment to increase the rate base and depreciation expense of LAC by $3.2 million and $268 thousand, respectively.

[5] An example of this is the ** ** (discussed later in this testimony), which should be presented with the corresponding costs to provide the services and goods allocable/chargeable to those affiliates (not just the amount of costs incurred to produce all goods or services in the aggregate as is presented by the company).

- All—not just some—Spire entities should be included in the allocation of shared services costs and appropriate allocation factors for each entity should be calculated accordingly.

III. BACKGROUND

A. Regulatory Standard

Q. Please summarize the purpose of 4 CSR 240-40.015.

A. In order to help ensure that Missouri gas utilities are not subsidizing their affiliates, the Affiliate Transactions Rule primarily sets forth three categories of standards and requirements: financial standards, evidentiary standards, and record keeping requirements. As stated in the Affiliate Transactions Rule, these standards or requirements are "applicable to any Missouri Public Service Commission (Commission) regulated gas corporation whenever such corporation participates in transactions with any affiliated entity."

Q. What specific issues are addressed by the Affiliate Transactions Rule?

A. The criteria discussed in 4 CSR 240-40.015(2) include standards to help ensure:

- No financial advantage is provided by a gas utility to any affiliated entity (4 CSR 240-40.015(2)(A));
- A gas utility does not provide any preferential service to an affiliated entity, except as necessary to provide corporate support functions (4 CSR 240-40.015(2)(B));
- Customer information is not shared among affiliates, unless upon the consent of the gas utility customer, or otherwise required by law or commission mandate (4 CSR 240-40.015(2)(C));

- A gas utility does not enter into any affiliate transactions which are not in compliance with the rule, unless a variance from the standards is obtained (4 CSR 240-40.015(2)(D));
- A gas utility complies with a customer's request regarding information about goods or services provided by an affiliate of the gas utility and it must inform the customer that regulated services are not tied to the use of the affiliate provider (4 CSR 240-40.015(2)(E));
- Advertisements, marketing materials and other types of information from an affiliate that shares the same or similar name as the regulated utility clearly display that the affiliate entity is not regulated by the commission (4 CSR 240-40.015(2)(F)).

Q. How are the evidentiary standards and record keeping requirements discussed in the Affiliate Transactions Rule?

A. The evidentiary standards and record keeping requirements are used to supplement the financial standards by discussing the considerations that the gas utility must be able to demonstrate to support its affiliate transactions and compliance with the Affiliate Transactions Rule. The record keeping requirements describe the documentation that must be maintained by the gas utility regarding its affiliate transactions.

Q. Have you assessed LAC's and MGE's compliance with this rule?

A. Yes. The section titled *Compliance with Regulatory Standard* contains the discussion of my analysis.

B. <u>Corporate Structure</u>

Q. What is your understanding of Spire's Corporate Structure?

A. As noted in Spire's 2016 10-K filing, Spire has two key business segments: Gas Utility and Gas Marketing. The Gas Utility segment includes the regulated operations of LAC/MGE, Alabama Gas Corporation ("Alagasco"), and EnergySouth. LAC/MGE is the largest natural gas distribution utility in Missouri, serving more than 1.1 million residential, commercial, and industrial customers. LAC serves St. Louis and eastern Missouri and MGE serves Kansas City and western Missouri. Alagasco serves approximately 400 thousand customers in central and northern Alabama. EnergySouth, through its operating subsidiaries Mobile Gas and Willmut Gas, serves approximately 100 thousand customers in southern Alabama and south central Mississippi.[6] LAC, MGE, Alagasco, Mobile Gas and Willmut are all wholly owned subsidiaries of Spire.[7]

Spire's Gas Marketing segment includes Laclede Energy Resources ("LER"), which markets natural gas and serves both on-system utility transportation customers, as well as customers outside of LAC/MGE's traditional service areas.[8]

Q. Has Spire's corporate organization been relatively constant over the recent past?

A. No. Spire has made three major utility acquisitions in the past four years: MGE in September 2013, Alagasco in August 2014 and EnergySouth in September 2016. It also formed three new subsidiaries and dissolved one subsidiary during 2016.[9]

Q. Does Spire anticipate additional utility acquisitions in the near future?

A. Not at this time. According to an earnings conference call held on August 2, 2017, Spire's CEO Suzanne Sitherwood stated, "As we have seen the market changing, we have shifted our thinking, (sic) while we believe there maybe (sic) opportunities for

[6] Spire 2016 10-K, page 4.
[7] Spire 2016 10-K, page 26.
[8] Spire 2016 10-K, page 10.
[9] Responses to Discovery, OPC Data Requests 7001 and 7134.

future utility consolidation. At this point in time, our position is that these market conditions do not support utility acquisitions for Spire."[10]

Q. Do you have any recommendations related to affiliate transactions in the event that additional changes in Spire's corporate structure take place?

A. Yes. Although, as noted in the previous answer, Spire's CEO claims that conditions have shifted in a manner that makes acquisitions less economical, market conditions are dynamic. As such, it is possible, if not likely, that Spire's corporate organization will change again in the future. Since such changes could have a significant impact on costs charged to LAC/MGE, I recommend that for any future Spire acquisitions, mergers and/or divestitures that Spire provide detailed quantitative analysis of how the event is anticipated to impact the costs assigned to Missouri-jurisdictional utilities. This analysis should include a five-year estimate of the future costs to be apportioned to Missouri-jurisdictional ratepayers, with a comparison and contrast to prior five-year equivalent data for all Missouri utilities involved.

Q. Do the Gas Utility and Gas Marketing segments comprise the entirety of Spire's business operations?

A. No. In addition to these two business segments, Spire's "Other" category principally consists of expenses related to its 2014 debt issuance for financing the Alagasco acquisition. This category also includes two wholly owned pipeline companies (Laclede Pipeline Company and Spire STL Pipeline LLC), as well as Spire subsidiaries engaged in activities such as risk management and natural gas compression. A list of all affiliates of LAC/MGE is provided below.

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[10] Spire's Q3 2017 Earnings Call Transcript, August 2, 2017, accessed from Seeking Alpha, https://seekingalpha.com/article/4093800-spires-sr-management-q3-2017-results-earnings-call-transcript?part=single

Listing of LAC/MGE Affiliates

Affiliate Name	Direct Parent Company	Business Purpose	Source
Alabama Gas Corporation	Spire Inc.	Public utility engaged in the purchase, retail distribution and sale of natural gas principally in central and northern Alabama, serving more than 0.4 million residential, commercial and industrial customers with primary offices located in Birmingham, Alabama.	A
Laclede Gas Company	Spire Inc.	Public utility engaged in the purchase, retail distribution and sale of natural gas, is the largest natural gas distribution utility system in Missouri, serving more than 1.1 million residential, commercial and industrial customers, and is headquartered in St. Louis, Missouri. Laclede Gas serves St. Louis and eastern Missouri and, through Missouri Gas Energy (MGE), Kansas City and western Missouri.	A
Spire Marketing Inc.	Laclede Investment LLC	Manages transportation and storage assets to help industrial businesses, other utilities, power generators and wholesale customers manage their volumes and hedge their risks.	B
Spire Storage Inc	Spire Marketing Inc.	Provides gas storage services.	C
Laclede Oil Services, LLC	Laclede Development Company	Operates oil wells.	C
Laclede Pipeline Company	Spire Inc.	Provided common carrier transportation services for propane and similar liquids and is regulated by the FERC.	C
Laclede Venture Corp.	Laclede Development Company	Operates CNG fueling stations.	C
Laclede Development Company	Spire Inc.	Invested in real estate and also owns Laclede Venture and Laclede Oil Services.	C
Laclede Investment LLC	Spire Inc.	Owns Spire Marketing (formerly Laclede Energy Resources). Spire Marketing provided natural gas marketing services.	C
Laclede Gas Family Services, Inc.	Laclede Energy Resources, Inc.	Entity no longer used at Spire. According to Spire, this entity was dissolved in September 2016 and had been inactive for years prior to dissolution.	C
Laclede Insurance Risk Services, Inc.	Spire Inc.	Captive insurance company.	C
Shared Services Corporation	Spire Inc.	Shared Services Corporation is currently used as a clearinghouse for shared services provided throughout the Spire organization.	C
Spire Resources LLC	Spire Inc.	Spire Resources owns Spire Midstream, which owns Spire STL Pipeline, which plans to operate an interstate natural gas pipeline.	C
Spire Midstream LLC	Spire Resources LLC	Spire Resources owns Spire Midstream, which owns Spire STL Pipeline, which plans to operate an interstate natural gas pipeline.	C
Spire STL Pipeline LLC	Spire Midstream LLC	Spire Resources owns Spire Midstream, which owns Spire STL Pipeline, which plans to operate an interstate natural gas pipeline.	C
EnergySouth, Inc.	Spire Inc.	Parent of Mobil Gas and Wilmut Gas	A
Wilmut Gas & Oil Company	EnergySouth, Inc.	Gas utility which serves about 19 thousand customers in southeast Mississippi.	C
Mobile Gas Service Corporation	EnergySouth, Inc.	Gas utility which serves about 89 thousand customers in southwest Alabama.	C

Sources:
A - 2016 Spire 10-K, page 4
B - http://www.spireenergy.com/our-businesses
C - Response to Discovery, OPC Data Request 7134

Q. What is the relative size of Spire's business segments?

A. As seen in the table below, in fiscal year 2016, Spire generated approximately 95% of its total operating revenues from its Gas Utility business segment, with the other 5% generated by Spire's gas marketing segment.[11]

Spire Operating Revenues by Business Segment

Segment	Operating Revenues		% of Total
Gas Utility	$	1,459.4	94.9%
Gas Marketing	$	78.5	5.1%
Other	$	4.8	0.3%
Eliminations	$	(5.4)	-0.4%
Total (Consolidated)Consolidated	$	1,537.3	100%

Source: Spire 2016 10-K, page 32

Q. Given that Spire's operations are primarily driven by rate-regulated gas utilities, should the Commission still be concerned with cost allocation issues?

A. Yes. While Spire's rate-regulated gas utility segment comprises most of its operations, the non-regulated gas marketing segment, which generated 5% of Spire's revenues in 2016, is still a significant portion of its operations.

Furthermore, improper cost allocations are not limited to revenue-producing units or allocations between regulated and non-regulated affiliates. For example, the timing of rate case test years in various jurisdictions could make the allocation of costs to one utility versus another utility more economically advantageous.[12]

[11] Operating revenues is only one indication of relative size and should not necessarily be viewed as a proxy for the segments' proportional share of corporate costs.
[12] Specifically, a utility holding company may attempt, for ratemaking purposes, to allocate more costs for a particular period to any of its regulated utility subsidiaries that will be using that period as a rate case test year.

Finally, it is possible, if not likely, that Spire will continue to grow its non-regulated business segments in the future. This seems particularly likely since, as stated previously, Spire believes current market valuations are undesirable for utility acquisitions.[13]

C. Shared Service Company

Q. Has Spire recently established a shared services company?

A. Yes. As noted in the testimony of Mr. Krick, Spire Shared Services Company ("SSC") was incorporated in July 2015.[14]

Q. What is the purpose of the SSC?

A. According to Mr. Krick, the purpose of SSC is to allow Spire to "adopt a more formal shared services model to facilitate, simplify, and provide transparency to the allocation of shared costs between operating companies and affiliates." Mr. Krick further states that the establishment of SSC was "the first step of an ongoing, longer-term initiative to evaluate, design, and implement a mature shared service model."[15]

Q. In what geographic location are the shared services functions and activities charged to LAC/MGE generally performed?

A. During the test year, all shared services charges charged to LAC/MGE were performed in either Alabama or Missouri.[16]

Q. How has Spire implemented its revised shared services model?

[13] Spire's CEO alluded to this shift in corporate priorities in Spire's Q3 2017 earnings call, stating that Spire has modified its focus on utility mergers and acquisitions and dropped the word "utility" for a more general focus on mergers and acquisitions that is not exclusive to utilities. See Spire's Q3 2017 Earnings Call Transcript, August 2, 2017, accessed from Seeking Alpha, https://seekingalpha.com/article/4093800-spires-sr-management-q3-2017-results-earnings-call-transcript?part=single
[14] Direct testimony of Timothy Krick, p. 9.
[15] *Id.*
[16] Response to Discovery, OPC Data Request 7104.

A. On pages 9-12 of his direct testimony, Mr. Krick describes four steps in Spire's "longterm initiative to evaluate, design, and implement a mature shared service model." The four steps described in Mr. Krick's testimony were as follows:

- The first step was to adopt a more formal shared services model to facilitate, simplify, and provide transparency to the allocation of shared costs between operating companies and affiliates;
- The second step involved designing, scoping, and planning the new approach;
- The third step involved the development of an approach to systematically collect costs in the shared services entity through use of the existing work order management process;
- The fourth step involved the redesign of the allocations process utilizing the SSC as the primary collector of costs that would then be pooled into allocation buckets and allocated to affiliates.

Q. Does Spire anticipate any other "steps" related to full implementation of the SSC?

A. While the SSC has not yet "reached maturity,"[17] according to Spire's response to discovery, the company has "not decided upon any future steps related to the shared service model and allocation process."[18]

Q. Does the SSC file an Annual Report of Centralized Service Companies, also known as a Form 60, with the FERC.

A. No, Spire has obtained a FERC-approved exemption and is not required to file a FERC Form 60.[19]

[17] Direct testimony of Thomas Flaherty, p. 15.
[18] Response to Discovery, OPC Data Request 7102

Q. Does the SSC have its own employees?

A. According to page 10 of Mr. Krick's direct testimony, "All employees are employed directly by the operating companies or other affiliates, and only charge time and expenses to the SSC for shared costs and activities." Mr. Krick further states that the SSC is currently primarily used as an "accounting vehicle."

Q. Has Spire considered placing employees in SSC?

A. Yes. Per its response to discovery, Spire stated this was discussed in 2015 as part of the decision to set up SSC as a legal entity, but it did not do so because of "various administrative issues" and "benefit plan restructuring requirements."[20]

IV. EXAMINATION OF LAC/MGE AFFILIATE TRANSACTIONS

A. Compliance with Regulatory Standard

Q. Did you assess whether LAC/MGE is compliant with the Commission's Affiliate Transactions Rule set forth in 4 CSR 240-40.015?

A. Yes. As part of my review I sought to determine whether LAC/MGE is in compliance with the Commission's Affiliate Transactions Rule set forth in 4 CSR 240-40.015. To make this assessment, I submitted data requests to LAC/MGE for purposes of verifying its compliance with this rule.

Q. How did you assess LAC/MGE's compliance with the Affiliate Transactions Rule?

A. I divided the Rule into its discrete sections and their subsections for purposes of assessing compliance and requested information and reviewed relevant public documents to confirm compliance with each component of the Rule.

[19] Response to Discovery, OPC Data Request 7086 and 7125.
[20] Response to Discovery, OPC Data Request 7093.

Q. Did LAC/MGE provide sufficient supporting evidence to demonstrate its compliance with the Affiliate Transactions Rule?

A. No. In many instances, rather than provide the requested information, the company instead referenced other discovery responses that did not address the same issue or deferred to its CAM. In fact, the company's most recent Commission-approved CAM expressly states that it "only addressed a portion of the requirements of the Rules and in Laclede's opinion ***compliance with this CAM constitutes evidence of compliance with those portions of the Rules***." (emphasis added). But when asked to provide specific evidence to demonstrate compliance with the Rule or the CAM, rather than provide the requested evidence, the company instead often asserted that it has "complied with the requirements of the Cost Allocation Manual."[21]

Q. Could you please provide illustrative examples of the company providing insufficient or irrelevant support to demonstrate its compliance with this rule?

A. Yes. When asked in discovery to indicate whether it obtained competitive bids to ensure it was paying a fair price for the procurement of information, assets, goods, or services, LAC/MGE did not provide a direct answer nor provide any evidence to support the assertion that it had used competitive bids to procure goods and services. Rather, in its discovery response it made a reference to irrelevant information, and claimed that it obtained competitive bids "where and to the extent required by its Commission approved Cost Allocation Manual."[22]

Q. In the "Recommendations" section of your testimony, you recommended an affiliate transactions audit be performed over LAC/MGE. Could you please discuss this in

[21] Refer to response to Discovery, OPC Data Request 7014 for an example.
[22] Responses to Discovery, OPC Data Requests 7012 and 7027.

greater detail and how it may be utilized to make the affiliate transactions process at LAC/MGE more transparent?

A. Yes. The audit I recommend should include an assessment of costing methodologies utilized to value the cost and fair market price and value attributable to the entities benefiting from services provided to and from Laclede Gas and MGE, on a separate-utility basis. For example, as the table below illustrates, the Laclede 2016 CAM Report[23] identifies **

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When asked in discovery to provide the support for the determination of the costs and charges and evidence of the consistency of the valuation of these charges with the Affiliate Transactions Rule, the company was not able to substantiate its figures.[24] As such, I recommend this to be one of the focuses of the affiliate transactions audit I recommend, with the aggregate of any cost overages to Laclede Gas or MGE identified.

[23] ** ** Attachment AA-D-1. *Laclede Gas Company Cost Allocation Manual Annual Report for the Fiscal Year Ending September 30, 2016.*

[24] Response to Discovery, OPC Data Requests 7052 and 7056 provide clear examples; also see generally responses to OPC Data Requests 7001 to 7049.

Q. Are you familiar with other instances in which a public service commission ordered an affiliate transactions audit as a result of a rate case?

A. Yes. In November 2010, the New York Public Service Commission initiated a proceeding to examine National Grid's cost allocations to its New York utility subsidiaries. The investigation was deemed necessary based on findings from National Grid's management audit and findings from National Grid's upstate utility subsidiary's 2010 electric rate case. The investigation ultimately resulted in customers of National Grid's Long Island and Brooklyn operations being credited $24.75 million related to identified overcharges.[25]

V. FLAHERTY TESTIMONY

Q. Mr. Flaherty discusses Spire's shared services and cost allocation methodology in his direct testimonies. Have you reviewed this information?

A. Yes.

Q. What was the stated purpose of Mr. Flaherty's testimony?

A. According to page 4 of Mr. Flaherty's testimony, the purpose of his testimony was, "to address several items related to the incurrence and recovery of charges between Spire Shared Services, and Laclede Gas Company…" Mr. Flaherty states that, "These charges relate to services performed by Spire Shared Services on behalf of Spire's operating companies, including Laclede."[26]

Q. Did Mr. Flaherty review the Commission's Affiliate Transactions Rule prior to developing his testimony?

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[25] New York Public Service Commission. (2016). *NATIONAL GRID GAS CUSTOMERS GET FINANCIAL CREDIT* [Press release] http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId=%7B66322120-CEA8-470A-AA5A-9D1AD0D40F9F%7D

[26] Direct testimony of Thomas Flaherty, p. 4.

A. When asked in discovery whether Mr. Flaherty reviewed the Rule prior to developing his direct testimony, Glenn Buck stated on Mr. Flaherty's behalf that Mr. Flaherty was "aware" of the Commission's Affiliate Transactions Rule.[27] In response to data request 7045, Mr. Buck stated that Mr. Flaherty "did not conduct any specific analyses" to assess whether the definition Mr. Flaherty was using to assess whether costs were "reasonable" was consistent with Missouri's Affiliate Transactions Rule.

Q. What were the conclusions of Mr. Flaherty's testimony?

A. As noted on page 10 of his testimony, Mr. Flaherty ultimately concluded that, "Spire Shared Services costs billed to Laclede are reasonable" and "provide direct value to Laclede's customers from their incurrence."

Q. Is Mr. Flaherty an employee of Spire?

A. No. Mr. Flaherty is a partner in the Power and Utilities Practice of Strategy&, a consulting firm that is part of the professional services company PwC. On page 5 of his testimony, Mr. Flaherty states that he was "retained [by Spire] to ***provide an objective assessment*** of the reasonableness of Spire shared service costs, specifically in the context of those billed to Laclede." (emphasis added).

Q. Do you have any reason to believe that Mr. Flaherty's analysis was not an "objective assessment"?

A. Yes. As noted on page 9 of Mr. Krick's direct testimony, an "assessment was performed in coordination with PwC's consulting company, Strategy&, which included a comparison of the existing structure and approach to cost allocations with industry peers," leading to Spire's incorporation of the Shared Services Company ("SSC") in July 2015.

[27] While data requests 7041 through 7046 requested specific information regarding Mr. Flaherty's direct testimony, Glenn Buck, Director, Regulatory and Finance for Laclede Gas Company signed these data request responses.

Q. Was Mr. Flaherty involved in this project?

A. Yes. In fact, Mr. Flaherty oversaw this project on behalf of Strategy&.[28] As such, it is unsurprising that Mr. Flaherty would not identify issues with Spire's cost allocation methodology, since he and his consulting firm helped design it.

Q. Is there any professional guidance that makes reference to this type of arrangement?

A. Yes. The Public Company Accounting Oversight Board ("PCAOB") alludes to this type of bias in its independence standard, stating that:

> *To be independent, the auditor must be intellectually honest; to be recognized as independent, [the auditor] must be free from any obligation to or interest in the client, its management, or its owners. For example, an independent auditor auditing a company of which [the auditor] was also a director might be intellectually honest, but it is unlikely that the public would accept [the auditor] as independent since [the auditor]* ***would be in effect auditing decisions which he [or she] had a part in making.*** *(emphasis added)*[29,30]

Q. Are you aware of any other factors that call into question the objectivity of Mr. Flaherty's assessment?

A. Yes. On pages 10 and 11 of Mr. Flaherty's testimony he states he has "previously been involved in the creation of, or cost reviews of, a number of service companies or shared services entities" and that his approach in this proceeding is "generally consistent with the approach used in the evaluations of other service companies" for which he has filed testimony before state commissions.

[28] Response to Discovery, OPC Data Request 7101.
[29] While Mr. Flaherty was not performing a financial statement audit, the PCAOB guidance is a useful tool to assess how an established professional organization defines and evaluates independence.
[30] Auditing Standard 1005: Independence (.03)

Q. Did you identify any examples from Mr. Flaherty's experience indicating a lack of objectivity in his analyses?

A. Yes. Mr. Flaherty has, by his own admission, performed "a number of" reviews concerning the reasonableness of service company costs charged to utilities.[31] Given the large number of reviews Mr. Flaherty has performed, a reasonable assumption would be that, at least in some of these reviews, Mr. Flaherty would identify service company costs that were inappropriately charged. However, of the eleven different proceedings that Mr. Flaherty notes on pages 11 through 13 of his testimony, he did not identify a single dollar of inappropriate charges.

Furthermore, when asked in discovery whether Mr. Flaherty has <u>ever</u> identified an inappropriate service company charge during his forty-plus year career as a consultant, the response provided was a vague reference to proceedings Mr. Flaherty was involved in approximately thirty years ago of which no written documentation was available.[32]

Q. Do you believe the Commission should disregard Mr. Flaherty's analysis?

A. No. Mr. Flaherty's testimony may be helpful to the Commission for informational purposes. However, Mr. Flaherty's objectivity in performing this analysis, for the reasons cited above, is questionable, particularly regarding his ultimate conclusions. I believe that a focused affiliate transactions audit performed by an independent auditor (approved by the OPC and Staff) should be performed to provide the Commission with a truly objective and independent review of LAC/MGE's cost allocation practices.

A. <u>LAC/MGE's Cost Allocation Procedures</u>

i. Allocation Factors

[31] Direct testimony of Thomas Flaherty, p. 10.
[32] Response to Discovery, OPC Data Request 7049. It was not possible to independently verify Mr. Flaherty's claim regarding his involvement in these proceedings because "Mr. Flaherty no longer has access to these testimonies."

Q. What is the structure of the Spire organization?

A. During 2016, the Spire family of companies consisted of the following 21 entities.[33]

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[33] Constructed by AzP based on information in the Laclede CAM Report, 2016, response to discovery 7001, and 7134.

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Q. Do all Spire companies share in the allocation of shared services costs?

A. No. Of the 21 Spire entities in place in 2016, 12 receive allocations and/or charges of shared services. As illustrated in the chart below, they exclude the following nine companies: (1) Spire Inc. (Holding Company), (2) Spire Resources LLC, (3) Spire Midstream LLC, (4) Spire STL Pipeline LLC (which, the company indicates will receive allocations in FY17 Q3), (5) Shared Services Company, (6) Laclede Investment LLC, (7) Laclede Gas Family Services, Inc. (which was dissolved on 9/30/2016), (8) Spire Storage Inc □ Storage Services, and (9) Energy South Inc.[34]

[34] Constructed by AzP based on information in the Laclede CAM Report, 2016, responses to discovery 7001, 7005, and 1021.5.

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Among the issues not addressed by Mr. Flaherty, is that many affiliates were not/are not being charged or allocated any cost of shared services. I recommend that in the suggested shared services/affiliate transactions audit, the other entities be examined with respect to the extent to which they benefit or should be benefitting from shared services such as common information technology and human resources services provided to all companies. To the extent these entities benefit from these activities, current charging practices should be examined to determine the amount of costs chargeable or allocable to those entities and/or the need to retain the cost of certain activities, such as corporate strategic planning, executive management, and other enterprise-level services, to be charged to all subsidiaries consistently, or to be retained by the parent.

Q. According to the figures presented in the direct testimony of Mr. Flaherty, what appears to be the cost of shared services incurred and charged to Spire companies during the test year?

A. Mr. Flaherty's testimony identifies $322.4 million dollars as Spire's O&M shared services costs for the calendar year 2016.[35]

Q. What portion of these charges are allocated versus directly charged to Spire companies?

A. Of the $322.4 million in shared services costs, approximately one half are allocated, and the other half are directly charged.[36] In dollars, this represents $159.6[37] million of costs that are allocated and $162.7 million directly charged.

[35] Direct testimony of Thomas Flaherty, p. 64, Figure VIII-3.
[36] Direct testimony of Thomas Flaherty, p. 64, Figure VIII-3.
[37] This is represented as $59.9 million allocated shared services, $84.5 million allocated benefits, and $15.2 million allocated insurance in Thomas Flaherty's testimony (p. 64, Figure VIII-3).

Q. Have you noted overarching issues with the manner in which Mr. Flaherty reviewed these costs for Laclede Gas and for MGE?

A. Yes. We've noted that, with a few exceptions, rather than analyze the information separately for the two utilities, which have non-contiguous service territories and distinct customer bases, Mr. Flaherty fails to identify and assess the costs to each utility separately. While the company has made the request that the two utilities be treated as "operating units" of one utility, given that the two serve customers in distinct, separate areas of the state, and have their own employees, they should be treated as two separate utilities in their entirety for purposes of a rate case to ensure that the charges recovered from MGE customers and Laclede Gas customers justly and reasonably represent the costs for providing services to those particular customers.

Q. Of the shared service costs incurred by Spire, what proportion and amount was charged to Laclede Gas and to MGE?

A. According to Mr. Flaherty's testimony, in 2016, \$213.2 million of shared service O&M costs were charged to Laclede and MGE combined, representing approximately 66% of total costs. Of the \$213.2 million, \$91.7 million—approximately 43%—were directly charged, and \$121.4 million—approximately 57%–were allocated.[38]

Q. Did you request supporting documentation for the company's allocation of shared services?

Yes. In discovery, I requested that the company identify the amount of corporate support provided to Spire companies in the test year,[39] and for the company to provide the allocation of all such costs among Laclede Gas and MGE affiliate entities.[40] I also requested a list of all changes in allocation methodology and/or allocation factors used by

[38] Direct testimony of Thomas Flaherty, p. 70, Figure VIII-7.
[39] Response to Discovery, OPC Data Request 7005.
[40] Response to Discovery, OPC Data Request 7006.

Spire among different utilities and jurisdictions from January 2011 to December 2016 along with descriptions for the reasons for change.[41]

Q. How did Spire respond to these requests?

A. Spire's response to these requests was a reference to filed testimony and other discovery responses provided, which contained tangentially related information, but did not provide the specific data requested.

Q. Did you analyze the information that was provided?

A. Yes. My review of the documents Spire referenced in response to these requests identified unexplained inconsistencies among varying sources and documents provided by the company.[42] This includes, for example, 14 of 25 allocation factors for Laclede, that were utilized during 2016 per the monthly allocation factor reports,[43] but not listed in other sets of documents provided by the company for the same period, which were supposed to provide CAM allocation factors for 2016.[44] Several other allocation factors differ yet from the allocation factors the company provided in response to discovery in the information presented to the PSC in the company's presentation in October of 2016.[45] And the factors differ, still in the company's response to OPC 1021.6. Thus, rather than provide an unambiguous, comprehensive listing of the figures requested, the company's records present inconsistent and incomplete listings that do not appropriately account for the figures in the testimonies of its witnesses.

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[41] Response to Discovery, OPC Data Request 7083.
[42] Response to Discovery, OPC Data Request 7005.
[43] Response to Discovery, OPC Data Request 1021.3.
[44] See Response to Discovery, Staff Data Request 0017.1b, *allocation basis support*, "SSC allocation summary" tab for 2016.
[45] See Response to Discovery, OPC Data Requests 7080 and 7082. As noted on slide "Allocation factors summary (pre-EnergySouth)" from file *7080 7082 - Spire Shared Service PSC Meeting_Oct 27 2016.* The net assets-based factors on the presentation slide are not utilized per the 2016 monthly allocations reports, and the "CNG" and "percentage of PR distribution total" are not represented on the presentation slide.

The lack of unambiguous, consistent figures for the test year is an issue not addressed by Mr. Flaherty. This results in figures that do not appropriately reflect shared services charged and chargeable to Spire companies in the test year or known and measurable changes in charges reasonably anticipated to be allocated to Laclede Gas and to MGE for shared services for the period in which new rates would be in place.

In addition, in my analysis, I noted several issues, including the allocation factors that accompany the direct testimony of Mr. Flaherty **

**[47] In addition, in 2016, Spire formed additional entities, including Spire Resources, LLC, Spire Midstream LLC, and Spire STL Pipeline.[48] The company has indicated that Spire STL Pipeline will receive allocation of shared services beginning in the third quarter of 2017 (that is, as of the time of filing of this testimony). Consideration for such factors, for example, inclusion of Spire STL Pipeline in the pool of affiliates sharing in the cost of shared services, should be considered in the course of the recommended audit to ascertain an accurate impact of all changes, including EnergySouth companies, as well as the other new additions to the Spire family to ensure the portion of costs allocated to the regulated segments of Spire's business, and its Missouri utilities in particular, adequately represent these changes.

Q. Was the company able to identify the amount of fully distributed cost (affiliate transaction charges) incurred and included in its revenue requirement in the test year for Laclede Gas and MGE?

[46] This was the same information that Spire presented to the PSC at an October 27, 2016 meeting (per response to discovery, 7080 and 7082, PowerPoint presentation: *7080 7082 - Spire Shared Service PSC Meeting_Oct 27 2016*)
[47] Response to discovery, 7080 and 7082, PowerPoint, and workpapers for the direct testimony of Mr. Flaherty, page 118 of 463, D2-B19, *(Allocation factors summary (pre-EnergySouth).*
[48] Response to Discovery, OPC Data Request 7001.

A. No. When asked in discovery, the company was not able to identify the amount of fully distributed cost in its revenue requirement. Instead, the company's representative, Mr. Glenn Buck, made vague and general references to the filed testimony and stated that the figures discussed in testimony "represent… fully distributed cost."[49] After further inquiry and follow-up with the company regarding the actual figures, the company provided a "supplemental response" that continued to be general references to information that did not identify the amounts requested.

Q. Have you requested and has the company provided support for allocation factors, and if so, what have you learned from your review of this information?

A. AzP, the OPC, and Staff, have requested a number of documents for the purpose of examining shared service costs at Spire and the charges to Laclede Gas and MGE during the test year. A summary of some of the relevant information regarding the company's allocation of charges to Laclede Gas and to MGE for the test year in this rate case follows.

I reviewed monthly allocation reports of costs from the Shared Services Company to each operating company and affiliate during 2016 and noted that Spire used the following 25 allocation factors in calendar year 2016 for charges allocated to Laclede Gas and MGE:[50]

[49] Response to Discovery, OPC Data Request 7007 and 7008.
[50] Organized by AzP from documents provided in response to discovery, OPC Data Requests 7005, 7006.

Calendar Year 2016
Laclede Gas Allocations
Per Monthly Allocations Reports

	Allocation Factor	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
1	% of PR distribution Total	X	X	X	X	X	X	X	X	X	X	X	X
2	700 Mkt (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
3	800 Mkt (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
4	CNG Total										X	X	X
5	Corporate Wide (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
6	Corporate Wide (AP Activity) Total	X	X	X	X	X	X	X	X	X	X	X	X
7	Corporate Wide (PR) Total	X	X	X	X	X	X	X	X	X		X	X
8	Direct Payroll Total										X		
9	Facilities Shared Services (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
10	Gas Utilities Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
11	Gas Utilities Only (Customers) Total	X	X	X	X	X	X	X	X	X	X	X	X
12	Gas Utilities Only (Field Ops HC) Total		X	X	X	X	X	X	X	X	X	X	X
13	Gas Utilities Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X
14	Gas Utilities Only (System Miles) Total	X	X	X	X	X	X	X	X	X		X	X
15	IT Driver - All companies Total										X	X	X
16	IT Driver - Excl AGC Total										X	X	X
17	IT Driver - Gas Utilities Total										X	X	X
18	IT Driver - MO Utility Total										X	X	X
19	MO Gas Utilities Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
20	MO Gas Utilities Only (Customers) Total	X	X	X	X	X	X	X	X	X	X	X	X
21	MO Gas Utilities Only (Field Ops HC) Total	X	X	X	X	X	X	X	X	X	X		
22	MO Gas Utilities Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X
23	MO Gas Utilities Only (System Miles) Total	X	X	X	X	X	X	X	X	X	X	X	X
24	MO Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
25	MO Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X

Calendar Year 2016
MGE Allocations
Per Monthly Allocations Reports

	Allocation Factor	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
1	% of PR distribution Total	X	X	X	X	X	X	X	X	X	X	X	X
2	700 Mkt (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
3	800 Mkt (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
4	CNG Total											X	X
5	Corporate Wide (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
6	Corporate Wide (AP Activity) Total	X	X	X	X	X	X	X	X	X	X	X	X
7	Corporate Wide (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X
8	Direct Payroll Total												
9	Facilities Shared Services (Sf) Total	X	X	X	X	X	X	X	X	X	X	X	X
10	Gas Utilities Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
11	Gas Utilities Only (Customers) Total	X	X	X	X	X	X	X	X	X	X	X	X
12	Gas Utilities Only (Field Ops HC) Total		X	X	X	X	X	X	X	X	X	X	X
13	Gas Utilities Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X
14	Gas Utilities Only (System Miles) Total	X	X	X	X	X	X	X	X	X	X	X	X
15	IT Driver - All companies Total										X		
16	IT Driver - Excl AGC Total										X	X	X
17	IT Driver - Gas Utilities Total										X	X	X
18	IT Driver - MO Utility Total										X	X	X
19	MO Gas Utilities Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
20	MO Gas Utilities Only (Customers) Total	X	X	X	X	X	X	X	X	X	X	X	X
21	MO Gas Utilities Only (Field Ops HC) Total	X	X	X	X	X	X	X	X	X	X	X	X
22	MO Gas Utilities Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X
23	MO Gas Utilities Only (System Miles) Total	X	X	X	X	X	X	X	X	X	X	X	X
24	MO Only (3 Factor) Total	X	X	X	X	X	X	X	X	X	X	X	X
25	MO Only (PR) Total	X	X	X	X	X	X	X	X	X	X	X	X

According to these monthly allocations reports, allocated shared services costs totaled \$37.6 million for Laclede Gas and \$19.9 for MGE during the test year. The sum of these charges, \$57.5 million, represent less than half of the \$121.4 million[51] in allocated charges in Mr. Flaherty's testimony. Thus, the monthly reports provided by the company do not appear to account for all charges from affiliate transactions, in particular, the benefits and insurance. The difference between the portion of charges marked specifically as "shared services allocations" (excluding benefits and insurance) represents a discrepancy of approximately \$11 million between these two sources.

Q. Did the monthly allocation reports of costs from the Shared Services Company to each operating company and affiliate reviewed as indicated above, include all costs allocable to Laclede Gas and MGE?

A. No. The company stated that three categories of costs—equity compensation costs for employees, equity compensation costs for directors, and director fees and expenses—were direct charged in 2016, and would be allocated starting in 2017. In 2016, the charges related to these categories totaled approximately \$3.1 million to Laclede and \$1.6 million to MGE.

Q. Have any changes been implemented in the allocation methodology or the factors used to charge shared services since the company's last rate case?

A. Yes. A number of changes have been implemented, including a complete revision to the company's cost allocation methodology and creation of the Shared Services Company in July 2015.[52] AzP requested a list of all changes to the company's allocation factors from January 2011 to December 2016, along with descriptions for the reasons for each

[51] \$121.4 is the sum of \$46.5 million in "allocated shared services", \$64.9 million in "allocated – benefits", and \$10.0 million in "allocated – insurance" presented by Mr. Flaherty in Figure VIII-7 O&M Trends… page 70 of his testimony, and in his Affiliate Transaction Cost Study, page 109: *S*.
[52] Direct testimony of Timothy Krick, p.9.

change.[53] The company did not provide the requested information. Based on a review of the monthly allocation reports,[54] I noted that in 2016 alone, seven factors were used to assign charges to Laclede Gas and MGE for some months, but not others, and the costs associated with the three cost categories noted earlier (equity compensation costs for employees, equity compensation costs for directors, and director fees and expenses) are currently allocated rather than directly assigned. Allocations are also anticipated to change based on at least one additional affiliate company, which was formed during the test year (Spire STL Pipeline), as well as the incorporation of actual (rather than estimated) figures for EnergySouth utilities acquired during the test year—Mobile Gas and Willmut Gas—starting in 2017.

The uncertainty and unavailability of information regarding actual figures related to these changes is strong evidence that Spire has not satisfied its burden of proof regarding its cost allocation charges. It is also one of the factors that, I believe, necessitates a detailed examination through an audit of the company's shared service costs and affiliate transactions resulting from the impact of the recent changes, including revisions to the company's allocation procedures and allocation factors, as well as Spire's recent acquisitions and formation and dissolution of subsidiaries, the impacts of which are ambiguous or not factored into the revenue requirement presented for Laclede Gas and MGE.

Q. Which allocation factors account for the greatest proportion of costs allocated to Laclede Gas and MGE?

As illustrated in the tables that follow, the top 13 factors account for over 90% of the shared costs allocated to Laclede Gas and MGE.

[53] Response to Discovery, OPC Data Request 7083.
[54] Response to Discovery, OPC Data Request 7005 and Response to Discovery, OPC Data Request1021.3.

Fiscal Year 2016
Laclede Gas Allocations
Per Monthly Allocations Reports

	Allocation Factor	*Amount Allocated to Laclede Gas per Monthly Reports*	*Percentage of Total Costs Allocated to Laclede Gas per Monthly Reports*
1	Corporate Wide (3 Factor) Total	8,563,981.93	22.8%
2	% of PR distribution Total	5,667,243.84	15.1%
3	MO Gas Utilities Only (Customers) Total	4,663,342.74	12.4%
4	Corporate Wide (PR) Total	3,611,474.64	9.6%
5	MO Gas Utilities Only (3 Factor) Total	2,154,656.50	5.7%
6	700 Mkt (Sf) Total	1,651,175.96	4.4%
7	Gas Utilities Only (3 Factor) Total	1,544,653.50	4.1%
8	IT Driver - Excl AGC Total	1,521,446.33	4.0%
9	MO Gas Utilities Only (System Miles) Total	1,082,715.19	2.9%
10	Corporate Wide (AP Activity) Total	1,059,419.65	2.8%
11	CNG Total	973,822.14	2.6%
12	MO Only (PR) Total	895,453.60	2.4%
13	Facilities Shared Services (Sf) Total	851,826.43	2.3%
14	Gas Utilities Only (Customers) Total	559,000.24	1.5%
15	MO Only (3 Factor) Total	532,881.52	1.4%
16	800 Mkt (Sf) Total	418,786.33	1.1%
17	IT Driver - MO Utility Total	392,604.17	1.0%
18	IT Driver - Gas Utilities Total	291,536.35	0.8%
19	MO Gas Utilities Only (PR) Total	274,831.82	0.7%
20	Gas Utilities Only (PR) Total	236,332.44	0.6%
21	IT Driver - All companies Total	169,660.62	0.5%
22	Gas Utilities Only (Field Ops HC) Total	155,584.29	0.4%
23	Direct Payroll Total	143,795.19	0.4%
24	Gas Utilities Only (System Miles) Total	142,219.68	0.4%
25	MO Gas Utilities Only (Field Ops HC) Total	21,118.36	0.1%
	Total	*37,579,563.45*	*100.0%*

91.1%

Fiscal Year 2016
MGE Allocations
Per Monthly Allocations Reports

	Allocation Factor	*Amount Allocated to MGE per Monthly Reports*	*Percentage of Total Costs Allocated to MGE per Monthly Reports*	
1	Corporate Wide (3 Factor) Total	4,907,952.68	24.7%	
2	MO Gas Utilities Only (Customers) Total	3,245,752.01	16.3%	
3	% of PR distribution Total	2,743,934.15	13.8%	
4	Corporate Wide (PR) Total	1,385,419.84	7.0%	
5	MO Gas Utilities Only (3 Factor) Total	1,090,144.37	5.5%	
6	MO Gas Utilities Only (System Miles) Total	931,263.95	4.7%	
7	Gas Utilities Only (3 Factor) Total	891,906.74	4.5%	93.4%
8	700 Mkt (Sf) Total	846,743.19	4.3%	
9	IT Driver - Gas Utilities Total	593,152.23	3.0%	
10	MO Gas Utilities Only (Field Ops HC) Total	591,093.84	3.0%	
11	Corporate Wide (AP Activity) Total	538,143.28	2.7%	
12	Gas Utilities Only (Customers) Total	502,146.68	2.5%	
13	MO Only (PR) Total	318,904.99	1.6%	
14	Facilities Shared Services (Sf) Total	312,706.15	1.6%	
15	MO Only (3 Factor) Total	275,474.08	1.4%	
16	IT Driver - MO Utility Total	142,443.45	0.7%	
17	Gas Utilities Only (System Miles) Total	133,722.43	0.7%	
18	IT Driver - Excl AGC Total	131,229.50	0.7%	
19	Gas Utilities Only (PR) Total	120,602.87	0.6%	
20	MO Gas Utilities Only (PR) Total	99,153.85	0.5%	
21	800 Mkt (Sf) Total	45,644.08	0.2%	
22	Gas Utilities Only (Field Ops HC) Total	40,620.63	0.2%	
23	IT Driver - All companies Total	17,730.46	0.1%	
24	CNG Total	142.16	0.0%	
25	Direct Payroll Total	-	0.0%	
	Total	*19,906,027.61*	*100.0%*	

The general allocator accounts for the greatest proportion of charges allocated to both Laclede Gas and MGE, with the corporate-wide 3-factor allocator accounting for approximately 23% and 25% of allocated costs for Laclede Gas and MGE, respectively. The 3-factor allocator (corporate-wide, MO gas utilities, gas utilities only, and MO only) in total accounts for $12.8 million and $7.2 million of the total allocated costs represented above for Laclede Gas and MGE respectively. This represents approximately 34% and 36% of allocated costs represented in the 2016 monthly allocations reports.

B. LAC/MGE Cost Allocation Manual

Q. Do LAC and MGE file separate CAMs?

A. No. Only one CAM is submitted on behalf of both utilities.[55]

Q. Have you reviewed the LAC/MGE CAM?

A. Yes. I have reviewed the 2016 LAC/MGE CAM, as well as the 2016 CAM report.

Q. Does the LAC/MGE CAM supersede the Affiliate Transactions Rule set out at 4 CSR 240-40.015?

A. No. In fact, as stated expressly in the company's commission-approved CAM:

> *The purpose of this CAM is to aid Laclede Gas Company ("Laclede") in complying with the requirements of the Rules and in doing so, to provide the Commission with transparency into processes and procedures that govern how costs are determined, allocated and assigned between Laclede and its affiliates, and define how fair market price (FMP) and fully distributed cost (FDC) are to be calculated. This CAM only addresses a portion of the requirements of the Rules and in Laclede's opinion compliance with this CAM constitutes evidence of compliance with those portions of the Rules.*

Thus, with the exception of variances from the Rule, approved by the commission, the Affiliate Transactions Rule is to govern the company's management of affiliate transactions.

Q. Do Laclede Gas and MGE anticipate any changes to cost allocation methodology from those described in the 2016 CAM?

[55] Response to Discovery, OPC Data Requests 7073 and 7074.

A. In discovery, the company noted that until "it receives the testimony and recommendations of the other parties to these cases, the Company cannot assess what, if any, changes to the allocation methodology...might be proposed, agreed upon or determined by the Commission."[56]

Q. Do you have any recommendations regarding the LAC/MGE cost allocation manual?

A. Yes. I recommend that LAC/MGE file for a new commission-approved CAM to reflect changes that have occurred at Spire, including the creation of Spire Shared Service Company.

I recommend that the new LAC/MGE CAM be updated to reflect the changes that have occurred at Spire described in the testimony of Mr. Krick. One specific item that should be included is a detailed description of the SSC and its role in LAC/MGE's cost allocation process.

I also recommend that the companies' annual CAM report include the allocation factor calculations for each and every factor utilized during the year, and document any changes to these factors made during the year.

It appears, based on Mr. Krick's testimony, that the structure of Spire's system is still in development. For example, when discussing whether SSC has any employees, Mr. Krick stated that there were no employees "at this time" and that SSC is primarily utilized "at this point" as an accounting vehicle.[57] As such, it is especially important that the role of SSC be defined and updated in the CAM on a regular (at least annual) basis.

Q. Do you recommend any other changes to the CAM?

[56] Responses to Discovery, OPC Data Requests 7084 and 7085.
[57] Direct testimony of Timothy Krick, p. 10.

A. Yes. Based on responses to discovery, it is clear that significant portions of the CAM are not enforced in their entirety.

For example, pages 13 and 14 of the LAC/MGE 2016 CAM state that some departments "are expected to provide a recurring, predictable level of services to a Party...For these departments...***annual reviews shall be performed and documented to determine a normal distribution of time***...The distribution percentages derived from such reviews shall then be used to allocate time with respect to each pay period. ***For these departments...direct labor shall be charged to the service under an exception time reporting methodology***..." (emphasis added). When asked in discovery how employees charge their time, the response Spire provided clearly contradicts the LAC/MGE CAM as it states that all LAC/MGE direct labor "is charged utilizing positive time reporting" and "exception time reporting isn't used."[58]

Other pervasive examples include the company's lack of evidence or calculation of the fair market price and fully distributed cost of affiliate transactions in compliance with the CAM or the Affiliate Transactions Rule.

As such, I recommend that the proposed audit include a comprehensive comparison of the procedures described in the CAM versus the procedures actually performed by the company to ensure that the procedures described in the CAM reflect those being utilized by LAC/MGE in practice.

C. Cost Allocation Training Practices

Q. How are LAC/MGE employees trained and informed regarding cost allocation practices?

A. When asked in discovery to provide copies of any cost allocation training materials provided to personnel since January 1, 2011, Spire provided three separate files: (1) a 2012 memo

[58] Response to Discovery, OPC Data Request 7126.

concerning how to record certain projects and tasks; (2) a 2014 PowerPoint document that discussed how to record project costs; (3) a 2016 PowerPoint presentation that was titled "Spire Shared Service PSC Meeting_Oct 27 2016," which appears to have been written to provide a public service commission, or its staff, an overview of Spire's shared services and cost allocation process.[59]

Q. Do you have any recommendations for how Spire could enhance its cost allocation training?

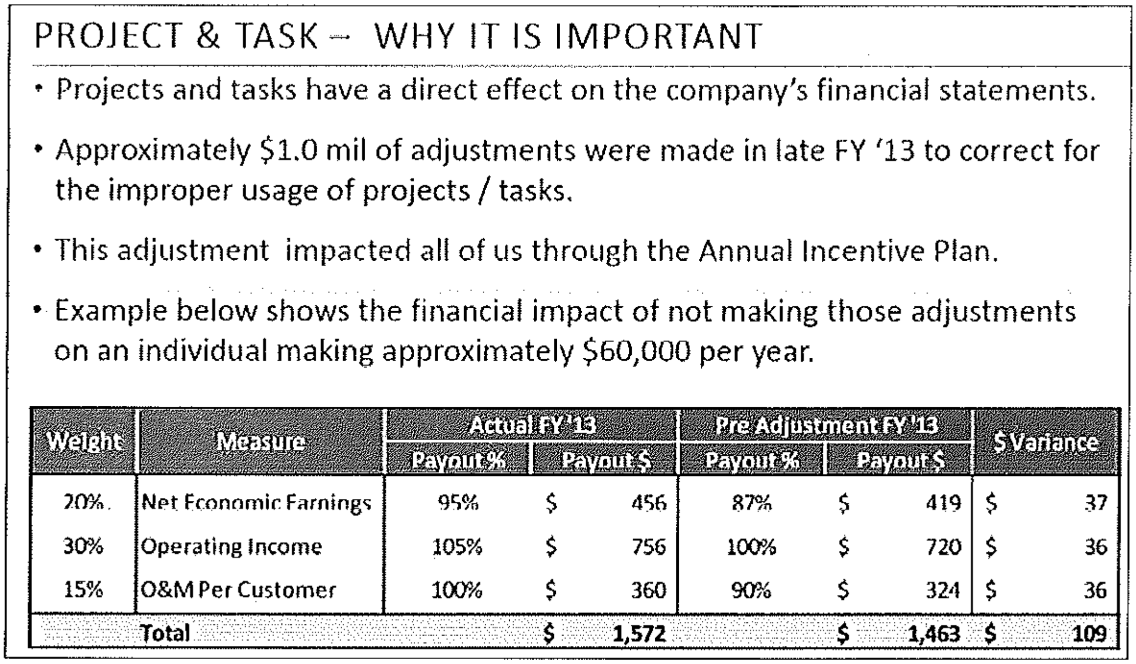
A. Yes. Given the implications of the cost allocation process on Spire's ratepayers, I recommend that Spire develop a formal training course for all employees who charge costs to Missouri-jurisdiction utilities. I further recommend that a copy of these training materials be provided to OPC and Staff, and that successful completion of this training course be an annual requirement of all Spire employees who charge costs through the SSC.

Q. Do you have any additional recommendations regarding these training materials?

A. Yes. The training materials LAC/MGE provided to employees in 2014, contained the following slide discussing why cost allocation is important:[60]

[59] Responses to Discovery, OPC Data Requests 7079, 7080, 7081, 7082, and related attachments, specifically: OPC Data Request 7080, 7080 7082 - Project and Task Communication 2012, 7080 7082 - Projects & Tasks Training 2014, 7080 7082 - Spire Shared Service PSC Meeting_Oct 27 2016.

[60] Responses to Discovery, OPC Data Requests 7079, 7080, 7081, and 7082, and related attachments, specifically: 7080 7082 - Projects & Tasks Training 2014.



PROJECT & TASK – WHY IT IS IMPORTANT

- Projects and tasks have a direct effect on the company's financial statements.
- Approximately $1.0 mil of adjustments were made in late FY '13 to correct for the improper usage of projects / tasks.
- This adjustment impacted all of us through the Annual Incentive Plan.
- Example below shows the financial impact of not making those adjustments on an individual making approximately $60,000 per year.

Weight	Measure	Actual FY '13		Pre Adjustment FY '13		$ Variance
		Payout %	Payout $	Payout %	Payout $	
20%	Net Economic Earnings	95%	$ 456	87%	$ 419	$ 37
30%	Operating Income	105%	$ 756	100%	$ 720	$ 36
15%	O&M Per Customer	100%	$ 360	90%	$ 324	$ 36
	Total		$ 1,572		$ 1,463	$ 109

As demonstrated in the slide above, the message Spire is communicating to its employees is that proper cost allocation is important because of its "direct effect on the company's financial statements" as well as its impact on "all [employees] through the Annual Incentive Plan." While both the company's financial performance and Spire's employees' compensation are important, the training materials should discuss the potential of improper cost allocations on *all* stakeholders, including regulated utility customers. To accomplish this objective, I recommend that Spire provide its employees with illustrative examples of how a cost improperly charged to LAC/MGE could potentially cause Spire's regulated utility customers to pay more than is proper for their utility service.

D. <u>Rate Case Adjustment</u>

Q. What rate case adjustments are you sponsoring?

A. I am sponsoring adjustments related to the improper cost allocation of LAC/MGE's costs associated with the "New Blue" enterprise information system and for the company's failure to account for the downward "trend" identified by the company's own witness, in shared services costs. In addition, I have identified discrepancies between the amount of shared service allocations in Mr. Flaherty's testimony and those identified in LAC/MGE's underlying cost allocation reports. I have noted this as one of the issues requiring the company's explanation and accounting in or prior to its filing of rebuttal testimony. In the absence of supported documentation for the discrepancy, I would recommend that this amount also be adjusted in the revenue requirements of LAC and MGE.

Q. Please describe how you determined the adjustment for the trend in shared services costs.

A. I noted that the company presented $213.2 million as 2016 O&M billings (shared services costs charged) to Laclede Gas and MGE.[61] The company also calculated a "trend" of 3.3% annual reduction in O&M billings to Laclede Gas and MGE.[62] The amount of reduction in Laclede and MGE O&M billings that may be anticipated for 2017 based on these figures is $7.0 million dollars.[63] I assigned this figure to Laclede Gas and MGE based on their relative proportion of allocated shared services and direct charges in 2016—69% and 31% respectively. The corresponding adjustments for Laclede Gas and MGE are a reduction to the O&M expenses of $4.9 million and $2.2 million respectively.

It should be noted that, though the preceding adjustment is recommended based on the information available at this time, the impact of the company's recent mergers should be investigated in detail in the course of the recommended audit, with a focus on the reasonable share of synergies achieved and achievable and their impact on shared service costs to Spire's Missouri utilities.

Thus, the figure proposed for adjustment in this testimony is conservative and understated and should be considered as such, given that: (1) the company's allocation

[61] Direct testimony of Thomas Flaherty, p. 70.
[62] Direct testimony of Thomas Flaherty, p. 72.
[63] Calculated at 3.3% of $213.2 million.

factors currently do not incorporate all the affiliates, (2) the company's assessment of 2016 shared costs identified lower savings to Laclede Gas and MGE than company-wide reductions in shared costs (3.3% versus 4.9% annually),[64] and (3) the addition of the new pipeline entities, and newly acquired EnergySouth utilities expand the pool of companies to absorb shared services costs, and going forward, Laclede Gas and MGE should expect greater savings.

Q. Are you proposing other adjustments related to the issues with Spire's shared services charges and allocations to Laclede Gas and MGE at this time?

A. Yes. I also propose an adjustment related to the cost of "New Blue", Spire's enterprise software account.

Responses to discovery show that this asset is being held entirely on the books of Laclede Gas Company with the costs allocated to LAC and MGE (OPC Data Requests 7128, 7129, 7130 and 7131). Compared to December 31, 2013, MGE's software account balance has increased 1,010 % as of the end of the test year.[65] The balance of enterprise software for all Spire companies, at December 31, 2016, was a net book value of $92.7 million,[66] and is currently on the books of only MGE ($55.5 million) and Laclede Gas ($37.2 million)[67]. Given that in an efficiently functioning organization, the enterprise management software should be designed to benefit the various entities and allocated accordingly, both the capital costs and related amortization expense should reflect this accordingly. In addition to the direct rate base and income impact of this on the revenue requirement, the amount of fixed assets impacts the costs charged to Laclede Gas and

[64] Direct testimony of Thomas Flaherty, p. 72.
[65] See Response to Discovery, OPC Data Request, 7131 and 8504. At December 31, 2013, the net book value of MGE's software account (Account 303) was approximately $5.5 million (close to its 3-year average for 2011-2013). At December 31, 2016, the net book value of MGE's software account (Enterprise Software Account 391500) was approximately $55.5 million.
[66] Response to Discovery, OPC Data Request, 7131.
[67] Response to Discovery, OPC Data Request, 8504.

MGE by inflating the allocation factors through overstatement of fixed assets attributable to these Missouri utilities.

Per Laclede's current CAM, regarding costs related to information systems:[68]

> *All costs, including capital costs related to the operation of mainframe systems will be allocated based on a percentage of operating and production time dedicated to routine affiliate activities as compared to the total for each system.* ***Such allocations shall be based on a study performed annually.*** *Costs related to network applications, including capital costs, will be allocated based on the number of personal computers assigned on a departmental basis. The departmental allocation of costs will be appropriately allocated to affiliates based on the proportion of direct labor reported by each department for an affiliate. (emphasis added)*

The company has provided no study to demonstrate compliance with the cost recording procedures outlined by the CAM or any analysis otherwise to demonstrate why or how the company believes it is prudent to account for the enterprise management system of the entire enterprise on the books of only its Missouri utilities. In fact, when asked in discovery how the company determined the amount of the enterprise management system (New Blue) allocated to MGE, rather than provide the required CAM study or other analysis, the company only stated that "the amounts allocated to MGE were dependent on the software."[69]

For the reasons noted above, I propose an adjustment to reduce the rate base and depreciation expense of MGE by $33.4 million and $2.8 million, respectively and an adjustment to increase the rate base and depreciation expense of LAC by $3.2 million and $268 thousand, respectively. This adjustment allocates the net book value and

[68] Laclede 2016 CAM, p. 17.
[69] Response to Discovery, OPC Data Request, 8504.

depreciation expense associated with the enterprise software system to the 12 companies that are allocated shared services costs per the company's 2017 company-wide 3-factor allocator rather than wholly accounting for the software on the books of MGE and LAC.

The comments I have made regarding the conservative nature of the O&M trend adjustment above also apply to this adjustment for the same reasons.

While I believe this adjustment is reasonable given the information available at this time, I would emphasize that the allocation of Spire's enterprise information management system should be reviewed in detail in the course of the recommended affiliate transactions audit. The audit should include a detailed review of whether, and the extent to which any other entities within Spire aside from LAC/MGE are and should be benefitting, directly or indirectly, from this system.

Q. Please describe the unaccounted discrepancies you identified between the amount of shared services discussed in Mr. Flaherty's testimony and the amount of shared services reflected in the company's allocations reports.

A. On page 70 of his testimony, Mr. Flaherty noted allocated-shared-services costs to LAC/MGE of $46.5 million. However, as noted in the *Allocation Factors* portion of this testimony, based on the company's monthly allocations reports, the amount of shared services allocated to LAC/MGE (based on the sum of the values attributable to both companies for each calendar month of the test year) was a total of $57.5 million ($37.6 million for LAC and $19.9 million for MGE). The difference of $10.96 million was not explained by LAC/MGE in its discovery and should be addressed in its rebuttal.

VI. OTHER MATTERS

A. Discovery Issues

Q. Was Spire adequately responsive for purposes of your cost allocation review?

A. No. In fact, Spire was the least responsive company in terms of discovery that I have encountered during the course of my career. Of the 137 data requests submitted in this area, 113 requests were provided after 20 calendar days. In other words, more than four out of every five data requests were responded to after the discovery turnaround timeframe established in the procedural schedule for this case. Given the delays in discovery, as well as the insufficient support regarding its compliance with Missouri's affiliate transaction statute, the cost allocation audit I recommended earlier in this testimony is both prudent and necessary.

Q. Were there any other discovery-related issues that negatively impacted your ability to conduct your analysis?

A. Yes. Many of Spire's data request responses were references to other data requests with no narrative clarification regarding why, how, or where the company believed the requested information was actually provided in the referenced data request.

Additionally, Spire overused designations of confidentiality and was non-compliant with the Commission's rules regarding confidentiality, found in 4 CSR 240-2.135 – *Confidential Information.*

Q. How was Spire non-compliant with the Commission's confidentiality rules?

A. According to 4 CSR 240-2.135 (5)(B), when a party designates information produced in discovery as confidential, it "shall inform, in writing, the party seeking discovery how that information qualifies as confidential under subsection (2)(A) of this rule at the same time it responds to the discovery request."[70]

Although Spire designated several pieces of information confidential, it never provided a written explanation for how such information qualified for confidential treatment under 4 CSR 240-2.135 (5)(B). Furthermore, some information Spire marked confidential was

[70] 4 CSR 240-2.135 (5)(B)

clearly public information. One example of Spire overusing confidentiality designations was its response to OPC Data Request 7048, which requested testimonies of company Mr. Flaherty from other jurisdictions. Given that Mr. Flaherty, presumably, provided public versions of his testimony in the various jurisdictions, there is no valid reason why these testimonies should be marked confidential.

Q. Do you have any additional comments for the Commission to consider regarding discovery issues during this proceeding?

A. Yes. Spire has changed dramatically over the past five years—making several acquisitions in different jurisdictions, increasing its customer base, and even changing the name of its holding company. Given the dynamic nature of this organization, it is especially critical that, in the future, the company demonstrate a greater degree of transparency and responsiveness regarding support for its affiliate transactions than was provided during this proceeding and in a manner that reasonably supports its application.

Q. Are you aware of any other issues related to LAC/MGE cost allocations that should be considered by this commission?

A. Yes. In addition to the adjustments that I have noted above, I believe the following issues should specifically be addressed by LAC/MGE in its rebuttal testimony:

- As noted previously in my testimony, of the twenty-one Spire entities only twelve received allocations and/or charges of shared services. Spire should provide evidence to support why nearly one-half of the corporate entities within its holding company do not receive shared services costs.

- Of the twelve Spire entities that received allocations, Mobile Gas and Willmut Gas only received charges for three months of the test year. The company should provide evidence for why Spire's allocation factors should not be adjusted to reflect the impact of these entities for an entire year.

- According to responses to discovery, during the test year LAC and MGE were allocated approximately $1.6 million and $896 thousand, respectively, for shared services performed in Alabama.[71] It is not clear what, if any, benefits these shared services costs from Alabama are providing to the ratepayers of Missouri. The company should provide evidence of benefits Missouri ratepayers are receiving from these services.

- The company should account for all differences between the support it provided and the figures in the testimony of its witnesses, specifically, Laclede Gas and MGE should account for the $10.96 million difference between the 2016 monthly allocation reports and the figures presented in its direct testimony as described in detail above.

Q. Does this conclude your testimony?

A. Yes, it does.

[71] Response to Discovery, OPC Data Request 7104.

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Laclede Gas Company
MGE

Schedule AZAD 1

has been deemed

"Confidential"

in its Entirety