BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Request to Increase Its Revenue 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**

STAFF'S INITIAL POST-HEARING BRIEF

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INTRODUCTION

Laclede Gas Company ("LAC") and Missouri Gas Energy ("MGE"), both now known as Spire Missouri Inc., doing business in Missouri as Spire, separately filed requests with the Missouri Public Service Commission ("Commission") to file revised tariffs to increase their rates for natural gas service. These cases were not consolidated but due to the overlapping nature of the issues to be heard, the Commission and the parties have handled these cases jointly for the purposes of hearing and all filings made in the cases have been identical. This Commission heard evidence on numerous issues in this rate case and is now charged with setting just and reasonable rates which will permit Spire to recover its costs to serve its customers across the state of Missouri, along with allowing Spire the opportunity to earn a fair rate of return. This is the first general rate case the Commission has heard since Missouri-regulated Laclede Gas Company acquired Missouri-regulated Missouri Gas Energy on July 17, 2013, and changed its name to Spire Missouri Inc., doing business as Spire on August 30, 2017.

PROCEDURAL HISTORY

LAC and MGE filed revised tariffs and direct testimony on April 11, 2017, reflecting a request for a rate increase totaling $58.1 Million for LAC and $50.4 million for MGE, collectively $108.5 million. Of this amount, $49 million was already being collected in rates between the two divisions through the Infrastructure System Replacement Surcharge ("ISRS") revenues, leaving LAC with a request of $25.5 million and MGE with $34 million. The Commission authorized a test year of 12 months ending December 31, 2016, updated through June 30, 2017, and trued-up through

September 30, 2017. Following the intervention of several interested parties and three rounds of testimony, an evidentiary hearing was held December 4 through December 15, 2017, with additional issues heard in the true-up evidentiary hearing held on January 3, 2017. The Commission has suspended LAC's and MGE's tariffs until March 8, 2018.

THE COMPANY

LAC serves approximately 630,000 residential, commercial, and industrial customers in the City of St. Louis and portions of ten counties in eastern Missouri. LAC received authorization of the Commission for an increase to its base rates most recently in Case No. GR-2013-0171.

MGE serves approximately 500,000 residential, commercial, and industrial customers in the cities of Kansas City, St. Joseph, Warrensburg, and Joplin, along with 151 other communities in western Missouri. MGE received authorization of the Commission for an increase to its base rates most recently in Case No. GR-2014-0007.

The Commission approved LAC's acquisition of MGE in Case No. GM-2013-0254, when it approved the unanimous stipulation and agreement submitted by the parties to that case on July 17, 2013.[1] LAC also acquired Alagasco located in Alabama in 2014 and EnergySouth located in Mississippi in 2016, both since its last general rate case. Through the rate cases currently before the Commission, in addition to their request to increase base rates, LAC and MGE state that Spire Missouri

[1] Ex. 55 Stipulation and Agreement in Case No. GM-2013-0254.

also seeks to align differing policies between its divisions to create a more streamlined company.[2]

CUSTOMERS

LAC presently has eight customer classes: Residential General Service; General Service; Large Volume Service; Large Volume Transportation and Sales Service; Interruptible Service; General L.P. Gas Service; Unmetered Gas Light; and Vehicular Fuel. MGE has four customer classes: Residential Service; General Service; Large Volume Service; and Unmetered Gaslight Service.

RATEMAKING

The Commission follows a standard that rates must be just and reasonable, based in statutory law,[3] and upheld by the United States Supreme Court; "Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."[4] The Supreme Court has also ruled that a commission must take into consideration a utility's customers when it stated, "the rate-making process … i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests."[5] The Commission has considerable discretion in rate setting due to the inherent complexities involved in the rate setting process.[6]

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[2] Ex. 6 Eric Lobser Direct Testimony, P. 5:17-18.
[3] Section 393.130.1, RSMo.
[4] ***Bluefield Water Works and Improvement Co. v. Pub. Serv. Com'n of the State of West Virginia***, 262 U.S. 679, 690 (1923).
[5] ***Federal Power Com'n v. Hope Natural Gas Co.,*** 320 U.S. 591, 603 (1944).
[6] ***In Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service and Midwest Energy Consumers' Group v. Mo. Pub. Serv. Comm'n***, 509 S.W.3d

A utility both incurs expenses and makes investments to provide its service. Its expenses include its operation, replacement of capital items that have depreciated and taxes on its return. Its investments include its rate base on which a utility receives a profit in the form of its return, calculated as a percentage of its rate base. Rate base includes the capital assets minus the accumulated depreciation of those assets, along with other items. The revenue requirement of a utility is the amount of revenue a utility must receive annually to meet the costs of providing service and permitting its investors an opportunity to earn a profit on their investment in the utility.[7] The first step is to calculate the cost-of-service. The cost-of-service for a regulated utility can be defined by the following formula:

$$COS = O + (V - D)R$$

where:
COS = Cost of Service;
O = Adjusted Operating Costs (Payroll, Maintenance, etc.), Depreciation Expense and Taxes
V = Gross Valuation of Property Required for Providing Service;
D = Accumulated Depreciation Representing Recovery of Gross Property Investment
R = Allowed Rate of Return
V – D = Rate Base (Gross Property Investment less Accumulated Depreciation = Net Property Investment)
(V - D)R = Return Allowed on Net Property Investment

Revenue requirement can be defined by the following formula:

$$RR = COS - CR$$

where:
RR = Revenue Requirement;
COS = Cost of Service;
CR = Adjusted Current Revenues

757, 765 (Mo. App. 2016). *Citing* State ex. rel. Assoc. Nat. Gas Co. v. Pub. Serv. Comm'n, 706 S.W.2d 870 (Mo. App. 1985).

[7] ***State ex. rel. Capital City Water Co. v. Mo. Pub. Serv. Comm'n***, 850 S.W.2d 903, 916 n.1 (Mo. App., W.D. 1993).

Once the revenue requirement is determined, rates must be designed that will produce the necessary revenue determination, given the usage characteristics of a utility's customers, while ensuring that no one class is significantly under- or over-contributing to the overall revenue produced.[8] A rate design should relate the manner in which customers are charged for a service to the manner in which the company incurs non-gas costs and expenses to provide that service.[9] The appropriate rate design is determined in the context of a class cost of service study ("CCOS"), which is designed to determine the rate of return produced by each customer class based on the class' currently tariffed rates, for the recovery of any calculated revenue requirement amount. Those determined amounts are used to recommend interclass revenue responsibility shifts to bring each class closer to ultimately producing the system-average rate of return that was used in determining the recommended revenue requirement. It is the shifts which ultimately redesign the rates to attempt to better align that class' method of recovering revenue with the cost-causation for that class that was indicated by the CCOS. If a CCOS is well-designed, it will produce non-discriminatory rates based upon established principles of cost-causation. Non-discriminatory does not mean that rates or rate increases must be the same; "discrimination as to rates is not unlawful where based upon a reasonable classification corresponding to actual differences in the situation of the consumers or the furnishing of the service."[10]

Rate design is not solely driven by recovery of the revenue requirement, but also by fairness, simplicity, stability, an avoidance of undue discrimination or preferences,

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[8] *See* **State ex. rel. Mo. Office of Pub. Counsel v. Pub. Serv. Comm'n of State**, 293 S.W.3d 63, 73 (Mo. Ct. App. 2009).
[9] Ex. 208 Staff Report- Class Cost of Service (Confidential).
[10] ***Smith v. Pub. Serv. Comm'n***, 351 S.W.2d 768, 771 (Mo. 1961).

efficiency, and conservation.[11] Fair rates should match cost causers so that similarly situated customers will pay the same rates; simple rates should be easy to both understand and administer; efficient and conservative rates send the appropriate price signals at the appropriate times to safeguard society's scarce resources and avoid waste and other societal harms from over-generation. It is also important to avoid "rate shock," an increase so exorbitant that ratepayers cannot easily adjust. Staff asks the Commission to consider all of these factors when setting fair and reasonable rates for LAC and MGE, collectively Spire Missouri.

Staff conducted a review of all the cost of service components (capital structure and return on rate base, rate base, depreciation expense and operating revenues and expenses) for both LAC and MGE and conducted separate CCOSs to arrive at its recommendations laid out in the sections below.

Staff recommends a revenue requirement of $15,420,268 for LAC and $9,881,174 for MGE as of the filing of its Updated True-Up Accounting Schedules.[12]

SETTLED AND NON-CONTESTED ISSUES

Agreed to in a Nonunanimous Stipulation and Agreement filed December 20, 2017:

- LAC Revenue Allocation
- LAC Rate Design[13]
- MGE Revenue Allocation
- MGE Rate Design[14]
- Billing Determinants

[11] Alt, *supra,* 58-60; J.C. Bonbright *et al.* Principles of Public Utility Rates, 85-179 (PUR: Arlington, VA, 2nd ed. 1988).
[12] Ex. 296 Staff's Updated True-Up Accounting Schedules – LAC; Ex. 297 Staff's Updated True-Up Accounting Schedules – MGE.
[13] Excluding the rate stabilization mechanism; residential customer charge; and residential rate design issues which were litigated at the evidentiary hearing and are briefed below.
[14] Excluding the rate stabilization mechanism; residential customer charge; and residential rate design issues which were litigated at the evidentiary hearing and are briefed below.

Agreed to in a Nonunanimous Stipulation and Agreement filed December 20, 2017:

- Transition Costs Relating to the Acquisition of MGE
- Capitalization of Hydrostatic Testing
- Cash Working Capital
- newBlue Software Allocation
- Rebranding

Agreed to in a Stipulation and Agreement filed December 13, 2017:

- Class Structure
- Tariff Modifications
    - Excess Flow Valves
    - Residential Customer Definition
    - Economic Development Rider
    - Special Contracts Rider
    - Extension Financing
    - Customer Confidentiality
    - Master Meters
    - EnergyWise and Insulation Financing
    - Red Tag Program
    - Lost and Unaccounted for Gas
    - Legal Description of Service Area
    - Off-System Sales and Capacity Release
    - Gas Supply Incentive Plan
    - Purchased Gas Adjustment/Actual Cost Adjustment
- Depreciation
- Infrastructure System Replacement Surcharge
- Laclede Insurance Risk Services
- St. Peters Lateral
- Propane
- Billing Conversion
- Cost of Service Exclusion
- Energy Efficiency Programs
- Low Income Weatherization

The Parties presented themselves for an on-the-record presentation at the True-Up Hearing January 3, 2018, and answered questions regarding these settled issues.

Agreed to in a Stipulation and Agreement filed January 9, 2017:

- Low-Income Energy Assistance Program[15]

ARGUMENT

I. LAC Only Issues

A. Forest Park Property

For several decades, Laclede owned and operated three service centers that provided critical services such as leak detection and repair, construction and maintenance, service and installation, meter replacement and engineering, and marketing, to name a few. Two of these service centers continue to exist, in Berkeley and Shrewsbury.[16] The third service center was located near Forest Park in the City of St. Louis, and it was sold in May of 2014 at a $5.8 million profit, with an additional $5.7 million to cover relocation costs.[17] Some operations housed at the Forest Park property were moved to other locations. However, certain essential functions could not be moved, forcing Laclede to lease the space back from the buyers following the closing date of the transaction. The Forest Park service center provided several additional utility service functions that were *not* provided at the Berkeley or Shrewsbury service centers, including gas procurement, gas controls, and diversion services.[18]

It is important to note that the Forest Park facility was necessary and used and useful for the provision of utility service at the time that LAC closed on the sale. In fact, in March of 2013, LAC closed on a transaction with West End BRB, LLC, in which it

[15] Excluding funding levels.
[16] Ex. 214 Staff Direct Cost of Service Report, p. 48.
[17] *Id.* at p. 49, lines 8 – 12.
[18] *Id.* at p. 48.

purchased two properties adjacent to LAC's existing Forest Park utility service center property.[19] LAC was still using the Forest Park facility at the time of its sale, so it leased back a portion of that property for nearly a year following the sale.[20] At the end of this lease period, LAC relocated several Forest Park management employees to the headquarters building in downtown St. Louis, and it sent other employees to the Shrewsbury and Berkeley service centers. Finally, approximately 100 Forest Park employees responsible for construction and maintenance, leak detection and repair, and various other vital utility functions were relocated to operate from a temporary leased location until a permanent replacement facility could be constructed.[21]

In November 2016, LAC placed into service a new facility at 5311 Manchester, to house roughly 100 employees and functions that were previously located at the Forest Park facility.[22] Essentially, and by the company's own words, the Manchester facility was constructed as a partial replacement of the Forest Park facility.[23]

The sale of the Forest Park property was not a land-only transaction, as the Company would have you believe; the Company was actually using those buildings for the provision of utility services. The buildings had a net book value of $1.8 million at the time of the sale in May 2014.[24] Importantly, this means that the buildings were capital assets for which costs continue to be recovered in rates today.

i. How should any gain resulting from the sale of the Forest Park property be treated for ratemaking purposes?

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[19] Ex. 250 Surrebuttal Testimony of Jason Kunst, Schedule JK-s1, para. 3.
[20] *Id.* at p. 49, lines 12 – 20; Ex. 42 Rebuttal Testimony of Susan M. Kopp, p.8, lines 13 – 15.
[21] Ex. 214 Staff Direct Cost of Service Report, p. 49, lines 21 – 26; Ex. 42 Rebuttal Testimony of Susan M. Kopp, p. 9, lines 8 – 15.
[22] Ex. 214 Staff Direct Cost of Service Report, p. 49, lines 27 – 30; Ex. 42 Rebuttal Testimony of Susan M. Kopp, p. 9, lines 20-21.
[23] *See* Ex. 250 Surrebuttal Testimony of Jason Kunst, p. 4, lines 13 – 20 and Schedule JK-s2.
[24] Ex. 250 Surrebuttal Testimony of Jason Kunst, p. 10, lines 1 – 12 and 22 – 23.

Statutorily,[25] a company is required to secure Commission authorization prior to the sale of any part of its system that is necessary or useful in the performance of its duties to the public. LAC did not seek Commission authorization prior to the sale of the Forest Park property, despite the fact that the Forest Park service center was necessary and useful in the provision of utility service. Because LAC did not seek Commission authorization of the Forest Park sale, the Commission did not have the opportunity to rule on the accounting of the proceeds and relocation costs. At the time this issue was presented in this case, the utility structures were already demolished and replaced by an IKEA retail store that was already in operation. Staff chose to address the accounting of the sale proceeds in the context of this rate case.

Staff's position is that the Commission should order a sharing of the $5.8 million gain on the sale of LAC facilities located at Forest Park Avenue between ratepayers and shareholders, using Staff's recommended true-up capital structure, to offset the higher costs of a partial replacement facility located at 5311 Manchester Avenue. The ratepayer portion would represent a regulatory liability for the portion of gain that is based upon the debt portion of Staff's recommended capital structure, to be amortized over five years with no rate base treatment. Staff's proposal serves to mitigate the harm to ratepayers of the sale and replacement of a piece of property that was still necessary and used and useful for the provision of utility service.

Staff's position regarding the proceeds follows prior Commission guidance that indicates that in certain situations the gain resulting from a sale of utility property would be appropriately shared between shareholders and ratepayers based on an appropriate capital structure. In the Report and Order issued in Missouri Cities,

[25] RSMo 393.190.1

Case No. WR-83-14 et al, (page 25) the Commission indicated one such sharing option could be based upon returning to the ratepayer a percentage of the net gain equal to the percentage of the Company's capital structure which is non-equity, and allowing the Company to treat "below-the-line" the percentage of gain representing the percentage of the Company's capital structure which is equity.

Staff believes this case to be one of those situations contemplated in the *Missouri Cities* case, due to the fact that the Company did not seek Commission approval of the sale prior to entering into the contract for sale, the sold property was still necessary and useful for the provision of service at the time of the sale, and the Company was required to build a replacement facility in order to maintain necessary and useful utility operations after the sale. Accordingly, Staff proposes to establish a regulatory liability for the portion of gain that is based upon the debt portion of Staff's recommended capital structure, and to amortize this regulatory liability over 5 years with no rate base treatment.

The company testimony on this issue addressed only the prudency of the decision to sell Forest Park.[26] Company witness Susan Kopp's rebuttal testimony discussed the restructuring of the company, the expected customer savings resulting from the restructuring, the possibility of a taking through eminent domain, and the condition of the Forest Park facilities.[27] All of these considerations are merely distractions from the real issue here. Staff is not suggesting that the decision to sell the Forest Park facility was in any way imprudent. If it were, Staff would not be recommending the shareholders get any portion of the proceeds of the sale. However,

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[26] *See generally* Ex. 42 Rebuttal Testimony of Susan M. Kopp.
[27] *Id.*

prudency is not the issue at hand. In fact, Staff believes the Company acted prudently in deciding to sell. The real issue is how the Commission should treat the windfall LAC received from the sale for purposes of ratemaking.

Staff's position is that ratepayers should not be harmed for the Company's decision to sell property that was necessary for the provision of utility service, when the transaction itself necessitated the construction of a replacement facility at a higher cost to ratepayers. Staff's suggestion is not only consistent with the Commission's finding in the *Missouri Cities* case (WR-83-14 et al), but it is also consistent with the treatment of sales of vehicles, for example. An extremely common transaction for most utilities is the sale of a vehicle, where the proceeds of the sale are used as salvage to offset depreciation reserve. This means the proceeds of those sales benefit ratepayers. If the Commission chooses not to adopt Staff's sharing recommendation, Staff recommends the Commission make an appropriate adjustment to depreciation reserve.

ii. How should the relocation proceeds from the sale of the Forest Park property, other than proceeds used for relocation purposes or contributed to capital for the benefit of customers, be treated for ratemaking purposes?

Staff's position with regard to the relocation proceeds that LAC received is that a portion of these proceeds should also be treated as a regulatory liability to be amortized over 5 years, with rate base treatment. Staff's adjustments allow a proper sharing between ratepayers and shareholders. Taken together, Staff's adjustments are intended to share the windfall of proceeds equitably between ratepayers and shareholders in a manner that mitigates harm to the ratepayers resulting from the higher cost replacement facility.

- Marcella Forck

II. MGE Only Issues

A. Kansas Property Tax

Each year the MGE division pays property tax to the state of Kansas for its natural gas inventory based on its volume of gas costs and the market price of gas as of January 1 of that year.[28] No other factors or time periods are considered in the calculation.[29]

i. What is the appropriate amount of Kansas property tax expense to include in MGE's base rates?

Staff in its direct case recommended a value of $1.1 million based on the information provided at that time that showed a four-year downward trend.[30] Staff in surrebuttal testimony changed its position to recommend $1.4 million based on the most recent property tax bill information provided by the Company, and for hearing the Company and OPC aligned with Staff's revised position.[31] Therefore, the appropriate amount to include in rates is $1.4 million.

ii. Should the tracker for Kansas property tax expense be continued?

Staff recommends continuation of the tracker currently in place for these property tax amounts.[32] The Company, Staff and OPC have agreed to review the tracker again in the next general rate case to determine if further continuation is appropriate at that time.[33] As discussed in Staff witness Mark Oligschlaeger's rebuttal testimony Staff does not believe trackers are appropriate for all circumstances[34], but given the volatility of the

[28] Ex. 204, Staff Report Cost of Service Revenue Requirement, P. 130.
[29] Ex. 204, Staff Report Cost of Service Revenue Requirement, P. 130.
[30] Ex. 252 Karen Lyons Surrebuttal Testimony, P. 4:12-13.
[31] Ex. 252 Karen Lyons Surrebuttal Testimony, P. 4:9-16.
[32] Ex. 252 Karen Lyons Surrebuttal Testimony, P. 6:1-2.
[33] Ex. 252 Karen Lyons Surrebuttal Testimony, P. 6:3-7.
[34] Ex. 224 Mark Oligschlaeger's Rebuttal Testimony, P. 3:15-19.

gas price on January 1 from year to year that Karen Lyons discusses in her surrebuttal testimony, finds that it is appropriate to continue the tracker in this situation.[35]

-*Whitney Payne*

III. Common Issues

A. Cost of Capital

The cost-of-capital issues are often the most expensive and contentious issues in a rate case. The rate of return is a percentage which, multiplied by the current net value of the Company's rate base, yields a reasonable annual return to the shareholders on their investment in the Company. In ratemaking, the calculated amount of the annual return is added to the operating and other costs in calculating the revenue requirement, which is the total annual revenue that the Company's rates are designed to produce. The rate of return is itself the result of a calculation; which is often premised on the weighted average cost of capital ("WACC") which is calculated by multiplying the percentage of each type of capital by its cost and summing the results. Thus, to determine the rate of return, one must know the capital structure and fair and reasonable inputs to use for the cost of debt capital and the return on equity capital. The contested issues in this case concern all three of these inputs, plus an additional issue concerning short-term debt.

In determining the cost-of-capital issues, the Commission must be mindful of the Constitutional parameters that guide regulatory decision-making in this area. In two

[35] Ex. 252 Karen Lyons Surrebuttal Testimony, Pp. 4-7.

frequently-cited decisions,[36] the United States Supreme Court described certain principles with which the Commission's decision must comply:

(1) An adequate return is commensurate with the returns realized from other businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain the utility's credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

i. Return on Common Equity – What is the appropriate return on common equity to be used to determine the rate of return?

The return on common equity ("ROE") cannot be ascertained by inspecting notes, bonds or other documents; it must be estimated by the expert application of financial analytical models to market data. The Companies' witness Pauline Ahern testified, "[t]he assessment of risk is essential in the proper assessment or estimation of the required return on equity because the required return on equity is a function of investors' expectations of risk."[37]

Three expert financial analysts testified in this case. Staff witness David Murray recommended that the allowed ROE should be set between 9.00% to 9.50%, at the midpoint of 9.25%. Michael Gorman, a well-known and respected cost-of-capital expert, offered a recommendation nearly synonymous with Mr. Murray: a range of 8.90% to

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[36] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, *43 S.Ct. 675, 67 L.Ed. 1176* (1923).
[37] Tr. Vol. 17:1140, lines 13-19.

9.40%, at the point-recommendation of 9.20%. Pauline Ahern, on the other hand, offered an artificially-inflated recommendation of 10.35%. For example, Ms. Ahern takes the unusual position that "it is reasonable to expect that analysts' 3-5 year growth rates can outpace the U.S. GDP growth."[38]

What is the appropriate Return on Equity (ROE)?	
Party	ROE Recommendation
Company – Pauline Ahern	10.35
OPC-MIEC – Michael Gorman	8.90-9.40, **9.20**
Staff – David Murray	9.00-9.50, **9.25**
Notes: Company: 10.00 plus 0.16 adder for Flotation Costs and 0.20 adder for Small Size.	

In view of the principles drawn from ***Hope*** and ***Bluefield,*** cost-of-capital experts generally develop their ROE recommendations by applying an array of analytical methods to market-driven data drawn from a proxy group of corporations similar in risk to the company under consideration. Companies with similar business risk are, of course, other gas LDCs.[39] Companies with similar financial risk are LDCs with similar bond ratings.

Ms. Ahern estimated a return on equity of 10.00% based on her market models – DCF, risk premium, and CAPM.[40] However, she increased her recommended return on equity to 10.35% by adding a business risk adjustment of 20 basis points and a flotation cost adder of 16 basis points to her 10.00% proxy group return.[41] Mr. Murray testified that only one of Ms. Ahern's studies implied a ROE higher than 9.5%.[42] Michael Gorman testified that "Ms. Ahern's return on equity estimates do not support

[38] Ex. 416 Gorman Surrebuttal, pp. 3-4. Historical data shows that GDP growth has been considerably greater than the utilities sector since the 1990s. Gorman Surrebuttal, p. 4.
[39] "LDC" means Local Distribution Company, the generic term for a retail natural gas utility.
[40] Ex. 38 Ahern Direct, p. 5.
[41] Ex. 38 Ahern Direct, p. 5.
[42] Ex. 221 Murray Rebuttal, p. 2.

the Companies' requested return on equity in this proceeding of 10.35%."[43] He noted that "Ms. Ahern's methodologies overstate a fair return on equity for Laclede/MGE, and her proposal for 35 basis points of return on equity adders for flotation costs and business risks is without merit and should be denied."[44] Elsewhere, he pointed out that "Ms. Ahern's estimated market return of 10.0% for her proxy group companies is significantly overstated based on her use of overstated risk premium estimates for both her risk premium and CAPM models."[45] Mr. Gorman characterized her proposed adders as "unjustified" and urged the Commission to reject them.[46] Mr. Murray also noted that Ms. Ahern's floatation cost adjustment violates Spire Missouri's Stipulation and Agreement filed in Case No. GM-2013-0254, the merger of LAC with MGE.[47] Spire Missouri agreed as part of that Stipulation and Agreement not to seek recovery of equity issuance costs associated with its acquisitions.[48]

Mr. Gorman criticized Ms. Ahern's methods, inputs and conclusions extensively. He testified that "reasonable adjustments to Ms. Ahern's return on equity estimates reduce her findings from 10.0%, excluding the unnecessary adders, down to approximately 8.80%."[49] He noted that Ms. Ahern's adder for the Companies' smaller size is unreasonable and its calculation flawed by "several fundamental errors and flaws in Ms. Ahern's quantitative estimate and logic."[50] In particular, Ms. Ahern ignored the

[43] Ex. 414 Gorman Rebuttal, p. 2.
[44] Ex. 414 Gorman Rebuttal, p. 2.
[45] Ex. 414 Gorman Rebuttal, pp. 9-10.
[46] Ex. 414 Gorman Rebuttal, p. 10.
[47] Ex. 55 Stipulation and Agreement in Case No. GM-2013-0254.
[48] *Id*.
[49] Ex. 414 Gorman Rebuttal, p. 18.
[50] Ex. 414 Gorman Rebuttal, p. 20.

fact that the Companies' smaller size is effectively corrected by their service agreement with Spire, Inc. and Spire Shared Services.[51] Mr. Gorman noted:

> These service company transactions mitigate Laclede/MGE's stand-alone small company risk from a standpoint of management expertise, access to capital, and technical expertise such as legal, engineering, financial and IT. Further, the public shareholders of Spire, Inc. benefit from the diversity of Spire subsidiaries that operate across regions. Therefore, this diversity in operations can mitigate small company risk of the operating performance of the subsidiaries impacts on Spire's financial results.[52]

Likewise, Mr. Gorman rejected Ms. Ahern's proposed flotation cost adder.[53] Mr. Gorman commented:

> This is not reasonable, particularly in the way she has constructed it. Specifically, she neglects to consider that not all common equity for Laclede/MGE American is derived from public stock issuances. Rather, a significant amount of equity is built through retained earnings, and certain transactions that increase common equity do not incur public stock issuance costs. As such, the percentage of market capitalization of Laclede/MGE's common stock of $3.0 billion (Schedule PMA5-D3 at 9) in relationship to flotation costs of $58.68 million would produce a flotation cost adjustment of around 0.06%. Reflecting a flotation cost adjustment to the price of the DCF formula, would produce a DCF return of 8.72%, rather than Ms. Ahern's 8.82%. This alternative would produce a flotation cost adder of around 0.6 basis points.[54]

Mr. Gorman explained that some of Ms. Ahern's analytical methods were designed to produce inflated results. While he accepted her DCF results as a reasonable high end for the ROE range,[55] he criticized her PRPM Risk Premium

[51] Ex. 414 Gorman Rebuttal, p. 20.
[52] Ex. 414 Gorman Rebuttal, p. 20.
[53] Ex. 414 Gorman Rebuttal, p. 22.
[54] Ex. 414 Gorman Rebuttal, p. 23.
[55] Ex. 414 Gorman Rebuttal, p. 24.

analysis as "flawed" and noted that it "biases the risk premium up, and distorts its volatility."[56] Mr. Gorman explained:

> Specifically, a significant component of return volatility on stock is created by capital gains and losses. Without recognizing capital gains and losses, stock return volatility and bond return volatility would be muted significantly. This is a significant distinction because Ms. Ahern reflects the increased return volatility for stocks based on capital gains and losses, but ignores this significant investment return component for bond yields. Therefore, Ms. Ahern has not accurately measured the level of the risk premium, nor accurately characterized the volatility across time caused by market factors. Importantly, both stock and bond returns will be impacted by the capital gains and losses created by market factors that influence stock prices and bond prices. Ms. Ahern has significantly understated the return volatility of investing in bonds, and inflated the equity risk premium. This methodology simply is not balanced, and does not reflect an accurate measurement of a market risk premium.[57]

Mr. Gorman also characterized Ms. Ahern's utility risk premium study as "substantially overstated."[58] He went on:

> This risk premium result of 9.51% was based on a projected prospective bond yield of 4.89% and an equity risk premium of 4.62%. This return on equity is substantially overstated for several reasons. First, her prospective bond yield of 4.89% overstates current observable A-rated utility bond yields of 4.16%. (Schedule PMA-D4). Overstating the bond yield overstates her risk premium by approximately 73 basis points. In fact, more recent data shows that the 13-week average A-rated utility yield is approximately 3.90%, which is approximately 100 basis points lower than Ms. Ahern estimate of 4.89%. (Schedule MPG-R-8).[59]

Mr. Gorman also criticized Ms. Ahern's ECAPM study. He noted that the return is based on a beta estimate of 0.77 instead of her actual Value Line utility beta of

[56] Ex. 414 Gorman Rebuttal, p. 28.
[57] Ex. 414 Gorman Rebuttal, p. 28.
[58] Ex. 414 Gorman Rebuttal, p. 28.
[59] Ex. 414 Gorman Rebuttal, pp. 28-29.

0.69.[60] Mr. Gorman testified, "[t]he ECAPM analysis significantly overstates a utility company-specific risk premium for use in a risk premium analysis."[61] Mr. Gorman further testified that Ms. Ahern used "a redundant CAPM return adjustment" and therefore "overstates a fair return for Laclede/MGE."[62] Mr. Gorman went on to say:

> Importantly, I am not aware of any research that was subjected to peer review that supports Ms. Ahern's proposed use of an adjusted beta in an ECAPM study. Therefore, Ms. Ahern's proposal to use an "adjusted" beta in an ECAPM is neither based on sound academic principles, nor is it supported by the academic community, and should be rejected.[63]

Finally, Mr. Gorman explained "using an adjusted beta in an ECAPM analysis, as Ms. Ahern proposes, double-counts the increase in the CAPM return estimates for betas less than 1.0, and correspondingly decreases the CAPM return estimates for companies that have betas greater than 1.0. Since utility companies have betas less than 1.0, Ms. Ahern's application of an ECAPM with adjusted beta estimates overstates a CAPM return estimate for a utility company."[64]

Mr. Gorman was particularly dismissive of Ms. Ahern's study of a non-price regulated proxy group, characterizing it as not reasonable.[65] For one thing:

> Ms. Ahern has not proved that these companies are risk comparable to Laclede/MGE. While these companies may have comparable beta estimates, she has not shown that they face comparable business and operating risk to a low-risk regulated gas utility company. To draw a valid comparison between Laclede/MGE and any proxy group, it is necessary to show that these companies have comparable risk factors that are commonly used by investment professionals to compare investment risk between different investment alternatives. Because she has not shown that these companies are indeed risk comparable to

[60] Ex. 414 Gorman Rebuttal, p. 30.
[61] Ex. 414 Gorman Rebuttal, p. 30.
[62] Ex. 414 Gorman Rebuttal, p. 30.
[63] Ex. 414 Gorman Rebuttal, p. 31.
[64] Ex. 414 Gorman Rebuttal, p. 31.
[65] Ex. 414 Gorman Rebuttal, p. 32.

Laclede/MGE, her estimated return on this proxy group is not reliable and should be disregarded.[66]

Mr. Gorman recommended an ROE of 9.20%, based on his DCF, risk premium, and CAPM studies which ranged between 8.90% and 9.40%.[67]

Staff's expert financial analyst, David Murray, developed a ROE recommendation for the Companies using recent ROEs of about 9.5% awarded by the Commission to large electric utilities as a benchmark.[68] Mr. Murray "compared the current broader and utility-specific capital markets to those which existed when the Commission issued those decisions."[69] Mr. Murray concluded that, while the utility capital markets are similar to those that existed when the Commission allowed an ROE of approximately 9.5% for Missouri's large electric utility companies, persuasive evidence supports a lower allowed ROE for the Spire Missouri operating companies.[70] In particular, Mr. Murray concluded that the cost of common equity differential between the electric utility industry and gas utility industry is about 50 basis points.[71] Mr. Murray used both the DCF and CAPM in developing his recommendation, applied to the market-driven data pertaining to a proxy group of natural gas utilities of similar risk to the Spire Missouri operating companies.[72]

Mr. Murray testified, "it is my considered professional opinion that an authorized ROE for LAC and MGE in the range of 9.00% to 9.50% would be reasonable, but given

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[66] Ex. 414 Gorman Rebuttal, pp. 32-33.
[67] Ex. 407 Gorman Direct, pp. 49-50.
[68] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p.8, p. 10, lines 18-21; Ex. 264 Murray Surrebuttal, p. 3; the cases are ***In the Matter of Union Electric Company d/b/a Ameren Missouri,*** Case No. ER-2016-0179 (*Order Approving Unanimous Stipulation and Agreement,* issued March 8, 2017) pp. 2-3; ***In the Matter of Kansas City Power & Light Company,*** Case No. ER-2016-0285 (*Report & Order,* issued May 3, 2017) at p. 22.
[69] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 8.
[70] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 8.
[71] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 8.
[72] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 10.

that investors view gas utilities in Missouri as having less business risk, an allowed ROE no higher than 9.25% would be most appropriate."[73] Ms. Ahern admitted that gas utilities are generally less risky than vertically-integrated electric utilities.[74] Mr. Gorman testified that since Spire's bond rating is higher than that of Ameren Corporation and Kansas City Power & Light Company, its ROE should be lower.[75] Mr. Murray's opinion is that the Companies' actual cost of common equity is significantly lower that his recommended range of 9.0% to 9.5%.[76] He further testified that state commissions generally are setting ROEs higher than the investors' cost of equity.[77] The effect of awarding to public utilities ROEs that are significantly higher than the actual cost of common equity is to create value for shareholders at the expense of the ratepayers.[78] Mr. Murray noted, "[g]iven that the cost of capital is as real a cost as any other cost of service, reducing this cost in the ratemaking formula to a value closer to its actual cost is consistent with the principles of cost-of-service ratemaking."[79] Mr. Murray testified, "[u]tilities have [consistently] outperformed the markets."[80] About sixty percent of these record profits were paid out to shareholders,[81] reflecting a government-enforced redistribution of wealth from ratepayers to shareholders.

Mr. Gorman testified:

> In 2014, the average authorized return on equity for a gas LDC was around 9.78. Through the first six months of 2017 that dropped down to about 9.5. Subsequent to me filing this testimony the third quarter report

[73] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 45, lines 24-27.
[74] Tr. Vol. 17:1141, lines 14-22; p. 1142, lines 3-10; p. 1150, lines 2-24.
[75] Tr. Vol. 17:1365, lines 6-14.
[76] Tr. Vol. 17:1357, lines 4-16.
[77] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 7, line 29, through p. 8, line 2; p. 10, lines 14-17; Tr. 17:1332, line 9, through p. 1333, line 1.
[78] Tr. Vol. 17:1357, line 17, through p. 1358, line 25.
[79] Ex. 214 Staff's *Cost of Service Revenue Requirement Report,* p. 45, lines 27-29.
[80] Tr. Vol. 17:1337, lines 2-4.
[81] Tr. Vol. 17:1338, lines 20-24.

for 2017 was made available. The average for the first three quarters is around 9.8 percent, but there are two rate decisions in there that are notable outliers that increase the average for the LDCs in the industry. Except for those two notable exceptions in the third quarter of this year, the authorized returns on equity for gas utilities and even electric utilities have been relatively flat over the last 18 to 24 months.[82]

Based on all the foregoing, Staff recommends that the Commission set the Companies' ROE at 9.25%.

ii. Capital Structure – What capital structure should be used to determine the rate of return?

Staff recommends that the capital structure should be based on Spire, Inc.'s consolidated capital structure, inclusive of short-term debt, as of the true-up date, which consists of 45.56% common equity, 47.97% long-term debt and 6.47% short-term debt.[83]

What is the appropriate Capital Structure?		
Party	**Equity**	**Debt**
Company	54.20	45.80
OPC-MIEC	47.20	52.80
Staff	45.56	54.44
Notes: Company: Spire, Missouri, *pro forma* capital structure, as of 9-30-17. OPC-MIEC: Spire, Missouri, adjusted capital structure – Goodwill excluded. Staff: Spire, Inc., consolidated capital structure; including 6.47% of short term debt at 1.5%.		

Staff's witness David Murray and OPC-MIEC witness Michael Gorman made similar recommendations, with equity in the range of 45.56% to 47.20% and debt in the range of 52.80% to 54.44%, with Staff including 6.47% of short-term debt. The

[82] Tr. Vol. 17:1366, line 11, through p. 1367, line 12.

[83] Ex. 204 Staff's *Cost of Service Revenue Requirement Report,* p. 7, lines 12-17; Ex. 264 Murray Surrebuttal, p. 2; p. 4, lines 8-12 and Sch. 1-1.

Company witnesses,[84] on the other hand, recommended equity at 54.20% and debt at 45.80%. Because equity is more expensive than debt, the Company's recommendation necessarily would result in a significantly higher revenue requirement, which means higher rates.[85] In this case, the Company's recommendation would cost ratepayers $16,745,156 more than Staff's.[86]

The Companies recommend a capital structure including 54.20% equity and 45.80% debt, based on the true-up date of September 30, 2017, and excluding short-term debt.[87]

David Murray testified, "[i]n deciding a fair and reasonable capital structure, Staff recommends the Commission authorize a common equity ratio that is consistent with the amount of financial risk (debt capacity) that Spire, Inc.'s gas distribution operations allow, which is best determined by using Spire, Inc.'s consolidated common equity ratio."[88] Mr. Murray testified that debt held at the holding company level, acquired on the strength of the operating companies' cash flows, has the effect of raising the operating companies' cost of capital, and thus the rates paid by customers, should the Commission adopt the higher equity ratios maintained by the operating subsidiary.[89]

Michael Gorman testified that the "Companies' filed capital structure, including a common equity ratio of 57.2%, is unreasonable for ratemaking purposes because a capital structure with an excessive amount of common equity unnecessarily increases costs to retail customers relative to a more balanced capital structure that will maintain

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[84] Pauline Ahern, Glenn Buck, Robert Hevert, and Steven Rasche.
[85] Ex. 414 Gorman Rebuttal, pp. 9-10.
[86] *Reconciliation,* filed November 30, 2017 (EFIS Item 276).
[87] Ex. 19 Buck Direct, p. 3.
[88] Ex. 221 Murray Rebuttal, pp. 2-3.
[89] Tr. Vol. 17:1352, lines 5-21; p. 1354, lines 13-20.

the utilities' credit standing and financial integrity, and preserve their access to capital."[90] Mr. Gorman went on to say that "Laclede/MGE's proposed filed capital structure in this proceeding has substantially more common equity in their capital structure than needed to meet this objective."[91] In particular, Mr. Gorman noted that "[t]he Companies' filed capital structure may overstate the capital structure at the true-up period because the Companies did not include an estimated amount of long-term debt expected to be issued to refinance short-term debt. This $170 million debt issue alone will reduce the Companies' filed capital structure common equity ratio from 57.2% down to 52.5%."[92] The capital structure recommended by OPC-MIEC not only removed the $170 million debt issue but also the goodwill balance of $210 million which represents the acquisition premium paid by Laclede to acquire MGE.[93] The inclusion of goodwill in the capital structure necessarily makes rates higher than they would be otherwise.[94]

Additionally, when Laclede acquired MGE, it agreed that it would not seek either direct or indirect recovery of any acquisition premium from ratepayers.[95] By even proposing the use for ratemaking of a capital structure including this acquisition adjustment, Spire has violated the stipulation and agreement. This issue is moot if the Commission adopts the capital structure of Spire, Inc., as recommended by Staff witness David Murray, because that capital structure does not attempt to carve out subsidiary assets and the capital structure. Staff's recommendation is consistent with

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[90] Ex. 414 Gorman Rebuttal, p. 2.
[91] Ex. 414 Gorman Rebuttal, p. 2.
[92] Ex. 414 Gorman Rebuttal, p. 2.
[93] Ex. 414 Gorman Rebuttal, pp. 2, 7; Tr. 17:1206, line 20, through p. 1207, line 6.
[94] Tr. Vol. 17:1209, lines 10-15; p. 1229, lines 5-7.
[95] Tr. Vol. 17:1228, lines 11-16.

S&P's recommendation for assigning Spire Missouri its credit rating. However, should the Commission decide to use the capital structure of Spire Missouri, then the adjustments Mr. Gorman recommended should be made.

iii. Cost of Debt – What cost of long-term debt should be used to determine the rate of return?

The cost of long-term debt should be based on Spire, Inc.'s consolidated embedded cost of long-term debt of 4.16% and the cost of short-term debt should be based on Spire, Inc.'s cost of short-term debt of 1.5% as of September 30, 2017.[96]

What is the cost of Long-Term Debt?	
Party	**Cost of Debt**
Company	4.123
OPC-MIEC	4.159
Staff	4.160

Michael Gorman's recommendation is essentially synonymous.[97]

iv. Should short-term debt be included in the capital structure? If so, at what cost?

Yes, short-term debt should be included in the capital structure based on Staff's recommended capital structure of 45.56% common equity, 47.97% long-term debt and 6.47% short-term debt.[98] However, if the Commission determines that Gas and Propane Inventories should not be included in rate base, then Staff recommends excluding short-term debt from the ratemaking capital structure.

[96] Ex. 264 Murray Surrebuttal, p. 4, lines 15-17.
[97] Ex. 414 Gorman Rebuttal p. 10, lines 6-7.
[98] Ex. 264 Murray Surrebuttal, p. 4, line 18, through p. 5, line 3.

Should Short-Term Debt be included in the Capital Structure?	
Party	**Include Short-Term Debt?**
Company	No
OPC-MIEC	No
Staff	Yes

Staff's recommended capital structure includes short-term debt to recognize the fact that Spire, Inc. and Spire Missouri have consistently carried high short-term debt balances well in excess of construction work in progress (CWIP) balances.[99] Because Staff is recommending short-term gas assets be included in rate base, the average short-term debt in excess of CWIP should be included in the ratemaking capital structure. Staff's recommendation to include short-term debt in the capital structure is applicable whether the Commission adopts Staff's recommendation to use Spire, Inc.'s consolidated capital structure or if the Commission uses Spire Missouri's capital structure.[100]

-Kevin Thompson

B. Rate Case Expense

i. What is the appropriate amount of rate case expense to include?

ii. What is the appropriate normalization period for recovering rate case expense?

The Companies request a three-year amortization of current rate case expenses and a five-year amortization of current depreciation study expenses, as described in the direct testimony of witness Michael Noack. At the time of LAC's and MGE's direct filing, the Companies budgeted $994,447 of Missouri jurisdictional rate case expenses, split between LAC and MGE, $596,668 and $397,779, respectively, for an annual expense

[99] Ex. 264 Murray Surrebuttal, pp. 2-3.
[100] Ex. 264 Murray Surrebuttal, pp. 2-3.

of $198,889 for LAC and $132,593 for MGE.[101] At the time of the hearing, the Companies had exceeded their $1.3 million estimate for litigation costs in this case, "largely because we had more issues than we expected."[102]

Staff recommends that all properly-verified rate case expenses should be recovered via the sharing mechanism described below.[103] Staff recommends that rate case expenses be shared between ratepayers and shareholders based on the ratio of LAC and MGE's Commission-authorized revenue requirement increase to their requested revenue requirement increase, net of Staff's adjustments. This methodology is consistent with the Commission's treatment of rate case expense in the *Report and Order* in Case No. ER-2014-0370.[104] The total amount of rate case expense should be split between LAC and MGE based on the requested revenue requirement increase. The normalized amount of rate case expense should be recovered over four years. Mr. Majors testified, "The total amount of incurred rate case expenses through September 30 is $1,396,399. Staff recommends this amount should be split 53.5% and 46.5% to LAC and MGE, respectively, based on their requested revenue requirement increase. This amount should be normalized over four years, which is the approximate time between rate cases for both LAC and MGE."[105]

With respect to the rate case expense sharing mechanism proposed in this case, the Western District of the Missouri Court of Appeals has stated:

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[101] Ex. 254 Majors Surrebuttal, p. 3.
[102] Tr. Vol. 19:1714.
[103] The expenses in question are primarily the costs of outside consultants and legal and other services; in-house rate case expense is not included and is not subject to sharing, but is paid through rate revenues. Major Surrebuttal, p. 6.
[104] ***In the Matter of Kansas City Power & Light Company,*** issued September 2, 2015.
[105] Ex. 254 Majors Surrebuttal, p. 3.

> Regarding rate case expenses, the PSC recognized that rate cases are both beneficial to shareholders of a utility and also utility customers, but in different ways. Shareholders benefit from the rate case expenses as the costs are incurred to increase the utility's revenues and profitability. Customers benefit by having a healthy utility. In this case, the PSC found that a standard prudency review of each expenditure in the rate case would not be possible and, even if conducted, would not provide a strong incentive for KCPL to impose cost controls because the utility holds all the information needed to identify imprudence. Therefore, the PSC did not identify any line item expense as explicitly imprudent, but rather found that the costs incurred by KCPL, as a whole, in pursuing its litigation strategy that in large part inured to the sole benefit of shareholders, were imprudent. An expert testified for the Staff of the PSC that, in similar contexts, highly discretionary costs that do not benefit customers, such as charitable donations, political lobbying expenses, and incentive compensation tied to earnings per share are typically allocated entirely to shareholders.[106]

The Court went on to conclude, "[w]e find that the remedy crafted by the PSC was a reasonable exercise of the PSC's discretion and expertise in determining just and reasonable expenses to be borne by ratepayers."[107] The use of the sharing mechanism must be supported by the Commission's finding, that in this case, the total amount of rate case litigation expenses is unreasonable and imprudent.[108]

Is the level of rate case expense incurred in this case unreasonable and imprudent? Staff suggests that it is. Staff expert Majors testified that the Companies' rate case expense in total in this proceeding has increased from the level of incurred rate case expenses in prior cases.[109] While Laclede has been economical in prior rate

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[106] ***In the Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n,*** 509 S.W.3d 757, 778 (Mo. App., W.D. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).

[107] *Id.,* 509 S.W.3d at 779.

[108] *Id.,* 509 S.W.3d at 778. Staff witness Majors testified, "Staff does not believe that there is a prudency issue in relation to rate case expense." Tr. Vol. 19:1768, lines 14-15.

[109] Ex. 254 Majors Surrebuttal, p. 5 and tables on that page.

cases, its expenses have increased significantly in the present case.[110] The charts presented by Mr. Majors show that, of four prior Laclede rate cases and one prior MGE rate case, only one cost more than $1 million.[111] Additionally, as in Case No. ER-2014-0370, the unusually large number of issues litigated in this case is driven by the Companies' requests, such as the requested ROE of 10.35%; the expensive consultants supporting the Companies' proposed capital structure; the request for three new trackers; the Revenue Stabilization Mechanism ("RSM"); the performance-based incentive mechanism (an ROE adder); and the proposed retention mechanism (another ROE adder).[112] Mr. Majors commented, "Comparatively, LAC and MGE have asked for more new, unique shareholder focused ratemaking tools than KCPL did in Case No. ER-2014-0370."[113]

The Companies have complained that they were required to file these rate cases.[114] Staff rejects that position.[115] At the hearing, the Companies' counsel admitted that the Companies controlled half of the many issues brought to hearing.[116] Mr. Buck also complained that the proposed rate case expense sharing mechanism would disincent the Companies from the economical practice of hiring expertise for the rate case project rather than maintaining it in-house.[117] Company witness Glenn Buck admitted that the use of the sharing mechanism might incent the Companies to be more

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[110] Ex. 254 Majors Surrebuttal, p. 5.
[111] Ex. 254 Majors Surrebuttal, p. 5.
[112] Ex. 254 Majors Surrebuttal, pp. 7-8.
[113] Ex. 254 Majors Surrebuttal, p. 8, lines 4-5.
[114] Ex. 20 Buck Rebuttal, pp. 16-17, 18.
[115] Ex. 254 Majors Surrebuttal, pp. 4-5. However, Staff admits that the Companies were required to file if they wanted to keep their ISRS. Tr. Vol. 19:1744, lines 11-17.
[116] Tr. Vol. 18:1666, lines 20-21 (Mr. Zucker).
[117] Ex. 254 Majors Surrebuttal, p. 9; Tr. 19:1704, line 17, through p. 1707, line 12.

efficient, a position with which Staff witness Mark Oligschlaeger agreed.[118] Mr. Buck also admitted that, while the Company goes into a rate case with an estimate of its litigation costs, there is no ceiling or other mechanism that actually serves to constrain its expenditures.[119] Mr. Buck testified that, while cost was a consideration in choosing consultants, he did not necessarily choose the cheapest.[120]

Staff has also proposed to disallow the cost of a Cash-Working-Capital ("CWC") study performed by one of the consultants because Laclede has previously done that study in-house in the past.[121] Staff expert Keith Majors testified, "LAC possesses the regulatory experience, knowledge, and resources to handle this entry level accounting issue in-house without assistance of an outside consultant. CWC lead lag studies involve large amounts of internally sourced company information which lends this issue to performance by in-house personnel."[122] Mr. Majors testified:

> As it applies to the CWC lead lag study, LAC has performed all lead-lag calculations by in-house personnel since at least 1999, in Case No. GR-99-315, which was supported by witness Buck himself. In each LAC case since, LAC has used in-house personnel to support CWC calculations; for the most part witness Buck. CWC calculations are data-intensive and involve sampling thousands of invoice and payment dates and amounts, which would be more efficiently completed by in-house personnel. In the current cases, there are no substantially new CWC issues that would necessitate the testimony of an outside expert such as LAC and MGE witness Timothy S. Lyons.[123]

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[118] Tr. Vol. 19:1707; p. 1777, line 24, through p. 1778, line 11.
[119] Tr. Vol. 19:1713, line 19, through p. 1715, line 3.
[120] Tr. Vol. 19:1715, line 4, through p. 1717, line 13.
[121] Ex. 204 Staff's *Revenue Requirement Cost of Service Report,* pp. 114-115; Tr. 19:1745, lines 3-20. Staff has since withdrawn all of the proposed disallowances except one, the CWC study. Majors Surrebuttal, pp. 10-11.
[122] Ex. 204 Staff's *Revenue Requirement Cost of Service Report,* p. 115.
[123] Ex. 255 Majors Surrebuttal, p. 9, lines 13-21.

Mr. Majors testified that the disallowance decision was driven in part by the principle of the least cost alternative, whereby public utilities are expected to provide safe and adequate service at the lowest possible cost.[124]

Finally, with respect to the Companies' depreciation studies, Staff recommends that the entire cost be recovered via a five-year normalization, with no sharing.[125] A depreciation study is required every five years by Commission rule.[126]

In conclusion, on account of all the foregoing, Staff recommends recovery of rate case expenses, net of Staff's adjustments, based on the ratio of Commission authorized revenue requirement to company requested revenue requirement. This methodology was ordered by the Commission in Case No. ER-2014-0370, upheld by the Court of Appeals, and is straight-forward, easy to implement, and creates an incentive for the Companies to manage their rate case expenses. This mechanism properly allocates the benefits of rate case expense to shareholders and ratepayers.

-Kevin Thompson

C. PGA/ACA Tariff Revisions

i, Should LAC have new PGA/ACA tariff provisions pertaining to costs associated with affiliated pipeline transportation agreements?

No. Given the lack of clarity as to how each of the several changes to Laclede's PGA/ACA tariff proposed by Environmental Defense Fund (EDF) witness Greg Lander would be applied, Laclede should not have new PGA/ACA tariff provisions pertaining to costs associated with affiliated pipeline transportation agreements.[127] The changes

[124] Tr. Vol. 19:1765, line 17, through 1766, line 10.
[125] Ex. 255 Majors Surrebuttal, p. 12.
[126] Ex. 255 Majors Surrebuttal, p. 12; Tr. Vol. 19:1722.
[127] Ex. 233, page 9, lines 11-12.

proposed by Mr. Lander are substantial and complicated, and could result in a major overhaul of the way the PGA/ACA process is handled in Missouri, and should not be imposed as long as there is any uncertainty as to precisely how they would be applied or without a showing of a need for such changes.

A look at the "brief overview" of Mr. Lander's proposed changes to the PGA/ACA clause, as set forth on page 5 of his direct testimony[128], quickly reveals the complexity of his proposal:

> In short, I propose that the Missouri Public Service Commission ("Commission") incorporate the following ranking process into the PGA/ACA:
>
> 1. Group the Company's capacity into a supply reliability capacity bucket and supply diversity capacity bucket;
>
> 2. Analyze the Company's portfolio, ranking each component by its all-in cost (i.e., the sum of all fixed and variable charges, including the gas commodity, associated with each asset or contract divided by the units of throughput or utilization of the asset or contract);
>
> 3. If a new contract is introduced into the ranking process (e.g., to replace the Company's propane-air capacity), identify the full cost of the propane-air capacity plus the cost of propane and divide that by the total quantity of design-winter usage (therms) and arrive at an all-in cost (per therm) for that means of meeting peak demand;
>
> 4. Then compare that all-in cost (per therm) with the all-in cost of using that portion of the new contracted capacity plus the cost of gas divided by the same usage (therms) and arrive at a comparable all-in cost; and
>
> 5. Permit recovery of the lesser of the equivalent all-in cost times design-winter usage of the propane capacity or the all-in cost of the new replacement capacity times the same usage.

Later in his direct testimony, Mr. Lander states "that this ranking type analysis be *incorporated into the PGA/ACA process*" and that the "actual ranking and analysis

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[128] Ex. 650.

would occur in a future PGA/ACA docket."[129] (emphasis added) His testimony also refers to the Commission determining certain "benchmarks" such as a "Commission approved replacement peaking capacity benchmark" and "FOM Benchmark."[130] As the Commission is aware, Staff generally has a 12-month time period in which to review an ACA filing and make its recommendation;[131] however, PGA changes become effective within 10 business days from the date of filing.[132] How all of the Commission determinations required under Mr. Lander's proposal would be made within the time confines of the current PGA/ACA process is unknown.

Mr. Landers also states his opinion that "Laclede should have *a rolling five year period* in which current under-recoveries (or over-recoveries) could be held to offset future over-recoveries (or under-recoveries) respectively *before flow-through of reductions in cost to ratepayers* are put through the PGA/ACA mechanisms."[133] (emphasis added) Waiting five years to flow-through cost reductions to ratepayers obviously does not seem very ratepayer friendly. In any event, such a provision may require that every Laclede ACA case would be held open for at least five years.

Mr. Landers' – and EDF's – main concern seems to be with the planned construction of Spire STL Pipeline by an affiliate of LAC, and LAC's current plan to enter into a transportation agreement with that as-yet-to-be-constructed pipeline, premised on the assumption that the current ACA prudence review process used in Missouri is inadequate. However, as stated by Ms. Anne Crowe of Staff, just because Mr. Landers' proposed PGA/ACA changes are not made does not mean that LAC's decision to

[129] Ex. 650, p. 11, lines 18-21.
[130] *See*, Ex. 650. Page 19.
[131] Tr. Vol. 19 page 1888.
[132] Tr. Vol. 19 page 1896.
[133] Ex. 650, page 21, lines 19-22.

contract with Spire STL Pipeline (assuming that a transportation agreement is eventually entered) – and the related costs of such contract to LAC – will not be reviewed by Staff at the appropriate time.[134] Staff will in fact review such decision and costs as part of the existing PGA/ACA process[135] when LAC seeks to recover such costs in a future PGA/ACA proceeding.[136] Staff has extensive experience conducting prudence reviews of both natural gas transportation and supply contracts, and has in fact proposed significant prudence disallowances related to transportation contracts.[137] Staff also has experience reviewing affiliate agreements in the existing PGA/ACA process.[138] There is simply no reason to believe, nor has EDF presented any evidence to indicate, that Staff has suddenly become incapable of performing PGA/ACA prudence reviews, or that the PGA/ACA process as it has existed in Missouri for years has suddenly become inadequate.

EDF's proposals to change Laclede's PGA/ACA tariff should be rejected.

-Jeffrey Keevil

D. CAM

i. *Should a working group be created following this rate case to explore ideas for modifying the LAC and MGE CAM?*
ii. *Should an independent third-party external audit be conducted of all cost allocations and all affiliate transactions, including those resulting from Spire's acquisitions, to ensure compliance with the Commission's Affiliate Transactions Rule, 4 CSR 240-20.015?*

[134] Ex. 233, page 9, lines 13-17.
[135] *Id.*
[136] Tr. Vol. 19 pages 1884, 1887.
[137] Tr. pages Vol. 19 1896-1897.
[138] Tr. pages Vol. 19 1886, 1898-1899.

As stated at hearing, Staff has not taken an official position on either the creation of a working group, or whether the Commission should order an independent third-party external audit of the Companies' affiliate transactions. However, Staff agrees that updates to the Companies' Cost Allocation Manual ("CAM") would be beneficial. While LAC and MGE currently have a Commission approved CAM, it was initially approved on August 14, 2013. Since that time, LAC has acquired four natural gas utilities, including MGE and three out of state utilities, and created a separate shared-services company.[139] Staff agrees with several of the other parties that improvements could be made to the Companies' CAM to reflect the recent changes to Spire's corporate structure.

Should the Commission determine that a third-party independent external audit is necessary Staff would have concerns as to the ultimate cost of such an audit, and as to how those costs would be recovered. While Staff is not aware of any party providing an estimate of the cost this type of audit may carry with it, it appears that all agree that it would involve analyzing an enormous amount of data. OPC witness Ms. Ara Azad stated at hearing, that she believed such an audit would be conducted at a very granular level, looking at all of the charges and allocation factors in a "level of detail that would far surpass the timeframe that's even allotted for a rate case proceeding."[140] A rate case is an eleven month process; one that incurs many substantial costs. One could imagine that an audit that would far surpass the timeframe allotted for a rate case could potentially incur expenses that exceed those incurred in a rate case. Because of this point, and because, similar to a rate case, Staff is of the opinion that

[139] Ex. 403, page 17, lines 19-21.
[140] Tr., Vol 19, page 1929, lines 20-25.

compliance with the Commission's Affiliate Transaction rules benefits both ratepayers and shareholders, Staff would recommend some type of cost sharing. At hearing, OPC witness Dr. Geoff Marke proposed that company shareholders would absorb initial costs of any third-party audit, up to $500,000. He went on to testify that any costs above that amount would be shared equally between ratepayers and shareholders.[141] Staff would be agreeable to such a funding mechanism.

While Staff did not take a position on the two listed issues regarding Spire's Cost Allocation Manual, Staff does take a position in regard to the Environmental Defense Fund's proposed changes to LAC's and MGE's Gas Supply Standards of Conduct, contained in their CAM. EDF is recommending the same bidding requirements that are currently imposed on short-term gas purchases for LAC and MGE be imposed on purchases of transportation capacity. Staff Witness Ms. Anne Crow testified that such a requirement would not necessarily mean the ultimate decision to purchase pipeline capacity was a prudent one;[142] such a determination would subsequently be made in an ACA review.[143] In addition, any changes to the transportation bidding requirements would not be applied retroactively to the Spire STL Pipeline.[144] Due to the lack of clarity as to how the proposed changes would be applied, Staff would recommend no changes to LAC's and MGE's CAM be made at this time. As represented at hearing, Staff would recommend that if changes are to be made to LAC's and MGE's CAM, they should be done through a more collaborative process between interested parties where the

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[141] Tr., Vol 19, page 1981, lines 11-16.
[142] Ex. 233 c, page 8, lines 4-5.
[143] Tr., Vol 19, page 1896, lines 10-17.
[144] Ex. 233 c, page 8, lines 5-7.

entirety of the Companies' operations would be considered, as opposed to a piecemeal fashion.

In summary, while Staff takes no position on whether a working group should be established to review LAC's and MGE's CAM, if ordered, Staff would happily participate in such a group. Additionally, should the Commission determine that a third party independent audit is necessary to evaluate the Companies' affiliate transactions and allocations, Staff would recommend that the Commission order the costs of such an audit be shared between the Companies' shareholders and their ratepayers. Finally, Staff recommends that the Commission reject the proposed changes to the Companies' CAM offered by EDF; any changes made to the CAM should be considered within a review of the entirety of the Companies' CAM.

-Mark Johnson

E. Gas Inventory Carrying Charges

i. Should LAC's natural gas and propane inventory carrying costs be recovered through rate base inclusion, as currently is the case with MGE, or recovered through the PGA/ACA process?

If a representative level of short term debt consistent with the level of gas inventories in rate base is included in capital structure, gas inventories, including propane inventory, should be included in rate base for LAC as has been the case for natural gas inventories for MGE.[145] Rate base treatment for gas inventory is consistent with all other Missouri gas local distribution companies except LAC.[146] Rate base treatment has the advantage of simplifying the review of gas carrying costs and locking

[145] Ex. 204, page 62, line 2 through page 63, line 2; Ex. 259, page 3, lines 17-23; Tr. Vol. 18 pages 1497 – 1503.
[146] Ex. 204, page 63, lines 1-2.

in those costs until the next rate case.[147] However, if short term debt is not included in the capital structure, PGA treatment (Gas Inventory Carrying Cost Recovery, or "GICCR", mechanism treatment) should be continued for LAC and extended to MGE's PGA tariffs.[148]

There are two primary reasons why gas inventories should only be included in rate base if a representative level of short term debt is included in capital structure: (1) to recognize that gas inventory is financed by short term debt and, (2) to offset the rate impact on customers from including inventory in rate base, as compared to recovering gas inventory carrying costs through the PGA.[149]

Regarding reason number (1), it is undisputed that gas storage inventory is financed by short term debt.[150] Mr. Glenn Buck of LAC has testified over the years that LAC considers gas inventory to be financed by short term debt.[151] At the hearing on December 12, 2017, after some equivocation Mr. C. Eric Lobser of LAC admitted that gas inventory is a short term asset for accounting purposes.[152] In fact, in a *Report and Order* issued in 2010, MGE had short term debt in its capital structure and the Commission included the cost of short term debt in determining MGE's rate of return.[153]

Regarding reason number (2), as the Commission is aware, since 2005 LAC has recovered its gas inventory (including propane) carrying costs through the PGA/ACA process rather than by including those inventories in rate base as proposed in this case. PGA/ACA recovery has been at short term debt rates. Because of the difference

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[147] Ex. 204, page 62, lines 22-25; Tr. Vol. 18, pages 1498-1499.
[148] Ex. 259, page 5, lines 8-14.
[149] Ex. 259, page 3, lines 12-13, 17-19; Tr. Vol. 18 pages 1497-1498.
[150] Tr. Vol. 18 page 1497.
[151] Ex. 259, page 3, lines 22-23.
[152] Tr. Vol. 18 page 1454 line 23 through page 1455 line 16.
[153] Ex. 271, *In the Matter of Missouri Gas Energy and its Tariff Filing to Implement a General Rate Increase for Natural Gas Service,* Report and Order issued February 10, 2010, pages 11-20.

between short term debt rates and overall cost of capital, allowing LAC recovery of its natural gas and propane inventory carrying costs through rate base inclusion of those inventories will have a significant detrimental impact on customers of LAC unless a representative level of short term debt consistent with the level of gas inventories in rate base is included in capital structure.[154]

So what level of short term debt is "consistent" with the level of gas inventories in rate base? Simply stated, the key is to compare (a) the percentage of gas inventory to rate base and (b) the percentage of short term debt to the entire capital structure used for ratemaking purposes;[155] to be consistent, the percentages should be approximately the same.[156] In other words, the key is to look at the percentage, or ratio, rather than focus on the dollar figures themselves as LAC would like to do. This is because the gas inventories and rate bases in question are those of LAC and MGE, whereas the capital structure proposed by Staff is the consolidated parent Spire Inc.'s capital structure.[157] Therefore, the short term debt amount of approximately $282 million included in the capital structure as proposed by Mr. Murray is the correct amount.[158]

Although LAC proposed to move its natural gas inventories into rate base and filed tariffs to this effect, in its *rebuttal* testimony LAC indicated that it does not propose to include propane in rate base, but based upon Staff's review of LAC's direct testimony, it appears that propane was being proposed for rate base inclusion just like natural gas inventories.[159] Most importantly, there is not a comparable tariff sheet

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[154] Tr. Vol. 18 page 1498.
[155] Tr. Vol. 18 page 1492.
[156] Tr. Vol. 18 pages 1501-1502.
[157] Tr. Vol. 18 pages 1501-1502.
[158] *Id.*
[159] Ex. 259, page 5, lines 17-18.

(sheet 28-h in LAC's currently effective tariff) for continued propane PGA treatment proposed in LAC's tariffs filed in this case.[160] Propane inventory should be accorded the same treatment as natural gas inventories, whether included in rate base or not.

ii. Should Line of Credit (LOC) fees be removed from LAC's PGA consistent with inventory inclusion in rate base?

The proposal to recover gas inventory carrying costs by including gas inventories in rate base rather than by flowing those costs through the PGA/ACA tariff results in the elimination of LAC's Gas Inventory Carrying Cost Recovery ("GICCR") mechanism from its PGA tariff, assuming that the Commission includes gas inventories in rate base.[161] Therefore, if the Commission includes gas inventories in rate base, Staff recommends that Line of Credit ("LOC") fees be removed from LAC's PGA to be consistent with inventory inclusion in rate base and elimination of the GICCR mechanism.[162]

-Jeffrey Keevil

F. Credit Card Processing Fees

LAC has asked in this case to include credit card processing fees in rates. This would permit customers to pay their bills by credit or debit card without incurring a fee at the time of payment, which is how credit and debit card payments are currently charged. Kansas City Power & Light ("KCPL") has been offering credit card payment since 2007 for which it pays the processing fees initially and then incorporates into its requests for rate increases in its general rate cases.[163] Pursuant to the Stipulation and Agreement in

[160] *Id.* at lines 18-20.
[161] Ex. 208, page 33, lines 7-10.
[162] Ex. 208, page 33, lines 10-14.
[163] *Report and Order* Case No. ER-2006-0314.

Case No. GR-2009-0355, MGE has been including these fees in its rates since 2010.[164] Including the fees for LAC would align Spire's two divisions.

i. Should an amount be included in LAC's base rates to account for fees incurred when customers pay by credit card, in the same manner fees are currently included in MGE's base rates?

The Company and Staff are in agreement that it is proper to include an amount in base rates to account for credit card fees. OPC argues that this practice is discriminatory and is unfair to customers. Under section 393.130.3, electric, gas and water corporations have been forbidden from granting undue preference or advantage to any ratepayer, just as they may not unduly or unreasonably prejudice or disadvantage any ratepayer in the provision of services.[165] The question of whether discriminatory rates are unlawful and unjust is usually a question of fact.[166] The facts surrounding this proposal show that it does not constitute discriminatory ratemaking because the option of using a credit or debit card to pay a gas bill will be open to all of Spire's customers if the Commission approves this request. Nothing in the statutes prohibits costs being socialized which benefit all customers. The Commission in its Report and Order in MGE's Case No. GE-2008-0352, determined that it was proper to grant a variance from several Commission rule provisions to permit MGE to offer electronic billing because, "customer choices are increased, and both MGE and its customers may enjoy savings from the elimination of paper bills, checks, envelopes and postage stamps;"[167] signifying the Commission's recognition of the value of diversifying

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[164] Staff Report Revenue Requirement Cost of Service, Case No. GR-2014-0007, Pp. 88-89.
[165] ***State ex rel. City of Joplin v. Public Service Com'n of State of Mo.,*** 186 S.W.3d 290, 296 (Mo. App., W.D. 2005).
[166] ***State ex rel. Mo. Office of Pub. Counsel v. Mo. Pub. Serv. Comm'n,*** 782 S.W.2d 822, 825 (Mo. App., W.D. 1990).
[167] *Report and Order* Case No. GE-2008-0352.

a customer's payment options and the costs associated with non-electronic forms of payment.

OPC states that it is a "small" number of LAC customers that utilize credit cards; however, this is based on current practices which charge the customer the additional fee at the time of the transaction. As Staff stated in its Revenue Requirement Report for KCPL in Case No. ER-2016-0285, and for MGE in Case No. GR-2014-0007, increased customer participation in the program has resulted in a decrease in the fees KCPL and MGE must pay and, therefore, the amount included in rates.[168] Spire witness Michael Noack states in his surrebuttal testimony that, When MGE proposed the adjustment in Case No. GR-2009-0355 the number of credit card payments estimated to be made was 228,852 at a discounted rate of $3.50 per payment.[169] Staff found that in the first year following MGE's implementation of the credit card fee program credit card transactions jumped to 481,840 at $2.33 per transaction, and by 2013 had reached 894,819 at $1.42 per transaction.[170] In 2016 MGE received almost 1.6 million electronic payments with an average cost of $.71 per payment."[171] This indicates that customers are more likely to use the option of paying by credit card after the removal of the fee at the time of the transaction.

ii. If yes, what is an appropriate amount to include in LAC's base rates for credit card fees?

The Company would have the Commission project an estimated cost of credit card fee expense based on the expected amount of increase in customers paying by

[168] Staff Report Revenue Requirement Cost of Service, Case No. ER-2016-0285, P. 115.
[169] Ex. 30 Surrebuttal Testimony of Michael R. Noack, P. 4.
[170] Staff Report Revenue Requirement Cost of Service, Case No. GR-2014-0007, P. 88.
[171] Ex. 30 Surrebuttal Testimony of Michael R. Noack, P. 4.

credit card going forward.[172] Staff, however, recommends that the Commission order LAC to include an annualized amount of credit card fees in its rates, which Staff calculated using the 12 months ending September 30, 2017, and the average transaction fee incurred by MGE.[173] Staff's numbers are known and measurable, unlike the Company's, and meet the matching principle set forth by the Uniform System of Accounts ("USOA") which have been upheld by the courts of this state.[174] The matching principle seeks to prevent single issue ratemaking. In reliance upon § 393.270.4, Missouri courts have traditionally held that the Commission's "determination of the proper rate for [utilities] is to be based on all relevant factors rather than on consideration of just a single factor."[175] Thus, when a utility's rate is adjusted on the basis of a single factor, without consideration of all relevant factors, it is known as single-issue ratemaking.[176] Single-issue ratemaking is generally prohibited in Missouri "because it might cause the [Commission] to allow [a] company to raise rates to cover increased costs in one area without realizing that there were counterbalancing savings in another area.[177]" "The criteria used to determine whether a post-year event should be included in the analysis of the test year is whether the proposed adjustment is (1) 'known and measurable,' (2) promotes the proper relationship of investment, revenues and expenses, and (3) is representative of the conditions anticipated during

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[172] Ex. 30 Surrebuttal Testimony of Michael R. Noack, P. 4-5.
[173] Ex. 204, Staff Report Revenue Requirement Cost of Service, P. 126.
[174] *See* State ex rel. GTE N,. Inc. v. Missouri Pub. Serv. Comm'n, 835 S.W.2d 356, 368 (Mo. Ct. App. 1992).
[175] ***Midwest Gas Users' Ass'n v. PSC,*** 976 S.W.2d 470, 479 (Mo. App., W.D. 1998).
[176] ***Midwest Gas Users' Ass'n v. PSC,*** 976 S.W.2d 470, 479 (Mo. App., W.D. 1998).
[177] ***Midwest Gas Users' Ass'n v. PSC,*** 976 S.W.2d 470, 480 (Mo. App., W.D. 1998); ***State ex rel. Public Counsel v. Public Service Com'n,*** 397 S.W.3d 441, 448 (Mo. App., W.D. 2013) (internal citations omitted), *quoting* ***State ex rel. Midwest Gas Users' Ass'n v. Pub. Serv. Comm'n,*** 976 S.W.2d 470, 479-480 (Mo. App., W.D. 1998); and see extended discussion in ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 51-58 (Mo. banc 1979) (***"UCCM"***).

the time rates will be in effect."[178] Using the Company's proposed amount would violate these principles because the amounts are not known and measurable and would not be taken into consideration with all other factors for the time period during which these fees would be incurred. Therefore, it is appropriate to use Staff's proposal for the 12 months ending September 30, 2017, and the average transaction fee incurred by MGE.[179]

-Whitney Payne

G. Trackers (Environmental)

i. Should LAC and MGE be permitted to implement an environmental tracker?

No, Spire Missouri should not be able to implement an environmental cost recovery tracker. A tracker refers to a rate mechanism under which the amount of a particular cost of service item actually incurred by the utility is tracked and compared to a base amount included in current rates.[180] Any over or under recovery of the item is eligible for consideration in the utility's next general rate proceeding.[181] Trackers should be considered on a case by case basis to account for unusual conditions such as a high volatility of costs, costs for which there is no historical data, or for uncertain level of costs imposed on utilities by new Commission rules.[182] The Commission has previously stated that use of trackers should be limited because they violate the matching principle, tend to unreasonably skew ratemaking results, and dull the incentives a utility has to operate efficiently and productively under the rate regulation approach employed in

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[178] ***State ex rel. GTE N,. Inc. v. Missouri Pub. Serv. Comm'n***, 835 S.W.2d 356, 368 (Mo. Ct. App. 1992).
[179] Ex. 204, Staff Report Revenue Requirement Cost of Service, P. 126.
[180] Ex. 217, *Rebuttal Testimony of Karen Lyons* (Confidential), p. 2, lines 5-7.
[181] *Id.*
[182] *Id.* at p. 9, lines 7-9.

Missouri.[183] The Western District Court of Appeals has supported the Commission's view on a limited usage of trackers, stating that the Commission is within its discretion to limit the usage of trackers to extraordinary items and circumstances.[184] This is good policy, as trackers are a form of single issue ratemaking, and isolate a single cost for examination, without considering other costs that may decline, or other savings that could offset increases in the isolated cost.[185]

Spire Missouri, when requesting the environmental cost tracker, cannot point to any unusual circumstances to justify its request. There is no volatility of cost present. Historically, LAC and MGE environmental costs have not had a high degree of volatility.[186] MGE has not incurred any environmental costs since 2014.[187] Due to insurance proceeds, LAC has not incurred environmental costs since 2007.[188] LAC still has access to insurance proceeds to offset any incurred environmental costs.[189] There is not a lack of historical data for the cost present in this case. LAC and MGE have consistently incurred zero expense in at least the last four years. Finally, this is not a case where there is any new Commission rule, or in fact, any state or federal law, that would require a new or increased level of cost incurred. Spire Missouri cannot point to any pending environmental remediation claims, tightening environmental remediation requirements, or new laws that would be evidence that costs could rise in the future. Spire Missouri witness Mr. Eric Lobser can only state vaguely in his surrebuttal

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[183] In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n, 509 S.W.3d 757, 769 (Mo. Ct. App. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).
[184] *Id.*
[185] Ex. 217, *Rebuttal Testimony of Karen Lyons*, p. 2, lines 15-18.
[186] *Id.* at p. 9, lines 19-20.
[187] *Id.* at line 17.
[188] *Id.* at lines 14-16.
[189] *Id.* at lines 20-21.

testimony that Spire Missouri anticipates environmental costs **may** be incurred beginning next year.[190] This is contrary to Spire Missouri's responses to discovery. Staff requested budgeted environmental costs for the period of 2015-2020 in Staff Data Request No. 0227, attached to the rebuttal testimony of Staff witness Ms. Karen Lyons as Schedule KL-r1.[191] Spire Missouri stated that there were no budgeted costs for expected environmental costs for MGE or LAC.[192] Spire Missouri in its own budgets and plans for the future does not believe any environmental remediation costs will be incurred.

Spire Missouri tries to point to RSMo. 386.266.2 to justify its request. However, Spire Missouri readily admits it is not asking for a rate adjusting mechanism or a rider, as contemplated in RSMo. 386.266.2. Those mechanisms have periodic rate adjustments in between cases, but also require strict reporting. Instead, Spire Missouri is requesting a tracker mechanism, which has its own set of standards to be met before implementation, in which the Company must justify why the cost is extraordinary.[193] Spire Missouri has not done so here. Even if one was to evaluate the tracking mechanism as an approved mechanism under 386.266, subpart 4 allows the Commission to reject any request. For a utility that has not paid costs out of pocket in several years, this power to reject should be exercised. Finally, RSMo. 386.266.7 allows the Commission to take into account any change in business risk to the corporation resulting from the implementation of such an adjustment mechanism, but

[190] Ex. 9, *Surrebuttal Testimony of C. Eric Lobser (Confidential)*, p. 22, lines 8-10.
[191] Ex. 217, *Rebuttal Testimony of Karen Lyons*, Schedule KL-r1.
[192] *Id.*
[193] In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n, 509 S.W.3d 757, 769 (Mo. Ct. App. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).

Spire Missouri has been silent on that provision, or the appropriate downward ROE adjustment to make if they are granted a mechanism under this statute.

Mr. Lobser also refers to accounting authority orders he states the Commission has approved in the past regarding environmental costs.[194] However, Schedule CEL-S3 has a blurb of language from what appears to be a Stipulation, without context or case number. There is also contrary case law to Spire Missouri's position. The Commission has twice previously denied MGE's request for an environmental tracker. In Case No. GR-2004-0209, MGE requested an environmental response fund, which the Commission in its *Report and Order* labeled a tracking mechanism.[195] The Commission stated, "there is no certainty that Southern Union or MGE will ever have to pay any costs associated with these cleanup efforts."[196] The Commission also expressed concerns that such a mechanism would reduce MGE's incentive to challenge claims brought against them.[197] Finally, the Commission recognized that trackers reduce the incentive to prudently control costs by stating, "the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line."[198] The Commission made the same conclusion in 2006, again rejecting MGE's request for the same reasons.[199] All of the Commission's logic in the 2004 and 2006 cases applies today. Spire Missouri has not shown with any certainty that it will have to pay cleanup costs. A tracker would also

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[194] Ex. 9, *Surrebuttal Testimony of C. Eric Lobser (Confidential)*, p. 21, lines 22-23.
[195] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service*, Case No. GR-2004-0209, **Report and Order**, issued September 21, 2004, p. 37.
[196] *Id.* at p. 38.
[197] *Id.*
[198] *Id.*
[199] *In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area*, Case No. GR-2006-0422, **Report and Order** issued March 22, 2007.

reduce Spire Missouri's incentive to challenge claims brought against it or to prudently control its costs. The Commission should deny Spire Missouri's request for a tracker.

-Nicole Mers

H. Surveillance

> *i. Should LAC and MGE provide surveillance data to the Commission?*

In this case, Staff proposed a new format of surveillance data to allow earnings monitoring separately for LAC and MGE. A sample surveillance template is set forth in Attachment 1. Staff requested that LAC and MGE provide completed surveillance templates separately for LAC and MGE as well as their general ledger and CC&B subledger data on a quarterly basis.

Before this issue was taken up at hearing, OPC, the Company, and Staff reached an agreement for the Company to provide Staff and OPC quarterly surveillance reports in Staff's requested template format, and to provide the general ledger and CC&B subledger on an annual basis, within 30 days of the close of the Company's fiscal year. As part of the agreement, Staff and OPC reserved the right to request copies of the general ledger and CC&B subledger on a more frequent basis than annually, if further support of the surveillance data is needed. This information will be considered confidential, and Staff agrees to follow all statutory provisions and Commission rules governing the use and protection of such confidential information.

The only issue taken up at hearing with regards to surveillance reporting was whether MIEC and MECG should also be provided the quarterly surveillance reports. Staff has no position on this matter.

Staff asks that the Commission order the Company to provide Staff and OPC the surveillance data in the format agreed upon and set forth in Attachment 1 on a quarterly basis. Staff also asks the Commission to order the Company to provide Staff and OPC its general ledger and CC&B subledger on an annual basis, within 30 days of the close of the Company's fiscal year, and to make both the ledger and subledger available more frequently in the event further support of the surveillance data is needed.

-Marcella Forck

I. Rate Design/Class Cost of Service[200]

i. Should a Revenue Stabilization Mechanism or other rate adjustment mechanism be implemented for the Residential and SGS classes for MGE and LAC? If so, how should it be designed and should an adjustment cap be applied to such a mechanism?

Staff recommends that a Rate Stabilization Mechanism ("RSM") not be implemented in this case for these companies.[201] First of all, no party has disputed Staff's finding that LAC's and MGE's proposed RSMs adjust for changes beyond those authorized by §386.266.3, RSMo. Secondly, the analysis of Staff witness Michael Stahlman shows that a RSM is not needed. No other party has provided any analysis on the need for any type of revenue stabilization mechanism, and so there is absolutely no evidence that a RSM is needed by these companies. However, should the Commission determine that either or both of these companies should have a RSM, Staff recommends that it be limited to adjustments for weather and applied only to the residential customer class.

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[200] Except for the issues addressed in this brief, the issues listed under the heading **Rate Design/Class Cost of Service** in the *Motion to Delay the Start of Proceedings, and Amended List of Issues, Order of Witnesses, Order of Cross-Examination and Order of Opening Statements*, filed on December 1, 2017, were resolved by one of the Stipulations filed in these cases after the filing of the *Amended List of Issues*.

[201] Ex. 238 Stahlman Rebuttal, p. 10.

The Companies seek a RSM whereby a separate charge would appear on customer bills that would vary in response to changes in average customer usage.[202] Such a surcharge is authorized by § 386.266.3, RSMo., which provides:

> Subject to the requirements of this section, any gas corporation may make an application to the commission to approve rate schedules authorizing periodic rate adjustments outside of general rate proceedings to reflect the non-gas revenue effects of increases or decreases in residential and commercial customer usage due to variations in either weather, conservation, or both.

Staff objects to the RSM proposed by the Companies because it "would adjust for all changes in average customer use, not solely due to variations in weather and/or conservation."[203] Martin Hyman, witness for the Missouri Division of Energy ("DE") which supports the RSM, admitted as much.[204] The proposed RSM is a full decoupling mechanism; the statute only authorizes a partial decoupling mechanism.[205] Staff's witness, Stahlman, noted that the Companies' proposed RSM would also adjust for the effects of fuel switching, rate switching, new customers with non-average usage, and economic factors, none of which are among the factors for which the statute authorizes adjustment.[206] The proposed RSM assumes that a consumer's average usage is based on the outcome of a rate case and would only change as a result of weather and conservation.[207] However, if the Companies were to add low usage customers, the RSM would treat their usage as too low and would make a rate adjustment allowing the Companies to recover the difference between those new customers'

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[202] Ex. 238 Stahlman Rebuttal, p. 5.
[203] Ex. 238 Stahlman Rebuttal, p. 6.
[204] Tr. Vol. 21:2326, lines 1-7.
[205] Ex. 260 Stahlman Surrebuttal, pp. 5-6.
[206] Ex. 238 Stahlman Rebuttal, p. 6.
[207] Ex. 238 Stahlman Rebuttal, p. 7.

lower-than-average usage and an average customer's usage.[208] If one of the several large Small General Service ("SGS") customers that are more like Large General Service ("LGS") customers were to move to an LGS rate, the overall average usage of the SGS class would decrease, thus providing the Companies with additional compensation despite there being no change in actual total usage.[209]

The proposed RSM is unauthorized because it would make adjustments for all variations in average usage per customer regardless of the cause of the variation, whereas the statute only authorizes adjustments for variations due to weather or conservation.[210] Staff rejects the argument that the proposed RSM would provide greater stability for both customer bills and company revenues.[211] Customers can already achieve stability by opting for budget billing.[212] The ephemeral "misalignment problem" raised by Companies' witness Timothy Lyons is best resolved by using Staff's climatic normal and weather normalization because annual natural gas usage is 95% correlated with annual HDD.[213] Companies' witness Eric Lobser admitted that a RSM was not needed because of revenue insufficiency.[214] These points demonstrate that the proposed RSM is not needed by these companies.

Because of all the foregoing, the Commission should reject the Companies' request to implement a RSM. However, if the Commission decides to implement a RSM for these Companies regardless, then Staff recommends that it be limited to

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[208] Ex. 238 Stahlman Rebuttal, p. 8 and Sch. MLS-r2; Stahlman Surrebuttal, p. 6.
[209] Ex. 238 Stahlman Rebuttal, p. 8; Stahlman Surrebuttal, p. 6.
[210] Ex. 260 Stahlman Surrebuttal, p. 7; Tr. Vol. 21:2472, line 13 (Marke).
[211] Ex. 260 Stahlman Surrebuttal, pp. 7-8.
[212] Ex. 238 Stahlman Rebuttal, p. 8.
[213] Ex. 260 Stahlman Surrebuttal, pp. 4-5. The "misalignment problem" is the divergence of actual annual gas usage from the level of normal usage assumed in the previous rate case. Stahlman Surrebuttal, p. 2. The Companies have provided no analysis whatsoever of the earnings impact of the "misalignment problem." Stahlman Surrebuttal, p. 3.
[214] Tr. Vol. 21:2359, lines 1-6.

adjustments for weather and applied only to the residential customer class in accordance with statutory provisions.[215] The Commission should also reduce the Companies' ROE by 10 basis points to reflect the reduction of business risk.[216]

Staff submitted a specimen tariff sheet for such a RSM for LAC at the hearing, Ex. 281, the "Weather Normalization Adjustment Rider" ("WNAR"). At the true-up hearing, the Companies filed the affidavit of Glenn Buck proposing three modifications to the WNAR. Staff opposes all three proposed modifications and does not recommend that the Commission implement the WNAR or any other RSM for these companies.

The Companies' first recommendation is to extend the WNAR to the proposed SGS classes. Staff opposes this recommendation for two reasons: first, in the case of LAC, there is no established coefficient for the relationship between weather and usage; and second, Staff continues to be concerned about rate switchers as this seems to be a common occurrence for LAC. These two issues are related since existence of customers improperly included in the SGS class impacts the relationship between weather and usage. It is often assumed that larger customers are less weather sensitive than smaller customers. Without knowing the final makeup of customers in the SGS class, it is impossible to calculate an unbiased coefficient for the SGS class.

The Companies' second recommendation is to raise the proposed cap from a bi-directional $0.01 to an upward adjustment cap of $0.05 (approximately 25% of the volumetric rate revenues) and defer recovery for amounts falling outside that cap. Contrary to the Companies' assertion, Staff's formulation of the $0.01 cap is not arbitrary; that cap was calculated to approximate a 5% of the volumetric rate revenues,

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[215] Staff submitted a specimen tariff sheet for such a RSM for Laclede at the hearing, Ex. 281.
[216] Tr. Vol. 21:2475, lines 6-11, p. 2498, line 22, through p. 2499, line 9. The Companies ROE witness, Pauline Ahern, also admitted that implementation of a RSM would reduce risk. Tr. Vol. 17:1152, lines 16-20.

which is near OPC's proposed 3% cap. The purpose of the cap is to provide protection to the Companies and ratepayers because Staff does not know what the impacts will be on them. The Companies' analysis of the impact on a residential customer is flawed; it assumes an average annual usage and divides that impact by twelve. As noted is the testimony of Robin Kliethermes, most usage is in the winter months. Based on her workpaper, the impact on an average customer (~150 therms/month) in January at $0.05 would be $7.50, more than twice the impact estimated by the Companies, which is just for an average user and not accounting for above-average users. Additionally, the Companies' inclusion of deferred recovery defeats one of the dual purposes of this cap, which is to limit the unknown impacts of this mechanism on the ratepayers and company. Staff's proposal is to limit (1) bill volatility for customers, and (2) limit the impacts of this mechanism and then review the mechanism's impacts in a later case.

The Companies' third recommendation is to allow for the company to make three rate adjustments per year at their discretion. Judging by this proposal, it seems that the Companies do not understand Staff's alternative proposal. As discussed in paragraph three of the specimen tariff sheets, Staff's proposal would require the Companies to make two adjustments per year. These adjustments would create rates that remain effective for a year, but the ultimate rate paid by customers would be the sum of all effective rates (subject to the proposed rate cap). A semiannual adjustment was chosen so that each period would include half a heating and cooling season plus a full shoulder period. The rate period was chosen to account for customers who have limited seasonal usage (e.g. water heat only). Staff would be open to a quarterly filing,

but does not think that any additional benefits would outweigh the additional workload placed on the Companies. Staff is less open to a triannual filing since such a requirement would cause one period to include either a majority of summer months, where there is little usage affected by weather, or a majority of winter months, where the majority of changes would occur.

In summary, Staff recommends the Commission reject any RSM since the Companies have failed to demonstrate any need for such a mechanism and because their proposed mechanisms are contrary to the authorizing statute. Should the Commission decide to grant a mechanism, Staff recommends the mechanism described by the specimen tariff sheets in Exhibit 281 without the modifications discussed by Companies' witness Glenn Buck.

ii. Reflective of the answer to part i, what should the Residential customer charge be for LAC and MGE, and what should the transition rates be set at until October 1, 2018?

Although this issue begins with the introductory phrase "Reflective of the answer to part i," the answer to part i is actually irrelevant, given that the resolution of this issue is, or at least should be, independent of the answer to part i. In addition, although the list of issues separated issues ii and iii under Rate Design/Class Cost of Service, this brief addresses them somewhat jointly, given the relationship between customer charges and variable charges and the fact that they should be considered together rather than in isolation from each other.

Stated somewhat broadly, a Class Cost of Service ("CCOS") study provides a basis for allocating and/or assigning to the customer classes a utility's cost of providing

service to all customer classes in a manner that best reflects cost causation.[217] Rate design is the relative pricing of one element of a rate structure to another, within or across classes; cost causation is typically the driving factor of rate design, although other policies must be considered.[218] The purpose of the rate design process is to recover costs in each time period *from each rate component for each customer* in a way that equates the cost of providing service with the amount the customer is billed in accordance with the rate schedule.[219]

Staff performed a CCOS study for LAC and a separate CCOS study for MGE.[220] Staff's CCOS found that according to strict allocation, the cost to be recovered through the residential customer charge is approximately $26 per customer for LAC and $17.01 for MGE.[221] Staff included the following costs in the calculation of the residential customer charge:[222]

- Distribution – services (investment and expenses)
- Distribution – meters and regulators (investment and expenses)
- Distribution – customer installations
- Customer deposits
- Customer billing expenses
- Uncollectible accounts (write-offs)
- Customer service & information expenses
- Portion of income taxes

Of all the parties to these cases, only Spire (LAC and MGE) and Staff filed CCOS studies. And even though it filed a CCOS study, the Company's residential customer charge recommendation is not really based on its study; rather, the Company proposed customer charges which it claims were designed to be in alignment with the Revenue

[217] Ex. 208, page 2, lines 14-16.
[218] Ex. 211, Schedule CCOS-d1, page 2 of 3.
[219] *Id.*
[220] Ex. 208, page 1, lines 28-29.
[221] Ex. 208, page 20, lines 16-17.
[222] *Id.* at lines 19-26.

Stabilization Mechanism proposal as filed by the Company.[223] Unlike the Company – or any other party – Staff's residential customer charge recommendations are primarily based on cost, as derived from its CCOS study (as discussed in detail in Staff's Class Cost of Service Report, Exhibit 208), with concern for customer impacts and other policy considerations such as encouragement of energy efficiency.[224]

Currently, LAC's residential rate consists of a customer charge of $19.50 and a seasonal volumetric charge of $0.91686 per therm for the first 30 therms used in the winter, but no charge for therms used after 30 in the winter; in the summer it is $0.31290 per therm for the first 30 therms, and $0.15297 for all therms over 30.[225] MGE's residential rate currently consists of a customer charge of $23.00 and a flat volumetric rate of $0.07380 per ccf.[226]

Although LAC's customer charge is currently set at $19.50, the current LAC "weather mitigated" rate design results in a flat charge of $47.01 for virtually all residential customers in winter billing months (not including PGA). There is no per-therm charge for LAC residential customers in the winter months after the first 30 therms, thus no non-PGA cost-based price signal to control consumption. Staff's CCOS study indicates, and Staff recommends that *the LAC customer charge should be increased*; however, Staff also recommends moving to charge customers for all usage, including usage after the 30th therm, which significantly moderates the customer impact of an increase to the customer charge. [227] **Exhibit Number 284**, requested by Chairman Hall, shows a comparison of bill impacts of the various LAC

[223] Ex. 236, page 5, lines 12-15.
[224] Ex. 236, page 6, lines 12-16.
[225] Ex. 208, page 20, lines 11-14.
[226] *Id.* at lines 14-15.
[227] Ex. 208, page 20, line 27 through page 21, line 2.

residential customer charge and volumetric rate design alternatives presented by Staff versus LAC's current "weather mitigated" rate design.[228]

As noted above, MGE's current rate design is simpler than LAC's, in that it has a customer charge and a flat per-unit volumetric rate. However, MGE's current rate design includes a residential customer charge that over-recovers the CCOS-determined residential average cost per customer.[229] Staff recommends continuing this customer charge plus volumetric rate design; however, Staff recommends that *the MGE customer charge should be decreased*.[230]

Of the parties that filed rate design rebuttal testimony on this issue, the parties (other than Staff) proposed the following: LAC proposed a customer charge of $17 after October 2018 and MGE proposed a customer charge of $20 after October 2018.[231] Prior to October 2018, LAC proposed a customer charge of $23.50 and MGE proposed a customer charge of $25.50 (these are the so-called "transition rates" proposed by Spire, and which are addressed further below).[232] The Office of the Public Counsel ("OPC") proposed a customer charge of $14 for both LAC and MGE.[233] DE simply said it supports lower customer charges.[234] It is important to note here that, as discussed earlier, only Spire and Staff filed CCOS studies and Spire's residential customer charge recommendation is not based on its study. Furthermore, some of the parties who opined as to a customer charge failed to address a corresponding volumetric rate.

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[228] Ex. 284.
[229] Ex. 208, page 21, lines 8-9.
[230] Ex. 208, page 21, line 9 through page 22, line 4.
[231] Ex. 249, page 8, lines 9-11. National Housing Trust witness Ms. Brink supported these post-October 2018 rates in her direct testimony.
[232] Ex. 236, page 5 tables.
[233] Ex. 249, page 8, line 11.
[234] *Id.* at lines 12-14.

Staff has proposed alternative residential rate designs for both LAC and MGE, which contain different rates; however, all of Staff's proposed alternatives include both a customer charge and a volumetric rate.

For MGE, Staff recommends a customer charge of $20 plus a flat volumetric rate per ccf;[235] alternatively, Staff presented an inclining block residential rate design for MGE with a $20 customer charge and a volumetric charge per ccf to increase for usage beyond 50 ccf.[236]

For LAC, if the Commission wishes to move completely to the true cost of service, Staff has proposed a customer charge of $26 plus a flat volumetric rate per therm;[237] alternatively, Staff presented an inclining block residential rate design for LAC with a $26 customer charge and a volumetric charge per therm to increase for usage beyond 50 therms.[238] However, in recognition that the Commission may have concern with a $26 customer charge and may want to move more gradually toward true cost of service, Staff also presented an alternative design consisting of a customer charge of $22 plus a flat volumetric rate,[239] and an alternative inclining block residential rate design with a $22 customer charge and a volumetric charge per therm to increase for usage beyond 50 therms.[240] Staff would particularly like to draw the Commission's attention to **Exhibit Number 284**, since it includes bill impact analyses for the various

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[235] Ex. 208, page 14, line 3. At the time Staff filed its Class Cost of Service Report, this volumetric rate was calculated to be $0.13859 per ccf. However, the volumetric component of the rates for both MGE and Laclede will change based on the revenue requirement outcome of this case, as well as the billing determinants which were stipulated after the filing of Staff's Class Cost of Service Report.
[236] Ex. 208, page 23, lines 1-6.
[237] Ex. 208, page 13, line 19. At the time Staff filed its Class Cost of Service Report, this volumetric rate was calculated to be $0.16338 per therm. However, the volumetric component of the rates for both MGE and Laclede will change based on the revenue requirement outcome of this case, as well as the billing determinants which were stipulated after the filing of Staff's Class Cost of Service Report.
[238] Ex. 208, page 24, lines 1-2.
[239] Exhibits 282, 283, and 284.
[240] Ex. 284. This alternative was requested by Chairman Hall during the hearing on December 15, 2017.

LAC residential rate design alternatives presented by Staff and uses the stipulated billing determinants contained in one of the Stipulations filed on December 20, 2017.

As written, this issue concludes with "what should the transition rates be set at until October 1, 2018?" The answer to this is simple – there should be no pre-October "transition rates," given that there is no reasonable reason to delay implementation of ongoing permanent rates.[241] If rates are set correctly – pursuant to any of the alternatives presented by Staff – there is no need for "transition rates."

> *iii. Reflective of the answer to part i, should LAC's weather mitigated Residential Rate Design be modified to collect a customer charge and variable charge for all units of gas sold, or should it be continued in its current form?*

Although this issue begins with the introductory phrase "Reflective of the answer to part i," the answer to part i is actually irrelevant, given that the resolution of this issue is, or at least should be, independent of the answer to part i. In addition, although the list of issues separated issues ii and iii under Rate Design/Class Cost of Service, as noted above this brief addresses them somewhat jointly given the relationship between customer charges and variable charges and the fact that they should be considered together rather than separately in isolation from each other. Therefore, Staff would refer the Commission to the immediately preceding issue for further discussion of this.

Regardless of whether a revenue stabilization mechanism is implemented, Staff recommends that LAC's "weather mitigated" residential rate design be modified to consist of a customer charge and a per unit charge for all units of gas sold – whether a flat volumetric charge or inclining block volumetric charge (see detailed discussion under preceding issue, and Exhibit No. 284 for bill impacts). As discussed at length

[241] Ex. 236, page 8, lines 6-10.

under the preceding issue, LAC's "weather mitigated" residential rate design contains a customer charge that is significantly too low, and a high winter seasonal volumetric charge for only the first 30 therms – with *no charge* for therms used after 30 in the winter.

Although LAC's residential customer charge is currently set at $19.50, the current LAC "weather mitigated" rate design results in a flat charge of $47.01 for virtually all residential customers in winter billing months (not including PGA). There is no per-therm charge for LAC residential customers in the winter months after the first 30 therms, thus no non-gas (*i.e.,* non-PGA) cost-based price signal to control consumption. Staff's CCOS study indicates, and Staff recommends that *the Laclede customer charge should be increased*; however, Staff also recommends moving to charge customers for all usage, including usage after the 30th therm, which significantly moderates the customer impact of an increase to the customer charge. [242]

For the reasons discussed in detail under the preceding issue, LAC's "weather mitigated" residential rate design should be modified to consist of a customer charge and a per unit charge (flat or inclining block) for all units of gas sold.

-Jeffrey Keevil

J. Pensions and OPEBs

i. What is the appropriate amount of pension expense to include in base rates?

The appropriate amount of pension expense to include in base rates is the amount sufficient to achieve an 80% funded status as calculated by the federal ERISA

[242] Ex. 208, page 20, line 27 through page 21, line 2.

legislation. That amount is $29 million for LAC and $5.5 million for MGE.[243] OPC has indicated that it supports the Staff position on this issue.[244] Spire Missouri requests a 90% funded status as calculated by ERISA.[245]

ERISA's statutory funding minimum is premised on LAC and MGE's pension trusts earning a sufficient amount of return on investment in future years, which eliminates the need for increased funding contributed by ratepayers.[246] Staff's position is a conservative position that relies on statutorily required funding levels, as opposed to Spire Missouri's solution to address uncertain assumptions and market rates used in calculating its pension liability.[247] Spire Missouri's solution to address certain pension related assumptions is to raise rates.[248] This position is contrary to Spire Missouri's witness's own statement that utility industry standard for funding levels was probably 80%.[249]

Spire Missouri spoke often of avoiding Pension Benefit Guaranty Corporation ("PGBC") premiums to justify its higher level of pension expense. PBGC is a federal agency created by ERISA that provides a form of insurance that protects pension benefits in the event of a default by a sponsor of a pension plan.[250] In other words, if a company cannot meet its pension benefit obligations, the PBGC will pay a portion of the pension benefits.[251] PBGC is funded by premiums charged to covered companies,

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[243] Ex. 296, Staff Updated True-Up Accounting Schedules-LAC, Ex. 297, Staff Updated True-Up Accounting Schedules-MGE.
[244] Motion to Late File Position Statements and Amended Statement of Positions filed November 30, 2017.
[245] Ex. 19, *Direct Testimony of Glenn Buck*, p. 9, lines 19-20.
[246] Ex. 231, Rebuttal Testimony of Matthew R. Young, p. 2, lines 6-8.
[247] Ex. 262, Surrebuttal Testimony of Matthew R. Young, p. 4, lines 1-5.
[248] *Id.* at line 6.
[249] Tr. Vol. 20:2092, line 25- 20:2093, line 3.
[250] Ex. 231, Rebuttal Testimony of Matthew R. Young, p. 6, lines 2-3.
[251] *Id.* at lines 3-5.

including LAC and MGE.[252] However, for each additional $1,000 dollars in ratepayer funded contributions, Spire Missouri would only save $34 dollars in PBGC costs.[253] The benefits over contributions over 80% in reduced PBGC costs would not outweigh the increased pension costs ratepayers would face. Staff also believes that future PBGC premiums can be avoided by an increase in the market return earned by the pension assets, which would eliminate the need to increase pension expense for customers to minimize PBGC premiums.[254] As pension expense is also tracked, there is no danger Spire Missouri will not be able to meet future funding requirements.[255] The Commission should adopt an 80% ERISA funding level to balance the needs of ratepayers and still allow Spire Missouri to fulfill its pension obligations.

ii. What is the appropriate amount of the LAC and MGE pension assets?

As of the September 30, 2017 true-up date, LAC's pension asset is $131,393,693 and MGE's pension liability is $28,440,981. LAC's pension asset excludes FAS 87 amounts deferred prior to September 1, 1994, and FAS 88 gains recognized from September 1, 1994, to September 1, 1996.[256] OPC agrees with Staff's position on excluding the prepaid assets.[257] Spire Missouri would have ratepayers pay an additional 29 million for assets that its own cases had removed from rate base previously, and its witnesses had agreed were accounted for financial reporting purposes and not ratemaking purposes.

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[252] *Id.* at lines 5-6.
[253] *Id.* at 10-11.
[254] Ex. 262, Surrebuttal Testimony of Matthew R. Young, p. 6, line 21 – p. 7, line 3.
[255] Tr. Vol. 20:2145, line 23- 20:2146, line 3.
[256] Ex. 204, *Staff Direct Cost of Service Report with Appendices (Confidential)*, p. 67, lines 8-17.
[257] Tr. Vol. 20:2067, lines 4-8.

LAC adopted FAS 87 for financial reporting purposes in 1987, however FAS 87 was not used for regulatory purposes prior to the effective date of rates in Case No. GR-94-220.[258] Similarly, prior to September 1, 1996, the first effective date of rates from Case No. GR-96-193, FAS 88 was not included in LAC's cost of service.[259] A glance at the supporting testimony from the period shows that parties were using a cash contribution method, and not FAS 87 or FAS 88 accrual accounting for ratemaking purposes. In GR-90-120, Staff witness Mr. Stephen Rackers analyzed cash contributions to make his recommendation.[260] Mr. Rackers stated in his direct testimony that cash contributions were approximately equal to the pension cost as calculated under FAS 87, so no adjustment was necessary.[261] Contrary to Spire Missouri's claim that Mr. Rackers was utilizing FAS 87 expense, Mr. Rackers simply did not make an adjustment as FAS 87 and the cash contribution amounts were the same. In the same testimony, Mr. Rackers discusses contribution amounts required, but explains that, as the fund was funded in excess of 72% of the accumulated benefit obligation and 39% in excess of the projected benefit obligation, that no contributions were required.[262] Nowhere in Mr. Racker's testimony is an acceptance of FAS 87 accrual accounting for ratemaking purposes, in fact, Mr. Rackers seems to be examining cash contributions when making each of his recommendations. Mr. Rackers again uses the cash contribution method in a subsequent 1992 LAC case.[263] Mr. Rackers states the Staff used a contribution approach in determining the appropriate level of pension

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[258] Ex. 204, *Staff Direct Cost of Service Report with Appendices (Confidential)*, p. 67, lines 8-12.
[259] *Id.*
[260] *In the Matter of Laclede Gas Company of St. Louis, Missouri for Authority to File Tariffs Increasing Rates for Gas Service Provided to Customers in the Missouri Service Area of the Company.*
[261] Ex. 276, *Direct Testimony of Stephen R. Rackers, Case No. GR-90-120.*
[262] *Id.* at p. 10, lines 17-28.
[263] *In the Matter of Laclede Gas Company for Authority to File Tariffs to Increase Rates for Gas Service in Missouri,* Case No. GR-92-165.

expense.[264] He reiterates this on page eight of his direct testimony, referencing minimum ERISA cash contributions to base qualified pension on, and basing Supplemental and Director's pensions on actual cash payments.[265] Furthermore, in the same 1992 case, LAC's own witness Mr. Mark Waltermire recommended cash contributions. Mr. Waltermire states that for financial reporting purposes only, the Company records its pension cost on an accrual basis in accordance with GAAP.[266] However, he states Laclede used annualized contribution levels as the appropriate basis for establishing rates.[267] Mr. Waltermire further states that using cash contributions is in line with other Commission decisions from the period, including a *Report and Order* issued in Kansas City Power and Light Company's 1991 rate case.[268] Mr. Waltermire also requests the Commission make a statement that cash contributions was the most appropriate method for establishing rates for future rate proceedings, implying that LAC intended on using the cash contribution method beyond the 1992 case.[269] Mr. Waltermire wrote direct testimony in the 1996 case that further supports Staff's position. Mr. Waltermire, still working on behalf of LAC, stated that the prepaid pension asset included in rate base represents account balances that have occurred since September 1, 1994, the effective dates of tariffs in Case No. GR-94-220.[270] Mr. Waltermire further stated that prior to September 1, 1994, the cost of service included pension expense determined on a cash contribution basis.[271] Staff confirms this historical treatment in a case in 1998, stating that FAS 87 was not used for rate

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[264] Ex. 277, *Direct Testimony of Stephen M. Rackers, Case No. GR-92-165*, p. 6, lines 1-2.
[265] *Id.* at p. 8, lines 5-6.
[266] Ex. 278, *Direct Testimony of Mark D. Waltermire, Case No. GR-92-165,* p. 5, lines 13-18.
[267] *Id.* at lines 19-27.
[268] *Id.* at p. 7, lines 21-27.
[269] *Id.* at p. 9, lines 15-19.
[270] Ex. 262, Surrebuttal Testimony of Matthew R. Young, p. 9, lines 13-18.
[271] *Id.* at p. 10, lines 3-6.

making purposes for LAC prior to Case No. GR-94-220, and the pension cost should only include accumulated cash flow difference between FAS 87 pension cost and the cash contributions after the effective date of rates in that case, which is September 1, 1994.[272] Twenty years later, Spire Missouri is now trying to rewrite history and challenge the removal of those prepaid pension assets for the first time.

Spire Missouri tried to refute Staff's claim that this issue is moot, and that LAC had not challenged the removal of those prepaid pension assets for 20 years by stating that those cases had settled.[273] Staff's review of the accounting schedules produced by both Staff and LAC between October 1, 1987, and September 1, 1994, found that both parties did not itemize a pension asset in rate base.[274] Spire Missouri attempted to refute Staff's assertion during the hearing by producing Spire Exhibit 62. Exhibit 62 shows LAC's accounting schedules included a pension asset in rate base in its 1994 rate increase request. However, Spire's exhibit is not irrefutable evidence that rates included a deferred pension asset in the 1994 case. Instead, Spire's exhibit serves to illuminate the reason Staff chose to explain its support for a pension asset in rate base in LAC's subsequent rate case in 1996.[275] In the 1996 case, Staff's direct testimony presents its support for a pension asset in rate base, but only beginning with the conclusion of the 1994 case, which is consistent with LAC's position on the pension asset amount in the 1996 rate case.[276] In other words, in their 1996 accounting schedules, LAC and Staff both removed the pre-1994 asset for ratemaking. Staff's 1996 direct testimony clearly shows Staff did not support a pension asset in LAC's 1994 rate

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[272] *Id.* at 11, lines 17-23.
[273] Tr. Vol. 20:2119, lines 11-15.
[274] Ex. 262, Surrebuttal Testimony of Matthew R. Young, p. 8, lines 20-22.
[275] Ex. 262, Surrebuttal Testimony of Matthew R. Young, p. 9, line 23-10, line 22
[276] *Id.*

case. Spire Missouri's single exhibit also does not contradict that cash contributions were used in the 1990 and 1992 LAC cases discussed above.

Spire's response to Staff's criticism on its lack of responsive testimony also ignores how rate cases proceed. It is not typical for rates cases to settle prior to rebuttal testimony being filed.[277] In fact, rebuttal testimony was filed by LAC in the 1999 Laclede case, the 2002 Laclede case, and the 2010 Laclede case.[278] In the 1999 case and the 2002 case, Staff discussed the reduction to prepaid pension asset in its direct, but LAC did not address those adjustments in its rebuttal testimony.[279] Staff included the reduction to the prepaid asset in its work papers in the 2010 case, but did not discuss it in direct.[280] LAC did not address the adjustment in its rebuttal testimony.[281] As Staff witness Mr. Matthew Young testified, parties write testimony, including rebuttal testimony, as if cases will not settle.[282]

Staff's long standing adjustment to remove the pre-1994 prepaid pension asset for FAS 87 and September 1, 1994, to September 1, 1996, prepaid pension asset for FAS 88 should be upheld.

iii. How should pension regulatory assets be amortized?

Staff believes an eight year amortization period is appropriate. Spire Missouri stated in position statements that an eight year amortization period is appropriate.[283] Counsel for OPC represented in opening statements that OPC would be willing to go

[277] Tr. Vol. 20:2142, lines 19-24.
[278] *See* GR-99-315, GR-2002-356, and GR-2010-0171.
[279] *See* GR-99-315 and GR-2002-356.
[280] *See* GR-2010-0171.
[281] *Id.*
[282] Tr. Vol. 20:2143, lines 4-9.
[283] *See* Statement of Position of Laclede Gas Company, filed November 30, 2017.

eight years for an amortization period.[284] It appears a consensus has been reached among the parties participating in this issue, but Staff reserves the right to respond in reply brief to any argument on this issue.

iv. Should the prepaid pension asset be funded through the weighted cost of capital or long-term debt?

Staff currently has accounted for the prepaid pension asset with a weighted cost of capital in its accounting schedules.

-Nicole Mers

K. Supplemental Executive Retirement Plan (SERP)

i. What is the appropriate amount of SERP expense to include in base rates?

The appropriate amount of SERP expense is $468,731.[285] Spire Missouri's direct case recommends $575,000[286] but indicated agreement with Staff's adjustment.[287] OPC's position is the outlier, coming in at $24,097, a value far below Staff and Spire Missouri.[288] Staff and Spire Missouri, recognizing that lump sum SERP payments are the most common way that employees elect to receive their benefits, have included lump sum SERP payments.[289] OPC's witness, Mr. Charles Hyneman, believing that lump sum payments are erratic, nonrecurring, and difficult to predict, has excluded them from Spire Missouri's cost of service.[290] Mr. Glenn Buck, and the Union witness,

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[284] Tr. Vol. 20:2066, lines 2-3.
[285] Ex. 296, Staff Updated True-Up Accounting Schedules-LAC and Ex. 297, Staff Updated True-Up Accounting Schedules-MGE.
[286] Tr. Vol. 20:2220, lines 12-15.
[287] Tr. Vol. 20:2219, lines 11-12.
[288] Ex. 425, Surrebuttal Testimony of Charles R. Hyneman, p. 38, line 3.
[289] Tr. Vol. 20:2213 line 22 through 20:2214, line 7.
[290] Ex. 425, Surrebuttal Testimony of Charles R. Hyneman, p. 33, lines 15-19.

Mr. Mark Boyle's experience[291] is that lump-sums are more commonly elected by retirees than annuities. Mr. Hyneman's reliance on the Staff position in Case No. ER-2012-0174, that recognized SERP as a unique expense due to being additional executive pension benefit, is misplaced and has not been Staff's position in prior Laclede rate cases.[292]

Because of the reality that most employees take SERP expense as a lump sum, many of Mr. Hyneman's claims can be dismissed. For example, his table on page 36 of his surrebuttal testimony is not an accurate table. Mr. Hyneman illustrates his example with only one SERP retiree taking a lump sum, when in fact, the reality would be that only one SERP retiree would take an annuity.[293] Mr. Hyneman ignores the reality of historical lump sum SERP payments that Spire Missouri has incurred. As opposed to Mr. Hyneman's hypothetical retirees, Staff witness Mr. Matthew Young produces a historical chart on page 21 of his surrebuttal testimony.

Fiscal Year[294]	2010	2011	2012	2013	2014	2015	2016
No. of Lump-Sums	1	3	2	4	2	2	1
No. of New Annuities	0	0	0	0	0	0	0

Mr. Hyneman may state Staff is including expenses that are not known and measurable,[295] but it appears Mr. Hyneman is in fact the one ignoring the known and measurable historical evidence, and thus violating a ratemaking principle. Mr. Hyneman instead claims, contrary to the evidence, that lump sum SERP payments are

[291] Tr. Vol. 20:2180, lines 3-13.
[292] Ex. 410, Rebuttal Testimony of Charles R. Hyneman, p. 17, lines 7-9.
[293] *Id*.
[294] Ex. 425, Surrebuttal Testimony of Charles R. Hyneman, p. 38, lines 22-23.
[295] Ex. 425, Surrebuttal Testimony of Charles R. Hyneman, p. 34, lines 15-22.

irregular.[296] Mr. Hyneman also claims lump sum SERP payments are excessive,[297] yet can only point to one payment that he adjusted for being "excessive" under his standards.[298] Mr. Hyneman, when accusing Staff of not following ratemaking principles, seems to forget that annualizing and normalizing expenses are common ratemaking tools.[299] Staff uses normalization and annualization on many items that, under Mr. Hyneman's refusal to accept normalization or averages for items that vary from year to year and desire to call them not known or measurable,[300] would be excluded from rate base. For example, injuries and damages is a highly volatile expense that is sporadic in nature but is included in rate base as a normalized expense.[301] Mr. Buck points to uncollectible expense, along with uncollectible accounts, as examples.[302] He also notes Ameren Missouri's Callaway refueling expense, which occurs every 18 months.[303] Under Mr. Hyneman's logic, if Ameren Missouri's Callaway refueling expense occurred outside the test year, despite being a reoccurring cost in which past known and measurable amounts can be used to produce a normalized average, the entire amount of refueling expense would be excluded as outside the test year and not known and measurable. Mr. Hyneman's approach is incorrect, as these costs are known and measureable because they have already been incurred and the size of each payment is certain.[304] Staff's understanding of known and measurable is the same as the Commission's, as evidenced by the inclusion of expenses incurred shortly outside the

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[296] Ex. 410, Rebuttal Testimony of Charles R. Hyneman, p. 17, lines 7-9.
[297] *Id.*
[298] Ex. 425, Surrebuttal Testimony of Charles R. Hyneman, p. 38, lines 22-23.
[299] Ex. 21, Surrebuttal Testimony of Glenn Buck, p. 18, lines 21-22.
[300] Ex. 410, Rebuttal Testimony of Charles R. Hyneman, p. 23, line 14 through p. 24, line 3.
[301] Ex. 264, Surrebuttal Testimony of Matthew R. Young, p. 22, lines 1-6.
[302] Ex. 21, Surrebuttal Testimony of Glenn Buck, p. 19, lines 1-5.
[303] *Id.*
[304] Ex. 264, Surrebuttal Testimony of Matthew R. Young, p. 20, lines 20-21.

test year the Commission finds are known and measurable. For instance, in Case No. ER-2014-0370, Kansas City Power and Light Company ("KCPL") requested the Commission exclude test-year revenues from a contract with KMEA, as the contract would be expiring.[305] However, the expiration of the contract would be outside of the test year, and traditionally, items and events outside of the test year are not included in the Company's cost of service analysis. The Commission found that revenues that KCPL would lose were known and measurable, since it was known the contracts would expire on September 30, and the amount of revenues lost was measurable.[306] This is the Commission definition of known and measurable, and the one Staff uses, if an expense, or loss of an expense in the KCPL case, has been incurred, and if the size of the expense is certain, or measurable. Normalization allows SERP expense, along with payroll, injuries and damages, and refueling costs to become measurable by examining historical expenses under Missouri's historical test year model to predict a going-forward amount.[307]

Staff believes accounting for SERP expense under the traditional ratemaking method, and on a case by case basis is appropriate. Under these circumstances, excluding lump sum SERP payments would exclude most of the SERP expense Spire Missouri incurs with the result of artificially lowering SERP expense.[308] Since Staff and OPC reflect cash payments in rates, rather than FAS 87 accruals, it is inappropriate for the same parties to not recognize payments from lump sum elections in rates.[309] As

[305] *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service*, File No. ER-2014-0370, **Report and Order** issued September 2, 2015.
[306] *Id.* at p. 106.
[307] Ex. 264, Surrebuttal Testimony of Matthew R. Young, p. 22, lines 1-6.
[308] Tr. Vol. 20:2214, lines 8-11.
[309] Ex. 20, Rebuttal Testimony of Glenn W. Buck, p. 15, lines 4-6.

OPC has not put forth evidence that the actual lump sum costs are unreasonable or imprudently incurred, it is not appropriate to ignore them and to not include some form of lump sum SERP payments in rates.

ii. Should SERP payments be capitalized to plant accounts?

SERP payments should not be capitalized, and neither Staff nor Spire Missouri has capitalized SERP payments. However, the accrued service cost relating to SERP expense is appropriate for capitalization. A service cost is the amount of a cost that is booked in the current rate period for obligations that will be paid in future periods.[310] FAS 87 ratably accrues service costs over the life of an employee's employment.[311] FAS 87 expense calculates what the pension is going to be at the end of an employee's career, which they know is going to be based on where that employee is today.[312] Spire Missouri discounts it back to today, figures out the portion that ratably is charged to expense over those years, for instance, 1/30 for a 30 year career, and expenses that portion of the service cost.[313] GAAP allows for the service cost component of FAS 87 SERP expense to be capitalized, under current and upcoming guidance.[314] This is consistent with Staff's previous positions in LAC rate cases that allow for capitalized SERP costs.[315]

-Nicole Mers

L. Income Taxes

i. What is the appropriate amount of accumulated deferred income tax to include for LAC and MGE?

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[310] Tr. Vol. 20:2213, lines 11-15.
[311] Tr. Vol. 20:2212, lines 20-22.
[312] Tr. Vol. 20:2212, line 23 through 20:2213, line 1.
[313] *Id.* at lines 2-6.
[314] Tr. Vol. 20:2211, line 15 through 20:2212, line 1.
[315] Ex. 264, Surrebuttal Testimony of Matthew R. Young, p. 19, lines 20-22.

As Issue (i) has been agreed to by the parties,[316] the only remaining contentious issue is Issue (ii), the appropriate amount of accumulated deferred income tax ("ADIT") to include. Deferred income taxes arise from temporary differences between the book and tax treatment of an item of income or expense.[317] Under well-established regulatory principles, deferred taxes are treated as a reduction to rate base so ratepayers do not pay a return on funds provided to the company at no cost.[318] In that way, ratepayers are given the benefit of what is, in effect, an interest free loan from the government to the utility.[319] In other words, the benefit the company receives from being able to keep money by delaying payment to the government is passed along to ratepayers. Staff believes the appropriate amount of ADIT to include is $338.6 million as an offset to rate base.[320] This excludes approximately $54.3 million of rate base dollars of FIN 48 liability, which, if excluded, has the impact of increasing revenue requirement by $5 million.[321] FIN 48 liability stems from uncertain tax positions that are in open tax years.[322] In other words, the Company may ultimately have to pay additional tax on these uncertain tax positions if the Internal Revenue Service (IRS) at some point rules against the Company's position.[323] At this time, a deduction was taken for these items and those taxes have not been paid. The IRS has the ability to audit the Company's open tax positions, which is why these are labeled open years.[324] Open years can still be challenged by the IRS, which means the Company could pay higher taxes if the

[316] Tr. Vol. 16:1074, lines 22-25.
[317] Ex. 204, *Staff's Direct Cost of Service Report with Appendices (Confidential)*, p. 72, lines 15-21.
[318] *Id.* at lines 22-24.
[319] *Id.*
[320] Tr. Vol. 16:1083, line 11.
[321] Tr. Vol. 16:1082, lines 13-15.
[322] Tr. Vol. 16:1081, lines 8-13.
[323] *Id.*
[324] *Id.*

IRS does not agree with the deduction the Company has taken on these items in its tax returns.[325] The IRS cannot challenge closed years, as their review has been finalized. Once a year has been closed and the IRS has not challenged the position, the known and measurable final amount is put into rates when the next rate case occurs.[326] Generally Accepted Accounting Principles ("GAAP") allow the Company to record as a deferred tax only the portion of tax liability upon which the Company expects to prevail.[327]

OPC wishes to include the FIN 48 liability in ADIT. However, this is contrary to prior Commission precedent. In Case No. ER-2008-0318, Staff made the same proposition OPC makes in this case; that all uncertain tax positions are treated as ADIT, and used to offset rate base.[328] The Commission found that both ratepayers and shareholders benefit when a company takes uncertain tax positions with the IRS, since saving money on taxes benefits the company's bottom line but also reduces the amount of tax expense the ratepayers must pay.[329] The Commission found the best way to encourage a company to pursue uncertain tax positions was to treat the company fairly in the regulatory process.[330] The Commission in this case should also treat Spire Missouri fairly by allowing uncertain tax positions, or FIN 48 liability, to be excluded from rate base and ADIT. OPC did not present any facts or evidence that a contrary decision should be reached. If Spire Missouri is successful with those uncertain tax positions, ratepayers benefit from reduced tax expense. Excluding FIN 48 liability

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[325] *Id.*
[326] Tr. Vol. 16:1083, lines 12-20.
[327] Tr. Vol. 16:1081, lines 8-13.
[328] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No, ER-2008-0318, **Report and Order** issued January 27, 2009 at p. 54.
[329] *Id.* at p. 55.
[330] *Id.*

from ADIT, and setting the ADIT amount as outlined in Staff's accounting schedules, encourages Spire Missouri to continue to take uncertain tax positions that benefit ratepayers.

-*Nicole Mers*

M. Incentive Compensation for Employees

i. *What level of expense should be included in the cost of service to account for incentive compensation plans utilized by LAC/MGE?*

Incentive compensation for union employees is appropriate to include in rates. This should eliminate the concerns in the testimony of Union witness Mr. Mark Boyle.[331] Spire Missouri's overall incentive compensation package for nonunion employees is heavily weighted towards financial metrics, and contains individual metrics that are vague, not designed to incent an employee to perform at a level higher than what is required for their base salary, and are not linked to ratepayer benefit. As a whole, this incentive compensation does not meet prior Commission standards, and should be excluded from rates.

ii. *What criteria should be applied to determine appropriate levels of employee incentive compensation?*

In accordance with prior Commission precedent, Staff evaluated incentive compensation to determine if the individual metrics produced a benefit to Missouri ratepayers and incented employees to perform duties at a level above the minimum required. Staff witness Matthew Young examined Spire Missouri's incentive compensation package for nonunion employees as a whole under five Commission articulated standards. On a whole, Spire Missouri's incentive compensation for

[331] *See* Ex. 900, Rebuttal Testimony of Mark Boyle.

nonunion employees did not meet the articulated standards, and should be disallowed from rates.

The first two articulated standards Staff applied to the nonunion employee individual incentive compensation package was if the goal provides the employee an incentive to perform at a level above what is already required for the applicable job title and if a goal requires improvement over past performance.[332] The Commission articulated this standard in Ameren Missouri's 1987 rate case. The Commission disallowed portions of the incentive compensation package stating, "an acceptable management performance plan should contain goals that improve existing performance."[333] The Commission has followed that line of thinking in more recent cases. In 2006, the Commission upheld Staff's use of straightforward criteria that at a minimum, an acceptable management performance plan should contain goals that improve existing performance.[334] The Report and Order in Empire's case further states "for incentive pay, the Staff used criteria espoused in a previous Commission order to analyze the goals on which the incentive pay was contingent. To be included in cost of service, Staff asserts that incentive compensation should be the result of employees performing beyond basic job requirements and provide a benefit to ratepayers."[335] The Commission also supported Staff's removal of incentive compensation awarded for "performing normal duties."[336]

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[332] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 27, lines 5-6.
[333] *In the Matter of Union Electric Company,* 29 Mo. P.S.C (N.S.) 313, 325 (Report & Order, 1987.)
[334] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 46.
[335] *Id.* at p. 46-47.
[336] *Id.* p. 48.

To truly be an incentive compensation package, and not just base salary under a different name, a portion of each employee's incentive compensation must truly be at risk, not guaranteed.[337] If goals are set that do not challenge an employee to perform above what is required, that incentive compensation is not at risk, but guaranteed.[338] It is Staff's position that guaranteed compensation does not incent superior performance so cannot incent superior quality of service. Base salary covers a normal level of performance.[339] Base salary does not leave any compensation at risk;[340] therefore, the minimum job duties or requirements of a position are expected to be included in base salary.

The argument put forth in Spire Missouri witness Mr. Mark Mispagel's rebuttal testimony that requiring improvement over past performance is unattainable is contrary to Commission precedent, and fails to recognize the underlying assumption that for individual incentive compensation to benefit ratepayers, it should make improvements to service quality and safety. As Mr. Young testified at hearing, requiring improvement from past performance is "based on the assumption that the company is attempting to identify areas of improvement."[341] Once Spire Missouri has reached a level where no improvement is possible, individual metrics should begin focusing on another area of concern.[342]

The third articulated standard Staff applied to the nonunion employee individual incentive compensation package was if the goal was objective and measurable.[343] The

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[337] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 27, lines 17-23.
[338] *Id.*
[339] Tr. Vol. 22:2719, lines 8-9.
[340] *Id.* at lines 21-23.
[341] Tr. Vol. 22:2717, lines 6-8.
[342] *Id.* at lines 12-13.
[343] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 27, lines 5-6.

Commission generally does not allow employee incentive compensation that does not have some reasonable degree of measurability.[344] In the 1987 Ameren Missouri rate case, the Commission stated, "the benefits of the plan should be ascertainable and reasonably related to the incentive plan."[345] The Commission has also found it reasonable that Staff used objective criteria to evaluate the plan and excluded the portion of individual incentive compensation that is not ascertainable or objective and lacked objective criteria in a 2006 Empire rate case.[346] The Staff in that case used criteria espoused in a previous MGE Report and Order to analyze goals on which the incentive pay was contingent.[347] The Commission stated that it "does understand the Staff's discussion of the use of objective criteria that it can apply even-handedly."[348] The Commission in 2007 again upheld the Staff and the US Department of Energy's removal of incentive compensation not tied to specific, ascertainable goals.[349] Those Commission precedents are still valuable today to encourage utilities to develop individual metrics for incentive compensation packages that are objective and measurable, to clearly show the benefit the objective has to ratepayers, and allow Staff to confidently include that portion of a plan in rates.

Staff did not receive clear, objective, or measurable metrics for a substantial portion of the individual performance metrics.[350] Examples used in Mr. Young's

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[344] Ex. 403, Direct Testimony of Charles R. Hyneman, p. 19, lines 13-14.
[345] *In the Matter of Union Electric Company,* 29 Mo. P.S.C (N.S.) 313, 325 (Report & Order, 1987).
[346] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 46.
[347] *Id.*
[348] *Id.* at p. 49.
[349] *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan*, Case No. ER-2007-0291, **Report and Order** issued December 6, 2007, p. 51.
[350] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 29, lines 7-8.

surrebuttal testimony are illustrative and representative, but no one metric listed is the reason Staff disallowed the entirety of individual nonunion incentive compensation.[351] Counsel for Spire Missouri tried to refute Staff's removal of metrics for being vague by implying Mr. Young did not look at the details of objectives, merely the title of the objective.[352] The information provided to Mr. Young via Staff data requests was much less detailed than the document counsel for Spire Missouri used to cross examine Mr. Young. Mr. Young noted this several times throughout his examination.[353] For example, Spire Missouri did not provide detailed objectives or individual evaluations.[354] Neither did Spire Missouri provide the threshold targets and the high achievement levels in its data request responses.[355] Just a general objective was provided, with no target performance or detailed objectives.[356] For instance, in surrebuttal testimony, Mr. Young noted an objective that simply stated **

. **[357] Mr. Young noted this was exactly how Spire Missouri provided the objective to Staff in the data request.[358] In determining each contested issue, the Commission should be ever mindful that the law places the burden of proof on the Company. Section 393.150.2, RSMo., provides:

> At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . gas corporation . . . and the commission shall give to the hearing and decision of such questions

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[351] Tr. Vol. 22:2703, lines 5-7.
[352] "Q. You were just looking at the title of the objective?" Tr. 22:2709, lines 6-7, "Q: Sure. Because you only looked at the title of the objective. It's like looked -- you looked at the title of a book and now you" Tr. Vol. 22:2710, lines 5-7.
[353] Tr. Vol. 22:2715, lines 8-9.
[354] Tr. Vol. 22:2711, line 24 through 2712, line 2.
[355] Tr. Vol. 22:2707, lines 15-18.
[356] Tr. Vol. 22:2709, lines 4-5, and lines 12-13.
[357] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 29, lines 9-10.
[358] *Id.*

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preference over all other questions pending before it and decide the same as speedily as possible.

In its most basic sense, the burden of proof is "that of establishing the affirmative of the ultimate issue [.]"[359] This burden never shifts away from the Company.[360] As the party who holds all of the information, it is in Spire Missouri's interest to support its case by providing thorough responses to data requests.[361] Staff may not be aware of the existence of documents that further detail objectives, may not know the data exists if not provided,[362] and will take Spire Missouri at its word that it has provided all the information it has in its possession regarding incentive compensation in response to Staff's data requests and discovery. For example, counsel for Spire Missouri questioned Mr. Young at hearing if he knew whether estimated to-dos for an employee were being completed prior to this year (2016).[363] Mr. Young answered he did not know.[364] Mr. Young did not know the answer to this because he took Spire Missouri at its word when it responded to discovery that it could only provide the individual objectives for plan year 2016.[365] Spire Missouri did not meet its burden of proof in producing objective metrics for Staff to evaluate, and cannot decry Staff's decision to remove vague and subjective metrics, as supported by prior Commission decisions, by confronting a Staff witness using information not provided to Staff in response to Staff's incentive compensation discovery or provided in its testimony.

Staff also disallowed arbitrary awards, those discretionary incentive compensation payouts for "exceptional company performance" for the same reasons it

[359] ***Been v. Jolly,*** 247 S.W.2d 840, 854 (Mo. 1952).
[360] *Id.*
[361] Tr. Vol. 22:2743, lines 5-11.
[362] Tr. Vol. 22:2743, lines 12-14.
[363] Tr. Vol. 22:2718, lines 20-22.
[364] *Id.* at line 23.
[365] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 30, lines 12-13.

disallowed subjective or unmeasurable metrics. [366] The Commission has previously excluded discretionary incentive compensation payout as well.[367]

The fourth articulated standard Staff applied to the nonunion employee individual incentive compensation package was the goal related to Missouri regulated operations.[368] The Commission has indicated its preference to assign shareholders incentive compensation costs if incentives are based on earnings that represent total company operations or based on non-Missouri regulated or unregulated activities. The Commission upheld Staff's removal of incentive compensation costs related to non-regulated activities, activities not related to the provision of retail electric service, and activities related to non-Missouri regulated acquisition activities.[369] The Commission expressed its concerns over focusing on total earnings per share and nonregulated operations in a KCPL case, stating:

> What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.[370]

By definition, any metric based on Earnings per Share is also based on the performance of all of Spire's subsidiaries, because Spire is the only entity that has shares outstanding. Also, Staff found that certain executives had individual goals based

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[366] Ex. 204, Staff Direct Cost of Service Report with Appendices (Confidential), p. 104, lines 9-13.

[367] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 49.

[368] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 27, lines 5-6.

[369] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 47-48.

[370] *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan*, Case No. ER-2007-0291, **Report and Order** issued December 6, 2007, p. 49-50.

on Spire's achievement of earnings.[371] Spire's earnings include the performance of non-regulated and non-Missouri business units of Spire.[372] Still other goals were tied to the performance of Spire's Alabama and Mississippi operations.[373] In accordance with prior Commission practice, and because goals related to non-regulated and non-Missouri operations do not further the last standard of linking incentive compensation to ratepayer benefit, they should be excluded from rates.

The final articulated standard Staff applied to the nonunion employee individual incentive compensation package was the goal, if achieved, directly linked to overall ratepayer benefit.[374] The Commission has stated if the method a utility chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service.[375] The Commission has removed incentive compensation costs that had too tenuous a relationship between the goals of the compensation plan and ratepayer benefits.[376] The prior case is not the first time the Commission found in favor of Staff's exclusion of incentive compensation that did not provide a benefit to ratepayers.[377] Much like other items booked above the line, incentive compensation must provide a benefit to ratepayers. Individual goals can be structured in a way that creates a risk that leads to deterioration of service quality, like substantially cutting costs in the customer service

[371] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 30, lines 5-7.
[372] *Id.*
[373] Ex. 204, Staff Direct Cost of Service Report with Appendices (Confidential), p. 103, lines 18-19.
[374] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 27, lines 5-6.
[375] *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan*, Case No. ER-2007-0291, **Report and Order** issued December 6, 2007, p. 50.
[376] *Id.* at p. 51.
[377] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 47.

area that could result in a reduction to customer service quality.[378] The Commission needs a finding that attainment of those criteria benefits customers and furthers the ability of the utility to provide safe and adequate service.[379]

Staff found several goals that cannot be directly linked to the benefit of ratepayers. Financial metrics was a large portion, and is discussed in detail below. Other metrics that can only be tenuously linked with ratepayer benefit included metrics such as **

. ** [380] The Commission should disallow metrics so tenuously tied to ratepayer benefit.

Staff evaluated Spire Missouri's incentive programs as a whole. The most recent Commission precedent regarding incentive compensation as a litigated issue states that an incentive compensation program must stand or fall as a program.[381] The Commission stated, "If the overall program is appropriate, AmerenUE should be able to recover the cost of that program through rates. If the overall program is unacceptable, then the entire program will be excluded from rates."[382] Spire Missouri's nonunion incentive compensation program fails overall. 50% of the individual metrics are based on earnings per share.[383] The remaining 50% are, overall, vague, subjective individual metrics that do not incentivize employees to improve beyond past performance, or even

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[378] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 31, lines 11-14.
[379] Ex. 403, Direct Testimony of Charles R. Hyneman, p. 19, lines 14-16.
[380] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 32, chart.
[381] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p. 90.
[382] *Id.*
[383] Tr. Vol. 22:2692, lines 13-14.

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beyond their basic job function. Spire Missouri's incentive compensation plan for nonunion employees should be excluded from rates.

iii. Earnings Based Incentive Compensation-Should LAC and MGE be permitted to include earnings based and/or equity based employee incentive compensation amounts in base rates?

Spire Missouri should not recover earnings based/or equity based employee incentive compensation amounts, as such incentives align the interest of employees with shareholder interest. Earnings-based incentives are incentives based on net income, return on equity, and increases in stock prices, most commonly.[384] The primary shareholder interest is wealth maximization, which is not a ratepayer interest. This policy extends to stock based compensation as well, which Spire Missouri is also requesting recovery of in rates. Shareholders should bear the costs of incentive compensation designed to benefit shareholders.

The Commission has a long history of removing earnings based employee incentive compensation amounts from rates. In Case No. GR-96-285, the Commission found that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth maximization, and it is not significantly driven by the interests of ratepayers.385 The Commission disallowed MGE's incentive compensation costs again in 2004, Case No. GR-2004-0209. MGE argued, much as Spire Missouri does in this case, that:

> [I]ts compensation plan is simply a portion of the means that it has chosen to pay its employees. It contends that nothing in the incentive compensation plan would harm ratepayers. On the contrary, MGE contends that its

[384] Ex. 403, Direct Testimony of Charles R. Hyneman, p. 21, lines 14-15.
[385] *In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Service Area*, Case No. GR-96-285.

incentive compensation plan encourages the efficient operation of the company to the benefit of both shareholders and ratepayers. MGE argues that it needs its incentive compensation plan to be able to compete with other companies for top employees. Furthermore, it contends that its decision to either pay its employees a straight salary or to offer incentives is simply a matter for its business judgment and should not be of concern to the Commission.[386]

The Commission stated in its Report and Order that:

> The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. Those financial incentives seek to reward the company's employees for making their best efforts to improve the company's bottom line. Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed some actions that might benefit a company's bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers.
>
> If the company wants to have an incentive compensation plan that rewards its employees for achieving financial goals that chiefly Benefits shareholders, it is welcome to do so. However, the shareholders that benefit from that plan should pay the costs of that plan. The portion of the incentive compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.[387]

The Commission has excluded earnings per share across the utility industry. The Commission upheld Staff's removal of incentive payments for goals related to financial performance and goals related to earnings, because those goals primarily benefit shareholders.[388] The Commission also upheld Staff's removal of stock options that focus executives' efforts on dividend maximization, with no direct connection to improvement

[386] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate increase for Natural Gas Service, Case No. GR-2004-0209,* Report and Order issued September 21, 2004, p. 42-43.
[387] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service*, Case No. GR-2004-0209, **Report and Order** issued September 21, 2004, p. 43.
[388] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 46-47.

in operating performance or quality of service to the ratepayers.[389] Another case the next year had a similar outcome. KCPL used the same argument Spire Missouri makes in this case.

KCPL witness Michael Halloran, a consultant with Mercer Human Resource Consulting, testified that the uses of short-term and long-term incentives are powerful tools to benefit both customers and shareholders. The use of financial measures is a very effective way to reflect performance on a broad range of customer service measures. In particular, a program that focuses on the achievement of Earnings Per Share is beneficial for customers and shareholders.173 The theory is because KCPL is a regulated public utility, the organization is committed to its responsibility to achieve its EPS through the provision of efficient, clean, safe and affordable electricity. Therefore, EPS is an important measure of performance and productivity in areas related to product and service delivery.[390]

The Commission held against KCPL's specialized human resource witness, stating,

> KCPL has the right to tie compensation to EPS. However, because maximizing EPS could compromise service to ratepayers, such as by reducing maintenance, the ratepayers should not have to bear that expense…Even KCPL admits it is hard to prove a relationship between earnings per share and customer benefits. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service.[391]

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[389] *Id.* at 47.

[390] *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan*, Case No. ER-2007-0291, **Report and Order** issued December 6, 2007, p. 48-49.

[391] *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan*, Case No. ER-2007-0291, **Report and Order** issued December 6, 2007, p. 49.

The Commission's rationale that earnings based metrics align employees' interest with shareholders' interest, and that the incentive to maximize earnings can negatively impact ratepayers is sound public policy that should be continued.

For instance, corporate based earnings provide an incentive for management to focus on the non-Missouri regulated portions of the overall corporate structure, which includes non-regulated business segments and out-of-state utilities, which could be detrimental via reduced focus on Missouri-regulated ratepayers.[392] Worries about reductions in quality of service are not farfetched, as Spire Missouri's current incentive compensation plan allows poorly performing employees that do not meet their individual metrics, to earn a bonus if the overall shareholder earnings expectations are met.[393] Ratepayers' interests are not aligned with shareholders when poorly performing employees are not meeting the individual metrics that benefit ratepayers, such as safety or customer service related goals, are still rewarded for meeting earnings per share metrics, which benefit shareholders. Spire Missouri admits that earnings based incentive compensation, in the form of stock, which Spire Missouri is requesting in rates, is to align the interests of Laclede's directors, officers and employees with the interests of Laclede's shareholders.[394]

Earnings per share can also incentivize management employees to file rate cases higher than justified and higher than needed to earn a reasonable return on equity.[395] Spire Missouri attempts to argue that the incentive to obtain a higher revenue

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[392] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 25, lines 20-23.
[393] *Id.* at 33, lines 18-20.
[394] Ex. 403, Direct Testimony of Charles R. Hyneman, p. 23, lines 2-14.
[395] Ex. 403, Direct Testimony of Charles R. Hyneman, p. 21, lines 21-24.

requirement is actually a good thing for customers.[396] However, the perverse incentive to ask for more than justified or required is not speculative fearmongering. Mr. Glenn Buck, a witness for Spire Missouri, stated that the company will ask for more aggressive positions, even if an alternative approach to an issue exists.[397] He further states that Spire Missouri does not expect to get that amount, and thus requests a revenue requirement above what is a realistic goal.[398] It is illogical to argue that requesting a revenue requirement above what is required to provide safe and adequate service, with the possibility of getting that inflated ask, benefits the ratepayers.

Spire Missouri makes much ado about an Ameren Missouri Report and Order from 2009. This is just another case that supports Staff's position on excluding earnings based incentive compensation. For Long-Term Compensation, such as the stock options or programs based on measures of earnings per share or on total shareholder return, like Spire Missouri requests in this case, the Commission stated:

> The Commission has frequently disallowed costs relating to incentive programs that are based on measures of the financial return achieved by the utility. It has done so because such measures are based on the level of profits the utility can achieve. At best, a utility's **level of profitability has little or no benefit to ratepayers**. At worst, an increase in the utility's profitability **may be harmful** to **ratepayers if that profitability is obtained by cutting customer service or system maintenance to cut costs and thereby increase earnings per share.** Because eligibility for AmerenUE's long-term compensation plans are based on measures of the financial return achieved by the utility, **the cost of those plans should fall on the shareholders who will primarily benefit from the company's increased financial return.** [399]

Far from overturning Staff's position, this *Report and Order* affirms Staff's removal of earnings based incentive compensation and stock costs. It refutes Spire Missouri's

[396] Ex. 48, Rebuttal Testimony of Mark C. Mispagel, p. 11, lines 3-6.
[397] Tr. Vol. 19:1712, lines 8-9.
[398] Tr. Vol. 19:1713, lines 4-9.
[399] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.86.

claims that wealth maximization and increased earnings benefit ratepayers as much as they benefit shareholders.

The *Report and Order* solidifies Staff's position on removing individual incentive compensation metrics based on financial metrics as well. Ameren Missouri did not even request to recover its 100% financial metric based Executive Incentive Plan for Officers.[400] Spire Missouri, however, seeks to include directors and executives with 100% financial based metrics.[401] Mr. Young testified at hearing that his adjustment to assign earnings-based compensation to shareholders is completely consistent with this *Report and Order.*[402] He removed those metrics consistent with the idea articulated in the *Report and Order* in the Long-Term Incentive Compensation section that an overall program with purely financial based incentives could be harmful to ratepayers.[403] Spire Missouri's corporate and business unit components of the incentive compensation plan were purely financial based.[404] The short-term metrics for three of the incentive compensation plans did not include earnings based metrics, and the fourth allowed in rates only included 25% of metrics focused on earnings.[405] Spire Missouri's program is much higher, and therefore distinguishable, at 50% financial metrics for all programs.[406] The non-earnings based individual metrics Ameren Missouri developed are also distinguishable from Spire Missouri's individual non-earnings based metrics. Ameren Missouri had individual metrics designed to focus the employee's attention on things

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[400] *Id.*
[401] Tr. Vol. 22:2696, lines 24-25.
[402] *Id.* at lines 13-15.
[403] *Id.* at lines 15-17.
[404] *Id.* at lines 17-20.
[405] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.86.
[406] Tr. Vol. 22:2692, lines 12-14.

such as increased reliability, customer satisfaction, safety, or operational matters.[407] A representative example from Spire Missouri's individual non-earnings based metrics would read ** .** **[408]** It's a hard sell to relate that metric to improved safety, increased reliability, customer satisfaction or operational matters with a direct link to ratepayer benefit. Ameren Missouri's non-earnings based individual metrics are also distinguishable from Spire Missouri in that Ameren Missouri's metrics put a portion of incentive compensation at risk. Ameren Missouri's witness explains that a threshold is a description of the level of improvement at which incentive compensation is earned, not the minimum job requirements.[409] Spire Missouri has argued it does not agree a goal must require improvement.[410] Furthermore, Spire Missouri demonstrated that what is expected of employees is the target, but an employee may earn bonus compensation even when the employee does not meet the duties of their base job or the target.[411] Ameren Missouri would define a target as a stretch goal that employee is striving to achieve, not what is required of an employee by their job duties.[412] The maximum level for Ameren Missouri is very difficult to achieve.[413] In contrast, Spire Missouri's goals are "attainable."[414] As the *Report and Order* concludes, as long as the overall program does not include incentives that could be harmful to ratepayers, such as purely financial incentives, the program was

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[407] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.87.
[408] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 28, Chart.
[409] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.89.
[410] Ex. 48, Rebuttal Testimony of Mark C. Mispagel, p. 11, lines 20-21.
[411] Tr. Vol. 22:2713, lines 2-11.
[412] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.87.
[413] *Id.* at p. 88.
[414] Ex. 48, Rebuttal Testimony of Mark C. Mispagel, p. 6, lines 9-11.

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allowable.[415] Staff, in keeping aligned with the Commission's decision that purely financial incentives not be included, has disallowed earnings based incentive compensation. Overall, Spire Missouri's incentive plans fail to accomplish its purpose "to motivate, reward and align the interests of employees with all stakeholders, including customers."[416]

It should be further noted that Ameren Missouri, along with KCPL, does not currently have earnings based incentive compensation in rates.[417] Ameren Missouri accepted in its 2011 rate case Staff's adjustments to incentive compensation expense as part of a Stipulation and Agreement.[418] Those adjustments were to remove an incentive compensation program entirely funded based on earnings and the 25% of the individual metrics that were earnings based, the very ones discussed in the 2009 *Report and Order.*[419] Ameren Missouri also accepted, as part of the *Stipulation and Agreement*, Staff's adjustment to remove incentive compensation costs relating to earnings that was capitalized between the period of 2002 through the end of 2010 from the plant in service and reserve balances.[420]

In conclusion, the Ameren Missouri 2009 *Report and Order* does not contradict or prohibit Staff's policy of refusing to include earnings based incentive compensation or primarily financial metrics from ratepayers. It, in fact supports it, which explains why, even with the language Spire Missouri mistakenly relies on to support its position, that

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[415] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Case No. ER-2008-0318, **Report and Order** issued January 27, 2009, p.90.
[416] Ex. 48, Rebuttal Testimony of Mark C. Mispagel, p. 5, lines 9-10.
[417] Tr. Vol. 22:2739, lines 18-19.
[418] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariff to Increase Its Annual Revenues for Electric Service*, Case No. ER-2011-0028, First Nonunanimous Stipulation and Agreement-Miscellaneous Revenue Requirement Items, filed May 3, 2011.
[419] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariff to Increase Its Annual Revenues for Electric Service*, Case No. ER-2011-0028, Ex. 201, Staff Report Cost of Service, p. 83, lines 8-9 and lines 16-17.
[420] *Id.* at 85, lines 5-8.

Ameren Missouri and KCPL did not request earnings based incentive compensation in their most recent rate cases, nor do they currently include those amounts in rates. The Commission should continue to uphold its long standing prohibition against including earnings based incentive compensation in rates.

iv. Should LAC and MGE be permitted to capitalize earnings based and equity-based employee incentive compensation amounts in base rates?

The Commission should remove capitalized amounts from rates. This is consistent with Staff's adjustments in the previous two LAC rate cases that removed disallowed amounts of incentive compensation from plant-in-service and accumulated depreciation reserve.[421] This is consistent with Staff's practice, as can be seen from in the 2011 Ameren Missouri rate case where incentive compensation costs relating to earnings that were capitalized between the period of 2002 through the end of 2010 were removed from the plant in service and reserve balances.[422]

v. To the extent the Commission declines to include employee incentive compensation in rates, what adjustment should be made to base salaries paid to employees?

Staff believes that no adjustment to base salaries is necessary or supported in this case.[423] Both Staff and Laclede compare base salary to market base salary.[424] Then Laclede compares incentive compensation to market incentive compensation.[425]

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[421] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 23, lines 16-18.
[422] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariff to Increase Its Annual Revenues for Electric Service*, Case No. ER-2011-0028, Ex. 201, Staff Report Cost of Service, p. 85, lines 5-8.
[423] Staff incorrectly stated its position in Staff's Corrected Position Statements, filed November 30, 2017. The position stated in Staff's Corrected Position Statements reflected Staff's position on if incentive compensation is included in rates, at what level should individual incentive compensation expense granted. It is Staff's fallback position, if the Commission should find Staff's arguments against excluding incentive compensation unpersuasive. It is further explained on page 34 of the Surrebuttal Testimony of Matthew R. Young. Staff apologizes for any confusion its mistake may have caused.
[424] Tr. Vol. 22:2720, lines 7-10.
[425] *Id.*

Base salary in this case would not be an amount less than market base salary.[426] Other utilities have argued, like Spire Missouri, that if incentive compensation was included in base salary, it would be included automatically. MGE has previously argued that

> [I]ts compensation plan is simply a portion of the means that it has chosen to pay its employees. MGE argues that it needs its incentive compensation plan to be able to compete with other companies for top employees. Furthermore, it contends that its decision to either pay its employees a straight salary or to offer incentives is simply a matter for its business judgment and should not be of concern to the Commission.[427]

The Commission did not adjust base salary when it denied recovery of MGE's incentive compensation. Empire has similarly argued that

> …variable pay is a primary component of a performance-based work culture… It asserts that if it were to roll the incentive-based compensation for those duties into the base salary, the Staff would not object to the higher base salary. It would remove "an effective driver of performance and achievement," which may "prevent an employer from operating as effectively and efficiently as possible." On the other hand, Empire could just as easily re-write its job descriptions in such a way that clarifies what level of performance is compensated by base pay and what additional performance merits incentive compensation. If that additional performance relates to the provision of retail electric service in Missouri, the Staff would not disallow it.[428]

Again, the Commission did not adjust base salary due to excluding incentive compensation. If Spire Missouri decided to place a portion of incentive compensation, or all incentive compensation, into base salary, Staff would continue its payroll analysis as usual. It would examine the market base salary of peer groups, and disallow excessive payroll. For example, for 2016, LAC and MGE's actual payout for individual incentive compensation was 13% above the individual's market compensation.[429] Therefore, if

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[426] *Id.* at lines 11-21.
[427] *In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service*, Case No. GR-2004-0209, **Report and Order** issued September 21, 2004, p. 42-43.
[428] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area*, **Report and Order** issued December 21, 2006, p. 48-49.
[429] Ex. 262, Surrebuttal Testimony of Matthew R. Young (Confidential), p. 28, lines 1-2.

Spire Missouri would shift incentive compensation to payroll, Spire Missouri would still face a disallowance for payroll that is higher than the base salary of its peer groups.

As a final note, Staff is not attempting to reduce the total compensation of LAC and MGE employees.[430] As the Commission has stated, a utility has every right to offer whatever compensation packages it wants, but those costs should be borne by the shareholders if they show no tangible benefit to ratepayers.[431] Spire Missouri is free to continue to offer the same incentive compensation program, and book it below the line, or, alternatively, Spire Missouri can create individual metrics with stronger ties to ratepayer benefits that actually encourage individuals to perform at a level above what's required as part of their job duties and compensated through base salaries. Staff will continue to evaluate incentive compensation plans based on the Commission's articulated standards, and as seen in the cases discussed above, allow plans that meet those standards to be considered for inclusion in rates.

-Nicole Mers

N. Uncollectibles

i. What is the appropriate amount of bad debt to include in base rates?

The appropriate level of bad debt expense (uncollectibles) to include in base rates is $7,318,951 for LAC and $3,501,893 for MGE. Staff determined this normalized level by using the twelve months ending June 30, 2017; this allowed Staff to use the most current data available following significant changes in the write off policies of both LAC and MGE.

[430] *Id.* at p. 25, line 15.
[431] *Id.* at lines 10-12.

Uncollectible expense is the portion of revenue that the Company is unable to collect from retail customers due to unpaid bills. After a predetermined amount of time has passed, these unpaid accounts are written off. Some portion of the written off amounts may be collected later, which would reduce the actual write-offs. This net write-off is used to determine the annualized level of bad debt expense. In September 2015, both Laclede and MGE made significant changes to their write-off policies for uncollectibles. LAC changed its write-off period from 180 days to 360 days following the final billing after disconnection of service. MGE changed from 30-45 days to 360 days.

LAC and MGE's approach to calculating the appropriate amount of bad debt to include in rate base, which is $14 million for both LAC and MGE, in this case was to follow the approach Staff has historically used; which is a multi-year average of uncollectible expense.[432] While Staff would typically look at past uncollectibles to determine an amount to include in rate base, Staff took into consideration the significant changes made to the write-off policies of both LAC and MGE. Because of these changes, Staff calculated an appropriate amount of uncollectibles to include in rate base using the twelve months ending June 30, 2017. Staff did update this number for true-up for the twelve months ending September 30, 2017.

One of Staff's primary goals in using this time period was to use known and measurable data available after the implementation of the new write-off policies. At the hearing Spire witness Timothy Krick admitted that, when normalizing the uncollectible data through September 30, 2017, he also included an estimated balance of customer write-offs scheduled to occur on or after October 1, 2017.[433] Therefore, Mr. Krick's

[432] EFIS, Statement of Positions of Laclede Gas Company.
[433] Tr., vol. 16, p. 967, lines 7-12.

calculations included data under two different write-off polices; according to Mr. Krick this was an attempt to convert data from a new policy to make it consistent with data from past practices.[434] However, including write-offs that were scheduled to occur on or after October 1, 2017, is using data outside of the test year and true-up period and includes bad debt that customers would still have time to pay off the "bad debt".[435] Because Mr. Krick chose to include future write-offs, which still had a chance of being paid, he used data that is not known and measurable which invalidates his calculations and recommendations.

In calculating an appropriate amount of uncollectibles for this case, Staff actually looked at over ten years of data before deciding to use the twelve months ending September 30, 2017, in its final position statement.[436] Staff witness Amanda McMellen, at hearing, stated that, without the policy change, she would probably have used a multi-year average when calculating the appropriate amount of uncollectibles to include in base rates.[437] However, due to the change in policy, McMellen states uncollectible amounts for LAC and MGE could change in the future, possibly lowering it, because customers are given more time to pay off their debts.[438] Therefore, Staff used only the twelve months ending September 30, 2017, as the best reflection of the proper amount to include in LAC's and MGE's cost of service going forward.

[434] Tr., vol. 16, p. 968, lines 1-4.
[435] Tr., vol. 16, p. 969-970, lines 17-20, 23-25, 1-2.
[436] Tr., vol. 16, p. 991-992, lines 18-15, 1.
[437] Tr., vol. 16, p. 1001. Lines 14-16; p. 1006, lines 11-15.
[438] Tr., vol. 16, p. 1008-1009, lines 16-25, 1-5.

OPC's position on this issue is consistent with Staff's: they state that because of the policy change they believe the most recent data should be used, calculated using the twelve months sending September, 2017.[439]

-Casi Aslin

O. **Software**

i. How should the costs of the NewBlue software be allocated?

The Company, Staff, and OPC came to an agreement regarding the proper allocation of NewBlue software costs and aligned their positions at hearing.[440] The Company and OPC adopted Staff's proposal to allocate the costs between LAC and MGE based on a determination of the software usage of each of the two divisions and the three-factor test.[441] This applies 64.27% of the cost to LAC and 35.73% of the cost to MGE.[442] OPC agreed not to pursue allocations of the costs to the other Spire affiliates. Should the Commission determine that it is appropriate to include the costs of the NewBlue software in both LAC's and MGE's costs of service, it should apply Staff's allocation factors as outlined in its Updated True-Up Accounting Schedules.[443]

-Whitney Payne

P. **Transition Costs**

i. Should LAC's and MGE's cost of service be adjusted to reflect the recognition of merger synergies through the test year?

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[439] EFIS, Motion to Late File Position of Statements and Amended Statement of Positions.
[440] Tr. Vol. 20, P. 2207:4-8.
[441] Ex. 204 Staff Report Revenue Requirement Cost of Service, P. 119.
[442] Ex. 296 Staff's Updated True-Up Accounting Schedules – LAC; Ex. 297 Staff's Updated True-Up Accounting Schedules – MGE.
[443] Ex. 296 Staff's Updated True-Up Accounting Schedules – LAC; Ex. 297 Staff's Updated True-Up Accounting Schedules – MGE.

The Company throughout the hearing repeatedly stated how it has saved countless dollars from its acquisitions of MGE, Alagasco and Energy-South and chastised Staff for crediting ratepayers with all of the savings and none of the costs. The parties reached agreement as to savings achieved through the acquisition of MGE in accordance with the stipulation and agreement signed in the GM-2013-0254 merger case of LAC and MGE.[444] However, the Company still seeks some rate recognition of alleged merger synergy savings associated with its separates acquisitions of Alagasco and Energy-South.

A review of the record produces a very unclear picture of what the Company is seeking in this proceeding beyond a generic request for additional rate recovery. In direct testimony Company witness Lobser stated that the Company wanted something similar to a retention mechanism or a one-time incentive adder to its ROE[445] on account of these transactions. Staff witness Mark L. Oligschlaeger in testimony best summarizes Staff's review of the Company's initial request by stating, "There is not sufficient information in LAC's and MGE's direct testimony supporting these proposals to respond to them in any other manner than at a high level of generality."[446] While this statement was made after only the first round of testimony, the proposal did not achieve clarity in either of the following rounds of testimony. In rebuttal, Mr. Lobser renewed the original proposals but also suggested this Commission could give the Company half of the total Alagasco and Energy-South transaction costs it incurred through an amortization, which is something the Company did not even seek in regard to the

[444] Ex. 55 Stipulation and Agreement in Case No. GM-2013-0254
[445] Ex. 6 Direct Testimony of C. Eric Lobser (Confidential)P. 45:9-10.
[446] Ex. 224 Mark L. Oligschlaeger Rebuttal Testimony, P. 14:10-12.

MGE acquisition.[447] Finally, in surrebuttal Mr. Lobser outlined a proposal to recover half of the Alagasco and Energy-South savings amounts the Company would have continued to collect through regulatory lag had it not come in for this rate case.[448] To clarify since the Company did not in its testimony, this amount would be in addition to the transition costs the Company has already asked for related to the acquisition of MGE. Staff's position is that the Company has already recovered more than enough of its savings and transition costs associated with the Alagasco and Energy-South transactions.

Staff witness Mark Oligschlaeger articulately lays out Staff's position in his rebuttal testimony that, "While customers can benefit as well from merger and acquisition efforts, the dollar amount of customer benefits are subjective and extremely difficult to quantify."[449] Furthermore, he states, "**no special accounting and/or ratemaking mechanisms are necessary to allow utilities the opportunity to derive an appropriate amount of benefits from discretionary merger and acquisition transactions**."[450] Base rates have not changed since any of these three acquisitions so due to regulatory lag, the Company has been realizing the "synergy savings" for the past 4 years in regards to MGE and Alagasco and the past year and a half for Energy South. None of those past savings amounts will be returned to ratepayers so the Company will keep them as profits.

In the approved stipulation and agreement for the MGE merger case, the parties identified several elements to be reported to Staff regarding the transition and related

[447] Ex. 7 Rebuttal Testimony of C. Eric Lobser P. 30:1-4.
[448] Ex. 9 Surrebuttal Testimony of C. Eric Lobser P. 15:17-21
[449] Ex. 224 Mark L. Oligschlaeger Rebuttal Testimony, P. 15:19-21.
[450] Ex. 224 Mark L. Oligschlaeger Rebuttal Testimony, P. 15:14-16.

costs and required LAC to develop and maintain documentation supporting any cost reductions and transition costs.[451] Such reporting was not required for the acquisitions of Alagasco or Energy-South because no prior agreement regarding transition costs or their deferral was established between Staff, OPC and the Company. In fact, the Company never sought Commission approval to acquire Alagasco or Energy South; therefore, there was no opportunity for prior evaluation or for parties to reach an agreement similar to the one reached in the GM-2013-0254 case regarding the other two Spire acquisitions. The Commission has approved rate recovery of transition costs in other merger and acquisition cases such as for Union Electric Company for its acquisition of Central Illinois Public Service Company in Case No. EO-96-14.[452] However, the Commission in its decision references the agreement the parties previously reached in Case No. EM-96-149, in which Union Electric sought Commission approval for the acquisition and reached an agreement with the parties regarding future recovery of transition costs.[453]

Mr. Lobser in rebuttal testimony suggested recovery of transaction costs[454], not transition costs. However, any transaction costs related to the purchase of Alagasco were incurred no later than September 2014, well outside of the test year, beginning January 1, 2016, for this proceeding. Therefore, any recovery of transaction costs for Alagasco would constitute retroactive ratemaking, which the Courts have repeatedly ruled is illegal; "The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional

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[451] Ex. 204 Staff's Direct Cost of Service Report (Confidential) Pp. 80:4-81:6, *citing* Ex. 55 Stipulation and Agreement in Case No. GM-2013-0254.
[452] *In re Union Electric Company* Case No. EO-96-14.
[453] *In re Union Electric Company* Case No. EO-96-14.
[454] Ex. 7 Rebuttal Testimony of C. Eric Lobser P. 30:1-4.

amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established."[455] "The Commission fixes rates prospectively and not retroactively."[456] The Commission in its Report and Order in Case No. EM-2007-0374, regarding the acquisition of Aquila by Kansas City Power and Light (KCP&L), referenced the net original cost rule:

> As a general rule, only the original cost of utility plant to the first owner devoting the property to public service, adjusted for depreciation, should be included in the utility's rate base. That principle is known as the net original cost rule. The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant. If a utility were allowed to revalue its assets each time they changed hands, it could artificially inflate its rate base by selling and repurchasing assets at a higher cost, while recovering those costs from the ratepayers. Thus, ratepayers would be required to pay for the same utility plant over and over again. The sale of assets to artificially inflate rate base was an abuse that was prevalent in the 1920s and 1930s and such abuses could still occur.[457]

The Commission in that case found specifically that transaction costs were generally not incurred for the purpose of providing service to ratepayers and that permitting KCP&L to

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[455] ***Board of Public Utility Commissioners v. New York Telephone Co.,*** 271 U.S. at 31, 46 S.Ct. 363.

[456] *Lightfoot v. City of Springfield,* 361 Mo. 659, 669, 236 S.W.2d 348, 353 (Mo.1951).

[457] In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief, Case No. EM-2007-0374, Report and Order; *Citing* In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & power Company with and into UtiliCorp United Inc.. and, in Connection Therewith, Certain Other Related Transactions, Case No. EM-2000-292, Second Report and Order, 12 Mo.P.S.C.3d 388, 389-90 (2004).

recover transaction costs in that case would be comparable to artificially inflating rate base by permitting recovery of an acquisition premium, which it had also denied.[458]

In conclusion, Mr. Oligschlaeger again provides the most succinct picture in his rebuttal testimony, "For these reasons, Staff recommends that the Commission neither encourage, or discourage **discretionary** utility merger and acquisition efforts, and instead attempt to maintain a set of consistent ratemaking policies governing how merger and acquisition savings and costs are treated."[459] His suggested policies are, "no rate recovery of any direct merger costs such as merger premiums and **transaction costs** are appropriate; transition costs are appropriate only when the utility can demonstrate that a greater amount of merger savings than merger costs was achieved; and that utilities retain all of their achieved merger savings through the operation of regulatory lag until new general rates become effective."[460] (Emphasis added.) These policies are not discriminatory to either the company or the ratepayers and create a productive, fair environment to the benefit of all parties. Therefore, Staff recommends the Commission deny the inappropriate request by the Company for some sort of rate recognition of alleged merger synergies related to the acquisition of Alagasco and Energy-South.

-Whitney Payne

Q. Low Income Energy Assistance Program

i. What is the appropriate funding level for each division?

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[458] In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief, Case No. EM-2007-0374, Report and Order.
[459] Ex. 224 Mark L. Oligschlaeger Rebuttal Testimony, P. 15:21-16:1.
[460] Ex. 224 Mark L. Oligschlaeger Rebuttal Testimony, P. 16:1-8.

Currently, LAC has two programs under the Low Income Energy Affordability Program. The first is called the "Winter Bill Payment Assistance Program," and it provides bill credits for participating customers in amounts that vary by month and by the customer's income eligibility as a percentage of the federal poverty level. The credit amounts vary by month to provide more funding during the winter heating season than during shoulder months, and no credit is provided during the summer. The second program, the "Arrearage Repayment Program," provides matching funds for eligible customers making payments on current month usage to reduce accrued arrearages.[461]

In this case, the Companies, Staff, the Division of Energy, and the Consumers Council of Missouri have come to an agreement to extend the program to the MGE service territory and to modify it to provide a year round credit to qualifying customers, households with incomes ranging from 0% to 185% of the federal poverty level, and an additional credit of up to $30 in the winter months to qualifying customers that have incomes ranging from 0% to 135% of the federal poverty level. In addition, the parties have agreed to meet, beginning no later than 120 days after the effective date of new tariffs approved in this case, to discuss the process for evaluating the effectiveness of the Program as well as potential enhancements to the parameters and structure of the Program.[462]

The only issue left for the Commission to decide is at what level ratepayers should fund these programs. Staff recommends the Commission approve the Companies' proposed budget, maintaining the current funding level of $600,000 annually for LAC, and approve a funding level for MGE of $500,000,

[461] Ex. 237, page 11, lines 9-21.
[462] *See* Partial Stipulation and Agreement Regarding Low Income Energy Affordability Program, filed January 9, 2018; EFIS # 512.

slightly lower than LAC, which recognizes the fact that it is a slightly smaller company than LAC. In recent history, LAC has not spent the allotted amounts designated for LAC's Low-Income Energy Assistance Program. Since program year 2014, LAC has only spent approximately ** ** out of an available $1,800,000.[463] Due to the past under-utilization of the program, Staff does not believe an increase in funding levels is appropriate at this time. As the parties have agreed to create a collaborative process to discuss potential improvements to the program on a going forward basis, similar to Ameren Missouri's Keeping Current program, the parties will have the ability to analyze the utilization of program funds, and determine if any change is necessary in future rate proceedings.

-Mark Johnson

R. CHP

i. Should LAC and MGE implement a CHP pilot program as proposed by Division of Energy?

No. The Division of Energy's proposal is a load-building program[464] that has the potential to impact the sales and revenues of electric utilities that are not parties to this case, could potentially violate the Commission's promotional practice rules,[465] and would constitute unduly preferential and discriminatory ratemaking.

Introduction

Combined Heat and Power ("CHP") refers to technologies that simultaneously generate electricity and useful thermal energy from a single fuel source; potentially

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[463] Ex. 501 C, page 7 line 19 – page 8, line 2.
[464] Ex. 244, page 2, lines 7-16.
[465] Ex. 214, page 4, line 18 - page 5, line 2.

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beneficial to customers who simultaneously need power and thermal energy.[466] The program recommended by the Division of Energy amounts to a $5.1 million subsidy from captive ratepayers to encourage up to ten large, sophisticated customers to construct combined heat and power facilities; an established technology that may already be redundant.[467] This subsidy would be socialized into the cost of service for all of the Companies' ratepayers. Division of Energy witness Ms. Jane Epperson, on pages 16-19 of her *direct* testimony, provides recommended guidelines for a pilot program to be implemented by Spire for certain critical infrastructure CHP projects. These guidelines include recommending that the Commission:

- Establish a definition of critical infrastructure;
- Authorize Spire to investigate and develop a proposed CHP pilot program to serve critical infrastructure with a budget of $5.1 million;
- Allow Spire to track and seek future recovery of costs. Costs may include offsetting a portion of the project's feasibility study and contribution to the project's installed cost;
- Allow Spire to extend cost recovery periods up to 15 years for customer repayments of natural gas line extensions and other natural gas facilities;
- Allow Spire to offer on-bill financing;
- Require Spire to use a societal cost test to evaluate the potential benefits of projects'

[466] EX. 214, page 2, lines 1-3.
[467] Tr. Vol 15, page 926, lines 19-22.

- Develop a formula to allocate and assign value of energy savings and project costs between natural gas and electric utilities when jointly offered with electric Missouri Energy Efficiency Investment Act (MEEIA) programs; and
- Allow potential CHP pilot program customers to participate in otherwise-applicable EDRs or Special Contract service rates.

Interested Parties Not Represented

Staff has concerns with the Division of Energy's proposal, outside of the enormous price tag. First, Ms. Epperson's proposal has the potential to impact the sales and revenues of electric utilities that are not intervenors in this case.[468] Staff witness Claire Eubanks testified that if followed, Ms. Epperson's guidelines may target various electric and/or steam utility customers including: hospitals, nursing homes, public water and wastewater treatment facilities, government facilities (military, correctional, police, and fire), emergency shelters (schools, universities, or community centers) and data centers.[469] MGE's natural gas service territory overlaps with portions of the electric service territories of Kansas City Power and Light, KCP&L Greater Missouri Operations, and The Empire District Electric Company; LAC's service territory overlaps with portions of Ameren Missouri's electric service territory. In addition, Veolia Steam Kansas City ("Veolia") has steam customers located within the MGE service territory.[470] Of those companies mentioned above, only Kansas City Power & Light and KCP&L Greater Missouri Operations are parties to this case.

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[468] Ex. 214, page 4. Lines 18-19.
[469] Ex. 214, page 5, lines 9-12.
[470] Ex. 214, page 5, lines 12-18.

Potential Violation of the Commission's Promotional Practices Rules

Secondly, Ms. Eubanks asserts that because Ms. Epperson's proposal includes allowing Spire to recover costs associated with contributing to a project's installed cost, it could potentially prohibit the Commission's promotional practices rules.[471] Commission Rule 4 CSR 240-14.020 describes Prohibited Promotional Practices, including practices which have the purpose of inducing any person to select and use the service or use additional service of the utility through the financing of real property, including the construction of any building, when the property is not owned or otherwise possessed by the utility or its affiliate.[472] Ms. Epperson proposes that Spire should contribute to a CHP project's installed cost, which could be considered a Prohibited Promotional Practice if that CHP project encouraged the customer to utilize more natural gas than their normal usage as the fuel source for the project.[473] In essence, Spire would potentially be incentivizing use of their commodity, over that of another utility's, by providing contributions to a CHP project's installed cost. Ms. Epperson recognizes this possibility in her rebuttal testimony, stating "[t]he use of CHP can result in the loss of physical load by an electric utility to the benefit of a natural gas utility, provided that the CHP unit is fueled by natural gas,"[474] but claims, however, that CHP is "conceptually recognized as an exception to the promotional practices rules."[475] In support of her claim, Ms. Epperson cites Commission Rule 4 CSR 240-14.010(4), which states "Nothing contained in this chapter shall be construed to prohibit the provision of consideration that may be necessary to acquire

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[471] Ex. 214 page 4, line 20 – page 5, line 2.
[472] 4 CSR 240-14.020(1)(A).
[473] Ex. 214, page 6, lines 4-8.
[474] Ex. 506, page 5, lines 3-4.
[475] Ex. 506, page 5, lines 6-7.

cost-effective demand-side resources." While this section does make an exception for consideration that may be necessary to acquire cost-effective demand-side resources, Ms. Epperson ignored the definition of demand-side resource:

> Demand-side resource means any inefficient energy-related choice that can be influenced cost=-effectively by a utility. The meaning of this term shall not be construed to include load-building programs.[476]

The Division of Energy's proposed pilot program is a load-building program; it would be offered by Spire and may result in a customer increasing their natural gas usage. This type of program would not be considered a demand side resource under the Commission's Promotional Practice Rules, and therefore, would not be covered by the exception cited by Ms. Epperson.[477]

Ms. Epperson also cites 4 CSR 240-14.010(4), stating that "the promotional practices rules also allow for pilot programs that are designed to evaluate the cost-effectiveness of potential demand-side resources."[478] However, DE's proposed pilot program is not designed to evaluate the cost-effectiveness of potential demand-side resources. DE suggests using a societal cost test to evaluate individual project benefits; however, the proposal does not address how the pilot program would be evaluated to determine cost-effectiveness to Spire.[479]

Unduly Preferential and Discriminatory Ratemaking

In addition to potentially violating the Commission's Promotional Practice Rules, DE's proposed pilot program, if approved, would constitute unduly preferential and discriminatory ratemaking**.** This pilot program would require all LAC and MGE

[476] 4 CSR 240-14.010(6)€
[477] Ex. 244, page 2, lines 16-19.
[478] Ex. 506, page 5, lines 10-12.
[479] Ex. 244, page 3, lines 6-8.

ratepayers to subsidize the development of CHP facilities to the tune of up to $5.1 million for *ten* LAC and MGE customers. Missouri law forbids the preferential subsidization of certain ratepayers at the expense of all other ratepayers**.** The law requires that "[a]ll charges made or demanded by any such gas corporation . . . for gas. . . or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission."[480] The law further provides that "[e]very unjust or unreasonable charge made or demanded for gas . . . or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited."[481]

A "just and reasonable" rate balances the interests of the various stakeholders in the light of the public interest.[482] A just and reasonable rate is fair to both the utility and to its customers[483] and is no more than is necessary to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[484] The Commission uses traditional cost-of-service ratemaking to set just and reasonable rates.[485] The fixing of just and reasonable rates involves making pragmatic adjustments; in determining rates, a regulatory body is not bound to the use of any single formula or combination of

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[480] Section 393.130.1, RSMo.
[481] *Id.*
[482] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").
[483] ***St. ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).
[484] ***St. ex rel. Washington University et al. v. Public Service Commission,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).
[485] FERC, ***Cost-of-Service Rates Manual,*** 1 (1999) [available electronically at www.ferc.gov]: ""Under cost-of-service ratemaking, rates are designed based on a [utility's] cost of providing service including an opportunity for the [utility] to earn a reasonable return on its investment."

formulae.[486] In the final analysis, it is not the methodology or theory used but the impact of a rate order of the Commission which counts in determining whether rates are just, reasonable, lawful and non-discriminatory.[487]

Just and reasonable rates are neither unduly preferential nor unduly discriminatory with respect to any customer or class of customers.[488] The Commission has no authority to approve discriminatory rates.[489] Section 393.130, RSMo., at subsections 2 and 3, forbids both unduly discriminatory and preferential rates. It would be both unlawfully discriminatory and preferential to require all ratepayers to subsidize the construction and installation of CHP facilities for a mere *ten* commercial and industrial customers.

In summary, because it could constitute a violation of the Commission's Promotional Practices Rules, several potentially effected entities are not parties to this case, and because, if approved, DE's proposed pilot program would constitute unduly preferential and discriminatory ratemaking, Staff recommends the Commission reject the Division of Energy's proposed CHP pilot program for the subsidization of CHP projects for a select few Spire commercial and industrial customers.

-Mark Johnson

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[486] ***State ex rel. Office of Public Counsel v. Public Service Com'n,*** 367 S.W.3d 91, 108 (Mo. App., S.D. 2012), *quoting* ***Fed. Power Comm'n v. Hope Nat. Gas Co.,*** 320 U.S. 591, 602-3, 64 S.Ct. 281, ___, 88 L.Ed. 333, ___ (1944).

[487] ***State ex rel. Associated Natural Gas Co. v. Public Service Com'n of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[488] Section 393.130.3, RSMo.; *see* ***State ex rel. City of Joplin v. Public Service Com'n of State of Mo.,*** 186 S.W.3d 290, 296 (Mo. App., W.D. 2005).

[489] ***City of Joplin,*** *supra,* 186 S.W.3d at 296.

CONCLUSION

WHEREFORE*,* on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law, determining just and reasonable rates and charges for Laclede Gas Company and Missouri Gas Energy as recommended by Staff herein; and granting such other and further relief as is just in the circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 9th day of January, 2018, to all counsel of record.

/s/ Whitney Payne

ATTACHMENT 1

HAS BEEN DEEMED

CONFIDENTIAL

IN ITS ENTIRETY