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In the Matter of Laclede Gas Company's Request to Increase Its Revenue for Gas Service) File 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) File No. GR-2017-0216

NANCY DIPPELL, Presiding
REGULATORY LAW JUDGE

DANIEL Y. HALL, Chairman,
WILLIAM KENNEY,
SCOTT T. RUPP,
COMMISSIONERS.

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P R O C E E D I N G S

(Whereupon, the hearing resumed at 9:00 a.m. CST.)

JUDGE DIPPELL: Let's go ahead and get started. Let's go on the record.

Good morning.

HEARING PARTICIPANTS: Morning, Judge.

JUDGE DIPPELL: It is Monday morning, December 11th, 2017, and we're here to continue the rate cases in GR-2017-0215 and GR-2017-0216. And let's see. In the matter of -- for preliminary matters, we had -- and Miss Payne, is she in here?

Mr. Thompson, maybe you can answer. We had an Exhibit No. 56 on Friday, which Ms. Payne was going to review before making -- deciding if she had any objections.

MR. THOMPSON: I'm sorry, Judge. She hasn't communicated anything to me about that.

JUDGE DIPPELL: Okay. We will hold that until after our next break.

And then we had the filing of some substitute surrebuttal testimony by Office of

Public Counsel. Do you know if that is -- am I to understand that's just corrections in the schedules and so forth?

MR. SMITH: Yeah. Are you referring to Ms. Azad, I think?

JUDGE DIPPELL: Yes.

MR. SMITH: I believe so. Mr. Williams, Nathan Williams had filed that, and I can't speak to that specifically --

JUDGE DIPPELL: Okay.

MR. SMITH: -- but that's my understanding.

JUDGE DIPPELL: All right. I guess we'll deal with that when we get to that as well.

We are ready to begin capital structure and cost of capital issues, and we're going to begin today with opening statements on those issues. Can we start with the Company?

MR. FISCHER: Thank you, Judge. May it please the Commission. Welcome back, and I hope everyone had a good weekend. I am Jim Fischer, and today Mike Pendergast and I will be representing Spire Missouri on this particular issue.

There are really four parts to the issue. There's of course the traditional ROE issue, the capital structure issue, which is a very important issue in this case, the cost of debt, and then also the question of whether short-term debt should be included in the capital structure.

All the major trends, all the economic trends over the last couple of years have showed substantial improvement. Economic growth has accelerated, the unemployment rate has fallen, I think, to 4.1 percent, which most people consider full employment, the Fed has raised interest rates on several occasions as -- and has indicated an intention to continue to raise interest rates in the future in light of the improving economy.

The Commission should determine what rate of return on equity will permit the Company to continue to attract investors while reflecting the concerns and interests of consumers. Such a balancing exercise should also be consistent with the ROEs recently determined by other regulatory utility commissions for comparable companies.

In this case, the Company requests an ROE of 10.35 percent based on the analysis conducted by our expert Pauline Ahern. Ms. Ahern has served as a consultant for investor-owned utilities and municipal utilities for nearly 30 years and has testified as an expert witness in over -- before 31 regulatory commissions. Her extensive background and experience, if you're interested, are summarized on Appendix A of her direct testimony.

Since Spire Missouri is not publicly traded, Ms. Ahern uses a proxy group of natural gas companies with similar risk to Spire Missouri to -- for insight into what should be the appropriate rate of return on common equity. She testified an ROE of 10 percent before adjusting for flotation costs and the smaller size of Spire Missouri, and 10.35 percent after those adjustments is both reasonable and conservative given the Company's greater business risk relative to the natural gas proxy group.

In the last natural gas case decided by the Commission, the Commission authorized an ROE for Liberty of 10.00 percent. By contrast, Staff's witness, David Murray, testifies in the current case that his analysis shows that the actual market cost of equity for Spire Missouri is in the range of 6.90 to 7.70 percent. The evidence will indicate that this remarkably low range is substantially below any return on equity authorized by the State Commission in more than 30 years.

Mr. Murray recognized that his cost of equity is much lower than the average allowed ROEs for gas utilities in the country on page 39 of the Staff's cost of service report. On the next page of that report, he indicates that the average allowed ROEs for gas utilities during the first six months of 2017 was 9.5 percent. More recent information will indicate that the authorized returns in 2017 have now gone up to about 9.89 percent.

Perhaps for this reason, he does not recommend his extremely low range of 6.9 to 70.0, and instead recommends an a range of 9.0 to 9.5 percent. And now as I understand his testimony, it essentially takes the ROE of 9.5 percent that was authorized to KCPL and lowers it to 9.25 percent to account for his perceived risk differential between natural gas companies and vertically integrated electric companies, but from our perspective, this approach is essentially a rearview mirror approach, looking back on the conditions in the test year in the KCPL rate case and not using the improved economic data to review the current conditions for the year that the rates will be going into effect, which of course will be 2018.

In other words, given the improving economy and the increasing Fed interest rates, the authorized ROE should be higher as recommended by Ms. Ahern.

Mr. Michael Gorman is appearing on behalf of the Office of Public Counsel and MIEC. His recommended range is 8.9 percent to 9.4 percent without adjustment for flotation costs or the business risk of a smaller-sized utility.

As Ms. Ahern explains in her rebuttal testimony, he has some flaws in his analysis and does not correct for flotation costs and business risk. With her corrections and adjustments, Mr. Gorman's recommended ROE would be 9.89 percent.

The Company's also sponsoring the testimony of three additional witnesses besides Ms. Ahern to discuss the appropriate capital structure to be utilized in this case.

Steven Rasche is the executive vice president and chief financial officer for Spire Inc., Missouri -- Spire Missouri's parent company. Robert Hevert is a partner in the consulting firm of ScottMadden and is a well-known expert, I think, to the Commission, since he's appeared in a number of cases before the Missouri Commission in recent years. Finally, Glenn Buck is the director of regulatory and finance for the Company.

These witnesses support the use of the actual capital structure of the public utility Spire Missouri, Inc. as of the true update of September 30, 2017.

As reflected in the Company's statement of position and the true-up testimony that Mr. Buck filed, the actual capital structure for Spire Missouri, Inc. as of the true-up date is 45.8 percent long-term debt and 54.2 percent common equity. We would also use the public utility's actual cost of debt for the cost of debt in this case.

Now, for purposes of setting rates, Staff -- Staff witness Murray has recommended the use of the capital structure of the parent Spire, Inc. instead of the capital structure of the public utility Spire Missouri as we have proposed.

Staff has also recommended the inclusion of short-term debt in Spire, Inc.'s capital structure. Staff's capital structure is more highly leveraged with 45.56 percent common equity, 47.9 percent long-term debt, and 6.47 -- I'm sorry -- 6.47 with short-term debt.

Public Counsel and MIEC witness Gorman has recommended the use of Spire Missouri's actual capital structure with a couple of adjustments. He -- he recommends the removal of $210 million of goodwill associated with the acquisition of Missouri Gas Energy.

The capital structure, from our perspective, is a very important issue. I believe it may be the largest issue from a dollar standpoint in the case. Much has changed at the parent company level since the previous Laclede Gas Company rate cases in which the consolidated gas -- consolidated capital structure of the parent was used.

In the past the use of the consolidated capital structure as compared to the utility specific capital structure was really a nonissue since the long-term assets and financing at the holding company level almost entirely consisted of a Laclede Gas Company.

In other words, in previous cases, the earnings potential of the parent, the Laclede Group, consisted overwhelming of the two regulated Missouri gas utility companies. Today, though, Spire, Inc. is a holding company with five local distribution companies across three states, each with their own unique regulatory and operating environments. It has a FERC regulated natural gas transmission pipeline as well as a gas marketing company, a propane pipeline, and other smaller nonregulated operations.

While it may have been appropriate in the past to use the parent company's consolidated capital structure when it essentially -- the parent had the -- only two Missouri regulated local distribution companies, that's really not the case today. Staff's proposed capital structure should be rejected, since it would result in Missouri customer rates being influenced by the financings completely unrelated to the Missouri utilities.

As I mentioned, now the parent owns out-of-state public utilities like Spire Alabama, which was formerly known as the Alabama Gas Corporation or Alagasco and the former subsidiaries of Energy South. The capital structure of the parent also supports the unregulated activities of Spire Marketing, an unregulated subsidiary of the parent, and a FERC-regulated pipeline operation.

Under Staff's approach, the debt of these operations would be included in the capital structures for the public utilities in Missouri. In fact, the public utility Missouri issues its own long-term debt, and it's approved by the Missouri Public Service Commission. It has its own bond rating, and none of the debt of the out-of-state utilities are secured by the assets of the Missouri public utilities. It's therefore appropriate to use the actual capital structure of the public utility Missouri as the capital structure for rate-making purposes.

In addition, as Ms. Ahern demonstrates, the actual capital structure of Missouri public utility is consistent with the capital structures of other regulated companies in her natural gas proxy group. It's also quite consistent with the capital structure that was previously used by the Staff in Laclede's last rate case.

With regard to the short-term debt issue, it's the Company's position that such short-term debt costs should not be included in the capital structure because the average level of construction work in progress and other commission tariff short-term assets such as the margin calls on the Company's multi-year hedging program and deferred gas costs, those exceed the average level of short-term debt outstanding during the true-up period after we take into account the long-term debt issue that recently occurred. This is consistent with the Commission's long-term practice of not using -- or not including short-term debt in major utilities' capital structures.

And then turning briefly to Mr. Gorman,

Mr. Gorman uses the capital structure of the public utility, but he makes two adjustments. The first adjustment is he takes -- he adjusts for the recent $170 million of long-term debt which was used to refinance the short-term debt. The Company now has also reflected that adjustment in its true-up testimony, and so I don't think that's any longer an issue between us.

The second adjustment, though, he argues that the common equity balance should be reduced by $210 million to remove capital supporting the goodwill. This unprecedented adjustment should also be rejected. The goodwill is related to the premium paid for MGE's assets in excess of the net book value of those assets.

The parties agreed in the acquisition case that no portion of the goodwill balance should be included in rates. In fact, the goodwill balance in this case has been removed or excluded from the Company's rate base.

The acquisition of MGE was funded by a mix of capital, primarily long-term debt and common equity. Unlike the implications of

Mr. Gorman's adjustment, the goodwill associated with the purchase of MGE assets was not financed entirely by common equity. But in any event, it's not possible to trace specific portions of the acquisition financing to specific assets, including the goodwill as Mr. Gorman suggests.

For these reasons, we believe Mr. Gorman's proposed adjustment should rejected.

Now, during the opening statement at the beginning of this case, Miss Shemwell showed you a chart of how Laclede's stock price has gone up over the years, and I'd like to show you a similar chart which shows you the -- also the performance during that five-year period of the Standard & Poors 500, which shows that our Spire performance has been almost the same as the Standard & Poors performance, and it also has another line that shows you the performance of peer groups in the natural gas peer group. They've done actually better. They went up 101.7 percent. Spire's stock increased by 73.6 percent or about the same rate as the Standard & Poors.

With that I would close and take any

questions. Our experts are here to answer your technical questions.

JUDGE DIPPELL: Commissioners, do you have questions for Mr. Fischer?

CHAIRMAN HALL: Yeah.

Could you explain to me why I should care about that? Why --

MR. FISCHER: You know, I know we talk about stock price as part of the ROE adjustments, and I think it's just important, if we're going to look at how much the stocks of utilities have gone up over a period, we need to also note that the market as a whole has gone up substantially during that period, but that's primarily. I don't think it's as important as folks might make it out to be.

CHAIRMAN HALL: But you think it is important, not just --

MR. FISCHER: I think if you're going to look at what our stock has done over five years --

CHAIRMAN HALL: Should we? Should we be looking at what your stock has done over the last five years?

MR. FISCHER: I think when you look

at things like yield, you do take into account the stock price, but I think it's important to understand all the economic condition, including the rising stock market.

JUDGE DIPPELL: I believe that's all the Commission questions.

Do we have an opening from Staff?

MR. THOMPSON: Thank you, Judge.

JUDGE DIPPELL: You're going to save me from not being able to get it back to the camera.

MR. THOMPSON: That chart simply depicts the positions of the parties if the four cost of capital issues.

May it please the Commission?

JUDGE DIPPELL: Go right ahead.

MR. THOMPSON: Four issues in the area of cost of capital. The first one, return on equity. The task of the return on equity witness in a case of this kind is to determine what an investor, what return an investor would have to have to invest in this security as opposed to another investment opportunity of similar risk.

So Staff has suggested a range of 9.0

to 9.5. Mr. Gorman, on behalf of OPC, MIEC, and I think NICG has suggested a range of 8.9 to 9.4, and the Company suggests 10.35. That is not the highest -- that does not exceed the highest awarded ROE for the past year, but it's quite close, it's quite close. It's well above the average, and so you would have to ask yourself is this company so affected with risk that an investor would have to have a return of 10.35 percent in order to choose this investment over the other opportunities in the market. I mean, of course an investor would like a return of 10.35, but as Mr. Fischer told you, Mr. Murray's analysis shows that investors are actually buying this stock with a return of 6.9 to 7.7.

So there is simply nothing but air in that 10.35, and as Mr. Gorman and Mr. Murray have testified, or I guess we should say will testify when you receive their pre-filed testimony, you will see that Ms. Ahern has adopted a number of different devices in order to inflate that number. Staff suggests that is an inflated number, you should not rely on it, you should not adopt it.

Capital structure. Traditionally with this company, the Commission has used the consolidated capital structure of the holding company, formerly the Laclede Group, now Spire. Things have changed. It's true. The Laclede Group, now Spire, owns several more operating companies than it used to. That's true. But Spire Missouri continues to be its main operating company, the largest and most lucrative of those operating companies.

Staff continues to believe that the consolidated capital structure of the parent is the appropriate capital structure for rate-making purposes.

Number one, it's the capital structure that investors can actually invest in. No one can buy stock of Spire Missouri. That stock is all owned by the holding company. So if you want to invest in Spire, you're investing the holding company.

Number two, there's that pesky goodwill that Mr. Gorman talks about. If Missouri ratepayers are going to pay the capital costs of the goodwill, which is to say the acquisition premium that this company paid when it purchased

Alagasco -- or excuse me -- I guess in this case when it purchased MGE, then that is an indirect recovery of the acquisition premium, which this company agreed it would never seek from Missouri ratepayers.

So if you decide to make rates with Spire Missouri's capital structure, then I suggest you make the adjustment that Mr. Gorman has suggested and remove that amount from the capital structure.

Cost of long-term debt, Staff and OPC are agreed at 4.159, here rounded to 4.16, and Staff alone of the parties urges the inclusion of the amount of short-term debt. The reason is the short-term debt represents the carrying costs of the gas and propane inventory, and it's unusual for Staff to propose a short-term debt be included, but this is an unusual situation.

How that short-term -- how the gas inventory and propane inventory are going to be handled is in fact an issue in this case that you will be taking up later on. Thank you very much. Be happy to answer questions.

JUDGE DIPPELL: Any questions for Mr. Thompson?

CHAIRMAN HALL: No questions. Thank you.

JUDGE DIPPELL: Thank you, Mr. Thompson.

MR. THOMPSON: Thank you, Judge.

JUDGE DIPPELL: Public Counsel.

MR. SMITH: Morning. My name is Ryan Smith with the Office of the Public Counsel. May it please the Commission?

JUDGE DIPPELL: Go ahead, Mr. Smith.

MR. SMITH: The topic of this issue is capital structure and the costs of capital which gets at the heart of OPC's overearnings complaint. The Company has requested in this case an equity-rich capital structure at a high return on equity. Before I get into my comments on that, I would like to address something that counsel for Spire, Mr. Rick Zucker, stated in his opening at the beginning of this case on this topic.

The start of this case, counsel accused Staff, Office of the Public Counsel and presumably many other parties of wanting to "misappropriate" millions of dollars that "rightfully belong" to the companies.

Words like "misappropriate millions of dollars" and "rightfully belong to the companies" may sound good to the shareholders, but these words take on a different meaning when we have customers in this state who cannot afford gas bills. OPC represents those customers. They are of all types, retired, fixed income, young families struggling to make ends meet.

OPC first raised concerns about excessive profits by this company in April of 2016, when OPC observed facts corroborating the theory that the Company was making excessive profits, and the facts that they observed came in part from these quarterly surveillance reports.

You will hear later today about these quarterly surveillance reports. In fact, the Company is resisting the invitation to enrich the transparency of its surveillance -- surveillance reports which will be a litigated topic on today's docket.

OPC is working with MIEC to explore these earnings issues. OPC and MIEC's position on capital structure and cost of capital are jointly sponsored by Mr. Michael Gorman. He'll be available for any questions about his methodologies, about his recommendations. He has testified many times before this Commission and others. He's highly skilled, highly experienced, highly credible.

Through Mr. Gorman's analysis, OPC points out about the capital structure issue, that common equity is the most expensive kind of capital. In fact, common equity is more than twice as expensive as debt capital. And the utility is requesting a capital structure that is equity rich. The capital structure, too heavily weighted with common equity, will unnecessarily increase the burden on ratepayers.

OPC and Staff are in agreement that the Company's proposed capital structure of 54.2 percent common equity to 45.8 percent long-term debt is weighted too heavily with common equity. Compare the 54.2 percent of the Company with Mr. Gorman's number of 47.2 percent equity, and Staff witness, Mr. David Murray's common equity structure of 45.6 percent equity.

Staff and OPC's structures are more in line with a reasonable and a prudent capital structure, and one that met more closer -- more close than matches the utility's peers. The Company has also unreasonably included a premium payment for the purchase of MGE or goodwill in its capital structure as a part of his capital structure proposal. Mr. Gorman can discuss further why it is inappropriate to make that adjustment.

Now, Staff capital structure is a little bit different than OPC's in the sense that it included a short-term debt rate for gas inventory carrying costs. The reason OPC's capital structure does not contain a short-term debt rate is that OPC is recommending that that short-term debt rate be recovered through the PGA.

So if this Commission wanted to give rate-based treatment to gas inventory, OPC actually agrees that some amount of short-term debt would need to be included, and actually, Staff witness Mr. Murray recommended a path to accomplish that objective at pages 38 and 39 of the surrebuttal testimony.

Staff and OPC/MIEC developed similar returns on common equity with Staff at 9.25 and

OPC at 9.2. It has already been discussed that the Company is proposing a 10.35 inflated return on equity. OPC would ask this Commission in closing that it order a prudent, reasonable capital structure that's not overweighted with equity and provides a just and a reasonable return that's no higher than the 9.4 percent recommended by Mr. Gorman. Thank you.

JUDGE DIPPELL: Are there any questions for Mr. Smith?

CHAIRMAN HALL: No questions.

JUDGE DIPPELL: Thank you.

All right. Is there anything from Division of Energy?

(No response.)

JUDGE DIPPELL: Not here today.

Environmental Defense Fund?

MS. KARAS: Nothing, your Honor.

JUDGE DIPPELL: Midwest Energy Consumers.

MR. WOODSMALL: Thank you. I'll be very brief.

One of the benefits of going later is a lot of times your comments are already taken, and I applaud Mr. Smith on behalf of Public

Counsel. Many of his comments reflect the positions that MECG takes. Similarly, Staff's position on capital structure and ROE, I think, are similar with MECG.

MECG's position is that you need to set a capital structure that recognizes the low cost of debt. You don't want to put too much debt in because it makes the Company too risky, but there needs to be an appropriate amount of debt. Staff and Public Counsel both get there in different ways. Staff says use the consolidated capital structure, and it makes a lot of sense. You do that in a lot of other cases. You just did it in KCP&L's case. And the theory there, as Mr. Thompson said is, the consolidated capital structure, that is the only company that investors can truly invest in. So it makes sense to use a consolidated capital structure as you've done many, many times over.

The other alternative that gets to similar position is what Mr. Smith told you is sponsored by Mr. Gorman. And that is if you use the assigned capital structure for Laclede/MGE, take out the goodwill.

Now, the companies would have you

believe this is an unprecedented adjustment, and to some extent, it is unprecedented, but that's because no other company faces this. If you think about when Great Plains was going to buy Westar the first time around, when it failed, they agreed, as part of their initial filing, to book all goodwill at the parent company level. Similarly, when Great Plains bought GMO, all goodwill was booked at the parent company level, so there was no need for this type of adjustment. Only here, where the Company didn't book this goodwill at the parent company level is an adjustment necessary. So it's only unprecedented because the other utilities don't book the goodwill at the subsidiary level.

So capital structure, we agree with either Public Counsel or Staff both lead to a reasonable capital structure. On ROE, Staff and Public Counsel get to the same point virtually.

A couple comments I wanted to make on the Company's capital ROE. The Company does an analysis and comes up with an ROE of 10.00, but then the Company adds 35 basis points through 2 adders. The first one is a size adder. The theory is that Laclede and MGE --

I'm not talking Spire -- Laclede and MGE are so small that they have additional risk, but that ignores the fact that Spire exists. That ignores the fact that Laclede and MGE have a shared services agreement with Spire.

So Laclede and MGE don't have the risk. They turn to Spire for legal services and IT services and capital access and for management services. So the risk of a smaller company doesn't exist. In fact, Spire allocates those costs, and they recover it through rates from Laclede and MGE ratepayers.

So the size adder doesn't make sense. The other adder, and Mr. Gorman can talk more about this, regards flotation costs. Flotation costs are the costs that you incur when you access the equity markets, the cost to issue stock.

Ms. Ahern says that she estimates that the Company's would have -- Laclede and MGE would have had you issue stock and incur -- I think it was $56 million of flotation costs. Mr. Gorman's primary position on that is well, that assumes that everything that they needed would have been done through equity infusion and ignores the fact that they would have retained a bunch of earnings.

So both of those adders are misplaced, as Mr. Gorman says, and MECG supports that position.

JUDGE DIPPELL: Any questions for MIEC?

CHAIRMAN HALL: No questions.

JUDGE DIPPELL: Thank you, Mr. Woodsmall.

MIEC.

MR. MILLS: Good morning. May it please the Commission.

The first thing I want to talk about is the capital structure issue, and the one thing that I would like you to take away from my opening statement is that a rate adjustment to correct a capital structure that is not in the public interest is just like any other rate-making adjustment. This is not a particular area that requires the Commission to keep its hands off.

So if the utility has chosen to reflect on its books a capital structure that is unreasonably costly to ratepayers, the

Commission should order an adjustment for rate-making purposes. It's that simple. This is no different than adjustments to remove unnecessary, unreasonable expense like luxury boxes or an adjustment to disallow a certain level of incentive compensation that doesn't benefit customers.

Now, it's a truism and to an extent, it is true that you should not substitute your judgment for that of the Company's management, but for regulation, to have any effect at all, you must make rate-making adjustments when the utility has chosen a path that rewards shareholders and harms ratepayers.

So back to my analogy of the luxury boxes, if you believe that a utility's expenditures on luxury boxes at a stadium is not an expense that benefits ratepayers, you make -- you make an adjustment and disallow that expense for rate-making purposes. It's pretty simple. It's done all the time.

Does that mean that the utility can't continue to spend money to keep its luxury box? Of course not. It just means it can't make the ratepayers cover that expense, because you have decided it's been reasonable.

Now, think about executive compensation. If the utility is paying its C-suite three times more than any other regulated utility and if there's good evidence that such compensation does not benefit ratepayers, you would disallow some level of that compensation, and you would set rates based on reasonable level of compensation. That doesn't mean you're limiting how much executives are paid.

If shareholders think the executives are worthy, they can certainly continue that level of pay, but you would have done your job of determining what level of cost is reasonable for ratepayers to bear, and after all, that's the whole point of rate cases. For all the issues that you're hearing, there's very little dispute over actual expenditures. What the utilities actually spent in the test here is rarely an issue, and it's not an issue in this case on capital structure. We can easily reconcile the rate-making impact of a commissioned decision that establishes a reasonable level of capital -- a reasonable level of equity in the Company's capital structure.

And just like any other rate-making adjustment, by ordering that rates be set on the basis of a reasonable capital structure, you are not requiring the Company to issue more debt, to issue more equity or retire any debt. Just like with luxury boxes or promotional advertising or executive compensation, if you order an adjustment for rate-making purposes, you're not ordering the utility to take any particular action. If you disallow the luxury box expense, they can keep paying it. That's a decision that management and shareholders need to come to.

So management may very well decide that it is -- that is not in the best interest to continue to pay for things like an equity-rich capital structure or luxury boxes or excessive executive compensation, and if they -- if they decide that they want to continue to pay those expenses, then we'll have to find some way to cut costs in other areas to cover them.

So it's the same thing with capital structure. If you determine, and you should, that the Company has chosen to finance its operations with too much expensive equity and too little cheap debt, you make a rate-making adjustment. That doesn't mean that you're ordering the Company to buy back stock or issue more debt. They can continue to maintain exactly the same capital structure as they -- as they have proposed in this case. Such an adjustment merely means that you've determined that just like paying for a luxury box at a stadium, that the Company has chosen a path that harms ratepayers and excessively benefits shareholders.

The other issue that's up for hearing this morning is -- is return on equity, and as I said in my general opening last week, ROE of course is a very important issue, there's a lot of dollars at stake there, and it certainly is -- is an issue that you need to take seriously, but frankly, it's a pretty routine issue at this point.

The Commission in Missouri has awarded electric utilities to regulate about a nine and a half percent return, and they're going gangbusters. They're increasing dividends, their stock prices are climbing, they're entering into mergers and acquisitions, and most importantly, they're continuing to provide safe and adequate service.

Now, there's no dispute that LDCs are less risky than vertically integrated electric companies, and a reasonable return for an LDC is therefore lower than a reasonable return for a vertically integrated electric company.

Now, from my point of view, you have made reasonable decisions over the last few years on return of equity. That's not to say they shouldn't have been a little lower, but they've been reasonable, and there's nothing in this record in this case that I think would make you want to abandon that path of awarding reasonable rates of returns.

So if your electric companies are flourishing at 9.5 percent, what earthly reason is there to award this company a 10.35 percent? There is none. Such a return would only benefit shareholders.

Now, Mr. Gorman, who's jointly sponsored by MIEC and OPC will be appearing today. You've always -- you've always found Mr. Gorman to be a reasonable witness, and he's recommended an ROE of 9.2 percent. And given what you've allowed other utilities and given the debt and equity markets today, and given the difference in risk profiles between vertically integrated electric utilities and gas LDCs, that's a very reasonable, even a comfortable rate of return for Spire in this case.

And I urge you to take advantage of Mr. Gorman's appearance today. He's not only a preeminent expert on this topic, but he's very approachable. He's not stuffy; he's not pretentious. If you ask him a straight question, he'll give you a straight answer, and that's certainly something that you all can benefit from today. Thank you.

JUDGE DIPPELL: Any questions for Mr. Mills?

CHAIRMAN HALL: No questions.

JUDGE DIPPELL: Thank you.

Are there any other intervenors present that would like to make an opening statement?

(No response.)

JUDGE DIPPELL: Seeing none, all right. With that then, I believe we are ready to begin with our first witness by Spire.

MR. FISCHER: Yes, Judge. Spire would call Pauline Ahern to the stand. We -- I don't know, your -- your witness list may have a different order, but we thought we'd put our ROE up first and then take capital structure altogether, if that's all right with you and the parties.

JUDGE DIPPELL: That's fine here and I'm not seeing any objections.

MR. FISCHER: Judge, just for purposes of letting people know what we had in mind too, after Ms. Ahern, we were going to put Steve Rasche and then Robert Hevert and then Glenn Buck on the stand, in that order.

JUDGE DIPPELL: All right.

(Witness sworn.)

THE WITNESS: I do.

JUDGE DIPPELL: Thank you.

Go ahead, Mr. Fischer.

MR. FISCHER: Thank you.

PAULINE M. AHERN testified as follows:

DIRECT EXAMINATION BY MR. FISCHER:

Q. Please state your name and address for

the record.

A. My name is Pauline M. Ahern, A-H-E-R-N. My business address is -- not my mailing address -- is 1900 West Park Road, Suite 250, Westborough -- that's O-U-G-H -- Mass, Massachusetts, 01581.

My mailing address is 3000 Atrium Way, Suite 241, Mt. Laurel -- two words -- New Jersey, 08054.

Q. Are you the same Pauline Ahern that caused to be filed in this proceeding Direct testimony which has been marked as Exhibit No. 38; Rebuttal that's been marked as 39; public version of a Surrebuttal which has been marked 40; and a confidential version of that Surrebuttal has been marked as Exhibit 41?

A. Yes, I am.

Q. Do you have any changes or corrections that need to be made to any of those exhibits?

A. I have a few, about six.

Q. Okay.

A. The first one is in the direct Exhibit 38, page 25, lines 18 and 19, the phrase after the word "DCF, comma," it reads: "The recent dramatic rise in interest rates in response to recent Federal Reserve comments." Should be deleted.

Q. And do you have another change?

A. Not in the direct, no.

The next is in the rebuttal, Exhibit 39 on page 20 -- I'm sorry -- page 30, footnote 38 should read all caps: SBBI-2017, underlined, at 10-22. And that document was provided as part of the work papers to the rebuttal.

JUDGE DIPPELL: Can you repeat that?

THE WITNESS: Footnote 38 should read: SBBI, all caps, hyphen, 2017. That should be all underlined, at 10-22.

And the last changes are in the surrebuttal, my surrebuttal. All I have here is the proprietary Exhibit 41. On page 5, line 26.

BY MR. FISCHER:

Q. Is any of this confidential?

A. No. It -- I don't believe so. I'll double check. (Reviewing document.)

No.

Q. Okay. Go ahead then.

A. Okay. Page 5, line 26, the fourth word from the right margin is "appear." It should be plural, "appears." Oh, one is just a quotation that would go in the confidential. I won't read that one in. Is that all right?

Q. Yes.

A. Page 39. I mean a quotation mark not a quotation. Page 39, line 11. One, two, three, four, five, six... seven -- seven words from the right, there's the phrase "that is an RSM." It should read "that if an RSM."

Q. Do you have anything else that needs to be corrected?

A. No, I don't.

Q. And if I ask you the same questions that are contained in your testimony today, would your answers be the same and true and accurate to the best of your knowledge and belief?

A. Yes, they would.

MR. FISCHER: Judge, then I think this is the only set of issues that Pauline will be appearing on -- in this case on, and I would ask for the admission of Exhibits 38, 39, 40 and 41 and then tender her for Cross. Before I do, though, I should also -- I think I misspoke. Mr. Hevert will follow her in the order.

JUDGE DIPPELL: All right.

Would there be any objections to Exhibits 38, 39, 40 and 41?

(No response.)

JUDGE DIPPELL: Seeing no objection, I will admit those into evidence.

(SPIRE EXHIBITS NOS. 38, 39, 40 AND 41 RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: And we can begin Cross-Examination with Staff.

MR. THOMPSON: Thank you, Judge.

JUDGE DIPPELL: Oh, and I'll just interrupt briefly. Since we do have confidential testimony, I'll expect the attorneys to help me police that if something in the -- and the witness, for that matter, if you know of something that you need to answer or something that we need to go in camera, just let me know.

THE WITNESS: Okay.

MR. THOMPSON: Thank you, Judge.

JUDGE DIPPELL: Thank you, Counsel.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Ms. Ahern.

A. Good morning.

Q. You're employed, I believe you said,

with ScottMadden?
A. Correct.
Q. And what is your hourly rate?
A. I believe on this particular project, it -- it -- well, I know it's $350.
Q. Do you know how many hours you have devoted to this case so far?
A. No, I don't.
Q. Who would know that?
A. I would. I think it's in my time sheet, but I don't -- I have not added them all up.
Q. Okay.
A. And all the hours would be on my invoices that have been provided to the Company.
Q. Now, you're not the only employee of ScottMadden that's participating in this case; isn't that correct?
A. Correct.
Q. Who else is an employee of ScottMadden?
A. Mr. Robert Hevert.
Q. Mr. Hevert. And just you two?
A. As witnesses, yes.
Q. In other words, is there anyone -- okay. Thank you.

And do you happen to know how much ScottMadden has billed so far?
A. No, I don't.
Q. Okay.
MR. THOMPSON: No further questions, Judge. Thank you.
JUDGE DIPPELL: Thank you.
Public Counsel?
MR. SMITH: No questions.
JUDGE DIPPELL: MIEC?
MR. MILLS: Yes.
CROSS-EXAMINATION BY MR. MILLS:
Q. To follow up on Mr. Thompson's question, are there other employees of ScottMadden that have done work on this case that aren't appearing as witnesses?
A. Yes. We have a team and, you know, that we rely on. I'm not sure whether Mr. Hevert relied on the team for his testimony. I had analysts working on it with me and people editing.
MR. MILLS: Thank you. That's all I have.
JUDGE DIPPELL: Midwest Energy Consumers?

MR. WOODSMALL: Yes.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Very briefly, Mr. Thompson asked you some compensation questions. Do you know how much your budget is for this case?

A. No. And I'll tell you why. I typically -- my fees typically run -- and I don't know what it is for this particular case on a here it is, ready-to-file basis for the direct testimony, because that was a single charge, and following the filing of direct testimony, it's on an hourly basis. We don't know how many witnesses there are going to be, we don't know how many discovery requests there are going to be, we don't know whether we need to appear at hearings. Rarely am I asked for can you give me -- except for tiny companies, can you give me an estimate of what your rebuttal costs might be or your presence at hearings.

And to the extent I can, I utilize people at, you know, support Staff, technical Staff, analyst Staff, and then that reduces the overall composite hourly rate, but there was no budget, no -- I did not give a budget and said

this is the project cost.
Q. So there is no ceiling in the amount that you could have charged in this case?
A. The technical answer is yes, unless I had been involved in cases where if it exceeds a certain amount, I can't go over that without approval.
Q. So what is the ceiling that --
A. That was not specified in this case.
Q. So there is a ceiling, but it wasn't specified?
A. It wasn't specified, but I can tell you that on all the cases I've been in, the amount of hours that have been spent have been rather typical.
Q. Can you tell me then how the ceiling would be quantified if it wasn't specified?
A. No. It's not -- it's not quantified in this case. In other cases, the client has specified a ceiling.
Q. Okay. In this case, is there a ceiling --
A. No.
Q. -- in the amount you could have charged?

A. No, there is not.

MR. WOODSMALL: Okay. Thank you.

JUDGE DIPPELL: Is there anything from Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Are there questions from the Bench?

CHAIRMAN HALL: Yeah, I have a few.

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning.

Q. What is the role of risk in a proper determination of an ROE for a regulated utility?

A. The 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.

When they put their money, when they buy a common stock, they buy it with a required return necessary to compensate them for whatever risk they're taking on. So when they look at one, two or three different investments, they know they're -- you know, risk profile, how much -- how risk averse they want to be or they are, whether they want to invest in something safe such as municipal bonds, or they want to go into a riskier venture, utility stock, or an even riskier venture, like Amazon or venture capital project.

They assess their assessment of the risk they're willing to take on and they look at the opportunities they have to invest and what would match their risk assessment, and they try to maximize the return and put their money in an investment where the required return is going to match their risk assessment.

Q. Generally, what is the relationship of risk between vertically integrated electric utilities and gas utilities?

A. Generally, all else equal, vertically integrated utilities, because they are in a production process, are riskier than transmission LDCs or electric transmission companies, but the quantification of that risk comes through looking at the market data --

Q. Right.

A. -- and advising -- you know, because the market data represents the results of the decisions that the investors are making based on their perceptions of risk.

Q. So if this Commission were to determine that there was a particular appropriate ROE based upon risk for an electric utility and in the exact same time frame, was trying to make a risk analysis so as to determine an ROE for a gas company, the ROE for the gas company should be lower?

A. As I said earlier, all else equal.

Q. Right. Well, that was inherent --

A. Yeah, all else is not necessarily equal.

Q. That was inherent in the question.

A. Okay. What I think is if you've got two cases before you and one's ann electric and one's a gas, LDC, an integrated electric, you really need to look at the evidence of the individual records and see where it comes out, because all -- all of the factors that the investors take into account when making the decisions will be reflected in the market data and, therefore, should be reflected in the estimations of the -- the regular -- the cost of equity models that we use.

Q. So what's happened t -- and there's been some discussion about this and some testimony and evidence as well, but just to recap, what -- what has happened to -- to Spire's stock prices over the last five years?

A. They have risen. They have risen significantly. They -- as the chart showed, they have not risen as significantly as have their peers.

Q. When you say that, "as their peers," explain that to me.

A. Well the peer group or the S&P 500 that were on that chart and that's --

Q. Yeah, I couldn't see that chart. So --

A. Oh, okay.

Q. -- it didn't -- it didn't do much for me.

A. Oh, okay.

MR. FISCHER: Would you like to have something better to look at, Judge?

CHAIRMAN HALL: Sure. That'd be great.

MR. WOODSMALL: Can I get a copy of it if we're going to ask questions about it?

MR. FISCHER: Yeah. Well, we can

make it an exhibit later if you like.

MR. WOODSMALL: That doesn't help me now.

MR. FISCHER: Oh, okay.

THE WITNESS: Can I take a quick look at it and give it back to you?

MR. FISCHER: Judge, if we can just mark that as an exhibit and I can put it up there for everybody?

JUDGE DIPPELL: Sure. We'll mark the exhibit from Mr. Fischer's opening on this issue as Exhibit 57.

MR. WOODSMALL: Your Honor, is this a demonstrative exhibit or how are we handling this?

MR. FISCHER: It was originally, but I have a witness that can sponsor the data on it.

JUDGE DIPPELL: It is demonstrative until it's offered as something different.

(SPIRE EXHIBIT NO. 57 WAS MARKED FOR IDENTIFICATION.)

THE WITNESS: What this shows, so the orange -- the dark blue line shows the appreciation of the S&P 500 over five years.

Total appreciation is 74.9 percent. The top line, the gray line shows the average appreciation for peers identified by Spire. It's 101.07 percent.

CHAIRMAN HALL: And those peers, those are what types of companies?

THE WITNESS: They are LDCs, local gas distribution companies. And if I'm wrong, someone can correct that later, but I believe they're all LDCs.

MR. WOODSMALL: Your Honor, I'm going to object. I believe we have a witness here testifying on facts that are not in evidence and saying if I'm wrong, someone else can correct me. She's clearly testifying on things outside her firsthand knowledge. So if you want to lay a foundation, we can, but I don't believe a foundation has been laid yet for her to testify on the material in Exhibit 57.

CHAIRMAN HALL: Well, let me -- what witness do you have that will be able to testify?

MR. FISCHER: Steve Rasche is available, and he's the chief financial officer of Spire, Inc., and he can testify to this document and how it was prepared but --

CHAIRMAN HALL: Okay. Well, objection sustained.

MR. WOODSMALL: Thank you.

CHAIRMAN HALL: No. That's fair enough. I should be asking that witness those questions.

THE WITNESS: I can talk about the numbers, but --

CHAIRMAN HALL: I'm sorry?

THE WITNESS: I said I can talk about the numbers.

BY CHAIRMAN HALL:

Q. Well, then answer -- answer this if you can: Putting aside the validity of these numbers and where they came from, what -- what am I to gather from them of significance when trying to determine what is the proper ROE in this -- or return on equity in this case?

A. Okay. Two points. The first is that Spire, which is the orange line, the SR line, that their market price appreciation over the last five years has first -- was under, below the market and below the peer group until about 2015 when it rose, and it's now tracking very well with the S&P 500. But it is still below and it is well below since 2015 the peer group against which it's measured, which is considered comparable in risk.

Q. So why shouldn't I look at this --

A. Second point.

Q. Why shouldn't I look at this and say wow, it looks like the ROE -- it looks like Spire's doing comparable -- comparably with the S&P 500 and perhaps there's something going on with -- in other states, other state commissions that is awarding an ROE that is too high and that's why the peer average is so much higher than the S&P 500? Why shouldn't that be my conclusion?

A. No, because ROEs, the award isn't -- in my opinion is not as important as the performance, whether the companies are able to earn those ROEs, plus there are many factors that go into the investor assessment of what market price they're willing to pay.

This would tell the investor that Spire hasn't first -- for whatever reason, has not been performing as well in the market and is not necessarily as attractive an investment, because they can get a better return by moving to the peer group.

But then, as I have done in my testimony, no proxy group is identical in risk. One needs to do an assessment of the relative risk.

Q. Tell me what's wrong with the approach that Staff is advocating, that Staff went back and looked at an ROE determination in two recent cases of an approximately 9.5 and then did an analysis of the risk inherent for investors with Spire versus those two electric utilities and Staff determined that the risk was lower and so therefore, reduced the recommendation. But just not the analysis itself, not the numbers itself, but what's wrong with that approach?

A. In my opinion, it's an ad hoc approach. For one, you're going back to a return that was authorized under different economic conditions with a different evidentiary record, and I believe one of them was a settled case and one was litigated.

What Staff did, in addition to saying that, you know, integrated electrics are less risky than just gas distribution companies, made an ad hoc -- 25 basis points without an analysis just by looking at what ROEs had been in the past and then also added to its analysis that interest rates have fallen since the -- especially since the KCP&L case in May, and based on that, well, if you award -- this is my words, my interpretation of what Staff did. Well, if you're going to award 9.5 in May, interest rates have come down, gas is less risky, it should be a lower return without -- but that is not what Staff's analysis showed when Staff did its analysis of the market data, and it's not what I show based on my analysis of the market data, and it's not what Mr. Gorman shows based on the analysis of market data.

In fact, my analysis, the 10 percent for the proxy group that I had before the adjustments has now risen to 10.35. Beta risk has risen, the equity risk premium has risen. You can't just take one or two factors that go into the ROE, the estimation of the ROE and then say, oh, at this point in time, it was this, the Commission determined this, or somebody estimated it as this, and oh, interest rates have changed and they're less risky, and therefore, it should be X basis points lower.

Q. Tell me why LDCs are less risky than vertically integrated electric utilities?

A. Well, as I said earlier, it's the generation portion. That generation is considered less risky production, you know, sales issues, contract issues and water is similar because there's production issue -- production factor there as well.

Gas, you purchase gas, you don't have any fuel cost issue there, because it's generally a pass-through and is really just the distribution becomes an infrastructure issue. If you have the aging of the pipes and things like that, you have consumption, you have declining consumption issues, but it's a pretty straightforward operation as compared to generation.

Q. So the existence of a PGA reduces risk for the LDC?

A. In and of itself?

Q. Yes.

A. In and of itself, again, all else equal, yes.

Q. That's inherent in the question.

A. But my point is that you can't quantify by what basis points that would do that. It would be -- the reduction of risk is reflected in the market data.

Q. Does the existence of an ISRS reduce risk?

A. Yes. And that's reflected in the market data as well.

Q. Does the existence of additional trackers reduce risk?

A. Yes. And that's reflected in the market data because you find that generally, the estimated borrowing based on the models for gas distribution companies is generally lower than the integrated electrics.

Q. If we were to institute some type of RSM in this case, would that reduce risk?

A. Yes. But again, that's imbedded in the market data and especially the proxy group that I use, where the majority have such mechanisms.

Q. If we were to increase the customer charge, would that reduce risk?

A. Yes. But again, it can't be quantified in terms of basis points on ROEs. It would be reflected in the market data.

Q. Are there other issues in this case before us that -- you know, if we were to rule one way or the other would reduce risk?

A. Not of which I'm aware, and the reduction in risk always has to be relative to the proxy group that is being used to estimate the ROE.

Q. Do you think risk is the most significant thing that the Commission should be focused on when setting an ROE?

A. Oh. If I may answer it this way: I think it is the most important thing to focus on when analyzing the data, the ROE analysis, but I recognize that there are many other factors that go into Commission decision-making; factors about avoiding rate shock, fairness and things like that, and if you have other considerations to take into account, there are other factors in the rate case that I am not an expert in and I'm not testifying to that is more in your purview of judgment than in mine, but when estimating the ROE and the analysis that's been presented to you on ROE, I think you -- it's very important that you look at whether there's been a proper risk assessment.

Q. On page 17 of Staff's cost of service report, Mr. Murray -- I believe it was Mr. Murray --

A. Yes. I'm there.

Q. -- instructs or recommends to the Commission that if -- that the capital structure adopted by the Commission should impact the ROE determination as well on lines 8 through 13 on page 17. Do you see that?

A. Yes. Yes, I do.

Q. Do you agree with that analysis?

A. I agree with the concept without speaking to the -- this specifically whether it should be up or down that the capital structure is certainly a component of the risk I was discussing before, because the greater the amount of debt in the capital structure, the greater the financial risk. Therefore, the greater in general the cost of debt and the greater the cost of equity.

So that is a factor that is considered by investors. So that is a risk that you should consider as well. I did not make an adjustment for financial risk because the proposed capital structure was similar to the capital structure of my proxy group.

Q. Okay. And you may have alluded to this a moment ago, but I want to be sure I understand. On that same page, lines 3 through 8 on page 17, Mr. Murray discusses the credit rating.

A. Um-hum.

Q. The credit rating is higher for the gas companies vis-à-vis the electric companies?

A. Correct, minimally. It's one to -- one and a half notches higher.

Q. And is that something that the Commission should take into account in this case when -- when setting a ROE?

A. I think it's one component because it's one component that the witness has taken into account and I -- again, I did not make any adjustment because the bond rating of Spire Missouri is the same as the -- my proxy group.

Q. But if the Commission were to determine that the consolidated capital structure is appropriate, what type of adjustment would you make in your ROE recommendation, if any?

A. All right. I'll look back and tell you. Generally, when I make an adjustment for credit risk, I look at the different notches. I look at the spread between being A2 and a BAA2. There are three notches. So if there were -- if you're looking at a company with a BAA2 versus a company with an A2, it would be the full -- the full spread.

This is based on his A to A- and the B -- BBB+. That's about one-sixth of the spread. It's halfway between the notches. And based on my analysis at the time, spreads of BAA -- Moody's BAA over A was 52 basis points. So one-sixth of that, it would be one -- it would be about seven or eight basis points if I were to make a credit risk adjustment solely on those bond rating differences.

Q. Do you know when the Liberty rate case determination took place where there was a 10.0 ROE awarded referred to by counsel?

A. I believe it was at the end of 2014. Subject to check.

Q. What do you believe has happened to the capital market since the end of 2014 that would -- that would motivate us, the Commission, to award a higher ROE?

A. Well, first and foremost, the Federal

Reserve has begun to raise interest rates and is now reducing liquidity in the capital markets by reducing its balance sheet. It is expected -- if the government doesn't shut down this week -- that they will raise another 25 basis -- 25 to 50 basis points this week with both value line and blue chip expecting two to three more in 2018, even given the fact that Janet Yellen will no longer be Chairman once the new fellow is confirmed. He is of the same perspective that she is, and he is expected to maintain the same policy. That's one thing.

The other is we are living in a geo- -- be global geopolitical risk has increased for all markets. We are -- in fact, this morning I think I read or I did read that the Nobel Peace Prize winners who were all council -- I don't remember the name -- to stop the proliferation of nuclear weapons is calling for -- you know, is fearful that we -- we may have a nuclear war.

We -- I think those factors are bearing very greatly on the market, and we haven't seen what is happening. There is a lot of discussion in the market that the appreciations like this (indicating to Exhibit 57), that the market is

gradually reaching a high bubble and may burst.
And notwithstanding the low level of interest rates, there is still -- and the low volatility because the market keeps moving steadily up, there's a great deal of risk out there, and personally, I think people are seeking to get returns now because they don't think they're going to last. But I think that in the --
Q. Those are the two factors?
A. Those are two, yeah, that -- um-hum, I think.
Q. Okay. And then this may be the end of my inquiry. On page 15 of the cost of service report, lines 6 through 13 --
A. Yes.
Q. -- and I'm not going to read that into the record. It's -- I'm wondering if you could read that and tell me if you --
A. What lines again, please?
Q. 6 through 13.
A. Okay.
Q. If you agree with that analysis?
A. You want me to stop at the end of the sentence, "environment"?

Q. Why don't you read the whole paragraph.
A. Okay. "Goldman Sachs" --
Q. Just to yourself.
A. Oh, I'm sorry. Okay. Never mind. (Reviewing document.)
Okay.
Q. What is your reaction to that?
A. Um... (reviewing document.)
I have -- oh, never mind -- strike that.
I think I respond in my rebuttal that utility COE, cost of equity, is low precisely because interest rates are low because of the way the interest rates affect the estimation of the cost of equity. I'm not convinced that the cost -- investors' required return is low. The estimation of that return using the DCF and the CAPM is low. Interest rates come into play directly in both risk premium methods and the capital asset pricing method and market valuations, based -- the high market valuations based on the low interest rate environment come into play in the low dividend yields we have now.
That being said, this is -- I was

responding to you earlier, the Federal Reserve is expected to increase the interest rates, and I think treasury bonds are expected to be in the 4 percent range within five years. So I think you will begin to see that the cost of equity models will begin to show an increase in the estimated cost of equity.

Blue chip is projecting that by the fourth quarter of 2018, the 30-year treasury will be at 4 -- 3.5. By 2020, it will be 4.1, going out to about 4.2 by 2023. And similarly, value line is projecting the same.

Oh, and my other point was that if you go back to this chart, and I don't have the exhibit number marked on it, but I don't believe that -- never mind. I'm going to strike that without knowing for sure. Never mind.

CHAIRMAN HALL: Okay. I have no further questions, thank you.

COMMISSIONER KENNEY: No questions for me.

JUDGE DIPPELL: Commissioner Rupp.

QUESTIONS BY COMMISSIONER RUPP:

Q. Good morning.

A. Good morning.

Q. Can you remind me what the beta on a stock is?

A. The beta is an estimate measurement of something called systematic risk, non-diversifiable risk. It's the measure of -- to get wonky here -- the co-variability of a stock's returns or equity risk premiums relative to the market as a whole. It's not a complete measure of risk. It -- the R-square associated with it is only about 20 percent. The rest of the risk that is reflected in the volatility of returns is -- would be non -- nonsystematic or company-specific non-diversifiable risk.

Q. Okay. Your beta is relative to the S&P 500 risk. So if I have 1.0 beta, I'm right there with the S&P 500 on a risk standpoint?

A. Correct. And you have to remember that that 1.0 -- it's always 1.0. From year to year the market is 1.0, where its risk might change. If you look at a 1.0 beta, you say, "Oh, the risk never changes," but it does. It's always assumed to be 1.0.

Q. And then the beta for Spire is .53 currently?

A. Um... I don't believe so. Value line

has it at .70. You may be looking at an unadjusted beta.

Q. I was looking just at a market watch or something.

A. I think those are unadjusted.

Q. Unadjusted?

A. Right.

Q. Okay. So unadjusted, it's point -- or adjusted, it's .7 or something?

A. As of the September 1st value line, it was .70.

Q. .70. So according to the value line then, that would be less risky compared to the market as a whole?

A. Correct. If the market moves, say goes up 10 percent, it's going to go up 70 or vice versa.

Q. Okay. And I could not see the chart that was shown this morning --

A. Oh.

Q. -- because I was listening on the drive in, but what is the return of the S&P 500 in that chart?

A. There's not a return. It's just a total increase over the five years. But what beta measures, based on this chart, is the variability, the up and down for each of the lines. Relative to the up and down, the change in the blue line, the S&P 500.

Q. But over that period of time, the S&P, it rose 74.9 percent according to this chart?

A. Correct.

Q. And Spire's stock was up 73.6? So it --

A. Correct.

Q. With less risk, it still tracked the market as a whole?

A. But -- yes, based on the pure CAPM theory, but the peer group, who is my peer group, all of which are in this group, their beta is -- their average beta is about .71 right now. But as I said in response to one of your earlier questions, beta risk is only 20 percent -- explains only 20 percent of that volatility.

Q. So let's walk down that road. So if the average of the peer group is .71, so roughly in line with Spire, that the entire peer group -- how did the entire peer group do compared to the S&P 500?

A. This peer group did 101 percent or difference of 26, 27 basis points better.

Q. Okay. So with the same risk premium or the same level of risk, the peer group did better than the market?

A. That's only assuming that you're looking at beta risk, but that's only one factor of risk.

Q. We're just looking at beta risk right now?

A. Just -- yes. The math is correct on that.

Q. Okay. Great. So explain to me why if the beta risk in the peer group's beta risk and is tracking the market, they're getting a return above the market and stuff, why a need for a risk premium is there, in your opinion, for an investor?

A. It is not there based on beta risk. It is there based on those other -- the other component.

Q. Then explain to me what those other risks are besides the beta risk?

A. Well, okay. The only adjustment I made for that type of risk was for size, because all else equal and when one picks a proxy group, one assumes that that company is as similar as possible in risk to the target company, the regulated company, to Spire, but no company can be -- no proxy group can be. But based on the size, Spire is smaller and there are -- there is empirical quantitative evidence out there that indicates that you can determine approximately how large that premium -- or small that premium -- or whether there should be a premium at all.

And I think I've been in this Commission for Missouri American and actually didn't put one in or put a negative one in because their size was bigger than me, the proxy group at the time.

Those are the other risks. That is not the only risk, different business risk that may be seen by investors. As I said, they look at many more. One is regulatory environment. That's a big -- and cost recovery, big factor in credit ratings. Like 50 percent of the credit rating processes evaluates regulatory environment and cost recovery.

Q. And so without me having to dig into

your testimony again, what is the quantitative size difference of Spire to the peer group?

A. I believe it's 34 basis points, I believe. I can look it up.

Q. And so you just took the 34 basis points of --

A. (Shaking head.)

Q. So that's where you came up with your adjustment?

A. I used that, but it's a very kind of -- the comparison of the premiums, the size premiums for the group and for Spire fit kind of very grossly into deciles. They're broad. So I... it was 32 basis points and my adjustment was 20. I took something less than half of that.

Q. Okay. Switching gears to the goodwill, are you the person I should ask on that or is that --

A. No. That's Mr. Hevert.

Q. Okay. Mr. Hevert. I'll save my questions for that.

A. Thank you.

JUDGE DIPPELL: Is there further Cross-Examination based on questions from the

Bench from Staff?

MR. MILLS: Judge, before we get to that -- I didn't want to interrupt the Commissioner's questions -- what I want to make clear on the record that what we are calling for purposes of questions "the peer group" has no foundation. We don't at this point know what is in that group or how the returns for that group were calculated.

So I think the record needs to clearly reflect that in those series of questions, that's what we're talking about. We're talking about some unknown group determined by someone other than this witness and whose returns are were calculated by someone other than this witness.

JUDGE DIPPELL: And that's with regard to the peer group that is shown on Exhibit 57?

MR. MILLS: Exactly.

JUDGE DIPPELL: I'll just clarify with the witness, however, when you talk about your peer group --

THE WITNESS: I try to use the word "proxy group."

JUDGE DIPPELL: You used the word "proxy group," and you were discussing the proxy group from your testimony.

THE WITNESS: Correct.

COMMISSIONER RUPP: And that's what I was referring to your proxy group in your testimony.

THE WITNESS: Okay.

JUDGE DIPPELL: Right.

All right. Is there further Cross-Examination from Staff?

MR. THOMPSON: Just a little bit. Thank you, Judge.

RECROSS-EXAMINATION BY MR. THOMPSON:

Q. Referring to Exhibit 57, in response to a question from the Chairman, you testified that the exhibit shows that Spire wasn't doing as well as the peer group; isn't that correct? Do you remember that?

A. Yes.

Q. Okay. But it's true, isn't it, that investors may use Spire as more risky because of its acquisition activity?

A. I don't agree with that. They may. Who knows. Who knows. It's in the market data.

However --

MR. THOMPSON: Thank you very much. You've answered my question.

JUDGE DIPPELL: Is there further Cross-Examination by Public Counsel based on the questions from the Bench?

MR. SMITH: Yes. I just had a question about the geopolitical risk.

RECROSS-EXAMINATION BY MR. SMITH:

Q. I wanted to clarify. Did you say earlier that Spire should have a higher ROE because of the risk of nuclear war?

A. No. No. I said that the markets in general are riskier and that would affect all companies.

MR. SMITH: Okay. Thank you.

JUDGE DIPPELL: MIEC.

MR. WOODSMALL: Yes. Thank you, your Honor.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. Can you tell me how interest rates have changed since 2014?

A. They have been going up and down in a very general --

Q. But since 2014.

A. -- very narrow range.
Um... (reviewing document.)
Q. You don't know?
A. Off the top of my head, no.
Q. So when the Chairman asked you what has changed since the Commission issued its decision in 2014 and you said interest rates have gone up, you don't know that interest rates have gone up since 2014?
A. I was referring to the increases in the -- that Federal Reserves has made, and that has affected interest rates. So in general. They are going up and the forecasts are going up, but specifically, no.
Q. You don't know if interest rates --
A. Right.
Q. -- have gone up since 2014?
A. I didn't go back and see what they were in 2014 compared to now.
Q. If interest rates had gone down relative to when the Commission issued its decision in Liberty utilities in 2014, one would expect ROE to be less; is that true?
A. Not necessarily. The estimation may be lower, because as I said before, that the

estimation of the models is based in part on interest rates because they form part of the components and they form part of the reason market valuations are rising, but there are other factors that go into the ROE, investors' perception of risk being one of them.

Q. But all else being equal, interest rates go down, ROEs go down?

A. I can't answer that. All else equal is never equal.

Q. Okay. So when you were asked all the questions from the Chairman about all else equal and you kept placing the caveat "all else equal" --

A. Yeah.

Q. -- you don't know that --

A. Well, if all else equal, what happens when interest rates go down? If interest rates go down about a hundred percent, a hundred basis points, theoretically, the cost of equity, the equity risk premium rises by 50 basis points. They move in tandem, but they move at an in-risk relationship.

So it doesn't go down as far. If you're just going to do the math that way, you got a cost of equity, say 10 percent, you have a debt cost of 5 percent, it goes down to 4 percent, 10 percent goes to 9.5. It doesn't go down to 9.

Q. They move proportionately to each other?

A. In an inverse way, yes. Oh, I'm -- yeah, that's right.

Q. Can you tell me what Spire's credit rating is?

A. I believe it's in A. (Reviewing document.)

I have it as an A1/A2 by Moody's, and an A- by S&P.

Q. Do you know what Ameren's credit rating is?

A. Not off the top of my head.

Q. Do you know what Great Plains' credit rating is?

A. No. Not -- not -- I don't have it with me now.

Q. Okay. Would you agree that credit rating is a reflection of risk?

A. It's a reflection of default risk and the risk that the bondholders face. It is -- in

general, it can give an indication of the risk, but it doesn't measure in any way equity risk.
Q. It -- would you agree that you prepared your proxy group in large part based upon similar credit rating between the companies?
A. Credit rating was not one of my selection criteria.
Q. But you said earlier that Spire's credit rating matched that of your proxy group; is that correct?
A. It is correct. I did not select them. The proxy company is based on credit rating.
Q. But the fact that they have a similar credit rating reflects that they are comparable companies; is that true?
A. Correct. In everything but size.
Q. Okay. And would you agree that as a company's credit rating goes up, its ROE tends to go down?
A. Yes. In general --
Q. And --
A. -- it may. It may. Again, I'll put all else equal on it. It may; it may not, depending on investors' perception of the risk.
Q. So if Spire has a higher credit rating

than Ameren and Great Plains, all else being equal, it would require a lower ROE?

A. Again, we're back to talking about probably an authorized ROE. You -- we really want to emphasize -- you need to look -- one needs to look at the evidence in the record relative to what the market data of companies of similar risk, what we see their required returns by investors are.

Q. But if Spire has a higher credit rating than Ameren and Great Plains, it has a lower risk?

A. It has a lower credit risk.

Q. Right. And as credit risk goes down, the expected authorized return goes down, I believe you said earlier?

A. I didn't say "expected authorized return."

Q. Okay. Would -- do your recommended returns go down as credit rating goes down?

A. My recommended return is based solely on the market they'd apply to the proxy companies. I believe I was asked a question earlier about -- or we discussed if there were -- what kind of credit. I think it was relative to Mr. Mahr's (phonetic) Staff report, the double -- the BBB+ and the A/A-, what kind of adjustment would be made. If there were to be a significant difference in the bond ratings of the companies and I didn't have size or -- or not size, I'm sorry -- capital structure differences, there may need to be a credit risk adjustment up or down, but the basic ROE is based on the application of the models to the market data. For example --

Q. But you --

A. Yeah.

Q. -- determined the market data based upon a proxy group that has the same credit rating as Spire in this case?

A. Yes.

Q. Okay.

A. And that was -- but I didn't select them that way.

Q. Okay. An -- and -- I can do redirect.

And you don't know how Spire's credit rating compares to Ameren's and Great Plains?

A. Ameren and Great Plains are irrelevant to my analysis.

Q. But it's relevant to how investors

invest; is that true? Investors don't only have the option to invest in your proxy companies.

A. Correct. But they're not going to consider only credit ratings as the only difference.

Q. And you were undertaking some analysis on the fly -- excuse that characterization --

A. It's okay.

Q. -- about how ROEs would change based upon changes in capital structure. Do you recall that? I believe you were saying --

A. Yes.

Q. -- something about one-sixth of the differential?

A. That was credit rating difference, yes.

Q. Okay. And -- okay. So your attempt to assess a change in ROE was based upon credit rating differences?

A. Yes. That six or seven rate basis points was based on credit rating. I was specifically asked what an adjustment would be for the A/A- to BBB+, if I could identify that.

Q. And A to A- to BBB+, what did you say was the difference in ROE?

A. It would be one-sixth of 52 basis

points, but it's only relative --

Q. So approximately nine basis points?

A. Maybe nine, yes.

MR. WOODSMALL: Okay. I have no further questions.

THE WITNESS: But that's only relative to this analysis.

MR. WOODSMALL: Thank you.

JUDGE DIPPELL: Is there anything from MIEC?

RECROSS-EXAMINATION BY MR. MILLS:

Q. Is in fact the credit rating for your proxy group and Spire exactly the same?

A. I believe so, yes.

Q. By both S&P and Moody's?

A. No. The average for the proxy group is A2, but it is A- for the -- for S&P.

Q. Okay. But Moody's considers Spire to be more creditworthy than the proxy group, correct?

A. Minimally.

Q. But in that direction, correct?

A. If you're going to look at spreads, yes, there would be just a little -- a one -- a little, bitty bit, yes.

Q. You didn't make any adjustment for that, though, did you?

A. No, I did not.

MR. MILLS: No further questions.

JUDGE DIPPELL: Is there anything from the Environmental Defense Fund?

MS. KARAS: No, Judge.

JUDGE DIPPELL: Is there Redirect by Spire?

MR. FISCHER: Just a little, Judge.

REDIRECT EXAMINATION BY MR. FISCHER:

Q. Ms. Ahern, let's start with some of the later questions and go backwards, if that's all right.

A. That's fine.

Q. I believe it was Commissioner Rupp asked you some questions regarding the betas and also asked you a question about the fact that the peer group had performed better than Spire's performance over the last five years. Do you recall that question?

A. Yes.

Q. What is the better performance of the peer group tell you about relative to Spire?

MR. MILLS: Judge, I'm going to

object to the characterization of this peer group. We don't know in what sense it's a peer group, and he wants to qualify it by saying this unknown group that's labeled "Peer group," that's one thing, but I think coming from the Company attorney calling it a peer group assumes facts not in evidence.

MR. FISCHER: Judge, again, we're going to have a witness to sponsor that and just as a matter of expediency here to get through the cross, I would like to be able to reference the peer group as it's reflected on that exhibit.

MR. WOODSMALL: I believe he just proved the point. He said -- Mr. Lewis's [sic] objection was assumes facts not in evidence, and he just conceded that the facts will come in later, so...

MR. FISCHER: And, Judge, that happens all the time in this hearing room, where we put one witness up and then 15 witnesses later, we put somebody else's testimony in. He can move to strike it if we can't support it.

JUDGE DIPPELL: I'm going to allow the question. You might want to, just for the record, keep it clear that you're discussing the --

MR. FISCHER: Exhibit.

JUDGE DIPPELL: -- reference to the peer group on that exhibit.

BY MR. FISCHER:

Q. Ms. Ahern, you understand that caveat?

A. Yes.

Q. What does the better performance of that specific peer group on Exhibit 57 tell you relative to Spire's performance?

A. It tells me that Spire's performance, Spire has been underperforming the peer group, which is -- I do understand it's a group of LDCs.

Q. Does -- you mentioned in answer to -- I think it was the Chairman that you made an adjustment due to size of Spire. Would you explain why you did that?

A. Because size is a factor of a risk factor, what in regulation -- and this kind of goes a little bit to the capital structure issue as well and to some of the opening comments.

Rates are being set in this proceeding for Spire, for Spire Missouri only. They're not being set for Spire Energy. It is the use of funds which is important to -- that gives rise to the risk of that investment. The risk here is related only to Spire's operations, to Spire's rate base. We pick a proxy group. It's not related to Spire, Inc., and while Spire, Inc. has the shared services agreement, and as I said in either rebuttal or surrebuttal, it mitigates the effect of that risk on the consumers by lowering the costs.

If Spire were to be spun off and be an independent, standalone company, those costs would be higher, the risk would be the same, but the costs would be higher and the rates to -- rates for ratepayers would be higher.

Size is one of the -- I think it is the maybe other than credit risk, and financial risk, it's the -- to the best of my knowledge, the only risk difference that can be quantified and that has been empirically quantified.

What I've done is I've used one of those empirical studies to determine size of premium relative to the market associated with the proxy group and a size premium relative to the market for Spire based on their relative sizes. I subtract those two and got 32 percent or 32 basis points, and then I took a portion of that 20 basis points.

Q. Is the regulatory risk environment another risk that would be taken into account?

A. Yes, it would, and as I said earlier, it is one of -- it's 25 percent of what it affects, I should say, the credit rating analysis of both S&P and Moody's by about 25 percent.

Q. Within that regulatory risk category, what kind of things are typically considered by analysts?

A. One of the most important is cost recovery -- you know, cost recovery mechanisms which will enable and allow the earning of the authorized return. The authorized return, if it's a surprise, can be -- I've seen cases where an ALJ has recommended a 10.2 and it's been brought down to, say, 9.5 and caught the market and caught the credit analysts by surprise, and that was credit negative.

Transparency, consistency, even if that consistency is negative, you know, consistently low ROEs, you know what you're going to be getting, if the ROE is so low that it's going to put the Company in financial distress and begin to put pressure on cash flows and credit metrics, those sorts of things.

Q. And I believe the Chairman asked you about things like the existence of a PGA and the ISRS and trackers and how that affected the risk. Do you recall that?

A. Yes, I do.

Q. Would your proxy group -- what I'm talking now about is the companies that you actually use to compare Spire to in your testimony.

Would those companies also have those types of regulatory mechanisms available to them?

A. Yes, they do, and I've -- there's a schedule, I think the only schedule attached to my surrebuttal that shows that, and to the extent that those companies do have those kinds of mechanisms, it's reflected in the market data already. So it's reflected in that base 10 percent of mine and now currently 10.35.

Q. And to the extent that the Company didn't have an RSM or a rate design that was

weather mitigating, would that affect the risk of the Company?

A. Not a quantifiable way because that has not been empirically proved. However, if one's mindset is that you're going to reduce an authorized ROE, and there are some commissions that do because of the existence of these mechanisms, then relative to the proxy group if the Company in question, the target, the Company being regulated for whom rates are being set at that time, if they do not have those mechanisms, logic and symmetry dictates you need to increase the ROE. I'm sorry.

Q. Would decrease in customer service charges have an effect on the risk of the Company being able to recover its fixed costs?

A. Depends what they did with fixed costs in that case, how it's balanced out. If customer charges are decreased and fixed costs are increased to balance it, it would hurt the customers.

Q. And those are recovered in commodity rates then typically; is that correct?

A. Right.

Q. So if you don't recover as much up

front in the customer charges, you're more at risk --
A. Right.
Q. -- whether you're going to be able to recover them through the commodity rates; is that true?
A. Correct. Correct. If you get any fixed charges that are recovered and customer charges as there's declining consumption, then you're going to run the risk of not recovering your fixed charges.
Q. The Chairman also asked you about, I think, what has changed since the Commission granted Liberty a 10.0 percent increase -- or ROE in 2014. Do you recall those?
A. Yes, I do.
Q. I believe you mentioned there were market changes since that time and one of the ones that you mentioned were the Fed -- the Fed had raised interest rates?
A. Yes.
Q. Do you happen to know how many times roughly that's happened since either 2014 or 2015?
A. Well, they raised it from what 0 to 25

all the way up to 25 to 100, in 25-basis point increments of three or four, with another one expected Wednesday.

Q. Why are you suggesting that there's another one expected Wednesday?

A. Um, well, the -- something called the CME FedWatch tool is projecting a 90 to 95 percent expectation, the -- as I said, value line and blue chip are expecting it. I read it this morning in the paper, and I think investors are expecting -- I think it will be a big shock to the coun- -- to the market if they don't raise it.

Q. You also mentioned, I think in that same discussion, that the Fed was reducing its balance sheet. What did you mean by that?

A. They're reducing the securities that they're holding outright, the quantitative easing that they began at the financial crisis. They pumped a lot of money into the market by buying bonds. Now they're selling them again and they are reducing liquidity by taking money out of the market.

Q. What does that tell you about their goal, if you want -- if you use that term for

where interest rates should be?

A. Their goal is to move them back -- not back. They don't think -- they think they're going to be low for sometime, but they -- and they recognize that they're low. In fact, they said in the November 1st press release, which was echoed in their minutes: "The Committee expects the economic conditions will evolve in a manner that will warrant gradual increases in the federal fund's rate: The federal fund's rate is likely to remain, for sometime, below levels that are expected to prevail in the longer run."

So they recognize that they are low now.

Q. And what does that tell you -- or what would that suggest to you that long-term interest rates will do over --

A. That long-term interest rates will increase. While they may not increase to levels they were prior to the financial crisis, they're certainly going to increase above what they are now, and given that the investors' required return of equi- -- cost and equity and rate-making are all expectational, that's my argument, my support for using forecasted interest rates in cost of equity analysis.

Q. I believe you also mentioned one of the other factors that have changed have been authorized rates of return. Do you recall that?

A. I recall discussions of authorized rates of return, yes.

Q. What has happened since 2014 or 2015 to authorized rates of return or even more recently than that, if you have that data?

A. Yes, I do. If you look -- I think it's the last page of my surrebuttal, which is 40, there's a chart there from SNL Energy, Regulatory Research Associates that shows litigated LDC authorized ROEs since January 2015 through the end of September 2017. They are -- and I put a trend line in there to show they are rising. The average for 2017 alone is 9.89 percent.

Q. Well, and that was the number I had mentioned in my opening; is that right?

A. That's right. Correct.

Q. Okay. There was also some discussion, I believe, with the Chairman about the capital structure issue?

A. Yes.

Q. Would using an artificially low equity component have an effect on overall risk?

A. Yes, for two reasons -- and two reasons. Number one, if a company actually had an overall equity component that was, you know, significantly lower than its peers, it would have significantly greater risk. If Spire is authorized an equity ratio that is significantly lower than its actual ratio and lower than its peers, that will be perceived negatively in my opinion by -- by the market and by credit rating agencies because there would be -- the Company would have more difficulty servicing the debt which it would -- the debt that would have to be serviced is based on the lower the debt ratio and they would have lower funds to do so.

Q. Does a lower debt ratio also affect a credit rating?

A. It can. It is one of the factors that they look at. More importantly, I think, if there were an authorization of a lower than actual credit rating -- I mean -- I'm sorry -- lower than actual common equity ratio, I think that would affect the credit -- I mean the regulatory environmental portion of the risk analysis.

Q. A lower credit rating could increase cost of debt; is that true?

A. Absolutely.

Q. If a commission were to substantially change from one case to the next, the capital structure that has been used in the past to make it less equity in that capital structure, how do you think that would be perceived?

A. I believe that the credit rating agencies would perceive that negatively, and I believe RRA would perceive that negatively. Any time that there's a departure from, you know, prior -- I would say prior policy and prior decision-making, that is -- can be detrimental to the Company is generally perceived as -- it's uncertainty and uncertainty is risk.

Q. And what is RRA, for the record?

A. Regulatory Research Associates. They're formerly SNL Energy. They're now owned by S&P Global venture.

Q. And what do they do?

A. They -- RRA analyzes, they keep track of databases of mostly electric and gas. Now they're doing some water regulatory decisions, mechanisms. They provide evaluations of the decisions, they provide evaluations of state commissions, they provide on a quarterly basis a chart of a grading of regulatory commissions.

Q. Okay. Just -- I'm almost done here. There was a mention, I think, on recross about the -- your discussion about the geopolitical risk?

A. Yes.

Q. Would you be more specific about what you're talking about there?

A. I'm just talking about the instability globally that we have. Some of the things that the U.S. has done, some of this morning, if you don't know, there was an attempted terror attack on Port Authority in New York. It wasn't foiled. He bumbled it. But we face some significant issues with trade, with sanctions of different countries. NATO is -- is not very happy with us. So...

Q. Are you concerned -- would you have included --

A. And in the Middle East and North Korea more importantly.

Q. Okay. I believe too you might have been cut off when you were trying to answer a question about whether the acquisition activity of the Company has --

A. Right.

Q. -- has somehow affected its risk?

A. Yes.

Q. Could you expand on what you were trying to say?

A. What I was going to say is I don't think it really will because the acquisition activity and the expansion has been into regulated natural gas distribution companies and in a state that has a very good regulatory evaluation by RRA is considered very credit supportive and it's a good state to operate in.

Q. Do you know if Alabama has a pretty high environ- -- regulatory rating by RRA?

A. They do. I don't have it off the top of my head. But I have it here.

Q. Okay. Well --

A. Yes, they do. They're rated quite high.

MR. FISCHER: Judge, that's all the questions I have. I appreciate your indulgence.

JUDGE DIPPELL: Thank you. And I believe that's all the questions for you, Ms. Ahern. You may step down and be excused.

THE WITNESS: Thank you.

(Witness excused at 10:57 a.m.)

JUDGE DIPPELL: We are going to go ahead and take a short break and come back at 11:10. Go off the record.

(Recess taken from 10:57 a.m. to 11:10 a.m.)

JUDGE DIPPELL: It's 11:10. We can go back on the record. Okay. We've returned from break, and we are ready to begin with Spire's next witness.

MR. PENDERGAST: Thank you, your Honor. At this time we would call Robert E. Hevert to the stand.

JUDGE DIPPELL: Mr. Hevert, will you please raise your right hand.

(Witness sworn.)

THE WITNESS: Yes, I do.

JUDGE DIPPELL: Thank you.

ROBERT E. HEVERT testified as follows:

DIRECT EXAMINATION BY MR. PENDERGAST:

Q. Good morning, Mr. Hevert.

A. Good morning.

Q. Are you the same Robert E. Hevert who has previously caused to be filed in this proceeding surrebuttal testimony marked as Exhibit 36?

A. Yes, I am.

Q. Do you have any changes or corrections to make to your testimony?

A. I've got three typographical errors. So I apologize. They're not at all substantive. The first is at page 6, line 3, toward the right-hand margin, there should be a closed quote after the word "debt."

The second is on page 14, line 8, there should be a period after the word "equity." And lastly, page 15, line 19 toward the right-hand margin, the word "ratio" should be plural, "ratios," and those are all my corrections.

Q. Thank you.

With those corrections, if I were to ask you the same questions today that appear in your surrebuttal testimony, would your answers be the same?

A. Yes, they would.

Q. And are those answers true and correct

to the best of your knowledge and belief?
A. Yes, they are.
MR. PENDERGAST: With that, your Honor, I would tender Mr Hevert for Cross-Examination and request that his surrebuttal testimony be admitted into the record.
JUDGE DIPPELL: And does Mr. Hevert -- is this his only issue?
MR. PENDERGAST: It is.
JUDGE DIPPELL: All right. Is there any objection to Exhibit No. 36?
MR. SMITH: No objection.
JUDGE DIPPELL: All right. Seeing no objection, I will admit Exhibit No. 36 into the record.
(SPIRE EXHIBIT NO. 36 RECEIVED INTO EVIDENCE.)
JUDGE DIPPELL: Is there Cross-Examination by Staff?
MR. THOMPSON: Thank you, Judge.
CROSS-EXAMINATION BY MR. THOMPSON:
Q. Nice to see you, Mr. Hevert.
A. Good morning.
Q. I wonder if you could tell me what your

hourly rate is?
A. I believe my hourly rate is the same as Miss Ahern's, which would be $350.
Q. And do you have any idea how many hours you've devoted to this case up until now?
A. I don't, but it is of course a limited issue. It came in late in the case. It's not many.
Q. Do you have any idea how many hours ScottMadden as a whole has devoted to this case so far?
A. I do not.
Q. Or what they've billed so far?
A. Same answer, I do not.
Q. Okay. Now, were you present while Ms. Ahern testified?
A. Yes, I was.
Q. And did you hear her testify that there was no cap on the charges for ScottMadden with respect to this case?
A. I thought her answer was with respect to her testimony, but I may be incorrect on that.
Q. Okay. Do you happen to know whether there's any cap or ceiling on how much

ScottMadden can bill for this case?

A. I don't know whether there's a cap. Quite often we will propose a budget, and I think for the reasons Ms. Ahern noted, quite often the scope of discovery, the scope of rebuttal is unknown at the beginning of a case, so it's difficult to put a firm cap on it.

Quite often we'll establish a budget and to the extent we approach the budget, we would then go to the client and talk about whether or not the budget can be increased.

As to Ms. Ahern's testimony and some of the other portions of the Company's testimony in this case, I could not say what that budget or limit might be.

MR. THOMPSON: Thank you. I have no further questions.

JUDGE DIPPELL: Is there Cross-Examination by Public Counsel?

MR. SMITH: Yes, Judge. Thank you.

CROSS-EXAMINATION BY MR. SMITH:

Q. Good morning, Mr. Hevert.

A. Good morning.

Q. Have you ever testified to a public advocate's office?

A. A public advocate?

Q. Yes, such as OPC?

A. I have not, but I'll also say I've never been asked.

Q. So is it fair to say you predominantly have testified for utility companies?

A. I would say that my principal testimony has been on behalf of utility companies. I have testified for and been retained by utility commissions in the past, but yes, that's -- I think that's fair to say. But again, my response earlier was not in jest. The point is I have not been asked to provide testimony on behalf of a consumer advocate or an Attorney General or Staff.

Q. You have been -- do you have a copy of your testimony in front of you?

A. Yes, I do.

Q. And I understand you only produced surrebuttal testimony in this case; is that correct?

A. Yes, that's correct.

Q. Would you please go to page 6 of that testimony?

A. (Witness complying.)

Yes, I'm there.

Q. And my understanding this is not a C designation, but you state that the acquisition price for MGE was $1,013 million. Isn't that true?

A. What I think -- you're referring to Table 2?

Q. Yes.

A. Right. So Table 2 at this point was the -- the amount shown from the Laclede Group investor presentation as of September 13th -- excuse me -- September 2013. As to whether or not that was the actual final purchase price, I'm not entirely sure.

Q. Would you have any reason to doubt that the purchase price was approximately that amount which appears on your table?

A. That it was approximately that amount?

Q. Yes.

A. And I'm sorry, your question was would I be surprised to know that?

Q. Would you have any reason to doubt?

A. No, I would not.

Q. Okay. And it's your understanding that a portion of those funds were used to pay for a

premium price; is that correct?

A. Let me --

Q. Or a goodwill? There's a certain amount of goodwill; is that correct?

A. Yeah. Well, I think the way I would describe it is this: The Company paid roughly a billion dollars. That billion dollars was for the assets, generally the rate-based, other assets, and a premium over-the-book value. That premium over-the-book value generally would be the goodwill amount. So the funding raised to finance the transaction, paid for both the physical assets and the goodwill asset. Does that answer your question?

Q. Well, I'm trying to see. So the price paid above the book value for the goodwill, wouldn't that number be $210 million?

A. It is, yes.

Q. And that's what appears in your testimony?

A. Yes, that's correct.

Q. So if my math is correct then and the purchase price is relatively consistent with the table you cited to the book value of the -- the utility assets would be approximately

$800 million, right?

A. Approximately, right.

Q. After that acquisition and merger, it's my understanding Laclede had combined their assets with MGE's assets; isn't that true?

A. My understanding, yes.

Q. And then on the liability side of the balance sheet, isn't it also true that Laclede had combined utility debt with MGE's debt to produce a new combined company debt?

A. When you say combined the debt, I want to be sure. My understanding is the existing debt remained the existing debt but came together under an entity, if that's what you mean.

Q. True. I'm not referring to a package refinancing or something like that.

A. Okay.

Q. So in this combination, it's my understanding that an amount was recorded to increase the common equity by $210 million to account for the premium in the acquisition price; isn't that true?

A. There would have been a goodwill amount of about $210 million.

Q. Okay. And was that recorded to increase common equity by $210 million?

A. Was the book entry to increase common equity by $210 million when it was pushed down? I will -- I would agree with that subject to check, yeah.

Q. Each year isn't it true that for a goodwill asset, there needs to be an impairment study done, correct?

A. There is, and I refer to the impairment tests in my surrebuttal testimony, that's right.

Q. And that's a GAAP requirement, correct?

A. Correct.

Q. And what is GAAP? What is that acronym?

A. Generally accepted accounting principles.

Q. If you're still under surrebuttal, if you'd flip the page, generally in 7 and 9 on those pages --

A. I'm sorry. 7 through 9?

Q. Yes.

A. Yes, I'm there.

Q. Isn't it true you discuss fungibility? Is that how you pronounce it?

A. That's how I pronounce it as well.

Q. Isn't it true that you discuss that capital is fungible?

A. Yes.

Q. So if Laclede had invested in a new utility plan, it could fund that investment with a variety of things such as debt, retained earnings, equity from the parent, internal cash? Those would be the tools in toolbox, correct?

A. Generally, and let me just describe it a slightly different way, but I think we're saying the same thing. At any given point in time. There's a pool of dollars, and that pool of dollars under your scenario would be used to invest in an asset. We don't know where every dollar from that pool came from, we don't know whether it was from operating cash flow, we don't know whether it was from -- from equity received, from debt received. We don't know where each dollar came from. We just generally know that those are the sources of those dollars.

Q. When a utility invests in an asset such as a line or something like a gas line, that would, I assume, be recorded when it's put into

service and rate-based, correct?
    A. Yes.
    Q. So in that sort of situation, that type of asset would produce cash flows, correct?
    A. It would -- yes, once it's put into -- to rate base, it would produce cash flow, correct.
    Q. Isn't it true you recognize that a goodwill asset is never included in rate base?
    A. Well, I think in this case, it is not included in rate base. There are other cases where the premium is in fact included in rate base, and it's recoverable to the extent that the savings created by the merger exceed the cost. But in this case, my understanding is that the Company has agreed not to put the acquisition premium, not to put goodwill in rate base.
    Q. Right. And that was a part of a prior stipulation, correct?
    A. Yes.
    Q. Is it your understanding that a company such as Laclede would be required to do an impairment test on utility rate base assets each year? Is that a requirement under GAAP?

A. On utility rate base assets?
Q. Correct.
A. I think from what I've seen -- and again, I'm not an accountant, so I'm not going to speak to accounting rules or to GAAP as it's applied, but I've a seen goodwill impairment tests taken on things like natural gas distribution operating segments. So it may be.
Q. But not in this case, correct?
A. Here, what we've been focused on, what I've been focused on is the impairment of the goodwill amount.
Q. So not in this case, correct?
A. Insofar as I know, correct.
Q. You've testified for Ameren Missouri, KCP&L on rate of return?
A. I have, yes.
Q. Do you recall that Ameren had made an acquisition about ten years ago in Union Electric Company?
A. I do, yes.
Q. And that did not result in a goodwill asset being recorded on Ameren Missouri's balance sheet. Is that your recollection?
A. I have no way to say one way or the

other.

Q. Meaning you don't recall?

A. Meaning I don't recall.

Q. And you testified for Great Plains Energy; isn't that correct?

A. Yes, I did.

Q. And it's a proposal to acquire Westar?

A. In the Kansas proceeding you're talking about?

Q. I believe so, yes, or --

A. It was not here, so it must have been Kansas, that's correct.

Q. And in that proceeding, you know, you would agree that Great Plains Energy had agreed to keep the goodwill asset off of the books. Wasn't that a condition of the proposed transaction?

A. So when you say "off the books," are you -- if your question is like in this case, did the Company agree not to -- excuse me -- not to seek recovery of the acquisition premium, yes, that's my recollection, just as it is in this case.

MR. SMITH: That is my question. Okay. Thank you.

JUDGE DIPPELL: Is that all your questions?
MR. SMITH: It is.
JUDGE DIPPELL: Is there Cross-Examination by MIEC?
MR. MILLS: Yes, thank you.
CROSS-EXAMINATION BY MR. MILLS:
Q. When you recently testified in rate cases for KCPL and Ameren, was there any significant amount of goodwill reflected in their capital structure?
A. I can't recall as I sit here. It was not an issue for my testimony.
Q. You don't recall that there was or was not hundreds of millions of dollars of goodwill in the capital structure?
A. I was not -- as I said, I do not recall and it was not an issue for my rate of return testimony.
Q. So sort of tracking from the acquisition when -- and I'm speaking of Laclede's acquisition of MGE --
A. Okay.
Q. -- an acquisition premium was paid, correct?

A. Yes.
Q. Of $210 million?
A. That's right.
Q. And in turn, that $210 million was recorded on the books as goodwill, correct?
A. Yes.
Q. And because of the recording of that goodwill on the books and included on the capital structure, rates proposed in this case are higher than they would have been had it not been recorded on the Company's books; is that correct?
A. No. I don't agree with that.
Q. You don't agree that rates are higher in this case because of the inclusion of goodwill?
A. No. I don't believe -- I think the Company's -- as I say in my surrebuttal testimony, the Company's capital structure is appropriate. I think at 54.2 percent for the many reasons I note in my capital -- excuse me -- in my surrebuttal testimony that capital structure is proper and putting aside -- excuse me -- putting aside any questions, however many I may have regarding a goodwill adjustment.

So if your question is, is the Company's capital structure too high, is it somehow creating cash flows that are too much, I disagree with that.

Q. In point of fact, that was not my question at all.

My question was: Because of the inclusion of the goodwill in the capital structure, are rates in this case that are proposed, are they not higher than they would be had that amount not been included in the capital structure?

A. I don't believe so and I'll -- for this reason: When I go back and I look at how the Company was financed, how the acquisition was financed, the proportions in which it was financed, if we're going to look at how rate base is financed, if we're going to look at how assets are financed, if we recognize that the acquisition financing was arranged through a combination of long-term debt and common equity, then any adjustment to the capital structure -- excuse me -- relating to goodwill ought to be taken out in that proportion.

Q. And if you weren't -- so you're saying

that if you -- you're saying that if we accept Mr. Gorman's recommendation that we take the goodwill out of the capital structure, that rates would not go down?
A. Oh, no. As a matter of math, I agree with you. Yes. I agree with that. I'm sorry. If that was your question --
Q. Yes.
A. -- I'm sorry. I missed that.
Q. As a matter of math, if you do not include the goodwill in the capital structure, rates would be lower?
A. Right. And boy, I hate to do this, but I'm going to say something Ms. Ahern said, which is all else remaining equal.
Q. Sure. I understood.
A. But yes.
Q. So tracking from the payment of the acquisition premium to the recording of the goodwill to the inclusion of the goodwill and the calculation of rates in this case, because of the acquisition premium being included in the capital structure, rates are higher than they would otherwise have been all else equal?
A. So be- -- again, I think I can agree

with your prior question, that if a -- if the goodwill amount is taken out of the equity portion of the capital structure and the equity ratio is lower as a consequence --
Q. Yes.
A. -- and we hold all else equal, then yes, I agree with you.
MR. MILLS: That's all the questions I have.
JUDGE DIPPELL: Thank you.
Midwest Energy Consumers.
CROSS-EXAMINATION BY MR. WOODSMALL:
Q. Good morning, sir.
A. Good morning.
Q. As I understand from your testimony, you are a partner in ScottMadden; is that correct?
A. Yes, that's right.
Q. And Ms. Ahern is an executive director; is that correct?
A. Yes, that's right.
Q. What's the difference? Who is higher on the totem pole?
A. We are -- we are all equal.
Q. Everybody makes the same amount?

A. Well, we're not going to talk about compensation, but -- but no, I think generally speaking, there are partners and then there are nonpartners. I am a partner. Ms. Ahern's position as an executive director is a nonpartner.

Q. Got you. Are you her supervisor?

A. No. In ScottMadden, there's -- the structures are not the way they had been in our prior firm. So I would not say I'm her supervisor, no.

Q. You're not asked to review her testimony?

A. In this case I did not review her testimony, and I would only do so if asked, but as a matter of practice, as a matter of course, given the Company's structure, no, that's not a requirement.

Q. When you were at Sussex were you her supervisor there?

A. I -- I think it's generally the same answer. When I was at Sussex, I was the managing partner of the firm, which really meant I got to do all that real fun administrative stuff, but as a matter of practice, as a matter of protocol, every witness's testimony is that witness's testimony.

Q. Okay. Let's move on to some substance then. Mr. Gorman characterizes goodwill as a paper asset. Do you agree with that characterization?

A. I think that's fair.

Q. Okay. And could Laclede and MGE provide safe and adequate service even without goodwill, the goodwill asset in this capital structure?

A. I'm sorry. Is your -- there's a lot of things wrapped up in that question. So --

Q. Let me try to break it down.

You referred to goodwill as a goodwill asset. Do you recall using that phrase?

A. Yes, that's right.

Q. And could Laclede/MGE provide safe and adequate service without the goodwill asset?

A. So again, if your question is goodwill is a paper asset, it's not a physical asset. It's the physical assets that provide safe and reliable service. I assume that's what you're getting to?

Q. Right.

A. And the Company's ability to continue to provide safe and reliable service with those physical assets of course is dependent upon its ability to gain reasonable and appropriate regulatory outcomes. If we assume all of that, then yes, I would agree.

Q. Okay. And so if this paper asset, the goodwill asset was included on Spire's books instead of Laclede's, we would not have the issue here today; is that correct?

A. That's probably right.

Q. Okay. Mr. Smith was asking some questions about Westar, and I don't know, maybe it was me hearing it wrong.

In the first iteration, Great Plains was going to buy Westar and make it a subsidiary; is that correct?

A. Correct.

Q. And there was an acquisition premium associated with that; is that correct?

A. There was.

Q. And Great Plains agreed as part of its initial request that it would keep that acquisition premium at the parent company level; is that correct?

A. That's right.
Q. Okay. And so we wouldn't have the issue there if the goodwill was kept at the parent company level; is that correct?
A. Right. If the accounting were such that it was agreed for accounting purposes keep it there, that's right.
Q. And I believe you testified earlier that you've testified on behalf of the Great Plains subsidiaries, KCP&L and GMO; is that right?
A. Yes, that's right.
Q. And is it your understanding that GMO was created by the Great Plains purchase of the former Aquila Properties?
A. Yes.
Q. And do you know if there was an acquisition premium associated with that?
A. I could not tell you as I sit here.
Q. Okay. So you don't know if the acquisition premium, if it existed was kept at the parent company level or at subsidiary level?
A. No, I couldn't tell you as I sit here. Never really became an issue in any of my testimony.

Q. Okay. Do you recall -- even if it wasn't an issue in your testimony, do you recall it being an issue in the last rate cases?

A. I don't recall, no.

MR. WOODSMALL: Okay. I have no further questions. Thank you.

JUDGE DIPPELL: Thank you.

Is there anything from Environmental Defense?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Any questions from the Bench for Mr. Hevert?

CHAIRMAN HALL: Maybe just a few.

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning.

Q. Do you believe that the goodwill adjustment being advocated by Mr. Gorman in this case is unprecedented?

A. My understanding is it's unprecedented in this jurisdiction. I think there may be other jurisdictions where goodwill adjustments had been made. I think there probably are many others where it has not, and as I said earlier, there are certainly jurisdictions where an acquisition premium was included in a rate base, there was a recovery on itself. I think in terms of precedent, it goes a lot of ways, but my understanding is that in Missouri, this would be uncommon.

Q. Were you in the hearing room when counsel for MECG suggested some explanation for why such an adjustment has not been made in prior cases in this jurisdiction?

A. I was, yes.

Q. And how would you characterize that description or that explanation?

A. Because it really just hasn't been at issue in terms of the -- the goodwill being at the subsidiary level.

Q. Because the parties in those cases specifically mandated that it -- that it not be so recorded, correct?

A. Correct. There would be no recovery of the goodwill either directly or indirectly as there is in this case.

Q. So then it really is somewhat irrelevant that it's unprecedented, because it just hasn't been an issue. So no one's made the

request before because it's never been at issue before?

A. No one's made the request for the adjustment that Mr. Gorman has recommended. Is that your point?

Q. Correct.

A. Yes. That may well be, yes, yes.

Q. Have you done a calculation on the financial impact to the revenue requirement if the Commission were to adopt Mr. Gorman's suggestion on the $210 million goodwill adjustment?

A. I have not, and I think it would be somewhat difficult to do so. We can easily say what is the effect of a lower equity ratio if we keep everything else constant. I think what's more difficult is -- for the reasons Ms. Ahern noted, is understanding what the effect on the costs of capital would be as a consequence of that decision. So I think there are a couple of moving parts to that analysis.

CHAIRMAN HALL: I believe that's all I have. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Thank you.

Commissioner Rupp.
COMMISSIONER RUPP: Thank you.
QUESTIONS BY COMMISSIONER RUPP:
Q. Good morning.
A. Good morning.
Q. So help me remember. Goodwill can be things that have an inherent value even though they are not a physical asset, such as positive name ID, viewpoint of the companies, how they're looked in the community and things.
Are all those things attributable to goodwill as some value?
A. I think that's right, and to the extent that an acquirer has a view of value above the net book value of the assets for whatever reason, likely including the factors that you just noted, that would contribute, that would give rise to goodwill.
Q. So like if I wanted to go buy Nike, I'm buying more than just the inventory and the production plant. I'm buying the name and their image and their -- that's why I'm paying a premium?
A. Yes, that's right.
Q. I'm sorry, I'm going back to the

beginning here because I thought I understood a few things and everybody's questions got me all confused again.

A. Yeah, it's not a simple topic.

Q. So there is an inherent value of goodwill and that's why people pay a premium. So I guess help me from your viewpoint -- I know you don't work for the Company, why would a company book the goodwill in Laclede instead of in Spire when they did their -- what would be a possible reason for that?

A. You know, I wish I could answer, but, again, I'm not an accountant and perhaps Mr. Rasche might be able to answer that a little bit better for you.

Q. Okay. We'll save that one for Mr. Rasche.

So if there is a value to the goodwill and there's an agreement not to include any of that into rate base, how -- by including goodwill in the calculations, how is that not violating that agreement? Can you explain to me that?

A. Well, we're -- first off, as you know, the Company's not including goodwill in the rate base and the Company is looking at the capital structure that it uses to finance its assets and it's looking at the -- how -- what the proper mix of that capital ought to be, and in the Company's discretion it's about 54, 54 percent.

So in my view, there is no -- there's no indirect or certainly no direct recovery of goodwill. The Company is simply financing its assets in the way that it would in the course of business, given the nature of the utility operations that it provides.

Q. Okay. So if the goodwill comes from the purchases of the other companies and we're just looking -- let's say that I wanted to do just a Laclede capital structure and the goodwill came from organizations outside of Laclede. How should I handle that in your opinion?

A. I -- that's a great question. I think you should handle that in large measure the way we've been looking at it in some of this testimony, which is to say we recognize that establishing capital structure is a complicated business. It depends on the individual company, it depends on the assets it's financing, it depends on the nature of the risks.

And so we have to look at measures of industry practice, is the Company's capital structure as it's been managed generally consistent, for example, with those we see elsewhere, does the Company consider things like the life of its assets and the corresponding life of the securities that it issues to support those assets?

I think to me that's how we look at it. And I say that because I've spent a good ten years of my career managing a gas utility's balance sheet, so these type of issues were very real to me.

I think that the perspective that we take when we look at whether a capital structure is reasonable: Has the Company financed its assets in a manner that's consistent with the industry, is it consistent with the nature of the operations, is it prudent in the sense that there's neither too much nor too little equity, is it prudent in the sense that it has properly staggered maturities? There's a whole lot of things that go on in terms of determining the capital structure, but at the end of the day we have to look at practices -- excuse me -- measures of industry practice as measures of reasonableness.

Q. Okay. So the premium comes from the other companies outside of Laclede if we're looking at a Laclede capital structure. Is there a way to tease out or to quantify the cost savings?

Because I'm sure there's -- you know, there's been savings by spreading your costs over a larger group and some efficiencies and things. Is there a way to tease out those cost savings so as if you're not going to be charged the premium, can you back out the cost savings as well?

A. Well, my understanding is that Mr. Flaherty had done an analysis of savings that arose from the merger, and so that as a consequence of the merger and, of course, the financing that was raised to consummate the merger or the transaction, those savings were generated.

Q. And Mr. Flaherty is? When's he coming? Oh, he's on Wednesday, December 12th?

MR. PENDERGAST: 13th.

COMMISSIONER RUPP: 13th.
BY COMMISSIONER RUPP:
Q. So if I dig back into Mr. Flaherty's testimony, I can find a way if I was to have a capital structure for Laclede and not to count goodwill, I -- there would be a way in there to identify the savings that would be passed only to Laclede as well from --
A. Well, I think from Mr. Flaherty's testimony you would be able to see his estimate of the savings that were created by the transaction. And in my view, those savings, of course, were enabled by the capital that was raised to be able to finance the transaction, so -- and that capital, of course, relates to the capital structure.
Q. So let's go back to the 10,000-foot-level view. If there's savings from the merger, I have to make the assumption that those savings are being passed on to Laclede and to that organization as well?
A. I -- well, if there are savings in the merger -- again, I think I'd defer to Mr. -- I'm doing a lot of deferring here, aren't I? I'd defer to probably Mr. Loehster, but in terms

of how they're reflected in the cost of service. But savings arising from the merger were estimated being realized, and so those savings have occurred.

Q. Okay. So how do I get my head around if I'm not going to count the goodwill in my capital structure, so I can't count that premium, but I'm going to allow any potential efficiencies and stuff to be counted, is -- how do I do it either way, if I'm not going to count it, I'm not going to count it or I'm going to count it all? Is there a way -- I want to make sure that we're not taking the juice and, you know, giving away the pain.

A. Well, again, I think in terms of how the savings are reflected in the cost of service, another witness, maybe Mr. Loehster, can explain that.

But just at a high level, we know that there's a capital structure, 54 percent equity, 46 percent debt call it. And if your question is, does that capital structure create savings, are there benefits that arose from it, I think the benefits that arose from it were in the context of operating cost savings that were enabled by the merger itself. So -- and, again, that was, I understand, the topic of Mr. Flaherty's testimony what those savings were and how they were created by the transaction.

Q. Okay. I still think I'm confused. So, hopefully, I -- the other people -- I know I'm not articulating my question. Many times we have people come before us and they want to enjoy the fruits of this, but, you know, not have to pay for it over here, and with all the different people wanting to pull this and that out, I'm -- I want to make sure that if -- I want to make sure I'm trying to be as fair as possible and not just -- you know, trying to get to a certain number and -- in that way. So that's what I'm trying --

A. And I appreciate that. Just what I would say at a very high level is that you have a capital structure that's consistent with industry practice, you have savings that were created by the transaction. So that's what I would say.

Q. So a 10,000-foot view in your opinion is the capital structure, this is what got us

here, so you need to dance with those that brought you rather than start -- you wouldn't have this the savings if you didn't have the existing capital structure?

A. Well, I think the -- even if we were to sort of put aside the transaction, I think the capital structure is reasonable. I think it's consistent with industry practice. I think it's a reasonable capital structure. It so happens that that capital structure enabled the transaction which created the savings.

Q. All right. Very good. Now I've got to find the original questions that I had.

In your testimony you talked about -- you were talking about the economic value -- that equity investors -- we were talking about the economic value of the goodwill and like who would invest in a risk-free asset and it was when you were talking about, I think, Mr. Gorman's -- walk me through that again.

A. Sure. I think the issue -- the proposition for Mr. Gorman was that you could not finance goodwill with debt because goodwill in and of itself produces no cash flow and therefore it would not be possible to service debt used to finance goodwill and therefore it must have been financed with equity. That's as I understand the proposition.

My response is really twofold. One is, again, we cannot say in the context of the transaction that this dollar of equity was raised specifically to finance this dollar of goodwill and, in fact, I think if you look at. For example the prospectus that was issued prior to the transaction, you'd see that the financing was expected to be a mix of debt and equity. And I think if you were to look at how the proceeds of the acquisition debt, debt raised in the context of the acquisition, the use of proceeds there too, it was to fund the acquisition. Not to fund rate-based, but the acquisition. So that's the first thing. We can't say that a dollar of equity necessarily was pointed towards goodwill.

Secondly, if goodwill produces no economic value, probably not even I would invest in it. You wouldn't invest in something that has no value if you can put your money in a treasury bill that gives you a very low risk return. So I didn't -- I didn't agree with that proposition.

Q. Okay. I think you answered those questions. Thank you, sir.

A. Thank you.

JUDGE DIPPELL: Thank you.

Is there further Cross-Examination based on questions from the Bench from Staff?

MR. THOMPSON: Thank you, Judge, just a few.

RECROSS-EXAMINATION BY MR. THOMPSON:

Q. You understand, Mr. Hevert, that as a condition precedent to being permitted to acquire MGE, Laclede Gas Company agreed to forego any direct or indirect recovery of the acquisition premium?

A. I understand that, yes.

Q. So the issue is not whether the goodwill has value. The issue is whether or not it's permitted to be in the capital structure; wouldn't you agree?

A. I would agree that there should be no direct or indirect consequence of goodwill in the transaction, yes.

Q. So if the Commission were to adopt the capital structure recommended by the Company

rather than the capital structure recommended by Mr. Gorman, ratepayers would pay a higher rate; isn't that correct?

A. I think we talked about this a little bit ago. As a matter of math, if there's a lower equity ratio, then, yes, that would be the case.

Q. Okay. And how is that not an indirect recovery of that acquisition premium?

A. Because I think a 47 percent equity ratio is inconsistent with industry practice. I don't think it's a proper capital structure and I don't think that's how the Company would finance itself. I don't agree. Nor do I agree that when the asset -- excuse me -- when the transaction was financed that equity was raised specifically to fund goodwill. But in terms of your math, I agree with you.

MR. THOMPSON: Thank you. That's all my questions.

JUDGE DIPPELL: Is there further Cross-Examination from Public Counsel?

MR. SMITH: Yes, very briefly.

RECROSS-EXAMINATION BY MR. SMITH:

Q. You had discussed with Commissioner

Rupp about the characterization of Mr. Gorman's testimony and I think you characterized his testimony as saying it would not be possible to finance the goodwill with debt. Wasn't he saying it would not be prudent?

A. That's fair. Yeah, I think that's fair. That's right. But to be quite honest with you, again, having financed --

Q. And that was all the question I have. Thank you.

JUDGE DIPPELL: Thank you.

MIEC.

MR. MILLS: Yes, thank you.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Is it your testimony that the capital structure proposed by Mr. Gorman is so unreasonable that no company would ever operate using it?

A. That -- I don't think that's what I said.

Q. Okay. Next question. Have you ever proposed an adjustment to a capital structure in a rate case?

A. Proposed an adjustment to a capital structure? I can think of instances that are unlike this case where the subject company was, let's say, a division of another entity, it had no capital structure of its own and therefore we had to develop a capital structure.

So if that would fall under your definition, then, yes, I suppose I would agree with that.

Q. Now, I believe you testified in response to a question from Chairman Hall that if the Commission were to make an adjustment to the capital structure, that would have such a profound impact on return on equity that it shouldn't be done. Is that more or less what you said?

A. I don't -- I don't think that's what I said. I think what I said was that I don't think -- I think what I said is that there are moving parts here.

And the moving part would be: If you're going to have an adjustment from -- and let's talk round numbers -- 54 percent to 47 percent equity, I don't think the cost of equity would remain constant.

Q. All right. Say, for example, there was a 100, $200 million issue with respect to costs

for remediating a manufactured gas plant --

A. Okay.

Q. -- and the Commission worked to make a disallowance of $200 million. Would that also have a similar impact on return on equity?

A. Let's -- I need a little more information in your hypothetical. Was it disallowed because of imprudence?

Q. Yes.

A. Okay. I don't think here in this case we're talking about a 54 percent equity ratio as being imprudent, so I just don't see the two as being the same.

Q. My question wasn't whether they were similar, but would they not from your point of view have a similar impact on the appropriate authorized return on equity if there is a -- if they disallow us for any reason?

A. I don't think that's necessarily true. I think investors understand that companies are always at risk for prudence disallowances, and that's why I was a little bit -- I don't think your hypothetical flows from one to the other.

But as to a disallowance of a hundred million dollars for the imprudent management of an asset as opposed to a capital structure that's consistent with industry practice, I do think investors would see a difference between those two things.

Q. Have you proposed anything in this case that would allow the Commission to make an adjustment to the capital structure and make an according adjustment to the return on equity?

A. And is your question do I have any testimony here saying, let's say, the Commission decides the equity ratio should be 47 percent, what then should be the cost of equity?

Q. Yes.

A. Oh, I haven't, but I can tell you it would be higher.

Q. So it's your testimony that the Commission simply shouldn't make an adjustment to the cost of -- to the capital structure because that would have a big impact on return on equity and there's been no proposal made to address that?

A. I don't -- I think that's -- you've mischaracterized my testimony with that. That's not my testimony.

My testimony is that the Company -- the

Company's capital structure is proper, it's consistent with industry practice and in my view should be allowed.

Q. I'm not talking about your pre-filed testimony. I'm talking about your testimony in response from the questions from Chairman Hall --

A. Okay.

Q. -- about the impact on return of equity from making a capital structure adjustment.

A. And what is your question?

Q. Is it not your testimony that based -- in response to his question, that the Commission should not make an adjustment to the capital structure aside from all the other reasons that you said in your pre-filed testimony but also because it would have an impact on return on equity which has not been addressed in this case?

A. No, I did not say that. What I said was I don't think the Commission should make an adjustment because I think the Company's capital structure is prudent. If the Commission were to make an adjustment, then there should be a corresponding adjustment to the return on equity.

MR. MILLS: Okay, thank you. That's all I have.

JUDGE DIPPELL: Midwest Energy Consumers.

MR. WOODSMALL: Yes, briefly.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. If the Company came in with a capital structure of 47 percent in this case, would you say that the Company's capital structure was imprudent?

A. If the Company had reason to believe that 47 percent was the proper reason -- excuse me -- the proper equity ratio, then I would typically defer to the Company's discretion there. But, of course, that's not the case here.

Q. Right.

There were some questions from Commissioner Rupp and I just want to get some clarification. First off, would you agree that the merger -- the acquisition, excuse me, of MGE occurred in 2013?

A. Yes, I agree with that.

Q. Okay. And would you agree that there's

a difference between transition costs and acquisition premium?

A. Yes.

Q. And what is that difference?

A. When you say "transition costs" -- so transition costs to me are costs incurred to effectuate the transaction -- excuse me -- the transaction from an operational perspective. They're typically one-time costs that are incurred that subsequently would enable ongoing operating synergies. Premium simply is that -- it's the amount paid in excess of book value.

Q. Okay. And would you agree that some refer to transition costs as the costs to unlock synergy savings?

A. I've used the term "cost to achieve," but I think it's the same thing.

Q. Okay. And is it your understanding that some amount of transition costs have been recovered from ratepayers in this case?

A. I could not speak to that, but I'll tell you my understanding about those type of costs to achieve. They're typically recovered to the extent that the savings exceed costs to achieve. So if that were the standard and that were the case, yes, I would agree with that.

Q. Okay. And would you agree that any cost savings that have been realized since 2013, since the acquisition, have benefited entirely to the shareholders to this point?

A. That's a really interesting question. For that limited period, yes.

But keep in mind that when these cost savings occur, they then will go on for quite a period of time. So whereas perhaps in some situations the Company, the shareholders may have realized benefits for a couple of years, ratepayers will realize benefits for many, many years.

Q. Right. But for the past four years, the cost savings have been solely to the benefit of shareholders?

A. I would defer to probably Mr. Loehster on that, but just as a general proposition, again, in my experience if -- if there are savings realized between cases, then often they would go to the shareholders, but in the long run, the order of -- it's significantly greater, the benefits, that over time go to the ratepayers.

Q. And if cost savings increase between rate cases, so let's say there's further cost savings following this case, those will go entirely to the shareholders until the next case; is that correct?

A. I think that's the case in any construct when there's regulatory lack.

Q. Thank you.

A. And then, conversely, if costs go up, the shareholders eat those.

MR. WOODSMALL: No further questions. Thank you.

JUDGE DIPPELL: Thank you.

Anything from the Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Thank you.

Is there Redirect from Spire?

MR. PENDERGAST: Yes. Thank you

REDIRECT EXAMINATION BY MR. PENDERGAST:

Q. Mr. Hevert, you were asked a number of questions about why the goodwill is on Laclede Gas Company's books rather than its parent company's books. Do you recall those questions?

A. I do.

Q. Do you know who bought MGE, the assets of MGE? Was it Laclede Gas Company or was it its parent company?

A. The transaction was MO Laclede.

Q. Okay. And since it was Laclede that purchased the assets of MGE. Would you expect any goodwill associated with it to be on Laclede Gas Company's books?

A. At Laclede Gas Company's books, yes.

Q. Okay. Just so we're all clear on what impact this acquisition had on Laclede's capital structure, first of all, as you said, the goodwill or the premium that was paid to acquire those assets has been excluded from rate base?

A. Yes.

Q. A couple hundred million dollars, it's sitting over here (gesturing) and Laclede is not earning anything on that?

A. Correct.

Q. Okay. The transaction costs that were incurred by Laclede Gas to make this acquisition happen, are they also not reflected in rates?

A. Yes, that's my understanding.

Q. And what may be reflected in rates will

be some transition costs, to the extent the Commission allows them, that, if you know, are relatively small in comparison?

A. That would be my experience, that's right.

Q. Okay. And in exchange for the Company paying the entire premium, paying all the transaction costs and getting back a small amount of transition costs, to the extent that we have quantified tens of millions of dollars of cost of service reductions in this case that are going to be passed through to customers, has the premium that's not being earned on allowed those cost savings to be achieved?

MR. MILLS: I object. That's a leading question.

BY MR. PENDERGAST:

Q. What is the impact of the premium that was paid and that is being absorbed by the Company on savings that have been achieved by customers?

A. Well, as I think I say in my testimony, in my surrebuttal testimony, it was the financing that was -- that was arranged. It was the financing that enabled the acquisition, including the goodwill that enabled those savings. So the financing that arose and the goodwill that arose from the transaction was enabled by all the financing that was raised, including the equity, including the debt. So that is what enabled those savings that you just mentioned.

Q. Okay. And in terms of the acquisition and the premiums impact on the Company's capital structure, can you tell me generally what equity component Laclede had prior to this acquisition activity?

A. I -- I couldn't tell you exactly as I sit here. I'm sorry.

Q. Okay. So you wouldn't know whether it was in the mid 50s for years before this acquisition activity started?

MR. MILLS: Objection. That's leading.

THE WITNESS: Well, what I --

JUDGE DIPPELL: Mr. --

THE WITNESS: Oh, I'm sorry.

JUDGE DIPPELL: Objection sustained.

Do you have a nonleading question?

MR. PENDERGAST: Yeah.

BY MR. PENDERGAST:
Q. If you could turn to page 6.
A. (Witness complying.)
Q. In there you have the table "The Source of Funds."
A. Yes.
Q. Okay. And if I look at that table, was a little bit more debt issued than equity in order to go ahead and acquire MGE?
A. Yes. Well, about 5 million more.
Q. Okay. So what would that tell you as far as whether this acquisition had an impact on increasing the equity ratio for Laclede Gas Company?
A. It would tell me that slightly more debt was raised than equity. So at the margin, it would not have increased the equity ratio.
Q. Okay. And on the first mortgage bonds, do you know what the cost of those first mortgage bonds were and how they compared to the existing debt that Laclede had at the time?
A. Just bear with me one minute. (Reviewing document.)
So the yield on the first mortgage debt, the coupon, anyway, was in the range of,

say, 3.7 percent to 4.8 percent across the three tranches.

Q. Okay. And, to your knowledge, is Mr. Gorman proposing to somehow exclude that low-cost debt from the capital structure in this case?

A. No, he's not.

Q. Okay. In fact, is it true that what he's doing is just assigning all of the goodwill to common stock, to equity, and none of the debt?

A. Yes.

Q. Okay. Do you believe that's appropriate?

A. No. As I say in my testimony, when the acquisition occurred, the financing noted in that table was raised to acquire all the assets, both physical and intangible, the rate base and the goodwill, and it was raised in those proportions to acquire all of those assets without being able to assign portions of the financing to either the rate base or the goodwill.

Q. You were asked a number of questions about whether or not absent this goodwill

adjustment you would see an adverse effect on the cost of capital for the Company. Do you recall those questions?

A. I do, yes.

Q. And whether or not having an impact on cost of capital was prohibited by the stipulation and agreement?

A. Yes.

Q. Okay. Can you tell me what's your opinion of allocating all of the goodwill to equity and excluding equity has on rates?

A. Well, that was the second part of the pieces that move. If you were to reduce the equity ratio by seven percentage points from, again, say, 54 to 47 percent, two things would happen. One is you increase financial risk. And financial risk simply means that there's more debt leverage in the capital structure and increased financial risk means increased costs of capital, typically on both the debt and the equity side.

Now, there certainly are methods and models that have been used to estimate what that cost would be, but I think it's fair to say that the effect would be to increase the cost of equity simply because of the additional financial leverage in the capital structure.

The reason is that when you add leverage, it tends to effectively concentrate business risk on the equity owners. You have a certain amount of business risk out there and now a lot more of it's taken on by the equity owners because debt holders are protected to some extent from business risk simply by the fact that there's a contractual obligation to pay them first and often they are secured by other means.

Second, there's an element of increased regulatory risk. So if you were to make a seven percentage point change to go from an equity ratio that's within the range of those we see elsewhere to an equity ratio that is below the Company's peers, in my view both sides, both equity and debt investors, would see increased risk.

Now, we know that's the case when we look to as example for Moody's that assigns 57 percent of its credit ratings to the nature of regulation. For debt -- excuse me. For equity investors, that additional uncertainty would create an additional risk. So I think we would see increase of costs of capital, plural, both debt and equity, for a variety of reasons.

Q. And you said that as a matter of simple math that if you go ahead and reduce the equity component as proposed by Mr. Gorman, that that would lower rates; is that correct?

A. That's right, as a matter of math.

Q. Okay. And in lowering rates, were you suggesting that was an appropriate result?

A. No. It simply was, again, a matter of math. I don't think that math at the end of the day would hold for the reasons we just discussed. I don't think we could hold constant the costs of capital, so I don't believe those savings would accrue, as suggested by a question, aimed at keeping everything else constant.

Q. And do you have any opinion on whether allocating nothing but equity to this goodwill is consistent with the stipulation and agreements requirement that these acquisitions not have impact on rates?

A. Well, it seems that to me -- again, I'm not an attorney, but my plain reading would be that if the intent -- if the parties' intent was for the transaction not to have an effect on rate and if the Company's capital structure as proposed is reasonable and consistent with industry practice, then making an adjustment would have an effect on rates re- -- owing to the transaction.

MR. PENDERGAST: Thank you very much. I have no further questions.

JUDGE DIPPELL: Thank you. Seeing no further questions then for Mr. Hevert, you may step down.

THE WITNESS: Thank you.

(Witness excused at a 12:14 p.m.)

MR. THOMPSON: Judge, before you go off the record, if I may, you had asked a question at the beginning of the proceedings today about Exhibit 56.

JUDGE DIPPELL: Yes.

MR. THOMPSON: And I am told by Miss Payne that Staff has no objection.

JUDGE DIPPELL: Okay. Would there be any objection to Exhibit No. 56 which was offered on Friday?

(No response.)

JUDGE DIPPELL: Then seeing none, I will admit No. 56.

(SPIRE EXHIBIT NO. 56 RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: Thank you for that information, Mr. Thompson.

MR. THOMPSON: Thank you, Judge.

MR. SMITH: And, Judge, you had also asked counsel a question about Mrs. Autt's testimony and I was able to find out that the correction was just a formatting correction, added a cover page to her testimony and added a designation of the schedules so it was more clearly labeled.

JUDGE DIPPELL: All right. So when we get to that, we will go off that most recently filed exhibit.

MR. SMITH: Yes.

JUDGE DIPPELL: All right.

Well, it is lunchtime, so we will take a lunch break. We are moving very slowly this morning. These are some big issues that need to be covered thoroughly, but just keep that in mind as you prepare your questioning for later today and the other witnesses.

We can go ahead and take a lunch break until 1:30.

MR. THOMPSON: Thank you, Judge.

MR. SMITH: Thank you, Judge.

(Recess taken from 12:15 p.m. to 1:30 p.m.)

JUDGE DIPPELL: Let's go back on the record. Okay, we're back on the record after our lunch break and we, I believe, are ready for the next Spire witness.

MR. PENDERGAST: Thank you, your Honor. The Company would call Steven P. Rasche to the stand.

(Witness sworn.)

THE WITNESS: I do.

JUDGE DIPPELL: Okay. Go ahead, Mr. Pendergast.

MR. PENDERGAST: Thank you.

STEVEN P. RASCHE testified as follows:

DIRECT EXAMINATION BY MR. PENDERGAST:

Q. Good afternoon, Mr. Rasche.

A. Good afternoon.

Q. Are you the same Steven P. Rasche which has previously been caused to be filed in this proceedings surrebuttal testimony that has been

marked as Exhibit 37?
A. Yes, I am.
Q. Do you have any corrections to make to that testimony?
A. No, I do not.
Q. If I were to ask you the same questions today that appear in your direct -- or your surrebuttal testimony, would your answers be the same?
A. Yes, they would.
Q. And are those answers true and correct to the best of your knowledge?
A. Yes, sir.
MR. PENDERGAST: At this time I would offer Mr. Rasche's surrebuttal testimony into evidence and would tender him for Cross-Examination.
JUDGE DIPPELL: Is there any objection to the Exhibit No. 37?
(No response.)
JUDGE DIPPELL: Seeing no objection, I will enter that into evidence.
(SPIRE EXHIBIT NO. 37 RECEIVED INTO EVIDENCE.)
JUDGE DIPPELL: And we can begin

with Cross-Examination by Staff.
MR. THOMPSON: No questions. Thank you, Judge.
JUDGE DIPPELL: Public Counsel.
MR. SMITH: Yes.
CROSS-EXAMINATION BY MR. SMITH:
Q. Good afternoon, Mr. Rasche.
A. Good afternoon.
Q. Are you a shareholder of Spire Missouri's parent or Spire Inc.?
A. Yes, I am a shareholder, as are most all of our employees and many of our customers.
Q. And your current title is a CFO or the executive vice president?
A. I have both titles. I generally refer to myself as the CFO.
Q. What is your understanding of the net income for 2016 of Spire Inc.? What is that number?
A. The net income for 2016 for Spire Inc.? I can remember the number in earnings per share, but I can't give you the dollar amount because, as you can imagine, I've had eight quarters' worth of performance since then and I can only keep certain numbers in my brain. I could

clearly look it up. It's -- $3.42 per share was the Spire Inc. consolidated earnings per share for that year.

Q. Does $144.2 million sound correct?

A. It sounds familiar, but, again, without being able to reference anything, I couldn't verify it or not.

Q. And you said there were eight quarters in between. So November 2017 earnings were recently reported; isn't that correct?

A. Um-hum.

Q. And isn't it true that the net income at that time was $161.6 million?

A. Yes, it was.

MR. SMITH: Okay. Thank you. No further questions.

JUDGE DIPPELL: Thank you.

Anything from MIEC?

MR. MILLS: No questions.

JUDGE DIPPELL: Midwest Energy?

MR. WOODSMALL: No questions.

JUDGE DIPPELL: Environmental Defense?

MS. KARAS: No questions.

JUDGE DIPPELL: Questions from the

Bench?

CHAIRMAN HALL: No questions.

COMMISSIONER KENNEY: No questions.

JUDGE DIPPELL: Is there any Redirect?

REDIRECT EXAMINATION MR. PENDERGAST:

Q. The only Redirect I had -- we had a number of questions about Exhibit 57 and I think we've pointed to Mr. Rasche as somebody who could reveal who the peer companies were and I thought we'd give him an opportunity to go ahead and do that?

JUDGE DIPPELL: Okay. Mr. Rasche, can you answer that question about the Exhibit No. 57? There's a dark gray line -- or a gray line.

THE WITNESS: This (indicating to document), right?

JUDGE DIPPELL: Yes. Can you identify the companies that were the peer companies.

THE WITNESS: Yes, I can.

This was a standard analysis that we perform on a monthly basis and look at it in detail on a quarterly basis, comparing our performance from a share price perspective against the broader market which would be the S&P 500 which is the dark blue line and then also our peer set.

Our peer set which we also use to benchmark operating performance, compensation and other issues has consisted of the following: South Jersey Industries, New Jersey Resources, Northwest Natural, WGL, Southwest Gas --

MR. WOODSMALL: Hold on. I'm sorry.

THE WITNESS: Northwest Natural...

JUDGE DIPPELL: If you can please go a little slower.

MR. WOODSMALL: Yeah.

THE WITNESS: Southwest Gas, Atmos, Black Hills, Alliant, NiSource, Northwestern, ONE Gas, Vectren and Avista.

And these -- that group is the sub- -- is the set of either LDCs, pure LDCs or largely gas-focused utilities that would -- that we benchmark ourselves against for many operational and also financial and market metrics. So it's a standard performance.

And this analysis compares straight up the shared performance for those peers as a group against us in the market, and as you can see and I think it was outlined in earlier testimony, that our performance, even though our shares have been -- increased dramatically, as have most of the shares in each of your 401(k) plans or 403(b) plans, our performance against our peer set which is whom we not only compete with for talent, but we compete with in the investment market for both debt and equity investment, our performance is 2700 basis points below that peer set for that period. That's 27 full percentage points below, and it -- the purpose of this -- and we look at this on a routine basis to make sure that we understand what's going on in the market and to the extent that we can address any under-performance or can explain any over-performance -- and you can see there isn't much of a time period where we're over-performing except for a few brief periods in late 2013 and early 2014 -- so that we can refine our message because ultimately our communication to the capital markets is important in our raising of capital at all levels of the stat, whether that be at the Spire Inc. level where -- it's the only place we issue equity because that's the most cost effective way to raise equity, but also debt raises which happen not only at Spire Inc., but also at Spire Missouri including our $170 million offering that we announced earlier and funded in September this year. Spire Alabama, we're actually in the process of completing a $75 million offering there. Half of that was funded on December 1st.

JUDGE DIPPELL: Thank you.

BY MR. PENDERGAST:

Q. Thank you. And was this Exhibit 57 prepared by you or under your supervision?

A. It was prepared under my supervision.

Q. Thank you.

MR. PENDERGAST: At this time I would offer Exhibit 57 into evidence, and I have no further questions for Mr. Rasche.

JUDGE DIPPELL: Okay. I'm just going to give a little caveat before I ask for objections, and that is I'm going to allow you all to do Cross-Examination based on those -- the information that we just heard. But at this time would there be any objection to Exhibit 57?

(No response.)

JUDGE DIPPELL: Seeing none, then I will admit that.

(SPIRE EXHIBIT NO. 57 RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: And I'm going to let you all have an opportunity to Cross based on that testimony.

Is there anything from Staff?

RECROSS-EXAMINATION BY MR. THOMPSON:

Q. What happened at the end of 2015, Mr. Rasche? Looks to me based on this graph that Spire was more or less tracking the peer group until the end of 2015 when Spire's share price plummeted and that of the peer group rose and it hasn't caught up again.

A. Actually, if you look in that time frame, everybody's shares plummeted. Ours plummeted a little bit more.

In fact, if you go to the point where they do drop, I would say that the percentage performance between the two was within three percentage points over a three-year period, which in my mind would not be statistically significant. And you can see that we, the stock market overall, and our peer set all dropped.

I believe that was -- as was mentioned by a couple of the other witnesses today, the stock market and the debt markets are influenced by actions by the market overall, by the Treasury Department and also by actions outside of the United States. And I don't specifically recall what the action was in that time period, but I can tell you that the consistent movement of all three tells me that it was probably something internationally because, if you see, the market overall dropped fairly significantly and in a time of duress, think of North Korea or other things outside of the U.S., including the Brexit vote, which may be what this is, utilities are viewed as a defensive stock and therefore usually get more than their share of interest and investment as a place to put money in a relatively safe fashion.

Q. If you know, when was the Alagasco acquisition?

A. We closed the Alagasco acquisition on Labor Day 2014, so well before the time period you're pointing out.

Q. Thank you.

MR. THOMPSON: No further questions.

JUDGE DIPPELL: Anything from Public Counsel?

MR. SMITH: No questions.

JUDGE DIPPELL: MIEC?

RECROSS-EXAMINATION BY MR. MILLS:

Q. So that what you have established as a peer group here is not the same as the proxy group that Ms. Ahern used; is that correct?

A. I'm sorry, the proxy group that...

Q. Ms. Ahern used in your return on equity analysis.

A. It would be not exactly the same, however, there would be many utilities that would be consistent between the groups.

Q. But her group has utilities that yours does not and yours has some that hers does not; is that correct?

A. I would suspect so, but I don't specifically know all the companies that were in her peer group.

Q. And if you had, for example, run this analysis a month ago, it would probably show that you were noticeably above the S&P 500; is that correct?

A. (Reviewing document.)

Actually, you have to go back about three months, and you can see that we've tracked with the S&P fairly closely.

And, again, you know, those differences over a five-year period are probably not statistically significant, the point of this chart being the delta from the gray line rather than the delta from the orange line.

Q. And when you run these analyses, do you sometimes put trend lines to these marks?

A. We do analyze them a number of ways, yes.

Q. And if you were to do it -- from looking at this, it appears to me, and correct me if I'm wrong, that if you were to do a trend line for both Spire and the S&P 500, those lines would be very, very close to each other just at the end.

A. Actually, I would say if you took the trend line from the date on which we filed the Missouri rate case, the trend line for us would be down and the market would be up. And the reason for that is the risk associated with a rate case, especially in a jurisdiction where, oh, 60 percent of our earnings are driven.

Q. But over the five-year period that this graph depicts, they would be fairly similar?

A. Well, by definition if you would draw a trend line over a five-year period, if the beginning point and the end point were exactly the same, the trend line would be exactly the same. But the meaning of trend lines is looking at shorter periods and trying to predict where that performance is going in the future rather than using a base in the past.

Q. And if you'd looked at this and stopped your analysis about halfway through 2015, in fact Spire would probably -- at least for a brief period of time, would have been above the peer groups, correct?

A. Um... I can do that mentally in my head. I'm not sure whether we'd be above the peer group for any time period from the start change which really started about the end of 2015, so I think it would still show that we would have underperformed our peers.

Q. But there are times in here in which the orange line is higher than the gray line, which would indicate that you were at that point outperforming the peer group?

A. You are looking at the same information I have and I see one brief period of time where the orange line is above the gray line during the entire analysis.

Q. And are you familiar with the criteria that Ms. Ahern and Mr. Gorman used to select their proxy group for purposes of determining return on equity?

A. I read their testimony. I can't speak to their methodology, but it's consistent with what I would have expected.

Q. Do you know why neither of them included a number of the companies in their proxy groups that you did not include in your -- that you did include in your proxy group?

A. No. You'd have to ask them directly on that.

Q. Okay.

MR. MILLS: No further questions.

JUDGE DIPPELL: Thank you.

Midwest Energy Consumers?

MR. WOODSMALL: Very briefly.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. You weren't here, I know, but there were questions asked of Public Counsel witness

Chuck Hyneman the first day of the hearing in which he provided stock price information for the Dow Jones Industrial Average and the Dow Jones Utility Average. Are you aware of that testimony?

A. I am not.

Q. But just my point, the Dow Jones Industrial Average and the S&P 500 are different metrics; is that correct?

A. Um-hum.

Q. Is that a yes?

A. Yes. Yes, they are.

Q. And it wouldn't surprise you if both pieces of testimony were accurate? They're not in conflict since they're different metrics; is that --

A. They are different metrics. The Dow is a much smaller sample of companies than the S&P 500 and we think it's a better reflective overall view of market active versus than any of the Dows.

Q. And the Dow Jones Utility Average is a different metric than your self-filled peer group; is that correct?

A. Yes, it would include a lot of very

large electric utilities, which we don't believe are appropriate comparators for our performance given our mix of business.

Q. Okay.

MR. WOODSMALL: No further questions. Thank you.

JUDGE DIPPELL: And anything from the Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: All right. Is there any further Redirect based on --

MR. PENDERGAST: No, your Honor.

JUDGE DIPPELL: All right. Thank you for indulging me on that.

Mr. Rasche, I believe that completes your testimony for now and you may step down.

THE WITNESS: Thank you.

JUDGE DIPPELL: Or I believe that completes your testimony completely.

(Witness excused at 1:46 p.m.)

JUDGE DIPPELL: So we're ready for the next Spire witness?

MR. FISCHER: Yes. Glenn Buck.

(Witness sworn.)

THE WITNESS: I do.

JUDGE DIPPELL: Thank you.

Go ahead, Mr. Fischer.

MR. FISCHER: Thank you.

GLENN BUCK testified as follows:

DIRECT EXAMINATION BY MR. FISCHER:

Q. Please state your name and address for the record.

A. My name is Glenn Buck. My address -- business address is 700 Market, St. Louis, Missouri, 63101.

Q. Are you the same Glenn Buck that has cause to be filed in this case Direct testimony which has been marked as Exhibit 19, Rebuttal testimony that's been marked as Exhibit 20, Surrebuttal that's been marked as Exhibit 21 and True-Up Direct which has been marked as 22?

A. Yes, I am.

Q. Do you have any changes or corrections that should be made to any of those testimonies?

A. A few. They're all grammatical and, frankly, are not significant, but the first one's are in Rebuttal on page 3, line 8, the word "refunding" should be "refunded."

Q. What's your next one?

A. On page 6, line 20, the word "combine" should be "combined."

Q. Okay.

A. On line 22, there's a superfluous period at the end of the sentence.

Q. Okay.

A. On page 11, line 1, you need to add a semicolon after the term "20 years." So it would read "20 years;."

Q. Okay.

A. On line 8 of that same page, please add a space between the word "item" and the number "4."

Q. Any others?

A. Two left. Page 13, line 16, add the word "make" after "likely." It's supposed to say "likely make."

And then, finally, in my Surrebuttal on page 9, line 12, the word "witness" should be replaced with the word "witnesses."

Q. If I were to ask you the questions that are contained in your various testimonies today, would your answers still be the same and are they accurate to the best of your knowledge and information and belief?

A. Yes, they are.
MR. FISCHER: Judge, Mr. Buck is going to be appearing on several issues, but he does address the capital structure issue in this area, so at this time I would tender the witness for Cross-Examination.
JUDGE DIPPELL: Thank you. Is there Cross-Examination by Staff?
MR. THOMPSON: No thank you, Judge.
JUDGE DIPPELL: Public Counsel?
MR. SMITH: Yes, briefly.
CROSS-EXAMINATION BY MR. SMITH:
Q. Does Laclede or MGE anticipate funding gas inventories with short-term debt going forward?
A. I don't think -- actually, I don't really think we're funding it with short-term debt currently. So the answer would be: You never know what's going to happen in the future, but my anticipation would be no.
Q. Now, you say that the Company is in financing with short-term debt currently. Is that because it was refinanced to long-term debt?
A. No. I mean we've been managing our

debt, both short-term and long-term, based on cash available to us, and for the long-term debt that we've got out there -- or the short-term debt that we've got out there has been largely funding other short-term assets besides the inventories.

Which is why if you look at my Schedule Surrebuttal -- I mean Rebuttal Schedules AWB1, it shows we compared our short-term debt averages compared to other short-term assets and the short-term assets were higher than that with the funded inventories.

Q. In the past has the Company funded gas inventories with short-term debt?

A. Yes, we have.

Q. Thank you.

MR. SMITH: No further questions.

JUDGE DIPPELL: MIEC?

MR. MILLS: No questions.

JUDGE DIPPELL: Midwest Energy?

MR. WOODSMALL: No questions.

JUDGE DIPPELL: Environmental Defense?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Are there questions from the Bench for Mr. Buck?

CHAIRMAN HALL: No questions.

COMMISSIONER KENNEY: No questions.

JUDGE DIPPELL: Any Redirect?

MR. FISCHER: Yes, briefly.

REDIRECT EXAMINATION BY MR. FISCHER:

Q. Mr. Buck, you were asked some questions about whether the Company uses short-term debt to fund gas inventory?

A. Yes.

Q. Why doesn't Laclede or Spire Missouri include short-term debt in the capital structure?

A. Well, largely because it funds, first off, construction work in progress and it also funds other Commission-tarrifed -- or other assets that are based on Commission tariff are provided for at a short-term debt rate, usually prime minus 2 which is the equivalent of a short-term debt rate. So it only makes sense at that point to finance them -- those short-term.

Q. And do those items like construction work in progress and those other tarrifed items that you mentioned exceed the short-term debt

that you might have?

A. Absolutely.

Q. In past cases has Laclede included short-term debt in its capital structure?

A. No, sir.

Q. In past cases has -- do you know if the Staff has included short-term debt in its proposed capital structure?

A. In recent years, no. I think if you went back 15, 20 years there may have been, but not recently, no, sir.

Q. Do you know if the Public Counsel has included short-term debt in its capital structures in previous cases that you're familiar with?

A. Not as I'm aware.

Q. Are you aware of any party in cases you've been aware -- or are aware of that has included short-term debt in the capital structures in Laclede cases?

A. It's an awful lot of cases, but to my knowledge, no, sir.

MR. FISCHER: That's all the questions I have. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: I believe that's all for you at this time, Mr. Buck.

THE WITNESS: Thank you.

JUDGE DIPPELL: You may step down.

(Witness excused at 1:53 p.m.)

JUDGE DIPPELL: And, Mr. Fischer, can I just ask if you have three more copies of Exhibit 57?

MR. FISCHER: Oh, if we don't, we can make some.

JUDGE DIPPELL: If you don't have them here, that's fine.

MR. FISCHER: I do have some here, Judge. I do. I've got four, actually. (Tendering documents.)

JUDGE DIPPELL: All right. Then we are ready for Staff's witness.

MR. THOMPSON: Judge, Staff would call David Murray to the stand.

(Witness sworn.)

THE WITNESS: I do.

JUDGE DIPPELL: Thank you.

Go ahead, Mr. Thompson.

MR. THOMPSON: Thank you, Judge.

DAVID MURRAY testified as follows:
DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. David Murray, last name spelled M-U-R-R-A-Y.

Q. How are you employed, Mr. Murray?

A. I'm employed as a Utility Regulatory Manager in the Financial Analysis Unit in the Operational Analysis Department.

Q. And are you the same David Murray that prepared or caused to be prepared several pieces of testimony, first of all, a contribution to Staff's revenue requirement class cost -- or Cost of Service Report 204 Confidential, 205 Nonconfidential?

A. Yes.

Q. And then Rebuttal testimony 221 Confidential, 222 Nonconfidential?

A. Yes.

Q. And Surrebuttal testimony 264 Confidential, 265 Nonconfidential?

A. Yes.

Q. And do you have any corrections to those pieces of testimony?

A. I do have a few corrections. On

page 7 -- and this is on the Staff Cost of Service Report.

Q. Yes, sir.

A. Page 7, line 20, it indicates "6.41 to 6.65 percent." It should be "6.38 to 6.62 percent" which is consistent with the table on page 8.

JUDGE DIPPELL: Can you re- -- hang on, Mr. Murray. I was trying to catch up. So page 7, line 20 is what you said?

THE WITNESS: Yes.

JUDGE DIPPELL: And could you give me that change?

THE WITNESS: It should be "6.38 percent to 6.62 percent."

JUDGE DIPPELL: 26 did you say?

THE WITNESS: 6.62.

JUDGE DIPPELL: 6.62. Thank you.

THE WITNESS: And in my Rebuttal testimony, on page 1, line 24, I guess this will be -- I'll leave it up to you how to put this in here, but a line was left off and I don't know if it will be assigned a new line number, but after "the" at the end of the line, there should be "Capital asset pricing model ('CAPM'), and

the risk premium method ('RPM') and then --
JUDGE DIPPELL: Start with premium method?
THE WITNESS: Yes.
JUDGE DIPPELL: Start with premium method and give me the --
THE WITNESS: Oh, I'm sorry.
JUDGE DIPPELL: That's okay.
THE WITNESS: "Premium method" and then the parentheses with a quote and then an R and then a P as in Pam and an M as in mom with another parenthe- -- excuse me -- another quote and then parentheses and then "to her."
JUDGE DIPPELL: To what was the last thing?
THE WITNESS: Her, H-E-R.
And page 3, line 3, instead of "capitol" as a, you know, physical capitol, K -- C-A-P-I-T-O-L, it should be C-A-P-I-T-A-L.
Page 7 -- this is also on Rebuttal testimony, page 7, line 15, instead of "Spire Incorporated issued approximately," it should say "Spire Missouri issued approximately 40 million of short-term debt."
And on -- in Surrebuttal testimony on

page 5, line 1, before the abbreviation "ACA," "actual cost adjustment" was left out. So "actual cost adjustment" before "ACA."

And that's it.

BY MR. THOMPSON:

Q. Does that complete your corrections, Mr. Murray?

A. Yes.

Q. If I were to ask you those same questions again with those corrections in mind, would your answers be the same?

A. Yes.

Q. And are they true and correct to the best of your knowledge and belief?

A. Yes.

MR. THOMPSON: I will not offer the Revenue Requirement Cost of Service Report at this time since there are more Staff witnesses yet to come, but I will offer Exhibits 221, 222, 264, 265.

JUDGE DIPPELL: Would there be any objection to Exhibits 221, 222, 264 and 265?

(No response.)

JUDGE DIPPELL: Seeing none, I will admit those into evidence.

(STAFF EXHIBIT NOS. 221, 222, 264 and 265 RECEIVED INTO EVIDENCE.)

MR. THOMPSON: Thank you, Judge. I will tender the witness for Cross-Examination.

JUDGE DIPPELL: Is there any Cross-Examination from Public Counsel?

MR. SMITH: No questions.

JUDGE DIPPELL: MIEC?

MR. MILLS: No questions.

JUDGE DIPPELL: Midwest Energy Consumers?

MR. WOODSMALL: Yes, very briefly, your Honor.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Good afternoon. Were you here when Ms. Ahern testified this morning?

A. I was.

Q. And did you hear her comment that the investment community will look at it as a negative "a departure from a prior decision making." Do you recall her saying that?

A. I don't recall the context.

Q. Okay. Anyway, is your capital structure that you're representing in this case a consolidated capital structure a departure

from the way it's been done in the past in Laclede cases?

A. It is not.

Q. Okay. Is Laclede/MGE's proposed capital structure a departure from the way they've done it in the past?

A. It is.

Q. Can you tell me how?

A. They are recommending the subsidiary capital structure rather than the consolidated, and before -- before this case, they had recommended the Laclede Group consolidated capital structure for, you know, several rate cases. I don't recall exactly when they started doing so.

Q. And last question. In this case you included short-term debt in the capital structure. Did you include it in previous cases, and if not, why did you do it here?

A. I did not include it in previous rate cases because of the fact that, as of 2005, the Company and Staff and I believe some other parties agreed to recover carrying cost on gas inventory balances based on the logic that the -- you know, this -- it's a short-term asset, so therefore a short-term rate should be used for the gas inventory carrying costs flow through the PGA ACA process, so it was not in rate base. And with -- you know, with this case, obviously, Staff is recommending it be included in rate base and I believe -- you know, I believe that everybody understood that the logic was that the carrying charges for short-term assets should be consistent with the short-term rate.

MR. WOODSMALL: No further questions. Thank you.

JUDGE DIPPELL: Anything from Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Spire?

MR. FISCHER: Yeah, Judge, I do have some questions.

CROSS-EXAMINATION BY MR. FISCHER:

Q. Mr. Murray, your background, employment background credentials are all included in appendix 1, page 42, correct?

A. I don't know if I have that appendix up here with me, but --

Q. Oh, that's all right. We've been through it a number of times before. I just have a few more questions related to things that aren't there.

Prior to your employment with the Commission, just for the record, were you ever employed to work for any other regulatory agency or financial institution?

A. The Department of Insurance for the first five years of my working career after I graduated college.

Q. And during that period while you were with the Division of Insurance, did you do cost of capital testimony for them or --

A. I did not. The rates weren't regulated for insurance companies. Even with Workers' Compensation, they had deregulated their rates in 1993 I believe it was.

Q. And have you ever worked for any other financial institution?

A. No, I've been with the Department of Insurance and then Public Service Commission and we're here, so...

Q. And we've been doing this for like 17 years, right?

A. Approximately so.

Q. Let's -- on appendix 1, maybe without even referring to it, is it correct that the last natural gas rate case that you participated in personally was the Summit Natural Gas case, Case No. GR-2014-0086?

A. I recall that -- I believe that is the last case in which I personally filed direct testimony, and now I just supervise other employees.

Q. Yeah, you've supervised other employees recently on the Liberty case, right?

A. I did.

MR. FISCHER: Your Honor, just to short-circuit this, I would ask that the Commission take official notice of the report and order in the Summit Natural Gas case, Case No. GR-2014-0086 which was issued on October 29, 2014.

JUDGE DIPPELL: Would there be any objection to the Commission taking official notice of that report?

MR. WOODSMALL: I guess my only question is what's the relevance?

MR. FISCHER: Oh, I think it will

become relevant. It's the last one he participated in and made a recommendation. I do have some -- a couple of questions about that case and how it relates to this.

MR. WOODSMALL: Well, assuming he establishes some relevance, probably not, no.

JUDGE DIPPELL: Well, I will let you go ahead and question the witness, Mr. Fischer, and then I'll rule on the admittance.

MR. FISCHER: Okay.

BY MR. SMITH:

Q. Mr. Murray, I'd like to show you a copy of that report and I'm going to refer to a couple things here.

JUDGE DIPPELL: And just to keep it straight, I'm going to go ahead and mark that -- give that an exhibit number as 58.

MR. FISCHER: Okay. I don't have enough copies for --

BY MR. FISCHER:

Q. Let's just ask you to refer to page 36 of that report and order where the parties have -- or where the Commission lays out the parties' positions.

A. I'm there.

Q. Okay. Let's look at the -- at -- first at the capital structure issue on page 36. It indicates that Staff had suggested a capital structure of 60 percent debt and 40 percent equity in this case.

A. That is correct.

Q. And then Summit Natural Gas at that time was advocating the use of a 43 percent debt and a 57 percent equity capital structure; is that right?

A. Yes.

Q. Now, the Commission did not adopt Staff's proposed capital structure in that case; is that true?

A. It do not.

Q. It adopted a 57 percent equity ratio that was proposed by Summit?

A. That's correct.

Q. Let's look at page 37.

MR. THOMPSON: Judge, I'm going to join in Mr. Woodsmall's objection because there's certainly been no showing of relevance so far.

JUDGE DIPPELL: All right, that will be pending as well.

MR. THOMPSON: Thank you.
BY MR. FISCHER:
Q. The Commission on page 37 of the report and order, it begins to discuss the capital structure issue that you testified about and it indicates that the Commission is setting Southern Missouri Natural Gas and Missouri's capital structure at 43 percent debt and 57 percent equity as Southern Missouri Natural Gas asks because that it is how Southern -- Summit Natural Gas Missouri actually provided service during the test period?
A. That is correct.
Q. Is it correct then to conclude that the capital structure of Summit Natural Gas was used in that case rather than in the parent?
A. That is correct.
Q. The report and order also indicates the positions of the parties on page 36 on the cost of equity issue; is that correct?
A. Yes, it does.
Q. Does the report and order indicate that the Commission adopted a return on equity of 10.8 percent in that case?
A. It does.

Q. And that was the high end of your recommended range in that case; is that right?
A. That is correct.
Q. With the exception of our current case involving Laclede and MGE, have you presented cost of capital testimony personally at any natural gas case that's more recent that the Summit Natural Gas case?
A. Personally, no.
Q. Okay.
JUDGE DIPPELL: Is that all you have on that exhibit, Mr. Fischer?
MR. FISCHER: Yes.
JUDGE DIPPELL: I'm going to go ahead and allow -- we've talked about capital structure in various other cases throughout this whole thing. I'm going to take official notice of that report and order.
MR. WOODSMALL: Can I make my objection first and then you can overrule it?
JUDGE DIPPELL: Okay. Go ahead.
MR. WOODSMALL: Cross-examining him on it is fine, but putting it in as evidence and claiming that --
JUDGE DIPPELL: It's not --

MR. WOODSMALL: -- these are facts, it -- I have no problems with him assigning to it, but --

JUDGE DIPPELL: I'm taking official notice of it.

MR. WOODSMALL: But it's not evidence?

JUDGE DIPPELL: It's not the law and it's not a --

MR. THOMPSON: Mr. Fischer promised he was going to show us the relevance. He has not.

JUDGE DIPPELL: He did in fact show us the relevance. We have talked about capital structure, we have talked about past cases and how the Commission has ruled.

MR. WOODSMALL: And to finish my objection --

JUDGE DIPPELL: Finish your objection, Mr. Woodsmall.

MR. WOODSMALL: -- I have no problem stipulating to the fact that the Commission has disagreed with Mr. Murray on ROE and capital structure in other cases, but to then put this into evidence and claim that 57 percent is somehow relevant to Laclede is a reach. The Company doesn't even include Summit Natural Gas in their proxy group or in their peer group that they measure against. Similarly, to claim that giving 10.8 percent to Summit Natural Gas is somehow applicable to Laclede here is also completely irrelevant.

So I will stipulate to the fact that the Commission has disagreed with Mr. Murray in the past on certain things, but that is all irrelevant as to what is the appropriate capital structure and ROE here.

JUDGE DIPPELL: I still am going to take official notice. I believe it is relevant, though all of your arguments go toward the weight and you can include those in your brief.

MR. FISCHER: Thank you, Judge. I was merely trying to short-circuit this a little bit too.

BY MR. FISCHER:

Q. Mr. Murray, we've talked about earlier in this case the last decision by the Missouri Public Service Commission in a natural gas case, which was the Liberty case. Do you recall that?

A. Yes, I do.

MR. FISCHER: And, Judge, I'm going to ask a couple of questions, but I'd like for you to take official notice of that case as well. That was Case No. GR-2014-0152.

MR. WOODSMALL: Same objections.

JUDGE DIPPELL: Same -- can you state what --

MR. WOODSMALL: Just to clarify, when you take official notice, does that mean it is evidence or how do you mean when you take official notice?

JUDGE DIPPELL: Under Statute 536.070, the Commission is allowed to take official notice, and that's as far as I'm going to go --

MR. WOODSMALL: Okay.

JUDGE DIPPELL: -- until a later date.

MR. WOODSMALL: Okay.

BY MR. FISCHER:

Q. I'd like to show you a portion of that on the cost of capital issue. (Tendering document to witness.)

JUDGE DIPPELL: Mr. Fischer, can you tell me that case number again?

MR. FISCHER: Yes, it's GR-2014-0152. It was issued on December 3rd, 2014. And if you'd like a copy, Judge, I've got one here, we can mark it, but I just was asking it to be taken official notice of.

JUDGE DIPPELL: Proceed, Mr. Fischer.

MR. FISCHER: Okay.

BY MR. FISCHER:

Q. If you'd turn to page 29 of that decision, Mr. Murray.

A. (Witness complying.)

Q. There is a -- just a short paragraph where it has the Commission's decision at the top of the page. Do you see that?

A. (Reviewing document.)

I only see the ROE. I don't see the capital structure.

Q. Well, I think -- I'm asking you to turn to page 29 where it talks about -- I guess this is actually the ROE.

A. Oh, it's just ROE?

Q. Yeah.

A. Okay. I'm sorry.

Q. It says there that "The Commission

finds this issue in favor of Liberty. The Commission will set the return on equity at 10.0 percent, which is the bottom of the range Liberty proposed. Such a return on equity is commensurate with returns of other corporations with corresponding risks and will ensure confidence in the financial integrity of the Company and is near the midpoint of the above mentioned zone of reasonableness."

Do you see that?

A. I do.

Q. Okay. I think Mr. Hevert was a witness in that case, wasn't he, for the Company?

A. I don't recall. Sorry.

Q. Do you recall that Mr. Zephania Marengapo [sic] was a Staff witness in that case?

A. It's Marevangepo. And, yes, I do recall.

Q. I apologize. Marevangepo?

A. Yes, sir.

Q. And would you have supervised him as the head of the unit?

A. I did.

Q. Would you turn to page 19 of that report and order to paragraph 22.

A. (Witness complying.)

Is that -- I'm just trying -- is it just ROEs or capital structure?

Q. Well, this is on ROE.

A. Okay. And page -- I'm there.

Q. Okay. On paragraph 22, it indicates that the midpoint of Mr. Marevangepo's recommended return on equity range is 8.7 percent, which would give Liberty a return on equity more than 60 basis points lower than any return on equity at any state commission in at least 30 years." Is that what it says?

A. That's what it says.

Q. I believe in this case you've testified that the actual cost of equity for Spire Missouri's operating units is presently in the range of 6.9 percent to 7.7 percent; is that right?

A. That is correct.

Q. Is it correct that the high end of your cost of equity range of 7.7 percent is 100 basis points lower than the 8.7 percent return on equity that Staff recommended in the Liberty

case?
A. It is.
Q. And that 8.7 percent ROE, according to the Commission's findings in the Liberty case, was more than 60 basis points lower than any return on equity at any state commission in at least 30 years?
A. I think that was his recommendation, I mean. But that's -- that's not my recommendation, so it's a little different, but I understand what you're -- yeah, that is correct.
Q. But you did indicate that you had supervised him and approved that recommendation in that case?
A. Yes. It was cost of equity -- allowable return based on the cost of equity.
Q. Well, isn't the reason that you're not recommending that the Commission authorize an ROE in this case as low as what you believe is the real cost of equity, is that the reason, because it's never been adopted in 30 years?
A. No. The reason is I'm paying attention to what the Commission has adopted in cases in recent past that take into consideration all the

capital market activities that we have at this point in time and as much as I still believe that it's -- the capital markets support fairly low cost of equity. I mean, we do have priced earnings ratios for utilities at all time highs and dividend yields at all time lows. I recognize there is some hesitancy to come down to actual cost of equity which is corroborated by market participants that actually invest. So my point being --

Q. You recognize, don't you, that such a low range of 6.7 to 7.7 hasn't been found reasonable by any state agency for many years, correct?

A. For an allowable return, that's correct.

Q. And if we refer to page 28 of that Liberty case, in paragraph 26 it describes -- well, here, it says "The Commission has described a 'zone of reasonableness' extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations." Is that right?

A. Yes. I can actually remember when that

zone test was created. It was in 2004.
Q. Okay, good. And then it goes on to say "Because the evidence shows the recent national average ROE for gas utilities is 9.69 percent, that zone of reasonableness for this case is 8.69 to 10.69," correct?
A. That is correct.
Q. And in that case the Commission found an ROE of 10 percent even for -- was reasonable for Liberty or in the upper part of the zone of reasonableness; is that true?
A. As applied to their capital structure, that is correct.
Q. On page 40 of the Staff Cost of Service Report at line 14 -- do you have that?
A. I'm there.
Q. Page 40 at line 14, you state that "The average allowed ROEs for gas utilities are closer to 9.5 for the first six months of 2017." Is that right?
A. I do.
Q. So if the Commission applies its zone of reasonableness concept in this case, those zone of reasonableness would be a hundred basis points above and a hundred basis points below

that 9.5 recent national average for gas utilities; is that right?

A. I mean, that's what -- just taking a pure average without looking at the details. I think we've learned a little bit more as time has gone on.

Q. And so that would mean that the zone of reasonableness would be 8.5 to 10.5 using that 9.5 recent -- or national average?

A. If that was assumed to be the reasonable average, that's correct.

Q. So a 10.35 would be within that range of reasonableness, correct?

A. Yes, it would.

Q. And, of course, if the national average goes up, so would that zone of reasonableness, correct?

A. Again, depending on what you believe should be in that national average, yes.

Q. Well, in this case, while you testified, -- and I think you just reiterated that you still believe the actual cost of equity for Spire is 6.9 to 7.7, you've recognized that that range is below the authorized returns that other state agencies are giving in recent years,

correct?
A. Can I clarify something? This is not something that I just pulled out of thin air. It's corroborated.
Q. Well, I just really need an answer.
A. Okay.
Q. Is that a yes?
A. Please repeat the question.
Q. Yeah. While you've testified that in your opinion the actual cost of equity for Spire is 6.9 to 7.7, you've recognized that that range is below the authorized returns of any state regulatory agencies in recent years?
A. Oh, without a doubt, yes.
Q. So, instead, you're recommending the Commission utilize an ROE of 9.25 and your upper end of that range is 9.5; is that right?
A. I recommended a range of nine to nine and a half.
Q. So nine and a half would be -- nine and a half would be in the high end of the range?
A. Yes.
Q. Is it correct that you're not recommending an ROE based upon your professional opinion of what is the actual cost of equity for

Spire Missouri?

A. That is correct.

Q. Your actual cost of equity is simply not appropriate in light of what other natural gas companies are being authorized around the country?

A. As taking into consideration allowable returns, that is correct.

Q. As I understand your testimony on page 10 of the Staff's Cost of Service Report, you used the Commission's recently authorized ROE of 9.5 percent for KCPL in Case No. ER-2016-0285 as a benchmark to determine the just and reasonable allowable return on equity for Laclede and MGE in this case; is that correct?

A. Yes.

Q. Now, since the Commission issued its order in that case, is it correct that the Federal Reserve has raised interest rates?

A. The Federal Reserve has raised Fed funds rate at a short-term rate. That -- interest rates, long-term rates are more market oriented.

Q. On page 11 of your Staff Cost of

Service Report at line 7, you state "As recently as its June 2017 meeting, the Federal Open Market Committee agreed to raise the benchmark rate a quarter point which stands at 1.00 to 1.52 percent. Since December of 2015, the Fed has increased the rate four times." Is that correct?

A. That is correct.

Q. Would you agree that there's been a trend for the Fed to periodically raise interest rates since the end of 2015?

A. The Fed funds rate. I think it's important to specify what rates. They have control over the Fed's fund rate and that has been increased, but the long-term rates have not followed suit.

Q. And the Fed has raised those rates four times, correct, since 2015?

A. That is a fact.

Q. Would you agree that the interest rate hike by the Federal Reserve is an indication the Fed is confident about the pace of the growth in the U.S. economy?

A. I don't believe they're confident about the pace. It's a kind of wait and see and see how the information comes in.

Q. In your job as the head of the financial unit, do you follow the comments of the Chair of the Federal Reserve?

A. Through -- through financial media, yes.

Q. Did you see the recent news reports at the end of November that the Federal Reserve chair, Janet Yellen expected to continue to raise interest rates gradually?

A. I recall that.

Q. Did you also see the reports that the new Chair that's been nominated, Jerome Powell, also intends to continue that trend?

A. Taking into consideration the flexibility of -- as market data comes in and adjusting as necessary, that's correct.

Q. Do you agree with Miss Ahern's comments that she's expecting -- or that the market is expecting the Fed rates to be -- interest rates to be raised in December of this year?

A. The Fed funds rate, yes.

Q. Okay. Is it also true that since the Commission issued its order in the last KCPL case, the rate of annual growth of the GDP has

been reported in excess of 3 percent?

A. I believe it was 3 percent in each of the last two quarters.

Q. And that was an improvement over previous years' growth rates, correct?

A. There were 3 percent quarters in the previous years as well. They weren't sustained.

Q. But now they're in excess of 3 percent today in the last quarter?

A. I'm just telling you I recall there were 3 percent quarter GDP rates in past years since the financial crisis as well.

Q. Would you agree that that's the strongest growth that -- since the first quarter of 2015?

A. I'm not sure how much stronger, but I have no reason to dispute that.

Q. Okay. As I understand your testimony, Mr. Murray, you're indicating that, while you believe the cost of equity is less than the average allowed ROEs around the country, you have essentially put aside that cost of equity analysis and instead attempted to quantify the difference in the cost of equity of a vertically integrated electric utility and local

distribution natural gas company; is that right?

A. Yes, I'm looking at the relative difference in the cost of equity between the two industries, yes.

Q. And you just apply that differential between the natural gas companies and the vertically integrated electric companies to lower the ROE that the Commission authorized in the KCPL case, correct?

A. I'm sorry. Repeat that question, please.

Q. You adjusted or you applied that differential between electric and gas risks, as I understand your testimony, and applied that to lower the authorized return that was granted in the KCPL case in 2015?

A. The -- I -- the lower allowed ROE I recommend to the Commission. I mean, I'm not lowering the authorized ROE. I'm just making a recommendation.

Q. Oh, I understand it's the Commission job to do that.

A. Okay.

Q. But you're recommending, aren't you, that you look at the KCPL ROE and adjust that

downward because of this risk differential that you believe exists; is that right?

A. That is correct.

Q. On page 28 of the Staff Cost of Service Report, you also indicate that "I used a CAPM analysis and survey of other indicators as a check on the reasonableness of my recommendation." Is that right?

A. I'm sorry. What page?

Q. It's page 28.

A. (Reviewing document.)

That's 30 to 31?

Q. Yeah, probably so. I didn't have a line reference, but...

A. That is correct.

Q. Okay. So is it correct that you did not use a CAPM analysis as the primary basis for your ROE recommendation?

A. No, I think that corroborated my 7 percent cost of equity estimate, along with other data.

Q. And then on page 43 you talk about the rule of thumb method; is that correct?

A. Yes, that's my test of reasonableness method.

Q. Is it correct that you did not include the rule of thumb method as the primary basis for your ROE recommendation?

A. Yes.

Q. And did you include anywhere in your Staff Cost of Service Report or any of your testimony any decision by the Commission that's relied on that rule of thumb method?

A. It's not a primary driver. The recommendation is just to test reasonableness. So I don't know why that it would be, but, no, I did not.

Q. Okay. Let's turn to the capital structure issues. Did you happen to look at the True-Up testimony of Laclede's witness Glenn Buck where he laid out the capital structure as of the true-up?

A. I did.

Q. And would it be correct that that capital structure was 54.2 percent common equity and 45.8 percent long-term debt?

A. That's his recommended capital structure. I don't agree that that's the actual cap structure, but yes.

Q. Okay. On page 21 of the Staff Cost of

Service Report at line 18 --
A. Yes.
Q. -- you say there at line 18 "Based on my analysis, I recommend that the capital -- that the Commission use Spire Inc.'s capital structure with an average level of short-term debt in setting the authorized ROR" -- which is return on rate of return; is that right?
A. Yes.
Q. -- "for Laclede and MGE." Is that correct?
A. Yes.
Q. And then you go on to explain that Spire Inc.'s consolidated capital structure contained 46.05 percent common equity with short-term debt included and 51.3 percent common equity with short-term debt excluded; is that right?
A. That is correct.
Q. Is it correct that the last time the Staff reviewed the capital structure issue for Laclede and MGE was in Case No. GR-2014-0007, which was the rate case involving MGE after it had been acquired by Laclede?
A. In a rate case, that's correct.

MR. FISCHER: Your Honor, I would like to have an exhibit marked.

JUDGE DIPPELL: I'm going to mark your previous report and order as Exhibit 59, so we're up to 60.

MR. FISCHER: Okay.

(SPIRE EXHIBIT NO. 59 AND 60 MARKED FOR IDENTIFICATION.)

BY MR. FISCHER:

Q. Mr. Murray, does this appear to be one of the Staff's accounting schedules that appeared in Case No. GR-2014-0007?

A. It is.

Q. And does this appear to be the capital structure schedule for the true-up period ending December 31st, 2013 which was included in those schedules in the MGE's last rate case?

A. It is.

Q. Is it correct that this schedule shows that the Staff's capital structure for the true-up in that case contained a 53.56 percent common equity ratio and a 46.44 percent long-term debt ratio?

A. And no short-term debt, that's correct.

Q. And no short-term debt. That was my

next question.

So is it correct that the Staff's recommended use of a 53.56 equity ratio with no short-term debt, that's what your recommendation was in that case?

A. Yes, it was.

Q. In this case Spire Missouri's recommending an equity ratio of 54.2 percent with no short-term debt included; is that your understanding?

A. That is correct.

Q. So in the last MGE case, Staff recommended a 53.56 equity ratio in the true-up and Spire Missouri in this case is recommending a 54.2 percent without short-term debt, correct?

A. There are different circumstances in this case, but that is correct.

Q. Would it be correct to conclude that the equity ratio used by Staff in MGE's last rate case is less than one percentage point lower than what Spire Missouri's recommending in this case?

A. That is correct.

Q. To be more precise, Spire Missouri's actual capital structure as of the true-up date

is only 0.64 percent higher than what Staff was using in the MGE last rate case?

A. That is correct.

Q. I would like to try to be clear in the transcript for the next couple of questions. So if it would be okay with you, Mr. Murray, I would like to describe Spire Missouri's capital structure as Laclede's capital structure and refer to the parent Spire Inc.'s capital structure as just the consolidated capital structure of the parent. Would that be all right?

A. I understand.

Q. Okay. Staff agrees that Laclede's capital structure includes the first mortgage bonds issued to outside investors by the operating company Laclede, correct?

A. Yes.

Q. And, in other words, Laclede, they issued their own -- it issues its own long-term debt, correct?

A. Yes.

Q. Laclede issues bonds to the market that support its regulated operations, correct?

A. Yes.

Q. Laclede's long-term debt is secured by the operating company's own assets and not the assets of the parent company, correct?
A. Yes.
Q. And Laclede's long-term debt is not secured by the assets of the parent's other public utilities, Alabama Gas Corporation or the subsidiaries of Energy South, correct?
A. Yes.
Q. And Laclede's assets do not guaranty Alagasco's long-term debt; is that correct?
A. Yes.
Q. And Laclede's assets do not guaranty the long-term debt for other subsidiaries of Energy South, former Energy South subsidiaries?
A. Yes.
Q. And Laclede's assets do not guaranty the long-term debt of Spire Marketing; is that right?
A. I don't think Spire Marketing has long-term debt, but...
Q. Okay. And Laclede's assets do not guaranty the operations of Spire Marketing, correct?
A. Yes.

Q. And Laclede's assets do not guaranty the operations of Spire STL Pipeline; is that your understanding?
A. Yes.
Q. And the Staff agrees that the Missouri Public Service Commission has approved the long-term debt issuances of Laclede, the operating utility in Missouri, correct?
A. Yes.
Q. Has the Missouri PFC, approved any long-term debt issuance for Alagasco?
A. No.
Q. Has the Missouri Commission approved any long-term debt issuances for any other Spire public utilities operating outside of the state of Missouri?
A. No.
Q. Does Staff agree that Laclede does not obtain any long-term debt from its parent Spire Inc.?
A. Please re- -- ask that question again, please.
Q. Do you agree that the Laclede, the public utility, does not receive debt from Spire Inc., the parent?

A. I do not.
Q. You don't agree with that?
A. I do not agree with that.
Q. Okay. Do you agree that Laclede's long-term debt is secured by its own public utility assets and not the assets of the parent?
MR. THOMPSON: Asked and answered.
MR. FISCHER: If we got it, could -- I can withdraw it if he has answered that.
MR. THOMPSON: He has answered that.
JUDGE DIPPELL: Was that -- Mr. Thompson, are you saying that was the last question?
MR. THOMPSON: No, I'm saying it was one of the previous questions.
JUDGE DIPPELL: Okay. I'm going to let him answer it again just because it's going to take too much time to go back through the transcript.
MR. THOMPSON: Very well.
THE WITNESS: Please repeat the question.
BY MR. FISCHER:
Q. Oh, sure. Do you agree that Laclede's long-term debt is secured by its own public

utility assets and not the assets of the parent?
A. Yes.
Q. On a previous question you disagreed that -- I think that we didn't -- that the Laclede Gas Company didn't have debt from the parent, our -- would you explain why that is? Is that because of the commercial paper?
A. No. There's been proceeds and when Laclede -- Laclede Group has issued long-term debt specifically before the transactions, but where they would issue long-term debt and they admitted themselves that they don't need any capital proceeds for their LER operations and there would be cash infusions into -- into Laclede Gas Company. So, you know, if you follow their cash flow, there's only -- and there's investments into the Laclede Gas subsidiary, there's really no other way to explain it than the proceeds from the debt issued at Laclede Group were infused into Laclede Gas. So that's why I disagree with that.
Q. And it's infused as equity, correct?
A. It may be infused as equity. You have a lot of things going on, there's a lot of

moving parts. There's, you know, short-term loans made from Laclede Group to Laclede Gas even before the commercial paper. But now with the commercial paper -- consolidated commercial paper program as of January 2017, yes, Spire Incorporated consolidated directly borrows from the commercial paper markets and loans those proceeds to its subsidiaries.

Q. You agree that the long-term debt of Laclede, the public utility, is used to support the public utility operations of Laclede, correct?

A. Yes.

Q. Do you agree that the parent's capital structure includes long-term debt and common equity of Alagasco?

A. Yes.

Q. Do you agree that the parent's capital structure includes the common equity capital of the subsidiaries that were formerly with Energy South?

A. Yes.

Q. The capital structure of the parent also supports unregulated activities of Spire Marketing, an unregulated subsidiary of the

parent; is that right?
A. Yes.
Q. And does the parent have any other unregulated activities that you're aware of?
A. They have several subsidiaries. I don't know if it's very material at this point in time, but I think you've covered the material entities.
Q. Okay. And the capital structure of the parent also supports the activities of Spire STL Pipeline; is that right?
A. Yes.
Q. Now, that's an interstate pipeline; is that your understanding?
A. At least FERC regulates, yes, so it would be interstate.
Q. Yes, it's under the jurisdiction of the FERC?
A. Yes.
Q. The operations of this interstate pipeline company would also be supported by the parent's capital structure, correct?
A. Yes, I don't think they've set up separate facilities at this point.
Q. Do you believe that an interstate

pipeline has somewhat different risk profiles than a regulated local distribution company like Laclede?

A. I think they're both viewed fairly as low risk operations. I can't say that, you know, there's a lot of differentiation within the investment community for pipelines versus LDCs.

Q. Are the FERC-authorized ROEs for interstate pipelines typically higher than what you're recommending for Laclede in this case?

A. Yes.

Q. Does Laclede, the operating utility, have access to any capital that is being used by Alagasco or the subsidiaries of Energy South?

MR. THOMPSON: I'm going to object. There's been no showing that Mr. Murray would know that.

MR. FISCHER: If he doesn't know, he can say that, Judge.

JUDGE DIPPELL: I'll let him answer.

THE WITNESS: Well, and this -- I mean, there's a lot of indirect influences. I know that there was, you know, discussion earlier about cash being fungible and, obviously, there's dividend that come up from subsidiaries and loans that go back down to the subsidiaries and, you know, to the extent that long-term debt is issued at Alagasco and to the Treasury and there's a dividend paid to Spire Incorporated and then some of those proceeds were from the long-term debt issuance, just like in the past where Laclede Group would issue long-term debt and make either equity infusions or small -- or short-term loans to the subsidiary, there's a lot of fungibility. So I agree that this is where the debt is issued, but I don't agree that everything has been kept separate.

BY MR. FISCHER:

Q. Well, do you know that Laclede has access to capital from Alagasco?

A. Indirectly through Spire. If there's, you know, loans being made to Spire Missouri for commercial paper and through dividends through Alagasco, it -- they -- they allocate the capital where it's needed.

Q. Were you involved in the Laclede holding company stipulation?

A. I was.

Q. Were you --

A. No. You're talking 2001.

Q. Yeah.

A. I mean, I've been around for awhile, but I was not directly involved in that.

Q. Okay, I'll let that go.

Do you happen to have Mr. Buck's True-Up testimony?

A. I do.

Q. Would you look at his testimony where he lays out the long-term debt and equity and it aggregates to a little more than $2.1 billion. Is that right, on page 2?

A. What page? Can you help me, please?

Q. Page 2. He's got four pieces, but it's the true-up, correct?

A. (Reviewing document.)

I see that.

Q. Okay. Now, according to -- did you review Miss Ahern's rebuttal testimony?

A. I did.

Q. Let's short-circuit it a little bit. On page 6 of her testimony, she laid out the parent's consolidated capital as of December 31, 2016 and indicated it was about 3.6 billion.

Do you have any dis- -- do you have any reason to disagree with that?

A. (Reviewing document.)

Q. If you're looking it up, it's page 6, line 24.

MR. THOMPSON: Is that the direct?

MR. FISCHER: Rebuttal.

MR. THOMPSON: Thank you.

THE WITNESS: (Reviewing document.)

It's right from their 10-K, so I have no reason to dispute that.

BY MR. FISCHER:

Q. Okay. So is it correct that the total capital long-term debt and equity for Laclede is about one and a half billion dollars less than total capital of the parent Spire Inc.

A. Yes.

Q. And that's what you would expect, isn't it, because the parent's operations include more than the regulated activities of Laclede or Spire Missouri, correct?

A. Yes.

Q. I believe you indicated earlier that the Commission approved an equity ratio of 57 percent equity in the Summit Natural Gas

case; is that right?

A. Yes.

Q. I believe you also indicated Laclede is proposing an equity ratio of 54.2 percent in this case --

A. Yes.

Q. -- correct?

A. Yes.

Q. That 54.2 percent equity ratio that Laclede is proposing in this case is less than the 57 percent equity ratio approved by the Commission in the Summit Natural Gas case; is that right?

A. That's a fact. That's correct.

Q. Let's talk about short-term debt for a second. Is Staff proposing to include short-term debt in the Company's capital structure for rate-making purposes?

A. Yes.

Q. Isn't it true that the Commission did not include short-term debt in the capital structure of -- for Summit Natural Gas -- I think we've already addressed that -- in 2014?

A. Yes, that's true.

Q. And short-term debt was not included in

the Liberty case we talked about either, correct?

A. That is correct.

Q. You also discussed the 2014 KCPL rate case in your Staff report. Isn't it correct that the Commission did not include short-term debt in the capital structure in that case?

A. That's a fact.

Q. Are you aware of any KCPL or GMO cases in which the Commission has included short-term debt in the capital structure used for rate-making since you've been employed here?

A. Well, being that they had quite bit of construction and the construction work in progress exceeded short-term debt, I don't believe there was.

Q. In the last Ameren Missouri case isn't it true that the capital structure used for rate-making did not include short-term debt?

A. Again, for the same reason.

Q. Did you cite any case in your Staff Cost of Service Report where Ameren Missouri had any short-term debt included in the capital structure for rate-making?

A. I did not -- if there was, it's been

some time ago.

MR. FISCHER: Thank you for your indulgence. That's all the questions I have. Thank you.

JUDGE DIPPELL: Thank you, Mr. Murray. You may step down.

MR. THOMPSON: Redirect.

JUDGE DIPPELL: Oh, I'm sorry. Oh, I was done.

Are there questions from the Commissioners.

CHAIRMAN HALL: (Nodding.)

JUDGE DIPPELL: Chairman Hall.

QUESTIONS BY CHAIRMAN HALL:

Q. Good afternoon.

A. Good afternoon, Chairman.

Q. Is it fair to say that sometimes Staff recommends, sometimes the Commission adopts a subsidiary-specific capital structure, sometimes Staff recommends, sometimes the Commission adopts a consolidated capital structure?

A. Yes. And, actually, Staff has recommended hypotheticals and the Commission still recommended a consolidated capital structure. So, you know, we don't -- you listen to the evidence, and I understand that.

Q. Are there some broad principles that you would recommend the Commission employ to make that decision subsidiary specific versus consolidated?

A. Well, obviously, I mean, I know it's, you know, a situation that we're all well aware of where there's a holding company that does not issue debt at the holding company level to leverage its transactions that does not place financial risk on its subsidiaries. I mean, that's definitely a significant concern to Staff because to the extent that the holding company issues significant amounts of debt at its level, it constrains the credit rating of the subsidiary, and to the extent that the subsidiary is going to, you know, have a higher ratio and the ratepayers are going to provide more cash flow -- I mean, I understand from a business model perspective as to why they would want to continue to have a higher equity ratio at the subsidiary, because that supports the debt that they have at the holding company. So the more that -- you know, the more that, you know, they push that and, obviously, that makes a big difference on the revenue requirement, then the more financial risk they can take at the holding company level, which definitely impacts the credit rating at the subsidiary level, you know, more so with S&P, you know, but also to quite a bit of extent with Moody's. So it affects their credit rating.

Q. But is that the only principle that you think the Commission should employ in making this decision or are there some other considerations?

A. It's the debt capacity of these low risk gas operations. These are low risk gas utility operations, and in my opinion the holding company, you know, they understand that and they understand that's how they can create value with these transactions.

I don't have a problem with, obviously, creating value with transactions, but to the extent that you have to start taking into consideration all the holding company debt as to how you manage your subsidiary debt considerations, even to the extent you use a -- you could use a shorter term tenor at the holding company because of the fact that you typically don't want to, you know, have a 30-year debt at the holding company. So that influences the subsidiaries' financial management to the point where they, you know, will be more likely to issue longer-tenored debt because it's -- it is at the subsidiary, it is right at the assets, but as a -- I mean, regardless, if it's the same risk profile, a 30-year debt is going to be more costly than a 10-year debt.

So there's just no way to unwind this to show -- you know, to ensure that there's going to be, you know, a management of the subsidiary capital structure in the best interest of the ratepayers that provide these low risk cash flows. At the FFO-to-debt that Spire Incorporated consolidated, you know, it has right now is about 16 percent. The FFO-to-debt for Spire Missouri is 21, 22 percent. That should, you know, allow for a higher credit rating. But when you have a holding company that has over a billion dollars of debt that it's issued for its acquisitions, that has an effect on the credit quality of the subsidiary, and therefore, even though the subsidiary has a higher equity ratio -- and, you know, in the past when Laclede Group had similar or actually even higher -- you know, it had a higher equity ratio on a consolidated basis before it start making these acquisitions. That supported the credit quality of the subsidiary, and therefore, the ratepayers got credit for -- when I say "credit," a more financially sound flexible entity.

The holding company leverage, it puts financial risk, and that's what has changed since 2013/14 is we have much more aggressive financial policy at the holding company level than we did before.

Q. Okay, I understand that, I appreciate that and, I agree that that is an important criteria.

What about other aspects, though? I mean, if you have a truly independent subsidiary with different board of directors, different officers, is that something we should take into account?

A. I'll point to, I believe, you know, what some of the other states had done say, for instance, New York. Each time they look at a subsidiary that asks for subsidiary capital structure, they'll look at the holding company and they'll look as to, you know, are there sufficient ringfencing mechanisms in place.

And ringfencing is used way too loosely. Ringfencing is a very structural legal protection. It's not just, you know, a few conditions that they commit to with the regulator that may or may not be enforced. It is -- such as an independent director.

Actually, S&P has more stringent criteria as to what is considered an independent director than the New York Stock Exchange does -- excuse me -- the SEC does. And so, you know, whether or not you need a bankruptcy remote entity or a separate management, obviously, they -- you know, Spire is embracing the consolidated type of management where they use the one brand name. I mean --

Q. So does Spire Inc. and Spire Missouri have the same directors?

A. They have the same -- yeah, the board of directors is the same. There might be one separate -- one different person, but for the most part, their officers and the directors are mirrors.

Q. Is that something we should take into account in making this determination?

A. This is getting -- there's a lot of legal issues and I don't -- I don't want to, you know, pretend like I have not looked at these issues, but I do know when we explored this with other companies, they've told us that they need outside counsel to look at this closer. So I don't want to be -- you know, to give you the impression that I have all the answers as to how this can be completed. But, yes, those are things that would need to be looked at to determine whether you're going to get more rating separation.

Q. Any other criteria, any other principles, any other --

A. Separate credit facilities. I mean, like I've said, they've actually gone to consolidated credit facility, but...

I say credit facility. Commercial paper. They do have -- the credit facility that backs the commercial paper still has separate sub-limits for the credit- -- different entities, but Spire is actually going to the commercial paper markets and lending into it.

But, yeah, just as far as the intercompany transactions, to the extent that, you know, there is any -- you know, I guess right now we have, you know, in mid lease, so we have -- and we've done this in some of our stipulation agreements that if they fall below investment grade, then there's going to be restriction, but that's fairly reactionary. And so, yes, if you had more legal structural as far as somebody looking out for the interest of the individual operating entity, that would be, you know, more proactive.

Q. How does -- how do the credit rating agencies deal with Spire Inc. versus Spire Missouri? Do they do separate ratings for both?

A. At S&P, they approach it differently and that's -- actually, it ties in with some of the different viewpoints of the witnesses. But Spire -- excuse me -- S&P generally if they don't -- I mean, and they're much more stringent as to what they consider to be true separation. It's not reactionary it's proaction -- proactive. So if that -- you know, if they don't deem it sufficient, they're going to rate all the entities based on the consolidated family group of companies, which right now is A- for Spire Missouri and A- for Spire Incorporated consolidated.

Q. So S&P does not think there is sufficient separation to do two different credit ratings? It does one credit rating for both?

A. It does one corporate credit rating. I do want to explain that Spire Missouri -- I mean, this is another, I mean, thing that I'm not sure exactly how -- you know, if there is some benefit to this, but Spire Missouri has first mortgage bonds. Spire Alabama issues unsecured debt. So they do things differently. So as a result, because they are first mortgage bonds, they have -- they have an A rating. They could have one notch better if it wasn't for the affiliation with -- you know, with Spire consolidated and through the greater financial risk at the Spire consolidated level.

With Moody's, there's a -- generally a constraint of three notches between the holding company and a subsidiary. And Moody's has a grid indicator rating of unsecured rating for Spire Missouri of A, but they ultimately assign it at A-. There is not a lot of information in the report that explains why they do that, but they are very -- you know, very upfront about the 40 percent or so of debt at the consolidated level as compared to -- at the holding company level compared to the total debt is a concern because that puts pressure on the subsidiaries. It's just a natural concern of theirs, so that suppresses the credit rating.

Q. There's been some discussion about whether or not using a consolidated capital structure in this case is a deviation from prior decisions with regards to Laclede or whether it's a continuation of prior decisions.

And it's really kind of a hybrid because in the past -- and this is a question. In the past we used Laclede Group's consolidated capital structure and now the request from -- by Staff and some of the other parties is to use Spire Inc. consolidated capital structure. So there's some similarities and some differences; is that correct?

A. But Spire Inc. is just the new Laclede Group. So I --

Q. But it includes some entities that were

not part of the Laclede Group?

A. Well, that was true -- because they -- I don't know when they changed their name, but Laclede Group acquired Alagasco and they were still Laclede Group. I don't know when they changed their name.

But, yeah, the bottom line is the difference now is the holding company -- and let's just call it "the holding company" regardless of the name -- has Alagasco and the Energy South subsidiaries. That's what's different between now and 2013 or 2014.

But you're correct, Laclede Group, their main operation at the time besides Laclede Gas was their energy marketing operations and they did not -- I mean, through admission of their own testimony, they did not need to issue any long-term capital for Spire Marketing, but they still issued long-term capital at Laclede Group. So by that admission, and obviously they were issuing debt at the holding company to fund operations at the subsidiary.

Now, I think they'll say that they're committing to keeping these things separate going forward, but I don't know that we have anything that's going to prevent that from happening.

Q. Okay. Let me switch gears for a second. This chart -- I don't know the exhibit number.

JUDGE DIPPELL: I believe that was 56.

CHAIRMAN HALL: 56?

JUDGE DIPPELL: No, I'm sorry, 57.

BY CHAIRMAN HALL:

Q. Have you ever seen this before?

A. I've not seen this chart.

Q. Were you in the hearing room when that was discussed?

A. I was.

Q. So you understand roughly what it says?

A. Well, I understand this is a price-weighted index. This does not factor in dividends, which is a critical piece with utilities.

Q. Well... okay.

A. But so my point being is S&P 500, your dividend return is not going to be nearly as high as your dividend return with your utilities. So it makes a big difference. This is just price performance.

Q. Um-hum. Well, what I'm wondering is I'm looking at the LDCs being significantly higher performing companies to the S&P 500, and I'm wondering what -- and maybe you just answered this, but what I should take from that?

Because, I mean, I -- one thing you could take from that -- and I'm not there yet, so I will contemplate it -- is perhaps that is simply showing that state commissions around the country are awarding ROEs too high to LDCs because why should they be recovering -- why should their price be going up so much more than the S&P 500? So if you could respond to that?

A. I think it is -- I mean, regardless of the Fed -- I understand the Fed trying to increase the Fed fund's rate, but bottom line is -- and you guys just evaluated this back in 2016. In 2016, you know, we were at all time lows for interest rates in the middle of 2016. Obviously, at the end of 2016, you had, you know, the Trumpflation where rates increased for a short period of time from 2 point, say, 2 or somewhere -- and this is a 10-year treasury -- to about 2.6. Utility bond yield didn't follow suit, but they did increase.

And so point being is, even with a lot of the discussion about economic growth and the prospects of economic growth, utilities have still -- I mean, they're trading at all time highs. So the price of earnings ratio for gas utilities are 25, you know, electric's 24. I mean, that is incredible.

Q. So does that mean that ROEs are being set too high across the board?

A. That means the cost of equity's come down and we're maintaining our allowed ROEs. And so, yes, the value of that cash flow that comes from utilities based on our current rates, with that lower discount rate, it just -- you know, it -- obviously, you are going to have a lower discount rate assigned to those future cash flows and so you're willing to pay more because you have a lower discount rate because -- that makes your present value of your future cash flows worth more as of today.

And we're kind of in -- we have been in a sustained level of a long-term low -- lower long-term rates, and that bears itself out in utility bond yields as well as treasuries at this point in time.

Q. Okay. Let me switch gears again.

My understanding of your Staff position that you have articulated is that what the Commission should do is look at its decision in the Ameren and KCP&L rate case where we awarded I think one was 9.5 and one was 9.53 and look at what has happened since then and look at differences between Spire and those two vertically integrated electric utilities and make a downward adjustment accordingly. Is that, in essence, what you're suggesting?

A. That is correct. I am trying to be useful to the Commission and allow you to look at what you did in KCPL and decide whether or not you think a gas asset should be any different as far as allowed return.

Q. Okay. Well, that was characterized by -- and I can't remember the witness now, but a witness, a Spire witness as "looking in the rearview mirror as opposed to looking forward." And I was wondering if you could respond to that critique?

A. If anything -- and this -- I'm benchmarking off the nine and a half that you allowed for KCPL at -- and based on information at the end of 2016/early 2017 that showed, you know, interest rates and dividend yields coming back up a little bit for utilities.

As of right now, if you were looking at -- I'll first focus on electric utilities and go to gas, but electric utilities are trading at dividend yields below 3 percent. I've never seen that and it's been going on for the last three months or so. And natural gas utilities are -- have dividend yield of 2 and a half percent.

So when you have the utility industry, there's not a lot of big fundamental changes going on that are all of a sudden going to cause growth just go crazy. So it's a reaction to the macro factors. And so whenever I look at the investment market commentary -- so this is -- I mean, I -- we do our own analysis by looking at the bond yields, looking at price-earnings ratios, what have you, but I also spend a lot of time looking at the utility equity analysts. And the utility equity analysts -- and I have -- there's a quote in my testimony that they use a discount, a cost of equity that's 25 basis lower to determine the value of gas utility stocks versus electric utility stocks. They indicate they use a cost of equity that's 50 basis points lower to determine the value of water utility cash flows versus electric utility cash flows.

So the point being is that there's no doubt on the equity side that there's that -- there's that perspective and as well on the credit side because, on the credit side, both Moody's and Standard & Poors indicate that gas utility assets have a greater ability to -- they have more debt capacity than electric because they use a low -- what they call "a low volatility table" for gas utility companies as compared to a medial volatility table for the vertically integrated electric utility companies. What that means is that they can issue more debt and still have the same credit rating as an electric if it had less debt because it has lower business risk.

And so it's a credit and equity view that gas utilities -- and also, obviously, the higher credit ratings.

Q. So would you respond to that critique by saying that it's not rearview mirror analysis

because it's simply benchmarking based on prior decisions of the Commission and then you are looking at changes since the date of those orders and you are taking that into account in this analysis?

A. Oh, yes. And that's -- actually, I provide -- there's been a lot of discussion about return information for gas, electric and -- within this chart (indicating to document).

I mean, I provide that on page 14 of my Staff Cost of Service Report where I provide capital market performance for utilities since January 1st of 2014, and the reason why I picked that because that's when -- that's the general period of time when you had the nine and a half allowed ROEs for UE and KCPL, obviously, the Liberty utilities with ten and I show that the gas utility proxy group had a total return of -- this is my gas proxy group -- of 103 percent for a compound annual return of 24.2, so 20 percent per year. The electric utility proxy group had a total return of 96.64 percent for a compound annual return -- excuse me, of 20 -- that was 20.42. The gas was 21.45 percent, where the S&P 500 had a compound total return of

43.96 percent for that same period.

Utilities have outperformed the markets for the last five years since January 1st, 2014, and specifically since the middle of 2015.

Q. And why do you think utilities have outperformed the market generally?

A. It's a low yield environment. I mean, we are staying in a low yield environment.

As somebody pointed out, the Goldman Sachs, you know, indicated that anytime 10-year treasuries are within the two to three percent level, these low growth utility stocks will trade at premium to the higher growth market. And that's a flip. I mean, that's not -- I don't think that's a good thing because that means that -- you know, that the companies that don't have as much growth prospects are trading at higher premiums and, you know, I just -- it's obviously an opportunity cost that -- there's no -- there's no good return in bonds.

CHAIRMAN HALL: I think that's all I have. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Thank you.

Are there other Commissioner questions?

COMMISSIONER KENNEY: No.

COMMISSIONER RUPP: No.

JUDGE DIPPELL: All right. Is there further Cross-Examination based on the Commissioner questions from Public Counsel?

MR. SMITH: No questions. Thank you.

JUDGE DIPPELL: MIEC?

MR. MILLS: Just briefly.

RECROSS-EXAMINATION BY MR. MILLS:

Q. With respect to Exhibit 57, you pointed out that one of the salient differences between Spire's performance and the S&P performance is the question of dividends, correct?

A. Yes.

Q. And do you know if the dividends between -- dividend policies between Spire and the -- what's labeled as a peer group on this exhibit are the same?

A. I mean, I'll just tell you that on average dividend -- or utilities paid out about 60 percent, and I think it's just going to vary a little bit between the different companies, but I can't tell you specifically what --

Q. Okay, so you don't know that the

dividend policies are the same among all the peer group members in Spire?
A. No. No. Sorry.
MR. MILLS: That's all I have. Thanks.
JUDGE DIPPELL: Midwest Energy Consumers?
MR. WOODSMALL: No questions.
JUDGE DIPPELL: Environmental Defense Fund?
MS. KARAS: No questions.
JUDGE DIPPELL: Spire?
MR. FISCHER: Briefly.
RECROSS-EXAMINATION BY MR. FISCHER:
Q. You had a question I think from the Chairman about the board of directors --
A. Yes.
Q. -- of Spire Missouri and Spire Inc.
A. (Nodding.)
Q. Have you actually looked at who -- what individuals are on those boards?
A. It's been a little bit, but I did review that. It's been about a couple weeks ago.
Q. Would it surprise you if you learned

that Susan Sitherwood was on both boards?

A. That wouldn't surprise me.

Q. Would it surprise you that she's the only joint director on both boards?

A. I'm not aware of that.

Q. There were some questions about, I think, the financing requirements of the subsidiaries Alagasco.

If the Alabama Public Service Commission ordered Alagasco to have a hundred percent equity ratios, should that affect Missouri rates?

A. Well, that's a rate-making capital structure. I don't know that it's going to affect how they actually capitalize themselves.

Q. But would Staff want to include a hundred percent equity coming from Alagasco with the rate-making capital structure in the future?

A. Again, I'm not sure that the Company is going to follow through and do a hundred percent equity at the Company level, so that wouldn't be included in a consolidated capital structure. How they finance themselves would be.

Q. So if they were financed at a hundred percent equity, they were ordered to do so by

some other regulatory commission, that would show up, correct?

A. It would show up.

Q. And should that from your perspective be included in Missouri rates?

A. I would want to review the circumstances at the time as to whether or not that was done for, you know, something that's going on at the consolidated. Maybe Spire Incorporated is issuing the debt for them. I don't know.

Q. Do you happen to know when Spire Inc. made its last equity infusion into Laclede Gas or Spire Missouri?

A. I think I provide that example in my testimony. It was in 2012.

Q. Several years ago?

A. Yeah, right before the last rate case.

Q. Okay. I think you suggested the Commission ought to look at the KCPL order as far as benchmarking equity as guidance, correct?

A. I think I generally expect them to look at it as a benchmark, it is their order, yes.

Q. Would you expect them also to look at what they've done on short-term debt for capital

structure purposes for -- in KCPL?

A. I don't think they have gas inventories, but the -- there was a different circumstance. I think they really need to understand the details that with electric they don't have gas inventories that have a carrying charge. So I don't think it's appropriate for them to look at that as a benchmark.

Q. What about all the other public utilities that don't have short-term debt in their capital structure, should they look at those?

A. I think we need to look at what the short-term assets are and what the carrying charges should be for those.

Q. Okay. And in those cases construction work in progress often exceeds any short-term debt, right?

A. With electric, definitely from the period from 2005 to 2012. There was a large construction cycle during that period of time for electrics.

MR. FISCHER: Judge, I think I may have failed to move for the admission of Exhibit 60, and if that's the case, I would do so now. And that's all the questions I have.

JUDGE DIPPELL: Okay, Exhibit 60 was the Staff accounting schedule from GR -- or a portion of the Staff accounting schedules from GR-2014-0007. Would there be any objection to that exhibit?

(No response.)

JUDGE DIPPELL: Seeing none, then I will admit that into evidence.

(SPIRE EXHIBIT NO. 60 RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: And with that, I believe that concludes your testimony for today, Mr. Murray.

MR. THOMPSON: Do I get to do Redirect?

JUDGE DIPPELL: Oh, I'm terribly wanting to get him off the stand. Okay, one more time, you can stay.

Redirect, Mr. Thompson?

MR. THOMPSON: Thank you, Judge.

REDIRECT EXAMINATION BY MR. THOMPSON:

Q. Mr. Fischer asked you an extensive series of questions. Do you recall those questions?

A. Yes.
Q. Okay. He asked you questions, if you recall, about the Commission's order in GR-2014-0086 having to do with Summit Natural Gas of Missouri. Do you remember that?
A. Yes.
Q. Now, if you know, is Summit Natural Gas a subsidiary of Spire?
A. No.
Q. Was it in 2014?
A. No.
Q. Did it have any particular relationship to Spire?
A. Not that I'm aware of.
Q. Or to Laclede or Laclede Group?
A. No.
Q. And the recommendations that you made in that case, were they based on the particular facts that you became aware of pertaining to Summit Natural Gas's financial situation?
A. Yes. They're an expanding company in areas that have propane and they're trying to penetrate those markets, so it's almost -- it's almost a bit competitive, to be honest with you.
Q. And are the circumstances that existed

that led you to make the recommendations that you did in Case GR-2014-0086, are those same circumstances, do they apply today to Spire Missouri?

A. No.

Q. Is Spire Missouri's circumstance, would you characterize it as significantly different?

A. Significantly different because Summit Natural Gas Missouri is trying to even just earn a positive profit. I mean, they're barely -- I mean, they're not doing the best and actually they've had -- I know from doing finance cases on Summit Natural Gas in Missouri that they wish to have -- to termed out their long-term debt and have been unable to do so because their financial performance is not the best due to expanding into areas where there's never been any natural gas and, you know, competition with propane and electric.

Q. So in your professional opinion as a financial analyst, is there any logical relation between the recommendations you gave in Case GR2014-0086 and the present case?

A. Well, no. And I would just like to point out that actually the 40/60 percent capital structure Staff recommended was the Company's targeted capital structure that they wanted to achieve, but because their financial performance was not as what they had hoped it would be, you know, this is what the creditor said, you have to keep this capital structure more equity rich.

Q. And I appreciate that explanation, but does that have any rational relationship to the Company that's in front of the Commission in this case?

A. They're different risk profiles.

Q. Thank you.

And if I were to ask you the same questions about Case GR-2014-0152, would your responses be substantially the same?

A. I'm sorry, repeat your question. I was looking at --

MR. THOMPSON: I'm trying to speed this up, Judge.

THE WITNESS: Sorry.

JUDGE DIPPELL: Appreciate it.

BY MR. THOMPSON:

Q. Is there any rational relationship in your mind between the circumstances of Liberty

Utilities' Midstates Gas Corporation in 2014 and those of Spire Missouri in 2017?

A. The capital structure I do believe is -- there is some importance there because of the fact that Liberty Utilities issued all of the debt on behalf its gas operations and its electric operations. The Commission found the consolidated holding company capital structure to be appropriate, which had 45 percent equity in it.

Q. Okay. Was Liberty Utilities at that time, was that part of the Laclede Group?

A. No.

Q. Is it a subsidiary of Spire today?

A. No.

Q. And so were your recommendations in that case, were they driven by circumstances that are similar to the circumstances in the present case?

A. No.

Q. Is there -- so, again, in your professional opinion as a financial analyst, is there any logical, rational relationship between the recommendations you gave in this case in 2014 and those you have given in the present

case in 2017?
    A. I think it's important to evaluate the trend in capital costs, and I think that that's what I've done since 2014.
    Q. Okay. So you think there's an illustrative --
    A. Yes.
    Q. -- aspect that might be helpful to the Commission?
    A. Yes.
    Q. Okay. I'll accept that.
        And with respect to case GR-2014-0007, I think we were asked to look at a page out of Staff's accounting schedule to see to our surprise that there is no short-term debt in that capital structure. Do you see that?
    A. It wasn't to my surprise, but...
    Q. Is there a reason why there was none in that case, but you are recommending it in this case?
    A. Yes, the circumstances have definitely changed. There was no -- there were no -- there wasn't any gas inventories in rate base at that period of time. So if -- you know, just like looking at the 53.56 percent equity ratio, that

would look unreasonable at its face, but if you imputed 10 percent of short-term debt in here, that would lower your equity ratio to 47, 48 percent. And, you know, that is very important because even though the short-term debt isn't in this capital structure, we are, you know, through what we had done in the past or what have been doing right now, actually, where we allow, you know, carrying costs based on the short-term debt rate, that is based on the presumption that all parties agreed to that this -- that because gas inventories are short-term assets, short-term interest rates should be applied.

Q. So if I understand you, are you saying that the treatment of short-term debt that you recommend varies from case to case based on the circumstances of the case?

A. Yes.

MR. PENDERGAST: Your Honor, one of the issues in this case is whether we should have LEC's -- Laclede's storage inventories included in base rates as MGE's storage inventories are included in base rates.

Since that's an issue that all the

parties have recognized and since it establishes that storage inventories are included in MGE's base rates, I think that correction needs to go on the record.

JUDGE DIPPELL: I didn't quite follow you, Mr. Pendergast. I'm sorry.

MR. PENDERGAST: It's just Mr. Thompson asked a question: Why was there no short-term debt in MGE's case? And the answer was: Because it doesn't have storage inventories in base rates.

And I'm just saying the official issues in this case have the issue of whether or not LEC's case inventories should be in base rates like MGE's storage inventories are on base rates -- or in base rates.

JUDGE DIPPELL: I understand now. I wasn't sure -- I didn't recall that that was the MGE that was...

Mr. Thompson, were you -- did you have other questions?

MR. THOMPSON: Oh, I do.

JUDGE DIPPELL: Okay.

MR. THOMPSON: Thank you.

BY MR. THOMPSON:
Q. Now, Mr. Murray, you were asked questions about increases to the Fed fund's rates. Did I say that right? It's like Peter Piper, it's hard to say.
A. Yes.
Q. Fed fund's rate?
A. Yes. That's an abbreviation.
JUDGE DIPPELL: Mr. Thompson, your microphone, you're getting farther and farther away.
MR. THOMPSON: I apologize, Judge.
BY MR. THOMPSON:
Q. You agreed that those have increased several times; isn't that correct?
A. Yes.
Q. And, in fact, the Fed is contemplating raising them again; isn't that true?
A. Yes.
Q. Have long-term interest rates increased significantly over the past few quarters?
A. No.
Q. So the rise in the Fed fund's rate is not significant for long-term interest?
A. That's correct. There's actually a

flattening of the yield curve right now. Short-term rates are coming up, long-term rates haven't moved, so there's not much of a spread between two years and ten years.

Q. Okay. Now, let's talk about the operations of a holding company and a group of subsidiaries. That's what we have in this case; isn't that's correct?

A. Yes.

Q. When Laclede borrows money -- and I'm talking about the holding company. Let's just call it "the holding company."

When Spire borrows money, is it or is it not borrowing money on the strength of the cash flows from the operating companies?

A. Yes.

Q. And if Spire caries a significant quantity of debt in its capital structure, does that have an effect of raising the cost of capital for the operating companies?

A. Yes.

Q. And, in fact, the operating companies are rated lower than the holding company; isn't that correct?

A. No, that's --

Q. In terms of bond ratings. Isn't that what you testified?

A. No, the utility subsidiaries for S&P, it's rated all the same as far as the corporate credit rating. For Moody's, the -- Spire is rated two or three notches -- two notches lower than --

Q. Two notches lower, okay.

A. As compared to Spire Missouri.

Q. I see. So I had that backwards. Thanks for straightening that out.

Nonetheless, if Spire decides to make another acquisition, for example -- and they've made several in the past few years; isn't that correct?

A. Yes.

Q. So let's say they want to make another one. And they would raise, let's say, a mix of equity and debt to pay for it, correct? You with me?

A. Yeah, that would be consistent with what they have done in the past, yes.

Q. Okay. Would that have the effect of raising the cost of capital for Spire Missouri?

A. Depends on how they capitalize it. I

mean, if they capitalize it with more equity just like -- say, for instance, they were able to find a merger of equals and they just did stock-for-stock swap, no additional debt at the holding company, and it was a better -- it was a low risk operation, another, you know, I guess gas distribution operation somewhere else and -- but no additional financial risk. That could actually help improve it. It depends on how they finance it.

Q. It depends how they do it?

A. Exactly.

Q. Okay. Well, let's say it's heavily leveraged. What would the effect be in your opinion?

A. That would continue to suppress the credit ratings at the subsidiary level.

Q. And would that mean that Missouri ratepayers would be paying more?

A. Yes.

Q. Now, the Chairman asked you about the principles that the Commission should use to determine the capital structure issue. Do you remember those questions?

A. Yes.

Q. And those principles in fact have to do with the effect of holding company leverage on the operating company; is that right?

A. Yes.

Q. When you spoke about ringfencing, what did you mean?

A. Ringfencing is definitely much more involved than just a few conditions in the stipulation and agreement. I think there has to be significant structural and legal mechanisms put in place that has buy-in from the Company, that has enforcement ability from the Commission, that there might be penalties if they violate those.

I mean, that's where Wisconsin, because of their legislature, they made it -- you know, that you could be charged if you violated certain conditions that did not continue to allow the safety of the utility operations and the financing of those operations.

Q. Okay. So let me make sure I understand. Ringfencing would -- does that refer to a situation where legally and financially the operating company is separated from the holding company to such a degree that

they're regarded as separate entities, so that what happens to one will not necessarily affect the other?

A. Well, I think -- they're already separate entities.

Q. Okay.

A. It's whether or not somebody is actually looking out for the best interest of that subsidiary, and that's why many times you'll have an independent director that has -- basically has no interest and has not been part of the management of either company for sometime and that's their sole -- I mean, they could basically have a veto privilege of any action that may be taken that may be -- you know, cause financial harm to that subsidiary.

Q. So in your opinion, is there effective ringfencing between Spire Missouri and Spire?

A. Again, I don't think my opinion's the most important on this. I think it's the rating agency's, but no.

Q. You're the one on the stand.

A. I know and I understand that, but the investors' opinions are most important, and I am trying to say what investors think.

Q. And what do they think?
A. They do not see that there's effective ringfencing.
Q. Okay. Now, after all these questions from me and from other people, you agree that your recommendation continues to be 9 to 9.5?
A. Yes.
Q. A midpoint of 9.25?
A. Yes.
Q. Have you heard anything that would lead you to move away from that?
A. No.
Q. Now, you do believe that that's significantly higher than the actual cost of equity, don't you?
A. Yes.
Q. What's the effect of awarding ROEs to companies that are significantly higher than their actual cost of equity?
A. It continues to support higher market-to-book ratios. I mean, to the extent that -- to the extent that, you know, they are able to invest in projects where they earn more than their cost of equity, that creates shareholder value. I mean, that's the

fundamental economic principle between -- you know, as far as trying to set the allowed return equivalent to the of cost of equity is that any ongoing investment, you know, will not cause the shareholder to be better off or worse off.

But to the extent that you have, you know, let's say a margin of 225 basis points of allowable return over the cost of equity, I mean, obviously that encourages additional investment because to the extent that they are able to do so, that expected return over the discount rate creates more value, present value of those cash flows.

Q. Okay. You said that the shareholders are better off. What about the ratepayers? Are they better off?

A. Depends on if they're trying to preserve any of that cash at the subsidiary for investment in that stand-alone entity.

I mean, I think it may be more acceptable in my opinion to allow a margin over the cost of equity if you know that those cash flows are going to stay with the utility and benefit the financial soundness of that subsidiary.

MR. THOMPSON: I have no further questions. Thank you, Judge.

JUDGE DIPPELL: Thank you, Mr. Thompson.

I think third time is the charm.

THE WITNESS: Thank you.

JUDGE DIPPELL: And that you may step down, Mr. Murray.

THE WITNESS: Thank you.

(Witness excused discussed at 3:33 p.m.)

JUDGE DIPPELL: Okay. It's getting late in the afternoon and we're going to take a short break. But before we do, I just want to clarify my ruling on the official notice.

So I've taken a look at the statute and, yes, Mr. Woodsmall, that is in fact evidence and the facts for which we are taking notice are those which were discussed with Mr. Murray on the stand and the general premise that that is an action that the Commission took in those other cases and the weight of that is what the Commission has to weigh.

But in answer to your question --

MR. WOODSMALL: Thank you.

JUDGE DIPPELL: -- does that change

your objection of relevance or add any other objections?

MR. WOODSMALL: No. Your -- no.

JUDGE DIPPELL: Does that add other objections?

MR. WOODSMALL: No.

MR. MILLS: Judge, just to clarify, you're taking official notice of those portions of the reports and orders that were read into the record? You're not taking the entire case record?

JUDGE DIPPELL: No, not the entire case record. Just the report and order, the testimony that Mr. Murray gave about his opinions and the actions that the Commission took in that case.

MR. MILLS: Okay. Great. Thank you.

JUDGE DIPPELL: Okay. With that then, we will take a break for 15 minutes. Please come back, if I can do my math, at ten 'til, ten 'til 4.

We can go off the record.

(Recess taken from 3:33 p.m. to 3:51 p.m.)

JUDGE DIPPELL: Let's go back on the record. Okay, we're going back on the record.

And before we went back on the record, there were a few minor scheduling issues we discussed that MIEC's witness Greg Meyer need not come both Tuesday and Thursday, but we'll do the Cross-Examination on both of his issues on Thursday.

And the Environmental Defense Fund witness is only available on the 13th, correct?

MS. KARAS: Yes.

JUDGE DIPPELL: So we'll make sure to get that witness on that date.

Okay. I think we are ready to finish up this with Mr. Gorman.

MR. MILLS: Yes, OPC and MIEC call Mr. Michael Gorman.

(Witness sworn.)

THE WITNESS: I do.

JUDGE DIPPELL: Now, before we begin I should have gone through one more procedural issue with regard to Mr. Gorman. Since this is a witness that is sponsored by both MIEC and OPC, how is the direct going forward?

MR. MILLS: Mr. Smith will do

direct, the brief introductory direct, and then for Redirect, we both would like to conduct Redirect.

JUDGE DIPPELL: Would there be any objection to that occurring?

(No response.)

JUDGE DIPPELL: All right. Then that is the procedure that we will follow.

So go ahead, Mr. Smith.

MR. SMITH: Thank you.

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MR. SMITH:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. Would you please state and spell your name for the court reporter?

A. My name is Michael Gorman, M-I-C-H-A-E-L G-O-R-M-A-N.

Q. And by whom are you employed?

A. Brubaker & Associates.

Q. Did you prepare or cause to be prepared a Direct testimony --

A. I did.

Q. -- Rebuttal testimony, Surrebuttal testimony in both cases, GR-2017-0215 and

GR-2017-0216?

A. Yes.

Q. OPC has copies of those items which have been premarked as Exhibits 407, 414 and 44 -- sorry, 416.

JUDGE DIPPELL: And those are also the numbers that I had.

BY MR. SMITH:

Q. And, Mr. Gorman, do you have your testimony in front of you?

A. I do.

Q. Do you have any corrections to make to that testimony?

A. I do not.

Q. If I were to ask you the same questions that appear in your testimony, would your answer be the same or substantially the same?

A. Yes.

MR. SMITH: This will be Mr. Gorman's only issue that he'll be testifying on, and so at this time I would offer those exhibits into the record.

JUDGE DIPPELL: Would there be any objection to Exhibits 407, 414 and 416?

MR. PENDERGAST: None here.

JUDGE DIPPELL: Seeing no objections, I will admit those into the record.

(OPC EXHIBIT NOS. 407, 414 AND 416 RECEIVED INTO EVIDENCE.)

MR. SMITH: OPC tenders Mr. Gorman for Cross-Examination.

JUDGE DIPPELL: Is there Cross-Examination by Staff?

MR. THOMPSON: No questions. Thank you, Judge.

JUDGE DIPPELL: Midwest Energy Consumers?

MR. WOODSMALL: Yes, just briefly to clarify a couple of things from earlier.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. What is Spire's -- Spire Inc.'s credit rating?

A. That's actually shown on one of my schedules to my direct testimony.

As shown on my Schedule 1PG3 to my direct testimony, Spire Inc. has an A- bond rating from S&P and an AA2 rating from Moody's.

Q. And do you know what the Ameren and Great Plains credit ratings are?

A. Yes. Ameren has a BBB+ bond rating

from S&P and BAA1 bond rating from Moody's. That would be a weaker bond rating than Laclede Gas Company or Spire Missouri. KCP&L has a BBB+ bond rating from S&P and BAA1 bond rating from Moody's.

Q. And just so I understand, if Spire has a higher credit rating than investors, all else being equal, then investors would require a lower return on equity; is that correct?

A. Yeah, a higher bond rating is an indication of lower investment risk for both debt -- in equity investments and an indication of lower investment risk would -- it would be appropriate to have a lower return on equity.

Q. The second question: Ms. Ahern was saying that regulatory climate is large concern in the credit rating or consideration. Maybe "concern" is the wrong word.

Can you tell me how credit rating agencies view the Missouri regulatory environment for Spire Missouri?

A. Well, she's -- I agree that it is a significant concern, and to her Rebuttal testimony she attaches credit rating reports from both Moody's and S&P for Spire, and in both of those report, it refers to the Missouri regulatory environment for Spire Inc. and Laclede Gas specifically as supportive. So that the regulatory treatment for this utility has supported strong credit standing.

Q. And final question: Can you tell me in your view what authorized rates of return have done since 2014?

A. That also is shown on average on a couple of my schedules. One of them Schedule 1PG12 for gas utilities. 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 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. One of them was for an Alaskan gas utility where the Commission ordered a return on equity of approximately 11.9. I think it was 11.88 specifically.

And then Piedmont also had an

authorized return on equities of about 10.2 percent. And that's a company that has some financial difficulties in the consolidated enterprise. And I don't know if the South Carolina Commission considered those financial difficulties for that company in awarding return on equity, but they do exist.

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.

MR. WOODSMALL: No further questions. Thank you.

JUDGE DIPPELL: Anything from the Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Spire?

MR. PENDERGAST: Thank you.

CROSS-EXAMINATION BY MR. PENDERGAST:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. I understand you just got back from Alaska?

A. I did, yes.
Q. Was that higher return you referenced from Alaska your handy work?
A. It was not.
Q. It was not.
Let me ask you: When Laclede acquired MGE in 2013, would you agree with me that that was financed with roughly equal amounts of debt and equity?
A. When they acquired the total company, that's -- yes, I would agree with that.
Q. Okay. And do you -- you've worked on a number of Laclede cases before; is that correct?
A. I think that's a fair characterization, yes.
Q. Okay. And do you have a sense for Laclede, what sort of equity component it had in prior cases?
A. Its requested equity component, yes, it's been well above 50 percent. I would have to look at past records to nail that down more specifically.
Q. Okay. And to your knowledge, to the extent you remember, has that been for some time? Has that extended over a significant

period of time?

A. I think, yeah, consistently they have relied on Laclede Group, the parent company's capital structure and the recommended positions.

I have consistently recommended the utility-specific capital structure. Utility consistently opposed me in all cases up 'til this one, so I think that's kind of a -- from a high level of the review that's taken place historically.

Q. And can you tell me why you recommended the utility-specific capital structure?

A. Because I think the objective of setting rates for utility is to set price and I think the price is important.

When you set a utility price, it gives utility customers a signal on what the cost of utility service is, but it also sets discipline for utility management. The regulatory body says this is the price we have to manage our cost to to allow us to earn our authorized return on equity within the price, the parameters of the pricing discipline created by that regulatory body.

If you set the cost of service

consistent with utilities, actual financial statements and the information that they publish that represents what their cost to providing utility service is and prices are set, that gives clear direction to utility management that certain costs may be excessive and need to be reduced, other areas of the operation may need to be broadened and expanded consistent with the pricing structure approved by the regulatory commission.

So from that standpoint, I think it's important in setting utility prices that both customer and utility management get clear information and clear objectives from what the price-setting authority believes is appropriate cost structure for providing utility service.

Q. Thank you. Is it fair to say that your analysis or the scope of your work in this proceeding was limited primarily to return on equity and capital structure?

A. Overall rate of return, yes.

Q. Yes.

A. Yes.

Q. Yes, overall rate of return.

And would it also be fair to say that

you didn't attempt to undertake an analysis of the acquisitions that have been made by either Spire or Laclede Gas Company in terms of the synergies that they have produced?

A. Well, I did review the Company's testimony concerning its cost of service in this case and I do understand that they believe that certain synergies or cost savings have been realized as a result of the acquisition.

Q. Okay. But you didn't do an independent analysis of that on your own other than reviewing maybe what the Company filed?

A. Yeah, that's -- I did review what the Company's filing has been in terms of what the cost savings would be, the cost to achieve, and I did not dig further into that issue than to review the Company's position.

MR. PENDERGAST: Okay, great. Thank you very much. I have no further questions.

JUDGE DIPPELL: Are there any questions from the Bench for Mr. Gorman?

CHAIRMAN HALL: Yeah.

QUESTIONS BY CHAIRMAN HALL:

Q. Good afternoon.

A. Good afternoon.

Q. I'm going to ask you one of the questions I asked Mr. Murray, and that is: When the Commission is making a capital structure determination between a subsidiary only or a consolidated capital structure, what do you think is the most important criteria or principles that we should take into account?

A. Well, ideally it would be the utility-specific capital structure, and then the determination would be whether or not the utility's effectively managing that capital structure so as to maintain its financial integrity, credit standing, but to do that at the lowest possible costs to retail customers.

And that's how I approach my review of Laclede's actual capital structure, and I found that without removing goodwill, the common equity ratio was much higher than needed in order to support their current bond rating. Consequently, I found their proposed capital structure was unreasonable because it contained an excessive amount of common equity.

And as I alluded to earlier, I think focusing --

Q. Well, let me stop you there for a

second because -- so you looked at the numbers and determined whether or not the numbers were reasonable, and if the numbers were not reasonable -- and if they are not reasonable, then you propose some deviation from the standard course of a utility-specific capital structure; is that correct?

A. It's very close to correct. I looked at their position and I first asked: Is this the actual capital structure that represents the debt and equity capital actually used to make investment in utility plant and equipment?

In that first step, I concluded that it was not because on the utility's balance sheet is a goodwill asset, and for the reasons outlined in my testimony, goodwill cannot be supported by debt capital because it doesn't produce cash flows. It would be imprudent for the utility to issue debt to fund a goodwill asset. If they did, it would have wrote their credit standing.

So when I asked the question whether or not the utility's proposed capital structure actually represents the debt and equity used to support their investment in utility rate base assets, my conclusion was, no, it's not because it includes common equity that supports a goodwill asset.

When I adjust it, the capital structure, to remove the common equity supporting the goodwill asset, I arrived at what I believe to be the utility's actual mix of debt and equity capital used to support their investment in the utility rate-based assets.

And based on that determination, at the original filing the Company requested a 57 percent common equity ratio, I found that it would be appropriate to reduce the common equity ratio or the common equity balance by about $210 million and to reflect their plan to refinancing assumed short-term debt with long-term debt. And with those two adjustments, I got a utility capital structure about 47 percent equity and 53 percent debt, and that was the capital structure I believe the utility uses to finance investment in utility plant and equipment.

My next question then was: Is that capital structure and is the Company's capital structure reasonable for rate-making purposes?

And in that evaluation, I asked the question whether -- what is a reasonable capital structure, what does maintain financial integrity and credit standing at the lowest possible cost to customers?

And in that second analysis, I again rejected the Company's actual capital structure because it contains too much common equity. In that second analysis, I found that my adjustment to the Company's capital structure has a relatively thin amount of common equity, but still reasonably consistent with what we're seeing for other utilities and supporting their bond rating in -- around the country.

Q. Did you consider other possible adjustments other than the 210 million goodwill adjustment?

A. Well, there's two adjustments. One was their planned -- plan to refinance about $170 million of short-term debt to long-term debt and to remove the goodwill.

I didn't look at any other adjustments beyond that because --

Q. The first one has been agreed to by the Company, correct?

A. It has.
Q. Okay. So it's only the second one that's at issue now?
A. Yes. And I didn't look further to adjust the capital structure because I found that once you remove the common equity supporting goodwill, the resulting capital structure, it's a little light on common equity, but it's reasonable for rate-making purposes. I concluded that it will support their financial integrity, will support their bond rating, but will do so at a much lower cost to retail customers.
Q. Have you ever advocated for such an adjustment before any other commission in any other state?
A. Yes, I have, on several occasions. In Illinois -- right now in Illinois, there's a law that says you have to adjust the capital structure the way I'm proposing here if a utility has an acquisition adjustment of goodwill on their balance sheet.
But before the law was changed, we addressed this issue with respect to Commonwealth Edison, and the Commission -- and

the resulting adjustment to the capital structure moved their goodwill -- or their capital structure from about 60 percent equity down to less than 40 percent equity. The Commission found that the Company's proposed capital structure was unreasonable because the common equity ratio was too high, but it felt that my capital structure wasn't reasonable because the common equity ratio was too low, so it imputed a common equity ratio and debt ratio in setting rates in that case.

Subsequent to that, you know, some laws changed in Illinois and a formula rate-making process was implemented for electric utilities and largely based on the significant issues in my judgment -- you know, I'm not sure what happened at the legislature, but I do know that the law changed right after this issue we had with Commonwealth Edison's capital structure.

In the Commission's finding that it would be appropriate to make that kind of adjustment to a rate-making cap structure to remove goodwill from common equity, the legislature mandated that in the formula rate process, when you develop a capital structure to use in that formula, common equity will be adjusted to remove the common equity supporting goodwill. So now that's the rate-making practice in Illinois.

I was also in a Federal Energy Regulatory Commission with respect to Niagra Mohawk and there was suggestions of -- the New York Public Service Commission, they had made a goodwill adjustment to the capital structure. As a result, it was a settled process at the FERC, but part of that settlement did reflect a compromise on capital structure.

So there wasn't an explicit finding on that, but there was a willingness by the utility to adjust their capital structure rate-making -- to form a rate-making one that didn't reflect all the common equity supporting goodwill.

I would also point out that most recently in most of the acquisition cases I've been involved in, for example, Exelon's acquisition of PHI, big utilities out East, there was explicit statements by the utility that the goodwill asset would not be included in rate base and also the goodwill asset would be reported at the parent company's cap structure so it wouldn't impact the utility's cap structure.

The same thing was offered by GPE in its proposed acquisition of Westar, where if a goodwill asset will be recorded, it will be recorded at the parent company level, not at the operating utility's subsidiary. So that seems to be more of the trend now in order to ensure that no cost associated with a transaction, the creation of a goodwill asset will actually be included in the rate-making process.

Q. Okay. Thank you.

Concerning Staff's analysis with regards to the ROE recommendation --

A. Um-hum.

Q. -- Staff essentially, my understanding, is proposing that we look at two prior -- our last two major utility rate cases in Ameren/KCPL where we determined that a 9.5 ROE was appropriate or approximately and then use that as a benchmark and then look at what's happened since then and decide which way we should perhaps adjust that 9.5.

Is that essentially your understanding of Staff's analysis and recommendation?

A. It is, but then I think it's important -- and Mr. Murray also looked at what he thought to be the current market cost of equity. So when he implemented that procedure, he didn't result in an ROE -- recommended ROE that was less than the utility's cost of equity.

And I think that's important because Hope and Bluefield standard says an awarded ROE has to be fair compensation, also maintain financial integrity and support the bond rating.

Q. Right. So --

A. I do think that was a significant first step that he undertook to recommend his return on equity.

Q. So do you think that that is a proper analysis?

A. Well, I understand why he did it, but I prefer to do the analysis the way I'm -- I do it because I look at a lot of financial metrics to try to gauge what the current market cost of equity is, cost of capital is and what the independent market participants believe capital costs will be at least over the next two or three years as that reasonably reflects the period rates will be in effect.

And using that information and informed judgment -- I've been doing this for about 30 years now -- is largely what I rely on in order to form my recommended return on equity. But at the same time, similar to what Mr. Murray has done, I also look at commission-authorized returns on equity for every utility companies and I observe how the market responds to those authorized returns on equity.

And if the market responds in such a way that the utility does have access to capital, the securities of the utility are still well received in the marketplace, I think that is observable market evidence that the awarded return on equity has been embraced as fair by market participants.

Q. So how did the market react to the 9.5 ROE that this Commission issued in the Ameren and KCP&L cases?

A. Well, I can't tell you specifically, but the reaction to the security prices after those rate decisions has been very robust. Their equity shares are much higher now than they've been at any time in history and, you know, on a share divided basis their credit ratings are quite strong, their ability to issue debt at very low interest rates and plentiful amounts of capital are very strong right now.

I think all the market -- observable market evidence shows that the 9.5 was well received by market participants.

CHAIRMAN HALL: I think that's all I have. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Any other questions?

COMMISSIONER RUPP: I have some questions.

JUDGE DIPPELL: Commissioner Rupp.

COMMISSIONER RUPP: Thank you.

QUESTIONS BY COMMISSIONER RUPP:

Q. Good afternoon, sir.

A. Good afternoon.

Q. I'm sure you took a look at Mr. Hevert's comments about your testimony, and one of the things that he was stating is that it's not possible to trace, you know, specific portions of the acquisition financing back to specific assets as you had kind of suggest when it comes to goodwill. Can you respond to that

comment?
A. I can. In virtually every respect I would agree with it with one exception, and that's the purchase accounting used in a merger transaction.
When one utility buys another, you combine their assets together. You literally add the assets, you add the liabilities, you create a goodwill asset. In order to keep the liabilities and asset in balance, they write up common equity to keep the balance sheet in balance. So when they create the paper goodwill asset, they also create a paper amount of common equity as part of -- as normal GAAP-related purchase accounting. So that's the one instance where I disagree with him because of simply the accounting mechanisms used when two companies merge together.
In virtually all other aspects of making investments by utilities I agree, you cannot trace capital to the assets used. But that's not the case with purchase accounting. It's very clear what occurs when two companies combine their operations together and the GAAP-reported accounting mechanisms that allow

for tracing of the creation and the creation of the goodwill asset, at the same time writing up their common equity balance.

Q. Okay, thank you. That helped.

And then he also states that you mistakenly assume that equity investors would be satisfied with investing in an asset that produces no economic value, and then he states that that wouldn't be true.

A. Well, that's simply wrong on its face. And let me give you an example. Spire's stock right now is trading at about 170 percent of its book value. If you or I wanted to buy Spire stock, we could not buy it at its book value. We'd have to buy it at the market price, and the market price, again, is a significant premium to book value. All the earnings and cash flow that would be available to that share of stock would be based on the book value of the equity that is used to invest in utility plant and equipment.

The difference between market price and book value is not part of the cost of service equations at the rate-making level. So it's normal for investors to be willing to pay prices that exceed book value when they take ownership of the utility shares, more individually, or if they're buying the utility itself in the case of Laclede buying MGE. It's a normal transaction to pay a price in excess of the book value because that's the going market value of those assets. But that doesn't mean that after Laclede buys MGE, the customers of MGE have to pay more to support that higher price.

As a matter of fact, that's something regulatory commissions particularly protect customers against happening after an acquisition. In order to do that, there has to be a commitment by the utility, which there was in this case, that no costs associated with that premium paid for MGE by Laclede would have the effect of increasing the utility's cost of service if the transaction was completed.

It was completed, the premium is represented as goodwill asset, the cost of the goodwill asset is the utility's common equity, which is in the capital structure. The asset, however, is not being amortized, it's not in rate base, but, nevertheless, the cost of service for this utility is increased because of the existence of the goodwill asset.

Q. Okay. And so the Company on the short-term debt that is your adjustment number one the Company's agreed to, there's been a stipulation on that piece? You were first talking with Commissioner -- with the Chairman, you made two adjustments?

A. They did. Actually, at the true-up date, they refinanced about $170 million of short-term debt with long-term debt and they did include debt in their true-up capital structures.

Q. Okay, so that one -- that adjustment's been taken care of. So it really comes down to this goodwill piece?

A. Yes.

Q. And I had it written down here somewhere. So the capital structure without removing the goodwill piece, you thought was excessive?

A. Yes, because 57 percent of their direct filing, 54 percent in their updated filing is an equity ratio that exceeds what's necessary to support their bond rating and it's also much higher than the equity ratios typically allowed LCD companies around the country.

Q. So that they adjusted the 54 percent -- there was -- I don't know if you were in the room. I think it was the Company offered true-up evidence of MGE back in 2014 where their equity and debt ratio was roughly 54 percent equity almost?

A. Yes.

Q. Was that excessive at that time?

A. I'm sure I took issue with it in the gray (indicating) case leading up to it. You know, I don't know what that filing was, if it was a rate case filing or if it was simply a reporting requirement and it really didn't impact the development of rates, it was just reporting earnings. And if that's the case, then customers' rates weren't necessarily adjusted to reflect that much common equity, but their earnings, when they're reporting them to the Commission, may have.

So I have to know a little bit more about that report, but there is many filings before the regulatory commission, and not all of them are used to adjust rates to retail customers.

COMMISSIONER RUPP: I think that's

all I have. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Thank you.

Is there Cross-Examination based on questions from the Bench from Staff?

MR. THOMPSON: No thank you, Judge.

JUDGE DIPPELL: Midwest Energy Consumers?

MR. WOODSMALL: No questions.

JUDGE DIPPELL: Environmental Defense Fund?

MS. KARAS: No questions, your Honor.

JUDGE DIPPELL: Does Spire?

MR. PENDERGAST: Just few.

RECROSS-EXAMINATION BY MR. PENDERGAST:

Q. You mentioned an Illinois legislation that in some manner allocates equity to goodwill and I think you mentioned formula rates.

A. Yes.

Q. Is that part of the formula rate legislation that's, you know, been used to regulate utilities in Illinois?

A. The electric utilities, yes.

Q. Okay. And, in fact, the formula rate

legislation has a lot of different provisions to it as far as how rates get adjusted and how ROE gets set and how often it happens and that sort of thing.

I'm just wondering would you recommend a formula rate mechanism here in Missouri?

A. Well, no, but Ameren Missouri's gas rates are set using the same kind of limits that their electric side sets rates under. And the gas rates are not set based on formula. They're set based on traditional utility rate filings. But, nevertheless, Ameren has entered into agreements with the Staff and the industrial groups in Missouri to not set rates with a common equity ratio of greater than 50 percent, again, recognizing that Ameren Illinois has a lot of goodwill recorded on its balance sheet and that causes the common equity ratio to go up.

So it was enacted in law for the electric formula rate process, but other rate-making practices in Illinois result in some utilities that have a lot of goodwill on their balance sheets to make concessions with other stakeholders in the rate case to use a capital structure that the stakeholders find to be reasonable for rate-making purposes.

Q. Yeah, and I appreciate. My only question was -- you mentioned, you know, the goodwill feature of that legislation which also has, you know, various formula rate features to it.

And my only question was: You know, taking the good with the bad, would you say overall that that formula rate approach is preferable and should be used in Missouri?

A. Quite honestly, no. I think it has resulted in the utility kind of managing their systems and increased their cost of service under the formula rate. So I don't think it gives stakeholders an adequate ability to really test the reasonableness of the utility's cost structure. So I do not recommend the formula rate methodology be implemented here in Missouri.

Q. And you agree that goodwill is created as part of the completion of the final transaction for an acquisition?

A. It's accounting mechanism.

Q. It's an accounting. And it's part of

that accounting for that transaction?

A. To recognize the premium paid to the book value or the fair value of the utility's assets, yes.

Q. And would you generally agree that utilities are typically required under normal regulatory and accounting policies to use the net value -- net book value of their assets for rate-making purposes?

A. As a component of the rate-making process, yes.

Q. Is it also true that for income tax purposes that this markup in assets, specifically a 338(h)(10) election, is allowed to show the true value of the acquired tangible assets, if you know?

A. I haven't looked at that specifically.

Q. So you don't know if the tangible asset gets stepped up in value?

A. Well, I haven't looked at that specifically for this transaction.

I do know in other transactions there's been issue about whether or not it is a tax-free transaction or not, and that has an impact as to whether or not goodwill can actually be written off for income tax purposes.

I assume that this was a tax-free transaction when Laclede bought MGE because it's my understanding they are not amortizing goodwill against their income taxes. But I haven't specifically looked at that.

Q. But you're not sure?

A. I do not know.

Q. Okay. And, once again, I think in answer to one of the Commissioner's questions, you reconfirmed, if you will, that any goodwill, any premium paid by Laclede Gas to acquire MGE is not included in its rate base?

A. Well, certain costs associated with it are in their cost of service, but no part of the goodwill asset is included in rate base.

Q. Okay. And because it's not included in rate base, customers are not paying a return on that premium; is that correct?

A. No, the operating income of the utility is higher because the common equity supporting the goodwill is in the proposed capital structure.

Q. Well... and as we established when this acquisition took place, it was financed with an

equivalent amount of debt and equity; is that correct?

A. It did. I think Mr. Hevert's testimony shows about $450 million of debt for about $800 million of book value assets. So the $800 million of book value assets are in rate base and the 450 million of the debt issued to acquire those assets are included in the cap structure.

Q. So when it comes to the Company's debt-to-equity ratio, the fact that you had an equal amount of debt and an equal amount of equity would tend to go ahead and flow into what that capital structure is, would it not?

A. It would for financial reporting. It would not for measuring the utility's cost of supporting the net book value of the asset included in rate base.

That's the distinction and that's why goodwill, which is only supported by common equity, would distort the capital structure mix for supporting rate-based investments if you don't make an adjustment to the capital structure.

Q. And in paying that premium, that

goodwill that was created, would an investor look at what sort of benefits would be created by the transaction?

A. Yeah, all investors look at the expected cash flows after the transaction or after the acquisition is made.

So just like a stock investor in Spire right now would be willing to pay above book value for that stock based on the expected earnings in cash flow, Spire based on the rate-making mechanisms allowed in each of its regulatory jurisdictions -- that would include, at least in Missouri, Spire's commitment not to include any costs associated with that acquisition premium or that goodwill asset. So from an arms length transaction, investors are willing to pay prices well above book value in order to get a piece of the earnings that are produced by a rate of return only on book value assets.

Q. Okay. And just to look at it at a high level, you are defining as a cost the failure, is it, of Laclede Gas to reduce its normal equity component that it's had, I think as you admitted for quite sometime in the mid 50s, to

47 percent, that's what you would define as a cost?

A. No, sir, what I would define as a cost is what your actual capital structure mix is in this rate case for supporting the assets included in your rate base.

To the extent that common equity ratio is lower now than it's been in the past doesn't change the fact that that's how much common equity is being used to support your rate base investments in this case.

Q. And I'm simply asking you, Mr. Gorman: Is it your testimony that to avoid a cost to the Company's customers, you need to go ahead and use an equity component that is 70 or 80 basis points lower than what Laclede has typically had before any of these acquisitions occurred?

A. Well, my answer isn't going to change to that. I'm looking at what the capital cost is that Laclede incurred to carry its rate base in this investment.

I'm recommending you a fair return on equity on the equity capital used to fund investments in the utility infrastructure, investments and you recover your debt cost on the remaining components. So there is no disallowance. Rather, it's simply an improvement of identifying what your actual cost of carrying your rate-based investments are.

Q. What do you think the odds are we're going to reach agreement on this point?

A. (No response.)

(Pause in proceedings.)

Q. And so you have 1.87 million in your capital structure -- billion, excuse me?

A. (Reviewing document.)

Yes.

Q. Okay. And do you know what Laclede's actual rate base is?

A. You know, this -- it was -- I believe it's around 2 billion, but the difference is because I simply took the Company's capital structure and removed the common equity supporting it.

If the Company synchronized its capital structure to rate base, then this capital would be less than the rate base, which means either that there's more debt and equity in the Company's balance sheet, which based on my review of 10-K, that's not the case, or it would be an indication that there's some short-term debt being used to support investments in the utility's rate base.

Q. So --

A. I haven't recommended the use of short-term debt in developing an overall rate of return in this case.

Q. Yeah, and we appreciate that. Thank you. But Laclede has 2.1 billion in rate base which are assets being used to serve customers?

A. That's right.

MR. PENDERGAST: Okay. Thank you. No further questions.

JUDGE DIPPELL: Okay.

Mr. Gorman, I just wanted to get a definition from you just to clarify the record. When you referred to "10-K," you're referring to an SEC filing?

THE WITNESS: Thank you, I am. Security and Exchange Commission annual filing, yes.

JUDGE DIPPELL: Okay. Thank you.

THE WITNESS: Thank you. I apologize for that.

JUDGE DIPPELL: Oh, no, no, no

apology needed.

Is there Redirect? And we'll start with OPC.

MR. SMITH: Yes. Thank you.

REDIRECT EXAMINATION BY MR. SMITH:

Q. Mr. Gorman, you were asked some questions from a variety of parties on your capital structure and how you arrived at it.

Do you have a copy of your Rebuttal testimony?

A. I do.

Q. And would you turn to Schedule MPG-R-2?

A. (Witness so doing.)

I'm there.

Q. Would that be a good illustration of how you arrived at your capital structure?

A. It is, yes. And that is the workpaper used to develop it.

Q. Earlier Commissioner Rupp had asked you some questions about the capital structure relating to MGE. Do you recall those?

A. Yes.

Q. Would you agree that -- or I guess let me ask this a different way.

Would the circumstances be different

comparing MGE to this case when you have MGE and Laclede?

A. I'm sorry. Can you repeat that, please?

Q. Yeah. Sure.

So you were discussing the capital structure used for MGE with Commissioner Rupp. Do you recall that?

A. Yes.

Q. And would you agree that the circumstances for evaluating the capital structure for -- in this case with updated information and also including Laclede in addition to MGE are different circumstances?

A. Well, they are different, sir. They're different points in time, it's a different company and there's different management controlling the capital investment decisions and I do understand that there's been some infrastructure investments going on in each of the jurisdictions. So the question is how were they funding those infrastructure improvements?

All of that is encapsulated in what's included in this rate file, and in looking at that, the question then is: How much equity and how much debt was used to invest in the utility plant in this case? And I guess the -- another question is whether or not short-term debt should be included in the rate-making capital structure.

So that is exactly the process I went through to take the Company's recommended capital structure and adjust it down to what I think is an appropriate reflection of what the Company's capital costs actually are for -- and were relied on by the Company to invest in the utility plant and equipment.

MR. SMITH: I have no further questions.

JUDGE DIPPELL: MIEC?

MR. MILLS: Yes. Thank you.

REDIRECT EXAMINATION BY MR. MILLS:

Q. Mr. Pendergast asked you a question about when Laclede acquired MGE and asked whether it was financed with roughly equal debt and equity, and in your answer you emphasized that the acquisition of the total company was done with roughly debt and equity in equal portions.

Can you explain the emphasis on "total

company"?
A. Well, the acquisition funded both the net book value of around $800 million plus the goodwill assets of about 210 million. That total acquisition was roughly 50 percent debt and 50 percent equity. But because utility debt has to be serviced from investments that produce cash flows, the amount of -- the portion of the equity acquisition made by Laclede was the $800 million of net book value. So in relationship to the utility debt to the net book value, it was roughly 56 percent debt and about 44 percent equity or $450 million of debt relative to $800 million of net book value and about 44 million of equity relative to net book value.
The additional $210 million of the acquisition price was premium to the net book value, and that represented a transaction between shareholders, not a transaction that allowed the utility to secure capital from investors and make investment in utility plant and investment [sic]. Rather, it represented capital where one utility shareholder bought the stock of another utility shareholder.

Q. Mr. Pendergast also asked you whether or not you conducted an analysis of acquisitions and synergies.

Was such -- is doing such an analysis necessary for you to come to a supported conclusion as to the appropriate capital structure or return on equity in this case?

A. It's not, but consistent with the transaction that took place here, the Company claimed that the acquisition would produce significant synergies net of cost-to-achieve synergies.

So it was more of a point of curiosity to review their filing to see whether or not the proposed transaction actually created the benefits that they promised would be created at the time they got authority to go forward with the transaction and agreed not to include any costs associated with the acquisition premium and rates.

Q. In response to question, I believe it was a question from the Bench, you stated that issuing debt to support goodwill would erode credit standing. What do you mean by that?

A. If the utility was issuing debt to

support the goodwill asset, then the level of utility cash flows would not increase relative to the amount of debt that was taken on because goodwill doesn't produce cash flows.

On the other hand, by investing in $800 million of net book value plant assets for MGE, those do produce cash flows and then can be used to produce acquisition-related debt of 450 million.

To the extent the utility's total amount of cash flows and the predictability of those cash flows are weakened as a result of the acquisition, then that would erode the credit quality of the utility and we would see the credit quality go down. So it would be improvement for the utility to intentionally finance a goodwill asset, one they know will not produce cash flows because they committed not to seek recovery of it from retail customers. So it won't produce cash flows. If they financed it with debt, that would have the effect of reducing the cash available to fund debt on the cash -- on the debt issued to fund the transaction.

So I think it would be imprudent for

the Company to represent that they've funded the goodwill asset with debt, although I think it is prudent that the Company actually did fund the acquisition of the net book value of MGE with debt, because those do produce cash flows and I do think that was a prudent financing decision.

Q. Now, you were asked by Chairman Hall about whether you proposed similar goodwill adjustments in other cases, and you mentioned several cases in which you had.

Have you ever been involved in a case in which the utility had a percentage of goodwill in its capital structure as significant as the percentage in this case where you did not propose an adjustment?

A. No. No. I mean, the utility's common equity is about a billion dollars in this case, the goodwill asset's about 200 million. That's 20 percent of total outstanding common equity as represented by goodwill asset.

If you compare that to Ameren Missouri, it's also a de minimus percentage of the acquisition adjustment or goodwill recorded on their balance sheet. If you compare that to Missouri American Water Company, they'd have some goodwill asset, but that's because they're acquiring some districts where their acquisition actually benefits retail customers and there is an opportunity for them to recover some of that acquisition and premium from customers because the transaction itself was so -- so much in favor of customers that the Commission allowed them to recover that acquisition adjustment and rates.

The only other utility that had such a large percentage of goodwill relative to total common equity was Commonwealth Edison, and that was created based on a sale of nuclear-generating assets by Commonwealth Edison when it converted from a vertically integrated company down to only-wires company and then there was a creation of emergent nuclear generating company initially in the process which ultimately turned into Exelon. But that's the only other utility that had a very large percentage of total common equity being represented by the recording of a goodwill asset that I'm aware of.

Q. Okay. And I believe you testified in that case the Illinois Commerce Commission

disallowed a portion of that goodwill asset that was included in the capital structure?

A. Well, they accepted a capital structure adjustment, but the actual capital structure adjustment resulted in a hypothetical capital structure being used to set rates. The Commission didn't exactly prescribe how it got from the Company's requested capital structure or my proposed capital structure to a capital structure they found to be more reasonable, but that capital structure that was found to be more reasonable was closer to what I was recommending than it was to what the Company was recommending.

Q. And I believe you testified that in recent cases you believed that you've identified a trend in which the acquirer utilities agree with stakeholders to not put goodwill into the capital structure of the utility operated company level; is that correct?

A. It is, yes.

Q. In this case could Spire Inc. have recorded a goodwill on its books rather than on Spire Missouri's books?

A. You know, I don't know specifically the answer to that question, but I believe they could have, you know, if Laclede Group could have acquired MGE and then it could have merged its subsidiaries together later.

But, frankly, I haven't looked into the details of that and I don't know if there are any restrictions on that.

Q. Now, you answered some questions from the Bench about the response of investors to the Commission's awarding Ameren a nine and half percent return on equity in the most recent case, and I believe you said that the investment community accepted that quite well.

So my question is: Did that award of that level of return on equity have any observable impact on the ability of Ameren to provide safe and adequate service?

A. Well, it certainly was a factor known to the marketplace and we can see based on verifiable market evidence that their stock price is, I believe, the highest it's ever been. Its dividend yield is probably as low as it's ever been, at least as long as I've been watching that company now. It's under 3 percent, well under 3 percent, which is very low for an integrated utility company. Great Plains Energy's price also is very high and its dividend yield is right around 3 percent. Again, that's very low relative to historical standards. Both of them have very strong investment grade bond ratings, they've been able to issue debt at very low cost under reasonable terms based on my review of their financial records, and that is I believe observable market evidence that the market believes that the regulatory decisions made by this Commission have been supportive of investors for those utilities and the ability to come up with a balanced outcome that is fair to both investors and customers.

Q. You are familiar, I believe, with the stipulation and agreement in the acquisition case?

A. Laclede's acquisition of MGE? Yes.

Q. Yes, that's the case I mean. And Mr. Pendergast asked you some questions about that, correct?

A. Yes.

Q. Is there any way to characterize the inclusion of goodwill on capital structure other

than as an indirect impact of the acquisition premium?

A. No. I've represented MIEC -- and certainly not in our mind because that's exactly what we had expected, that there would be no cost associated with goodwill that would be included in the rate-making process, and that includes not included in a rate base, not amortizing it, but also excluding the common equity from the rate-making capital structure.

Q. So that including it in rate base and amortizing, that would be a direct impact, correct?

A. Well, both are direct impacts.

Q. Right.

A. I mean, one's amortization cost and the other is a carrying charge.

Q. Right.

A. So...

Q. But the stipulation didn't stop when it said "direct cost." It added the phrase "indirect cost" as well, did it not?

A. It did, yes.

Q. Moving on to some questions that Mr. Pendergast asked you about requirements for, I

believe, tracking tangible assets, is goodwill a tangible asset?

A. I believe it is recorded under plant and service. I believe the accounting is to recognize it as a tangible asset.

Q. Now, finally, with respect to the acquisition premium itself, did the ratepayers of Laclede or MGE have any choice in the level of acquisition premium that Laclede paid for MGE?

A. No, they weren't part of the management's negotiating on the acquisition price.

The only leverage customers had was in negotiating the settlement where Laclede agreed not to seek recovery of any of those transaction costs for those goodwill-related costs in the rate-making process.

Q. And if Laclede had not represented to -- that it would not include either directly or indirectly any costs of that acquisition premium, do you think the parties and the Commission itself would have looked more closely at the level of that acquisition premium in the acquisition case?

A. Well, I can tell you that where MIEC was headed was to lay out what we meant by "cost associated with goodwill" up until we reached the settlement with the Company.

So had we filed testimony, that would have broken that out explicitly like that. But the settlement, we thought, captured what everybody had agreed to, and that is no costs associated with goodwill would be included in the rate-making process.

MR. MILLS: Thank you. That's all the questions I have.

JUDGE DIPPELL: Thank you.

Mr. Gorman, I believe that ends your testimony, and you may step down and you are -- let me see, was that your only issue?

THE WITNESS: Yes, it is.

JUDGE DIPPELL: Okay, you may be excused.

THE WITNESS: Thank you.

(Witness excused at 4:49 p.m.)

JUDGE DIPPELL: All right. Well, that conveniently puts us at the end of the day, so we will go ahead and break for the day.

We can begin again at 8:30 in the

morning and move a little quicker through some issues. So we will start with the issues that we didn't get this time with the -- now, did I have somebody that was only available on the 12th or was it just the 13th?

MR. WOODSMALL: 13th.

JUDGE DIPPELL: Just the 13th. Okay.

Then we will pick up where we left off in the morning with opening statements on that issue. We can adjourn.

(Whereupon, the hearing was recessed at 4:50 p.m. CST.)

I N D E X

COST OF CAPITAL AND CAPITAL STRUCTURES

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C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF ST. LOUIS)

I, Deborah Habian, Certified Shorthand Reporter with the firm of Alaris Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of St. Louis, County of St. Louis, State of Missouri.

Deborah Habian

DEBORAH HABIAN, CSR, RMR, CRR, CBC
Notary Public
CSR No. 084-02432

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