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Source: Moody's Investors Service

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Spire Missouri Inc.

State regulator rate case order includes inconsistent and less transparent cost recovery provisions, a credit negative

On 12 November, the Missouri Public Service Commission (MPSC) unanimously approved an amended rate order on Spire Missouri Inc.'s (A1 senior secured, stable) rate case which includes provisions that are inconsistent with past rate orders, less transparent on cost recovery timing, and not supportive of the company's credit quality. The decision is credit negative for Spire Missouri because of the adverse impact on both the company's cash flow and credit metrics. It also signals the potential for a less consistent and predictable regulatory environment in Missouri which may lead to a more contentious relationship between Spire Missouri and state regulators going forward.

The rate order approved a base rate revenue increase of about $72 million, which includes $47 million already being collected from customers through the infrastructure system replacement surcharge (ISRS) cost recovery mechanism. The authorized revenue increase was lower than the company's request for base rate revenue increase of $112 million. The revenue increase is premised on an allowed return on equity (ROE) of 9.37%, down from 9.8% authorized previously in Spire Missouri's 2018 rate order, and well below the average 9.62% ROE authorized in rate cases for natural gas distribution utilities conducted in the first half of 2021 as citied in the MPSC rate order.

Contrary to prior rate orders, the MPSC order includes Spire Missouri's short term debt within the company's regulated capital structure, which effectively reduces Spire Missouri's authorized equity ratio to about 50%, down from 54.2% previously and materially less than the company's request of 54.28%, another credit negative.

Furthermore, the order precludes Spire Missouri from capitalizing non-operational overhead costs into rate base and earning a return on those costs. At the same time, the order does not allow those costs to be expensed as incurred and thereby recovered through customer collections as part of the company's revenue requirement. Instead, the rate order states that non-operational overhead costs should be deferred on the balance sheet as a regulatory asset with the potential for recovery in a future rate case. The accounting treatment of these costs is not clear; the decision increases regulatory lag or the time between cost incurrence and recovery from customers; and also adds to the risk of recovery, either partially or in full.

We expect that Spire Missouri will file another rate case in early 2022 in an effort to, among other things, revisit the composition of the company's authorized regulated capital structure, including the MPSC's decision to include short term debt. The company may also attempt to reduce the regulatory lag in the recovery of prudently incurred overhead costs. While the rate order will negatively impact the company's near term cash flow coverage metrics, the longer term impact is less certain, particularly if the company files another rate case proceeding next year that succeeds in improving some of these provisions. However, the pancaking of rate case proceedings year after year could result in a more contentious relationship between the company, the MPSC, the Office of Public Counsel and other key intervening parties, and may result in another unsupportive rate case outcome.

Spire Missouri’s credit metrics were already weak following the impact of higher gas costs driven by market volatility from extreme cold weather during winter storm Uri in February. For the 12-months ended 30 June 2021, Spire Missouri’s ratio of cash flow from operations pre-working capital changes (CFO pre-W/C) to debt was 9.4%, which is down considerably from the company’s average ratio of CFO pre-W/C to debt of about 19.5% from 2016 through 2020. Spire Missouri's cash flow coverage metrics were also negatively impacted by higher debt issuance to cover the increased gas costs and the delay in the recovery of these costs from customers over a three year period.

Spire Missouri is a regulated natural gas local distribution company serving almost 1.2 million customers, primarily residential, in Missouri, including the cities of St. Louis and Kansas City. The company is composed of two utility segments, Spire Missouri East (fka Laclede Gas Company), and Spire Missouri West (fka Missouri Gas Energy, or MGE). Spire Missouri is the largest utility subsidiary of Spire Inc. (Baa2 stable), a public utility holding company based in St. Louis, MO, and represents about 65% of Spire Inc.'s consolidated cash flows.

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