MEMORANDUM

TO: Missouri Public Service Commission Official Case File Case No. GF-2023-0280, Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty

FROM: Randall Jennings, Senior Utility Regulatory Auditor, Financial Analysis Department

/s/ Seoung Joun Won, PhD 06/15/2023 — Financial Analysis Department / Date

/s/ Carolyn H. Kerr 06/15/2023 — Staff Counsel's Office / Date

SUBJECT: Staff Recommendation concerning the Amended Application of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty ("Liberty Midstates", "Company," or "Applicant"), for Approval of Financing Authority to issue, in principal amount, up to Ninety Million, Six Hundred Thousand Dollars ($90,600,000), in an unsecured note at a fixed rate to its Parent Company, Liberty Utilities Co. ("LUCo") to repay or refinance outstanding indebtedness.

DATE: June 16, 2023

1. (a) **Type of Issue:** Unsecured fixed rate note of up to $90.6 million and a maturity of 10 years to refinance an existing unsecured debt obligation ("Existing Note") maturing May 1, 2023, and the issuance of additional long-term unsecured debt to fund long-term capital expenditures and Storm Uri costs already incurred.

   (b) **Amount:** Up to $90.6 million.

   (c) **Rate:** Fixed rate based on a 10-year U.S. Treasury note at the time of the authorizing order plus a credit spread of 225 basis points.[1]

2. **Proposed Date of Transaction:** An anticipated date has not been provided, as this transaction will also require approval from the Illinois Commerce Commission.[2] As of June 14, 2023, the Illinois application has not been filed.[3]

3. (a) **Statement of Purpose of the Issue:** The Company proposes using the proceeds of the notes to refinance an existing unsecured debt obligation and issue additional unsecured long-term debt to fund long-term capital expenditures and Storm Uri costs already incurred.

1 Paragraph 13, page 3, Liberty Midstates' Amended Application.
2 Liberty Midstates' response to Data Request No. 0018.
3 Case Search - Results (illinois.gov)
https://www.icc.illinois.gov/docket/search/cases/results?u=3691&u=3858&o=False

(b) **From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?**

Yes, with conditions imposed.

4. **Copies of executed instruments defining terms of the proposed securities:**

No instruments have been executed, but the general terms and conditions of the indebtedness were detailed in the Company's Amended Application.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes

6. **Pro-forma Balance Sheet and Income Statement reviewed:**

Yes

7. **Capital expenditure schedule reviewed:**

Yes

8. **Journal entries required to be filed by Liberty Midstates to allow for the Fee Schedule to be applied:**

No. The debt issuances are not expected to be subject to the fee schedule authorized in Section 386.300, RSMo, as the new issuances are to repay existing debts to Liberty Midstates' parent company, LUCo.

9. **Recommendation of the Staff:**

The Staff recommends Partial Conditional Approval be granted pending the receipt of definite terms of issuance (see Comments and Recommended Conditions below).

COMMENTS:

Liberty Midstates is a Missouri utility corporation engaged in distributing and selling natural gas in portions of Missouri under the jurisdiction of the Missouri Public Service Commission ("Commission") and is a subsidiary of LUCo, serving approximately 58,000 customers in Missouri.[4] Liberty Midstates does not have a public credit rating assigned by Moody's or S&P.[5]

4 Paragraph 6, Liberty Midstates' Amended Application.
5 S&P Capital IQ Pro – Liberty Midstates.

On May 7, 2023, Liberty Midstates filed a Financing Application and Request for Waiver ("Application") and, on May 19, 2023, Liberty Midstates filed an Amended Financing Application ("Amended Application") with the Commission, requesting approval for authority to issue long-term unsecured debt. Liberty Midstates states in its Amended Application:

> The Company seeks the Commission's approval to refinance an existing unsecured debt obligation to LUCo in the amount of $25.6 million that matured on May 1, 2023 ("Existing Note") as well as the issuance of additional long-term debt to LUCo of up to $65 million to fund long term capital expenditures and Storm Uri costs shown on **Appendix 1**.[6]

** [redacted] **[7] The Applicant further states in its Amended Application:

> As previously noted, the proceeds from the New Note will be used to replace maturing long-term debt ($25.6 million) and to fund long term capital investments since 2019 (up to $65 million for the capital expenditures and Storm Uri costs shown on **Appendix 1**). No new funds are being generated by the requested financing.[8]

The Company states LUCo intends to make accounting entries on its books to cancel the Existing Note and issue the New Note, with no cash exchanged between the Applicant and LUCo.[9]

Staff applies the "not detrimental to the public interest" standard to financing applications. In reviewing requests for long-term financing authority, Staff analyzes the requested amount as it relates to the stated uses to ensure that the amount requested is reasonable and generally supports long-term capital investment. Staff also analyzes the pro forma impact the requested financing may have on the company's credit metrics, which may include the estimated impact on the parent company's credit metrics if the subject company's rating is influenced by the parent company's financial risk.

Staff typically recommends the Commission include a condition that approval of the financing is not considered approval of the terms and conditions of the financing transaction for ratemaking purposes.[10]

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6 Paragraph 10, Liberty Midstates' Amended Application.
7 Liberty Midstates' response to Data Request No. 0011.
8 Paragraph 18, Liberty Midstates' Amended Application.
9 Liberty Midstates' response to Data Request No. 0010.1.
10 See "Recommended Condition" number 1 on page 6 of this memorandum.

Liberty Midstates' Amended Application states:

> In replacement of the Existing Note and for the additional long-term debt issuance requested, Applicant proposes to issue a new unsecured fixed rate note to LUCo in like amount for a 10-year term (the "New Note").
>
> Upon receipt of Commission approval, Liberty Midstates anticipates that the New Note will be priced based on the 10-year U.S. Treasury note, plus a credit spread of 225 basis points (or such other like term credit spread based on the most recent indicative issuance pricing received from a bank).[11]

Concurrent with the issuance of the New Note, Liberty Midstates intends to pay LUCo, its parent company, a placement fee equal to 80 basis points of the principal amount of the New Note. Liberty Midstates states that the placement fee ** [redacted]. **[12] Liberty Midstates further states that ** [redacted] **[13] The placement fee of 80 basis points is made up of two parts. ** [redacted] **[14] Liberty Midstates has not provided any evidence that LUCo has incurred these costs.

Staff recognizes "placement fees" or other transactional costs are inherently part of obtaining debt financing. These fees and costs are a part of an Applicant's total debt costs, and the impact thereof is determined during a subsequent general rate case when calculating the cost of debt; not during a finance case. Staff also recognizes that this specific finance application is to obtain long-term debt from the Applicant's parent company in order to pay existing outstanding debts to the same parent company. Because of these facts, Staff does not find the "placement fee" of 80 basis points reasonable.

As the proposed debt transaction is simply an affiliate loan transaction between the intermediate parent company, LUCo, and Liberty Midstates to refinance previous affiliate loan transactions, this transaction is mainly an internal accounting matter. LUCo intends to make accounting entries

11 Paragraphs 12 & 13, Liberty Midstates' Amended Application.
12 Liberty Midstates' response to Data Request No. 0010.1.
13 Liberty Midstates' response to Data Request No. 0010.
14 Liberty Midstates' response to Data Request No. 0010.1.

on its books to cancel the Existing Note and issue the New Note, with no cash exchanged between Applicant and LUCo.[15]

The Applicant states that the interest rate for this unsecured debt issuance will be based on the 10-year Treasury note, plus a credit spread of 225 basis points.[16] The average May 2023 yield on U.S. Treasury Securities at a 10-Year Constant Maturity was 3.57%.[17] Adding 225 basis points to this yield, as an example, would make the interest rate for this debt issuance 5.82%. In May 2023, the Fed increased the benchmark rate to a range of 5.00% to 5.25% in order to reduce inflation.[18] The most recent Mergent Bond Record indicates that the average yield for a 'Baa' Public Utility bond for May 2023, was 5.71%.[19] Failing to grant this request and disallowing for the financing of this debt could potentially not support the public interest or be detrimental to the public interest. Without the approval of this financing, the debt would need to be funded through either the contribution of additional equity capital or external long-term debt.

As of December 31, 2022, the Applicant's total long-term indebtedness is ** [redacted]. **[20] Liberty Midstates indicated in the Amended Application that the purpose of this issuance is to refinance an existing unsecured debt obligation and issue additional unsecured long-term debt to fund long-term capital expenditures and Storm Uri costs already incurred. Using amounts from Liberty Midstates' Amended Application, Liberty Midstates' total embedded cost of long-term debt will increase from ** [redacted] ** to ** [redacted] **[21] assuming an interest rate of 5.82% for the new issuances. For the purpose of this application process, Liberty Midstates used an interest rate of 5.746% to calculate the pro forma embedded cost of long-term debt.

Liberty Midstates' list of long-term debts indicates two intercompany notes will mature in 2027 and total ** [redacted] ** million.[22] Liberty Midstates' projected five year capital expenditures, including 2027, does not include these maturities.[23] Liberty Midstates' 2023 total projected capital expenditures total just over ** [redacted] **, equating to roughly ** [redacted] ** of expenditures per month, and 2024 expenditures are projected to be ** [redacted] ** or just

15 Ibid.
16 Paragraph 13, Liberty Midstates' Amended Application.
17 Federal Reserve Economic Data | FRED | St. Louis Fed (stlouisfed.org); https://fred.stlouisfed.org/data/GS10.txt
18 Federal Reserve Board - Federal Reserve issues FOMC statement; https://www.federalreserve.gov/newsevents/pressreleases/monetary20230503a.html
19 Mergent Bond Record, May 2023.
20 Liberty Midstates' response to Data Request No. 0011.
21 Liberty Midstates' response to Data Requests No. 0011 and No. 0012.
22 Liberty Midstates' response to Data Request No. 0011.
23 Liberty Midstates' response to Data Request No. 0004.

over ** [redacted] ** per month.[24] Liberty Midstates currently projects that it will have approximately ** [redacted] ** in capital expenditures for the period of 2023 to 2027.[25]

The pro forma impact of Liberty Midstates' proposed debt financing on their balance sheet as of December 31, 2022, is as follows:[26]

(in Thousands)	As of December 31, 2022		Pro Forma	
Total Equity	** [redacted] **	42.50%	** [redacted] **	42.36%
Total Debt	** [redacted] **	57.50%	** [redacted] **	57.64%
Short-term Debt	** [redacted] **	24.67%	** [redacted] **	7.34%
Long-term Debt	** [redacted] **	32.83%	** [redacted] **	50.31%

The data request responses indicate a negligible change for the Total Debt and Total Equity. The Pro Forma Total Equity decreases by 0.14% due to an increase in interest Expense that subsequently causes a decrease in the retained earnings. The Pro Forma Total Debt increases by the same amount. The result is this transaction would have a negligible impact on the Applicant's financial ratios as of December 31, 2022, such as Funds from Operations ("FFO") to Debt, Debt to Earnings, ("EBITDA"), and Debt to Capital. These ratios are expected to remain "Highly Leveraged," "Highly Leveraged," and "Aggressive" respectively.

In the end, this application for financing does not generate any additional debt; it simply renews an already existing long-term debt and allocates funds already spent on long-term capital expenditures. With approval of the Amended Application, total long-term debt increases by $65 Million, but Liberty Midstates' short-term debt decreases by an equal amount. Consequently, the overall impact of the proposed refinancing on Liberty Midstates' financial risk is insignificant and merely accounts for funds that have already been distributed.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve the Amended Application submitted by Liberty Midstates in this case as not being detrimental to the public interest, subject to the following conditions:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, specifically including, but not limited to, the placement fee (if authorized), and that the

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24 Ibid.
25 Ibid.
26 Liberty Midstates' responses to Data Requests No. 0002 and 0003.

Commission reserves the right to consider the rate making treatment to be afforded the financing transaction and its impact on cost of capital, in any later proceeding;

2. That the Company shall file with the Commission within thirty (30) days of issuance of any financing authorized pursuant to a Commission order in this proceeding, a report including the amount of the unsecured indebtedness issued, date of issuance, interest rate (initial rate if variable), maturity date, redemption schedules or special terms, if any, use of proceeds, estimated expenses, and loan or indenture agreement concerning each issuance. In addition, the Company shall also provide the ledger entries for each company for each issuance;

3. That the Company shall file with the Commission through its electronic filing and information system ("EFIS") any information concerning communication with credit rating agencies concerning this issuance;

4. That the Company shall file with the Commission as a non-case related submission in EFIS under "Resources" - "Non-Case Related Query" - "Ordered Submission" any credit rating agency reports published on Liberty Midstates' or LUCo's corporate credit quality or the credit quality of its securities;

5. That the Company be required to file a five-year capitalization expenditure schedule in future finance cases;

6. That, to the extent that any non-regulated investments made by the Company or LUCo and affiliated companies may potentially impact the Company's credit quality and resulting credit ratings, the Company shall notify Staff of such possibility and provide a status report to the Commission;

7. That the Commission's grant of authority shall expire three years from the effective date of the order in this proceeding; and

8. That the Commission not approve a specific "placement fee" in this finance case, and that any ratemaking treatment involving a "placement fee" or the amortization thereof shall be determined in future rate proceedings.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Liberty Utilities (Midstates) Natural Gas Corp.'s d/b/a Liberty (MNG) Application for Authority to Issue Long Term Unsecured Debt	))))	**Case No. GF-2023-0280**

AFFIDAVIT OF RANDALL T. JENNINGS

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

COMES NOW Randall T. Jennings and on his oath states that he is of sound mind and lawful age; that he contributed to the foregoing *Staff Recommendation in Memorandum form*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

Randall T. Jennings
RANDALL T. JENNINGS

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 14th day of June, 2023.

Dianna L. Vaught
Notary Public

DIANNA L VAUGHT
Notary Public - Notary Seal
STATE OF MISSOURI
Cole County
My Commission Expires: July 18, 2023
Commission #: 15207377