

Exhibit No.:
Issue(s):
Witness/Type of Exhibit:
Sponsoring Party:
Case No.:

Financial Conditions
Burdette/Rebuttal
Public Counsel
GM-2001-342

REBUTTAL TESTIMONY
OF
MARK BURDETTE

FILED²
MAY 17 2001
Missouri Public
Service Commission

Submitted on Behalf of
the Office of the Public Counsel

LACLEDE GAS COMPANY
Case No. GM-2001-342

May 17, 2000

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of Laclede)
Gas Company for an Order Authorizing)
Its Plan to Restructure Itself Into a Holding) Case No. GM-2001-342
Company, Regulated Utility company, and)
Unregulated Subsidiaries.)

AFFIDAVIT OF MARK BURDETTE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Mark Burdette, of lawful age and being first duly sworn, deposes and states:

1. My name is Mark Burdette. I am a Financial Analyst for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 11.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Mark Burdette

Subscribed and sworn to me this 17th day of May 2001.



Notary Public

Joyce C. Neuner
Notary Public, State of Missouri
County of Osage
My Commission Exp. 06/18/2001

1 **REBUTTAL TESTIMONY**
2 **OF**
3 **MARK BURDETTE**
4 **LACLEDE GAS COMPANY**
5 **CASE NO. GM-2001-342**

6
7 **INTRODUCTION**

8 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

9 A. Mark Burdette, P.O. Box 7800, Ste. 250, Jefferson City, Missouri 65102-7800.

10 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

11 A. I am employed by the Office of the Public Counsel of the State of Missouri (OPC or Public
12 Counsel) as a Public Utility Financial Analyst.

13 Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

14 A. I received a Bachelor of Science in Electrical Engineering from the University of Iowa in
15 Iowa City, Iowa in May 1988. I received a Master's in Business Administration with dual
16 emphases in Finance and Investments from the University of Iowa Graduate School of
17 Management in December 1994.

18 Additionally, I have been awarded the professional designation Certified Rate of
19 Return Analyst (CRRA) by the Society of Utility and Regulatory Financial Analysts. This
20 designation is awarded based upon work experience and successful completion of a written
21 examination.

22 Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THE MISSOURI PUBLIC
23 SERVICE COMMISSION?

24 A. Yes.

1 Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

2 A. I will comment on Laclede Gas Company's application to "restructure itself, merge, and
3 form subsidiary companies (the "Proposed Restructuring")..." (Laclede's application in this
4 case, page 1). The effects of Laclede's reorganization will be to form a holding company
5 (the Laclede Group), a regulated utility (Laclede Gas Company), and unregulated
6 subsidiaries.

7 Q. DO YOU BELIEVE LACLEDE'S PROPOSED RESTRUCTURING IS DETRIMENTAL
8 TO THE PUBLIC INTEREST?

9 A. I believe the proposed restructuring will put Laclede's ratepayers at greater risk for
10 potential detriment. It is difficult to determine, in advance, exactly what effects will result
11 for ratepayers from Laclede's restructuring. However, the areas where potential detriments
12 exist can be identified and should be considered before the transaction is approved.

13 Q. IS THE INCREASED RISK OF DETRIMENT TO THE PUBLIC INTEREST AS
14 IMPORTANT AS ACTUAL DETRIMENT?

15 A. Certainly an increased risk of public detriment is important to consider before the detriment
16 has already occurred, just as actions by a company that would increase the chance of
17 bankruptcy would be important to consider before actual bankruptcy occurs.

18 Risk is the possibility that the actual outcome of an event will be different than the
19 expected outcome. Increased risk means an increased chance that the outcome will be
20 different than expected. Laclede Gas Company can act in a manner that increases the risk
21 of causing detriment to the public without actually causing *immediate* detriment. But the
22 risks faced by the ratepayers have still increased; the chance that detriment will occur is
23 greater than it otherwise would have been. Adding a second bullet while playing Russian
24 Roulette doesn't necessarily mean you will cause yourself detriment at the *next* pull of the
25 trigger, but the risk for detriment is certainly increased.

1 Q. WHAT POTENTIAL DETRIMENTS HAVE YOU IDENTIFIED ASSOCIATED WITH
2 LACLEDE'S PROPOSED RESTRUCTURING?

3 A. Two general areas exist for potential detriment to the public interest. First, there is the
4 possibility that Laclede Gas Company will face a greater risk profile due to the operations
5 and actions of the parent company, The Laclede Group. Second, the possibility exists that
6 the parent company could utilize and abuse Laclede Gas Company from a financial
7 standpoint. I will discuss each of these general areas in more detail.

8 Q. HOW MIGHT LACLEDE GAS COMPANY FACE A GREATER RISK PROFILE DUE TO
9 THE OPERATIONS OF THE PARENT?

10 A. Laclede Gas Company could face a greater risk profile primarily because its parent will be
11 free to participate in risky, unregulated operations outside the jurisdiction of the Missouri
12 Public Service Commission. To the extent that new ventures are more risky than the gas
13 distribution business, the ventures would increase the fundamental business risk faced by
14 The Laclede Group. Even if Laclede Gas is separated from The Laclede Group's
15 unregulated ventures by corporate structure, Laclede Gas will be impacted by the parent's
16 actions.

17 Also, to the extent that The Laclede Group gets into *unsuccessful* unregulated
18 ventures, the entire company, including Laclede Gas, would be faced with an overall
19 weakened financial position.

20 Laclede Gas could also face a greater risk profile due to changes in the Company's
21 capital structure, as effected by the parent company. A more debt-heavy capital structure
22 would generally increase the level of financial risk faced by the company.

23 Q. IS THE LIKELIHOOD OF AN INCREASED RISK PROFILE RECOGNIZED IN THE
24 FINANCIAL MARKETS?

25 A. Yes. The following statements are taken from a Standard & Poor's report on Laclede Gas
26 Company, dated 14 March 2001.

1 The Company plans to form a holding company to separate the
2 nonregulated ventures from the regulated utility business in 2001.
3 **Expansion of the diversified businesses will require even stronger**
4 **earnings and cash flow measures to compensate for the riskier**
5 **consolidated business profile.** [page 1] [Emphasis added]
6

7 Expansion in nonregulated areas is expected to be financed in a moderate
8 fashion. However, as these operations grow, **the consolidated business**
9 **risk profile will weaken**, and stronger earnings and cash flow levels will
10 be needed to support current ratings. [page 8] [Emphasis added]
11

12 However, **given Laclede's continued expansion into diversified**
13 **enterprises that have a higher risk profile than the regulated utility**
14 **business** and increasing debt leverage, its financial policy is viewed as
15 becoming more moderate. [page 8] [Emphasis added]
16

17 Q. HOW MIGHT THE LACLEDE GROUP UTILIZE THE LACLEDE GAS COMPANY IN A
18 FINANCIAL MANNER THAT COULD LEAD TO DETRIMENT OF THE PUBLIC
19 INTEREST?

20 A. First, the parent could use The Laclede Gas Company as a 'cash cow' over and above the
21 receipt of reasonable dividends -- a source of free cash flow to use for purposes other than
22 the needs of Laclede Gas. This would weaken Laclede Gas Company's financial position
23 and could cause them to have to borrow money for investment rather than use internally
24 generated funds. Increased borrowing could bring all the associated aspects of increased
25 financial risk, including increased costs for both long term debt and common equity, tighter
26 restrictions in Indentures of Mortgage, and the possibility of insufficient borrowing
27 potential. In the worst case, Laclede Gas would be unable to meet its financial obligations
28 and would be forced into bankruptcy.

29 Second, The Laclede Group, as sole owner of Laclede Gas Company's common
30 stock, could pledge that common stock as collateral for unregulated investments. So
31 pledged, the common stock is then at risk of changing ownership should the investment fail.
32 This change of ownership would occur outside the jurisdiction of the MPSC. Certainly a

Missouri-regulated utility changing owners without review by the MPSC would be detrimental to the public interest.

Q. CAN YOU PROVIDE EXAMPLES OF A REGULATED UTILITY BEING FINANCIALLY ABUSED BY A NONREGULATED HOLDING COMPANY PARENT?

A. Yes. The recent events in California provide ample evidence of public detriment caused by the financial abuse a parent company can inflict on a regulated utility.

In the case of Pacific Gas & Electric Company (PG&E), the abuse by the parent company (Pacific Gas & Electric Corporation) resulted in the regulated utility filing **bankruptcy**.

Southern California Edison has suffered similar financial problems as PG&E as a result of the financial decisions at the parent level.

Q. PLEASE PROVIDE DETAILS ON THE RELATIONSHIP BETWEEN PG&E AND ITS PARENT COMPANY, PACIFIC GAS & ELECTRIC CORPORATION, THAT RESULTED IN PUBLIC DETRIMENT.

A. The following statements are taken from "Review of Pacific Gas and Electric Company Financial Condition", which was prepared by an independent auditor (Barrington-Wellesly Group) for the California Public Utilities Commission, and from a memo prepared for the California Assembly and Senate by The Utility Reform Network (TURN), Consumers Union.

From the TURN memo prepared for the California Legislature:

(4) PG&E transferred billions to its parent corporation

Between 1997 and 1999, PG&E transferred \$4 billion to its parent corporation. In the first nine months of 2000, PG&E transferred an additional \$632 million. The audit concludes "historically, cash has flowed only one direction, from PG&E to PG&E Corp. and then to the unregulated subsidiaries.

(5) PG&E subsidized its parent corporation by overpaying its taxes

PG&E transferred an additional \$663 million between 1997-99 to the holding company by overestimating its income taxes. PG&E Corporation was able to use the extra money "to apply to other activities."

(8) PG&E's parent has an obligation to assist the utility

PG&E Corporation is required to give first priority to using capital to meet the utility's obligation to serve. PG&E executives deny that such a requirement exists. The audit disagrees with PG&E's position.

Q. PLEASE PROVIDE DETAILS ON THE RELATIONSHIP BETWEEN SOUTHERN CALIFORNIA EDISON (SCE) AND ITS PARENT COMPANY THAT RESULTED IN PUBLIC DETRIMENT.

A. The following statements are taken from "Southern California Edison's Solvency and Liquidity Concerns", which was prepared by an independent auditor (KMPG) for the California Public Utilities Commission, and from a memo prepared for the California Assembly and Senate by The Utility Reform Network (TURN), Consumers Union.

From the TURN memo prepared for the California Legislature:

(3) SCE transferred billions to its parent corporation

SCE transferred \$4.8 billion to its parent corporation (Edison International) since 1995.

(5) SCE's affiliates have profited from the California crisis

Payments by SCE to its unregulated affiliates increased by approximately 50% in 2000.

(6) SCE's parent corporation invested heavily in SCE affiliates

Edison International invested \$2.5 billion in unregulated SCE affiliates since 1996.

(8) SCE's indebtedness increased due to holding company transfers

SCE's debt to equity ratio "increased substantially" as a direct result of actions taken well before last summer's price crisis including large transfers to their parent corporation in 1997.

Q. SHOULD LACLEDE'S PROPOSED RESTRUCTURING BE APPROVED, ARE THERE WAYS THAT THE MISSOURI PUBLIC SERVICE COMMISSION CAN PROTECT MISSOURI CONSUMERS FROM THE POTENTIAL DETRIMENT THAT COULD RESULT?

A. Yes. The MPSC can help protect Missouri's consumers from detriment by imposing certain conditions and restrictions on both The Laclede Group and Laclede Gas Company.

1 Q. CAN YOU GIVE EXAMPLES OF REASONABLE CONDITIONS AND RESTRICTIONS
2 THE MPSC COULD IMPOSE AND THE POTENTIAL DETRIMENT THE CONDITION
3 IS SUPPOSED TO ADDRESS?

4 A. Yes. Following is a list of financial conditions similar to those contained in the unanimous
5 Stipulation and Agreement from Case No. EM-2001-464, which is Kansas City Power &
6 Light Company's restructuring case. This Stipulation and Agreement was signed on May
7 1, 2001. After each condition, I list the specific detriment the condition addresses.

8
9 a. The Laclede Group ("Holding Company") and its subsidiaries will not
10 conduct any material business activities that are not part of the "electric
11 industry or natural gas industry business" or are not reasonably related to
12 business activities derived from changes in the electric industry or natural
13 gas industry as a result of competition, without Commission approval.
14

15 This condition limits the extent to which the companies can get involved in unregulated
16 ventures outside the area of expertise or experience, without first obtaining Commission
17 approval. The limitation will help contain business risk.

18
19 b. The Laclede Group will not pledge Laclede Gas Company's common
20 stock as collateral or security for the debt of the Holding Company or a
21 subsidiary without Commission approval.
22

23 This condition keeps the parent company from pledging the common stock of the regulated
24 subsidiary as collateral or security for new investments, without Commission approval.

25 This condition ensures that the MPSC will not suddenly find itself dealing with a wholly
26 new, and unapproved, owner of a Missouri utility.

27
28 c. Laclede Gas Company will not guarantee the notes, debentures, debt
29 obligations or other securities of the Holding Company or any of its
30 subsidiaries, or enter into any "make-well" agreements without prior
31 Commission approval.
32

1 This condition is intended to ensure that the regulated subsidiary will not find itself facing
2 repayment of the *parent company's* debt (or any other obligations connected to that
3 venture). If the parent company got involved in a questionable unregulated venture that
4 failed, the regulated utility would not be liable for the parent company's debt associated
5 with that venture.

6
7 d. The Laclede Group agrees to maintain consolidated common equity of
8 no less than 30 percent of total consolidated capitalization. The Laclede
9 Group and Laclede Gas Company agree to maintain Laclede Gas
10 Company's common equity at no less than 35 percent. Total capitalization
11 is defined as common equity, preferred stock and long-term debt. Common
12 equity is defined as par value of common stock, plus additional paid-in
13 capital, plus retained earnings, minus treasury stock.
14

15 This condition is intended to limit the amount of financial risk both the parent and the
16 regulated subsidiary can take on, as measured by the common equity ratio of each. The
17 parent must maintain a common equity ratio of at least 30% and the regulated subsidiary
18 must maintain common equity of at least 35% of capital. Restrictions on both the parent
19 and subsidiary are necessary because it is financially possible to maintain the parent's level
20 of common equity while financing the regulated subsidiary completely with debt.

21
22 e. Reports:

23
24 Laclede Gas Company shall submit quarterly to the Financial Analysis
25 Department of the Missouri Public Service Commission and The Office of
26 Public Counsel certain key financial ratios as defined by Standard and
27 Poor's Credit Rating Service, as follows:
28

29 Pre-tax interest coverage;
30 After-tax coverage of interest and preferred dividends;
31 Funds flow interest coverage;
32 Funds from operations to total debt;
33 Total debt to total capital (including preferred); and
34 Total common equity to total capital
35

1 This condition will enable the Staff and The Office of Public Counsel to monitor the
2 financial condition of Laclede Gas and aid in the discovery of any potential financial
3 problems.

4
5 f. Laclede Gas Company's total long-term borrowings including all
6 instruments shall not exceed Laclede Gas Company's regulated rate base.
7

8 This condition will ensure that Laclede Gas Company cannot take on leverage (borrow debt
9 capital) to the extent that those borrowings are greater than the assets providing the cash
10 flow to service that debt.

11
12 g. Laclede Gas Company shall maintain separate debt. Laclede Gas
13 Company agrees to maintain its debt at investment grade. This condition
14 should not be construed to mean the Staff recommends or will recommend
15 in any future application to the Commission or Commission proceeding the
16 approval of any preferred stock issuance below investment grade.
17

18 h. The Laclede Group, Laclede Gas Company and the Staff agree that the
19 allowed return on common equity and other costs of capital will not
20 increase as a result of the reorganization.
21

22 i. The Laclede Group and Laclede Gas Company guarantee that the
23 customers of Laclede Gas Company shall be held harmless if the
24 reorganization creating The Laclede Group, with Laclede Gas Company as
25 a subsidiary, results in a higher revenue requirement for the Laclede Gas
26 Company than if the reorganization had not occurred.
27

28 These conditions are intended to protect ratepayers from increased costs (general revenue
29 requirement and cost of capital) due to the reorganization. It is a detriment to the public
30 interest if capital costs, as reflected in rates, increase as a result of the reorganization.

31
32 j. The Laclede Group and Laclede Gas Company shall provide the Staff
33 and Public Counsel unrestricted access to all written information provided
34 to common stock, bond, or bond rating analysts, which directly, or
35 indirectly, pertains to Laclede Gas Company or any affiliate that exercises
36 influence or control over Laclede Gas Company, or has affiliate
37 transactions with Laclede Gas Company. Such information includes, but is
38 not limited to, reports provided to, and presentations made to, common

1 stock analysts and bond rating analysts. For purposes of this condition,
2 “written” information includes, but is not limited to, any written and printed
3 material, audio and videotapes, computer disks, and electronically stored
4 information. Nothing in this condition shall be deemed to be a waiver of
5 The Laclede Group and Laclede Gas Company’s right to seek protection of
6 the information.
7

8 This condition is intended to protect Laclede Gas Company and Missouri’s ratepayers from
9 potential abuses within the realm of affiliate transactions. In the California examples, the
10 parent companies continued to draw cash from the regulated utility to use to invest in
11 unregulated affiliates even as the regulated utility was facing potential financial trouble.

12
13 k. The Holding Company will provide the Staff and Public Counsel, upon
14 request and with appropriate notice, all information needed to verify
15 compliance with the conditions authorized in this proceeding and any other
16 information relevant to the Commission’s ratemaking, financing, safety,
17 quality of service and other regulatory authority over Laclede Gas
18 Company.
19

20 This condition will ensure that Staff and Public Counsel will be able to verify compliance
21 with the other conditions as well as obtain relevant information necessary for the MPSC to
22 retain fully-informed regulatory authority over Laclede Gas Company.

23 Q. DOES THE EXISTENCE OF CONDITIONS AND RESTRICTIONS ON THE
24 REGULATED UTILITY AND THE UNREGULATED PARENT EFFECTIVELY
25 REMOVE THE MOTIVATION FOR REORGANIZATION?

26 A. No. Recently, as I mentioned, KCPL was party to a unanimous Stipulation and Agreement
27 in its own restructuring case (EM-2001-464). That Stipulation and Agreement contained
28 every one of the conditions I mention above, in essentially the same form.

29 Q. ARE CONDITIONS AND RESTRICTIONS PRESENT IN RESTRUCTURING CASES IN
30 OTHER JURISDICTIONS?

31 A. Yes. The Arizona Corporation Commission approved the restructuring plan of Tucson
32 Electric Power Company (Case No. U-1933-97-176) with a total of 28 conditions and

1 restrictions. In fact, the company itself listed 17 conditions in its original application.
2 Many of the conditions adopted in the case are similar to the conditions I propose for
3 Laclede Gas and the conditions agreed to by all parties in EM-2001-464.

4 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

5 A. Yes.