Exhibit No.:	
Issues:	*Insulating Conditions*
Witness:	*Ronald L. Bible*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case Nos.:	*GM-2001-342*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

RONALD L. BIBLE

LACLEDE GAS COMPANY

CASE NO. GM-2001-342

Jefferson City, Missouri
MAY, 2001

REBUTTAL TESTIMONY OF

RONALD L. BIBLE

LACLEDE GAS COMPANY

CASE NO. GM-2001-342

Q. Please state your name, occupation and business address.

A. My name is Ronald L. Bible. I am employed by the Missouri Public Service Commission (MoPSC) as the Manager of the Financial Analysis Department. My business address is 200 Madison, Jefferson City, Missouri.

Q. Please describe your educational and professional background.

A. In 1981, I earned a Master of Business Administration degree with an emphasis in Finance and Investments from the Southern Illinois University at Edwardsville, Illinois. In 1976, I earned a Bachelor of Arts degree in Social Science from Colorado State University, Ft. Collins, Colorado.

Q. Would you please review your work experience.

A. Yes. I was employed by Credit Union National Association from 1995 to 1997 and by American Express from 1991 to 1995 as a Financial and Investment Analyst/Planner. Prior to that, I was with Voluntary Hospitals of America and Hospital Corporation of America where I performed statistical and financial analysis. Previous to these positions, I was an officer in the United States Air Force and was responsible for a unit that provided statistical analysis.

Q. Have you previously filed testimony?

A. I have testified before the MoPSC a number of times. My testimony at the MoPSC has addressed issues including rate of return, proposed financings, and merger and acquisition issues.

Q. What issues are you addressing in this testimony?

A. My testimony addresses the financial implications of Laclede's Application to reorganize into a holding company. The Company's application as filed presents a detriment to Laclede's ratepayers. I will present the conditions intended to eliminate the detrimental impact of Laclede's proposal. These conditions are intended to insulate the regulated utility from the business and financial risk of the unregulated subsidiaries of the holding company and thereby protect Laclede's ratepayers.

Q. Would you define business and financial risk?

A. Yes. Business risk is the risk associated with the nature of business and the operations of the firm. Financial risk is the risk associated with a firm's sources of financing and its use of leverage. Leverage is the amount of debt and fixed charges the business incurs.

Q. Does the Staff believe the Company's Application should be approved as filed?

A. No. The application as filed has a detrimental impact on Laclede's customers. The application should, however, be approved with the proposed insulating conditions that remove the detrimental affect of Laclede's request.

Q. Why are these insulating conditions necessary?

A. In the absence of insulating conditions, the business risk and financial risk of the unregulated operations will be transferred to the regulated utility. This will increase the cost of capital for the regulated utility with no offsetting benefit to the ratepayer. Increasing the cost of capital will result in a detriment to the ratepayer. Standard & Poor's assumes that an entity's creditworthiness reflects not only its own business and financial profile, but also its relationships with other corporate family members. Therefore, after the proposed transaction occurs, Standard & Poor's will assign a consolidated credit rating, which will include the operating and financial characteristics of the regulated entity, the unregulated holding company and the unregulated subsidiaries.

Q. What will be the effect of this consolidated rating?

A. Standard & Poor's, as well as other credit rating agencies, view the regulated utility operations as being more stable than the unregulated operations. Therefore, the consolidated credit rating will be lower due to the unregulated operations. Without insulating conditions, the credit rating of the regulated utility will be no higher than the consolidated credit rating.

Q. How will this be detrimental?

A. With a lower credit rating, the debt of the regulated utility will be issued at a higher cost. Debt purchasers will expect a higher interest payment to induce them to assume the increased risk associated with buying debt with lower credit quality. Also, the increased cost of debt will have the same effect as increasing the total amount of debt outstanding due to higher interest charges. The end result is higher fixed costs. With higher fixed costs, common equity holders can demand a higher return for assuming the greater risk of buying common equity from an entity with more or greater fixed charge obligations before dividends can be paid. The overall effect will be an increase in the cost of capital.

Q. What has been the experience in the energy business with regards to insulating factors?

A. The Commission's Financial Analysis Department has researched the experience in the energy business with regards to restructurings and mergers and has determined that credit rating agencies, as well as other public utility commissions, have taken a position on the need for insulating conditions. Standard & Poor's has taken positions and provided extensive information that indicates its opinion on the relevance of insulating conditions.

Q. What is Standard & Poor's, and what is its relationship with Laclede?

A. Standard & Poor's is a company that provides opinions on the credit worthiness of the bonds, commercial paper, notes, preferred stock and other financial instruments issued by companies in various industries, including the public utility industry. Standard & Poor's relationship with Laclede Gas Company is that it provides credit ratings regarding Laclede's financial instruments. Investors rely on these ratings as a means of assessing the ability of a company to meet its financial obligations. This information enables investors to determine the risk and return they can expect to experience with a particular investment.

Q. What information has Standard & Poor's provided related to insulating conditions?

A. In an article entitled "Behind The Ratings: 'Ring-Fencing' A Subsidiary" in the *Standard & Poor's CreditWeek*, October 27, 1999, Standard & Poor's stated:

In the past, the mere existence of regulation was given considerable weight when determining the adequacy of protection for the utility's cash flow and assets. However, Standard & Poor's will require a progressively higher standard of evidence that insulation exists as the nonregulated component of a holding company's business becomes greater, and the regulated utility shrinks in absolute and relative size. If it is not clear that insulation exists, Standard & Poor's will assume that it does not. Importantly, the corporate credit ratings of utilities that operate in jurisdictions that do not provide insulation, and where no other insulatory measures exist, will be the same as the consolidated corporate credit rating. Under these conditions, this same rating will also apply to the holding company.

Standard & Poor's analysis of the adequacy of regulatory insulation will focus on barriers erected by state commissions and lawmakers to limit the parent company's ability to access the funds of the utility. Such determinations will be made on a case-by-case basis. The parent's ability may be restricted by disincentives created during specific proceedings, such as consideration of mergers or formation of a holding company. The conditions may come in the form of dividend limitations or restrictions, capital structure requirements, or stringent reporting requirements. The more restrictions placed on the parent's access to the cash flow of its utility, the better the opportunity for insulation to be recognized. A demonstrated willingness by state regulators to protect the creditworthiness of the utility is an important consideration. Structural factors will also enhance the value of regulatory rules.

Q. Has Standard & Poor's provided any examples of insulating conditions?

A. Yes. In the "Behind The Ratings: 'Ring-Fencing' A Subsidiary" article in the *Standard and Poor's CreditWeek*, October 27, 1999, Standard & Poor's provided the following as examples of insulating conditions:

<u>STRUCTURAL INSULATION</u>

-Partial ownership of a subsidiary by an outside party,

-Separate boards of directors for each entity (preferably with outside representation),

-Separate management,

-Separate country or jurisdiction,

-Separate name,

-Absence of cross-default covenants, and

-Separate financing activities.

<u>REGULATORY INSULATION</u>

-Restrictions on cash flow,

-Restrictions on debt as a percentage of capital,

-Restrictions on dividends,

-Debt rating targets established by a commission,

-Limitations on the amount of investment in nonutility businesses, and

-Limitations on the types of investments that a utility or holding company can make.

Q. Are there other state public utility commissions that have placed insulating conditions on these types of applications?

A. Yes. A number of public utility commissions have implemented insulating conditions as protective measures. These states include: Oregon, New York, Virginia, California and Arizona. Measures utilized by the Oregon Public Utility Commission include restrictions on dividend distributions that would cause the utility's equity ratio to fall below 48 percent. The New York Public Service Commission requires subsidiaries to maintain separate debt ratings and has used other restrictions, including a cap on the debt to equity ratio and a limit on the holding company's investment in nonutility operations. The New York Public Service Commission implemented these and additional protective measures when all of its utilities formed holding companies. The additional protective measures include limits on dividends the utilities pay to the holding company. Virginia law grants the Virginia Corporation Commission the authority to prohibit its utilities from paying any dividend. The California Public Utilities Commission has applied restrictions on capital structure and new financings, and has set minimum equity ratios for ratemaking purposes. The Arizona Corporation Commission placed 32 insulating conditions on Tucson Electric Power's request to form a holding company.

Q. Have you utilized any other information in forming your opinion that insulating conditions are necessary when a regulated utility is involved in a restructuring?

A. Yes. In a Standard & Poor's article "U.S. Utility Rating Downgrades Outpace Upgrades in First Quarter; Negative Trend Likely To Continue", April 20, 2001, Standard & Poor's reported that 20 of 28 utility credit ratings nationwide were downgraded in the first three months of this year. This number compares to 13 downgrades out of 21 ratings changes during the same period last year. Standard & Poor's stated that most of the downgrades this year resulted from mergers or restructurings. This is the same activity Laclede proposes in its pending Application. A copy of this report can be found at Standard & Poor's website, www.standardpoors.com/Forum/RatingsCommentaries/Corporat.../042401_utilities.htm.

Q. Has Staff applied insulating conditions to any utilities as part of that utility's restructuring request?

A. Yes. Staff developed and applied insulating conditions in Kansas City Power & Light Company's (KCPL) current restructuring request. Laclede's request is similar to KCPL's application to reorganize into a holding company.

Q. What are the insulating conditions that Staff recommended for Laclede?

A. The insulating conditions proposed by Staff are as follows:

1. The Laclede Group, Inc. ("Holding Company") and its subsidiaries will not conduct any material business activities that are not part of the "Energy Business" or are not reasonably related to business activities derived from changes in the natural gas industry as a result of competition, without Commission approval. With regard to expansion of Laclede Gas Company's current operations in natural gas marketing, real estate development, insurance services and the compression of natural gas, activities will be limited to those considered incidental to current operations.

2. The Laclede Group, Inc. will not pledge Laclede Gas Company's common stock as collateral or security for the debt of the Holding Company or a subsidiary without Commission approval.

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

4. The Laclede Group, Inc. agrees to maintain consolidated common equity of no less than 30 percent of total consolidated capitalization and for Laclede Gas Company to maintain its common equity at no less than 35 percent. Total capitalization is defined as common equity, preferred stock, long-term debt and short-term debt. Common equity is defined as par value of common stock plus additional paid-in capital, plus retained earnings, minus treasury stock.

5. Reports:

Laclede Gas Company shall submit quarterly to the Financial Analysis Department of the Missouri Public Service Commission certain key financial ratios as defined by Standard & Poor's Credit Rating Service, as follows:

a. Pre-tax interest coverage;
b. After-tax coverage of interest and preferred dividends;
c. Funds flow interest coverage;
d. Funds from operations to total debt;
e. Total debt to total capital (including preferred); and
f. Total common equity to total capital

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

7. Laclede Gas Company shall maintain separate debt and, if outstanding, preferred stock ratings. Laclede Gas Company agrees to maintain its debt and, if outstanding, preferred stock rating at investment grade.

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

9. The Laclede Group, Inc. guarantees that the customers of Laclede Gas Company shall be held harmless if the reorganization creating The Laclede Group, Inc., with Laclede Gas Company as a subsidiary, results in a higher revenue requirement for Laclede Gas Company than if the reorganization had not occurred.

10. The Laclede Group, Inc. and Laclede Gas Company shall provide the Staff unrestricted access to all written information provided to common stock, bond, or bond rating analysts, which directly or, indirectly pertains to Laclede Gas Company or any affiliate that exercises influence or control over Laclede Gas Company or has affiliate transactions with Laclede Gas Company. Such information includes, but is not limited to, reports provided to, and presentations made to, common stock analysts and bond rating analysts. For purposes of this condition, "written" information includes but is not limited to any written and printed material, audio and videotapes, computer disks, and electronically stored information. Nothing in this condition shall be deemed to be a waiver of The Laclede Group, Inc.'s or Laclede Gas Company's right to seek protection of the information.

11. The Holding Company will provide the Commission Staff, upon request and with appropriate notice, all information needed to verify compliance with the conditions authorized in this proceeding and any other information relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over Laclede Gas Company.

Q. Is there any reasonable assurance or guarantee that by adopting these insulating conditions, Laclede's regulated utility will be insulated from the business and financial risk of the nonregulated operations of the subsidiaries and the holding company?

A. Yes. However, there is no guarantee that the insulating conditions Staff proposes will be adequate to protect the regulated utility from all the business and financial risk of the nonregulated operations, or result in a specific credit rating. It is not appropriate to ignore the experience and knowledge gained by other state public utility commissions and the credit rating agencies, and not adopt these insulating conditions. Laclede will be exposed to the business and financial risk of its nonregulated operations, the result of which will be a detriment to the ratepayers if the regulated operations are not insulated. Staff believes that adopting the insulating conditions will balance the needs of ratepayers and shareholders, and is the best course of action.

Q. Are there any examples of a utility's unregulated operations negatively affecting their regulated operations?

A. Yes. Western Resources (Western) is a consumer services company based in Topeka, Kansas. Western's business operations include generation, transmission, distribution and sales of electric energy in Kansas, and interests in unregulated monitored services. In its December 31, 2000 Form 10K filed with the Securities and Exchange Commission, Western stated that its monitored services has had a history of losses and expects these losses to continue. Western goes on to say that credit rating agencies are applying more stringent guidelines when rating utility companies due to increasing competition and utility investment in non-utility businesses. Standard & Poor's, June 6, 2000, *Ratings Direct* for Western Resources states that Western faces significant challenges and uncertainty because of its extremely weak financial condition.

Western expanded largely by acquisitions financed with debt. These debt financings have placed significant pressure on its balance sheet and resulted in lower creditworthiness. Western's financial flexibility is unusually weak for a highly regulated utility company. Western has had to make amendments to credit lines that Standard & Poor's has said will increase their cost of borrowing.

Another example is Tucson Electric Power (TEP). As mentioned previously in this testimony the Arizona Commission placed 32 insulating conditions on TEP as a result of its request to form a holding company. TEP is an Arizona corporation providing electric service to the public within portions of Pima and Cochise Counties, Arizona. The Arizona Commission, in its Opinion And Order dated February 22, 1996 for Docket No. U-1933-95-069, stated that during the 1980's time period, TEP diversified into non-utility areas that did well for a while. However, most of the diversified areas turned sour toward the end of the 1980's. As a result of the aforementioned diversification, as well as a spin-off to market TEP's excess capacity, TEP reached a point in the early 1990's whereby it simply could not pay all of its bills. On July 16, 1991, a group of owner participants filed Involuntary Petitions for reorganization of TEP under Chapter 11 of the U.S. Bankruptcy Code.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Staff of the Missouri Public Service Commission, v. Laclede Gas Company	))))	Case No. GM-2001-342

AFFIDAVIT OF RONALD L. BIBLE

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Ronald L. Bible, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Ronald L. Bible

Ronald L. Bible

Subscribed and sworn to before me this 16th day of May, 2001

Rosemarie Riedl

Notary Public

My Commission Expires June 1, 2001