

Exhibit No.:  
Issue(s):

Witness/Type of Exhibit:  
Sponsoring Party:  
Case No.:

Rate of Return;  
Demand Charge  
Burdette/Rebuttal  
Public Counsel  
GR-99-315

**REBUTTAL TESTIMONY**

**OF**

**MARK BURDETTE**

Submitted on Behalf of  
the Office of the Public Counsel

**LACLEDE GAS COMPANY**

**Case No. GR-99-315**

August 5, 1999

**FILED**  
AUG 5 1999  
Missouri Public  
Service Commission

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


In the Matter of Laclede Gas Company's     )  
Tariff Sheets to Revise Natural Gas Rates    )     Case No. GR-99-315

**AFFIDAVIT OF MARK BURDETTE**


STATE OF MISSOURI     )  
                                  )     ss  
COUNTY OF COLE     )

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

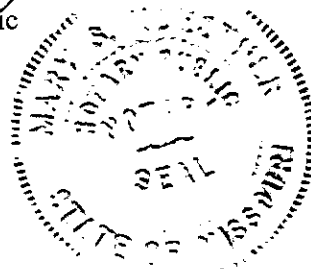
1. My name is Mark Burdette. I am a Financial Analyst for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 11.
3. I hereby swear and affirm that my statements contained in the attached testimony are true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

  
\_\_\_\_\_  
Mark Burdette

Subscribed and sworn to me this 5th day of August, 1999.

  
\_\_\_\_\_  
Mary S. Koestner  
Notary Public

My commission expires August 20, 2001.



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1 As any observer of both the stock market and the regulatory process  
2 knows, Corporate America has restored its profitability to much higher  
3 sustainable levels than those traditionally awarded by regulators to gas  
4 utilities. This has diminished the relative attraction of utility equities  
5 generally, resulting in chronic underperformance in recent years. [Olson-  
6 Direct, page 2, lines 21-27]  
7

8 Regarding this portion of Mr. Olson's testimony, I submitted Public Counsel data request  
9 2015, which asked, in part,

10 What industries and companies does he include in Corporate America?  
11

12 Mr. Olson responded:

13 Corporate America would include the universe of companies that would  
14 provide equity investment opportunities to an investor. [Company response  
15 to OPC data request 2015]  
16

17 I also asked:

18 Does Mr. Olson believe the overall risk levels of the regulated natural gas  
19 industry are equal to the overall risk levels of what he terms Corporate  
20 America?  
21

22 Mr. Olson's response is as follows:

23 Mr. Olson is not addressing risk within the context of page 2, lines 21-27.  
24 [Company response to OPC data request 2015]  
25

26 Q. DO YOU AGREE WITH MR. OLSON'S ASSERTION THAT THIS SECTION OF HIS  
27 DIRECT TESTIMONY DOES NOT CONCERN RISK ISSUES?

28 A. No, I do not agree. It is meaningless to compare one company's or one industry's  
29 profitability or returns to another without also taking into account risk differences between  
30 the companies or the industries. To attempt to do so provides no useful information to this  
31 case. While Mr. Olson's statement "...Corporate America has restored its profitability to  
32 much higher sustainable levels than those traditionally awarded by regulators to gas  
33 utilities" might be correct, he fails to consider or mention that traditional gas utilities  
34 continue to be perceived by the market as less risky than "Corporate America" (which Mr.

1 Olson defines as the **universe** of alternative equity investments). Being less risky,  
2 regulated gas utilities are therefore not “entitled” to returns at levels equal to the returns  
3 earned by more risky companies.

4 Q. IS THERE AN INDICATION OF THE RELATIVE LOWER RISK OF GAS UTILITIES  
5 AS COMPARED TO THE ENTIRE MARKET?

6 A. Yes. One such indication is the value of Beta. Beta is a company-specific risk measure  
7 that indicates the relative riskiness of the company as compared to the market as a whole.  
8 The overall market has a beta equal to 1.0. Laclede had a beta equal to 0.55 (according to  
9 Value Line) at the time I filed Direct testimony. The Company’s current Value Line beta is  
10 0.50. This means that for every 1.0 percentage point change in the market as a whole,  
11 Laclede’s stock price could be expected to change only 0.50%. This lower volatility is  
12 perceived as lower risk. According to the risk-return trade-off, lower risk implies lower  
13 expected returns. Mr. Olson’s comparison of returns of the nonregulated market comprised  
14 of the universe of equity investments, to the returns of regulated natural gas companies, is  
15 flawed without the consideration of risk differences.

16 Q. DOES MR. OLSON UNDERSTAND THE BASIC FINANCIAL TENANT OF THE RISK-  
17 RETURN TRADEOFF?

18 A. Mr. Olson says that he does. Public Counsel data request 2016 asks:

19 Is Mr. Olson aware of the basic financial tenant commonly referred to as  
20 the “risk return tradeoff?” Please provide Mr. Olson’s interpretation of  
21 that concept.

22  
23 Mr. Olson’s answer is as follows:

24 Investors would be willing to accept a higher level of non-achievement of  
25 financial measures in return for a higher achievable overall return  
26 possibility.

27  
28 Conversely, investors are willing to accept a lower level of non-achievement of financial  
29 measures in return for a lower achievable overall return possibility; i.e. lower risk implies

1 lower expected returns. However, Mr. Olson fails to consider risk or the connection  
2 between risk and return in making his comparisons and stating his opinions.

3 Q. DOES MR. OLSON MAKE ANY STATEMENTS CONCERNING INVESTORS'  
4 PERCEPTIONS OF DIFFERENT COMPANIES?

5 A. Yes, he does. Mr. Olson states:

6 Investors do not distinguish much any more between investing in a gas  
7 utility, GENERAL ELECTRIC, or CITIGROUP;" [Olson-Direct, page 6,  
8 beginning on line 3]  
9

10 Q. DO YOU AGREE WITH THIS ASSERTION?

11 A. No, I do not. I believe it wrong to think that investors do not "distinguish much any more"  
12 between an investment in Laclede Gas Company versus investing in a company such as  
13 General Electric. For example (from Value Line), Laclede has a beta of 0.50; *General*  
14 *Electric has a Value Line beta of 1.20.* Laclede's dividend yield is approximately 6%;  
15 General Electric's dividend yield is 1.3%. Laclede's dividend payout ratio hovers in the  
16 range of 80%-90% (or more); General Electric's dividend payout ratio is approximately  
17 42%. Laclede has a price-to-earnings (P/E) ratio of 13.9; General Electric's P/E ratio is 37.

18 Investors do not consider such differences as indistinguishable. A comparison of  
19 the profitability of a company such as Laclede versus a company like General Electric is  
20 not a fair comparison nor is it relevant in determining Laclede's cost of equity capital. I  
21 believe Mr. Olson's statement is false and that his conclusions, in general, warrant little if  
22 any consideration by the MPSC regarding Laclede's cost of equity.

23 Q. DID MR. OLSON MAKE ANY ADDITIONAL ASSERTIONS THAT YOU QUESTION?

24 A. Yes. In the process of attempting to attack "cost-of-capital models, such as the DCF  
25 [Discounted Cash Flow] method", Mr. Olson states:

26 Their application has resulted in a subsidization of ratepayers by  
27 stockholders in many jurisdictions. [Olson-Direct, page 3, lines 6-8]  
28

1 I questioned Mr. Olson's statement via Public Counsel data request 2018. I requested a list  
2 of the jurisdictions in which subsidization has occurred and documentation supporting his  
3 assertion. He provided neither. Rather, in response to the data request, Mr. Olson supports  
4 his statement by saying his testimony "reflects his general expert knowledge of the industry  
5 and the overall market."

6 While expert knowledge and experience are important, they are not always  
7 adequate support for assertions or opinions put forth as fact. Mr. Olson appears to make a  
8 factual statement, "Their application **has** resulted...", yet he is unable to provide a list of  
9 jurisdictions in which subsidization has occurred. Indeed, he has failed to provide the  
10 Missouri Public Service Commission with any supporting documentation or analysis  
11 related to his assertion. Given that Mr. Olson cannot provide any foundation for his  
12 statement, Public Counsel wonders on what information he based his "expert knowledge  
13 and experience."

14 Q. DOES MR. OLSON MAKE ANY ADDITIONAL ASSERTIONS, ABOUT WHICH HE  
15 WAS UNABLE TO PROVIDE SUPPORTING DOCUMENTATION?

16 A. Yes. Again attempting to attack certain cost-of-equity models, Mr. Olson makes claims on  
17 behalf of "most independent Wall Street observers." Public Counsel data request 2020  
18 asks, in part, the following question:

19 Concerning Olson-Direct, page 11, beginning on line 14, which states: "**In**  
20 **the opinion of most independent Wall Street observers**, inadequacies in  
21 the models typically employed (DCF, Risk Premium, and CAPM) by state  
22 commissions to set these returns, such as those identified by Ms. McShane,  
23 are responsible for this growing and unsustainable disparity. Indeed, they  
24 believe such models are: (1) outdated at best; (2) no longer employed in  
25 mainstream investment decision making; and (3) are often abused in both  
26 spirit and practice."

27  
28 Please provide documentation supporting the assertions made in this  
29 section of testimony, including support that the opinions expressed are held  
30 by "most" independent Wall Street observers. [Emphasis added]  
31



1 Mr. Olson's response is as follows:

2 The "assertions" made in the referenced section of testimony are based on  
3 Mr. Olson's opinion based on his knowledge of, and interactions with,  
4 other analysts.  
5

6 Once again, Mr. Olson presents his opinion before the MPSC as a factual statement. He  
7 puts forth a position he claims represents the opinions of "most Wall Street observers" yet  
8 he can provide no documentation supporting his claim.

9 Certainly professional knowledge and experience are valuable. However, opinion,  
10 even expert opinion, should be differentiated from hard fact. The MPSC should be aware  
11 of which is actually being presented. When the conclusion is opinion, it should have  
12 reasonable support behind it. Mr. Olson's testimony and his responses to data requests  
13 submitted by Public Counsel contain no support for his assertions.  
14

15 **COMMENTS ON THE DIRECT TESTIMONY OF KATHLEEN MCSHANE**

16 Q. IN APPLYING THE RISK PREMIUM AND DCF MODELS, MS. MCSHANE USES  
17 GROUPS OF LDCS SHE CLAIMS SERVE AS A PROXIES FOR LACLEDE. DO YOU  
18 AGREE WITH THE COMPANIES SHE SELECTED?

19 A. I do not agree with all of Ms. McShane's choices. Ms. McShane chose a group of 17 LDCs  
20 for her risk premium analysis and a group of 13 companies for her DCF analysis. Six of  
21 Ms. McShane's 17 companies are the same companies I selected for my comparison group  
22 (AGL Resources, Connecticut Energy Group, Indiana Energy, Peoples Energy, Piedmont  
23 Natural Gas, and Washington Gas Light). The remaining eleven companies are  
24 questionable as to their appropriateness to serve in a proxy group for Laclede. For  
25 example, three of Ms. McShane's choices (Cascade Natural Gas, NUI Corp. and Southwest  
26 Gas Corp.) are rated BBB+ or below by Standard & Poor's, implying they are considered  
27 more risky companies than Laclede. Five of her companies earn a low percentage of their

1 revenues from the sale of natural gas, namely: Keyspan Energy, 57%; New Jersey  
2 Resources, 78%; Nicor Inc. 59%; NUI Corp., 48%; and South Jersey Industries, 69%,  
3 which means these companies are earning much of their revenues from enterprises other  
4 than the regulated sale of natural gas. They are simply not comparable to Laclede. One of  
5 Ms. McShane's selections, Atmos Energy, has operations within the jurisdiction of the  
6 MPSC. To avoid circularity, many analysts do not use comparison companies operating in  
7 the same jurisdiction as the company being analyzed.

8 The questionable appropriateness of Ms. McShane's comparison companies  
9 implies that any recommendations for Laclede based on the analysis of those companies is  
10 also questionable.

11 Q. DO YOU HAVE SIMILAR CONCERNS WITH MS. MCSHANE'S COMPARIBLE  
12 EARNINGS TEST?

13 A. Yes, I do. Ms. McShane uses 35 companies she claims are similar in overall risk to  
14 Laclede (McShane-Direct, page 10, lines 26-27]. However, I do not believe the risk  
15 profiles are similar for many of the companies she selected. For example, six of the  
16 companies are rated BBB+ by S&P and four more are rated only BBB. A BBB rating is  
17 just barely investment grade, hardly comparable to Laclede's AA- rating.

18 Also, the 35 companies have an average beta of 0.83, significantly greater (more  
19 risky) than Laclede's beta of 0.50. Eleven of Ms. MsShane's selected companies have a  
20 beta of 0.90 or greater. Although she attempts to take this difference in beta into  
21 consideration, *I believe a more sound and valid approach would be to actually select*  
22 *companies comparable in risk, rather than select companies that are not comparable and*  
23 *then attempt to make some adjustment to the results.*

1 Q. DO YOU BELIEVE MS. MCSHANE APPLIED THE COMPARABLE EARNINGS  
2 STANDARD APPROPRIATELY, AS SET FORTH IN THE SUPREME COURT  
3 DECISION IN THE BLUEFIELD WATERWORKS CASE (BLUEFIELD WATER  
4 WORKS AND IMPROVEMENT COMPANY V. PUBLIC SERVICE COMMISSION, 262  
5 U.S. 679 (1923))?

6 A. No, I do not. In the Bluefield Case, the Court states,

7 A public utility is entitled to such rates as will permit it to earn a return on  
8 the value of the property which it employs for the convenience of the  
9 public **equal to that generally being made at the same time and in the**  
10 **same general part of the country on investments in other business**  
11 **undertakings which are attended by corresponding risks and**  
12 **uncertainties**; but has no constitutional right to profits such as are realized  
13 or anticipated in highly profitable enterprises or speculative ventures.  
14 [Emphasis added]

15  
16 Ms. McShane's 35 companies and Laclede do not face "corresponding risks and  
17 uncertainties." Also, Ms. McShane analyzed those companies' returns over a ten-year  
18 historical period rather than following more closely the Bluefield standard of "at the same  
19 time."

20 Ms. McShane's comparable earnings analysis violates basic tenants set forth in  
21 Bluefield. The analysis should be disregarded by the MPSC.

22 Q. DID MS. MCSHANE USE THE DCF MODEL TO CALCULATE A COST OF COMMON  
23 EQUITY FOR LACLEDE?

24 A. Ms. McShane did use the DCF, however, she did not apply that model directly to Laclede.  
25 She applied the DCF to a group of 13 LDCs she claims serve as proxies for Laclede, but  
26 failed to utilize financial and market information for Laclede itself.

27 Q. DO YOU AGREE WITH THIS PROCEDURE?

28 A. No, I do not. When actual market data is available for a company (and assuming the  
29 company is in reasonable financial health), I believe the data should be used in the analysis  
30 of that company. Laclede's stock price is an important, market-driven, indication of actual  
31 investor's expectations for *Laclede*. Similarly, Laclede's own historic and projected

1 growth rate data are important to use when analyzing the company. Once the company  
2 itself has been analyzed, then I think an analysis of a group of comparison companies is a  
3 useful and valid check of reasonableness. In order to calculate a DCF cost of equity for  
4 Laclede, Ms. McShane applied the DCF not to Laclede but to a group of other companies,  
5 some of which are hardly comparable to Laclede.

6  
7 **CHANGES FROM DIRECT TESTIMONY**

8 Q. WHAT CHANGE TO THE LEVEL OF SHORT-TERM DEBT DO YOU WANT TO  
9 MAKE FROM YOUR DIRECT TESTIMONY RESULTING FROM PREHEARING  
10 CONFERENCES IN THIS CASE?

11 A. The Company requested that the level of short-term debt included in the capital structure  
12 be calculated using an average-daily balance method rather than the end-of-month balance  
13 method I used in my Direct testimony. I agreed to this change and therefore altered the  
14 level of short-term debt in my capital structure from \$83,871,924 to \$79,231,000. The  
15 change in method reduced the cost of short-term debt to 5.33% from 5.34%. The effect on  
16 the overall weighted average cost of capital was an increase to 8.37% from 8.34%, using  
17 the level of common equity, long term debt, and preferred stock from my direct testimony,

18 Q. DID THE COMPANY RECOMMEND ANY ADDITIONAL CHANGES IN THE LEVEL  
19 OF SHORT-TERM DEBT?

20 A. Yes. The Company also requested the level of short-term debt included in the capital  
21 structure be reduced by \$50M, to a level of approximately \$29M, to account for the recent  
22 \$25M issuance of common equity and also by the recent \$25M issuance of long term debt.

23 Q. DO YOU AGREE WITH THIS RECOMMENDATION?

24 A. **No, Public Counsel does not agree to these adjustments.** The \$29M level of short-term  
25 debt proposed by the Company simply is not representative of the Company's historical or  
26 pro forma levels of short term debt. It is an inappropriate level to include in the capital

1 structure and would arbitrarily increase the Company's overall rate of return by lowering  
2 the level of low-cost short-term debt, thereby artificially increasing the levels of higher cost  
3 common equity and long term debt.

4 Q. DO YOU AGREE TO RECONGNIZE THE COMPANY'S RECENT ISSUANCES OF  
5 COMMON STOCK EQUITY AND LONG TERM DEBT?

6 A. Yes. Public Counsel would agree to update the level of common equity and long term debt  
7 to account for each of these new issues.

8  
9 **COMMENTS ON DEMAND CHARGE PROPOSAL**

10 Q. DO YOU HAVE ANY COMMENTS REGARDING THE COMPANY'S PROPOSAL TO  
11 IMPLEMENT A DEMAND CHARGE?

12 A. Yes. A demand charge would tend to reduce the volatility of Laclede's earnings. Any  
13 adjustment or change in the revenue stream that reduces the variability of revenues tends to  
14 decrease the risk associated with those revenues. The implementation of a demand charge  
15 would therefore warrant a reduction in the Company's authorized ROE in consideration of  
16 the reduction in risk.

17 Q. HAS THE MPSC EXPRESSED AN OPINION REGARDING THE REDUCTION OF  
18 REVENUE VOLATILITY AND AN ASSOCIATED REDUCTION IN ROE?

19 A. Yes. The Report and Order from Case No. GR-96-285 states:

20 It is clear to the Commission that approval of the WNC [weather  
21 normalization clause] proposed by MGE would benefit MGE insofar as the  
22 variability of its revenues resulting from weather changes would be  
23 reduced, thus reducing MGE's business risk. The WNC would shift  
24 virtually all weather-related risk onto ratepayers. In the event that the  
25 Commission would authorize a WNC similar to the one proposed herein,  
26 the Commission would seriously consider a downward adjustment to  
27 return on equity as proposed by OPC. [Page 60]

28  
29 A demand charge and a weather normalization clause both work to reduce the variability of  
30 a company's revenues. Any reduction in the variability of revenues is accompanied by a

1 reduction in business risk. That reduction in risk warrants a reduction in the authorized

2 ROE.

3 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

4 A. Yes.