Exhibit No.:	
Issue:	Cost of Capital
Witness:	Donald A. Murry, Ph.D.
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Laclede Gas Company
Case No.:	GR-2010-0171
Date Testimony Prepared:	June, 2010

LACLEDE GAS COMPANY

GR-2010-0171

REBUTTAL TESTIMONY

OF

DONALD A. MURRY, Ph.D.

JUNE 2010

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. My name is Donald A. Murry. My business address is 5555 North Grand Boulevard, Oklahoma City, Oklahoma 73112.

Q. ARE YOU THE SAME DONALD A. MURRY WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am offering Rebuttal Testimony to the Direct Testimony filed by Staff Witness Zephania Marevangepo and Missouri Industrial Energy Consumer's Witness Michael Gorman.

Q. WHAT ARE THE BROAD ISSUES THAT YOU ARE REBUTTING IN THE TESTIMONIES OF MR. MAREVANGEPO AND MR. GORMAN?

A. In each of their cases, these witnesses have not effectively considered the current economic environment and the financial market crisis and the impact of the volatile markets on investors. In each of their cases, they rely too heavily on mechanically applying the very erratic data produced by the volatile financial markets and virtually ignore the analytical significance of the current economic environment. I will also comment on the capital structures recommended by these witnesses.

II. ECONOMIC ENVIRONMENT

Q. WHAT IS IMPORTANT ABOUT THE CURRENT ECONOMIC ENVIRONMENT THAT MR. GORMAN AND MR. MAREVANGEPO DID NOT EFFECTIVELY CONSIDER?

A. Both witnesses ignored critical factors associated with the domestic economic recession and its recovery and the international financial crises and how these factors are affecting investors' perceptions of risk. These factors influence the true cost of capital in the current markets.

Q. HOW DOES THE ECONOMIC RECESSION AFFECT THE COST OF CAPITAL IN THIS PROCEEDING?

A. The economic recession impacts consumer spending and utility revenues, but the important issue relative to the cost of capital is how the uncertainty of utility revenues affects investors' decisions about investing in utility common stock. "Growth in household spending has picked up recently but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit."[1] Moreover, a survey by CoreLogic, showed that 23.7 percent of homes have negative mortgages, and a slow housing market means slow customer growth for utilities.[2]

Q. HOW DOES THE FINANCIAL CRISIS AFFECT INVESTORS' PERCEPTIONS OF RISK?

A. Market rates directly impact a utility's cost of capital and cost of doing business. Although the Federal Reserve continues to support very low, stimulative money market rates, an expanding federal deficit and economic recovery could bring about a shift, perhaps abruptly, to an anti-inflation policy. The Federal Reserve has announced that it is prepared to respond by raising interest rates, when merited. For example, Ben Bernanke of the Federal Reserve recently testified:

[1] Board of Governors of the Federal Reserve System, *Press Release,* April 28, 2010.
[2] *Tulsa World,* May 12, 2010.

> By increasing the interest rate on banks' reserves, the Federal Reserve will be able to put significant upward pressure on all short-term interest rates, as banks will not supply short-term funds to the money markets at rates significantly below what they can earn by holding reserves at the Federal Reserve Banks. Actual and prospective increases in short-term interest rates will be reflected in turn in higher longer-term interest rates and in tighter financial conditions more generally.[3]

Q. WHAT ARE THE PROSPECTS THAT THE FEDERAL RESERVE WILL SHIFT TO A TIGHTER MONETARY POLICY IN THE NEAR-TERM?

A. Vice Chairman Kohn of the Federal Reserve recently stated, "Central banks have widely chosen to target inflation rates near 2 percent."[4] According to *Value Line*, the rate of inflation could reach over two percent as soon as 2011 and be nearly three percent by the 2013-15 period. (See Schedule DAM-R1) This could indicate that monetary policy will shift before that date.

Q. IS THERE OTHER EVIDENCE TO SUPPORT THAT ANALYSTS ARE ANTICIPATING INCREASES IN LONG-TERM INTEREST RATES IN THE NEAR FUTURE?

A. Yes. One such forecast is *Value Line's* prediction for AAA bond rates. As Schedule DAM-R2 shows, *Value Line* is forecasting one full percent increase in the AAA bond rate by the period 2013-15. Significantly, this forecasted increase in long-term rates is one that is readily available to utility common stock investors looking to the future, and one that they are

[3] Chairman Ben S. Bernanke, Board of Governors of the Federal Reserve System, *Testimony Before the Committee on Financial Services,* U. S. House of Representatives, March 25, 2010.
[4] Vice Chairman Donald L. Kohn, Board of Governors of the Federal Reserve System, Cornelson Distinguished Lecture, Davidson College, North Carolina, March 24, 2010.

likely to act upon. Forecasts such as this are surely influencing common equity investors.

Q. YOU HAVE COMMENTED THAT MR. MAREVANGEPO AND MR. GORMAN DID NOT ADEQUATELY CONSIDER THE CURRENT MARKET CIRCUMSTANCES. HOW DO YOU THINK THEY FAILED TO CONSIDER THE RECENT MARKET CIRCUMSTANCES?

A. Despite recent financial market turmoil and the current economic conditions, in each of their direct testimonies, both witnesses rather mechanically applied market-based measures of the cost of common equity. Although the changed economic circumstances from earlier, more stable periods are obvious, in neither case did the witness adequately acknowledge or compensate for the current market conditions. Persisting high unemployment, slow growing GDP, languishing stock market prices, while at the same time short-term borrowing rates are exceptionally low, shows that investors generally do not find the risk-return calculus attractive.

Q. MR. MAREVANGEPO AND MR. GORMAN BOTH USED MARKET-BASED METHODS IN THEIR DIRECT TESTIMONIES. DID THAT COMPENSATE FOR AND MEASURE CURRENT MARKET CONDITIONS?

A. No. The use of data from the current markets without interpretation is the problem. The financial data that they each used in their market-based analyses under-priced the real market risks and uncertainties of investors. Consequently, the calculated results of these measures are biased, and in this case, they are biased to the low side. The mechanically calculated

results do not represent the necessary cost of capital sufficient to attract and maintain capital in the current markets.

Q. PLEASE EXPLAIN.

A. The financial crisis has created a market that is radically different from earlier periods. The results of the witnesses' calculations are misleading and do not accurately measure the cost of common equity. The results of their calculations have led to return recommendations that are below the market cost of capital. This is a threat to utility investors, and it is revealed by the pricing of utility common stocks in the current markets.

Q. WHAT DO YOU MEAN THAT THE THREATS TO UTILITY INVESTORS ARE REVEALED BY THE PRICING OF UTILITY COMMON STOCKS?

A. From a comparison of the utility common stock market prices to industrial prices, it is clear that investors have not valued utilities as favorably as industrial common equities over the past year. I have illustrated this comparison in Schedule DAM-R3. Since the middle of last summer, the S&P 500 index has increased between 25 and 30 percent. However, over the same period, the Dow Jones Utilities Index is up only 5 percent.

Q. YOU EXPLAINED THAT THE UTILITY INDEX HAS LAGGED THE S&P 500 INDEX SINCE MID-YEAR 2009. DO YOU KNOW WHY THE MARKET HAS DISTINGUISHED BETWEEN COMMON EQUITIES OF UTILITIES AND INDUSTRIALS DURING THIS PERIOD?

A. Different investors will have different interpretations of market values, but generally, the utilities have not shown attractive earnings prospects during

this period. For example, when reviewing the market's performance in 2009, *Value Line* stated regarding gas utilities on June 11, 2010,

> The macroeconomic climate continues to pressure this group. The dormant construction sector, reduced industrial demand, and unfavorable gas prices have hurt results in recent months. Weakness in the housing market has also weighed on demand in this industry. Indeed, new customer growth has been uninspiring of late. And existing customers are increasingly focusing on conservation, further dampening this sector's performance.[5]

III. RECENT MARKET VOLATILITY

Q. YOU CALLED THE CURRENT MARKET "VOLATILE." ARE YOU AWARE OF ANY EVIDENCE SHOWING THAT THE MARKET FOR UTILITY STOCKS IS ESPECIALLY VOLATILE?

A. Yes. I reviewed the Dow Jones utility price index since the beginning of 2006. It shows a sharp drop in the market valuation of utility common stocks in the mid-summer of 2008. I also reviewed the contemporaneous VIX, which is sometimes called the "fear index."[6] I have compared the utility price and the volatility indices in Schedule DAM-R4. Simple inspection of this chart shows that the measure of volatility prior to the market crisis in the fall of 2007 was generally close to 10. Since that time, it has stayed above that level. Moreover, the extremely high measures of market volatility, which were five to eight times the earlier measured levels of volatility, mirrored the sharp decline in utility market prices in

[5] "Natural Gas Utility Industry," *Value Line Investment Survey, June 11, 2010, p. 445.*

[6] Robert Whaley, the developer of the VIX (See: "Understanding the VIX," *Journal of Portfolio Management,* Spring 2009, pp. 98-105) described this index, as follows:
"The VIX is a forward-looking index of the expected return volatility of the S&P 500 Index over the next 30 days and is implied from the prices of S&P 500 index options, which are predominantly used by the market as a means of insuring the value of stock portfolios. High levels of VIX reflect investor anxiety regarding a potential drop in the stock market, just as flood insurance premiums reflect homeowner anxiety about possible inclement weather."[6]

the winter of 2008-09. Clearly, the financial market crisis has dramatically altered the utility investors' perceptions of risk and uncertainty. The interpretation of market data from the more stable before-the-financial-crisis period cannot be the same as for data generated during the financial crisis, and neither Mr. Gorman nor Mr. Marevangepo adequately addressed these major market changes.

Q. YOU STATED THAT MR. GORMAN AND MR. MAREVANGEPO EACH IGNORED THE MARKET VOLATILITY IN THE CURRENT MARKETS. WAS THIS IMPORTANT TO THEIR ANALYSES?

A. Yes.

Q. WHY?

A. They each used data generated by this recent very volatile market and applied these data in market-based measures, namely the DCF and CAPM cost of capital methods.

Q. YOU HAVE IDENTIFIED A MEASURED INCREASE IN MARKET VOLATILITY SINCE THE FINANCIAL MARKET CRISIS. DOES THAT AFFECT THE COST OF UTILITY COMMON EQUITIES?

A. Yes.

Q. PLEASE EXPLAIN.

A. Investors, as a group, are inherently risk averse. If they perceive an increase in market volatility, or in this case, any increase in the "fear index," this will increase the common equity risk premium ("ERP"). The empirical evidence from this three and one-half year period illustrates that this undoubtedly has been the case. This puts upward pressure on the current cost of utility common stock.

IV. INVESTOR UNCERTAINTY

Q. IN ADDITION TO YOUR SHOWING A CONTEMPORANEOUS INCREASE IN MARKET VOLATILITY AND A DECREASE IN UTILITY MARKET VALUES OF COMMON STOCK, YOU ALSO SHOWED THAT THE UTILITY INDEX HAS NOT EXPERIENCED THE SAME GROWTH AS THE INDUSTRIAL INDEX OVER THE PAST YEAR. WHAT DO YOU BELIEVE CAUSED THE RELATIVELY POOR MARKET VALUATION OF UTILITY COMMON STOCKS IN RECENT MARKETS?

A. As I stated previously, some analysts have viewed the earnings prospects of utilities unfavorably. If earnings prospects are not favorable during a period of higher market uncertainty, one can only expect the market values of utility equities to decline relative to other common equities.

Q. WHAT IS YOUR UNDERSTANDING SOME OF THE CONCERNS OF UTILITY INVESTORS?

A. The prospect of recovery from the economic recession, with its domestic and global implications, is a dominant economic consideration for infrastructure industries such as utilities. The uncertainty of the pace of economic recovery is a risk to utility revenues. The implications of the rising federal deficit and changes to monetary and fiscal policies or defaults on sovereign debt raising interest rates are risks to cost structures of utilities. The financial crisis in Greece demonstrated the current sensitivity and interconnectedness of the world credit markets. For example, the yields on Portugal's bonds spiked to a level that was "…more than eight percentage points over what ultra-safe Germany pays

to borrow for two years."[7] Despite the low U. S. short-term rates resulting from stimulative policies, the threat of increasing interest rates in the longer term is a risk to common equity investors.

Q. WAS THERE A REACTION IN THE U.S. STOCK MARKET TO THE SITUATION IN GREECE?

A. Yes. The recent U.S. stock market indicators declined, at least partially, in response to the threat of Greece defaulting on debt issues. They then recovered sharply.

Q. DOES THIS MEAN THAT THIS DEFAULT THREAT IS NO LONGER IMPORTANT TO INVESTORS?

A. No. If anything, the wild movements of the various world stock markets at the time of Greece's debt crisis demonstrate investors' market volatility and investor sensitivity to this threat of default. These events showed how rapidly the equity markets now respond to such happenings. Investors are now mindful of the threat that the Greek austerity program and the "bail-out" may fail. "Investors' apparent short-term relief was tempered by some economists' worries that in the longer term, the agreement's pledge to bail out troubled members saddle the Euro zone with gargantuan debts."[8]

Cautious investors are now watching developments in even larger countries, such as Ireland, Italy, Portugal and very recently Spain. Fitch recently downgraded its debt. In fact, larger countries, with larger amounts of debt outstanding, are a greater threat to the stability of world equity

[7] *Wall Street Journal,* May 11, 2010.
[8] *Wall Street Journal,* May 11, 2010.

markets. The BBC News reported, "The International Monetary Fund (IMF) has raised 'fresh concerns' about Spain's economy, saying 'far-reaching' reforms are needed to ensure recovery."[9]

V. DATA LIMITATIONS ON THE DCF METHOD

Q. MR. GORMAN AND MR. MAREVANGEPO BOTH APPLIED THE DCF METHOD FOR ESTIMATING THE COST OF COMMON EQUITY. HOW WERE THE DCF CALCULATIONS AFFECTED BY THE CURRENT MARKET CONDITIONS?

A. Although the DCF method is theoretically sound, when market prices gyrate dramatically over such a short time span, it is illogical to assume that each of these market prices is a carefully calculated discounted value of an anticipated stream of returns. However, both Mr. Gorman and Mr. Marevangepo necessarily made this implied assumption in their DCF analysis. The recent volatility of the financial markets is, among other things, indicative of investors' difficulty in determining accurate and appropriate evaluations of risk. Any DCF analysis may have conceptual or data problems, but because of the recent financial markets, the risk of misleading results is heightened.

VI. CURRENT LIMITATIONS TO THE CAPM METHOD

Q. GIVEN THE RECENT AND CURRENT MARKETS, ARE THERE CONSIDERATIONS WHEN USING THE CAPM METHOD TO ESTIMATE THE COST OF COMMON EQUITY?

[9] BBC News, "IMF Raises Fresh Concerns about the Spanish Economy," May 26, 2010.

A. Although under more normal market conditions, the CAPM can be a relatively stable measure of the cost of common stock, in the current markets, it is a very unreliable measure of the cost of common equity. It under prices market risk, and the low administered "risk free" rate is not a market rate.

Q. PLEASE EXPLAIN.

A. The CAPM calculations for a company are very sensitive to the beta used in the analysis. Under any circumstance, the estimated beta is a single, measure of risk; it measures market volatility only. Consequently, the CAPM will not incorporate the many current market risks into the cost of common equity. Also, in the current debt markets, with the Federal Reserve holding U.S. Treasury rates at historically low levels, the use of U.S. Treasuries as a benchmark "risk free" rate is illogical. It is a policy driven, administered rate and does not represent a market rate between a willing buyer and seller. In fact, the low level of this policy determined rate is a measure of the unwillingness of banks to offer credit and borrowers to seek credit.

Q. WHY IS THE POLICY INFLUENCE ON THE BENCHMARK "RISK FREE" RATE IMPORTANT TO THE CAPM?

A. The administered "risk free" rate directly reduces the resulting CAPM calculations, biasing them downward.

Q. HAVE OTHER ANALYSTS NOTED THE PROBLEM OF USING THE ADMINISTERED, POLICY DETERMINED RATES IN A CAPM ANALYSIS AT THE PRESENT TIME?

A. Yes. For example, Roger Grabowski, Managing Director of Duff & Phelps, recognized how the low rates of U.S. Treasury bonds would result in "unreasonably low" estimates of the cost of equity capital when using the CAPM:

> U.S. Treasury bond ("T-bond") yields, the typical benchmark used in either the Capital Asset Pricing Model ("CAPM") or the Build-up methods of estimating COEC, were temporarily low for several months, resulting in unreasonably low estimates of COEC as of the important valuation date, December 31, 2008.[10]

Q. HAS THE FINANCIAL CRISIS HAD OTHER EFFECTS UPON THE DATA USED IN A CAPM ANALYSIS?

A. Yes. A CAPM calculation requires the measure of a risk premium, but the Federal Reserve's interest rate policies and the investors' changing perceptions of investment risk have undoubtedly altered the equity risk premium.

Q. DOES THE STAFF WITNESS RECOGNIZE THIS?

A. I think so. Mr. Marevangepo, without diagnosing the cause, noted a problem with historical risk premiums in his CAPM analysis. He stated, at page 9, lines 8-11, of his report, "Although its CAPM analysis resulted in lower estimated costs of common equity than the DCF analysis, Staff did not adjust its ROE recommendation downward due to Staff's continued concerns about the reliability of its CAPM results when using historical earned return spreads as an estimate of the current equity risk premium."

Q. WHAT IS THE IMPACT ON THE EQUITY RISK PREMIUM?

[10] Grabowski, Roger J., "Cost of Capital Estimation in the Current Distressed Environment," Journal of Applied Research in Accounting and Finance, Volume 4, Issue 1, pp. 31-39.

A. Grabowski explained the impact on the equity risk premium, in the following way:

> …the expected equity risk premium ("ERP"), the rate of return expected on a diversified portfolio of common stocks in excess of the rate of return on an investment in T-bonds, has likely increased as the broad stock market level has declined.[11]

Q. WHAT DO YOU CONCLUDE FROM THIS?

A. If the beta, the "risk free rate" and equity risk premium are flawed measures of market risks, the CAPM results are also flawed.

Q. ARE YOU AWARE OF OTHER REASONS THAT THE CAPM METHODOLOGY UNDERESTIMATES THE COST OF COMMON EQUITY?

A. Yes. Many analysts have concluded that when the beta of the company being evaluated is less than one, the CAPM underestimates the cost of capital.[12] In this instance, all of the LDCs used by Mr. Gorman and Mr. Marevangepo in their testimonies have betas less than one, but neither witness compensated for the inherent bias of the beta.

Q. WHAT ARE THE IMPLICATIONS OF THESE PROBLEMS WITH MR. GORMAN'S AND MR. MAREVANGEPO'S CAPM ANALYSIS?

A. Just as Mr. Marevangepo ignored the CAPM calculations, the Commission should ignore Mr. Gorman's CAPM analysis.

[11] *Ibid*.

[12] Liztenberger, Robert, Krishna Ramaswamy, and Howard Sosin, "On the CAPM Approach to the Estimation of A Public Utility's Cost of Equity Capital," *Journal of Finance*, Volume XXXV, Number 2, May 1980, pp. 369-387.

VII. MR. GORMAN'S DIRECT TESTIMONY

Q. IN ADDITION TO THE PROBLEMS THAT YOU ADDRESSED PREVIOUSLY, DO YOU HAVE SPECIFIC CONCERNS WITH MR. GORMAN'S DIRECT TESTIMONY?

A. Yes. In addition to ignoring the effects of the current market conditions on his CAPM, Mr. Gorman also mechanically applied several conceptually deficient approaches to his DCF and Risk Premium analyses that resulted in his producing unrealistically low estimates of the costs of common equity with these measures as well.

Q. HOW CAN YOU BE CERTAIN THAT MR. GORMAN DID NOT ACCOUNT FOR THE CURRENT MARKET CONDITIONS?

A. Mr. Gorman did not even acknowledge the current market volatility and the financial crisis; he applied no compensating adjustments to his cost of equity estimates or methods. In fact, he never explained how he calculated a lower cost of capital in the current, i.e., 2010, volatile markets than he calculated in the more stable market of 2007, using similar methodologies. For a characterization of the market conditions in which Mr. Gorman developed these two comparative returns, see DAM-R5. He subsequently recommended a lower allowed return on common equity in 2010 for Laclede in the current case than in Laclede's previous rate case

Q. WHAT AFFECTED MR. GORMAN'S DCF CALCULATIONS THAT LED TO HIS LOW ESTIMATES OF THE COST OF COMMON EQUITY?

A. Mr. Gorman applied three different DCF methodologies, and each has conceptual weaknesses. In his Schedule MPG-4, for example, he reported

an average 13-week price for his seven comparable companies. Then he averaged these seven averages together to develop a representative market price for DCF calculations. This average of averages hides the market volatility even during the brief period that he selected for his analysis. As Mr. Gorman correctly stated at page 13, lines 5-7, "The DCF model posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return or cost of capital." However, all of the varying market prices in a brief period cannot represent carefully considered discounted present value of anticipated streams of returns consistent with his DCF description. He made no attempt to evaluate or compensate his calculated results for the market volatility and changed market uncertainties.

Q. IS THERE ANY EVIDENCE THAT MR. GORMAN'S DCF METHODOLOGY PRODUCED AN UNREASONABLY LOW ESTIMATE OF THE COST OF COMMON STOCK FOR AN LDC UTILITY?

A. Yes. Mr. Gorman (at Schedule MPG-9) reported an average "Sustainable Constant Growth DCF" result of 10.13 percent. However, to calculate this result, (which he reported at Gorman, Direct Testimony, page 20, line 9), he reported an average "ROE" for his comparable LDCs of 12.20 percent (Column 4, Schedule MPG-8, Page 1 of 2). That is, he reported a 12.20 percent return for his comparable companies in order to calculate a DCF result of 10.13 percent. Illogically, he then used this lower calculated return to develop his recommended allowed return on common equity for Laclede.

Q. YOU CALLED MR. GORMAN'S REPORTING OF AN AVERAGE RETURN FOR HIS COMPARABLE COMPANIES OF 12.20 PERCENT AND USING IT TO CALCULATE A RETURN FOR LACLEDE OF 10.13 PERCENT "ILLOGICAL". WHY IS THIS ILLOGICAL?

A. Using larger actual returns to mechanically calculate a lower result as an estimate of a market return is illogical. In addition, it is inconsistent with the standard that he set forth for determining an allowed return for Laclede. Mr. Gorman stated, at lines 16-17, page 11, of his Direct Testimony that the "…authorized return should…be commensurate with returns investors could earn by investing in other enterprises of comparable risks." He never reconciled the apparent inconsistencies between this stated standard, the reported LDC earned returns for the comparable LDCs and his ultimately calculated DCF result.

Q. DID YOU DETERMINE THAT MR. GORMAN'S RISK PREMIUM ANALYSIS ALSO HAS CONCEPTUAL PROBLEMS?

A. Yes. Mr. Gorman's risk premium analysis was not a measure of the market risk premium. He stated at lines 4-5, of page 23 of his Direct Testimony, "This model [Risk Premium] is based on the principle that investors require a higher return to assume greater risk". At page 23, lines 13-14, he stated "The difference between the *required return on common equity* [emphasis added] and the bond yield is the risk premium." However, he never estimated the market "required return on common equity". Instead, he calculated the spread between the average "authorized" LDC returns since 1986 with average yields on 20-year Treasury Bonds and "A" rated utility bonds. This is not an estimate of a

market-based equity risk premium. It does not recognize the impact of the current financial crisis or the impact of the market uncertainties on investors. Moreover, it does not identify the risk premium for any specific company, including Laclede, and only by coincidence could it represent the market risk premium of Laclede's common stock.

VIII. MR. MAREVANGEPO'S REPORT

Q. WHAT POINTS CONCERNING MR. MAREVANGEPO'S REPORT DO YOU WISH TO REBUT?

A. As I stated previously, I concur with Mr. Marevangepo's rejection of the CAPM results in the current market. With regard to his DCF analysis, by averaging many equally weighted growth rates together, he has masked the growth rates on returns that investors may reasonably be expecting. For example, he averaged dividend growth rates equally with earnings per share growth rates, although dividend growth ignores any investor expectations of capital gains. He averaged book value per share growth rates, although investors may have little concern about book value per share growth. He failed to reconcile how six of the seven of his comparable LDCs are expecting to earn more than even the top of his recommended range in 2010, (See Marevangepo, Testimony, Schedule 17, column 7). He reported an average expected return for his comparable LDCs of 12.00 percent.

His recommendation does not square with his stated objective (Marevangepo, Report, page 11, lines 29-30), "A fair return is consistent with that realized from an investment in comparable companies, that is, an investment of comparable risk" (Marevangepo, Report, page. 19, lines 1-

2). Mr. Marevangepo described the group of comparable companies, as follows: "This list was reviewed for the following criteria to develop a proxy group comparable in risk to Laclede Gas," but his recommended allowed return is much lower that the return expected for this group.

IX. CURRENT MARKET RETURNS

Q. CAN YOU DETERMINE WHAT INVESTORS ARE LIKELY TO EXPECT FROM NATURAL GAS UTILITIES IN THESE EVOLVING MARKETS?

A. As I illustrated in my Direct Testimony, *Value Line* expects the comparable LDCs in my testimony to earn an average 11.7 percent on common equity in 2010. As Schedule DAM-R6 shows, the 2010 common equity returns for Mr. Marevangepo and Mr. Gorman's comparable companies are 12.20 percent and 12.00 percent respectively.

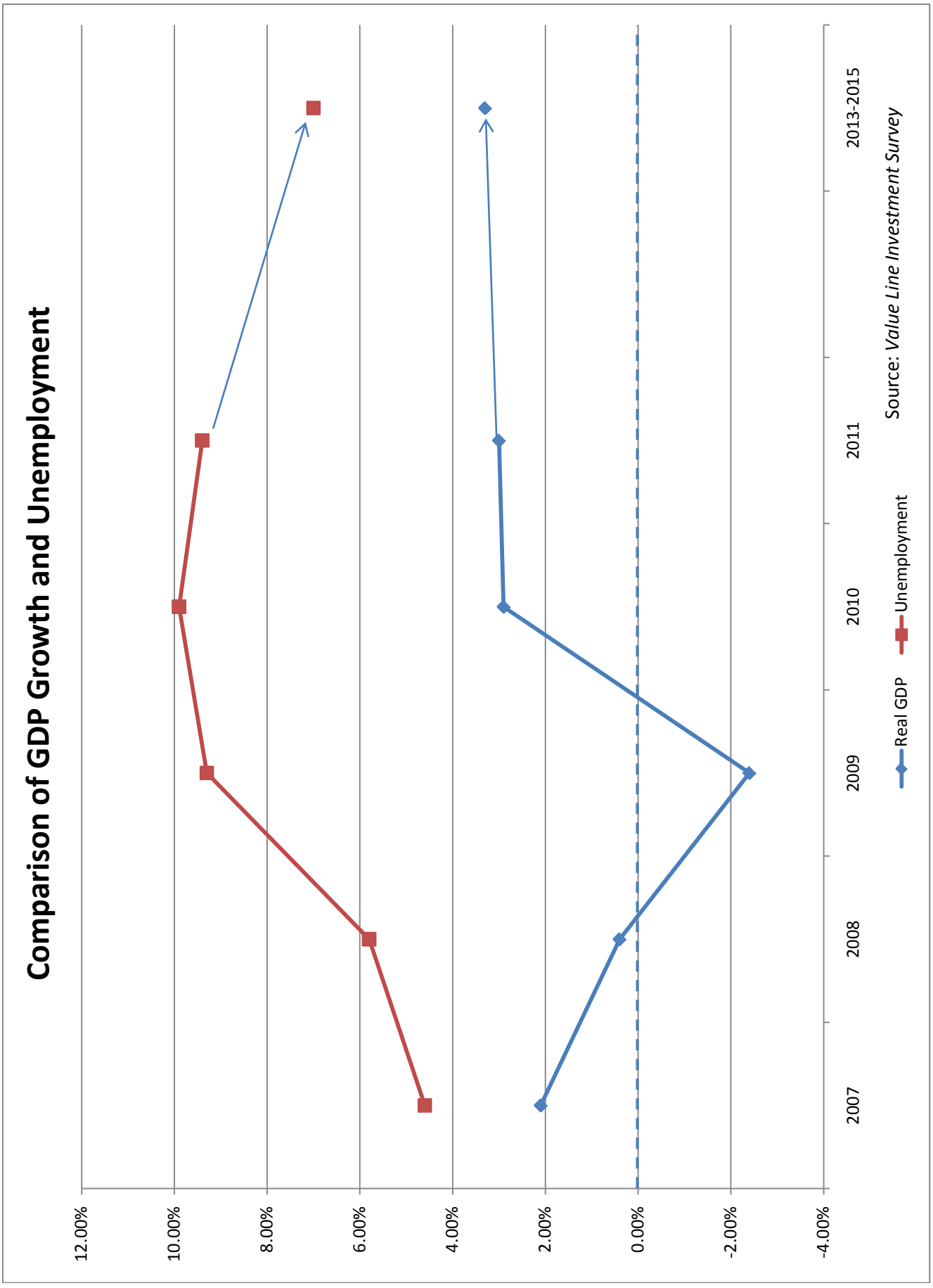
X. SHORT-TERM DEBT IN LDC CAPITAL STRUCTURE

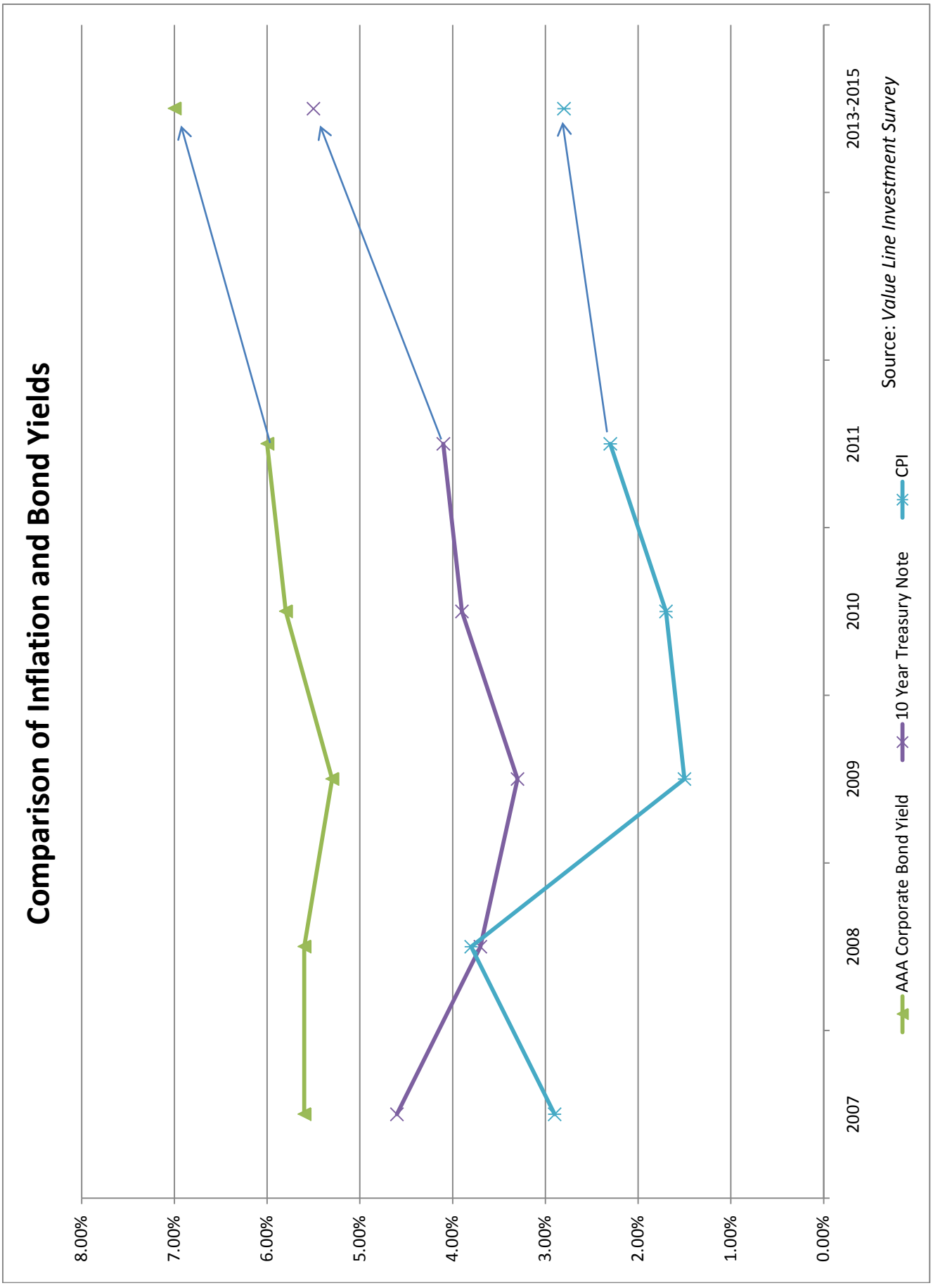
Q. YOU MENTIONED CONCERNS REGARDING THE CAPITAL STRUCTURE THAT IS APPROPRIATE FOR LACLEDE IN THIS CASE. WHAT ARE THESE CONCERNS?

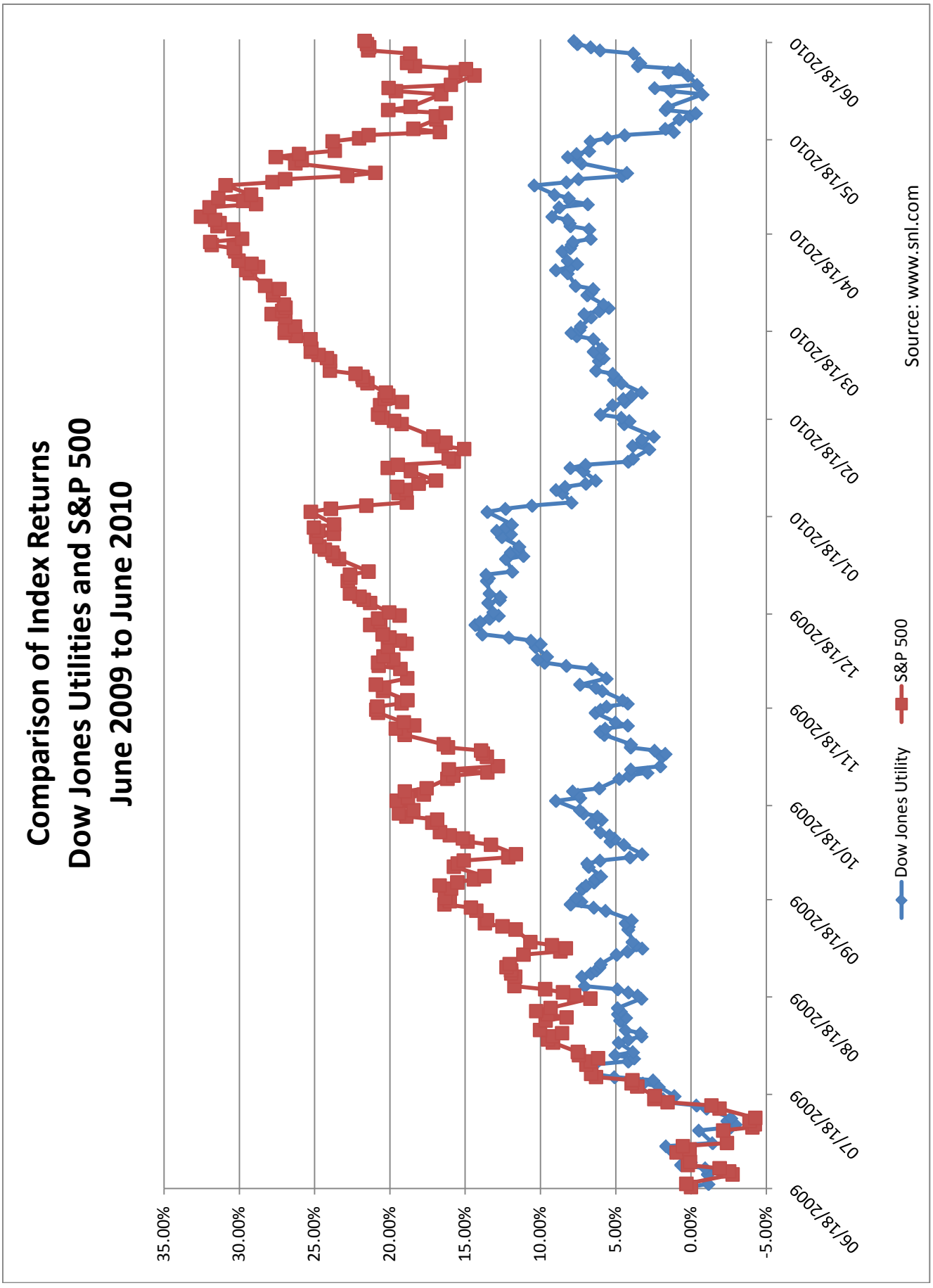
A. Staff's recommended capital structure of 57.41 percent common equity and 42.59 percent long-term debt is consistent with the common practice of LDCs that use short-term debt for the purchase of gas supplies. The levels of short-term debt fluctuate seasonally and are typically not a permanent capital source of funds that support system capacity. Mr. Gorman's inclusion of short-term debt as part of Laclede's permanent capital is inconsistent with this economic principle.

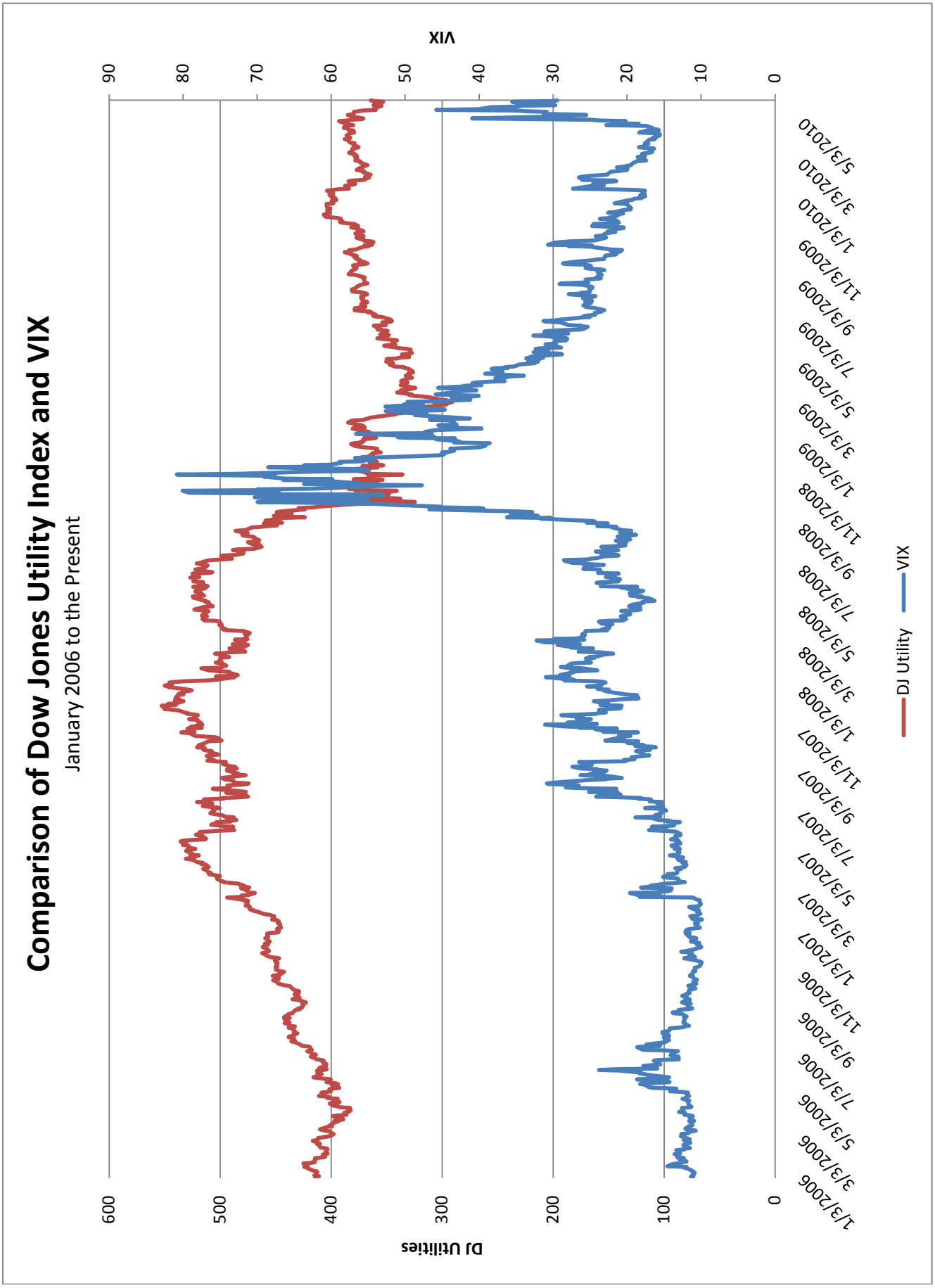
Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?

A. Yes, it does.


Comparison of GDP Growth and Unemployment
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
2007
2008
2009
2010
2011
2013-2015
Real GDP
Unemployment
Source: Value Line Investment Survey


Comparison of Inflation and Bond Yields
8.00%
7.00%
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
2007
2008
2009
2010
2011
2013-2015
AAA Corporate Bond Yield
10 Year Treasury Note
CPI
Source: Value Line Investment Survey


Comparison of Index Returns
Dow Jones Utilities and S&P 500
June 2009 to June 2010
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
06/18/2009
07/18/2009
08/18/2009
09/18/2009
10/18/2009
11/18/2009
12/18/2009
01/18/2010
02/18/2010
03/18/2010
04/18/2010
05/18/2010
06/18/2010
Dow Jones Utility
S&P 500
Source: www.snl.com


Comparison of Dow Jones Utility Index and VIX
January 2006 to the Present
DJ Utilities
VIX
DJ Utility
VIX
600
500
400
300
200
100
0
90
80
70
60
50
40
30
20
10
0
1/3/2006
3/3/2006
5/3/2006
7/3/2006
9/3/2006
11/3/2006
1/3/2007
3/3/2007
5/3/2007
7/3/2007
9/3/2007
11/3/2007
1/3/2008
3/3/2008
5/3/2008
7/3/2008
9/3/2008
11/3/2008
1/3/2009
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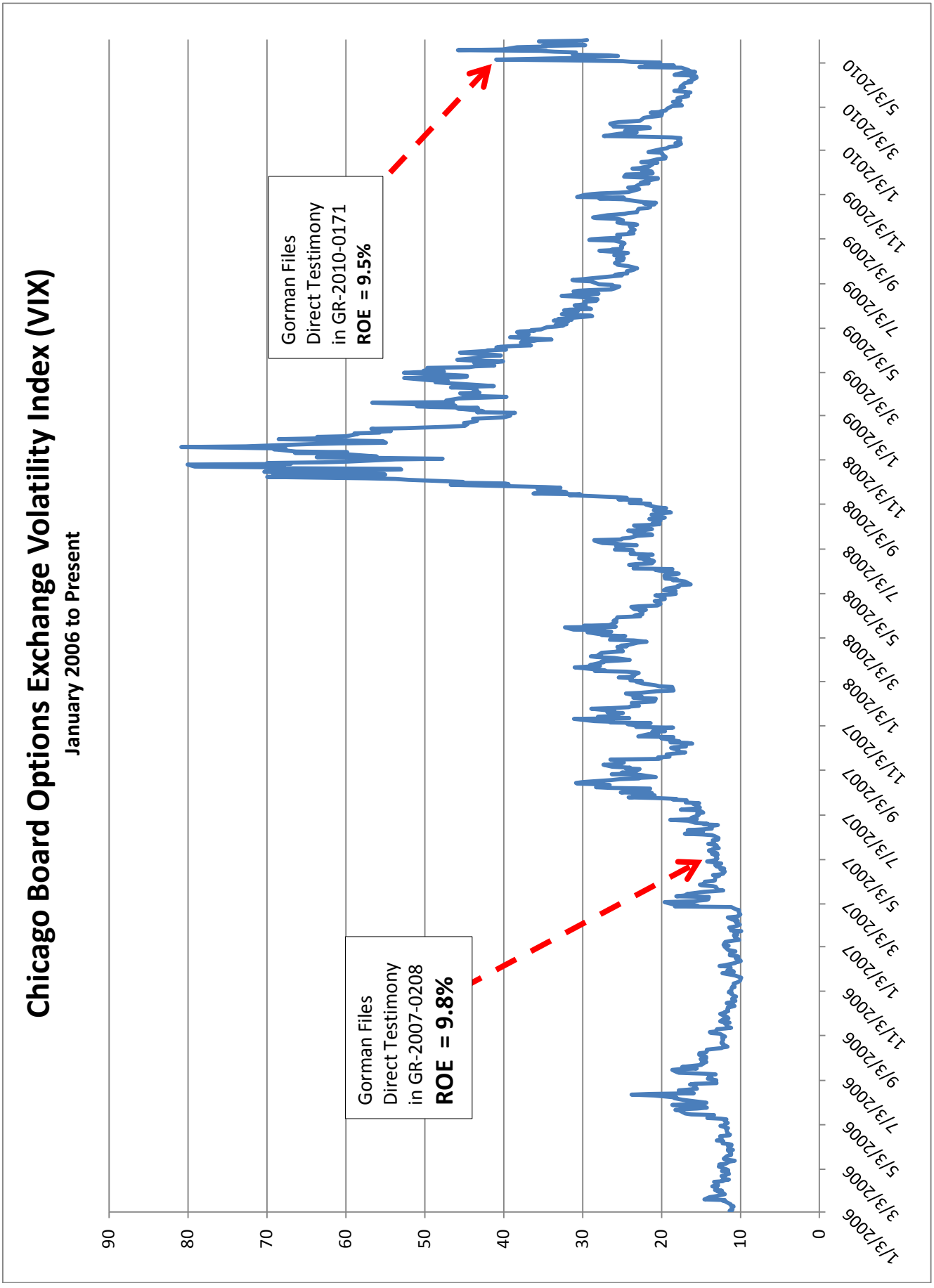
7/3/2009
9/3/2009
11/3/2009
1/3/2010
3/3/2010
5/3/2010


Chicago Board Options Exchange Volatility Index (VIX)
January 2006 to Present
Gorman Files
Direct Testimony
in GR-2007-0208
ROE = 9.8%
Gorman Files
Direct Testimony
in GR-2010-0171
ROE = 9.5%
90
80
70
60
50
40
30
20
10
0
1/3/2006
3/3/2006
5/3/2006
7/3/2006
9/3/2006
11/3/2006
1/3/2007
3/3/2007
5/3/2007
7/3/2007
9/3/2007
11/3/2007
1/3/2008
3/3/2008
5/3/2008
7/3/2008
9/3/2008
11/3/2008
1/3/2009
3/3/2009
5/3/2009
7/3/2009
9/3/2009
11/3/2009
1/3/2010
3/3/2010
5/3/2010

Laclede Gas Company

Expected Returns for Marevangepo and Gorman's Comparable Companies

	Gorman ROE	Marevangepo ROE
AGL Resources, Inc.	N/A	12.00%
Atmos Energy Corp.	N/A	9.00%
New Jersey Resources	16.45%	15.00%
Nicor, Inc.	11.30%	N/A
Northwest Natural Gas	11.02%	11.00%
Piedmont Natural Gas	13.27%	13.00%
South Jersey Industries, Inc.	14.44%	13.50%
Southwest Gas Corp.	8.83%	N/A
WGL Holdings	10.09%	10.50%
Average	12.20%	12.00%

Sources:
Gorman, Schedule MPG-8, pg. 1 of 2
Marevangepo, Schedule 17

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's	)	
Tariff to Revise Natural Gas Rate Schedules	)	Case No. GR-2010-0171

AFFIDAVIT

STATE OF OKLAHOMA	)	
	)	SS.
COUNTY OF OKLAHOMA	)	

Donald A. Murry, of lawful age, being first duly sworn, deposes and states:

1. My name is Donald A. Murry. My business address is 5555 North Grand Boulevard, Oklahoma City, Oklahoma 73112; and I am Economist with C. H. Guernsey and Company.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony on behalf of Laclede Gas Company.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Donald A. Murry

Subscribed and sworn to before me this 24th day of June, 2010.

SHARON EPPERLY NOTARY PUBLIC #05006679 EXP. 07/22/13 STATE OF OKLAHOMA

Notary Public