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MISSOURI GAS ENERGY

GR-2014-0007

REBUTTAL TESTIMONY

OF

STEVEN P. RASCHE

MARCH 2014

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REBUTTAL TESTIMONY OF STEVEN P. RASCHE

1 **Q. Please state your name and business address.**

2 A. My name is Steven P. Rasche, and my business address is 720 Olive Street, St. Louis,
3 Missouri 63101.

4 **Q. What is your present position?**

5 A. I am Executive Vice President for The Laclede Group and the Chief Financial Officer.

6 **Q. Please state how long you have held your position and briefly describe your
7 responsibilities.**

8 A. I was elected to my current position effective October, 2013. In this position, I am
9 responsible for the Company's accounting, financial reporting, treasury and capital
10 market activities, tax, and investor relations. I also provide executive oversight of
11 Laclede Energy Resources and our corporate development and strategic planning
12 activities.

13 **Q. Will you briefly describe your experience with Laclede prior to becoming Chief
14 Financial Officer?**

15 A. I joined Laclede in November 2009 as Vice President – Finance and was elected Chief
16 Financial Officer of Laclede Gas Company in May 2012. Prior to that time, I have held
17 various executive positions in my twenty-nine year career at companies in healthcare,
18 public safety and transportation industries, most recently as the CFO of TLC Vision
19 Corporation and Public Safety Equipment, Inc.

20 **Q. What is your educational background?**

21 A. I graduated from the University of Missouri, Columbia with a Bachelor's of Science in
22 Accountancy. I subsequently received a Master's of Business Administration, with

1 concentrations in Finance and Marketing from the J. L. Kellogg Graduate School at
2 Northwestern University.

3 **Q. Have you previously filed testimony before this Commission?**

4 A. Yes, In GR-2013-0171.

5 **PURPOSE OF TESTIMONY**

6 **Q. What is the purpose of your testimony?**

7 A. On January 29, 2014, the Staff filed its Cost of Service Report. Included with the report
8 was a recommendation from Zephania Marevangeo regarding the appropriate Return on
9 Equity and Return on Rate Base. The same day, the Office of Public Counsel (“OPC”)
10 filed the Direct Testimony of Michael P. Gorman with its own ROE and RORB
11 recommendations (details can be found on Rebuttal Schedule GWB-2 attached to the
12 rebuttal testimony of Company Witness Glenn W. Buck). The purpose of my testimony is
13 to rebut these witnesses by presenting evidence addressing: (a) the detrimental impacts of
14 Staff and OPC proposals on the Company’s financial strength and ability to attract
15 capital, as well as the inconsistent logic used to support these assertions; (b) the
16 fundamental inconsistency of Staff and OPC proposals with the financial imperatives
17 underlying the acquisition; and (c) capital structure updates that impact the weighted
18 average costs of capital calculations used by the Staff and OPC. Company Witnesses
19 Ahern and Buck will also be addressing aspects of these irresponsible recommendations.

20 **DETRIMENTAL IMPACT ON COMPANY’S**
21 **FINANCIAL STRENGTH AND ABILITY TO ATTRACT CAPITAL**

22
23 **Q. Please describe the position of the parties as it relates to ROE and capital structure.**

24 A. Laclede’s initial filing uses a capital structure and ROE approach that is consistent with
25 stipulation and agreements approved and orders issued by the Commission in both

1 Laclede and MGE general rate cases. Specifically, we based our filing, consistent with
2 past practice, on The Laclede Group capital structure and weighted average cost of debt,
3 which had been updated after the closing of the MGE purchase to an historically low
4 4.35%. In this case, our ROE witness, Pauline Ahern, supported a 10.25% ROE. With
5 the Laclede Group capital structure of 53.6%, and the cost of debt and ROE discussed
6 above, an appropriate pre-tax cost of capital in this case would be 10.936%. However, in
7 the Stipulation in Case No. GM-2013-0254, the Company agreed that it would not
8 sponsor a pre-tax cost of capital greater than 10.224%, which was the figure used in the
9 last MGE rate case. In order to reduce its cost of capital to meet the agreed upon ceiling,
10 the Company made two adjustments. First, it reduced its sponsored ROE to 9.7%, which
11 was the same ROE agreed to for ISRS purposes in Laclede's 2013 Rate Case, Case No.
12 GR-2013-0171. Second, Laclede also lowered the equity percentage (to 51.5%) until the
13 weighted cost of capital equaled 10.224%.

14 **Q. What is your understanding of Staff's position on this issue?**

15 A. Staff filed based on the Laclede Group capital structure and advocated an 8.9% ROE (at
16 its high end) – a recommended ROE that is well outside the mainstream of authorized
17 returns granted both here and in other jurisdictions. Instead, of using the parent company
18 Laclede Group's embedded cost of debt, as it normally would, the Staff inexplicably
19 utilized only the debt that Staff attributed directly to the MGE asset acquisition (3.12%).

20 **Q. What is OPC's position on this issue?**

21 A. For its part, OPC witness Gorman used the Laclede Group's consolidated cost of debt.
22 However, he manipulated capital structure to reduce costs in a very transparent manner.
23 Witness Gorman first used the Laclede Gas capital structure, rather than The Laclede

1 Group's capital structure, and then removed goodwill from the capital structure so as to
2 ensure that Laclede did not recover the premium paid for MGE. However, before
3 removing \$247 million in goodwill, witness Gorman first assigned it 100% equity and
4 0% debt. This maneuver greatly skewed the capital structure to 45% equity and 55%
5 debt, a mix that cannot be reconciled with either Laclede Gas, The Laclede Group or
6 reality.

7 **Q. Which capital structure should be applied in this case?**

8 A. The parent company capital structure has been consistently applied in Laclede and MGE
9 rate cases. The consolidated Laclede Group capital structure was applied in Laclede Gas
10 general rate cases including GR-2010-0171 and GR-2007-0208. The last two MGE
11 general rate cases have used the consolidated capital structure of its then-parent company
12 Southern Union (see Case Nos. GR-2009-0355 and GR-2006-0422). The Company
13 filing in this case remains consistent with this practice, and Staff has agreed with that
14 approach. OPC has recommended using the Laclede Gas capital structure, and the
15 Company opposes this approach as both inconsistent with past practice and precedent.

16 A. **Are the Staff and OPC ROE recommendations in line with what market
17 expectations would be?**

18 A. Absolutely not. Although Company witnesses Pauline Ahern and Glenn Buck will
19 address these matters in more detail, I have been advised that the Staff recommended
20 return (at the *high* end) is lower than **any** ROE adopted by any Commission in the United
21 States in either 2012 or 2013 (as reported in RRA). According to RRA, the mean and
22 median ROEs authorized in 2013 and 2012 respectively were 9.68% (mean) 9.7%

1 (median) in 2013 and 9.94% (mean) and 10% (median) in 2012. OPC's recommendation
2 is even more deficient when compared to industry norms and market expectations.

3 **Q. Is Staff's use of only those incremental debt costs it attributes to the acquisition**
4 **appropriate?**

5 A. No. It is completely inappropriate for numerous reasons. First, I have been advised by
6 legal counsel that such an approach is inconsistent with the terms of the Stipulation and
7 Agreement in Laclede's recent rate case (GR-2013-0171) because it effectively seeks to
8 re-trade the result that was negotiated in that case. It does so by artificially decreasing
9 the debt costs that Staff asserts should be recognized in this case to "make up" for a
10 reduction in debt costs that Staff says it could not obtain in the negotiation of the Laclede
11 rate case settlement. Second, Staff's utilization of what it attributes as MGE acquisition
12 related debt (3.12%) is inconsistent with how the debt was issued or with the collateral
13 that supports those first mortgage bonds (FMB's). The acquisition of MGE by Laclede
14 Gas was a purchase of assets, and at the date of purchase, the assets of MGE fell
15 underneath the mortgage indenture for Laclede Gas. As a result, when the Company
16 issued the FMB's, they were collateralized by the assets of the entire utility business, not
17 strictly the MGE business. Therefore, the credit rating agencies evaluated the debt
18 offering, and the debt holders purchased the bonds, with the understanding that payment
19 of principal and interest on those bonds was supported by the assets and the cash flows of
20 the entire entity. That is one reason why the interest rate was so favorable, in addition to
21 the historically low underlying treasury rates. To imply that the investors were only
22 buying based on the MGE system does not match up with market expectations and would
23 make future investors concerned about "earmarking" specific issues to specific assets. I

1 should also note that these favorable interest rates were also the result of the Laclede
2 Group's successful hedging strategy that "locked in" interest rates well in advance of the
3 date the debt was actually issued. Although these hedges were performed at the parent
4 company level, the Laclede Group did not hesitate to pass along to its regulated
5 customers the nearly \$21 million in hedging gains that resulted from these transactions.

6 Q. **Mr. Gorman recommended a 55% debt ratio after making his equity adjustment.**

7 **How does this compare with the actual transaction and market expectations?**

8 A. In determining the capital structure, OPC witness Gorman has proposed to remove the
9 acquisition premium or goodwill. The only reason to do so is if one assumes that the
10 goodwill asset was financed in some manner different from the rest of the assets owned
11 by Laclede. In Mr. Gorman's case, he would have the Commission believe that the
12 goodwill asset was financed 100% by equity and 0% by debt. When he removed \$247
13 million in equity from the capital structure, he turned the structure on its head, dropping
14 the equity ratio from 54% to 45%, and conversely raising debt from 46% to 55%.

15 Q. **Is Mr. Gorman's adjustment appropriate?**

16 A. No. At the outset, I should re-emphasize that Mr. Gorman's adjustment is nothing more
17 than an artificial and, in my view, rather obvious attempt to use the fact that the Company
18 paid an acquisition premium to affirmatively reduce rates below the level they would
19 have been at had the Company not paid such a premium. Again, I have been advised by
20 legal counsel that such an adjustment is flatly inconsistent with the provision of the
21 Stipulation and Agreement in the MGE acquisition case that says the acquisition
22 premium is to have *no* impact on rates. Moreover, Mr. Gorman's adjustment is also
23 fundamentally flawed because it is based upon the mistaken assumption that the debt

1 must be supported by MGE's hard assets, and therefore equity investors were satisfied
2 with investing in goodwill. This assumption has no basis in reality for a number of
3 reasons. First, when equity investors invest they are seeking a return on the assets of the
4 entire company, and, as an intangible asset, goodwill does not in and of itself create
5 value. It is the combination of all assets that produce the return that the equity investor is
6 seeking. As such, our successful debt and equity offerings focused on the growth and
7 profitability of the entire organization. Secondly, were there any validity to his approach,
8 it would logically follow that the resulting, highly leveraged capital structure would cause
9 the cost of interest used in his theoretical approach to be significantly higher than that
10 actually achieved by the Company. Our communications with the financial community
11 during the entire process consistently referenced a reasonable and sustainable long-term
12 capitalization, consistent with Laclede's traditional and long-standing approach of
13 maintaining a fairly conservative capital structure. In fact, that is one of the primary
14 reasons why we have been able to issue \$575 million of debt since December of 2012 at
15 an effective rate of 3.17% (including the substantial benefits related to the interest rate
16 hedges). It is highly unlikely that a company with a 55% debt to capital ratio, as Mr.
17 Gorman now proposes, could issue debt on anywhere close to such favorable terms.

18 **Q. How do you believe that the financial markets would receive either of these**
19 **recommendations if approved by the Commission?**

20 **A.** If either of these irresponsible positions were adopted, I believe that it would make access
21 to the capital markets (both debt and equity) substantially more difficult and at a much
22 higher cost.

1 Q. **Can you provide an update on the premium paid for MGE and also the current**
2 **average interest rate?**

3 A. Yes. At September 30, 2013, the end of the first month after the MGE acquisition closed,
4 we estimated the total premium to be \$247 million. Subsequent to that date, we have
5 further refined that estimate as we have completed the allocation of the purchase price
6 and resolved several outstanding contingencies, including the conclusion of the purchase
7 price adjustment as defined in the Purchase and Sale Agreement that documented the
8 transaction. As of mid-February, the premium has been revised downward to \$213
9 million. This is a significant and favorable movement and serves to further reduce the
10 risk of any future impairment of this intangible asset.

11 Q. **Did Laclede remove the acquisition premium or goodwill from The Laclede Group**
12 **capital structure?**

13 A. No. Laclede treated all assets equally and therefore did not need to remove goodwill
14 from the capital structure because it would not have had an effect. However, Laclede did
15 ensure that its MGE rate base did not include goodwill so that the acquisition premium
16 had no effect on rates.

17 **RECOMMENDATIONS ARE INCONSISTENT WITH**
18 **FINANCIAL IMPERATIVES UNDERLYING THE ACQUISITION**
19

20 Q. **Please briefly explain your role in the acquisition process as it pertains to the MGE**
21 **assets?**

22 A. As the Chief Financial Officer of Laclede Gas, I provided executive oversight over the
23 due diligence process, was involved with settlement discussions involving the Merger

1 application before the MPSC, and had a leadership role in the placement of both the 10+
2 million shares of equity and \$450 million of debt used as part of the acquisition process.

3 **Q. What were the Company's expectations while it was in the process of making its bid**
4 **for the MGE assets and procuring the financial resources necessary to complete the**
5 **acquisition?**

6 A. Having been regulated by the Commission since its inception in 1913, the Company is
7 very familiar with the Commission, its rules and recent Commission decisions, including
8 those related to assets sales and acquisitions.

9 **Q. In determining an appropriate offering price for the MGE assets, was the Company**
10 **anticipating any "special" ratemaking treatment to assist in the process?**

11 A. The Company anticipated no special treatment. Rather, we were expecting to receive
12 what I would term "normal" ratemaking actions, including no recovery of the acquisition
13 premium, a possible rate moratorium, and the possibility of retaining or sharing in
14 acquisition synergies. In fact, we discussed this expectation at length internally and
15 directly with Staff on several occasions as we were preparing to enter the capital markets,
16 as this was of significant interest to the underwriters and their counsel. Our messages to
17 the external debt and equity capital markets, potential investors, underwriters and credit
18 rating agencies all were predicated on the feedback from those deliberations – namely
19 that we would receive a reasonable and balanced regulatory outcome, consistent with past
20 practice. With that support and confidence, the markets reacted favorably to our
21 message, and we were able to achieve exceptional financing terms, which terms are now
22 inuring to the benefit of MGE ratepayers. At no time did we anticipate or convey that we

1 would be exposed to the kind of punitive recommendations that Staff and OPC have put
2 forth in regards to their ROE and Capital Structure recommendations.

3 Q. **Did the Company, in fact, convey a different message to the investment community**
4 **regarding utility regulation in Missouri?**

5 A. Yes. By our very decision to invest hundreds of millions of dollars to acquire utility
6 assets that would nearly double our size in the state of Missouri, we made a very
7 significant and tangible demonstration of our faith in the Commission as a fair and
8 impartial body that seeks to reasonably balance the interests of shareholders and
9 ratepayers. We also focused more on what we viewed as the constructive approach that
10 we have often encountered when trying to work out differences in a sensible and fair way
11 with the Staff, OPC and other stakeholders in the regulatory process. In my view,
12 adoption of the punitive financial adjustments of the kind being proposed by Staff and
13 OPC regarding the Company's debt and capital structure would be seen as a major step
14 backwards from the kind of mainstream, balanced regulatory treatment that we have told
15 our investors and our shareholders they can expect in Missouri. I think it would also
16 result in an unfortunate reversal of the progress that I believe has been made with this
17 transaction in changing some of the negative investment community perceptions that,
18 fairly or not, have historically characterized the regulatory climate in Missouri.

19 **CAPITAL STRUCTURE UPDATES**

20 Q. **Do you wish to provide any updates of material facts included in the testimony filed**
21 **by Staff or the OPC?**

22 A. Yes. First, as I noted earlier, we have further refined our purchase price allocation for the
23 MGE acquisition, and the premium as of the date of this testimony has been reduced to

1 \$213 million. Secondly, as announced in December 2013, Laclede Gas redeemed \$80
2 million of FMB's on January 6, 2014. These FMB's were redeemed at par and carried an
3 interest rate of 6.35% annually. As a result, the long-term average interest rate for the
4 Company was further reduced to 4.16% on a pro forma basis. In addition, the long-term
5 equity capitalization for the Company improved to a pro forma 55.8% after taking this
6 redemption into account.

7 **Q. How does this impact the testimony and general rate case filing?**

8 A. As noted earlier, the terms of the Stipulation in GM-2013-0254 stated that the Company
9 would not sponsor a pre-tax cost of capital greater than 10.224%. Our initial filing was
10 predicated on the then-current average interest rates, with the Company then lowering the
11 equity percentage until the weighted cost of capital equaled this level. Given the new,
12 lower interest rates, and applying the same principle and approach, the new capital
13 structure would include an equity mix of 52.35%. See Rebuttal Schedule GWB-2 for
14 details of the calculation. This adjustment just further demonstrates the care and
15 conservative approach employed by the Company to the financing of the MGE
16 acquisition.

17 **Q. Does this conclude your rebuttal testimony?**

18 A. Yes, it does.

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

In the Matter of Missouri Gas Energy's Filing of)
Revised Tariffs to Increase its Annual Revenues) Case No. GR-2014-0007
For Natural Gas Service)

A F F I D A V I T


STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Steven P. Rasche, of lawful age, being first duly sworn, deposes and states:

1. My name is Steven P. Rasche. My business address is 720 Olive Street, St. Louis, MO 63101 and I am the Executive Vice President and Chief Financial Officer of Laclede Gas Company.

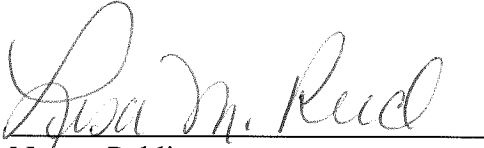
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony on behalf of Missouri Gas Energy.

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.



Steven P. Rasche

Subscribed and sworn to before me this 24 day of February, 2014.



Notary Public

