Exhibit No.	______________
Issue:	Rate of Return
Witness:	David P. Broadwater
Type of Exhibit:	Surrebuttal Testimony
Sponsoring Party:	MO PSC Staff
Case No.:	Case No. GR-99-315

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

LACLEDE GAS COMPANY

CASE NO. GR-99-315

SURREBUTTAL TESTIMONY

OF

DAVID P. BROADWATER

Jefferson City, Missouri

August 1999

SURREBUTTAL TESTIMONY

OF

DAVID P. BROADWATER

LACLEDE GAS COMPANY

CASE NO. GR–99–315

Q. Please state your name.

A. My name is David P. Broadwater.

Q. Are you the same David P. Broadwater who filed direct and rebuttal testimony in this proceeding for the Staff of the Missouri Public Service Commission (Staff)?

A. Yes, I am.

Q. In your direct testimony, did you recommend a fair and reasonable rate of return for the Missouri jurisdictional natural gas distribution rate base for Laclede Gas Company (Laclede or Company)?

A. Yes, I did.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to portions of the rebuttal testimony of Ms. Kathleen C. McShane, Mr. Glenn W. Buck, and Mr. James A. Fallert. Ms. McShane and Mr. Fallert sponsored return on equity testimony for Laclede. Mr. Buck sponsored capital structure testimony for Laclede.

Response to Ms. McShane's Testimony

Q. Please discuss the issues presented by Ms. McShane, as you believe they impact this case.

A. On page two of her rebuttal testimony, Ms. McShane says that "[t]he criteria that govern the determination of a fair return on equity include not only the ability to maintain the financial integrity of the firm and to attract new capital but also the opportunity to earn a return on common equity that is commensurate with return on investments in other enterprises of corresponding risk. This third criterion has been basically ignored by Messrs. Broadwater and Burdette." She is using this statement as a basis for supporting her market to book adjustment to her DCF analysis and her comparable company analysis. However, the companies that she uses in her comparable company analysis are not comparable to Laclede as she admits by making a downward adjustment to her analysis "since the industrials are of somewhat higher risk . . ." Also, her market to book adjustment is not appropriate and has previously been rejected by the Commission. The Discounted Cash Flow (DCF) model is designed to determine the return that investors are requiring the company to earn not the return that investors want to earn.

The output of the DCF model has proven its value over time. Attached as Schedule 1 are the actual earned Return on Equity (ROEs) of Laclede and the companies I chose as part of my comparable company analysis, which are actually comparable to Laclede. This schedule shows that over the last ten years Laclede has averaged a return on common equity of 11.3 percent as compared with the comparable companies that have averaged anywhere from 10.2 to 12.6 percent with an overall average of 11.7 percent. What this simple analysis shows is that Laclede has achieved a return on common equity that is commensurate with returns earned on investments in other enterprises of corresponding risk. Laclede has achieved these results during a time when Laclede has been subject to the regulation of the Missouri Public Service Commission and the DCF model has been employed as the primary tool to determine Laclede's return on common equity.

Q. On page four of her rebuttal testimony, Ms. McShane also points out the following two implications for investors that would result from the Commission adopting a return on common equity in Staff's range.

(1) Application of an expected return, estimated by reference to market value, to book value will tend to push the market/book ratio of Laclede's stock toward 1.0. At a current price of $23.25, Laclede's market/book ratio is approximately 1.60 times (book value as of 9/30/98 of $14.57). A reduction in price from $23.25 to book value is equivalent to a loss in shareholder value of over 35%.

(2) A return of 9.5-9.7% on a book value per share of $14.90 (<u>Value Line</u> forecast for 1999) is equivalent to earnings per share of $1.43. With the 1999 dividend at $1.34, Laclede's dividend payout ratio would be close to 95%. The Company would be precariously close to being unable to cover its dividend (and would be unable to do so if weather is warmer than normal) and unlikely to be able to maintain its recent moderate dividend increases.

What is your response?

A. With regard to Ms. McShane's first point, Laclede has been subject to Missouri regulation and the DCF model as the primary tool to set Laclede's return on common equity for more than 20 years and, as Ms. McShane points out, Laclede's current market/book ratio is 1.60. However, the use of the DCF model for the last 20 years has not forced the market value of Laclede's stock to be equal to its book value. As a matter of fact, approximately 20 years ago utility companies in general had market to book ratios of less than one and now, as both Ms. McShane and Mr. Olsen point out in their direct testimony, utility companies in general have market to book ratios greater than one. This general increase in market to book ratios for the utility industry has happened during a time when utility commissions have generally used the DCF analysis as the primary method for determining a utility's cost of common equity.

The second point that Ms. McShane makes concerning Laclede's dividend policy and payout ratio are management decisions of Laclede Gas Company. The Commission's role is to set a fair return, not to determine dividend payout ratios. By adopting a return in the Staff's range the Commission will be setting a fair return, one that allows the Company to maintain the financial integrity of the firm, to attract new capital and is commensurate with returns on investment in other enterprises of corresponding risk.

Q. How do you respond to Ms. McShane's use of your testimony from Case No. GR-98-374 on page five of her rebuttal testimony?

A. Ms. McShane quotes my 1998 testimony where I state that "Staff does not feel comfortable recommending to the Commission the adoption of the return on common equity range that the DCF model has produced." My statement did not say and it was not my intent to imply that the Staff was not comfortable with the output of the DCF model, what I said was that the Staff was not comfortable **recommending** to the Commission the output of the DCF model. Staff's concern at the time was not with the model but the economic environment. The statement described illustrates Staff's use of caution with respect to its recommendation to the Commission of investors required returns for Laclede.

Q. In Ms. McShane's rebuttal testimony on page six she states that she has two basic disagreements with your use of the DCF model. First, that you have applied the DCF test to Laclede alone, and secondly, that you relied on historic growth rates. Do you have any response to her characterization of your use of the DCF model?

A. Yes. The primary tool I used in my analysis of Laclede's cost of common equity was the DCF analysis. However, I have also looked at the Capital Asset Pricing Model and an equity risk premium analysis of Laclede cost of common equity. I also prepared an analysis of the interest coverage ratios of Laclede. In addition to the analysis of Laclede, I have also applied the DCF model, the Capital Asset Pricing Model and an equity risk premium model to a group of companies that are comparable to Laclede. It is an accurate statement that I used as my main tool the DCF model as applied to Laclede, but I have performed significant other analyses to ensure that the results of the DCF model as applied to Laclede are reasonable and fair.

Ms. McShane's statement concerning my reliance on historic growth rates in the application of the DCF model, is simply not true. I have looked at what the historic growth rates for Laclede and the comparable companies as part of my DCF analysis, and they were factored into my estimate of the growth component of the DCF analysis. However, I relied much more heavily on projected growth rates. Below are the historic and projected growth rates for Laclede as presented in Schedule 15 of my direct testimony.

Average DPS Annual Compound & Trend Line Growth	1.67%
Average EPS Annual Compound & Trend Line Growth	2.85%
Average BVPS Annual Compound & Trend Line Growth	3.13%
Average of Historical Growth Rates	2.55%
5 Year Growth Forecast (Mean) I/B/E/S Inc.'s Institutional Brokers Estimate System April 15, 1999	4.00%
5 Year Projected EPS Growth Rate Standard & Poor's Corporation's Earnings Guide May 1999	4.00%
Projected EPS Growth Rate (3 – 5 Years) Value Line's Ratings and Reports March 26, 1999	4.00%
Average of Project Growth Rates	4.00%

Based on the above data, I selected a proposed range of growth for Laclede of between 3.25% and 4.00%. My proposed growth rate range for Laclede is heavily weighted towards the projected growth rates, but it does consider historic growth rates, because I believe that they are used at least to some degree by investors.

Response to Mr. Fallert's Testimony

Q. Please discuss the issues presented by Mr. Fallert, as you believe they impact this case.

A. Mr. Fallert lists several percentages in an attempt to compare my recommendation with Missouri Gas Energy Company, Union Electric Company and the average authorized return on common equity for gas distributors during 1998. However, none of these are relevant to this proceeding. Mr. Fallert admits that "no two companies are exactly alike," but he still attempts to convince the Commission that because other companies were granted a higher return than what the Staff is proposing for Laclede (in the case of Union Electric there was not an authorized return on equity) in this proceeding that Staff is being unreasonable. The Staff has done an independent analysis of the cost of common equity for Laclede, and has developed an appropriate return on equity for Laclede based on the current economic environment and conditions. Mr. Fallert's testimony is an emotional appeal to the Commission to grant a return on common equity greater than the market is requiring. The returns he sites were granted to other companies at different points in time and based on different conditions.

Response to Mr. Buck's Testimony

Q. Please discuss the issues presented by Mr. Buck, as you believe they impact this case.

A. Mr. Buck is proposing a downward adjustment to the 12-month average of short-term debt by $50 million or 63% to reflect the Company's issuance of long-term debt and equity in May and June of this year. If this refinancing reflected a permanent shift to long term financing this adjustment might have some merit. However, a look at the history of Laclede's use of short-term debt and Laclede's expected use of short-term debt shows that this is not a reasonable adjustment.

Over the last 42 months Laclede's average daily short-term debt balance net of construction work-in-progress has been approximately $58 million, the balance over the last 24-months has been approximately $66 million, and the balance over the last 12-months has been approximately $79 million. This shows that over the last approximately 3-1/2 years Laclede's use of short-term debt has been increasing. Laclede's projections show that its use of short-term debt is increasing during the three year period of 1999, 2000 and 2001. By looking back and looking forward, it is evident that Laclede's use of short-term debt is growing. Therefore, a downward adjustment to the Company's 12-month average daily balance of short-term debt net of construction work-in-progress would not be appropriate. The Staff's inclusion in the capital structure of the average of short-term debt experienced during the last 12-months is an appropriate measure of the ongoing level of short-term debt for Laclede.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

LACLEDE GAS COMPANY
CASE NO. GR-99-315

Earned Return on Common Equity
for Laclede and the Seven Natural Gas Distribution Companies

Name	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998		Average
Laclede Gas Company	12.4%	9.2%	10.8%	9.9%	13.2%	11.3%	9.2%	13.6%	12.9%	10.8%		11.3%
AGL Resources	10.6%	11.2%	10.8%	11.5%	10.8%	11.3%	12.5%	12.1%	11.3%	11.3%		11.3%
Connecticut Engergy	10.4%	9.3%	10.2%	11.0%	11.0%	10.2%	10.7%	11.0%	11.4%	10.7%		10.6%
Indiana Energy	15.3%	10.9%	11.2%	11.3%	10.9%	12.7%	11.7%	14.2%	14.8%	13.2%		12.6%
Northwest Natural Gas	12.4%	12.8%	5.5%	5.5%	13.2%	11.8%	10.9%	12.7%	11.0%	6.0%		10.2%
Peoples Energy	14.8%	12.4%	12.1%	11.4%	11.7%	11.6%	9.7%	15.2%	13.7%	10.7%		12.3%
Piedmont Natural Gas	13.7%	13.1%	8.6%	13.3%	13.2%	11.8%	11.4%	12.6%	13.1%	13.2%		12.4%
Washington Gas	12.0%	12.3%	11.7%	11.7%	11.7%	12.2%	12.0%	14.4%	13.7%	11.1%		12.3%
Average	**12.7%**	**11.7%**	**10.0%**	**10.8%**	**11.8%**	**11.7%**	**11.3%**	**13.2%**	**12.7%**	**10.9%**		**11.7%**

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 DAVID P. BROADWATER

STATE OF MISSOURI	)	
	)	ss
COUNTY OF COLE	)	

David P. Broadwater, of lawful age, on his oath states: that he has participated in the preparation of the foregoing written surrebuttal testimony in question and answer form, consisting of 8 pages and 1 schedule to be presented in the above case; that the answers in the foregoing written surrebuttal 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.

David P. Broadwater

Subscribed and sworn to before me this 17TH day of August 1999.

Toni M. Willmeno
Notary Public, State of Missouri
County of Callaway
My Commission Expires June 24, 2000

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI