

Exhibit No.:

Issue:

Financial Policy

Witness:

Mark D. Waltermire

Type of Exhibit:

Direct Testimony

Sponsoring Party:

Laclede Gas Company

Case No.:

GR-2010-

LACLEDE GAS COMPANY

GR-2010-

DIRECT TESTIMONY

OF

MARK D. WALTERMIRE

TABLE OF CONTENTS

	<u>Page</u>
General Information/Qualifications	1
Purpose of Testimony	2
Financing Requirements	2
Sources of Financing.....	3
Effects of Regulation on Financial Stability and Creditworthiness.....	5
Regulatory Considerations.....	7

1
2 **DIRECT TESTIMONY OF MARK D. WALTERMIRE**
3

4
5 **GENERAL INFORMATION/QUALIFICATIONS**
6

7 Q. Please state your name and business address.

8 A. My name is Mark D. Waltermire, and my business address is 720 Olive Street, St. Louis,
9 Missouri 63101.

10 Q. By whom are you employed and in what capacity?

11 A. I am employed by Laclede Gas Company (“Laclede” or “Company”) in the position of
12 Senior Vice President and Chief Financial Officer.

13 Q. Please describe your qualifications and work experience.

14 A. I was elected to my current position in 2007. As Senior Vice President and Chief
15 Financial Officer, I am responsible for a number of functions at the Company, including
16 financial reporting, accounting, treasury, information technology, compliance with
17 Sarbanes-Oxley and Securities and Exchange Commission requirements, and overseeing
18 investment community and credit rating agency activities. Since joining Laclede in 1990,
19 I have held a number of other positions including Manager of Rate and Financial
20 Planning, Director of Internal Audit, Assistant Vice President - Planning and Vice
21 President - Operations and Marketing.

22 Q. Will you briefly describe your business experience and education background prior to
23 joining Laclede?

24 A. Before joining Laclede, I held positions as Senior Accountant for Deloitte & Touche,
25 Division Controller for St. Joe Minerals Corporation, and Vice President and Treasurer
26 for Newhard, Cook & Co., Incorporated, a regional securities broker/dealer. I hold a B.S.

1 Degree in Accounting from the University of Illinois and am a Certified Public
2 Accountant.

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

4 A. Yes, I have, in Case Nos. GR-92-165, GR-94-220 and GR-96-193.

5 **PURPOSE OF TESTIMONY**

6 Q. What is the purpose of your testimony in this case?

7 A. The purpose of my testimony is to provide the Commission with additional perspective
8 on the major financial and regulatory considerations that affect the Company's ability to
9 attract and maintain the liquidity and capital resources necessary to finance our
10 fundamental public utility obligations.

11 **FINANCING REQUIREMENTS**

12 Q. What are some of the more significant financing needs and operating activities that
13 require the Company to maintain ready access to liquidity and the ability to attract
14 capital?

15 A. By far, I think one of the most important factors is the extraordinary degree to which the
16 Company's ability to provide utility service depends on its ability to access the credit and
17 capital markets for both its short- and long-term financing needs. Simply put, the
18 Company, like many other utilities, is a capital spending intensive business that must
19 routinely invest tens of millions of dollars each year to expand, replace and maintain the
20 over 16,000 miles of pipes, hundreds of thousands of meters and other infrastructure
21 needed to distribute gas to our customers. In addition to having to finance these
22 construction-related expenditures, the Company also invests hundreds of millions of

dollars throughout the year to support the purchase, storage, transport and billing lag associated with the sale of natural gas to customers.

SOURCES OF FINANCING

Q. Aren't Laclede's funds from operations sufficient to provide the cash flows necessary to finance and support all of these business requirements?

A. No they are not. As a gas distribution utility, Laclede earns and retains for its shareholders a relatively small amount of its total revenues (approximately 3% in fiscal 2009) as compared to the enormous expenditures we have to make not only for construction and replacement of utility infrastructure but also to purchase, store and transport the gas supplies required to furnish service.

Q. Please explain.

A. Certainly. In general, revenues are billed and collected from customers to pay for things like gas costs, operating and maintenance expenses (such as employee wages, materials, tools, supplies, etc.), taxes, and interest. The remainder that is left over after deducting all expenses from revenues is referred to as net income. This represents the amount that belongs to shareholders and may either be reinvested in the business (e.g., as a source of funds for the items discussed above) or paid to them as a dividend. In its fiscal year just ended, Laclede's net income was \$33 million on total revenues of \$1,056 million.

Q. What other sources of financing does Laclede use to fund its utility activities?

A. In addition to using internally-generated funds, Laclede must also attract investments from the equity and debt markets, banks and other external sources of liquidity. These can be classified between long-term sources of capital (e.g., equity and bond investments) used to finance long-lived assets such as mains, service lines, and regulators and the other

1 capital components of our utility infrastructure, and short-term sources of capital (e.g.,
2 commercial paper, bank lines of credit, and other debt instruments with short maturities)
3 used to finance shorter-term purchases of gas, hedging instruments, and other operational
4 cash requirements. This means that capital must be attracted, invested and retained for
5 literally decades to pay for the cost of materials and workers' wages to construct utility
6 plant, the depreciation recovery of which may be spread over twenty, thirty, even up to
7 80 or more years, depending on the asset at issue. Each year, Laclede invests upwards of
8 \$50 to \$60 million or more in these kinds of assets. In other situations, funds must be
9 retained for shorter periods of time but in far greater amounts. The hundreds of millions
10 of dollars in short-term debt that Laclede incurs to finance gas purchases months in
11 advance of when it receives customer payment for the related services is but one
12 example.

13 Q. Has the Company's need to have access to these financial resources increased over the
14 years?

15 A. Yes. Increased volatility in natural gas prices alone, such as that experienced in 2008,
16 resulted in a significant increase in the Company's borrowing requirements as it financed
17 the purchase of physical natural gas supplies for storage in the early summer when prices
18 were exceptionally high; and then was required to fund "margin calls" related to its gas
19 supply hedging program as natural gas prices plummeted during the last half of the year;
20 and then finally to finance customer accounts receivable balances during the winter when
21 they are typically at their highest levels. To provide a sense of the variability in just the
22 funding requirements for the Company's natural gas inventories alone over the last
23 several years, our September 30th fiscal year ending inventory balances for 2007, 2008,

1 and 2009 have been \$138.3 million, \$206.3 million and \$93.3 million, respectively.
2 Certainly, these year to year variations demonstrate why it is so important for the
3 Company to always maintain, and have readily available, adequate access to the financial
4 resources it needs in order to meet its service obligations to its customers.

5 **EFFECTS OF REGULATION ON FINANCIAL STABILITY AND**
6 **CREDITWORTHINESS**
7

8 Q. What does all this mean in terms of any regulatory action that the Commission might take
9 in this proceeding?

10 A. Because external funding sources are so critical to the Company's ability to fulfill its
11 public utility obligations, it is imperative that the Commission approve regulatory
12 measures in this case that will maintain and, preferably even enhance, Laclede's financial
13 stability and strength and thereby its capacity to access the credit and capital markets.

14 Q Is such action warranted solely to assure that Laclede will continue to have access to the
15 credit and capital markets when it needs it?

16 A. No. It is also warranted to ensure that such access will be on favorable terms. In the end,
17 it is the utility's ratepayers that must shoulder the cost of attracting capital. Accordingly,
18 more favorable terms means lower costs for utility customers. The prices and terms
19 under which credit and capital markets will invest in or lend money to a particular firm,
20 however, are driven by their perceptions of the firm's financial strength, creditworthiness
21 and ability to provide a competitive return on and full return of the funds being provided
22 – all factors that this Commission can profoundly influence by the regulatory measures it
23 pursues.

1 Q. How does the broader investment community view the relationship between a utility's
2 regulatory treatment and its ability to access the capital funds it requires to finance its
3 operating requirements at reasonable cost?

4 A. In determining credit ratings for regulated firms – a factor that can significantly affect the
5 cost of issuing debt – it is routine for rating agencies to focus on the firm's regulatory
6 environment and whether it is, or is not, supportive of maintaining appropriate financial
7 metrics. In fact, in their recent credit analyses of the Company, both Moody's and
8 Standard & Poor's specifically noted the various regulatory mechanisms, including the
9 ISRS, our weather mitigation rate design, and reasonable rate relief, that have enabled
10 Laclede to maintain an overall business profile supportive of its current first mortgage
11 bond credit ratings ("A2" from Moody's and "A" from Standard & Poor's). At the same
12 time, their analyses also noted that Laclede's stand-alone financial metrics related to
13 funds generated by operations and times interest earned coverages were weaker than
14 would typically be required for these ratings, and emphasized that a continuation of
15 reasonable regulatory treatment was therefore critical to maintaining these ratings in the
16 future.

17 Q. Are similar considerations taken into account by equity investors?

18 A. Yes. Equity investors only achieve a return on their investment after all other costs,
19 including those owed to debt holders, have been satisfied. As a result, they are even
20 more concerned as to whether regulatory policies are sufficient to not only support the
21 kind of financial metrics noted above, but also to generate sufficient earnings to provide
22 them with a reasonable and competitive return that recognizes this additional risk.

1 Q. Has the recent turmoil in the financial markets affected Laclede's ability to attract
2 capital?

3 A. Overall, Laclede has managed well through the recent turmoil in the financial markets as
4 compared with other utilities that have lesser regulatory certainty and lower credit
5 ratings. Laclede's ability to work with the Commission and its Staff to adopt reasonable
6 rate treatments in key areas has helped the Company to maintain a strong credit profile,
7 and to continue to attract the capital it needs to serve customers at reasonable costs
8 despite the turmoil. I would, however, reiterate the fact that the rating agencies have
9 noted that these reasonable approaches must continue if the Company is to retain its
10 current credit ratings.

11 **REGULATORY CONSIDERATIONS**

12 Q. Given these considerations, what specific actions should the Commission take in this
13 proceeding to ensure that Laclede maintains access to the capital markets on favorable
14 terms?

15 A. As Laclede witness Douglas Yaeger has explained in his direct testimony, the steps
16 necessary to accomplish this goal are clear and readily achievable. They include
17 establishing a competitive return on shareholder monies that have been invested in our
18 utility infrastructure, adopting reasonable revisions to our weather mitigation rate design,
19 and permitting recovery of our actual costs of providing utility service in accordance with
20 the cost of service and ratemaking proposals we have made in this case. Fortunately, all
21 of these steps for ensuring favorable access to the credit and capital markets, and thereby
22 safeguarding our ability to render safe and adequate service at just and reasonable rates,
23 can be taken with only modest customer impacts. Indeed, even at the full level of rate

1 relief we have proposed, only a small proportion of revenues would go to compensate our
2 shareholders for the hundreds of millions of dollars in investments they have made so we
3 can provide the kind of reliable utility service our customers have come to expect.

4 Q. Does this conclude your direct testimony?


5 A. Yes, it does.

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

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

1. My name is Mark D. Waltermire. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Senior Vice President and Chief Financial Officer 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.


Mark D. Waltermire

Karen A. Zurliene
Notary Public
KAREN A. ZURLIENE
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis City
My Commission Expires: Feb. 18, 2012
Commission # 08382873