

Exhibit No.:

Issue:

Witness:

Type of Exhibit:

Sponsoring Party:

Case No.:

Return on Equity

John E. Olson

Surrebuttal Testimony

Laclede Gas Company

GR-99-315

FILED

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AUG 1999 *nh*

LACLEDE GAS COMPANY

GR-99-315

SURREBUTTAL TESTIMONY

OF

JOHN E. OLSON

Missouri Public
Service Commission

SURREBUTTAL TESTIMONY OF JOHN E. OLSON

1 Q. Please state your name and business address.

2 A. My name is John E. Olson. My business address is: Sanders Morris Mundy,
3 3100 Chase Tower, Houston, Texas 77002.

4 Q. Are you the same John E. Olson who filed direct testimony in this proceeding?

5 A. Yes, I am.

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

7 A. I will respond to criticisms of my direct testimony contained in the rebuttal
8 testimony of Staff witness David P. Broadwater and Office of the Public Counsel
9 witness Mark Burdette.

10 Q. Both Mr. Broadwater and Mr. Burdette argue that your direct testimony is
11 irrelevant to this proceeding and should be ignored by the Commission. Do you
12 have any response to this testimony?

13 A. Yes. Both Mr. Broadwater's and Mr. Burdette's testimony in this proceeding
14 provide the Commission with very narrow analyses of Laclede Gas Company's
15 required rate of return, including the required return on equity. In developing
16 their recommendations for Laclede's return on equity, they utilized the discounted
17 cash flow, the risk premium, and other analyses that focus either solely on
18 Laclede or on a limited number of other regulated firms that provide natural gas
19 service. Apparently, they believe that only testimony focused directly on these
20 analyses has any relevance at all to the establishment of Laclede's return on
21 equity, and that any information or viewpoint that does not conform to these
22 narrow models should not even be considered by the Commission.

1 Laclede has supported its rate of return position primarily with two witnesses.
2 Ms. Kathleen McShane filed testimony addressing the analyses traditionally
3 employed by the Commission in determining the appropriate returns for utilities.
4 *My direct testimony in this proceeding, on the other hand, was designed to*
5 *provide the Commission with evidence demonstrating that increasing returns*
6 *earned by unregulated companies in the last decade have rendered the returns*
7 *calculated through the employment of these traditional rate of return analyses*
8 *unreasonably low. My testimony addressed the broader equity market that*
9 *provides the context in which the Commission must set a return for Laclede.*
10 *Given the concern that Mr. Broadwater expressed on page 16 of his direct*
11 *testimony over what “can happen when outdated economic ideals are applied to*
12 *current economic situations...,” I would have thought that Mr. Broadwater would*
13 *have welcomed my testimony describing these recent developments in the equity*
14 *market.*

15 Q. Do you believe that your testimony in this regard is irrelevant to the
16 Commission’s establishment of an appropriate return on equity for Laclede?

17 A. Absolutely not. The Commission must make its determination of the proper
18 return on equity in the context of real world returns being earned in both the
19 regulated and unregulated sectors. After all, Laclede competes for capital with all
20 other companies. The Commission cannot set Laclede’s return in a vacuum,
21 without considering the higher returns that unregulated sector investors have
22 earned in the last decade. I believe that the testimony that I have provided in this
23 regard is critically important to the Commission in reaching a decision on

1 Laclede's return on equity. Moreover, I offer the Commission the perspective of
2 an investment analyst whose job it is to evaluate investment opportunities
3 available in both the regulated and unregulated sectors. This is a worthwhile
4 perspective for the Commission to consider, since the very purpose of this inquiry
5 is to determine the return required by investors. It is not an "irrelevant"
6 perspective as the Staff and Public Counsel would have the Commission believe.
7 In fact, one significant deficiency with both Staff's and Public Counsel's
8 testimony is that they are completely uninformed by any real world perspective.
9 The Staff and Public Counsel witnesses have absolutely no experience in
10 evaluating investment opportunities or addressing returns outside of the
11 regulatory environment. And they apparently have no interest in considering how
12 these equity markets work. Like academics in an ivory tower, they calculate their
13 return formulas with blinders on, assuming away inconvenient facts and
14 dismissing as irrelevant the perspective of investors operating in the context of the
15 broader market for capital that exists outside, in the real world. Under such
16 circumstances, it is not surprising that they would attempt to characterize as
17 irrelevant any testimony that challenges the results of their theoretical models
18 with the real world concerns of investors.

19 Q. On pages 2-4 of his rebuttal testimony, Mr. Burdette implies that your testimony
20 does not take into account the differences in risk between regulated utilities, such
21 as Laclede, and unregulated companies. Is this true?

22 A. No. Although I agree with Mr. Burdette that investors require higher returns to
23 compensate them for investing in companies with higher levels of risk and I have

1 recognized that in my recommendation, I disagree with Mr. Burdette's and Mr.
2 Broadwater's assumption that the returns generated by unregulated companies can
3 be completely ignored in establishing a rate of return for Laclede, simply because
4 some of these firms may have different levels of risk. In the final analysis,
5 Laclede is competing for investors' funds in the broader market, which includes
6 firms with varying risk levels.

7 Q. On page 4 of his rebuttal testimony, Mr. Burdette criticizes your testimony that
8 "Investors do not distinguish much any more between investing in a gas utility,
9 GENERAL ELECTRIC, or CITIGROUP." Do you have any response to his
10 criticism?

11 A. Yes. Mr. Burdette argues that differences in risk, dividend yield and other factors
12 cause investors to make distinctions between Laclede and unregulated companies.
13 Of course I would agree. Many investors do make distinctions among all
14 investment opportunities based on these and other considerations. My only point
15 was that Laclede must compete with these unregulated companies for investment
16 dollars. Investors do not place Laclede in a separate category from unregulated
17 companies in making investment decisions. Any analysis that ignores this reality,
18 such as the analyses submitted by Mr. Burdette and Mr. Broadwater in this case,
19 is fatally flawed.

20 Q. Throughout his rebuttal testimony, Mr. Burdette criticizes you for providing
21 testimony that is based on your experience as an investment analyst, rather than
22 based on studies you may have conducted. Do you have any response to these
23 criticisms?

1 A. Yes. Laclede did not ask me to conduct any studies or analyses in preparing my
2 direct testimony. Rather, the Company asked me to provide the Commission with
3 my perspective on Laclede's return requirements as an investment analyst, who
4 evaluates companies in the regulated and unregulated sectors. Although my
5 testimony contains my opinion on various considerations that should affect the
6 return established for Laclede, these views are based on my thirty years of
7 experience as an investment analyst. I believe my testimony offers the
8 Commission a valuable perspective that has not typically been presented by
9 parties or considered by the Commission in determining the rate of return required
10 by Missouri utilities.

11 Q. Does this conclude your surrebuttal testimony?

12 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT

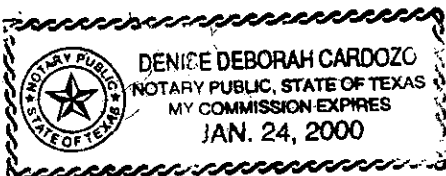
John E. Olson, of lawful age, being first duly sworn, deposes and states:

1. My name is John E. Olson. My business address is Suite 3100, Chase Tower, Houston, Texas 77010; and I am Senior Vice President – Securities Research of Sanders Morris Mundy.
2. Attached hereto and made part hereof for all purposes is my surrebuttal testimony, consisting of pages 1 to 5, inclusive.
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.

John E. Olson

John E. Olson

Subscribed and sworn to before me, the undersigned Notary Public, this 18 day of August 1999, at Houston, Texas.



Denise Deborah Cardozo