

Exhibit No.:
Issue: Capital Structure, Cost of Debt
and Stipulation Terms
Witness: Glenn W. Buck
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Laclede Gas Company, d/b/a MGE
Case No.: GR-2014-0007
Date Prepared: April 3, 2014

MISSOURI GAS ENERGY
GR-2014-0007
SURREBUTTAL TESTIMONY
OF
GLENN W. BUCK
APRIL 2014

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SURREBUTTAL TESTIMONY OF GLENN W. BUCK

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

2 A. My name is Glenn W. Buck and my business address is 720 Olive Street, St. Louis,
3 Missouri 63101.

4 **Q. Are you the same Glenn W. Buck who has previously filed Direct and Rebuttal**
5 **Testimony in this proceeding on behalf of Missouri Gas Energy?**

6 A. I am.

PURPOSE OF TESTIMONY

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

8 The purpose of my testimony is to respond to the rebuttal testimony and
9 recommendations of Staff witness Marevangepo and OPC witness Gorman as it relates to
10 the issue of what capital structure should be used to establish rates in this case. Laclede
11 witness Ahern is also addressing this matter, as well as responding to the assertions made
12 by these witnesses on the issue of what return on equity should be established by the
13 Commission in this proceeding.

RESPONSE TO STAFF WITNESS MAREVANGEPO

14 **Q. Did you participate in Laclede’s last rate case and in the acquisition proceeding?**

15 A. Yes. I was the lead company financial witness and case coordinator in the recent Laclede
16 rate case, Case No. GR-2013-0171 (the “Laclede Rate Case”) and was fully involved
17 with all aspects of the MGE acquisition case, Case No. GM-2013-0254 (the “Acquisition
18 Case”) from due diligence through the signing of the Stipulation authorizing approval in
19 that proceed. Further, I was involved with all substantive settlement discussions in both
20 proceedings as well as in this one.

1 Q. **In his rebuttal testimony, has Staff witness Marevangepo continued to**
2 **inappropriately use this case to try and re-trade and alter the bargain that was**
3 **struck in the agreements reached by the parties and approved by the Commission in**
4 **these very recent cases?**

5 A. Unfortunately yes. At page 2, lines 18-20, p 4, l. 9 through p 7, l. 3 of his rebuttal
6 testimony, Mr. Marevangepo continues to reference what he says was the cost of debt
7 used to establish rates in the Laclede Rate Case as support for his recommendation to use
8 only the incremental cost of debt issued in connection with the MGE acquisition, rather
9 than following Staff's normal practice of using the blended cost of debt contained in the
10 capital structure of MGE's corporate parent. To Mr. Marevangepo's credit, he makes it
11 abundantly clear that he is using only the acquisition cost of debt in this case because, in
12 his view, such an approach is necessary to make up for the "fact" that a pre-acquisition
13 cost of debt was used to establish rates in the Laclede Rate Case.

14 Q. **Why is this inappropriate?**

15 A. It is inappropriate in the first instance because it seeks to go behind the Stipulation and
16 Agreement in the Laclede Rate Case (the "Rate Case Stipulation") and purportedly
17 identify the cost of debt that was ultimately used to establish the revenue requirement that
18 was agreed upon by the parties and approved by the Commission in that case. There is
19 simply nothing in the Rate Case Stipulation, however, that identifies what cost of debt
20 was ultimately used for this purpose. In fact, the only cost of debt item agreed upon and
21 identified in the Rate Case Stipulation related to the capital structure and costs that would
22 be used to calculate future ISRS filings by the Company. As set forth in paragraph 16 of

1 the Stipulation, the provision relating to future ISRS filings indicated that the capital
2 structure used for such filings would:

3 “ ... be updated within 30 days of the end of the month in which the
4 acquisition is closed to reflect the actual, post-acquisition equity
5 percentage and cost of long-term debt, provided that the equity percentage
6 shall be actual equity percentage or 53%, whichever is less. Such update
7 shall be submitted as a late filed exhibit and shall be approved by the
8 Commission. Consistent with the method commonly used to calculate
9 Laclede’s capital structure and embedded cost of long-term debt, the total
10 capital structure and the long-term debt component included in the late-
11 filed exhibit shall be as recorded on the consolidated financial statements
12 of The Laclede Group, Inc., the parent company of Laclede Gas Company,
13 as of that date, and shall reflect The Laclede Group’s weighted average
14 interest rate calculated in accordance with generally accepted accounting
15 principles, including the interest rate swaps procured at The Laclede
16 issuances.”
17
18

19 **Q. Is there any comparable language in the Rate Case Stipulation that addresses what
20 cost of debt was used to establish the overall revenue requirement?**

21 A. No. The overall revenue requirement was an amount negotiated by the parties based on a
22 compromise of many revenue requirement and non-revenue requirement issues. Under
23 such circumstances, it is fundamentally inappropriate for Mr. Marevangepo to go behind
24 this negotiated settlement and claim that he can identify what one of one of the building
25 blocks of that negotiated amount was and then use that unspecified building block to
26 prejudice the Company’s interests in this case.

27 **Q. Where the parties’ resolution of a specific cost of service item is not explicitly
28 identified in a Stipulation and Agreement, does the Stipulation and Agreement
29 generally preclude a party from taking the kind of action that Mr. Marevangepo has
30 taken in this case?**

1 A. Although I am not an attorney, I have been advised by legal counsel that Stipulations and
2 Agreements filed with the Commission generally have provisions that preclude the use of
3 unspecified elements of a negotiated settlement. The Laclede Rate Case was no
4 exception, as indicated by paragraph 27 of the Stipulation and Agreement which states in
5 part:

6 “Except as otherwise expressly specified herein, none of the signatories to
7 this Stipulation and Agreement shall be deemed to have approved or
8 acquiesced in any ratemaking or procedural principle, including, without
9 limitation, any method of cost determination or cost allocation,
10 depreciation or revenue-related method, or any service or payment
11 standard; and none of the signatories shall be prejudiced or bound in any
12 manner by the terms of this Stipulation and Agreement in this or any other
13 Commission or judicial review or other proceeding, except as otherwise
14 expressly specified herein.”
15

16 Q. **Aside from the capital structure and costs that were to be used for**
17 **calculating future ISRS filings were other items explicitly identified in the**
18 **Rate Case Stipulation as having been resolved by the parties in a certain**
19 **manner?**

20 A. Yes. There were many details built into the Stipulation language including, the
21 amount of the rate increase and the nature of the rate design, treatment of
22 underground storage losses, pension and OPEB allowance, and the Company’s
23 propane cavern, the continuation of a low income program, the treatment of
24 energy efficiency and weatherization programs, and billing and reporting data and
25 various tariff issues. Exclusive of these items, that are addressed in very explicit
26 detail, no other ratemaking outcomes were assumed or identified by any party and
27 certainly not the cost of debt that Mr. Marevangepo now says was used to
28 establish the revenue requirement in that case.

1 Q. **Even if the cost of debt used to establish the overall revenue requirement in**
2 **the Laclede Rate Case could be identified, would it be appropriate to make**
3 **an adjustment in this case because, in Mr. Marevangepo's opinion, it was a**
4 **pre-acquisition cost of debt?**

5 A. Absolutely not. Because the overall revenue requirement in the Laclede Rate
6 Case was a negotiated amount, the Company, as well as other parties, made
7 multiple concessions of significant value on a variety of issues in order to arrive at
8 that amount. Indeed, for settlement purposes, the Company ultimately reduced
9 its revenue requirement request from approximately \$58.4 million to \$14.8
10 million in the settlement. The Company also made significant concessions on a
11 variety of other issues, many of which are explicitly noted in the Stipulation. I
12 can assure the Commission that in agreeing to this sharply reduced revenue
13 amount and the other non-revenue requirement items in the Stipulation, the
14 Company made financial concessions far in excess of any benefit it may have
15 received from using a pre-acquisition cost of debt (assuming, for the sake of
16 argument, that's what the revenue requirement was based on).

17 Q. **Can you identify the financial concessions that the Company made?**

18 A. It would be as inappropriate for me to go behind the settlement and do that as it
19 has been for Mr. Marevangepo to do what he has done relative to the cost of debt
20 underlying the settlement. Since it is explicitly addressed in the Rate Case
21 Stipulation, however, I would note that one of the concession included Laclede's
22 agreement to have future ISRS filings calculated based on an updated capital
23 structure that reflects its post-acquisition cost of debt as well as a 53% equity

1 ceiling. Normally, future ISRS filings would be based on the debt and equity
2 costs in effect at the time a rate case settlement is reached and would not be
3 updated in this manner. The agreement to update capital structure and costs and
4 limit its equity percentage will cost Laclede millions of dollars in ISRS revenues
5 over the next several years. Nevertheless, it is one of the many financial
6 concessions that Laclede made to arrive at an overall settlement. Notably, Mr.
7 Marevangepo does not propose any adjustment in this case to reflect this financial
8 concession. Instead, in classic “have my cake and eat it too” fashion, Staff would
9 retain this benefit of the bargain that was struck in the Laclede Rate Case while
10 taking away any benefit the Company may have received from whatever
11 concession Staff may have made with respect to the cost of debt underlying that
12 settlement. Obviously, there is nothing reasonable or fair about this kind of one-
13 sided, opportunistic re-trading of isolated elements of an approved settlement.
14 While Staff’s actions may not have been intentional, by taking this position, Staff
15 has effectively violated the Rate Case Stipulation.

16 **Q. You also indicated that Mr. Marevangepo’s approach to calculating a cost of**
17 **debt was inconsistent with the terms of the Acquisition Case Stipulation and**
18 **Agreement. Please explain.**

19 A. In his testimony, Mr. Marevangepo suggests that his use of an artificially low cost
20 of debt is necessary because Laclede and MGE did not file cases simultaneously.
21 In the Acquisition Case, however, Laclede negotiated, and the parties agreed to,
22 provisions that explicitly permitted Laclede to file an MGE-only rate case, as long
23 as it did so by September 18, 2013. (Paragraph 1, pages 7-8 of the Stipulation)

1 Only in its next rate case would Laclede and MGE have to file rate cases at the
2 same time. It is clear from Mr. Marevangepo's testimony, however, that he is
3 trying to adjust MGE's rates in this case based on a theory that such an
4 adjustment is necessary because Laclede Gas did not also file a rate case at the
5 same time as MGE. Again, Mr. Marevangepo is denying Laclede the benefit of
6 this provision in the Acquisition Case Stipulation and Agreement, while ignoring
7 all of the concessions Laclede made in that settlement to obtain this provision.
8 For all of these reasons, Staff cost of debt recommendations should be rejected by
9 the Commission.

10 **RESPONSE TO OPC WITNESS GORMAN**

11
12 **Q. Does OPC witness Gorman continue to allocate all goodwill to equity in his rebuttal
13 testimony?**

14 **A.** Yes. Mr. Gorman continues to use a hypothetical capital structure which allocates all of
15 the "goodwill" created by the transaction so as to reduce the equity component as a
16 percentage of capitalization. In his rebuttal testimony, Staff witness Marevangepo
17 essentially endorses this approach stating, "Staff understands and acknowledges the
18 reasoning behind Mr. Gorman's capital structure recommendation. Staff believes Mr.
19 Gorman's approach is acceptable based on its own merits." (Marevangepo Rebuttal, p.
20 14, lines 10-12)

21 **Q. Is Mr. Gorman's approach, as endorsed by Staff in its rebuttal testimony,
22 appropriate?**

23 **A.** No. Company witness Ahern has already pointed out some of the more serious flaws in
24 the reasoning underlying Mr. Gorman's approach. As someone who was deeply involved

1 in the Company's recent acquisition proceeding, I would just re-emphasize how contrary
2 Mr. Gorman's approach, and Staff's apparent endorsement of that approach, are to the
3 explicit terms of the Acquisition Case Stipulation and Agreement. Specifically, the
4 Stipulation and Agreement entered into by Staff, OPC and the Company in Case No GM-
5 2013-0254 permitted any party to take whatever actions were necessary in a rate case to
6 ensure that the acquisition premium had no impact on rates. (Acquisition Case
7 Stipulation, Paragraph 3(a))

8 Q. Does Mr. Gorman's application of all the goodwill to equity result in the very kind of
9 impact that this provision precludes?

10 A. Yes. By applying all goodwill to equity, Mr. Gorman is using the fact that Laclede paid a
11 premium to artificially reduce Laclede's rates. Had Laclede not been required to pay an
12 acquisition premium for the MGE assets, it would not, as Mr. Gorman's approach
13 assumes, simply issue less equity to finance what would have been a lower purchase
14 price. Indeed, to have done so would have resulted in a much higher debt to equity ratio
15 than Laclede has customarily maintained consistent with its conservative approach to
16 supporting a strong financial profile. Instead, Laclede would have paid the lower
17 purchase price by issuing both less debt and less equity and its capital structure would
18 have remained roughly what it is today. By allocating all of the acquisition premium to
19 equity, Mr. Gorman's approach ignores this reality and effectively uses the acquisition
20 premium as a device to lower rates by establishing a capital structure that is radically
21 different than the one that would have existed had no premium be paid. In my opinion
22 there is no way to square this result with the explicit provisions of the Acquisition Case
23 Stipulation and Agreement.

1 Q. What ratemaking measures does the Commission have to take to ensure that the
2 acquisition premium does not impact rates in this proceeding as required by the
3 Stipulation and Agreement?

4 A. The Commission's needs to reject Mr. Gorman's capital structure recommendation in its
5 entirety to ensure that the provision agreed to by the parties and approved by the
6 Commission is honored.

7 Q. In his rebuttal testimony Mr. Gorman, in response to Staff's direct testimony, states
8 "Staff's proposed capital structure is not reasonable because it includes common equity
9 that funds a goodwill asset." (Gorman Rebuttal, p. 23, lines 1-2) Do you agree with Mr.
10 Gorman's assertion?

11 A. No. Mr. Gorman goes to great lengths to make the Commission believe his fallacy that
12 the funding of a goodwill asset can only be done with equity. The Company's own
13 Mortgage indenture, used to pledge assets securing our debt issuances, states that for
14 property additions that have been operated as a public utility prior to our acquiring it, the
15 cost of this property may include intangible property "for which no separate or distinct
16 consideration shall have been paid or apportioned" and specifically says that "in such
17 case the term property additions...may include such rights and intangible property."
18 (Mortgage indenture, Sections 1.04 and 6.06). Put another way, our debtholders do place
19 value on the intangible assets including the goodwill.

20 **UPDATE OF CAPITAL STRUCTURE**

21 Q. What are the current positions of the parties on capital structure?

22 A. Rebuttal Schedule GWB-2 filed with my rebuttal testimony details the positions of the
23 parties. The Company included the actual capital structure of the parent company

1 Laclede Group as of December 31, 2013 adjusted for the \$80 million 6.35% debt issue
2 that was called in December 2013, and redeemed on January 6, 2014. The debt call
3 decreased the weighted average cost of debt from 4.35% to 4.16%. It also decreased the
4 percentage of debt in the capital structure from 46.8% to 44.2%. Staff did not update the
5 capital structure to December 31, 2013 when it filed true-up testimony on February 14,
6 2013. Rather, Staff left the capital structure as it was on September 30, 2013. OPC
7 witness Gorman did not file any true-up schedules.

8 Q. Did either of these witnesses correct this oversight in their rebuttal or true-up testimony?

9 A. No.

10 Q. Had Staff updated the capital structure, what would Staff's recommended capital
11 structure have been at December 31, 2013 based on its methodology?

12 A. If Staff took into account the call of the 6.35% debt, Staff's recommended capital
13 structure would be 44.2% debt and 55.8% equity, resulting in an increase to revenue
14 requirement of \$1.67 million. It should be noted that although MGE's weighted average
15 cost of debt fell from 4.35% to 4.16% due to this debt call, Staff's weighted average cost
16 of debt would not be affected by the call because Staff's 3.12% cost of debt is based only
17 on specially selected low-priced bonds, rather than on LG's actual consolidated cost of
18 debt.

19 If Staff instead chose to ignore Laclede Gas' call of the 6.35% series debt, the Staff's
20 capital structure would include 46.44% long-term debt and 53.56% equity. In this
21 instance, even taking into account Staff's unreasonably low ROE of 8.9%, the true-up
22 revenue requirement would increase by approximately \$300,000.

23 Q. **Does this conclude your surrebuttal testimony?**

1 A. Yes, it does.

**Laclede Gas Company
Case No. GR-2013-0171
ISRS Capital Structure and Costs
Post Acquisition Update**

<u>Component</u>	<u>% of Total</u>	<u>Cost</u>	<u>Wtd. Cost</u>
Common Equity	53.00% *	9.70%	5.1410%
Long Term Debt	<u>47.00%</u>	4.35%	<u>2.0445%</u>
Total Capital	<u><u>100.00%</u></u>		<u><u>7.1855%</u></u>
Tax multiplier			1.626737
Composite Weighted Cost of Debt			2.0445%

