BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Verified Application for Authority to Issue and Sell First Mortgage Bonds, Unsecured Debt and Preferred Stock, in Connection with a Universal Shelf Registration Statement, to Issue Common Stock and Receive Capital Contributions, to Issue and Accept Private Placement Securities, and to Enter Into Capital Leases, all in a Total Amount Not to Exceed $600 Million	)))))))))	Case No. GF-2009-0450

INITIAL BRIEF OF
LACLEDE GAS COMPANY

Pursuant to the briefing schedule established in this proceeding, Laclede Gas Company ("Laclede" or "Company") submits the following Initial Brief for the Commission's consideration:

I. INTRODUCTION

This proceeding was initiated nearly a year ago when Laclede filed an Application to renew, with certain modest changes, its financing authorization for another three year period. To that end, Laclede recommended that the Commission continue the same overall approach to granting such authority that it currently employs to govern the Company's issuance of stock, bonds and other evidences of indebtedness.

Specifically, Laclede recommends that the Commission continue to provide the Company with the financing flexibility it needs to respond in a timely way to the increasingly volatile financial environment and marketplace it faces today by approving an overall authorization amount over the next three years within a range of $520-600 million. This recommended range is at or below the $600 million authorization amount initially requested by the Company, and recommended by the Staff. Although Laclede continues to believe that it should be granted authority for the full $600 million requested under the governing statute[1] and corresponding Commission rule (393.200 RSMo 2000; 4 CSR 240-3.220), Laclede nevertheless recommends that the Commission authorize financing within this range, as such amount would represent a reasonably conservative level of overall financing authority. Laclede emphasizes that it intends to use the overall financing authority, as it has in the past, only to the extent necessary to meet its public utility obligations and consistent with the specific purposes set forth in the statute.

Moreover, in an effort to provide additional assurances in that regard, Laclede has also recommended that the Commission continue those conditions which it has previously approved to ensure that such flexibility will be exercised by the Company in a manner that adequately safeguards the interests of its utility customers. These conditions include: (1) a requirement that the total amount of long-term debt issued and outstanding at any given time not exceed the lesser of: (a) the value of Laclede's regulated rate base or (b) an amount equal to 65% of Laclede's capital structure; (2) a requirement that Laclede conduct its financings in such a way so as to maintain an investment grade credit rating; and (3) a requirement that any proceeds from any of the financing instruments issued under such authority be used solely for the benefit of the Company's regulated operations. In response to the concerns raised by the Commission Staff in this proceeding, Laclede also agrees that any preferred stock issuances or capital leases entered into under such authority count as debt, and be made subject to these conditions. Based on figures from its last general rate case proceeding, the regulated rate base

[1]For the Commission's convenience, the Company has attached Exhibit 1 to this Brief to show how the $520 - $600 million range was derived in relation to the specific language in Section 393.200.

condition alone would currently result in an overall ceiling of approximately $280 million on Laclede's authority to issue these debt-related instruments.[2]

For its part, the Staff has proposed a set of conditions that depart radically from the current approach. Although Staff has recommended that Laclede be authorized to issue a combined amount of debt and equity equivalent to the $600 million proposed in the Company's application, it has simultaneously proposed that a strict limit of $100 million be placed on the amount of long-term debt that the Company may issue over the three year period based solely on a formula of Staff's own invention. Laclede submits that the Commission should reaffirm its existing conditions as proposed by the Company, and reject the debt limit proposed by Staff, for a number of legal and policy reasons:

- First, in contrast to the self-invented, formulaic approach used to derive Staff's proposed debt limitation, the Commission's existing conditions and safeguards can actually be reconciled with the statutes, rules and regulatory principles that do and should govern utility financings, including the requirements set forth in Section 393.200 (RSMo. 2000). Unlike Staff's approach, the existing conditions do not completely ignore the fact that payment of unreimbursed capital expenditures is a legitimate and statutorily-authorized purpose for which long-term debt may be issued. The existing conditions also do not create the kind of artificial distinction between debt and equity that lies at the heart of Staff's proposed approach but is nowhere to be found in the statute. The existing

[2]This amount will vary depending on how the value of Laclede's regulated rate base changes over time. By way of illustration, for example, in Laclede's current rate case proceeding, Case No. GR-2010-0171, the Staff has proposed a regulated rate base amount that would place a ceiling of approximately $300 million on the Company's ability to issue long-term debt. The essential thing to remember, however, is that the amount of debt Laclede is authorized to issue will always

conditions are also far more consistent with the Commission's traditional practice of permitting utility management to make fundamental business decisions, subject to subsequent prudence reviews. In contrast, the approach recommended by Staff would effectively require that the Commission pre-approve every financing decision that involves the issuance of long-term debt for any reason other than to support a current estimate of future capital expenditures or the refinancing of existing long-term debt.

- Second, when combined with the Company's conservative stewardship of its financial resources, the Commission's existing conditions and safeguards have proven to be completely effective in protecting ratepayers from any improvident financing activities. During the period in which these conditions have been in effect, the Company has managed to maintain an "A" credit rating, a capital structure that is comprised of less than 50% debt, and an overall level of long-term debt and preferred stock that is about $280 million below the value of its regulated rate base.
- Third, these existing conditions and safeguards have afforded the Company the financing flexibility needed to obtain capital quickly and on favorable financing terms during periods of rapid change in the credit markets. The Company's ability to issue $80 million in First Mortgage Bonds in 2008 right before the interest rates on such instruments soared by nearly 250 basis points in less than a month is a prime example of the value of such flexibility.

---

be tied to whether there are regulatory assets in amounts sufficient to support it – a result that ensures such debt will only be used to fund assets rather than operating expenses.

- Fourth, and even more importantly, the financing flexibility afforded by the Commission's existing conditions and safeguards provide the Company with a greater ability to weather disruptions in the credit markets or external factors that can suddenly drive up the amount of cash resources needed to meet its public utility obligations; an attribute that is critical to ensuring safe and adequate service for utility customers;
- Finally, continuation of the Commission's existing conditions and safeguards, and the flexibility they provide, is also far more consistent with the real nature and magnitude of the Company's longer-term financing obligations in that they do not artificially exclude regulatory assets that, while non-capital in nature, must still be financed over extended periods of time.

Given these considerations, it is exceedingly difficult to understand why the Staff has proposed to depart from the Commission's existing financing authorization approach for Laclede in favor of a new one that cannot be reconciled with either the law or long-standing Commission policies. Since there is absolutely no evidence in this proceeding which would show that the existing approach has been ineffective or that such an approach is anything but completely consistent with the statute governing utility financings, the Staff's position seems to be nothing more than a solution in search of a problem, and an ill-conceived one at that. For all of these reasons, the Commission should reaffirm its existing conditions, as proposed by the Company, and approve Laclede's financing authorization consistent with the recommendations set forth herein.

II. ARGUMENT

1. What conditions can and should the Commission place on Laclede's financing authority?

It is not entirely clear from the answers provided and arguments made by Staff during the evidentiary hearing in this case what issues actually remain in dispute between the Company and the Staff regarding the conditions that should be placed on Laclede's financing authority. In contrast to the position taken in his pre-filed testimony, Staff witness Marevangepo testified during the hearing that there was nothing imprudent after all about the Company's proposal to make its financing authority subject to the same financing conditions that the Staff had previously proposed and the Commission previously approved to govern such matters. (Tr. 245, line 21 – Tr. 246, line 1) In fact, Mr. Marevangepo's acknowledgement of the prudence of the Company's proposal was sufficiently stout and unqualified that Staff counsel had to try and clarify on redirect whether Mr. Marevangepo was still recommending the Staff's proposed conditions in this case or was now supporting the Company's proposed conditions. (Tr. 267, lines 6-13).

Staff counsel also took legal positions at the evidentiary hearing that were far more supportive of the Company's proposed conditions than Staff's. For example, much of the difference between the amount of the respective long-term debt limitations recommended by the Staff and the Company relates to the use of financing proceeds to reimburse the Company for capital expenditures it has made, but not yet recovered through rates. This use of financing proceeds is explicitly authorized by Section 393.200 for any such expenditures made in the five year period prior to the filing of a financing application. Accordingly, consistent with this statute and the Commission's own rules, the Company included an exhibit with its financing application in this case (as it has in numerous financing cases in the past) showing that it had incurred unreimbursed expenditures of approximately $279 million for the five-year period ending March 31, 2009. (Exh. 1, Schedule 3). In trying to explain why Staff had completely ignored these eligible expenditures in deriving its recommended debt ceiling, Staff counsel asserted during the evidentiary hearing that the five year period referenced in the statute was meant to be a prospective rather than historical one. (Tr. 36, line 12). Laclede believes there is really no basis for such an interpretation since it is impossible to be reimbursed for expenditure that have not yet been made. Even if such a basis existed, however, adding two more years of capital expenditures, and debt repayments, to the three years of projected expenditures and repayments already identified by the parties, would still increase Laclede's authorized long-term debt level by approximately $200 million above the $100 million debt ceiling proposed by Staff. (Tr. 175, line 25 – Tr. 177, line 1). Accordingly, whether the Commission adopted Laclede's historical view of the five-year expenditure period referenced by the statute or Staff's prospective view, it would still arrive at an authorized debt level comparable to that permitted by the Commission's existing conditions (currently about $280 million based on the figures from Laclede's last rate case).

Perhaps most significantly, while the Staff has proposed a $100 million limitation on the amount of long-term debt the Company may issue, it has continued to a recommend that the Commission approve an overall level of financing authority equal to the $600 million originally requested by the Company. Given Staff's overall recommendation of $600 million, there is simply no basis upon which the Staff can claim that the far lower long-term debt amount that the Company would be authorized to issue under the Commission's existing conditions is not justified or has not been adequately supported. Section 393.200 makes absolutely no distinction based on whether the security under consideration is debt or equity. Instead, it simply references the various kinds of financing instruments that may be authorized by the Commission, including "stocks, bonds, notes, and other evidences of indebtedness payable at periods of more than twelve months" and specifies that such instruments must be used for the purposes identified in the statute. (*Id.*). As a result, a financing authorization under the statute is either warranted by the purposes identified in the statute or its not, regardless of whether the authorization consists of debt, equity or any other covered instrument. In view of this consideration, Staff's affirmative recommendation that Laclede should be authorized to issue up to $600 million in financing for the statutory purposes specified by Section 393.200 is, by necessity, an admission that the Company has also fully substantiated, for purposes of the statute, the much lower long-term debt amounts that the Company would be authorized to issue under the Commission's existing conditions.

In short, Staff has now endorsed the prudence of the long-term debt limitations already approved by the Commission under the existing conditions applicable to Laclede's financing authority. The Staff has also advocated a legal position that would produce results consistent with these existing long-term debt limitations. Moreover, the Staff has recommended the propriety of an overall authorization amount that far exceeds the amount of long-term debt that the Company would be authorized to issue pursuant to those existing limitations. Given these considerations, as well as Staff's inability to justify its own alternative conditions (or even explain how they would work for that matter (*see e.g.* Tr. 221-231)), Laclede submits that there really is no substantive issue as to whether the Commission should continue those existing conditions as proposed by Laclede in this case. Based on the undisputed evidence on the record, the Commission unquestionably should.

That said, because the Staff has not formally abandoned its position, Laclede will use the remainder of this brief to address the "issues" as identified in the Statement of Issues originally submitted by the parties to this case.

A. What amount of long-term debt should be authorized under the Commission's authority?

(i) <u>The Parties respective recommendations:</u>

As previously discussed, Laclede has proposed that it be authorized to issue long-term debt in amounts that the Company believes are reasonable and in the best interests of its customers, provided that the amounts issued and outstanding do not exceed the level currently permitted by the conditions that the Commission has previously approved. Specifically, such amounts may not exceed the lesser of: (a) the value of Laclede's regulated rate base or (b) an amount equal to 65% of Laclede's capital structure. In addition, Laclede has proposed, consistent with prior Commission conditions, that the Company continue to be required to conduct its financings in such a way so as to maintain an investment grade credit rating and that any proceeds from any of the financing instruments issued under such authority be used solely for the benefit of the Company's regulated operations. In response to the concerns raised by the Commission Staff in this proceeding, Laclede has also proposed that any preferred stock issuances or capital leases entered into under such authority count as debt and be made subject to these conditions. As previously noted, based on the regulated rate base calculated in

Laclede's last general rate case proceeding in 2007, these conditions would currently permit the issuance of such instruments in an amount of approximately $280 million.

For its part, the Staff has proposed that Laclede be authorized to issue only $100 million in long-term debt, with the value of any preferred stock with debt-like characteristics, and any new capital leases counted toward the $100 million. The amount recommended by Staff was derived based on a Staff-devised formula that considers only: (a) Laclede's projected capital expenditures over the next three years; (b) plus any planned retirements of current long-term debt; (c) minus all anticipated funds from operations, excluding those funds used to pay dividends.

As discussed below, the Company's proposal to utilize the Commission's existing conditions for purposes of determining how much long-term debt may be issued by Laclede is the only approach proposed in this proceeding that can be reconciled with the law, long-standing Commission policies, and the interests of Laclede's customers in ensuring that the Company has the flexibility to meet the very real challenges posed by today's volatile capital and natural gas markets.

(ii) Continued use of the Commission's existing conditions on the amount of long-term debt that may be issued should be approved because it is the only approach presented in this proceeding that can be reconciled with the statutes, rules and Commission policies governing such matters.

During the course of the evidentiary hearing, it became clear that the Commission, as well as the parties, were struggling in their efforts to divine the exact meaning and intent of the rather arcane language of Section 393.200; the Missouri statute that governs utility financings. Laclede believes that this statute could indeed benefit from a legislative overhaul or even a rulemaking proceeding that would be focused on codifying a clearer interpretation of the statute. One thing that is abundantly clear from the record in this case, however, is that the Company's proposal to continue the Commission's existing conditions on how much long-term debt may be issued by the Company can be reconciled with the statute, as well as with the Commission rules and policies in this area, while the Staff's proposed $100 million condition is completely divorced from and unsupported by these governing authorities.

(a) <u>Failure to consider unreimbursed expenditures</u>

As the statute makes clear, one of the purposes for which "stocks, bonds, notes or other evidences of indebtedness payable at periods of more than twelve months" may be issued is "for the reimbursement of monies actually expended from income" … "within five years next prior to the filing of an application..." Section 393.200.1. The statute goes on to provide that such monies must have been spent for one of the "aforesaid purposes" outlined in the statute which include "the acquisition of property, the construction, completion or improvement of its plant or system, or for the improvement or maintenance of service or the for the discharge or lawful refunding of its obligations." (*Id.*) The only items excepted from this five year reimbursement amount are expenditures made for "maintenance of service" and "replacements." *Id.* In addition to authorizing financings to cover these prior expenditures, the statute also provides that such authorization may be given for future expenditures of a similar nature by stating that the Commission must be of the opinion that the "money, property or labor *to be procured* or paid for" is reasonably required for the purposes specified in the order approving the financing authority. (*Id. emphasis supplied*).

Consistent with these statutory provisions, and Commission rule 4 CSR 240-3.220(1)(G), which requires an applicant to include a "five (5)-year capitalization expenditure schedule," Laclede has for many years submitted an exhibit with each of its financing applications which sets forth the exact amount of unreimbursed expenditures it has incurred for the five year period prior to the filing of such applications. (Exh 4, pp. 6-7). For purposes of this proceeding, that exhibit showed that for the five year period ending March 31, 2009, Laclede had incurred approximately $279 million in unreimbursed expenditures for net property additions, minus retirements, and for repayments of maturing debt. (Exh. 3 to Exh. 1; Exh. 5). Notably, no party has ever taken specific issue with the method used or results obtained by the Company in deriving this quantification of unreimbursed expenditures, either in prior financing proceedings or in this proceeding. And yet Staff has completely ignored these expenditures in developing its recommended debt ceiling. In fact, Mr. Marevangepo testified that he developed his recommendations in this case without *any* reference to, or consideration of, these unreimbursed expenditures. (Tr. 252, lines 18-23).

Adding this amount alone to Staff's recommended debt ceiling of $100 million would result in an overall debt ceiling level of $379 million. Of course, such an amount would be in excess of the $280 million in long-term debt that the Company would be currently able to issue under the Commission's existing conditions limiting such amounts to the lesser of the Company's regulated rate base or 65% of its capital structure. Nevertheless, the Company has previously agreed to such limitations and is willing to abide by them in the future. What the Company should not be required to do, however, is abide by a Staff imposed condition that is completely untethered from the seminal statute and rule that is supposed to govern such matters.

(b) Inappropriate use of funds from operations to reduce authorized amount

The Staff's proposed debt limit of $100 million is also inconsistent with Section 393.200 in that is seeks to artificially reduce the level of projected capital expenditures for which the Company may receive financing authority by arbitrarily assuming that all funds from operations (other than those used to pay dividends) should be allocated to construction. (Exh. 4, pp. 7-8). In other words, rather than base its long-term debt recommendation on the $189 million in capital expenditures that Laclede is projected to incur over the next three years, the Staff has offset that amount by assuming that all funds from operations, an amount equal to $148 million, will be applied toward payment for those expenditures on long-term assets. (Exh. 9, Schedule 1).

There is simply nothing in the statute, however, to suggest that the amounts necessary to fund the purposes for which financing instruments may be issued under the statute must first come from funds generated by operations. In fact, the statute suggests just the opposite by requiring the Commission to certify in its financing approval orders that the authorized financing proceeds will not be reasonably chargeable to operating expenses or income. Section 393.200.1. This indicates a clear legislative intent that financing proceeds be used to support longer-lived utility assets, and not to pay for ongoing operational expenses or as a substitute for income. The other side of the coin, however, is that the amount of financing authority needed to finance such assets should not be artificially reduced by offsetting them, as Staff has, with operating income. Indeed, unless this demarcation is applied both ways, Staff's approach would effectively guarantee that utilities would never be able to issue financing instruments in amounts sufficient to cover the purposes specifically authorized by the statute, particularly when such an approach is combined with Staff's complete disregard for prior unreimbursed expenditures. This is obviously a result that cannot be reconciled with the statute.

In addition to being inconsistent with the statute, Staff's proposed use of funds from operations is also inappropriate for a host of other reasons. For example, such an approach arbitrarily assumes that all funds from operations in excess of those needed to pay dividends should be used to support construction, rather than support the myriad of other utility functions that also require money, including acquisition of non-rate base materials and supplies, and even elimination of a portion of short-term debt. There is simply no support for such an assumption. Indeed, such an assumption is even more inexplicable given the concerns that Staff has raised in this proceeding regarding the fact that the Company has not reduced its short-term debt levels to zero on a seasonal basis over the past several years. (Exhibit 8, p. 4) While Laclede believes the reasons for this are perfectly understandable given the amounts the Company has had to spend on purchasing, transporting and storing gas for delivery to its customers and on its hedging program, the point is that Staff's proposed allocation of all funds from operations to construction would leave the Company with absolutely none of the internally-generated dollars that would be necessary to reduce its short-term debt levels. Clearly, an approach that simultaneously raises a concern and then proposes a course of action that guarantees the concern cannot even be addressed, let alone rectified, is not an approach that deserves to be taken seriously.

Finally, Staff's use of funds from operations is also inappropriate because it makes the very availability of financing proceeds in amounts sufficient to address the Company's capital needs subject to factors that are completely beyond the Company's control and that may vary significantly over time. As Mr. Marevangepo acknowledged during cross-examination, projections of the funds from operations that will actually be achieved by the Company over the next three years require that assumptions be made about the Company's expense profile over that time, as well as what revenues will be received by the Company. As a consequence, if the Company's expenses turn out to be higher over that period of time or its revenues lower, it will not achieve the funds from operations relied upon by Staff to reduce the Company's long-term debt authorization, and Staff's recommended long-term debt amount will be inadequate.

For all of these reasons, the Commission should reject Staff's use of funds from operations to reduce the amount of long-term debt financing authorized for Laclede and instead use Laclede's projected capital expenditures without adjustment. When added to the $50 million in bond repayments which Staff has also identified will occur over the next three years, use of Laclede's actual capital budget of $189 million for the same period would raise Staff's recommended debt ceiling for future expenditures from $100 million to $239 million. When combined with the $279 million in unreimbursed expenditures for past property additions made by Laclede, this would round to a financing authorization of $520 million, without any allowance for financings done to pay down short term debt or finance other as yet unknown utility purposes that would qualify under the Section 393.200. Allowing for these other factors results in a financing authority range of $520-$600 million that is both lawful and reasonable, and should be authorized by the Commission in this proceeding.

(c) <u>Artificial distinction between debt and equity</u>

Another flaw in Staff's approach to deriving its recommended $100 million limit on long-term debt issuances is the unsupported and artificial distinction that Staff makes between debt and equity. In effect, Staff has adopted two entirely different standards based on whether the financing authority is for long-term debt or equity. If it is for long-term debt, then Staff does everything in its power to minimize the amount of authority granted, from ignoring unreimbursed capital expenditures to offsetting future capital expenditures by applying funds from operations. Moreover, Staff summarily rejects as speculative any other long-term issuances that may be warranted by the need to meet unexpected cash requirements, significant changes in the credit markets, or other events that cannot be definitely foreseen at this time. On the other hand, when it comes to equity, the Staff has shown no hesitancy in recommending that the Company be allowed to issue up $600 million in such securities, with no other restrictions or limitations of any kind.

This striking dichotomy between how Staff approaches its debt versus equity recommendations has no basis in either law or policy. As even a summary reading of Section 393.200 makes clear, the statute makes no distinction based on whether the security under consideration is debt or equity. Instead, it simply references the various kinds of financing instruments that may be authorized by the Commission, including "stocks, bonds, notes, and other evidences of indebtedness payable at periods of more than twelve months" and specifies that such instruments must be used for the purposes identified in the statute. (*Id.*). As a consequence, a financing authorization under the statute is either warranted by the purposes identified in the statute or it is not, regardless of whether the authorization consists of debt, equity or any other covered instrument.

Given these considerations, there is no tenable basis upon which the Staff can assert, as it has, that the Company has substantiated its request for $600 million in overall financing authority, but then take the position that the Company has only supported the need to issue $100 million in long-term debt. Unless the Staff is taking the extraordinary position that it has recommended to the Commission approval of an overall level of financing authority that cannot be justified under Section 393.200, then it is clear as a matter of simple logic that the lower long-term debt amount that would be permitted by the Commission's existing conditions would also be fully justified under the relevant law.

In addition to being inconsistent with the statute, Staff's attempt to impose such harsh limitations on the issuance of debt, while freely permitting the Company to issue six times more in equity, is also non-sensical when one considers the current cost of these instruments. As Mr. Marevangepo acknowledged, Laclede can issue debt for around 6.5% today, and also obtain a tax deduction for the interest paid on that debt. According to Staff's own analysis in Laclede's pending rate case, however, Laclede's cost of common equity is some 300 basis points higher, or 9.5%, at Staff's recommended mid-point and does not come with a tax deduction for interest. Why the Staff would think it makes any sense to sharply limit the amount of 6.5% money that the Company can issue while simultaneously promoting the use of 9.5% money is and remains a mystery. In any event, such anomalous results are simply another indication of the lack of any reasonable policy basis for the inconsistent treatment afforded by Staff to these two kinds of financing instruments.

(d) <u>Conflict with traditional roles of utility management and regulator</u>

In addition to being inconsistent with the statute and rules that govern utility financings, Staff's approach for deriving the amount of long-term debt authorization that should be granted in this proceeding is also fundamentally inconsistent with the Commission's duty to regulate, but not manage, the utilities subject to its jurisdiction. (Exh. 2, p. 17). The Commission has repeatedly recognized that while it may regulate a public utility's operations, it may not substitute its business judgment for that of the company's management so long as safe and adequate service is being provided. For example, in ***Re: Transportation of Natural Gas***, the Commission recognized that it could not and should not attempt to dictate decisions relating to the particular mix of gas supplies and transportation capacity that a local distribution company should procure to serve its customers. As the Commission explained:

> The next issue pertains to the Commission's authority to regulate the mix of system supply gas, transported gas and spot market gas. The majority of the parties filing legal memoranda agree that the Commission cannot regulate the mix of various types of gas procured by LDCs. The parties believe the Commission may only look, after the fact, at the prudence of management's decisions to produce different types of gas. At least one party believes that the Commission may regulate the LDCs' mix of gas through its ability to assure the provision of safe and adequate service.
>
> Although the Commission has the authority to regulate local distribution companies, it does not have the "authority to take over the general management of any utility." Missouri ex rel. ***Laclede Gas Co. v. Missouri Pub. Service Commission,*** 600 S.W. 2d 222, 228 (Mo.App.1980). "The utility retains the lawful right to manage its own affairs and to conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation and does no harm to public welfare." ***Missouri ex rel. Harline v. Missouri Pub. Service Commission,*** 38 PUR3d 451, 343 S.W.2d 177, 182 (Mo.App.1960).

> The Commission finds that a company's choice of the appropriate mix of gas to procure is a management decision and is properly left to the company. The Commission may review for prudency the management decisions made in connection with said procurement as it does other management decisions, in the company's rate cases.

Case No. GO-85-264, 28 Mo.P.S.C. (N.S.) 619 (Opinion and Order issued March 20, 1987)

If approved by the Commission, however, the draconian debt limitations recommended by Staff would result in this very kind of outcome for financing decisions by effectively requiring that the Commission specifically approve each instance where Laclede seeks to issue long-term debt.

Such an outcome would be no more permissible or advisable for financing decisions than the Commission found it would be for decisions relating to the acquisition of gas supplies and transportation capacity. To the contrary, just like wholesale natural gas prices, the record in this case shows that the credit markets can change dramatically over very short periods of time. Indeed, the last time Laclede issued bonds in 2008, the interest cost of similar debt placements rose by over 250 basis points in just the one month following this issuance. (Exh. 2, pp. 17-18). Fortunately, the Company was able to use the flexibility it had under the Commission's existing conditions to issue bonds and save its ratepayers millions of dollars over the life of the bonds. (*Id.*) Cash requirements can also escalate tremendously in just a month or two as the result of other external factors beyond the Company's control, such as rising gas prices and the impact of margin calls in connection with the Company's hedging program. (Exh. 2, p. 18). Indeed, in just the past several years alone, the Company has been faced with the need to pay literally hundreds of millions of dollars in margin calls over a period as short as nine months. Recent history also has demonstrated the breathtaking speed with which serious disruptions in the credit markets can take place, potentially limiting the Company's ability to issue short-term debt and forcing it into the intermediate-term debt market.

Because the Staff has proposed to artificially reduce the amount of long-term debt that the Company would be permitted to issue over the next several years, however, the only way that the Company could issue debt in response to any of these developments, would be to request specific approval from the Commission. Presumably, such an approach would entail having the Company come forward with whatever market data or circumstances it believes warrants a particular issuance. (Exh. 2, p. 17). Such data, together with the Company's supporting analysis, would be evaluated by the Staff and then the Commission for purposes of determining whether the issuance should be approved. (*Id*.) Then, and only then, would the Company be permitted to move forward with the issuance, assuming that there were no issues to litigate and the Staff and the Commission decided it was reasonable and appropriate to do so under the circumstances. (*Id*.). Of course, if there was a need to litigate because the Staff did not agree with the Company's reasoning or data, such an approval process could take up to a year to complete, just as this one has, in which time any favorable opportunities in the market could have evaporated or the Company's funding need could have escalated to a crisis level.

There is simply no justification for such an approach. It promises to prevent utilities like Laclede from taking the kind of timely financing actions that can save customers money over time or assure full access to the credit markets. Moreover, it would place the Staff, and potentially the Commission, in the position of having veto power over whether a particular financing decision is acted upon. Indeed, in many instances, the Staff alone would be effectively deciding the issue since its recommendation against approving a particular financing request on the terms proposed by the Company would foreclose any opportunity to take the kind of timely action required to respond to a rapidly changing market.

In other instances, including those where the amounts being financially committed by the utility are far greater than is the case here, the Commission has expressed a clear preference for allowing the utility to make the decision, subject to a subsequent review of its prudence. Indeed, hundreds of millions of dollars in financial commitments are made each and every year by numerous Missouri utilities for gas supplies, hedging instruments, transportation contracts and other expenditures necessary to provide utility service; all without the kind of advanced, pre-approval suggested by Staff's approach in this case. Unless the Commission is prepared to undertake the responsibility for managing the financial activities and decision for the utilities subject to its jurisdiction – a result that Laclede believes would be ill-advised and inconsistent with current law – it should reject Staff's attempt to lead it down that road.

For all of these reasons, the Commission should conclude that Laclede's proposal to continue the long-term debt limitations imposed by the Commission's existing financing conditions is fully consistent with the law, its own rules and its long-standing policies regarding the proper role of utility management and utility regulation. For the same reasons, the Commission should conclude that Staff's proposed long-term debt condition satisfies none of these legal and regulatory requirements and should accordingly be rejected.

(iii) <u>Continued use of the Commission's existing conditions on the amount of long-term debt that may be issued should be approved because</u>

<u>such conditions have been proven to be completely effective in protecting ratepayers and would continue to provide the Company with the flexibility it needs to respond to rapidly changing conditions in the credit and natural gas markets.</u>

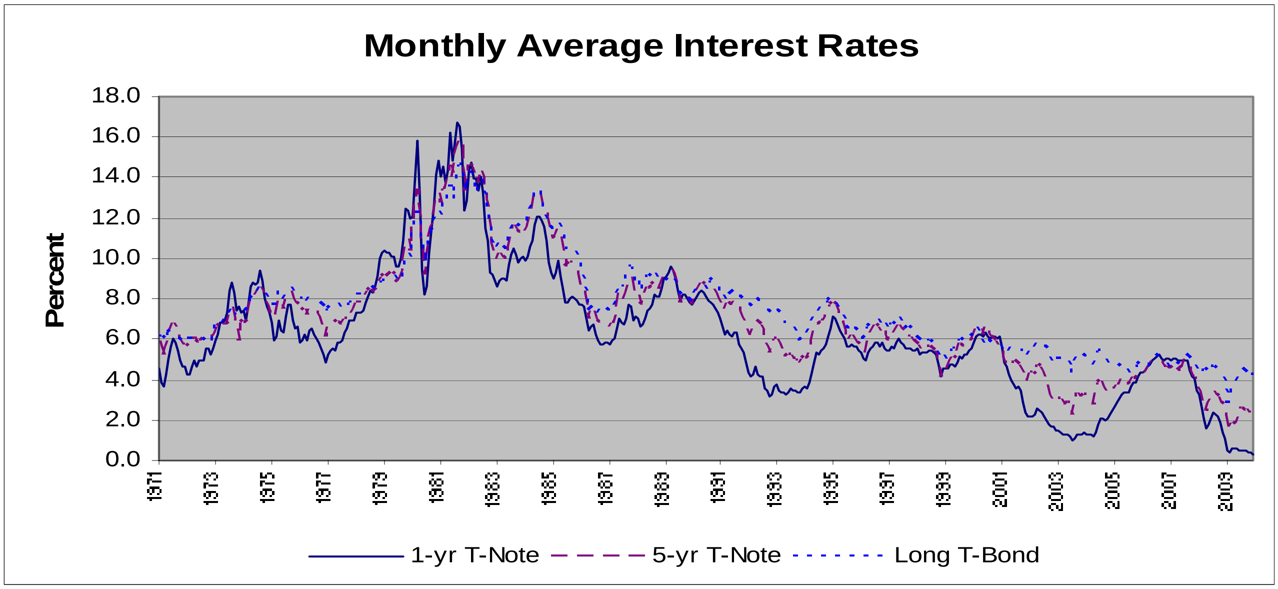
Based on the foregoing, it is clear that the Staff is seeking to have the Commission depart from financing conditions it has previously approved and that can be easily reconciled with the statutes, rules and policies governing these matters in favor of a new Staff-invented condition that does none of these things. The record demonstrates, however, that there is literally nothing to support such a radical change in policy and much to recommend continuation of the current one.

In terms of any evidence that would warrant a change in the Commission's policy, there is simply nothing in the record, nor was the Staff able to point to anything, that would suggest that the Company has not properly and prudently managed the financing flexibility it currently has under its existing authority. (Exh. 2, p. 14). In fact, the Staff itself has repeatedly noted that Laclede had only issued $80 million in long-term debt under its existing $500 million financing authorization together with approximately $50 million in equity. (Exh. 10, p. 3).

In addition, Laclede has substantially exceeded *all* of the safeguards that the Staff itself had previously recommended and the Commission approved to ensure that customers would not be adversely affected by Laclede's exercise of its authority to issue long-term debt. Specifically, Laclede has continued to maintain an investment grade credit rating. (Exh. 2, p. 3). It has also maintained an overall amount of long-term debt that is substantially less than 65% of its capital structure (48.3%) and some $275 million below the value of its regulated rate base. (Exh. 2, pp. 3-4). In short, Laclede has demonstrated in about every way it can that it is a prudent steward of its financial resources and can be trusted to exercise the financing flexibility it has previously been given by the Commission in a conservative and constructive manner.

Given these considerations, there is absolutely no basis for concluding that a diminution in this financing flexibility is warranted, let alone the kind of draconian reduction proposed by the Staff. In fact, as explained by Lynn Rawlings, Laclede's Treasurer, maintaining such flexibility is critical for both the Company and its customers, as well as the Commission. First, it provides the Company with the agility it requires to respond on a timely basis to external factors that can quickly alter the relative cost, availability and need for various forms of capital. (Exh. 2, p. 9). By doing so, it enhances the Company's ability to take advantage of favorable pricing opportunities that may arise in the credit markets, including the ability to determine the mix of financing alternatives that is best calibrated to benefit customers based on changing market conditions. (*Id*.) It also allows Laclede to respond proactively to challenging credit environments, like the one that has prevailed since 2007, that have and can threaten or economically preclude its access to certain forms of credit. (*Id*.). Finally, such an approach relieves the Commission and its Staff of the need to separately evaluate and approve each financing decision – an exercise in efficiency that not only frees up Commission resources for other regulatory demands but, as previously discussed, also honors the long-standing dividing line between permissible regulation and impermissible management of utility business activities. (*Id*.).

Ms. Rawlings provided a number of examples of why maintaining such flexibility is critical. One of them relates to the potential need to respond to changes in the absolute and relative cost of the "long-term" debt instruments (i.e., those with maturities of one year or more) that require financing authorization from this Commission. (Exh. 2, pp. 9-10). Currently, rates for long-term debt with shorter (one- to five-year) maturities are low, due largely to current federal fiscal policies, but that has not always been the case.



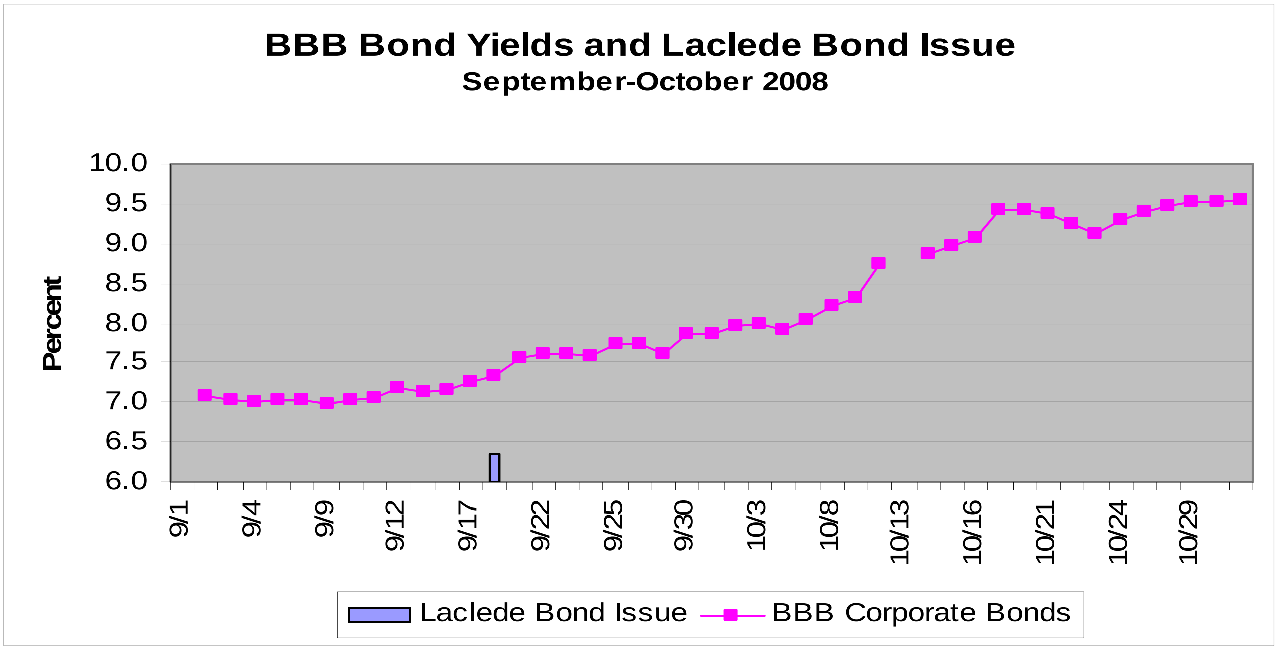
As the above graph shows, U.S. Treasury securities yields of all maturities (on which the cost of Laclede's debt would be based) have fluctuated widely over the years. Treasury rates have declined below 6% in more recent periods, after having exceeded 9% for nearly a decade in the 70's and 80's, with a peak approaching and even exceeding 16% in 1981. (Exh. 2, p. 10). Increases and decreases in the cost of corporate debt instruments such as Laclede issues can be just as significant and volatile.[3]

Moreover, such fluctuations can occur rapidly. A good example of just how rapidly can be found in the movements of bond yields that occurred around the time Laclede last issued long-term debt in 2008. As the graph presented below shows, within

---

[3] The graph presented above utilizes historical rates for one-year treasury notes, five-year treasury notes, and long-term treasury bonds, as taken from the Federal Reserve Statistical Release H.15 Selected Interest Rates (www.federalreserve.gov/releases/h15/) (*See also* Exh. 2, p. 10).

just weeks of the time Laclede completed its debt issuance in September 2008, the yield on BBB-rated corporate bonds had increased by an astounding 250 basis points (that is, 2.5 percentage points)! Given the $80 million value of the financing, this would have represented an additional cost of $2 million per year over the 30-year duration of the bonds, had Laclede been delayed in completing the transaction.[4]



Although Laclede has a somewhat higher bond rating, these movements in BBB bond yields are indicative of what Laclede could have experienced had it not been able to issue bonds on a timely basis. (Exh. 2, p. 11). Fortunately, the current approach to financing authorizations provides utilities, like Laclede, with the ability to take these absolute and relative cost trends into account – and make appropriate and timely

[4] The graph utilizes data on the Moody's BBB Corporate Bond Index from the Federal Reserve Statistical Release H.15 Selected Interest Rates (www.federalreserve.gov/releases/h15/) (*See also* Exh. 2, p. 11).

adjustments – when determining what mix of debt securities is best designed to meet the capital needs of the business and achieve favorable results for their customers. (*Id*.).

Another external factor driving the need to maintain such flexibility is a change in the working capital requirements that Laclede and other LDCs face as a result of fundamental changes in their businesses and the natural gas marketplace. (Exh. 2, p. 12). For example, Laclede has always been required to purchase and pay for gas supplies in advance of when it receives payment for such supplies from its customers. (*Id*.). The cost of procuring such supplies, however, has increased several-fold over more recent years. So too has the magnitude of spikes in natural gas prices, which can impose particularly heavy cash demands over short periods of time, as evidenced by comparing the peak NYMEX price of about $4.50 per MMBtu for the period of 1994-1999 to the peak NYMEX prices seen in the 2000's, which exceeded $8.00 per MMBtu in eight of the ten years of that decade, and climbed to over $15.00 per MMBtu in 2005.[5] (*Id.*). This simply reconfirms the need to maintain the financing flexibility necessary to issue various layers of debt or equity on a timely basis so that the Company's overall funding portfolio can support such cash requirements. (*Id.*).

The possibility that disruptions in the credit market may make certain forms of debt completely unavailable is another factor that argues for such flexibility. Certainly the credit events that began in 2007 indicate that this is not an idle concern, as even utilities regulated by this Commission effectively found themselves shut out of certain portions of the commercial paper market, and bank lines of credit became difficult or impossible to obtain. (Exh. 2, p. 12-13). If such a circumstance were to recur, Laclede

---

[5] See the website of the U.S. Energy Information Administration, U.S. Department of Energy, http://tonto.eia.doe.gov/dnav/ng/hist/rngc1d.htm

might be forced to look to medium-term notes (with maturities of one to five years) to fund its operations. (*Id*.). While the Company does not currently plan to take such action, establishing and maintaining the ability to do so is simply prudent risk management. Although Laclede has, to date, managed to retain sufficient access to the credit markets – in part because of its careful stewardship of its financial portfolio – the possibility that future credit market disruptions occur that might be severe enough to eliminate even its access to certain forms of credit cannot be dismissed and, once again, argues for not only maintaining the financing flexibility inherent in the existing approach but also enhancing it by authorizing additional forms of funding. (*Id*.). Again, Laclede would note its issuance of bonds in September 2008, which the Company was able to complete quickly after credit markets had just begun to falter, and before access to bond markets became more severely restricted.

Unfortunately, Staff's proposed limitations on long-term debt would severely reduce this flexibility for no apparent reason. Given the complete absence of any evidence suggesting that Laclede has in any sense misused this flexibility, and the demonstrated value of maintaining such flexibility, the Commission should approve continuation of its existing conditions for purposes of determining how much long-term debt, capital leases, preferred stock and private placements Laclede shall be authorized to issue or enter into.

B. Should Laclede be allowed to issue preferred stock within the debt limit or above the debt limit?

For the reasons previously stated, Laclede should be permitted to issue preferred stock in amounts that it believes are reasonable and in the best interests of its customers, provided that such amounts are counted as debt, and made subject to the currently approved conditions described above. Based on the clarification provided by Staff witness Marevangepo, it appears that Staff also agrees that Laclede should be permitted to issue any preferred stock with debt-like characteristics subject to whatever debt ceiling is established in this case and permit Laclede to issue preferred stock that has equity characteristics subject only to the overall financing authorization amount approved by the Commission in this case. (Tr. 215, line 15 – Tr. 218, line 22).

C. What information should be considered appropriate for purposes of determining a reasonable amount of financing authority?

Based on the foregoing, Laclede submits that the information considered by the Commission in determining a reasonable amount of financing authority should include: (a) the quality of the utility's track record in exercising its financing authority under existing conditions approved by the Commission; (b) the statutory purposes for which securities may be issued, including the payment of unreimbursed capital expenditures, repayment of short-term debt, and support of future capital expenditures; (c) the need and advisability of providing utilities with a measure of flexibility to respond to changing market conditions and cash requirements; (d) the impact of any limitations on the proper roles that the Commission and utility management should play in making financing decisions; and any other considerations discussed in the testimony submitted by Laclede in this proceeding.

2. Can and should the Company be required to file with the Commission any credit agency reports issued on the Company, on its debt issuances, or on the Laclede Group?

Laclede should not be required to file credit agency reports to the extent such action would potentially require the Company to violate copyright laws and burden the Company and Commission with unnecessary filings. Since the close of the evidentiary hearing in this case, Laclede has conferred with several credit rating agencies and has been advised that they would not object to Laclede providing copies of agency reports relating strictly to Laclede. Accordingly, to the extent this condition is limited to those credit agency reports involving only Laclede or its affiliates and only those reports that Laclede has received and obtained permission to provide, Laclede would have no objection to furnishing such reports. That said, Laclede still believes it would be most efficient for the Staff to register with the rating agencies to obtain such reports for itself, not only for Laclede but for other utilities it regulates.

III. CONCLUSION

Laclede has requested nothing more in this proceeding than a determination by the Commission that the Commission itself has, in fact, been exercising its financing authorization powers over the past ten years in a manner that is both prudent and fully consistent with the statute under which those powers are derived. The Commission can and should do that by reaffirming both the financing flexibility and the ratepayer safeguards that it has previously approved to govern Laclede's management of its financing resources. The Staff has presented nothing in this proceeding to warrant any other course of action. Indeed, its proposed debt limitation is completely divorced from the applicable legal and policy considerations that the Commission has properly reflected in its existing financing conditions for debt issuances and should accordingly be rejected. For all of these reasons, Laclede Gas Company respectfully requests that the Commission approve the Company's financing requests consistent with the recommendation set forth herein.

Respectfully submitted,

/s/ Michael C. Pendergast

Michael C. Pendergast
Vice President and Associate Gen. Counsel
Missouri Bar No. 31763
Rick Zucker
Missouri Bar No. 49211
Assistant General Counsel - Regulatory

Laclede Gas Company
720 Olive Street
Room 1520
St. Louis, MO 63101
(314) 342-0532
(314) 421-1979 (Fax)
mpendergast@lacledegas.com

ATTORNEYS FOR LACLEDE GAS COMPANY

Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing pleading was served on the parties to this case on this 21st day of May, 2010, by hand-delivery, e-mail, fax, or by United States mail, postage prepaid.

/s/ Rick Zucker

393.200.1 RSMO

A gas corporation, electrical corporation, water corporation or sewer corporation organized or existing or hereafter incorporated under or by virtue of the laws of this state may issue stocks, bonds, notes or other evidences of indebtedness payable at periods of more than twelve months after the date thereof, when necessary for the acquisition of property, the construction, completion, extension or improvement of its plant or system **($189 Million)**[1], or for the improvement or maintenance of its service or for the discharge[2] or lawful refunding of its obligations **($50 Million)**[3] or for the reimbursement of moneys actually expended from income, or from any other moneys in the treasury of the corporation not secured or obtained from the issue of stocks, bonds, notes or other evidence of indebtedness of such corporation, within five years next prior to the filing of an application with the commission for the required authorization **($279 Million)**[4], for any of the aforesaid purposes except maintenance of service and except replacements[5] in cases where the applicant shall have kept its accounts and vouchers of such expenditure in such manner as to enable the commission to ascertain the amount of money so expended and the purposes for which such expenditure was made; provided, and not otherwise, that there shall have been secured from the commission an order authorizing such issue, and the amount thereof, and stating the purposes to which the issue or proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property or labor to be procured or paid for by the issue of such stock, bonds, notes or other evidence of indebtedness is or has been reasonably required for the purposes specified in the order, and that except as otherwise permitted in the order in the case of bonds, notes and other evidence of indebtedness, such purposes are not in whole or in part reasonably chargeable to operating expenses or to income.

Authority for Financing Identified Items per Statute (rounded):	**$520 Million**
Plus other unknown amounts that may be needed for the purposes described above, including converting short-term debt into long-term debt and financing regulatory assets, etc.	**$ 80 Million**
TOTAL	**$600 Million**

[1] Exhibit 8HC, Schedule 1
[2] This would cover discharge of short-term debt. Laclede has not specified an amount of short-term debt that it might convert to long-term, so this authority would fit under the need for flexibility. See Tr. 116-18, 139;
[3] Long-term bonds maturing during the authorization period. See Exhibit 8HC, Schedule 1.
[4] Exhibit 1, Schedule 3.
[5] Replacements were excluded from Exhibit 1, Schedule 3 in arriving at the figure of $279 million.