

**Exhibit No.:**  
**Issue:** Capital Structure, Weighted  
Average Cost of Capital  
**Witness:** Glenn W. Buck  
**Type of Exhibit:** Direct Testimony  
**Sponsoring Party:** Missouri Gas Energy, a Division of  
Laclede Gas Company  
**Case No.:** GR-2014-0007  
**Date Prepared:** September 16, 2013

**MISSOURI GAS ENERGY**

**GR-2014-0007**

**DIRECT TESTIMONY**

**OF**

**GLENN W. BUCK**

**SEPTEMBER 2013**

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**SCHEDULE GWB-1 -- CAPITAL STRUCTURE**

**SCHEDULE GWB-2 -- WEIGHTED AVERAGE COST OF CAPITAL**

**DIRECT TESTIMONY OF GLENN W. BUCK**

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**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

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

**Q. WHAT IS YOUR PRESENT POSITION?**

A. I am presently employed as Director, Regulatory and Finance, for Laclede Gas Company (“Laclede” or “Company”).

**Q. PLEASE STATE HOW LONG YOU HAVE HELD YOUR POSITION AND BRIEFLY DESCRIBE YOUR RESPONSIBILITIES.**

A. I was appointed to my present position in April 2013. In this position, I am responsible for the financial aspects of rate matters generally, including financial analysis and planning. I am also responsible for monitoring regulatory trends and developments.

**Q. WHAT WAS YOUR EXPERIENCE WITH THE COMPANY PRIOR TO BECOMING DIRECTOR, REGULATORY AND FINANCE**

A. I joined Laclede in August 1986, as a Budget Analyst in the Budget Department. I was promoted to Senior Budget Analyst in June 1988, and transferred to the Financial Planning Department in December 1988 as an Analyst. I was promoted to Senior Analyst in February 1990, Assistant Manager in February 1994, and Manager in January 1996. In March of 1999 I was promoted to Manager, Financial Services.

**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

A. I graduated from the University of Missouri - Columbia, in 1984, with a Bachelor of Science degree in Business Administration.

**Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THIS COMMISSION?**

1 A. Yes, I have, in Case Nos. GR-94-220, GR-96-193, GR-99-315, GT-2001-329, GR-2001-  
2 629, GR-2002-356, GO-2004-0443, GR-2005-0284, GR-2007-0208, GT-2009-0026, ER-  
3 2010-0036, GR-2010-0171, GC-2011-0006, GC-2011-0098, GO-2012-0363, and GR-  
4 2013-0171. Further, I provided oral testimony before the Commission regarding the  
5 Infrastructure System Replacement Surcharge rulemaking in Case No. AX-2004-0090.

6 **PURPOSE OF TESTIMONY**

7  
8 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. The purpose of my testimony is to present evidence to the Commission concerning the  
10 following:

- 11 1. The capital structure that the Company recommends be used in this proceeding;
- 12 and
- 13 2. The Company's recommended rate of return and return on equity as reflected in  
14 the proposed tariffs.

15 **CAPITAL STRUCTURE**

16  
17 Q. **PLEASE EXPLAIN SCHEDULE GWB-1.**

18 A. Schedule GWB-1 details the elements of the Company's capital structure and calculates  
19 certain embedded costs for the various kinds of capital used to finance the Company's  
20 provision of utility service. Page 1 of Schedule 1 shows the capital structure of the  
21 Laclede Group, the parent company of Laclede Gas, at July 31, 2013 on a Pro-Forma  
22 basis. The capital structure components consist of common equity and long-term debt.  
23 Schedule GWB-1 contains the adjusted two-component capital structure as further

1 adjusted for the pro-forma effect of the August 2013 debt placements utilized in the  
2 financing of the asset acquisition of the Missouri Gas Energy assets approved in GM-  
3 2013-0254. Short-term debt was not included in the capital structure because the average  
4 level of construction work in progress, underground storage inventories, margin calls on  
5 our multi-year hedging program, and deferred gas costs subject to PGA carrying costs  
6 (none of which are either included or proposed to be included in base rates) exceeded the  
7 average level of short-term debt outstanding during the test year. Page 2 of Schedule  
8 GWB-1 shows the embedded cost of long-term debt including the aforementioned debt  
9 placements that settled on August 13, 2013. The embedded cost of debt also included the  
10 beneficial effect of the interest rate swaps Laclede Group entered into related to the  
11 acquisition financing. The net effect of the interest rate swaps was to lower the weighted  
12 average cost of debt by 23 basis points (from 4.58% to 4.35%). Further, the beneficial  
13 effect of the acquisition related financing in a low interest rate environment has lowered  
14 the Laclede Group's embedded cost of debt from 5.59% (as of March 2013, the update  
15 period in the Laclede Division's last rate case) to 4.35% which will inure to the benefit of  
16 MGE customers in this case, and to all Laclede customers for years to come.

17  
18 **Q. ARE YOU REQUESTING THAT THESE CAPITAL STRUCTURE**  
19 **COMPONENTS BE UPDATED?**

20 **A.** Yes. The Company is requesting an update of all elements of the capital structure.  
21

1 **RATE OF RETURN**

2

3 **Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE CALCULATION OF**  
4 **THE RATE OF RETURN THE COMPANY IS SEEKING ON ITS ORIGINAL**  
5 **COST RATE BASE?**

6 A. Yes. Schedule GWB-2 demonstrates the calculation of Laclede's rate of return to be  
7 7.108% (10.224% on a pre-tax basis). This overall rate of return calculation is based on,  
8 among other things, a 9.7% return on common equity which is the same return on equity  
9 agreed to by the Parties to the Laclede Division's last rate case to be used for ISRS  
10 calculations.

11

12 **Q. WHAT IS THE COST OF COMMON EQUITY RECOMMENDED BY**  
13 **COMPANY WITNESS PAULINE AHERN?**

14 A. Ms. Ahern is recommending a return on equity point estimate of 10.25%.

15

16 **Q. MS. AHERN'S RECOMMENDATION INCLUDES A DISCOUNTED CASH**  
17 **FLOW COMPONENT IN THE RANGE OF 8.6% – 8.7%. DO YOU HAVE ANY**  
18 **COMMENTS REGARDING HER RESULTS?**

19 A. While Ms. Ahern's recommendation includes that DCF component in determining her  
20 overall recommendation, she also notes that the DCF result is understated by as many as  
21 350 basis points due to a highly unusual, and in all likelihood temporary, convergence of  
22 historically anomalous market conditions. If only half of this anomalous effect were to

1 be taken into account, her DCF result would be 10.41% ( $8.66\% + (3.5\% / 2) = 10.41\%$ ),  
2 which fully supports her conservative ROE recommendation.

3  
4 **Q. IF MS. AHERN IS RECOMMENDING A RETURN ON EQUITY OF 10.25%,**  
5 **WHY ARE YOU PROPOSING A LOWER COST OF CAPITAL?**

6 A. While Ms. Ahern's recommendation is entirely justified, I am proposing a lower cost of  
7 capital in order to comply with the Stipulation and Agreement approved by the  
8 Commission in our acquisition case (see Paragraph 11(k) of the Stipulation in GM-2013-  
9 0254). In that paragraph, the Company agreed to cap its pre-tax return at a rate no greater  
10 than the pre-tax return authorized by the Commission in Case No. GR-2009-0355. That  
11 pre-tax return was 10.224%. As the Laclede division ROE used for ISRS purposes was  
12 just recently set at 9.7%, for simplicity's sake, I chose to include that rate as the return on  
13 equity. I then lowered the percentage of equity in the capital structure until the pre-tax  
14 return on rate base was equivalent to that authorized in GR-2009-0355

15  
16 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

17 A. Yes.

THE LACLEDE GROUP, INC.  
CAPITAL STRUCTURE  
July 31, 2013 Pro-Forma  
(Thousands of Dollars)

	<u>Amount</u>
Common Equity:	
Common Stock	\$32,699
Paid-in Capital	593,935
Retained Earnings	427,831
Accumulated other comprehensive income (loss)	14,985
Total Common Stock Equity	\$1,069,450
Long-Term Debt:	
5.5% Series Due May 1, 2019	50,000
7% Series Due June 1, 2029	25,000
7.9% Series Due September 15, 2030	30,000
6% Series Due May 1, 2034	100,000
6.15% Series Due June 1, 2036	55,000
6.35 Series Due October 15, 2008	80,000
3% Series Due March 15, 2023	55,000
3.31% Series Due December 15, 2022	25,000
3.4% Series Due March 15, 2028	45,000
2.0% Series Due August 15, 2018	100,000
3.4% Series Due August 15, 2023	250,000
4.625% Series Due August 15, 2043	100,000
Unamortized Discount, Expense, Loss On Reacquired Debt, and Hedging Gains	9,815
Total Long-Term Debt	\$924,815
Short Term Debt:	
Average Short Term Debt	\$0
Total Capitalization	\$1,994,265



Missouri Gas Energy  
Embedded Cost of Debt  
July 31, 2013 Pro-Forma

(Thousands of Dollars)

	<u>Amount Outstanding</u>	<u>Annualized Cost</u>
<u>Long-Term Debt</u>		
3% Series Due March 15, 2023	55,000	1,650.000
3.31% Series Due December 15, 2022	25,000	827.500
3.4% Series Due March 15, 2028	45,000	1,530.000
5.5% Series Due May 1, 2019	50,000	2,750.000
7% Series Due June 1, 2029	25,000	1,750.000
7.9% Series Due September 15, 2030	30,000	2,370.000
6% Series Due May 1, 2034	100,000	6,000.000
6.15% Series Due June 1, 2036	55,000	3,382.500
2.0% Series Due August 15, 2018	100,000	2,000.000
3.4% Series Due August 15, 2023	250,000	8,500.000
4.625% Series Due August 15, 2043	100,000	4,625.000
6.35 Series Due October 15, 2008	80,000	5,080.000
Unamortized Discount, Expense, Loss on Reacquired Debt and Hedge Gains	<u>9,815</u>	<u>(244.957)</u>
Total	<u><u>\$924,815</u></u>	<u><u>\$40,220.043</u></u>
Embedded Cost of Long-Term Debt		<u><u>4.35%</u></u>

**Missouri Gas Energy  
Weighted Average Cost of Capital  
GR-2014-0007**

**Approved Capital Structure GR-2009-0355**

	<u>Percent</u>	<u>Cost</u>	Weighted <u>Cost</u>	Pre-Tax Weighted <u>Cost</u>
Long-Term Debt	56.16%	6.258%	3.514%	3.514%
Short-Term Debt	3.26%	5.920%	0.193%	0.193%
Preferred Stock	1.92%	7.758%	0.149%	0.242%
Common Equity	38.66%	10.000%	3.866%	6.275%
Total	<u>100.00%</u>		<u>7.722%</u>	<u>10.224%</u>

**MGE GR-2014-0007 Pro-Forma Capital Structure  
Based on Ahern ROE Recommendation**

	<u>Percent</u>	<u>Cost</u>	Weighted <u>Cost</u>	Pre-Tax Weighted <u>Cost</u>
Long-Term Debt	46.40%	4.350%	2.018%	2.018%
Short-Term Debt	0.00%	0.000%	0.000%	0.000%
Preferred Stock	0.00%	0.000%	0.000%	0.000%
Common Equity	53.60%	10.250%	5.494%	8.917%
Total	<u>100.00%</u>		<u>7.512%</u>	<u>10.936%</u>

**MGE GR-2014-0007 Proposed Capital Structure  
In Compliance with GM-2013-0254**

	<u>Percent</u>	<u>Cost</u>	Weighted <u>Cost</u>	Pre-Tax Weighted <u>Cost</u>
Long-Term Debt	48.45%	4.350%	2.108%	2.108%
Short-Term Debt	0.00%	0.000%	0.000%	0.000%
Preferred Stock	0.00%	0.000%	0.000%	0.000%
Common Equity	51.55%	9.700%	5.000%	8.116%
Total	<u>100.00%</u>		<u>7.108%</u>	<u>10.224%</u>