

Exhibit No.:	
Issue:	Capital Structure
Witness:	Glenn W. Buck
Type of Exhibit:	Surrebuttal Testimony
Sponsoring Party:	Laclede Gas Company
Case No.:	GR-2010-0171
Date Testimony	
Prepared:	July 20, 2010

LACLEDE GAS COMPANY

GR-2010-0171

SURREBUTTAL TESTIMONY

OF

GLENN W. BUCK

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1 Q. Please state your name and business address.

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

4 Q. Are you the same Glenn W. Buck who previously filed direct and rebuttal testimony in
5 this proceeding on behalf of Laclede Gas Company (“Laclede” or “Company”)?

6 A. I am.

7 Q. What is the purpose of your testimony?

8 A. The purpose of my testimony is to respond to the rebuttal testimony of MIEC witness
9 Gorman on the subject of the appropriate capital structure to use in this proceeding.

10 Q. Please explain your understanding of the position of the parties on the issue of capital
11 structure.

12 A. The Company and the MPSC Staff (“Staff”) both support utilizing the actual capital
13 structure for The Laclede Group (“Group”) as of March 31, 2010. Mr. Gorman has
14 apparently changed his chief argument and position from that filed in his direct testimony
15 to that filed in his rebuttal testimony. In his direct testimony, Mr. Gorman used the
16 capital structure of Group as of September 30, 2009 including a certain level of short-
17 term debt. In rebuttal, for reasons that are not apparent to Laclede, Mr. Gorman changed
18 his recommendation to be based on the September 30, 2009 capital structure of the
19 Laclede Gas Company (instead of Group) and excluding short-term debt (Gorman
20 Rebuttal, page 18, lines 6 – 9).

21 Q. Did Mr. Gorman give any explanation at all for this change in position?

1 A. In his rebuttal testimony (Rebuttal, page 14, lines 13 – 15), Mr. Gorman claims that he
2 was “mistakenly led to believe” based on his review of Laclede witness Murry’s
3 testimony that the Company was using Laclede Gas Company’s capital structure rather
4 than the capital structure of its parent, The Laclede Group, Inc. and that his change in
5 position was taken once he learned otherwise.

6 Q. Does this sound plausible to you?

7 A. I certainly think that Mr. Gorman could and should have known that Laclede Group’s
8 capital structure was used as the basis for the Company’s filing. Mr. Gorman had more
9 than five months to review Laclede’s testimony and schedules before he filed his own
10 direct testimony. Even a cursory review of that testimony would have revealed that the
11 capital structure of Laclede Group was being used and it is clear that Mr. Gorman
12 performed such a review. For example, at page 7 of his direct testimony, Mr. Gorman
13 specifically cited Laclede Accounting Schedule 3, which is a two page document entitled
14 **“THE LACLEDE GROUP, INC CAPITAL STRUCTURE”** (emphasis supplied).
15 Obviously, that schedule clearly indicates that Laclede Group’s capital structure is being
16 used by the Company. In his direct testimony, Mr. Gorman also cited pages 9-10 of my
17 direct testimony where I, as well, indicated that the “capital structure of *Laclede Group*”
18 as reflected in schedule 3 was being used. Dr. Murry also referenced the “Laclede
19 Group” in Schedule DAM-6 to his direct testimony.

20 Q. Has use of the utility parent’s capital structure also been routine in other proceedings?

21 A. Yes, having testified in numerous proceedings here in Missouri, Mr. Gorman must be
22 well aware that the Commission has consistently approved rates of return based upon

1 parent company capital structures. This was most recently done in the MGE rate case. It
2 has also been done in Laclede's last two rate cases, including the 2007 case in which Mr.
3 Gorman also submitted return on equity testimony. Given these considerations, I am at a
4 loss to understand how there could have been any real confusion on this issue.

5 Q. Did you notice any factual errors with Mr. Gorman's position in his rebuttal testimony?

6 A. Mr. Gorman made both an error of fact and an error of omission in his rebuttal testimony.
7 His factual error is a result of not reducing the balance of the outstanding long-term debt
8 for the amount of debt issuance expenses and unamortized call premiums outstanding as
9 of September 30, 2009. Ignoring these items artificially increases the long-term debt
10 proceeds "received" by the Company, and would also understate the effective interest
11 cost of the debt. A corrected version of Mr. Gorman's position is detailed on Schedule
12 GWB-S1. Mr. Gorman's error of omission is related to the fact that the capital structure
13 should have been updated to March 31, 2010 levels, consistent with the Commission's
14 Order Adopting Procedural Schedule and Establishing Test Year issued on February 1,
15 2010. A corrected version of Mr. Gorman's position as updated for both the correction
16 and omission is also detailed on Schedule GWB-S1. Please note that Laclede believes
17 that Mr. Gorman is **fundamentally wrong** in the positions he has taken as will be
18 addressed later in this testimony. The noted corrections to Mr. Gorman's schedule are
19 only included to ensure that the parties are not quibbling over fact issues in the hearing
20 room.

21 Q. Mr. Gorman is now recommending that the Commission utilize the capital structure of
22 Laclede Gas Company rather than that of the parent company. How do you respond?

23 A. That is neither rational nor consistent with past practice of the Commission.

1 Q. Please explain.

2 A. Interestingly, Mr. Gorman discusses a recent MGE rate case in his rebuttal (Rebuttal,
3 page 18, lines 1 – 5) in an attempt to bolster his position. But a review of the
4 Commission order in that case (Case No. GR-2009-0355) reveals that the Commission
5 found that it was most appropriate to utilize the capital structure of Southern Union in
6 determining the revenue requirement of MGE. Similar findings were made in other MGE
7 cases, including Case Nos. GR-2004-0209 and GR-2006-0422. Additionally, there are
8 numerous past cases involving Aquila, Inc. wherein the Commission found that it was
9 appropriate to use the corporate consolidated capital structure in setting rates.

10 Q. Is it appropriate to use the parent company capital structure in determining rates for the
11 utility subsidiary?

12 A. Yes.

13 Q. Why?

14 A. There are two very good reasons to use the parent company capital structure. First,
15 investors cannot invest in the equity of a wholly-owned subsidiary company. As such,
16 equity investors will look at the overall capital structure of the consolidated parent
17 company to determine their risk/reward outlook. As the Commission noted in the recent
18 MGE case, the consolidated company management has the management levers over how
19 a company is financed, and investors can evaluate that capital structure in making
20 investment decisions. Similarly, debt investors look at the company as a whole and
21 evaluate, among other things, the leverage the company has and whether there is any
22 amount of “ring-fencing” when determining whether to invest in debt securities. Further,

1 by utilizing a consolidated capital structure, the Commission does not have to worry
2 about the prospect of a company “double-leveraging” parent company debt.

3 Q. Please explain.

4 A. In a scenario where the ratemaking capital structure is set based on the subsidiary’s
5 “stand-alone” books, the parent has the ability to issue lower-cost debt at the parent
6 company level, and “equity infuse” the same dollars down to the utility subsidiary where,
7 presumably, regulators will allow a return on the “equity” at a significantly higher cost to
8 its customers. Use of a consolidated parent company capital structure eliminates any
9 benefit from this activity.

10 Q. Mr. Gorman states in his rebuttal testimony (Rebuttal, page 17, lines 3 – 16) that the
11 “industry average” capital structures, as cited on Schedule MPG-R2, have a lower
12 percentage of equity than the actual Laclede Group capital structure which both the
13 Company and Staff have recommended be used in this case. Do you have any comments
14 on this assertion?

15 A. Yes. First, Mr. Gorman seems to be contradicting his own direct testimony and
16 schedules. Specifically in Schedule MPG-2 to his direct testimony, Mr. Gorman notes
17 that the Value Line listing for Laclede’s comparable companies shows an average
18 common equity percentage of 58.7%. Additionally, the capital structures of the
19 comparable companies used by Mr. Gorman in his direct testimony also have equity
20 ratios very similar to the one being recommended by the Company and Staff in this
21 proceeding, and substantially higher than the one being recommended by Mr. Gorman.
22 Further, if one were to “drill down” on the rebuttal data Mr. Gorman uses in Schedule
23 MPG-R2, it becomes apparent that the underlying data is based largely on the natural gas

1 subsidiaries or divisions of integrated companies and electric/gas combination companies
2 who have very dissimilar risk to “pure-play” gas companies. Additionally, some citations
3 are to settled cases, where the parties to the case brought a combined package before the
4 respective Commission(s), and the amount of equity in the capital structure in the
5 settlement was nothing more than a “data point” in the respective Commission(s) overall
6 decision as to the appropriateness of the respective settlement agreements. When all is
7 said and done, both Mr. Gorman on Schedule MPG-2 of his direct, and Schedule DAM-6
8 of Dr. Murry’s direct testimony, support the updated capital structure recommended by
9 the Company and Staff in this proceeding. It must also be noted that Mr. Gorman has an
10 additional mathematical error relating to his Schedule MPG-R2. He states that he used a
11 5-year average on the schedule, yet the math and the data works out to be that of a period
12 over six years.

13 Q. Schedule MPG-2 of Mr. Gorman’s direct testimony also shows a peer group average
14 equity ratio as reported by AUS of 51.3%. Does this support Mr. Gorman’s contention
15 that Laclede’s equity ratio is too high for ratemaking purposes?

16 A. As I stated in my rebuttal testimony, the AUS data includes short-term debt. For all the
17 reasons discussed in my rebuttal testimony, short-term debt should not be considered in
18 the permanent capital structure. As noted in the rebuttal testimony, Laclede has a data
19 request in to MIEC seeking details of Mr. Gorman’s citation to the AUS report.¹ To date,
20 Laclede has not received a response to the inquiry. However, I was able to independently
21 acquire a copy of the AUS report, and to confirm that AUS ratios include short-term debt.

¹ Information request e-mailed from Mike Pendergast to Diana Vuylsteke on June 22, 2010.

1 Q. Are there any other reasons why Mr. Gorman's recommended capital structure is
2 inappropriate?

3 A. Yes, Mr. Gorman is advocating use of a less favorable capital structure than what the
4 rating agencies see when evaluating Laclede. Laclede is very protective of its strong
5 credit ratings and believe that such ratings have provided our customers with access to
6 low cost debt and, perhaps more importantly, access to the debt markets when lower-
7 rated utilities were unable to access the market. Under the kind of capital structure
8 recommended by Mr. Gorman, and under the credit restrictions imposed by various
9 underwriters in the credit crisis of 2008, Laclede would have been hampered from issuing
10 debt under reasonable terms, if at all. Instead, because of our strong credit rating, within
11 a week of the period when Lehman Brothers was declaring bankruptcy, we were able to
12 access the debt markets and issue 30-year First Mortgage Bonds at a rate of 6.35%.
13 During the same period, other utilities with lower credit ratings were issuing debt
14 instruments for shorter durations, with interest rates ranging upwards of 8.75%, or an
15 amount more than 200 basis point higher than Laclede. If Mr. Gorman wants to adjust
16 the capital structure of the Company, he should likewise adjust the weighted cost of debt
17 to reflect a hypothetically weaker capital structure and lower credit ratings.

18 Q. At page 18, lines 1 – 5, Mr. Gorman notes that the MGE approved capital structure has
19 less equity than that sought by Laclede. Do you have any comment?

20 A. I believe that the Commission decided the MGE capital structure issue in light of all
21 relevant factors in that proceeding. I could speculate on why the Commission found as it
22 did in GR-2009-0355, but it would only be that – speculation! The reality is that
23 different companies manage risks (including financial risks) in a fashion that they feel is

1 in balance with their shareholders' risk tolerance. Laclede is as close to a "pure-play"
2 company as one could be, and our capital structure should emulate those of our "pure-
3 play" peers, as sponsored by Company witness Dr. Murry.

4 Q. Does this complete your surrebuttal testimony?

5 A. Yes.

GR-2010-0171**Capital Structure - Positions of the Parties**

Laclede & Staff - Based on the March 31, 2010 Capital Structure

MIEC Direct - Filed based on September 30, 2009 Group Capital Structure with STD

MIEC Rebuttal - Filed based on September 30, 2009 Gas Company Capital Structure

	<u>Amount Outstanding</u>	<u>Percentage</u>
<u>Laclede & Staff</u>		
Common Equity	\$ 553,526	59.06%
Short-term Debt	-	0.00%
Long-Term Debt	383,754	40.94%
Total	<u>\$ 937,280</u>	<u>100.00%</u>

<u>MIEC - Direct</u>		
Common Equity	\$ 517,145	48.41%
Short-term Debt	168,464	15.77%
Long-Term Debt	382,666	35.82%
Total	<u>\$ 1,068,275</u>	<u>100.00%</u>

<u>MIEC - Rebuttal</u>		
Common Equity	\$ 402,585	50.84%
Short-term Debt	-	0.00%
Long-Term Debt	389,240	49.16%
Total	<u>\$ 791,825</u>	<u>100.00%</u>

<u>MIEC - Rebuttal - Corrected</u>		
Common Equity	\$ 402,585	51.27%
Short-term Debt	-	0.00%
Long-Term Debt	382,666	48.73%
Total	<u>\$ 785,251</u>	<u>100.00%</u>

<u>MIEC - Rebuttal - Corrected & Updated to March 31, 2010</u>		
Common Equity	\$ 431,804	52.95%
Short-term Debt	-	0.00%
Long-Term Debt	383,754	47.05%
Total	<u>\$ 815,558</u>	<u>100.00%</u>

In the Matter of Laclede Gas Company's)
Tariff to Revise Natural Gas Rate Schedules) Case No. GR-2010-0171

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

Glenn W. Buck
Glenn W. Buck

Joanne E. Allen
Notary Public