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Issue: Finance Case
Witness: Zephania Marevangepo
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

ZEPHANIA MAREVANGEPO

LACLEDE GAS COMPANY

CASE NO. GF-2009-0450

Jefferson City, Missouri
February 2010

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Q. Please state your name?

A. My name is Zephania Marevangepo.

Q Please state your business address.

A. My business address is P.O. Box 360, Jefferson City, Missouri 65102.

Q. What is your present occupation?

A. I am employed as a Utility Regulatory Auditor II for the Missouri Public Service Commission (Commission). I accepted the position as a Utility Regulatory Auditor I in December 2008 and have since been promoted.

Q. Were you employed before you joined the Commission's Staff (Staff)?

A. Yes, I was employed by ABB Inc. in a manufacturing position.

Q. What is your educational background?

A. In July 2007, I earned Bachelor of Science degrees in Business Administration with an emphasis in Accounting and Financial Services from Columbia College. I also earned a Masters in Business Administration with an emphasis in Accounting from Lincoln University in May 2009.

Q. Have you filed testimony in other cases before this Commission?

A. No.

Q. Have you made recommendations in any other cases before this Commission?

A. Yes, I have made recommendations on finance cases, small water and sewer rate cases, and telephone certificate cases before this Commission.

Q. What is the purpose of your testimony in this case?

A. My testimony renders a recommendation to the Commission concerning Laclede Gas Company's 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 or accept Private Placement Securities, and to enter into Capital Leases, all in an amount not to exceed $600 million.

Q. Have you prepared any schedules to support your position that the Commission place a reduced limit on Laclede's debt authority?

A. Yes. I used data provided by the Company to create ***Schedule 1*** attached to this direct testimony.

Q. What limit on Laclede's financing authority do you recommend?

A. I recommend that Laclede's financing authority be disaggregated to allow a maximum authorization of $100 million for long-term indebtedness (Schedule 1), but still allow a total aggregate financing authority of $600 million.

Q. What are the proposed dates for the above-mentioned transactions?

A. The securities may be sold anytime up to three years from the date of Commission approval.

Q. Do you understand the purpose for which the proceeds shall be used?

A. Yes. The proceeds shall be used for the following purposes:

1) To discharge or redeem previously issued securities,

2) To finance the purchase, acquisition and construction of additional properties and facilities, as well as improvements to the Company's existing plant,

3) To improve or maintain service,

4) To discharge or lawfully refund all or a portion of the Company's outstanding short-term debt,

5) To reimburse moneys actually expended from income, and / or

6) To provide the financial resources required to meet the Company's other utility obligations.

Q. What type of business is Laclede Gas engaged in?

A. Laclede Gas Company (Laclede or Company) is a public utility engaged in providing natural gas and natural gas distribution services to residential, commercial and industrial customers in the City of St. Louis, St. Charles, Jefferson, Franklin, Iron, St. Genevieve, St. Francois, Madison and Butler.

Q. What analysis did you perform to allow you to formulate your recommendation in this case?

A. I reviewed Laclede's last financing case, Case No. GF-2007-0220, and learned that Laclede was granted the authority to issue up to $500 million of financing in that case. As of September 30, 2009, Laclede had used approximately $125 million under its existing authority, of which $80 million was debt. This caused Staff to question whether Laclede needed to continue to have such a high level of financing authority from the Commission. Staff is specifically concerned about the amount of debt that should be allowed under financing authorities. For example, if Laclede were to issue long-term debt in order to finance short-term operating needs, then this would cause financial instability and consequently, higher financing costs. If Laclede proposes to issue long-term debt, then the Commission should only authorize amounts that do not exceed Laclede's financing needs for long-term investments.

In reviewing the Application, Staff observed that Laclede had been carrying a higher balance of short-term debt than it had in the past and this level of short-term debt had been increasing year after year for the last three years. Because an LDC's short-term balance is usually reduced considerably, if not completely eliminated by the end of the heating season, Staff questioned this trend. Staff is particularly concerned about this trend given the fact that the holding company, The Laclede Group, does not have any debt outstanding, while Laclede Gas Company's debt continues to increase. The Company has not shown to Staff proof that its short-term debt balance has been reduced to below $100 million. In response, Laclede explained that this short-term debt is related to gas purchases and margin calls associated with hedging, and that this short term debt should eventually be collected through rates – thereby reducing the outstanding short term debt balances. According to Laclede, this would allow for the reduction of this outstanding balance. That has not happened. Although Laclede admits that some of these margin calls would not be recovered within the next year, Laclede never provided a specific amount that would not be recovered within its yearly billing cycle. Notwithstanding Laclede's statements to Staff, the Staff still cannot recommend that the Commission authorize Laclede to issue long-term debt for working-capital needs. From a technical point of view, it is not prudent for a company to use long-term debt to finance working-capital operations that do not provide growth or increase productivity.

In light of these concerns, the primary focus of Staff's analysis of Laclede's Application was determining whether the amount of long-term financing authority Laclede requested could be reconciled with past and planned long-term capital needs. During the course of Staff's evaluation of Laclede's application for determining a reasonable level of long-term debt authority, Laclede requested that Staff also consider the following issues: (a) a change in the market availability of short-term debt on reasonable terms; (b) a change in the comparative cost of short-term debt versus long-term debt; and (c) cash requirements necessary to support a multi-year hedging program significantly comprised of fixed-price instruments. Laclede generally refers to these possibilities as "market driven debt" considerations.

Q. Did Staff consider the issues that Laclede raised?

A. Yes.

Q. What is your conclusion?

A. After considering all of the above factors, conducting discovery, and having discussions and meetings with Laclede personnel, Staff concludes that the level of Laclede's requested financing authority is not supported by Laclede's projected total long-term capital needs. Based on the financial information provided by Laclede (see Schedule 1), Staff recommends that Laclede's debt authority be limited to $100 million because Laclede's total capital needs associated with long-term capital investment and probable refinancing of current long-term debt do not exceed this amount. However, Staff does not propose a limit on Laclede's total requested authority of $600 million. Staff recommends Laclede not be permitted to issue preferred stock within the $600 million limit. If Laclede wishes to issue preferred stock, it should provide to Staff the amount of preferred stock it plans to issue and the expected terms and conditions of such issuance.

Q. Is Staff's proposed limit of $100 million of long term debt a reasonable amount based on Laclede's support for its application?

A. Yes. Staff recommended $100 million of long-term debt based on its analysis of projected Laclede Gas Company financial statements provided by Laclede. This amount is actually more than my estimate of Laclede's total capital needs for the next three years. Laclede's projected capital needs are approximately ** __________ ** (see Shedule 1). Of these capital needs, $50 million is required to refinance two $25 million debt issuances; one in 2010 and another in 2012. Therefore, the *total* estimated external funds needed for Laclede's proposed new investment is approximately ** __________ **.

Assuming Laclede funds this total capital requirement with 65 percent debt (consistent with the minimum equity requirement imposed in Case No. GM-2001-342), then this would require authority to issue approximately ** ________ ** in debt over and above the $50 million required to refinance existing debt. Consequently, Staff believes that based on the financial projections provided by Laclede, a recommended debt authority of ** ________ ** would be justified. However, based on Laclede's representations made to Staff in prior discussions, the approval of $100 million of debt authority may allow Laclede's debt to be more marketable, and therefore, less costly to Laclede's ratepayers. Staff has considered this possibility and believes it to be reasonable. Therefore, Staff recommends an additional ** ________ **

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in debt authority be approved by the Commission to accommodate Laclede's request for this flexibility in the financial markets.

Q. Did you perform any computations to justify your position?

A. Yes, Staff's Schedule 1 shows items Staff believes are identifiable long-term capital needs that Laclede may incur over the next three years. Specifically, $50 million will be used to refinance a $25 million long-term bond maturing in 2010 and another $25 million long-term bond maturing in 2012. An additional ** ___________ ** will be needed to fund anticipated capital expenditures to be incurred in 2010 through 2012.

Q. Do you have any additional concerns or comments?

A. Yes. Staff does not recommend that the Commission authorize Laclede to issue long-term debt for the purposes of financing current or future short-term debt not attached to the Company's identifiable long-term capital needs. Also, Staff does not recommend Commission authorization to issue long-term debt to finance unknown and unsupported short-term debt amounts because Staff is unable to determine the appropriateness of issuing long-term debt to refinance unknown short-term debt not yet incurred. Staff is guided by the provisions of section 393.200, RSMo which addresses the Commission's authority concerning approval of forms of indebtedness, including long-term debt. Staff understands that this statute precludes the issuance of long-term debt for meeting short-term operational needs. Staff believes that an authorization by the Commission for Laclede to issue long term debt for yet to be incurred short term debt would be contrary to the provisions of this statute. Moreover, the Staff believes it imprudent and not in the public interest for the Company to issue long term debt to retire short term debt used for working capital needs.

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Notwithstanding, Staff's concern about the use of long-term debt for short-term needs, Laclede has not provided any pro forma financial information that supports how Laclede plans to execute its required authority. Such information is required for Staff to evaluate Laclede's capacity to issue the financing requested. Because Laclede is requesting a three-year financing authority, it is necessary for Laclede to provide information regarding the amounts, types and timing of planned issuances and the possible impact these financings would have on Laclede's financial ratios.

Staff believes that it must review the requested financing authority to ensure "no detriment" to the public. Laclede's application is for a broad, open-ended financing authority and because Laclede has not provided projected financial statements that at a minimum show a plan as to the timing and expected amounts of security issuances, the Staff cannot assure the "no detriment" standard has been met. If Laclede should accumulate short-term debt financing that it wishes to refinance with long term debt, Laclede may file a supplemental application asking for Commission authority to do so. Staff will endeavor to handle any new request in an expedited manner and to ensure that any such request that may encumber Laclede's natural gas distribution property is a proper use of Laclede's long-term debt capacity attributable to specific operational needs. Although Staff did not mention this in its initial recommendation, the Staff has become aware of the Laclede Group's increasing non-regulated operations through Laclede Energy Resources. Staff believes it is even more important for the Commission to review sizeable debt financings proposed by Laclede to ensure that they are necessary for the regulated operations of Laclede Gas.

Q. What is your recommendation regarding leases?

A. Staff analyzed the Company's request to convert operating leases to capital leases. According to the Company, this conversion will be necessary for the Company to be in compliance with a possible change in the treatment of certain operating leases under Generally Accepted Accounting Principles (GAAP). Staff recommends that the Commission authorize this request, but with the condition that the Company convert only the operating leases addressed specifically by the GAAP rule change. Staff also believes that the Company should notify the Commission when the GAAP rule change will become effective and specify which operating leases will be converted to capital leases.

Q. Do you have any suggestions with regards to the Application process?

A. Yes. For purposes of any subsequent multi-year (no more than three years) financing authorities requested by the Company, Staff believes the process could progress more efficiently if the Company were required to provide with its application detailed evidence showing the amounts of long-term capital investments that have not been financed under the prior financing authority, the type of long-term securities they intend to issue and when the Company intends to issue such securities.

Q. Did you suggest any conditions in your recommendation?

A. Yes. Based on the analysis of Laclede's Application and the supporting information Laclede provided to Staff, Staff recommends approval of the Company's Application with the following conditions:

1. That the Company be authorized to issue and sell debt securities, solicit and accept private placements and issue common stock and receive paid-in capital in an aggregate amount not to exceed $600 million at any time, or from time to time, for three years from the effective date of the Commission's Order,

provided that the total amount of long-term debt issued and outstanding under such authority shall not, at any time during the period covered by this authorization exceed $100 million, and, provided further that the Company shall not be authorized to use any portion of the $600 million for any purpose other than for the exclusive benefit of Laclede Gas Company's regulated operations, as such purposes are specified in Section 393.200.

2. That the Commission's Authority under this case does not include the authority to issue preferred stock.

3. That the current Commission Authority under Case No. GF-2007-0220 shall be superseded by the Commission Authority under Case No. GF-2009-0450.

4. That, if and when individual debt securities are issued under this Application, the Company shall submit a verified report to the Commission's Internal Accounting Department documenting such issuance, the use of any associated proceeds and the applicability and measure of fees under Section 386.300.2.

5. That the Company shall also be required to file with the Commission all final terms and conditions on this financing including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, portion subject to the fee schedule and loan or indenture agreement concerning each issuance.

6. That if debt securities are set at a fixed rate, the interest rate shall not exceed a rate equal to the greater of 300 basis points above the yield on a

United States Treasury security with a comparable maturity at the time of the issuance of the Debt or a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers. If a variable rate is set, the basis for determining the interest rate shall be defined at the time of issuance, along with any maximum or minimum interest rates that may be specified for that series; provided, however, that the initial interest rate will not exceed a rate equal to the greater of 300 basis points above the yield on a United States Treasury security with a maturity comparable to the period that the initial interest rate would be in effect, or a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers.

7. That the Company shall submit to Staff and Public Counsel any information concerning communications with credit rating agencies concerning individual debt securities issued under this Application.

8. That the Company shall file with the Commission any credit rating agency reports issued on the Company, the Company's debt issuances, or on the Laclede Group.

9. That nothing in the Commission's order shall be considered a finding by the Commission of the value of these transactions for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

10. In seeking a renewal of the authority granted in this case, Laclede and Staff shall operate under the general time frames set forth for financing cases in the 2004 case management roundtable project.

11. That the Company shall only convert the existing operating leases to capital leases only after the existing accounting rules or statements on capital leases have been amended. The Company shall notify the Commission when the change has been effected before the conversion takes place.

12. That in future finance cases, the Company shall be required to provide detailed evidence showing the amounts of long-term capital investments that have not been financed under the prior financing authority, the type of long-term securities they intend to issue and when the Company intends to issue such securities.

Q. Does this conclude your direct testimony?

A. Yes, it does.

SCHEDULE 1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY