MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Official Case File Case No. GF-2015-0181

FROM: David Murray, Financial Analysis

/s/ David Murray 06/08/2015 — Project Coordinator / Date

/s/ John Borgmeyer 06/08/2015 — Staff Counsel's Office / Date

SUBJECT: Staff Recommendation concerning the Application of Laclede Gas Company ("Laclede," "Company," or "Applicant") to Re-Establish and Extend the Financing Previously Approved by the Commission

DATE: June 8, 2015

1. (a) **Type of Issues:** First Mortgage Bonds, Unsecured Debt, Preferred Stock, Common Stock, Capital Contributions and Private Placements.

   (b) **Amount:** Up to $550,000,000.

   (c) **Rate:** Unknown and not applicable in terms of stock.

   (d) **Other Provisions:** Further terms and provisions including provisions for prepayment and redemption will be determined at the time of issuance.

2. **Proposed Date of Transactions:** Anytime during the requested period of financing authority through September 30, 2018.

3. (a) **Statement of Purpose of the Issuances:**
   The proceeds from the securities will 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 public utility obligations.

   (b) **From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?**

   Yes, but the authority should be limited to ** __________ **.

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4. **Copies of executed instruments defining terms of the proposed securities:**

   Such instruments have not been executed, but an indication of possible general terms and conditions were included in the Application.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

   Yes

6. **Pro-forma Balance Sheet and Income Statement reviewed:**

   Yes

7. **Capital expenditure schedule reviewed:**

   Yes

8. **Journal entries required to be filed by Laclede Gas to allow for the Fee Schedule to be applied:**

   Unknown until securities are issued.

9. **Recommendation of the Staff:**

   Reject requested amount of $550 million, but authorize ** __________ ** of total capital issuance over the period requested (see Comments and Recommended Conditions)

<u>COMMENTS</u>:

Laclede Gas Company ("Laclede" or "Company") is a public utility engaged in distributing and transporting natural gas to customers in both the eastern and western portions of the State of Missouri. Under the name Laclede Gas Company, Laclede serves customers in the City of St. Louis and ten counties in eastern Missouri. Under the name Missouri Gas Energy ("MGE"), Laclede serves customers in the City of Kansas City and thirty counties in western Missouri. Laclede is a gas corporation subject to the jurisdiction of the Missouri Public Service Commission. Laclede Gas Company is a wholly owned subsidiary of The Laclede Group, which owns other companies.

On April 15, 2015, in Case No. GF-2015-0181, Laclede filed an Application pursuant to Sections 393.190 and 393.200 RSMo, and Commission Rules 4 CSR 240-2.060 and 3.220. The Application requests that the Commission re-establish and extend Laclede's authority to issue

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registered securities (first mortgage bonds, unsecured debt and preferred stock), issue common stock and receive capital contributions, issue and accept private placement investments, and to enter into capital leases, all in a total amount not to exceed $550 million. Laclede claims that it needs the requested authority for the following purposes: (1) to discharge or redeem previously issued bonds; (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 public utility obligations.

While all of the purposes Laclede lists in its Application reflect purposes for which the Commission may authorize financing as listed in Section 393.200(1) RSMo., Staff's concern is whether it is practical and/or reasonable to conclude that Laclede has the need to issue financings for the purposes listed. In addition to setting forth a list of purposes for which a utility may request financing authority, Section 393.200(1) also states that the Commission's order authorizing the financing must also include the Commission's determination that "…in the opinion of the commission, the money, property or labor to be procured or paid for by the issue of stock, bonds, notes or other evidence of indebtedness *is or has been reasonably required for the purposes specified in the order*."

As explained below, experience has demonstrated that the amount of authority the Commission granted Laclede in Case No. GF-2009-0450 and extended in Case No. GF-2013-0085, was not, in fact, reasonably required for the purposes specified in the orders in those cases. Based on experience, and based on Staff's analysis of the evidence in this case, Staff does not believe that the amount of financing authority Laclede requests in this case is reasonably required for the purposes set forth in its Application.

Laclede's Application requests the Commission provide it authority to issue securities for up to $550 million through September 30, 2018. In order to evaluate the reasonableness of Laclede's request, Staff initially issued three data requests to request financial data as it pertains to the period in which Laclede is requesting the Commission grant it financing authority. Staff requested Laclede provide projected financial statements for this period, any information Laclede provided to or received from rating agencies during its most recent interaction with rating agencies, and the pro forma impact of the proposed financings on Laclede Gas' projected credit metrics over the period of the requested financing authority. Staff requested the information in order to assess the reasonableness of Laclede's request and the potential impact of requested debt issuances on credit quality.

Laclede did not provide complete responses to Staff's data requests. Laclede redacted certain amounts of projected funds flow it expects to receive from its operations, specifically cash flows from net income, but also other material items, such as funds provided by ratepayers for taxes it is currently not required to pay on income for purposes of its tax filings (deferred income taxes).

The information Staff requested from Laclede is not unusual, especially for this case, in which Laclede is requesting the Commission provide a very broad financing authority over multiple years. Staff notes that Laclede is the only regulated utility in Missouri for which the Commission has authorized such a broad and high amount of financing authority. For example, Missouri's two largest electric utilities, Ameren Missouri and Kansas City Power & Light Company, typically limit their financing authority requests to specific long-term debt financing requests that they actually plan to issue during the upcoming year in order to refinance short-term debt that has accumulated due to past capital expenditures, or to refinance upcoming maturities or early redemptions of long-term debt. In such situations, it is usually fairly simple for Staff to verify whether the request is reasonable because these utilities only request financing based on identifiable needs, not speculative and convoluted purposes, as Laclede continues to do in this case and in previous cases. Fortunately, the Commission now has evidence from actual experience to judge how much of the requested authority is reasonably required.

For purposes of estimating potential capital needs, it is common corporate financing practice to estimate the difference between the amount of funds the company expects to receive from its operations and the amount of funds the company expects to use in its operations (inclusive of capital expenditures and dividend payments). To the extent that there is a projected deficiency in the amount of funds the company has available for reinvestment in its operations, the company usually incurs short-term debt to initially fund these deficiencies. To the extent Laclede's short-term debt balances reach sustained, higher levels due to investment in long-lived assets, it will need to issue long-term financings to reduce the amount of short-term debt to continue to have adequate capacity in the short-term capital markets to maintain sufficient liquidity. Consequently, Staff issued its data requests in this case to determine not only Laclede's projected capital deficiency, but also how the planned financings requested in the Application may impact Laclede's credit quality by analyzing certain key credit metrics, to which rating agencies give significant consideration.

In response to Staff's Data Request No. 1, Laclede's projected cash flow statements indicate it plans to issue ** **

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Consequently, the amount of financing that Laclede Gas reasonably anticipates it will need for purposes of funding its capital needs is ** __________ . ** This is the amount of authority Staff recommends the Commission authorize for purposes of Laclede's Application.

Staff believes its recommended amount of Commission financing authority is fair and reasonable due to the fact that it is based on the Company's own financial projections (without any downward adjustments made by Staff). Generally, Staff does not recommend that the Commission grant utilities financing authority unreasonably in excess of what the utility reasonably anticipates that it will actually use. Therefore, Staff takes particular issue with this Application's reference to Exhibit 3. In its Application, Laclede asserts that Exhibit 3's total of more than $1 billion represents the maximum amount of authority Laclede would be "allowed" or "permitted to obtain" pursuant to the Commission's Report and Order in GF-2009-0450.

Staff does not agree that Exhibit 3 should form the basis for the maximum amount of financing authority the Commission should allow Laclede. As explained in more detail below, experience has shown that Laclede's assertion of the amount of financing authority the Commission should allow was much higher than what was reasonably required. Therefore, Staff believes the Commission should reevaluate the reasonableness of the approach Laclede proposes to use to determine the amount of authority it needs.

In GF-2009-0450, the Commission's financing authority for Laclede included total capital expenditures projected over the next three years, plus net property additions made in the past, plus amounts needed to redeem maturing debt over the next three years. Laclede asserts that its requested amount of financing authority calculated in Exhibit 3 is consistent with allowable purposes outlined in Section 393.200 RSMo.

However, Staff does not agree that Laclede's calculations of these amounts are consistent with what is reasonably required for the purposes identified. Staff will discuss these items one at a time in the order presented.

First, Laclede's Exhibit 3 asserts that it should be allowed an amount of total capital expenditures over the next three years (total of $562 million). This request for total capital expenditures gives no consideration for cash flows Laclede receives from its operations due to the return on and the return of capital built into Laclede's rates.

In GF-2009-0450, the Commission determined that it was not reasonable to charge all of Laclede's projected income against property, plant, and system expenses to the exclusion of long-term financing. Even though Staff believes it is reasonable to expect that Laclede will reinvest approximately 25% of its income into its operations,[1] thereby reducing the amount of external financing needed over the projected period, Staff did not assume any projected income

1 Laclede's historical financials indicate that it typically distributes about 75% of its income in dividends to the LG.

was used to finance projected capital expenditures. However, Staff believes cash flows received from operations other than from income should be netted from the $562 million of gross capital expenditures shown on Exhibit 3. The most material cash flows provided from operations other than from income are from non-cash expenses, such as deferred income taxes, depreciation and amortization. In the Commission's Report and Order in the 2009 finance case, these items were lumped in with the amount of cash flow received from operations and were generally considered to be capital expenditures that were reimbursable. The cash flows received through these non-cash expenses are not expenditures of capital, but rather a deduction to capital. Depreciation causes a decline in the book value of the company, except if the funds received from depreciation are reinvested back into plant, which it would then be classified as a "replacement." Requests for authority for replacements are explicitly prohibited by the statute because this is just maintenance of capital already contributed. Accumulated deferred income taxes are booked as a liability because while the Company may not have to pay the amount of taxes it records on the financial statements it reports to its investors, it is possible that the Company will have to pay these amounts at some time in the future, which will cause a reversal in the amount of the liability. Consequently, to the extent that these funds are available for investment into the Company's system, they should also be netted from the amount of capital requested.

Because Laclede objected to providing Staff the financial information that would have identified the amount of projected cash flows contributed by income and deferred income taxes, Staff had to estimate the amount of cash flows Staff believes should be the minimum amount netted from gross capital expenditures for purposes of estimating projected capital needs. If the Commission needs the projected amounts of these non-cash expenses to determine the amount of financing authority to allow, the Commission will need to compel the Company to provide this information.

Schedule 1 attached to Staff's recommendation nets out Staff's estimate of the amount of funds from operations other than income that Laclede expects to receive over the period of the authority from the gross amount of capital expenditures Laclede identified in Exhibit 3 attached to its Application. Staff estimates that Laclede will receive cash flow from non-cash expenses from ratepayers in the amount of approximately ** __________ ** over the period of the authority. This results in net capital needs of approximately ** __________ ** for projected capital expenditures.

Second, Staff will explain why Laclede's quantification of $339 million in net property additions made in the past is not reliable for purposes of estimating a reasonable amount of financing for purposes of "reimbursement" of past expenditures. Although the statute provides the "reimbursement of moneys actually expended from income" as one allowable purpose to justify financing authority, Staff does not agree that Laclede's request for this amount is reasonably required for such purpose. Perhaps the most obvious and simplest explanation as to why Laclede's claim for an amount for "reimbursements" of past expenditures based on the formula Exhibit 3 is not reasonable is the fact that experience has proven Laclede does not plan and execute its financings based on the formula in Exhibit 3. Although the statute mentions "reimbursements" as a potential consideration for an amount of financing, the statute also indicates that the Commission must determine that the amount of the authority "is or has been reasonably required for purposes specified in the order." Staff issued Data Request No. 4 to determine how much of Laclede's current financing authority had been used for "reimbursement." Laclede responded (*see* Schedule 2) that because "cash is fungible and is not specifically designated, on a dollar for dollar basis, for a specific purpose such as reimbursement of moneys expended from income," no specific amount of financing can be attributed to "reimbursement." Laclede directed Staff to its response to Staff Data Request No. 5 for the financings issued under the Commission's Authority in Case Nos. GF-2009-0450 and GF-2013-0085.

Laclede's response to Staff Data Request No. 5 (*see* Schedule 3) only shows two sizeable financings since June 30, 2010 (the effective date of the Commission's Financing Authority in Case No. GF-2009-0450). The first being an approximate $40 million issuance of equity to Laclede's parent company, LG, on September 14, 2012 and the second being a $100 million debt issuance on March 15, 2013. The remainder of Laclede's financings only aggregated to an additional approximate $8 million, which were mainly due to small periodic quarterly equity issuances over the period of the authority.

According to Laclede's March 31, 2013 SEC Form 10-Q and September 30, 2012 SEC Form 10-K filings, the proceeds from the equity issuance and the debt issuance were used to reduce the amount of short-term debt outstanding and for general corporate purposes. Staff accepts Laclede's statement that cash is fungible and therefore, attributing the balance of short-term debt to specific, identifiable uses is not easy, but there are some situations in which it is clear as to why Laclede had to incur a significant amount of short-term debt. For example, a few months before Laclede issued $100 million of long-term debt, it retired $25 million of long-term debt with proceeds from short-term debt. Consequently, Staff believes the other $75 million may be attributed to reimbursement for past expenditures. Staff would also accept Laclede's issuance of $40 million of equity to reduce the amount of short-term debt as a reimbursement of past expenditures made from short-term debt proceeds, i.e. the treasury. This results in total long-term financings used to reduce short-term debt of approximately $123 million ($75 + $40 + $8) during the period of the authority.

Perhaps the most important point for the Commission to consider is that the $123 million of long-term financings was not issued to reimburse capital expenditures made before Laclede filed its Application in Case No. GF-2009-0450, but for expenditures made during the period of the authority. If Laclede had truly needed to reimburse the treasury for past expenditures of $279 million as it had claimed at the time it filed its Application in Case No. GF-2009-0450, it would have issued $279 million of long-term financing shortly after being granted the financing authority and used the proceeds to refinance expenditures initially funded by short-term debt. It did not.

Under modern financial management, companies typically use short-term lines of credit and/or commercial paper to fund capital needs, which includes capital expended on property, plant and system. If the amount of short-term debt outstanding increases and is sustained at higher levels due to the fact that this financing was used for investment in long-lived assets, then long-term capital would need to be issued to reduce the amount of short-term debt outstanding. Staff accepts this as a reasonably required need for financing. In fact, Staff routinely recommends approval of financing requests from other Missouri utility companies requesting authority to issue long-term capital to refinance short-term debt outstanding. In Staff's opinion, this would be the amount of long-term financing reasonably required for purposes of reimbursing the company for past expenditures on the system.

It is obvious that although Laclede had maintained in GF-2009-0450 that it needed authority to issue up to $279 million of financing based on its proposed formula, experience has proven this formula is not practical for purposes of estimating a reasonable amount of required financing authority. However, if the Commission is still inclined to allow the Company consideration for past expenditures made from income, then the Commission should only allow for the amount of income retained for reinvestment in the system, i.e. retained earnings. Over the last five years, Laclede has only reinvested approximately $75 million of income back into its plant.[2] Consequently, Staff believes any consideration for reimbursement of income should be limited to $75 million.

The final financing need Laclede identified in Exhibit 3 is the refinancing of maturing long-term debt. Staff does not take issue with this amount. This is a clear and identifiable need which amounts to $100 million for the period of the financing authority.

Thus, after Staff supplemented Laclede's Exhibit 3 to consider other relevant cash flows, Staff estimates Laclede's reasonably required amount of financing authority is approximately ** __________ .** However, as Staff has noted throughout its recommendation, Laclede did not provide complete information in response to Staff's data requests, so it is difficult to ascertain whether Staff has given proper consideration for the various cash flow items that were redacted from Laclede's responses. If a larger amount of Laclede's expected cash flows were from income, then Staff's estimate may be too low. If a smaller amount of Laclede's expected cash flows were from income, then Staff's estimate may be too high.

Although Staff has gone through the convoluted process of attempting to estimate the amount of a possible financing authority based on considering other financial data in addition to Laclede's

2 Laclede Gas Annual Financial Statements for the period 2010-2014 as reported by SNL.

Exhibit 3, Staff's recommendation in this case is based on the simple fact that Laclede's own projected financial statements indicate that it expects to issue ** __________ ** of capital over the next three years. Therefore, even though Staff believes its estimate of ** __________ ** of financing authority is consistent with a reasonable consideration of the source of specific cash flows that are available to Laclede for reinvestment, Staff believes Laclede's projected financial statements indicate the amount of capital Laclede reasonably expects to need authority to issue over the next three years. Therefore, Staff recommends the Commission authorize this amount, subject to the following conditions:

1. That the Company be authorized to issue registered securities (first mortgage bonds, unsecured debt and preferred stock), issue common stock and receive capital contributions, issue and accept private placement investments, and to enter into capital leases in an aggregate amount not to exceed ** __________ ** at any time, or from time to time, through September 30, 2018, provided that the Company shall not be authorized to use any portion of the ** __________ ** 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 total amount of the long-term debt, capital leases, and preferred stock issued and outstanding under such authorization shall not, at any time during the period covered by this authorization, exceed the lesser of the value of Laclede's rate base or 65 percent of its total capitalization, as such conditions are defined in Case Nos. GM-2001-342 and GF-2007-0220.

3. That the current Commission Authority under Case No. GF-2009-0450, which was extended in Case No. GF-2013-0085, shall be superseded by the Authority granted in Case No. GF-2015-0181.

4. That the interest rate for any debt issuance covered by the Application shall not be greater than a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers;

5. 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.

6. 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.

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7. That the Company shall submit to Staff and The Office of the 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.

The Staff respectfully requests that this matter be placed on the Commission's Agenda as soon as possible.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Application for Authority to Issue and Sell First Mortgage Bonds, Unsecured Debt and Preferred Stock, and to Issue Common Stock and Receive Capital Contributions	)))))	Case No. GF-2015-0181

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW DAVID MURRAY and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing Staff Recommendation; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

David Murray

DAVID MURRAY

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 8th day of June 2015.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

Laclede Gas Company
Case No. GF-2015-0181

	Amount *(in millions)*
Gross Construction Expenditures	$562
less Funds from Operations (other than income)	($460)
Net Capex Financing Needs	**$102**

LACLEDE GAS COMPANY
Case No. GF-2015-0181

For the period of Laclede's Financing Authorities granted in Case No. GF-2009-0450 and extended in GF-2013-0085, please identify the specific financings issued for purposes of reimbursement of the $279 million of moneys expended from income. DR requested by David Murray (david.murray@psc.mo.gov)

Response to Data Request No. 0004

As Staff knows, cash is fungible and is not specifically designated, on a dollar for dollar basis, for a specific purpose such as reimbursement of moneys expended from income. Rather, proceeds of financings could be used for multiple other items, including but not limited to funding capital expenditures and discharge of debt (both short- and/or long-term). For funds issued under the authority granted in Case Nos. GF-2009-0450 and GF-2013-0085, please see the response to Staff DR 0005.

Signed by: Glenn W. Buck

LACLEDE GAS COMPANY
Case No. GF-2015-0181

Please specify how much of the $518 million of Commission Authority granted in Case No. GF-2009-0450 and extended in GF-2013-0086 has been used to date. Please reconcile the total amount of financings issued to each individual issuance during the period of the Authority allowed by the Commission under both cases. For each individual issuance, please specify the purpose for which Laclede used the proceeds. DR requested by David Murray (david.murray@psc.mo.gov))

Response to Data Request No. 0005

The attached excel file details the financings issued under the financing authority stemming from Case Nos. GF-2009-0450 and GF-2013-0085. For a discussion of the "purpose for which Laclede used the proceeds," please see the response to DR 0004.

Signed by: Glenn W. Buck

Laclede Gas Company
Case No. GF-2015-0181

PSC Order Granting LGC Authority to:
Issue and Sell First Mortgage Bonds, Unsecured Debt
or Common Stock; or to Receive Paid-in Capital

Total Not to Exceed $518,000,000.00: Expires 6-30-15

Settlement	Financial Instrument Type			Remaining available
Date	FMB	Capital Leases	Capital Contribution	for issuance/sell
				$518,000,000.00
8/27/2010			363,600.70	$517,636,399.30
12/6/2010		300,946.72		$517,335,452.58
12/31/2010			352,286.20	$516,983,166.38
2/25/2011			363,640.50	$516,619,525.88
5/27/2011			341,103.78	$516,278,422.10
8/29/2011			534,965.48	$515,743,456.62
12/21/2011			407,401.94	$515,336,054.68
2/27/2012			685,823.76	$514,650,230.92
5/21/2012			871,756.38	$513,778,474.54
8/28/2012			706,994.82	$513,071,479.72
9/14/2012			39,984,484.82	$473,086,994.90
12/28/2012			805,833.21	$472,281,161.69
3/15/2013	100,000,000.00		872,901.48	$371,408,260.21
5/29/2013			206,675.75	$371,201,584.46
8/22/2013			365,731.20	$370,835,853.26
8/30/2013				
9/30/2013				
12/16/2013			357,044.22	$370,478,809.04
2/24/2014			365,039.01	$370,113,770.03
5/20/2014			418,303.30	$369,695,466.73
				$369,695,466.73
				$369,695,466.73
Cumulative	$ 100,000,000.00	$ 300,946.72	$ 48,003,586.55	