Exhibit No.:	
Issues:	*Rate of Return and Capital Structure*
Witness:	*Zephania Marevangepo*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*GR-2014-0007*
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MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES – FINANCIAL ANALYSIS

SURREBUTTAL TESTIMONY

OF

ZEPHANIA MAREVANGEPO

MISSOURI GAS ENERGY
A Division of Laclede Gas Company

CASE NO. GR-2014-0007

Jefferson City, Missouri
April 2014

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ZEPHANIA MAREVANGEPO

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SURREBUTTAL TESTIMONY

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ZEPHANIA MAREVANGEPO

MISSOURI GAS ENERGY

CASE NO. GR-2014-0007

Q. Please state your name.

A. My name is Zephania Marevangepo.

Q. Are you the same Zephania Marevangepo who prepared the Rate of Return Section of the Staff's Revenue Requirement Cost of Service Report and rebuttal testimony that was filed in this case?

A. Yes. I presented direct testimony, in the Missouri Public Service Commission Staff's ("Staff") Cost of Service ("COS") Report filed on January 29, 2014, and rebuttal testimony filed on March 4, 2014.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to parts of the rebuttal testimony of Missouri Gas Energy's (MGE or Company) cost of equity expert witness Pauline M. Ahern ("Ms. Ahern") and two other Company witnesses, Glenn W. Buck ("Mr. Buck") and Steven P. Rasche ("Mr. Rasche").

<u>EXECUTIVE SUMMARY</u>

Q. Would please summarize the specific updates Staff performed through the true-up period (December 31, 2013)?

A. Staff updated its ratemaking capital structure and Rate of Return (ROR) range through the true-up period. The updated capital structure comprises 53.56 percent equity and

46.44 percent long-term debt. The capital structure update resulted in an updated ROR range of 5.68 percent to 6.22 percent with a mid-point of 5.95 percent.

Q. Would you please summarize the specific rate of return positions sponsored by Ms. Ahern, Mr. Rasche and Mr. Buck that Staff wishes to respond to?

A. Yes. While Staff recommends a ratemaking embedded cost of debt for the MGE division based on the debt issued to acquire the MGE assets, the Company witnesses insist on recommending an embedded cost of debt based on Laclede Group's consolidated debt issued both before and after the acquisition of the MGE assets.

The Company's repeated rationale for their proposed approach is that this is the way it has always been done. However, the Company fails to mention that it is not "business as usual" to issue close to $1 billion of capital and almost double the Company's size. The Company witnesses' proposed approach seeks to recover debt costs that were already appropriately considered in Laclede Gas Company's ("Laclede Gas") most recent rate case, GR-2013-0171.

Staff still vehemently believes that it is NOT appropriate, NOT fair and NOT reasonable for Laclede Gas to recover debt costs, through MGE's rates, that were already considered by both Staff and the Company in setting rates for the Laclede Gas division customers. If the Company wanted to reconsider all elements of costs related to the Laclede Gas Division and the MGE Division, the Company could have filed a consolidated rate case including both the MGE division and Laclede Gas division.

Staff has repeatedly stated in its testimony that the use of a consolidated-cost-of-debt approach would be appropriate when the two divisions file their next rate case, at which time the benefits of the lower cost acquisition debt would be shared among Laclede Gas and MGE division customers. Consequently, Staff still recommends a 3.12 percent embedded cost of debt for at least the MGE division's initial rate case under Laclede Gas Company.

Mr. Buck has since updated his capital structure and embedded debt cost (now 4.16 percent) to reflect the impact of removing the 6.35 percent long-term debt series ($80,000,000) that was redeemed in January 2014, which is beyond the true-up date of December 31, 2013. This post true-up date capital structure comprises 55.80 percent equity and 44.20 percent long-term debt.

Because Mr. Buck's overall pre-tax rate of return based on using these elements, in combination with an ROE any greater than approximately 9.25 percent, would be higher than the 10.224 percent overall pre-tax ROR cap specified in the Stipulation and Agreement in Case No. GM-2013-0254, Mr. Buck decided to lower the common equity ratio to 52.35 percent equity and also the requested ROE to 9.70 percent. After these manipulations, Mr. Buck's hypothetical capital structure yields an overall pre-tax rate of return no greater than 10.224 percent.

While this adjustment results in a pre-tax rate of return that complies with the ceiling specified in the Stipulation and Agreement (Stipulation) set in Case No. GM-2013-0254, Staff understands that the provision relating to the overall pre-tax rate of return of no greater than 10.224 percent was simply a safeguard to ensure that MGE's rates do not increase as a result of the acquisition transaction, and therefore no detriment to customers. The cap was not intended to be a predetermined or guaranteed rate of return for the Company in the instant case. Besides, Staff would not have executed a Stipulation with the Company that barred the potential for cost savings to be shared with customers.

Q. Did Staff update its capital structure and cost of debt to reflect the impact of the redeemed 6.35 percent long-term debt series?

A. No. The redemption occurred after the true-up period in this case. If this redemption were to be considered for purposes of this case, it would only be appropriate if another pro forma adjustment were made to consider the new long-term debt that will eventually be issued to refinance the capital used to redeem this debt.

The Company failed to provide a direct response that explains the **specific** type of financing that currently supports the redemption transaction. Instead, the Company provided an updated capital structure, attached to Mr. Buck's rebuttal testimony (Rebuttal Schedule GWB-2), which only shows a reduction in the consolidated long-term balance and, thereby, magnifies the consolidated equity percentage. If the Commission accepts this out-of-period adjustment to the capital structure, then short-term debt in the amount of $80,000,000 should be included in the capital structure.

Mr. Buck's December 31, 2013 capital structure would then comprise 53.50 percent equity, 42.50 percent long-term debt and 4.00 percent short-term debt. If short-term debt is imputed at a cost rate of 0.30 percent[1], Mr. Buck's resulting overall pre-tax ROR would be 10.20 percent –which is 24.4 basis points lower than overall pre-tax ROR cap (10.224 percent) set in the acquisition Stipulation. Consequently, there would be no need for Mr. Buck to further adjust his capital structure or equity ratio as a 10.20 percent overall pre-tax ROR would be compliant with the acquisition Stipulation.

[1] The Laclede Group, Inc., Form 10-Q, page 31 – 12/31/2013: Average short-term interest rate for the three months ended December 31, 2013 was 0.30 percent.

UPDATED CAPITAL STRUCTURE AND ROR

Q. Would you please explain the specific updates Staff performed in this surrebuttal testimony?

A. Staff updated its capital structure recommendation and the resulting ROR through the true-up period–December 31, 2013.

Q. What is Staff's updated capital structure as at December 31, 2013?

A. Approximately 53.56 percent equity and 46.44 percent long-term debt.

Q. What is Staff's updated ROR position?

A. The updated ROR range is 5.68 percent to 6.22 percent with a midpoint of 5.95 percent.

MS. AHERN'S REBUTTAL TESTIMONY

Embedded cost of debt:

Q. What embedded cost of debt is Ms. Ahern supporting in this proceeding?

A. An updated consolidated embedded cost of debt of 4.16 percent sponsored by Mr. Buck. Staff will discuss its specific concerns regarding this adjustment when addressing Mr. Buck's rebuttal testimony.

Q. What embedded cost of debt is Staff recommending in this proceeding?

A. Staff is recommending a 3.12 percent embedded cost of debt be used in this case. For reasons explained throughout Staff's COS Report and rebuttal testimony, Staff's recommendation is based on the cost of debt issued to acquire the MGE assets.

Q. Please highlight and explain the issues that Staff has with Ms. Ahern's general position regarding the embedded cost of debt that should be used for purposes of setting MGE's initial rates as a division of Laclede Gas?

A. While Staff recommends the use of the acquisition debt cost (3.12 percent) for MGE's initial rate case under Laclede Gas, Ms. Ahern believes it is reasonable to use a consolidated embedded cost of debt regardless of the peculiar circumstances surrounding this rate case proceeding.

Ms. Ahern stated the following on page 4, lines 17-21, of her rebuttal testimony:

> "… If anything, using the 3.12 percent cost of debt for MGE allocates an artificially low cost of debt to only one utility. The only way to share the entire cost of debt between the Laclede Gas customers and MGE Customers would be to use the embedded long-term debt cost of the entire company. That was the method used in last year's Laclede Gas rate case and it is the method that should be used here."

While it may have been inadvertent, Ms. Ahern's statement confirms the logic of Staff's approach. She very directly states that "the only way to share the entire cost of debt between the Laclede Gas and MGE customers would be to use the embedded long-term debt cost of the entire company." However, that could be done only if both divisions filed a rate case at the same time. This won't be done until anytime earlier than October 1, 2015 based on the acquisition Stipulation but more likely in 2017 because Laclede Gas just filed its first Infrastructure System Replacement Surcharge (ISRS) case, after a general rate case, early this year.

Q. What makes the circumstances in this case peculiar?

A. Laclede Gas filed a rate case, Case No. GR-2013-0171, for its Laclede Gas Division and the Stipulation and Agreement (Laclede Gas Stipulation) was approved by the Commission on June 6, 2013. Three months later, on September 1, 2013, Laclede Gas closed on the acquisition of the MGE assets. Because of the timing of the rate case approval and completion of the acquisition case, the embedded cost of debt that was considered for purposes of setting general rates for the Laclede Gas (which only consisted of the current Laclede Gas Division's assets) did not contemplate capturing or sharing the low-cost acquisition debt.

Thus, if a consolidated-embedded-cost-of-debt approach is accepted in this case, that would result in MGE customers servicing the same debt that is currently being serviced by Laclede Gas customers' rates. It does not appear that Ms. Ahern considered the fact that the savings from the lower cost of debt has not been shared with Laclede Gas' ratepayers. This cannot be done until both divisions file a rate case at the same time, at which time Staff would recommend a consolidated debt cost be applied to both divisions.

The rates for the current Laclede Gas Division were determined based on its own merits and without any consideration for the probable impact emanating from the acquisition transaction. Staff did not enter into the Laclede Gas Stipulation based on expected outcomes of the acquisition case or the MGE rate case. Consequently, MGE's rates should be based on the capital costs that support the MGE assets, which clearly included a mix of debt, at a cost of 3.12 percent, and equity, which should be based on a reasonable allowed ROE.

Q. Did Ms. Ahern provide the mix of capital used to finance the acquisition of the MGE assets?

A. Yes. Schedule PMA-16 attached to Ms. Ahern's rebuttal testimony shows a common equity ratio of 48.69 percent and a long-term debt ratio of 51.31 percent. If MGE had been acquired as a separate subsidiary of The Laclede Group, then this would be the approximate book value capital structure of MGE (no adjustment for goodwill is assumed).

Q. Could this be an alternative capital structure for the Commission to consider in this case?

A. Yes. Because MGE was recently acquired, it is reasonable to assume very little new capital has been used to make additional investments in the MGE system. Consequently, the acquisition capital structure is a fair representation of the capital supporting the MGE system.

Cost of Equity and Cost of Capital:

Q. What is Staff's response to the assertions made in Ms. Ahern's rebuttal testimony regarding Staff's cost of equity and cost of capital position?

A. Staff's cost of equity estimate is corroborated by financial experts Laclede hired for reasons other than attempting to justify a rate increase. Consequently, Staff believes its methodology and inputs are representative of what investors use in making investment decisions and, therefore appropriate to be used in this case.

<u>MR. BUCK'S REBUTTAL TESTIMONY</u>

Embedded cost of debt and Capital Structure:

Q. Would you please state and explain the embedded-cost-of-debt issue Staff has with Mr. Buck?

A. Mr. Buck recommends the use of an updated-consolidated-embedded-cost-of-debt approach for MGE's initial rate case under Laclede Gas Company. Staff has already explained its diametric opposition to this approach.

Q. What updated embedded cost of debt is Mr. Buck recommending?

A. 4.16 percent.

Q. What caused Mr. Buck's cost of debt recommendation to change?

A. Mr. Buck removed $80,000,000 of long-term debt that had a coupon rate of 6.35 percent from his ratemaking capital structure. Mr. Buck removed this debt even though it wasn't redeemed until January 2014, which is beyond the true-up period of December 31, 2013.

Q. Did Mr. Buck replace this debt with an equivalent amount of capital used to retire the debt?

A. No.

Q. Is this appropriate?

A. No. Although the retirement of this debt should be rejected simply because it is outside of the true-up period, it definitely should be rejected unless the capital used to retire the debt is known and measurable.

Q. What capital structure does Mr. Buck recommend in his rebuttal testimony?

A. In rebuttal Schedule GWB-2, Mr. Buck presents what he refers to as an updated capital structure as of December 31, 2013 (the true-up date), adjusted for the $80,000,000 debt redemption in January 2014. As already explained, Mr. Buck's adjustment assumes $80,000,000 of capital more or less disappeared from the capital structure. Mr. Buck's adjustment resulted in a pro forma capital structure of 55.80 percent equity and 44.20 percent long-term debt.

Mr. Buck further adjusted the equity (to 52.35 percent) and debt (to 47.65 percent) percentage portions of this capital structure in order to reduce the pre-tax rate of return to ensure the Company's recommended pre-tax overall rate of return did not exceed the cap (10.224 percent) agreed to in the MGE acquisition case (Case No. GM-2013-0254).

Q. Is the Company's pro forma adjustment consistent with arguments it has made in applications requesting financing authority from the Commission?

A. No. In the Company's last litigated finance case (Case No. GF-2009-0450), the Company requested authority, among other things, to issue and sell first mortgage bonds, unsecured debt, common stock and preferred stock, all in an amount not to exceed $600,000,000. Staff's analysis of the Company's cash flows as compared to the Company's list of proposed uses of the proceeds, as required under Commission Rule 4 CSR 240-3.220(1)(B), did not support a need for a $600,000,000 authority.

The first purpose the Company stated was to discharge or redeem previously-issued securities. Mr. Buck's proposed pro forma capital structure does not contemplate the issuance of any security (including short-term debt) or long-term debt to redeem the $80,000,000 debt issuance.

Q. Did Staff attempt to get the explanation as to why the pro forma adjustment did not include any short-term or temporary financing that currently supports the redemption?

A. Yes, but the Company failed to provide a direct response or reconciliation. Instead, the Company's data request response made a point to remind Staff that the transaction transpired outside the true-up period. Despite the fact that the $80,000,000 debt issuance was made beyond the true-up date of December 31, 2013, the Company still imputed the effects of that transaction in its recommended capital structure. Below a data request from Staff and MGE's response to Staff's data request 0214:

> **Staff's Data Request 0214**
>
> Please reconcile the source of funds used to redeem the 6.5% debt on January 6, 2014.
>
> **MGE's Response to Staff's DR 0214**
>
> Laclede is assuming that you mean the 6.35% series that was redeemed in January 2014. Please note that this redemption

> occurred subsequent to the "true-up" date in this proceeding. Nevertheless, Laclede included the benefit of this redemption in its "pro-forma" adjustment in my Schedule Rebuttal GWB-2. The 6.35% series was redeemed using general corporate funds.

Q. Does this response indicate that the Company will not issue long-term debt to refinance this redemption?

A. No. As a matter of fact, if the Company is consistent with its reasoning expressed in Case No. GF-2009-0450, the Company will eventually issue long-term debt so as to continue to support its long-term assets.

Q. In response to Staff Data Request No. 0214, the Company indicated that they used general corporate funds to redeem the 6.35 percent debt series. What is Staff's understanding of Laclede Gas' financing process in such situations?

A. Staff reasonably believes that the Company uses short-term debt borrowings when there is no excess cash on hand. To the extent there is any short-term debt outstanding, which is usually the case with Laclede Gas, any excess cash on hand is immediately used to reduce the amount of short-term debt outstanding.

Q. Is Staff's understanding consistent with explanations Laclede Gas has given in the past about its financing process and treasury functions?

A. Yes. In Laclede Gas' litigated finance case, Case No. GF-2009-0450, Mark D. Waltermire, Laclede Gas Company's Senior Vice President and Chief Financial Officer at the time, filed rebuttal testimony specifying that Laclede Gas would eventually seek to reimburse the treasury through the issuance of permanent long-term debt (permanent financing).

Consequently, by the Company's own explanation of its financing process, Mr. Buck's proposed pro forma capital structure fails to recognize the permanent capital that will eventually be issued to reimburse the treasury for the redemption of the $80 million of long-term debt. Although Staff continues to recommend that this adjustment be rejected simply because it falls outside the true-up period, it is completely absurd to ignore the obvious assumption that the redeemed $80,000,000 long-term debt will eventually be replaced by permanent long-term debt financing in the near future.

Q. What capital has been used to retire the debt?

A. Mainly short-term debt. So if this out-of-period adjustment is allowed, then Staff recommends short-term debt should be used in the capital structure at the corresponding cost.

Q. How would this affect Mr. Buck's overall rate of return recommendation?

A. If $80,000,000 of short-term debt is imputed in Mr. Buck's capital structure at a cost of 0.30 percent[2], Mr. Buck's overall pre-tax ROR (9.98 percent) would be 24.4 basis points lower than the pre-tax ROR ceiling (10.224 percent) he is bound by under his current recommendation. Therefore, Mr. Buck would have not adjusted his equity ratio or capital structure of 53.50 percent equity, 42.50 percent long-term debt and 4.00 percent short-term debt in order to be compliant with the acquisition Stipulation.

MR. RASCHE'S REBUTTAL TESTIMONY

Cost of Equity:

Q. Would you please explain Mr. Rasche's misconception of Staff's cost of equity position?

[2] The Laclede Group, Inc., Form 10-Q, page 31 – 12/31/2013: Average short-term interest rate for the three months ended December 31, 2013 was 0.30 percent.

A. Yes. Mr. Rasche stated on page 4, lines 19-22, and page 5, lines 1-2, that he was advised that the higher end (8.9 percent) of Staff's ROE recommendation was lower than any ROE adopted by any Commission in the United States in either 2012 or 2013.

To support his claim, Mr. Rasche cited the national allowed ROE averages for regulated gas companies as reported by the Regulatory Research Associates (RRA). Mr. Rasche noted a 9.68 percent national allowed ROE average for 2013 and a 9.94 percent for 2012.

Q. Please explain the problem Staff has with Mr. Rasche's presentation of RRA's allowed ROE averages for regulated gas companies to dismiss Staff's recommendation?

A. Mr. Rasche failed to discuss the decrease in the allowed ROE national averages from 2012 (9.94 percent) to 2013 (9.68 percent). In fact the allowed ROEs for natural gas companies, as reported by RRA, have been continuously trending downwards over the last several years.

In light of this trend (and other evidence Staff has provided), Staff believes the Commission has sufficient support to set MGE's allowed ROE at no greater than 9.50 percent. An ROE lower than the RRA average of 9.68 percent would be consistent with the trend in the national averages reported by RRA and discussed by Mr. Rasche.

Q. Did Staff discuss the national averages of the allowed ROEs for gas companies in its direct testimony?

A. Yes. On page 32 and 33 of Staff's COS Report, Staff explained that since 2007, average gas utility allowed ROEs have been lower than regulated electric companies' allowed ROEs.

In reference to the 2012 and 2013 time period noted by Rasche, Staff noted that the average allowed ROEs for regulated gas companies were 20 basis points lower in 2012 and 34 basis points lower in 2013 than the average allowed ROEs for regulated electric companies.

Consequently, Staff recommended that the Commission consider this trend should they decide to wholly or partly rely on RRA data in its ROE decision for this rate case proceeding.

Embedded cost of debt:

Q. Would you please explain Mr. Rasche's misconception of Staff's embedded-cost-of-debt position?

A. Mr. Rasche notes on page 5 of his rebuttal testimony that he was advised by his legal counsel that Staff's use of the acquisition cost of debt as the embedded cost of debt for this case is inconsistent with the terms of the Stipulation in Laclede Gas' recent rate case (Case No. GR-2013-0171) because it seeks to re-trade the result that was negotiated in that case.

Q. Does Staff agree with the Company's understanding and/ or characterization of the Laclede Gas Stipulation set in Case No. GR-2013-0171?

A. No. Again, the rates for the current Laclede Gas Division were determined based on its own merits. Staff did not enter into the Laclede Gas Stipulation based on expected outcomes of the acquisition case or the MGE rate case. Consequently, Staff's recommendation in the MGE case should not be perceived as a re-trade in any fashion.

Q. What embedded-cost-of-debt approach did Staff consider when determining the general rates in Laclede Gas' most recent rate case (GR-2013-0171)?

A. Staff and all parties considered a consolidated-embedded-cost-of-debt approach based on Laclede Gas' consolidated embedded cost of debt at the time.

Q. Did the consolidated cost of debt considered at the time include the acquisition debt cost?

A. No.

Q. Did the parties to Case No. GR-2013-0171 explicitly consider how much Laclede Gas' cost of service would decrease if the consolidated embedded cost of debt had been reduced on a pro forma basis to capture the acquisition debt?

A. No. The parties only considered the updated capital structure and cost of debt, which captured the acquisition debt for ISRS purposes ONLY.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy, Inc.'s Filing of Revised Tariffs to Increase its Annual Revenues for Natural Gas	)))	Case No. GR-2014-0007

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 15 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Zephania Marevangepo

Subscribed and sworn to before me this 3rd day of April, 2014.

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