

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Laclede Gas Company's Verified)
Application to Re-Establish and Extend the) Case No. GR-2015-0181
Financing Authority Previously Approved by the)
Commission)

LACLEDE GAS COMPANY'S INITIAL BRIEF

COMES NOW Laclede Gas Company ("Laclede" or "Company"), and files its initial brief in this case, and in support thereof states as follows:

ISSUES

This brief will address the two issues posed by the parties in this case, as set forth below:

1. What amount of financing should be authorized by the Commission for Laclede Gas Company through September 30, 2018?
2. What conditions should the Commission place on Laclede Gas Company's financing authority?

DISCUSSION

1. What amount of financing should be authorized by the Commission for Laclede Gas Company through September 30, 2018?

The Commission should approve the Company's request of \$550 million in financing authority, because the request is lawful, it is reasonable, and it can provide real benefits to customers.

A. The amount of financing requested by Laclede is authorized by law.

The \$550 million in long-term financing authority that Laclede is requesting is well below the limit authorized by the financing statute, 393.200.1 RSMo. (the "Statute"), as interpreted by the Commission in its June 16, 2010 Report and Order in Case No. GF-2010-0450 (the "2010 Order"). The purpose of the Statute and the role of the Commission is to ensure that utilities have the long-term financing available to make the capital investments in their plant and

system to safely and adequately serve their customers. It is also intended to limit the amount of long-term financing to capital expenditures made for the purposes in the Statute.

In the 2010 Order, the Commission painstakingly examined the Statute and applied it to the facts in Laclede’s case. The Commission’s efforts provided a roadmap that can be used to readily calculate the financing authority to be afforded to a utility. The following chart illustrates the divergence between the positions taken by the General Assembly and the Commission on one side, and by the Staff on the other side.

<u>The General Assembly and Commission authorize financing for:</u>	<u>Amount (millions)</u>	<u>Staff authorizes financing for:</u>	<u>Amount (millions)</u>
Capital Expenditures made for the purposes set forth in Section 393.200.	\$562	Capital Expenditures made for the purposes set forth in Section 393.200, <i>minus operating cash flow items</i> . (Exh. 11HC, Schedule 1 to Schedule DM-R2; Tr. 110 HC, lines 18-23)	\$562 - <u>\$412</u> \$150
Unreimbursed capital expenditures for the past 5 years (i.e. CapEx that exceeds previous long-term financings)	\$339	Capital Expenditures for the past 5 years, <i>but only for those paid with retained earnings</i>	\$75
Refinancing of long-term debt maturing in August 2018	\$100	Refinancing of long-term debt maturing in August 2018	\$100
TOTAL	\$1,001		\$325
LACLEDE REQUEST	\$550	STAFF RECOMMENDATION	\$300

(Exhibit 1, p. 5)

The first row above represents Laclede’s capital budget for the three fiscal years ended September 30, 2018. The second row, abbreviated from the Statute as “Reimbursement of

monies actually expended for any of the aforesaid purposes,” basically reflects the actual capital spending by the Company over the past five years net of any financings the Company has issued or redeemed. The third row, discharge or lawful refinancing of its obligations reflects Laclede’s plans to refinance \$100 million in debt scheduled to come due in August 2018. To summarize, subject to the conditions imposed by the Statute and by the Commission in the 2010 Order, the Statute simply permits the Company to raise money through long-term financing so long as the amount raised does not exceed the value of long-term capital investments made by the Company to provide utility service. (Exh. 2, p. 6, lines 6-18.) Staff agrees that Laclede’s figures accurately apply the decision of the Commission that interpreted the Statute in 2010, although Staff does not agree with that decision. (Tr. 123, lines 4-24)

The Staff’s flawed approach results in a legal authority limit that is \$675 million below that calculated under the 2010 Order. Staff confirmed at the hearing that its recommended authority of \$300 million is even lower than the \$325 million calculated in Staff’s testimony and set forth above. (Tr. 120, lines 5-16; 180, lines 14-24)

Staff chose its recommendation of \$300 million in financing authority, because that was the amount of long-term financings that Laclede estimated it would likely need to issue over the next three years in its forecast – an amount that represents a single, middle-ground scenario, and does not provide a range of possible or “worst case” scenarios. (Exh. 4, p. 15, lines 18-20) In making this selection, Staff completely ignores the Statute, which provides a list of allowed purposes, basically in the form of capital expenditures, that support long-term financings. In fact, Staff’s view is that the Statute is flawed and should be ignored, because the Staff and Commission should keep a much tighter rein on Laclede’s ability to go to market and finance its capital spending activities than the law allows. In essence, the Staff’s position is that Laclede

should exhaust virtually all of its funds from operations (“FFO”), other than income, before it may appropriately obtain financing from the markets. (Tr. 132, line 15 to 133, line 6) When choosing between the law’s mandates and the Staff’s preferences, the Commission is, of course, bound to choose the law.

As a practical matter, Laclede agrees with Staff that it is a good idea to use at least some FFO before issuing long-term financing.¹ However, the Statute does not legally require Laclede to do so. Laclede volunteered to reduce its request below the legal limit because it is willing to operate within a self-imposed limit that recognizes a substantial use of internal FFO before seeking external financing as a matter of good governance and prudent fiscal management. However, Laclede declined to request or agree to a reduction from the Statute’s limit so deep that it could present a significant risk that Laclede would not have the financing capacity to respond quickly to rapidly changing conditions in the financial markets because it had exhausted its authority. The Staff on the other hand offers no buffer at all over Laclede’s three year estimate of external financing. So the difference in this case is caused by the fact that Laclede seeks to avoid the likelihood of the abovementioned risk, while the Staff seeks to impose it.

The fundamental difference between Laclede and Staff is captured in this exchange between Chairman Hall and Staff witness David Murray:

CHAIRMAN HALL: Well, I look at the statute and... it lists a number of... uses for funds from financing, a number of acceptable uses; acquisition of property, construction, extension, improvement, et cetera, et cetera. So those are... the statutorily approved uses for... finance capacity; is that --

MR. MURRAY: Yes... It's a laundry list of issues for what they might need to use financing for.

¹ In fact, Laclede chose to reduce its request in this case to a point significantly below the limit decided by the Commission in 2010 with the hope of avoiding another clash with Staff over financing authority. (Exh. 2, p. 3, line 21 to p. 4, line 2)

CHAIRMAN HALL: Where in there does it say -- or another way, why is it Staff's position that some portion of... operating expenditures must be used to fund some of those uses? Does my question make sense?

MR. MURRAY: It makes sense. It's just -- at least from a financial perspective as far as managing the capital structure and... the capital balances of the company as far as --

CHAIRMAN HALL: But those are different issues, aren't they? I mean, it seems to me that what the issue -- that the statute says, Company, you want... to finance expenditures. Here are the things that you can finance those expenditures for. Come to the Commission and get approval for financing to cover those uses. That's the way the statute reads to me... And it almost seems that Staff is taking... a position that there has to be -- they have to go into other buckets for those funds to some extent in some circumstances. And I'm trying to understand where that... comes from.

MR. MURRAY: I'm not saying they have to. This is just the way companies are run. They manage their internal cash flows so they don't have to access external capital markets. Usually you don't want to access external capital markets. It could be (dilutive) to your common equity holders.

CHAIRMAN HALL: I understand that. And I understand... how in a rate case the Commission may make some decisions as to whether or not it was prudent to do so. But in a finance case, aren't we simply charged with the responsibility to see if what they want to spend the money on fits into this statute? And if it does, don't we just total up those expenditures and say... you have that authority?

MR. MURRAY: No. ...

(Tr. 156, line 16, to 158, line 13)

This exchange succinctly demonstrates the points that: (i) the Statute affords Laclede the right to financing authority commensurate with the capital expenditures it makes to improve its plant and system; and (ii) Mr. Murray believes that the Statute does not suitably recognize the way that companies actually manage their capital structure, because it fails to require companies

to use their FFO before permitting external financing. In the end, the Statute provides that the Company *can* issue long-term financing to the extent it has the capital to support it; and as discussed below, the conditions placed on the authority, along with the threat of the rate case disallowance referenced by Chairman Hall in the exchange quoted above, restrain the Company from using this authority in an imprudent manner. So whether Laclede requested authority of \$550 million, \$750 million, or the full \$1 billion to which it qualifies for over a three year period, the limiting conditions serve as an effective backstop to the Company's own longstanding practice of financing its business in a responsible and cautious manner.

As stated above, by requesting \$550 million in authority, the Company has requested an amount that is well within the statutory limits of what it is entitled to receive, and yet still sufficient to permit Laclede to react in a timely way to market conditions without having to first navigate an additional and unnecessary regulatory process. At the same time, by agreeing to continue the conditions discussed below, Laclede has wrapped its request in a safety net that ensures it will maintain a reasonable capital structure, preserve an investment grade credit rating; and use any financing proceeds for the exclusive benefit of its regulated operations. For over a decade, Laclede has managed its financial affairs under these very same financing parameters. Moreover, it has done so not only without any discernable detriment to the Company's customers, as acknowledged by Mr. Murray himself, but also with very real financial benefits for those same customers, as explained and quantified by Laclede witness Lynn Rawlings. (Tr. 129; Exh. 11, p. 11, line 11; Exh. 4, p.2, lines 1-9; p.3, lines 10-20) So even if one were to erroneously assume that there was some tenable legal basis for reinterpreting the Statute in a manner that reflects Staff's approach for determining financing authority, the Staff has failed to provide any real world justification that would warrant even undertaking such an exercise.

B. The amount of financing requested by Laclede is reasonable.

In addition to being reasonable from a legal standpoint, the \$550 million in financing authority requested by Laclede is also very reasonable compared to past financing approvals, including the \$500 million authority the Company was granted in 2007, and the \$518 million in authority the Commission approved in 2010. The 2010 Order granted Laclede financing authority over a three year period in the amount of \$518 million. Since 2010, Laclede has not only acquired MGE, nearly doubling its size, but it has also accelerated the rate of safety investments for both Laclede Gas and MGE, investments which form the basis for long-term financing authority. Given these circumstances, it is no surprise the same financing roadmap used by the Commission in 2010 resulted in a permissible level of financing authority in this case of \$1.0 billion, nearly double the pre-MGE financing authority. However, by seeking only \$550 million in authority, an amount that reflects the need to manage its external financing needs and well-earned solid credit ratings by utilizing an appropriate amount of operating cash flow, and is only slightly more than the pre-MGE authorization, the Company has made a conservative request that it hoped would avoid a protracted, time-consuming and contentious hearing, as well as additional regulatory costs. An illustration of how much the Company has grown in the past five years in comparison to its financing request in this case is attached hereto as Appendix 1.

Staff's own testimony demonstrates why the requested authority is not excessive even under the Staff's own standard for determining what that term means in the context of financing authorizations. Mr. Murray calculates that Laclede's financing authority in the 1990s was 26-29% of its total capitalization – a percentage which Mr. Murray twice characterizes as being “more reasonable.” (Ex. 11, p. 10, lines 6-21) Staff calculates that Laclede's current request of \$550 million in authority, however, represents only 25% of its total capitalization. (*Id.*, p. 4,

lines 3-6) If Staff considers authority equivalent to 26-29% of total capitalization to be more reasonable, it seems intuitive that Staff would view a request equivalent to 25% of total capitalization to be even more reasonable. (Exh. 4, lines 6-14)

C. The amount of financing requested by Laclede can provide real benefits to consumers.

The ability of the Company to be able to react to changing market conditions without being required to seek regulatory approval can and has produced real benefits for consumers. This is because dramatic swings in the capital markets can occur over short periods of time. The Company's ability to respond to such rapidly changing market conditions in a way that produces the best outcome for its customers could be seriously compromised if the Company had to wait 6 to 8 weeks, or longer, to advise Staff of such changes, receive a positive recommendation and obtain Commission approval. (Exhibit 2, p. 7, line 22 to p. 8, line 6)

Staff indicated that it routinely files recommendations in 30-45 days after an application is filed. (Exh. 11, p. 25, lines 13-15) Staff claims it can and has moved faster when required. (Tr. 145, line 17-19) However, even if Staff expedited its work, the legal, finance and administrative demands on the Company, the Staff, and the Commission during this additional review are certainly going to eat up precious time that Laclede could be in the market rather than in the Commission hearing or agenda room. (Tr. 138-144)

The kind of financing authority traditionally granted to the Company places it in a much better position to respond to market events in a way that can capture significant value for its customers. For example, pursuant to its then existing financing authority, Laclede issued \$80 million of 30-year bonds in September 2008. The bonds, which had a 5-year call, were issued at a 6.35% interest rate in the retail market at approximately the time of the Lehman Brothers collapse. Ameren IP, who had previously issued \$336 million of 10-year bonds at a 6.25%

interest rate in April of 2008, had to go to market again in October of 2008 (just a few weeks after Laclede went to market), and issued \$394 million of 10-year bonds at a 9.75% interest rate, or 350 basis points higher than just several months earlier. Based on Laclede's issuance in September 2008, as compared to Ameren IP's issuance just a few weeks later, this conservatively equates to a savings of 340 basis points² on the \$80 million. Over the five year term before these bonds were called, this generated interest savings of approximately \$13.6 million. Had the bonds been held to maturity, this would have translated into \$81.6 million in savings. (Exh. 4, p. 3, lines 5-20)

Needless to say, these results could not have been achieved if the Company was required to seek administrative approval before issuing its debt. In summary, because future market and other circumstances that may drive them are impossible to predict, the very nature of prudent risk management requires that provision be made for these kinds of uncertainties. (Exh. 2, p. 15, lines 9-22) Granting the requested authority would provide that capacity while also being supportive of Laclede's credit ratings by confirming the Company's ability to access capital markets as needs arise. (Exh. 2, p. 16, lines 6-11)

In addition to potentially lowering financing costs, granting Laclede's requested authority is also a more efficient way to use administrative resources, because it significantly reduces the risk that Laclede will have to prematurely return to the Commission to request additional authorization. Making the regulatory process more efficient benefits customers, just as making utility service more efficient benefits customers. (Exh. 4, p. 2, lines 20-21)

Staff's minimization of financing authority is endemic of its desire to micro-manage the Company. Staff denied the direct assertion that this case boiled down to Staff's unsubstantiated concern that Laclede might issue debt and dividend the proceeds to its parent. Staff's denial

² Ameren's 9.75% versus Laclede's 6.35%.

revealed its desire to not just avoid serious adverse consequences, but to review every financing, as it does with other utilities. (Tr. 169, line 14 to 170, line 5) Staff also attempted to reduce Laclede's authorization during the pendency of this case from \$370 million to \$100 million without any cause to support such a radical reduction. This act could have had negative consequences by causing credit analysts and investors to perceive the regulatory environment in Missouri as having greater risk and less certainty when it comes to utilities' ability to obtain financing. (Exh. 3, paragraphs 4 and 5; Exh. 14) Finally, Staff's tendency to micro-manage was further illustrated in another exchange between Chairman Hall and Staff witness Murray:

CHAIRMAN HALL: Why should we, as a Commission, micromanage the company and tell them how much they should fund from operations and how much they should fund from debt?

MR. MURRAY: I would want to know what they were going to use those funds for. I mean without knowing what that additional 250 million is for, I believe that there is concern as to okay, you may have some... unforeseen incident that occurs, and if that unforeseen incident occurs, it's probably not a good thing. And so to the extent that that may affect... the financial soundness of the utility, I believe the Commission would want to review that. I mean that's my opinion. I think it's important for us to be aware of what happened outside of their base plan. ...let me just state that if the rating agency has affirmed the rating based on their current plans. If something happened that wasn't consistent with what they plan to do, then... it may be something that I think could cause an increase to cost (of) capital if their... credit rating was downgraded from A to triple B, they could... have difficulty with accessing commercial paper markets, which is important to gas utilities specifically. And... those short-term debt costs get passed into rates. Yes, it could be proposed to be disallowed in the rate case, but bottom line is they're having difficulty attracting the capital. And so that's -- when I look at the no detriment standard, I'm trying to determine what is... a detriment? Is a detriment the difficulty to attract capital at a

reasonable cost to continue to fund the operations?

I mean, yes, they might be able – they could still raise the capital and do it at a higher capital cost, but will they have an incentive to try to reduce the amount of capital? I don't know. I mean that's something that would be an after-the-fact review.

(Tr. 164-65)

This testimony reflects Staff's recommendation that the Commission authorize no more than the amount of financing forecasted by Laclede over the next three years in a single, probable scenario, and if anything happens to cause Laclede to seek to finance more than that amount, the Company should be required to come to the Staff and the Commission for an additional authorization review. In effect, Staff is saying that when market events occur, it is the Staff, and not the Company, that should react. The Commission should not approve this usurpation of the Company's managerial discretion.

2. What conditions should the Commission place on Laclede Gas Company's financing authority?

Laclede believes the Commission should continue the same financing conditions that currently govern the Company's issuance of stock, bonds and other evidences of indebtedness and that have been in effect for several years. Specifically, the Commission should continue to require, among other things, (i) that Laclede use its long-term financings for the purposes specified in the Statute and for the exclusive benefit of its regulated operations; (ii) that the total amount of long-term debt issued and outstanding at any given time not exceed the lesser of: (a) the value of Laclede's regulated rate base or (b) an amount equal to 65% of Laclede's capital structure; and (iii) that Laclede conduct its financings in such a way so as to maintain an investment grade credit rating. (Exh. 2, p. 7, lines 6-8, 13-15)

These conditions provide ample regulatory protection from any potential harm that could occur if Laclede considers diverging from decades of responsible and prudent stewardship of its

balance sheet. It should first be acknowledged that both parties agree that Laclede has indeed established a longstanding record of prudent financing, has maintained a strong credit rating, and has never given the Commission any reason to believe this will change. (Tr. 129; Exh. 11, p. 11, line 11; Exh. 4, p.2, lines 1-9) While this should be a source of comfort for the Commission, it need not rely solely on Laclede's outstanding citizenship, because it has these conditions to serve as further protection against imprudent financing.

Staff witness Murray incorrectly believes that a credit crisis can be averted only if the Company can justify to Staff its plans for each dollar of long-term financing. But to the extent that long-term debt is simply a re-financing of short-term debt, finance authority cases do not provide a very meaningful point for regulatory protection. In other words, if a large debt has already been incurred to construct capital, nothing is really accomplished by requiring an in-depth regulatory analysis of the long-term refinancing of that debt. Laclede believes the Staff's insistence on, and the Commission's approval of, a condition committing the Company to maintain an investment grade credit rating as part of the financing authority is a more effective and efficient means of protection. Similarly, the Company has also agreed to limit long-term debt to no more than 65% of total capitalization. In summary, the Commission's task is to ensure the Company is not funding short-term assets with long-term capital and is not issuing long-term financing in excess of its long-term utility assets. Otherwise, within the parameters agreed to by the Company and ordered by the Commission, the timing and debt/equity mix of financings should be based on the judgment of management, subject, of course, to an after-the-fact prudence review. (Exh. 4, p. 7, lines 4-21)

As stated above, the worst case scenario raised by Staff is that Laclede might issue debt to the limit of its authority and dividend the proceeds to its parent. Staff may point to the fact

that Laclede considers issuing dividends to its shareholder to be part of its regulated operations.³ Staff may conclude that the condition that Laclede limit its financings to regulated operations would be ineffective in prohibiting the Company from paying the feared dividend. Assuming this is so, the best deterrent is the threat of a prudence disallowance related to the debt issuance in a subsequent rate case. The Commission could also rely on other financing conditions to prohibit such imprudent dividend activity. For example, Laclede could not issue the debt to pay that dividend if that caused its total debt to exceed its rate base. In other words, there must be rate base available to support all of Laclede's long-term debt. In addition, Laclede could not issue debt to fund the dividend if such action caused the equity in its capital structure to fall below 35%, or conversely, cause debt to rise above 65%. This is a very effective limitation because incurring a large debt and then distributing the proceeds out of the Company causes an immediate and substantial increase in debt, and a corresponding immediate and substantial decrease in equity. (Tr. 99, line 17 to 101, line 16) Further, Laclede could not take such action if it caused the Company to lose its hard-earned investment grade credit rating. Finally, Laclede could be stopped from issuing such a dividend by the debt covenants that accompany its first mortgage bonds. (Tr. 100, lines 5-12)

CONCLUSION

The Commission should approve Laclede's application for \$550 million in financing authority, subject to the usual conditions, including the financial conditions discussed herein.

The request is lawful, reasonable and beneficial to consumers. Laclede's request is well below

³ Laclede witness Rawlings appropriately noted that, since paying interest to bondholders would be a regulatory operation, then correspondingly paying dividends to equity holders should also be considered a regulatory operation. (Tr. 80, lines 5-10)

the lawful limit of authority as interpreted by the Commission in the 2010 Order, reflecting Laclede's willingness to use a substantial amount of its funds from operations before accessing the capital markets. Laclede's request is reasonable, as it is barely above the levels ordered in 2007 and 2010, years when Laclede did not own MGE and had a much smaller capital budget. Laclede's request can bring benefits to customers, as providing the requested amount would most likely permit Laclede the ability to access the markets without spending the time or resources to seek another, unnecessary financing authorization. Finally, the Commission should order such authority to be effective through September 30, 2018, which is now less than three years away, or to such other later date that the Commission believes to be appropriate under the circumstances.

WHEREFORE, for the foregoing reasons, Laclede respectfully requests that the Commission accept Laclede's initial brief in this case.

Respectfully submitted,

LACLEDE GAS COMPANY

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Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing pleading was served on all parties of record on this 18th day of December, 2015 by hand-delivery, e-mail, fax, or by placing a copy of such document, postage prepaid, in the United States mail.

/s/ Rick Zucker

The Company has grown – The Financing Request has not

