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Witness:	*Mark L. Oligschlaeger*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*GR-2004-0209*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
June 2004

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's	)	
Tariffs to Implement a General Rate	)	Case No. GR-2004-0209
Increase for Natural Gas Service	)	

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Mark L. Oligschlaeger, being of lawful age, on his oath states: that he has participated in the preparation of the following surrebuttal testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the following 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.

Mark L. Oligschlaeger

Mark L. Oligschlaeger

Subscribed and sworn to before me this 10th day of June 2004.

Toni M Charlton

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

SURREBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Jefferson City, MO 65102.

Q. Are you the same Mark L. Oligschlaeger who has previously filed direct and rebuttal testimony in this proceeding for the Staff?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of this testimony is to address certain matters raised by Missouri Gas Energy (MGE or Company) witness John J. Gillen in rebuttal testimony in connection with the capital structure issue in this proceeding.

Q. What specific capital structure issue will you be addressing in this testimony?

A. The Staff, through the testimony of its witness, Mr. David Murray of the Financial Analysis Department, is supporting use of a consolidated Southern Union (SU) capital structure in this proceeding. SU is the parent company of its division, MGE. MGE is an internal division within the SU corporate entity. The Staff's capital structure would reflect the financing that supports all of SU's operations, including its recently acquired subsidiary, Panhandle Eastern Pipeline Company (Panhandle).

The Company opposes use of its consolidated SU capital structure, and supports an adjusted version of its capital structure that eliminates certain debt components associated with the Panhandle acquisition. In his direct testimony, Company witness John C. Dunn advocates the elimination of only Panhandle debt from SU's capital structure, and does not propose the elimination of any equity associated with Panhandle operations.

Q. Is it reasonable to take a position that none of the current equity in SU's capital structure is associated with Panhandle?

A. No. It is unreasonable to assert that none of the equity in SU's capital structure supports the Panhandle capital structure. Staff witness Murray, in his direct testimony, presented a calculation of the amount of equity that could be associated with Panhandle, should the Commission choose to eliminate the Panhandle acquisition's impact on the consolidated SU capital structure. He calculated this amount by subtracting the amount of equity included on Panhandle's December 31, 2003 stand-alone balance sheet, filed with the Securities and Exchange Commission (SEC) as part of its Form 10-K, from the amount for equity included on SU's consolidated December 31, 2003 balance sheet, also filed with the SEC as part of SU's Form 10-K.

Q. Does the Company agree with Staff witness Murray's calculation of the amount of equity that should be associated with Panhandle?

A. No, as set forth in the rebuttal testimony of Company witness Gillen. Mr. Gillen, a CPA, argues that Mr. Murray's calculation is not in accord with "generally accepted accounting principles," or GAAP. Specifically, Mr. Gillen contends that one cannot, under GAAP, simply subtract the Panhandle equity amount from the total company

SU equity amount, as Mr. Murray proposes, and derive an SU stand-alone equity amount apart from Panhandle.

Q. Does the Staff agree with Mr. Gillen's arguments?

A. No. There are two distinctions regarding this matter discussed in Mr. Gillen's rebuttal testimony that must be identified in order to have a clear understanding of the issue. First, Mr. Gillen disagrees with Mr. Murray's use of the equity reported by SU to the SEC for the reasons given in his rebuttal testimony. Second, Mr. Gillen does not offer the Commission an alternative amount of equity in SU's capital structure that supports SU's Panhandle operations in lieu of the amount Panhandle reported to the SEC.

Mr. Gillen never disputes the propriety of Mr. Murray's adjustment to remove both debt and equity from SU's capital structure to derive a capital structure that supports SU's non-Panhandle operations. Mr. Gillen only disputes the use of the amount of equity reported by SU to the SEC for the purpose of deriving a capital structure that supports SU's non-Panhandle operations. Mr. Gillen does not state what he contends is the proper amount of equity contained in SU's consolidated capital structure that supports SU's Panhandle operations. Mr. Gillen does not state that there is no equity contained in SU's consolidated capital structure that supports SU's Panhandle operations as is premised in the capital structure proposed by the Company in this case.

Q. Are you a certified public accountant?

A. I am.

Q. What is GAAP?

A. GAAP constitutes the rules by which business entities must account for the financial results of their operations. GAAP pronouncements are promulgated by the

Financial Accounting Standards Board, and are intended to ensure that business entities issue financial statements in a generally consistent and comparable way.

Q. Is the Commission obliged to conform to GAAP in its ratemaking decisions and policies?

A. No. The Commission has freely deviated from GAAP on occasion in its past ratemaking decisions.

Q. Does GAAP itself address the unique circumstances that face rate-regulated entities in applying GAAP?

A. Yes. Financial Accounting Standard No. 71, *Accounting for the Effects of Certain Types of Regulation*, allows utilities, in certain circumstances, to account for items on their financial records in accordance with the rate policies of its regulator, as opposed to traditional GAAP standards.

Q. Do you agree that Mr. Gillen's Schedules JJG-1 and JJG-2 are presented in accordance with GAAP?

A. Yes, within the narrow context that they are presented. Mr. Gillen's schedules present an example of the use of elimination entries in consolidating the books of a parent company and a subsidiary company under current GAAP. However, with all due respect, Mr. Gillen's schedules and the conclusions that he draws from them could not be more irrelevant to the capital structure issue in this case. Mr. Gillen attempts to answer the question whether Mr. Murray's methodology for removing Panhandle equity from the consolidated SU capital structure is in accordance with GAAP. Mr. Gillen's concerns might have some substance if the Staff was making recommendations on the proper presentation of SU's and Panhandle's parent/subsidiary financial statements. However, the Staff is not doing that, and instead is asking the question, how much of SU's total level of equity in its consolidated capital structure supports the operations of its Panhandle subsidiary. Mr. Gillen's testimony does not even attempt to answer that question, and in fact is highly misleading in framing this issue in an inappropriate context.

Q. What valid conclusion can the Commission draw from Mr. Gillen's Schedules JJG-1 and JJG-2?

A. The Commission can safely draw the conclusion that the amount of SU's Total Consolidated Common Stockholders' Equity of $946,501,950 at year-end 2003 (found in the column "Total Consolidated" on Schedule JJG-1) represents all of SU's equity, including the portion of the equity that supports its Panhandle operations. Similarly, the $1,245,937,627 amount found on Schedule JJG-2 represents all of SU's common stockholders' equity as of March 31, 2004, including the portion related to SU's Panhandle investment.

Q. On Mr. Gillen's Schedules JJG-1 and JJG-2, what is the significance of the amount of equity shown for the Panhandle operations in the column marked "Panhandle Stand Alone?"

A. The Staff has requested support for these numbers from MGE in a data request. The Staff notes that the amounts shown on Mr. Gillen's schedules appear to be close to the total purchase price paid for Panhandle by SU.

Q. Do you agree with Staff witness Murray's approach of subtracting the stand-alone amount of Panhandle equity from Panhandle's Form 10-K from the total company SU equity on SU's Form 10-K to determine the appropriate amount of equity in an MGE capital structure excluding Panhandle?

A. Yes. ~~No.~~ This amount is the one Panhandle portrays as being an accurate quantification of the equity supporting its operations in its reporting to the SEC. However, if the Commission is not comfortable with that quantification, I will suggest some alternative estimations of Panhandle equity later in this testimony.

Q. Does the Staff believe that some portion of SU's equity supports the operations of Panhandle?

A. Yes. The Staff believes the evidence for this is irrefutable, and that the Company's position on this issue represents an attempt to establish rates in this case that will cause MGE's ratepayers to support SU's newly acquired Panhandle operations by paying a return on equity related to this line of business.

Q. If, hypothetically, no portion of SU's equity capitalization supports Panhandle, what are the implications of this?

A. If Panhandle were not supported by some portion of SU's current equity, then logically Panhandle would be financed 100% by debt.

Q. Is MGE supporting a position in this case that Panhandle should be presumed to be 100% financed by debt?

A. Neither Company witness Dunn, in his direct testimony, or Mr. Gillen, in his rebuttal testimony, affirmatively state that this is MGE's position. However, the logical implication of their position that, to eliminate Panhandle from the capital structure in this case one only needs to remove debt amounts, is to take the position that Panhandle is, in fact, 100% financed with debt.

Q. Are you aware of any evidence that supports MGE's implicit position in this case that Panhandle is financed entirely with debt?

A. No. However, I am aware of abundant evidence that some portion of SU's equity capitalization supports Panhandle.

Q. What specific evidence are you aware of that some portion of SU's equity is related to the Panhandle acquisition?

A. Reference to MGE's past representations to the Commission, as well as SU's 2003 Annual Shareholders Report (Annual Report), makes it very clear that SU planned to, and in fact has issued equity in direct relationship to the Panhandle acquisition transaction.

Q. Was SU's acquisition of Panhandle a cash transaction?

A. Yes, according to the SU Annual Report.

Q. In what ways could SU have obtained cash to purchase Panhandle?

A. SU had available to it the cash proceeds from the sale of its local distribution company (LDC) operations in Texas in January 2003. Generally, any other additional cash would come either from debt or from equity sources. Equity financing can come from issuances of new equity, or from SU's retained earnings.

Q. What were SU's original plans for financing the Panhandle transaction?

A. According to the direct testimony of MGE witness David J. Kvapil in Case No. GM-2003-0238, MGE's application to purchase Panhandle's equity, SU's plans were to finance the bulk of the Panhandle purchase price using the proceeds from the planned sale of SU's LDC operations in Texas. The remainder of the purchase price would be funded through "available resources," including short-term debt. (Kvapil direct, pp. 10-11). Mr. Kvapil goes on to state the following: "However, to maintain a balanced capital structure following the purchase (through the repayment of long-term debt) and to fund utility operations without raising debt levels, the Company will be issuing common and/or preferred stock up to an approximate aggregate value of $300 million" (Kvapil direct, Case No. GM 2003-0238, p. 11, ll. 5-9).

(At the time of Mr. Kvapil's testimony in Case No. GM-2003-0238, SU assumed that AIG Highstar Capital L.P. (AIG), a private equity fund, would contribute part of the purchase price of Panhandle. Later, AIG terminated it involvement in the transaction before the Panhandle purchase took place. This change in financing plans does not affect in any way the relevance of Mr. Kvapil's quoted testimony to the issue I am addressing.)

Q. If a utility decides to issue equity in order to maintain a balanced capital structure following an acquisition transaction, can that equity issuance be reasonably considered related to the acquisition transaction?

A. Yes.

Q. What was the actual purchase price paid by SU to acquire the equity interests of Panhandle?

A. According to the 2003 SU Annual Shareholders Report (Annual Report), SU paid $582 million in cash for Panhandle, with approximately $30 million in addition paid out by SU in transaction costs. The Annual Report goes on to state that CMS Energy Corporation (the previous owner of Panhandle) bought approximately $49 million of SU treasury stock from SU as part of the purchase transaction.

Q. Did MGE use its equity to purchase Panhandle?

A. Yes. It appears equity sources were used to finance the majority of the Panhandle transaction.

Q. How was SU's acquisition of Panhandle in actuality financed?

A. The 2003 Annual Report states:

> [I]n addition to using proceeds from its Texas assets sale to fund the Panhandle acquisition, in May 2003, Southern Union initiated concurrent common stock and equity linked units offerings...we sold common stock and equity linked units for completion of acquisition funding, debt reduction, as well as for other corporate purposes.

More specifically, later in the 2003 Annual Report, the document details the following sources of funds as being used by SU to purchase all of the equity of Panhandle:

> The Company funded the cash portion of the acquisition with approximately $437 million in cash proceeds it received for the January 1, 2003 sale of its Texas operations..., approximately $121 million of the net proceeds it received from concurrent common stock and equity units offerings..., and with working capital available to the Company.

The first funding source listed above (cash from the Texas LDC sale) is clearly an equity investment. The portion of the second item relating to equity units offerings is actually a debt instrument, but will be convertible to equity at some point in 2006. The third item (working capital) may be a combination of equity financing and short-term debt financing.

Q. Did SU make an issuance of common stock activities at or about the time of the Panhandle purchase?

A. According to the Annual Report, SU issued 9.5 million shares of common stock on June 11, 2003, which ultimately resulted in net proceeds of $168.7 million to SU.

Q. What was the date of SU's acquisition of Panhandle?

A. June 11, 2003.

Q. For what purpose were the 9.5 million shares of common stock issued by SU on June 11, 2003?

A. Based upon the Annual Report, the Staff believes it is clear that at least a portion of the issuance proceeds was used to directly finance the Panhandle transaction, and that at least part of the remainder was used to pay down long-term debt, in order to maintain a balanced capital structure after the Panhandle purchase was implemented.

Q. What overall conclusions do you draw from the information contained in SU's Annual Report concerning financing of the Panhandle transaction?

A. Based upon the information in the Annual Report, the Staff believes that there should be no dispute that some amount of SU's total equity following the Panhandle transactions was associated with the purchase transaction, and would not exist if that transaction had not been entered into. Accordingly, if the Commission desires to eliminate the impact of the Panhandle transaction from the capital structure it orders in this case, some amount of total SU equity needs to be eliminated from the capital structure.

Q. Based upon the above information from the 2003 Annual Report, what level of equity should the Commission assume is attributable to Panhandle, if it accepts the Company's recommendation to eliminate Panhandle impacts from the capital structure in this case, but it chooses to reject the quantification of Staff witness Murray in his direct testimony concerning SU's Panhandle equity?

A. The information in the Annual Report is not detailed enough to make exact quantifications of the equity investment SU made in Panhandle in June 2003. The Staff would first suggest that the Commission use the amount of equity related to the Panhandle operations as reported to the SEC. If the Commission is not inclined to use the number reported to the investing public, then the Staff would suggest alternative estimates derived from the amounts reported in the SU Annual Report. By use of this information, one can make some reasonable estimations of current Panhandle equity. There is no evidence of any kind, in the information in the Annual Report (which incorporates SU's 10-K filing with the

SEC) that supports the Company's position that there is no SU equity that supports Panhandle.

The Staff believes, at a minimum, the Commission should assume that at least $521.35 million of the total SU equity at year-end 2003 is attributable to the Panhandle acquisition. This amount is quantified by adding together SU's cash proceeds of $437 million from the sale of its Texas LDC operations (which in turn were invested in Panhandle), to half of the $168.7 million common stock issuance proceeds made concurrently with the Panhandle sale. The assumption that only half of this common stock issuance related to the Panhandle transaction is very conservative, in the Staff's opinion.

Q. Are there any other alternative methods for valuing the amount of equity attributable to Panhandle?

A. Yes. An even more conservative estimate would be to assign one-half on SU's total equity at year-end 2003 to Panhandle (or, more accurately, the entirety of SU's pipeline operations). According to Schedule JJG-1, this amount would be $473,251,000 ($946,501,950 divided by two). This allocation would be based upon the statement in SU's Annual Report that "[t]he new Southern Union is now comprised of approximately half FERC-regulated natural gas transportation and storage assets, and half state-regulated natural gas distribution assets."

Q. Is it possible that SU has issued preferred stock recently that was also related to the Panhandle acquisition?

A. Yes. This matter is discussed in the rebuttal testimony of Staff witness Murray at pages 14.

Q. Do you have any final point to make concerning the capital structure issue in this case?

A. Yes. The Staff continues to recommend that the Commission use a consolidated SU capital structure to set rates for MGE in this rate proceeding, for the reasons stated in Mr. Murray's testimony. If the Commission adopts the Staff's position on this issue, then all of this discussion as to how much of SU's equity relates to Panhandle becomes a moot point.

However, if the Commission decides to adopt MGE's position that a stand-alone SU capital structure (without Panhandle) be adopted, then some valuation of the equity associated with Panhandle must be made. While there may not be one "right" answer as to how much exact equity is associated with Panhandle, the Staff has presented several reasonable estimations of such. There is a "wrong" answer to this question, however -- MGE's position that no equity be assigned to Panhandle under MGE's stand-alone assumption. Based upon SU's own Annual Report, that position is demonstrably false. In addition, its adoption by the Commission would lead to use of a skewed capital structure in rates, with MGE's capital structure excluding all low-cost debt associated with Panhandle, and including all of SU's higher-cost Panhandle equity.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.