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September 18, 2001

FILED
SEP 18 2001
Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. GM-2001-585

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the **BRIEF OF STAFF** in HC version and the original of the NP version.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Lera L. Shemwell
Associate General Counsel
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LLS:sw
Enclosure
cc: Counsel of Record

FILED
SEP 18 2001
Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the Joint Application of Gateway Pipeline Company, Inc., Missouri Gas Company and Missouri Pipeline Company.	)))	Case No. GM-2001-585

BRIEF OF THE STAFF

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September 17, 2001

****DENOTES HIGHLY CONFIDENTIAL****

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BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

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BRIEF OF THE STAFF

I. INTRODUCTION

The Application by Gateway to acquire assets owned and operated by UtiliCorp United Inc. (UtiliCorp) should be rejected.

On April 18, 2001, Gateway Pipeline Company, Inc. (Gateway), Missouri Gas Company (MGC) and Missouri Pipeline Company (MPC) filed a Joint Application (Application) in this case seeking a determination by the Commission that the Commission either lacked jurisdiction over the requested transaction or, in the alternative, seeking authorization for Gateway to acquire the outstanding shares of UtiliCorp Pipeline Systems (UPL), a wholly owned subsidiary of UtiliCorp.

The Application indicated that UtiliCorp and Gateway have entered into a stock purchase agreement for UtiliCorp to sell to Gateway all of the outstanding shares of the capital stock of UPL. UPL is the unregulated parent and holder of the stock of MPC and MGC, two Missouri regulated intrastate natural gas pipelines. UtiliCorp, as the parent and owner of UPL, is the party entering into this transaction. (Joint Application at 3). UtiliCorp is a regulated Missouri electric and gas corporation under Sections 386.250 and 393.190[1] and there is no dispute that UtiliCorp is regulated by the Commission.

[1] All references are to RSMo 2000 unless otherwise specified.

Staff believes that the proposed transaction is, in fact, a sale or "other disposal" by UtiliCorp of assets that are used and useful in the performance of its duties to the public and should be treated as such under §393.190(1). "It is undisputed that UtiliCorp is regulated by the Commission and that, following the proposed transaction, UtiliCorp will no longer have an interest in MPC or MGC." (Reply of Gateway to Legal Memoranda of Staff and the Office of the Public Counsel with Respect to the Jurisdiction of the Missouri Public Service Commission).

Throughout this proceeding, Joint Applicants have insisted on expedited treatment, even as they have resisted Staff's efforts to obtain sufficient information to perform its analysis. Despite this impediment, Staff has been able to determine that this proposed transaction is detrimental to the public interest.

Staff has established that the proposed acquisition should be rejected. There are numerous detriments to the public interest, most importantly those immediate detriments that cannot be mitigated by conditions placed on the acquisition. Higher cost of service due to the capital structure proposed for this already uneconomic system, coupled with the fact that the purchaser has less ability to withstand the losses on this uneconomic system creates an immediate public detriment. (Oligschlaeger Rebuttal at p. 7, lines 17-22). Staff will also describe the less immediate detriments that deserve Commission consideration because, among other things, the Commission may lose the ability to protect ratepayers in future cases if it decides to authorize the proposed transaction and correspondingly loses its jurisdiction.

Staff concluded that Gateway's "plans" to make the system economically viable are likely to fail. First, aggressive competition from propane dealers makes it almost impossible for Gateway to raise rates. (Oligschlaeger Rebuttal, p. 4). Second, **______________________________

____** Third,

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because the system is almost fully subscribed (Lock Rebuttal, p. 6) any increase in throughput volumes will require additional capital expenditures that must somehow be recovered through rates.

The Commission is likely to lose jurisdiction if it authorizes this transaction. This could occur in several different ways. First, the Commission will lose jurisdiction over Gateway's parent company, Mogas Energy LLC, (Mogas), while UtiliCorp is regulated, Gateway will not be regulated, nor will Mogas be regulated. This loss of jurisdiction might not be as troubling if the Commission was able to retain jurisdiction over MPC and MGC, but **___________

____** and the Commission will lose jurisdiction over MPC and MGC as well. Staff explains below why **___________________

_______________________**

Finally, Staff demonstrates that UtiliCorp must comply with Section 393.190.1 and Commission rules and apply to this Commission for an order authorizing it to sell or otherwise dispose of these assets. If UtiliCorp fails to obtain such an order, this proposed transaction is void.

II. STANDARD

A. Joint Applicants and UtiliCorp as the seller in this proposed transaction must demonstrate that the proposed transaction is not detrimental to the public interest.

In this case, the Commission must decide whether the proposed transaction is "not detrimental to the public interest." (State ex rel City of St. Louis v. Public Service Comm'n., 73 S.W.2d 393, 400 (Mo.banc 1934). In establishing this standard, the Missouri Supreme Court recognized that one of the most important functions of the Public Service Commission is to balance competing interests, and the Court noted, with approval, a Maryland case:

> To prevent injury to the public, in the clashing of private interests with the public good in the operation of public utilities, is one of the most important

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> functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more than "not detrimental to the public."

City of St. Louis v. Public Service Comm'n., 73 S.W.2d 393(Mo. banc 1934).

In reviewing the procedural history of this case as it prepared for briefing, Staff realized that UtiliCorp made itself a party to the case, by the entry of appearance of counsel, but UtiliCorp has never made any application to this Commission to sell these assets. UtiliCorp must make such application and receive Commission authorization or the transaction is void under Section 393.190.1. The proper time for the Commission to consider such a sale of these assets is if, or when such an application is filed. (<u>In the Matter of the Joint Application of Missouri-American Water Co. and United Water Missouri Inc.</u> Report and Order, March 26, 2000).

In deciding whether to authorize what Staff views as the sale or disposal of assets by UtiliCorp, (T. at) the Commission must balance the interest of Missouri rate payers who depend on this regulated monopoly utility for natural gas service with UtiliCorp's property interest to sell or otherwise dispose of its property. Staff agrees that property owners have certain rights, including the right to sell that property. However, a public utility, as a monopoly with captive customers, also has certain obligations to the public. The Legislature has recognized those obligations and has concluded that a utility may not dispose of certain property without Commission oversight. (Section 393.190.1) In recognizing these competing interests, the courts have set the fulcrum of this balance at whether the transaction is "not detrimental to the public interest." (<u>City of St. Louis v. Public Service Comm'n.</u>, 73 S.W.2d 393, 400 (Mo. banc 1934)). In other words the public does not have to be benefited, but it should not be harmed. *Id.* In Case No. EM-91-213, Application of Kansas Power and Light Co., the Commission identified the "public" as Missouri ratepayers.

> The Commission has found no evidence in this record that KPL would be unable to render safe and adequate service to its Missouri ratepayers as a consequence of the proposed merger.
>
> . . .
>
> The Commission further believes it is important that Missouri ratepayers be shielded from any possible ill effects from the (transaction) . . . . Because of these possibilities (that estimates of cost savings might be unduly optimistic…) along with the chance that the . . . capital costs might ultimately increase, the Commission believes that it is essential that Applicant understand that the Commission will take all necessary steps to protect Missouri ratepayers from any such ill effects. 1 MPSC 3d at 156 (1991). (emphasis added).

In this case, where Gateway proposes to acquire MPC and MGC, Staff believes that the necessary step the Commission must take to protect Missouri ratepayers is to reject the proposed transaction. There is no other way to effectively protect Missouri ratepayers from the "possible ill effects" of this transaction.

III BURDEN OF PROOF

Burden of proof with its risk of non-persuasion rests with the Applicant. The initial burden of proof is on the applicant, or on the acquiring company, to show by substantial and competent evidence that the proposed transaction is not detrimental to the public interest. In the Matter of the application of Missouri-American Water Company for approval of its acquisition of the common stock of Missouri Cities Water Company. 2 MPSC 3d 305 (2000).

The Commission's rules indicate that the burden of proof is on the moving party. For example, Commission rule 4 CSR 240-2.110(5)(A) states, in part, that in all proceedings, except investigation proceedings, the applicant or complainant shall open and close. Thus, the party with the burden of proof has the right to open and close at hearing.

Black's Law Dictionary 190 (7th ed. 1999) states that the "burden of proof" includes both the *burden of persuasion* and the *burden of production.* The burden of persuasion is "[a] party's duty to convince the fact-finder to view the facts in a way that favors that party." The burden of production is "[a] party's duty to introduce enough evidence on the issue to have the issue decided by the fact-finder . . . " The party with the burden of proof must initially meet its burden of producing evidence sufficient to establish a *prima facie* case. McCloskey v. Kopler, 46 S.W.2d 557, 563 (Mo.banc 1932); Drysdale v. Estate of Drysdale, 689 S.W.2d 67, 72 (Mo.App. 1985).

Joint Applicants have not made their *prima facie* case. They have failed to show that this transaction would not be detrimental to the public. Gateway proposes to purchase a system that is not profitable and to add to the financial pressure through a capital structure that not only increases the cost of capital, but also the cost of providing service to the customers of MPC and MGC. (McKiddy Rebuttal, p. 10 lines 3-5).

UtiliCorp maintains that the proposed transaction is not detrimental to the public interest because the status quo will be maintained, at least for the immediate future. (Kruel Surrebuttal at p. 2). This theory is put forth generally on the basis that Gateway or MPC or MGC have not requested a rate increase in this proceeding, and that no evidence been placed in the record that service quality will decline as a result of its purchase. Neither of Gateway's points is valid.

First, Gateway has no Missouri property and does not currently conduct utility operations in Missouri. (Joint App. at 1). Therefore, it cannot request a rate increase at this time from the Missouri Commission. (Tr. p. 749). To assert that this transaction meets the "no detriment" standard if the associated application does not include a request to increase rates is absurd. It is impossible for an applicant with no Missouri operations to request a change in rates. Gateway evidently suggests that this Commission must "rubber-stamp" applications such as this one if there is not request for a rate increase.

Gateway's discussion of service quality is equally oversimplified. Presumably, no applicant intends to degrade service quality after entering into a purchase or merger transaction; and, even if they did, they would not nform the Commission of this intent. Nor can an adverse party "prove" that service quality will decline after a transaction is approved. Instead, the Parties can only present the Commission with evidence of what can reasonably be expected if it were to authorize this transaction. In this case, Staff and other parties have presented evidence that UtiliCorp's MPC and MGC properties are operating at a loss. Compared to UtiliCorp,

**____

__________** (Oligschlaeger Rebuttal at 6-7).

In these circumstances, if Gateway is not able to improve the throughput levels on its systems on an economical basis, it has an incentive to take one of three courses of action to avoid continuing losses on these operations: 1) file for increased rates, risking a "death spiral," 2) cut back on expenses, potentially negatively impacting service quality, or 3) seek to abandon service. All three possibilities would be detrimental, yet Gateway has not introduced meaningful evidence of how these situations can be avoided.

Nor has Gateway explained how it will increase throughput and revenues without significant capital investment. Since the system capacity on MPC and MGC is nearly fully subscribed by its current customers, any additional capacity or increased pressure flows on MPC and MGC will require additional capital investment that has not been quantified or analyzed in terms of a cost-benefit analysis. (Lock Rebuttal, p. 6). Gateway has not explained how it will

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add capacity without increasing the need for additional capital investment. Gateway has failed to meet its burden of proof.

Gateway failed to carry its burden of proof and its burden of production. Once a *prima facie* case is made, the burden of going forward with the evidence, or the burden of production, normally shifts to the adverse party. However, in this case, even if Gateway, MPC and MGC had made the required *prima facie* case, case law in Missouri is clear that where the facts relating to an issue are peculiarly within the control or knowledge of one party, the burden of production falls on that party. The burden of proof remained with Joint Applicants and Gateway; MPC and MGC have failed this burden as well.

The Missouri Supreme Court explained the burden of production in Robinson v. Benefit Ass'n. of Ry. Employees, 183 S.W.2d 407, 412 (Mo.App.1944) holding that:

> [G]enerally the burden is upon the plaintiff to make out his case. That if in the statement of his case negative averments are required, and the proof of such negative averments is not peculiarly within the knowledge and power of the defendant, then plaintiff must affirmatively establish such negative averments, but if, on the other hand, the proof of such negative averments lies peculiarly within the knowledge or power of the defendant, then such negative averments will be taken as true unless the defendant speaks and disproves them. Of course, if the knowledge and power to produce the evidence is possessed equally, the plaintiff must make the proof.

Cf. Kenton v. Massman Construction Co., 164 S.W.2d 349, 352 (Mo. 1942)("A plaintiff asserting a negative generally has the burden of proof as to such matter along with the other issues on which he bases his case . . . .").

This is a particularly appropriate rule in this case because most of the facts and documents relevant to the issues of the negative averment in this case are within the control of Joint Applicants and UtiliCorp. Gateway controls the information concerning the financial risk of this transaction and, in Staff's opinion, Gateway has provided very little information. Also, Gateway has been unable or unwilling to provide any substantive financial evidence of its ability to improve the earnings of these properties to the degree necessary to offset the additional costs associated with its capital structure.

As an example of this failure, Gateway has failed to provide support for the pro forma (projected) financial statements purporting to show Gateway's expectations for these pipelines' earnings for the year 2002 under its ownership. Attached to Mr. Ries testimony is HC Schedule 14, which shows **____** for 2002, based upon a **____.** The projected revenues are **______________________________________** experienced under UtiliCorp ownership, **____** current UtiliCorp levels. (Oligschlaeger Rebuttal p. 4-5). There is **______________ ______** under Gateway ownership, because the proposed Gateway **___________ ____________________** than UtiliCorp's. (Oligschlaeger Rebuttal , p. 6). According to Gateway's best guess, Gateway projects that it will **____________________________** on these properties in 2002 (Tr. p. 646), and that result assumes Gateway can achieve an increase of **________**in revenues compared to UtiliCorp's performance. (Tr. p. 646-647).

From its own experience, the Commission is aware that equity returns of **___** or less are not adequate in the long term to attract capital or be competitive with alternative opportunities afforded to equity investors. Staff was interested in testing the validity of Gateway's projected financial statements, which indicate that Gateway **_________________ ____ ____** so Staff sent a number of data requests asking for business plans and other information that would help support Gateway's projections. Gateway refused to provide any additional

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information beyond vague **____** (McKiddy Rebuttal, p. 14, lines 1-33; Oligschlaeger Rebuttal, p. 5). Staff specifically asked for a listing of the assumptions underlying the **__________________________** amounts referenced above from Gateway. (Tr. 689-690). Gateway refused to provide the assumptions and other supporting documents behind the **________________**claiming that to provide such information would be too "burdensome." (Id.) Accordingly, the Commission, Staff and other parties to this proceeding have been asked to rely upon unsubstantiated assertions of improved (but still inadequate) financial performance of these pipelines to offset the very real detriment associated with this transaction.

At the hearing for this case, however, in response to questions from the Commission, Gateway finally chose to supplement the information available on its expectations of future financial performance. On the witness stand, Mr. Ries indicated that Gateway expected an **____ ____________** (Tr. p. 291, lines 17-18). This estimate apparently forms the basis of Gateway's expectations for MPC and MGC to be financially viable if the purchase application is approved. Nonetheless, this information was never provided to Staff prior to the hearings, and this assumption was not reflected in the pro forma financial statements. (Tr. 695-696). Moreover, while Mr. Ries also provided some rough estimates of **________________ ____** Gateway never provided, at the hearings or at any time during this case, any comprehensive analysis of the additional revenues and rate base that would be necessary **___________________________________.**(Tr. 717-719). This would merely serve as the minimum amount of information necessary to judge whether **_____________________**(ignoring FERC jurisdictional issues for the moment)

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would be economical, and potentially offset some of the detrimental aspects of this proposed transaction. Gateway is either unable to provide this information, or not willing to provide it.

Staff unquestionable should have been privy to the information concerning the **__ ______________________________** during its audit of this application, as noted by Staff witness Oligschlaeger under cross-examination. (Tr. 702). Having this information, and asking questions concerning it, would have allowed the Staff to make a more informed recommendation on the financial ramifications of this transaction, and the ability of the owners to meet their future financial obligations. Evidently having decided that a strategy of candor would not be in its best interests, Gateway should not at this point be given the benefit of the doubt and excused from its failure to provide timely and adequate information in support of its acquisition request. (Tr. 697). Gateway has not produced any meaningful financial evidence to dispel any of the concerns of public detriment introduced by Staff and other parties to this proceeding.

IV. ISSUES OF THE CASE

A. Should the request of the Joint Applicants for Gateway to acquire all of the stock of UPL be approved?

No. The Commission has recently noted the factors that it considers in reviewing an acquisition. These factors include: the applicant's experience in the utility industry; the applicant's history of service difficulties; the applicant's general financial health and ability to absorb the proposed transaction; and the applicant's ability to operate the asset safely and efficiently. *See* In the Matter of the Joint Application of Missouri-American Water, et al., Case No. WM-2000-222 (*Report and Order,* issued March 16, 2000) 3 Mo.P.S.C.3d 216, 220. Staff considered these factors in investigating this application and identified numerous detriments to the public interest.

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These serious, direct and immediate detriments, coupled with the absence of information about the applicants and their financial arrangements, as well as the lack of any serious planning by Gateway to manage this system, leads to the inescapable conclusion that approval of this transaction would be detrimental to the public interest.

B. Would the sale be detrimental to the public interest?

Yes. Staff has pinpointed several detriments to the public that will occur immediately. This combined with the public detriments that may be less immediate, but are still highly likely to occur, demonstrate that this proposed transaction is detrimental to the public interest.

One of the immediate detriments identified by the Staff is the higher cost of capital.

** ____

** The cost of providing service is evolutionary, not something that is the result of a rate case as suggested by Gateway and UtiliCorp. Rather, cost of service is a cost that necessitates a rate case and allows a company an opportunity to receive a revenue requirement sufficient to cover its cost of providing service.

MPC and MGC are already financially stressed operations. The return on common equity associated with the common equity ratios achieved by MPC was (0.30) percent and MGC was (10.20) percent. (McKiddy Rebuttal at p. 9, l. 20-22). Under UtiliCorp ownership, the costs of capital for MPC were 5.89 percent and for MGC were 3.42 percent at December 31, 2000. (Id. at lines 24-25). As stated above, **____ ____**proposed by Gateway. It is Staff's opinion that this **____________________**will have an immediate impact on the financial viability of MPC and MGC.

Comments at hearing further raised Staff's concerns about the financial viability of this system. In response to Commission questions concerning the ability of these pipelines to earn an adequate equity return, Mr. Ries attempted to reassure the Commission by stating that even if the pipelines were operating at a loss, Gateway would have cash in the bank from depreciation expense (a non-cash expense item) that could be used to pay an equity return to the investors. (Tr. 320). These comments demand a response.

While apparently Mr. Ries intended to calm the Commission's financial viability concerns, the Staff believes that Mr. Ries' comments are, in fact, alarming. Staff witness Oligschlaeger testified under cross-examination that depreciation expense is not an element of return on equity, or a substitute for it. (Tr. 638). Depreciation is a rational and systematic allocation to expense of a utility's capital investment. (Tr. 637). Cash associated with depreciation expense is presumed to be available to the utility for re-investment in order to meet

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whatever capital needs the utility may have. (Tr. 638). A policy of paying equity returns out of depreciation expense (i.e., paying dividends in a greater amount than a utility's net income) means that utility is shrinking in size (reducing the amount of its total capital), while most utilities have increasing capital needs over time. (Tr. 638). Moreover, a policy of paying out equity returns in the manner advocated by Mr. Ries leads to concerns about whether the utility intends to be a going concern in the long run. (Tr. 639). The comments by Gateway witnesses concerning depreciation expense did not mitigate Staff's concerns about the financial viability of these properties under Gateway's ownership; their comments exacerbated these concerns. The concern that Gateway will use funds that should be reinvested in the company to pay equity investors is further heightened by the fact that it is almost impossible for Gateway to improve the financial viability of the system by raising rates.

"Unlike most situations involving utilities whose rates are regulated by the Commission, the service offered by MGC and MPC is directly subject to price competition from propane suppliers. Seeking to increase rates for MPC and MGC may have the unintended result of inducing current customers of the pipelines to change their fuel source from gas to propane. This result would in turn lead to decreased profitability for the gas pipelines, and any further increase in gas rates would potentially result in even further customer losses to propane, ending in a so-called "death spiral." For this reason, the Staff believes that Gateway's ability to seek increased rates for these properties in the future will be significantly constrained." (Oligschlaeger Rebuttal p. 4)

Another detriment that is of immediate concern is that the capital structure allows Mogas to double leverage these assets, putting them at greater risk. (McKiddy Rebuttal at p. 17, lines 3-9). Gateway and, indirectly, MPC and MGC's capital structures are influenced by Mogas, a non-regulated entity, which is not a party to the proposed transaction currently before the Commission. (McKiddy Rebuttal at p. 17, lines 3-9). However, in Staff's opinion, Mogas is very much a part of this proposed transaction. (Id.). As such, Staff believes Mogas could pledge the stock of Gateway, also a non-regulated entity, as collateral for its financing needs, thereby placing the assets of MPC and MGC at risk. Staff joins Office of the Public Counsel in its concerns with the ability of the owners to ** ____________________________ **(Burdette Supplemental Rebuttal at p. 3, lines 14-25; p. 4, lines 1-12). Such a situation creates several potential detriments to Missouri ratepayers. In *Associated Natural Gas,* the Western District explained how ** ____ ** can harm ratepayers:

> A corporation is "leveraged" to the extent that debt is included in its capital structure. The leverage arises from the advantage equity holders gain through the rental of capital at a lower rate than the return they receive on their equity. Leverage allows equity owners to earn an over-all rate of return in excess of the cost of capital. The added earnings above the cost of borrowed capital inure to the benefit of the stockholders who receive a higher rate of return than if the corporation had been financed entirely by equity.
>
> Utility regulators prevent these excess earnings by analyzing the utility's capital structure and allocating a different weighted cost to each of the individual elements of the capital structure, including debt. Therefore, utility owners can earn on debt only what it costs them to secure the leverage.

In this case, however, the Commission could not analyze Mogas' capital structure because of the involvement of ** _______________________ ** The Commission has no way of knowing if ** ____

____ The Western District explained how such an arrangement could harm ratepayers:

> Today, it is becoming more common for a utility to operate as a wholly owned subsidiary of a parent holding company. Double leveraging is an extension of the leveraging concept to a parent-subsidiary corporate relationship. For

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> example, Company A is an operating utility financed partly with debt capital and partly with equity capital. It uses leverage as explained above. However, the common stock of Company A [Gateway] is owned by Company B, [Mogas] the parent company. Company B obtained the funds it invested in the common stock of Company A by raising its own capital through the sale of stock and from a debt issue. Thus Company A enjoys its own leverage factor plus the leverage factor of Company B. This is the essence of the meaning of double leverage.
>
> The objective of leveraging or double leveraging is to apply a rate of return on the rate base in proportion to the weighted cost of capital. The principle behind the double leverage adjustment is to account for the parent's alleged use of low cost debt to acquire equity in its subsidiary, upon which it may earn a higher rate of return than it pays for the debt. If the cost of capital to the utility is considered without regard to the double leverage enjoyed in a parent-subsidiary relationship, an excessive return to the ultimate . . . stockholders could result at the expense of utility ratepayers.

State ex rel. Associated Natural Gas Co. v. Public Service Com'n of Missouri, 706 S.W.2d 870, 876-877 (Mo.App.1985).

OPC Witness Burdette testified that the Banc One loan **_______________________

____

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____

____

_____** (Burdette Supp. pp. 3, lines 17-25).

The Commission's inability to determine the nature of TCW's "equity" investment would prevent the Commission from protecting Missouri ratepayers in a subsequent rate case. While UtiliCorp does not have the corporate structure that allows this double leveraging to occur, Gateway does, creating an immediate detriment that is almost impossible to remedy later.

In addition to concerns about the capital structure, Laclede has raised concerns about the past business practices of one of the investors, Mr. Dennis Langley. (Pflaum Rebuttal p.4-p.8).

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While this Commission usually does not normally consider individual investors in a company, in this case there is reason to do so. The applicant's experience in the industry is one of the factors that the Commission considers. (Missouri American Water, WM-2000-222, Report and Order at 5). Both Mogas and Gateway are newly formed corporations so neither has any history of utility operations. One of Mogas's and Gateway's owners, Mr. Dennis Langley, does, however, have a history of utility operation in Kansas. Since Mogas and Gateway have only three shareholders, those individual shareholders exercise considerably more influence over the operations of MPC and MGC than do, for example, the shareholders of Laclede or KCPL over their respective operations. Mr. Langley will have a **________________________________ ____________________** (McKiddy REbuttal, pp. 16-17).

As a **___________** shareholder, Mr. Langley will have almost total control over the business practices of the MPC and MGC systems. This Commission has experience with proceedings at FERC involving companies operated and/or invested in by Mr. Langley. This Commission's most recent experience involved an extensive review of Mr. Langley's business practices in the KPC rate case at the FERC, Case No. RP99-485-000. This Commission filed testimony that expressed concern with the accounting and business practices of KPC. (Pflaum Rebuttal pp. 11-12). In that Initial Order, the FERC Judge agreed with this Commission's concerns. (Kansas Pipeline Company, Docket No. RP99-485-000, Initial Decision July 31, 2001).

Staff has focused primarily on the immediate increases in financial risk, cost of capital and cost of service and its impact on the financial viability of the MPC and MGC operations. Staff believes it is also important for the Commission to consider other factors when making its decision. The Commission should be equally concerned about the fact that Gateway has

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provided no business or strategic plans, no market analysis, no real plan of how throughput can increase without significant additional capital expenditures, and no clear plan of how Gateway will succeed in operating MPC and MGC operations. In the 1994 case permitting UtiliCorp to purchase these assets, one of the things that the Commission valued was UtiliCorp's financial stability. (Report and Order, Case No. EM-94-252, p. 7) Gateway does not have such stability and as an unregulated company, it would be easier for Gateway to walk away if the economics of the system do not improve. (Oligschlaeger Rebuttal, p. 8).

Gateway and UtiliCorp would like to narrow the Commission's focus to the immediate future. Taking such a narrow view of this proposed transaction would preclude a true balancing of the interest of the consumers dependent on this regulated monopoly utility for natural gas service with the property interest of UtiliCorp to sell or otherwise dispose of property that it owns. Loss of jurisdiction would mean that the Commission could not address the less immediate detriments in future cases.

Moreover, the detriments are not offset by the potential for bringing new gas supplies into Missouri. While the idea of a new source of gas supply into the St. Louis market may at first seem a benefit that overcomes the public detriments, unfortunately, in this case, the benefits are significantly outweighed by the detriments. Furthermore, Staff is convinced that with the entry of a new supplier into the East St. Louis market (Tr. p. 793) in the next year or so, someone will develop a plan that would bring the benefits to Missouri customers without the detriments of this proposed transaction. (Tr. 107-108).

In conclusion, Staff has a number of observations. Staff expects any operator to manage the system in a safe and reliable manner. Staff has no standard about the size of the company that operates this system. (Tr. at 712-713). Staff is simply pointing out the fact that the very qualities UtiliCorp possesses and that this Commission valued in its 1994 order, its "superior financial position" and the "'improved stability, capability, and commitment" (McKiddy Rebuttal, p. 13) would be lost *immediately* under Gateway's ownership.

C. Are there conditions that the Commission could impose to reduce or eliminate any detriment?

There are no conditions that the Commission could impose to protect Missouri ratepayers. Any conditions that the Commission placed on approval of this proposed transaction would not apply to Mogas, Gateway or TMP. First, neither Mogas or Gateway is a publicly-held company, and none of the three entities would be regulated by this Commission. The Commission cannot impose conditions, or regulate, any entity over which it does not have jurisdiction. Because of this, Staff believes there are limitations to the conditions that may be recommended in this proceeding that would protect the public from harm.

This case is distinguishable from cases in which the Commission could order and enforce conditions to protect against public detriment. The Commission ordered such conditions in both the Laclede and the KCPL restructuring cases. There are significant differences that made conditions reasonable in those cases and prevent conditions from being effective in this case.

Both Laclede and KCPL continue under this Commission's jurisdiction. In Case No. EM-2001-342, Staff filed Suggestions in Support of Unanimous Stipulation and Agreement and Laclede agreed to a condition restricting loss of Commission jurisdiction. That document specifically states:

> Staff was concerned with potential loss of Commission jurisdiction if the proposed transaction was approved, specifically in connection with infusion of federal jurisdiction through the Public Utility Holding Company Act (PUHCA). Therefore, a safeguard was negotiated that prohibits the Holding Company from seeking to become a registered holding company, or taking any action which has a material possibility of making it a registered holding company (subject to PUHCA), or subjecting any portion of its Missouri intrastate gas distribution

> operations to FERC jurisdiction without first obtaining Commission authorization.

In Case No. EM-2001-464, KCPL agreed to a condition restricting loss of Commission jurisdiction. That document specifically states:

> In *Re Western Resources, Inc./Kansas City Power & Light Company*, Case No. EM-97-515, and *Re Union Electric Company/Central Illinois Public Service Company*, Case No. EM-96-149, the Commission approved settlement agreements designed to ensure the protection of customers of Missouri utilities that were to possibly become or became a subsidiary of a Registered Holding Company. KCPL and GPE hereby agree to those same conditions as set forth below. KCPL further commits that it and its affiliates will continue to comply with the provisions of 4 CSR 240-20.015 and 20.017 after the reorganization is completed. As used in this Stipulation and Agreement, and in all attachments to this document, any reference to "GPE" includes both GPE and its successors in interest.

In both instances, Laclede and KCPL are and will continue to be regulated entities subject to the jurisdiction of this Commission. Gateway is not regulated and will not become a regulated entity subject to the jurisdiction of this Commission. As such, Staff believes it is impossible to recommend and for this Commission to order financial conditions necessary to insulate the assets of MPC and MGC from the business and financial risk of unregulated corporate activities.

Nor are there conditions that could protect MPC and MGC from additional risk because of the structure of company. The Commission has no control over the corporate structure of Mogas. The proposed capital structure puts the assets at greater risk because the corporate structure affects the company's financial creditworthiness. A credit rating agency an entity's relationships with other corporate family members (i.e., Gateway's relationship with Mogas). Thus, financial safeguards are essential to minimize any regulated entity's diminution of credit worthiness due to changes in corporate relationships. A reduction in credit worthiness increases the cost of borrowing money and these increased interest costs may be passed on to the ratepayers. As stated earlier in this brief, neither Mogas or Gateway is publicly-held, does this Commission regulate them. As such, Staff believes there are limitations to the conditions that may be recommended in this proceeding that would protect the regulated assets of MPC and MGC from additional financial risk.

If the Commission decides to authorize this proposed transaction, Staff recommends that it include in its order the attached conditions (Attachment A) that might protect the public, at least temporarily. Some of these proposed conditions, such as the condition placing the financial risk of making this system economically viable on the applicant, and not on the customers, were imposed on previous purchasers of these properties. These conditions remain applicable today. These conditions include safety conditions recommended by Staff witness, John Kottwitz, (Kottwitz Rebuttal at p. 3, lines 14-23, p. 4, lines 1-3). Because Gateway has failed to show evidence of planning, it is important that the Commission order Gateway and MPC and MGC to plan for the transition so that services such as SCADA monitoring and the 24-hour call center continue uninterrupted. Although Staff does not doubt that Gateway would make efforts to operate safely, these conditions would also not survive FERC jurisdiction, and the federal safety rules are somewhat less stringent than the Commission's safety rules.

D. Does the condition that the Commission placed on UtiliCorp when it acquired these properties, that UtiliCorp would not connect the intrastate pipelines to the interstate Trans Mississippi Pipeline, apply to Gateway should the Commission approve the proposed transaction?

Yes. Even UtiliCorp testified that the condition would survive this sale. (Kruel Surrebuttal, p. 6). However, having said that, this issue is not properly before this Commission. There has been no request for the Commission to issue a new Certificate of Convenience and Necessity (CCN), so the CCN currently in place for MPC and MGC remains. Until application is made for a new CCN the current CCN remains the one attached to these assets.

E. If so, should the Commission waive this provision?

No. Mr. Ries testified on behalf of Gateway that "I am not attempting in this proceeding to change their [MPC and MGC] means of doing business in any way and only attempting to make an acquisition at this point in time." (Tr. at 205, lines 8-11).

The Commission should not waive any conditions of the CCN unless and until a request is properly before this Commission. The question whether the provision should be waived may be irrelevant because the Commission does not have jurisdiction over Gateway or TMP. Any conditions that the Commission might order would not apply to either company. **________ ____** The Commission's ability to challenge an **__________________** is limited by several factors.

First, UtiliCorp voluntarily agreed to the restriction on the use of TMP when it purchased the property, Gateway has not. Second, once **____________________________________ ________**any Commission attempt to enforce an order to stop the **________** is unlikely to succeed. Third, such enforcement is hampered by the fact that **_______________ __________** and FERC jurisdiction preempts Missouri Commission jurisdiction.

In addition to preemption by the FERC, constitutional takings issues could prevent Commission enforcement of this restriction. Commission deprivation of Gateway's use of the property could lead to allegations of a taking.

F. Might the Commission lose jurisdiction over these pipelines? If so, how would the loss of jurisdiction affect the public interest?

Yes. The possibility of FERC jurisdiction over these pipelines increases enormously once **__________________** As explained by Staff witness Morrissey, "[g]enerally, a natural gas company is regulated by the state where its facilities are located and in which it provides transmission and/or distribution services. However, if a natural gas company's pipeline facilities cross state lines **__________** and are used for the transmission of gas in interstate commerce, then that company and its facilities come under FERC jurisdiction." (Morrissey Rebuttal at p. 3, lines 20-23 and p. 4, line 1):

Ms. Morrissey went on to explain the NGA's Section 1(c) Hinshaw exemption by stating "that, if all the gas the pipeline receives from out-of-state is consumed within the state and the pipeline is regulated by that state commission, it is not subject to FERC/NGA jurisdiction. (Morrissey Rebuttal p. 4, lines 1-3). FERC clearly held that to qualify as a Hinshaw pipeline, a pipeline must show that it will receive gas within or at the border of a state, that all the gas will be consumed within the state, and that the rates and services of such pipeline are subject to regulation by a state commission. Reliant Energy Gas Transmission Company., Docket No. CP00-137-000, 92 FERC 61,259 at 61,825 (Sept. 27, 2000).

Even though much of the discussion at hearing pertained to Hinshaw pipelines, **____ ______________________________________** (Tr. p. 449, lines 4-7). Therefore the direction of the flow of gas and whether all gas is consumed in a single state is irrelevant. Although a Hinshaw pipeline must be regulated by a state commission, there has been absolutely no indication that Gateway intends to bring **______________________________**, so it cannot qualify for the Hinshaw exemption. In addition, if **________________________ ________________________** as Mr. Ries indicated it would (Tr. at p. 257, p. 348) so as to **____ ____**interstate pipeline, not a Hinshaw pipeline. While Mr. Ries indicated that "you can't ever forecast" what the FERC will do (Tr. at 292, line 25), Staff believes that the FERC is much more likely to take jurisdiction of the **______________________________**

Staff's belief that FERC is likely to assert jurisdiction of the **____________________

________________** is supported by FERC's rulings in KansOk Partnership, *et al.*, 73 FERC ¶ 61,160, and Louisiana Gas System Inc. et al., 73 FERC ¶ 61,161. In those cases, FERC found the linking of several affiliated intrastate facilities, interconnected by short interstate facilities and the use of "artificial pipeline boundaries and corporations to service no operational or regulatory purpose" in fact, created an interstate pipeline system subject to its jurisdiction.

Joint applicants attempt to distinguish the Gateway situation and relationships (TMP connecting with MPC) from KansOK. (KansOk Partnership, *et al,* Docket No. RP95-212, 73 FERC ¶61,160 (Nov. 2, 1995). However, review of KansOK shows that the policy considerations that caused the FERC to exert jurisdiction over the entire KPC system are likely to apply to the **____**

For example, FERC determined that recognition of the separate corporate structures of these companies, KansOk, Kansas Pipeline and Riverside would frustrate the goals of Order No. 636, saying:

> It would be contrary to the goals of [Order 636] to allow some pipelines that perform interstate transportation to balkanize into a chain of affiliates subject to the regulations of various states. This would undermine the framework established by Order 636 and potentially penalize those pipelines and their customers who operate subject to its provisions. Moreover, such an interpretation of our regulations under section 311 of the NGPA necessarily would create a strong incentive for interstate pipelines to construct a second tier grid owned by affiliates in order to provide interstate service under a different regulatory framework than currently operates under Order NO. 636. Such a policy would advance the goals of neither the NGPA nor our open-access policies under the NGA. Rather, it would allow pipelines to establish artificial, separate corporate entities that would effectively deny consumers the protections and benefits of Order No. 636. Accordingly the Commission believes that in this case the public interest requires that we disregard the separate corporate status of the pipelines operated by KPOC and require the system be treated as a singe, interstate pipeline.

NP

KansOk Partnership, *et al,* Docket No. RP95-212, 73 FERC ¶61,160 at 61,485 (Nov. 2, 1995).

While Staff does not agree with the FERC that its jurisdiction is preferable and in the public interest, this opinion makes clear that the FERC is willing to disregard separate corporate structures to advance its goals.

The Sunshine case, quoted by Dr. Makholm in his testimony, (Makholm Rebuttal at 26, 27) is also quoted in Commissioner Massey's dissent in KansOk as the past policy of the FERC, and Commissioner Massey notes that the KansOk decision moves away from the policy set out in Sunshine to the policy described above.

How is the public interest affected?

The Staff and Laclede have addressed the detriments associated with the possible event ot the subject pipeline facilities coming under FERC jurisdiction. Ms. Morrissey does an evenhanded analysis of the difference between Missouri Commission jurisdiction and FERC jurisdiction and the effects on Missouri ratepayers or in other words on the public interest. as Ms. Morrissey explained:

> First, unlike the MoPSC, the FERC does not have an operation-of-law requirement. So, with respect to rate cases, the FERC does not have a required deadline by which it must issue a final order. This means rate increases sought by interstate pipeline companies, are permitted to go into effect, subject to refund, six months after they are filed. Customers are then obligated to pay those high, subject-to-refund rates until a final FERC order is delivered following a hearing or after an acceptable settlement is reached. It typically takes 3-5 years for a pipeline rate case to be settled or decided at FERC.
>
> Second, another FERC procedure, which delays final results (beyond those of the typical MoPSC case) is FERC's use of "tolling orders". Although there is a requirement for FERC to deliver an order on rehearing requests within 30 days, it usually disposes of this requirement by issuing a brief order indicating that it is "reconsidering" its previous order(s). This maneuver then allows FERC an unlimited time for issuing its substantive order on rehearing; all the while customers endure high rates and/or rate uncertainty.

> Third, FERC's agenda is dictated by an obligation to a broader base of companies, geographic regions, customers, and political influences, than that of this Commission. The pipeline companies that have considerable impact on gas service and rates to Missouri consumers are usually not a high priority for FERC and are not reviewed as closely/thoroughly as they would be if their requests were being presented to this Commission.

Morrissey Rebuttal, p. 6, lines 6-22.

Ms. Morrissey further stated, at the FERC, the MoPSC is merely an intervenor/interested party (not the decisional authority), so "it has less control over the outcome of" decisions affecting Missouri ratepayers. "At FERC, this Commission has less access to data, less leverage in negotiations, usually less resources than that of our opponents, and no-guarantee that the interests of Missouri consumers will receive a high priority because Missouri's interests are many times at odds with the federal agenda and the broader, public interest perspective of FERC. Moreover, Missouri consumers have less opportunity for input and are likely to suffer higher rates and more delays and uncertainty than if the MoPSC is the decisional authority." (Morrissey Rebuttal, p. 7, lines 3-13).

In addition, there has been considerable discussion of FERC's policy with respect to allowing customers' bypass of local distribution companies (LDCs). The FERC's policy is quite different than the policy of this Commission as was admitted by Mr. Ries. (Tr. at 207, lines 5-7). In its review and approval of bypass requests, the FERC is not concerned with the impact of rate shifts that will occur as a result of bypass. (Tr. p. 798, line 4 through p. 799, line 6). Moreover, ratepayers will suffer a detriment when an established customer bypasses its LDC, and the LDC seeks recovery of the costs previously bourn by the departing customer.(Tr. p. 810).

V. PROCEDURAL ISSUES

The Commission should not approve this transaction because it is detrimental to the public interest. However, if the Commission is considering approving this transaction, it should consider holding this case in abeyance until UtiliCorp applies to the Commission for an application to sell.

In its review of the filings in this case to develop the history section, Staff became aware that when UtiliCorp became a Party to this case, at the Commission's order, it did not also complete an application to sell or otherwise dispose of the property. This did not occur even though the Commission accepted jurisdiction under Section 393.190.1, and made it apparent that the reason it was accepting jurisdiction was that UtiliCorp is the seller. (Order Determining Jurisdiction and Order Directing Filing and Order Directing Notice).

This Commission accepted jurisdiction of this case on the basis that under §393.190.1, Missouri statutes require a gas corporation, before selling, leasing, transferring, mortgaging, or otherwise disposing of any part of its franchise works or system necessary or useful in the performance of its duties to the public nor by <u>any means direct or indirect</u> merge or consolidate any such works or system or any part thereof without first securing from the Commission an order authorizing it so to do. "Before a utility can sell assets that are necessary and useful in the performance of its duties to the public it must obtain approval of the Commission." (<u>State ex rel Fee Fee Trunk Sewer, Inc. v. Litz</u>, 596 S.W.2d 466(Mo.App. 1980). UtiliCorp has not requested such an order be issued.

This issue is further complicated by the 1994 Order in Case No. GM-99-252. Review of the 1994 Order Regarding Post-Hearing Motions and Applications for Rehearing in GM-94-252 also lists, at UtiliCorp's request, specific grants of authority. One of these says:

> "(e) Authorizing UtiliCorp or UCU Subs to own, operate, control, manage and maintain the Acquired Assets and to provide intrastate natural gas pipeline transportation service to the public subject to the jurisdiction of the Commission in those areas in which Sellers are now authorized to operate in Missouri."

A reasonable interpretation of this authorization, drafted by UtiliCorp itself, is that UtiliCorp, or its subsidiaries, were authorized to own, manage and operate this system only "subject to the jurisdiction of this commission," so any transfer of plant to an unregulated entity over which the Commission has no jurisdiction was beyond the authority granted to UtiliCorp in the 1994 case. In other words, UtiliCorp could both own and operate the assets subject to the jurisdiction of the Commission, or its subsidiaries could both own and operate the assets subject to the jurisdiction of the Commission. The order did not allow one entity to operate the assets subject to the Commission's jurisdiction and another entity to own the assets outside of Commission jurisdiction.. In light of this provision, the transfer to UPL required Commission permission and without it, such transfer is void under Section 393.190.1.

The only applicants in this proceeding are Gateway, Missouri Gas Company, and Missouri Pipeline Company. These applicants did complete an application to acquire the stock of a public utility. (4 CSR 240-2.060(12)). Apparently UtiliCorp hopes to ride the coattails of Gateway as it rushes through this proposed transaction. Legally, Commission authorization for Gateway to acquire this stock without an order authorizing UtiliCorp to sell the plant would be mainly advisory. Any transfer of these assets from UtiliCorp to another entity, without Commission authorization to UtiliCorp to do so is and was legally void under Section 393.190.1.

It is important to avoid any confusion over which company has the responsibility to manage and operate these assets. Accordingly, Staff suggests that the Commission postpone a decision until UtiliCorp completes the required application. The Commission may consolidate the two cases and incorporate by reference the testimony in this case if and when UtiliCorp applies.

CONCLUSION

Staff has established that the proposed acquisition should be rejected. Besides the numerous immediate detriments to the public interest, which cannot be mitigated by conditions placed on the acquisition. there are more remote detriments that deserve Commission consideration because, among other things, the Commission may lose jurisdiction to address these issues in later cases. Gateway's "plans" to make the system economically viable are likely to fail. First, aggressive competition from propane dealers makes it almost impossible for Gateway to raise rates ,and if it does try to raise rates, it will likely lose customers, and second, since the system is almost fully subscribed any increase in throughput volumes will require additional capital expenditures that must somehow be recovered through rates. **___________

____**

The Commission is likely to lose jurisdiction if it authorizes this transaction. Staff explained why Federal jurisdiction is of particular concern in this case. Finally, Staff demonstrated that UtiliCorp must comply with Section 393.190.1 and Commission rules and apply to this Commission for an order authorizing it to sell or otherwise dispose of these assets.

NP

This proposed transaction is detrimental to the public interest and should be rejected.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 18th day of September 2001.

PROPOSED STAFF CONDITIONS

1. That the risk of attaining increased throughput on these systems be placed totally upon Gateway, and not on its customers. Gateway will not be allowed to increase the current rates charged to MPC and MGC customers based upon a claim that its throughput levels are inadequate to support a reasonable rate of return on these properties.

2. That the physical separation of the affiliated interstate pipeline crossing the state boundary into Illinois from the current intrastate pipelines operated by MPC and MGC will continue to be mandated as a condition for any sale of the MPC and MGC pipelines. Any proposal in the future by the Applicant for the interstate and intrastate pipelines to be connected will require the prior approval of the Missouri Commission.

3. That the current restriction against "bypass" of local distribution companies and municipalities by MPC and MGC continue under Gateway ownership.

4. Mogas and Gateway will not pledge Gateway's/UPS' stock as collateral or security for the debt of the Parent Company or a subsidiary without Commission approval.

5. Gateway, MPC or MGC will not guarantee the notes, debentures, debt obligations, liabilities or other securities of the Parent Company or any of its subsidiaries, or enter into any "make well" agreements without prior Commission approval.

6. Gateway, on behalf of MPC and MGC, shall submit quarterly to the Financial Analysis Department of the Commission certain key financial ratios as defined by Standard and Poor's Credit Rating Service, as follows:

   (1) Pre-tax interest coverage;

   (2) After-tax coverage of interest and preferred dividends;

   (3) Funds flow interest coverage;

   (4) Funds from operations to total debt;

   (5) Total debt to total capital (including preferred); and

   (6) Total common equity to total capital.

7. Mogas' and/or Gateway's total long-term borrowings, on behalf of MPC and MGC, including all instruments, shall not exceed MPC and MGC's respective regulated rate bases.

8. Mogas and Gateway shall maintain its debt separate from that of MPC and MGC. At such time, Gateway/UPS should become publicly traded, Mogas and Gateway agree to maintain Gateway/UPS' debt at investment grade.

9. Mogas and Gateway shall hold the customers of MPC and MGC harmless if the acquisition that is the subject of this proceeding results in a higher revenue requirement for MPC and MGC than if the acquisition had not taken place.

10. MPC and MGC must follow the pipeline safety regulations as contained within 4 CSR 240-40.020, 40.030 and 40.080.

11. MPC and MGC must continue to use an adequate number of qualified personnel to operate and maintain the pipelines and respond to any

emergencies along the pipeline. These personnel must continue to be qualified in accordance with 4 CSR 240-40.030(12)(D).

12. There must be no lapse in the call center, dispatch, emergency response, SCADA monitoring and gas control functions for MPC and MGC during the transition of UPL to Gateway. Gateway should plan for the transition of these functions because they must continue to be provided on a 24 hours/day, 7 days/week, and 365 days/year basis.

13. That Gateway comply in entirety with the Commission's affiliate transaction rules applicable to gas pipeline companies.

14. That Gateway will file appropriate tariffs in full compliance with the findings set out in any Report and Order approving this transaction, including appropriate rate schedules for operation of the pipeline systems, valid legal descriptions of the service territories and maps setting out those territories, and a tariff reflecting maximum transportation rates as set out therein.

15. That Gateway will inform the Staff of the Commission as to the completion of the transaction, and the final purchase price, and will promptly file the appropriate documentation and a verified report reflecting all journal entries recording the creation and financing of this transaction.

16. That nothing in any Report and Order shall be considered as a finding by the Commission of the value, for ratemaking purposes, of the properties herein involved, nor as an acquiescence in the values placed upon said properties by the Applicant.

17. The Parent Company will provide Staff and the Office of Public Counsel, upon request and with appropriate notice, all information needed to verify compliance with the conditions authorized in this proceeding and any other information relevant to the Commission's ratemaking, financing, quality of service and other regulatory authority over Gateway, MPC and MGC.

18. That the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions in any later proceeding.

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Case No. GM-2001-585
Revised: September 18, 2001 (SW)

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