

Exhibit No.: _____
Issue: Merger
Witness: Timothy R. Johnston
Exhibit Type: Direct
Sponsoring Party: Missouri Gas Utility, Inc.
File No.: GM-2011-0354
Date: April 27, 2011

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

DIRECT TESTIMONY OF TIMOTHY R. JOHNSTON

ON

BEHALF OF

MISSOURI GAS UTILITY INC.

APRIL 27, 2011

**DIRECT TESTIMONY
TIMOTHY R. JOHNSTON
MISSOURI GAS UTILITY, INC.**

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**DIRECT TESTIMONY
TIMOTHY R. JOHNSTON
MISSOURI GAS UTILITY, INC.**

I. INTRODUCTION AND QUALIFICATIONS

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Timothy R. Johnston, my business address is 7810 Shaffer Parkway,
3 Suite 120, Littleton, CO 80127.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?**

5 A. I am employed by Summit Utilities, Inc., the parent company of Missouri Gas
6 Utility, Inc. ("MGU"), as the Executive Vice President and Chief Operating Officer.

7 **Q. PLEASE DESCRIBE YOUR EDUCATION, EXPERIENCE, AND EMPLOYMENT
8 HISTORY.**

9 A. I received a Bachelors of Science degree in Mechanical Engineering from the
10 Colorado School of Mines, in Golden, Colorado, and a Masters in Business
11 Administration from Colorado State University. I have 30 years in the natural gas
12 industry, and co-founded Summit Utilities, Inc., (then Colorado Natural Gas, Inc.)
13 14 years ago. Prior to founding the company, I held various positions in the
14 natural gas industry including President of TJ Engineering, Inc., which provided
15 contract engineering services to the natural gas industry, manager of the
16 engineering department and meter shop for Greeley Gas (now Atmos Energy),
17 and plant and operations engineer for MAPCO Inc., a natural gas processing and
18 liquids pipeline company.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

1 A. I will provide an overview of the proposed transaction and the rationale for the
2 merger of Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural
3 Gas (“SMNG”). In addition, I will provide the economic and financial support of
4 the Joint Application. Finally, I will discuss the details of financing for the
5 transaction. .

6 **Q. PLEASE DESCRIBE THE MGU GAS DISTRIBUTION SYSTEM, INCLUDING**
7 **ANNUAL SALE AND TRANSPORTATION VOLUMES.**

8 A. MGU has constructed and owns over 247 miles of natural gas distribution
9 pipeline in Missouri. The company transports gas through ANR, RexWest, and
10 Southern Star to provide service to our customers. MGU has annual sales of
11 288,000 MCF, and provides service to residential, commercial and industrial
12 customers in its Northern and Southern Divisions. MGU’s annual gas deliveries
13 include 48,000 MCF to transportation customers.

14 **Q. WHAT IS THE CURRENT OWNERSHIP STRUCTURE OF MGU?**

15 A. MGU is a wholly-owned subsidiary of Summit Utilities, Inc. (Summit). Summit is
16 owned by IIF CNG Investment LLC. IIF first invested in Summit, and by
17 extension, in its subsidiaries including MGU in 2007. In 2010, IIF purchased all
18 remaining shares of Summit and became 100% owner.

19 **Q. HAS THIS ALWAYS BEEN THE OWNERSHIP STRUCTURE?**

20 A. No. Prior to 2007, Summit Utilities was owned by a large group of investors,
21 none of which owned more than 5% of the company.

1 **II. OVERVIEW OF THE PROPOSED MERGER**

2 **Q. PLEASE PROVIDE AN OVERVIEW OF THE PROPOSED TRANSACTION.**

3 A. MGU and SMNG will be merged, with MGU as the surviving entity. All current
4 offices for both companies will remain open. Current rates will be maintained for
5 all service areas, and initially MGU will adopt the tariffs of SMNG for use in those
6 service areas that were SMNG territory. Additionally, in a separate filing, MGU
7 will seek approval to re-finance the merged companies. This is further explained
8 by Ms. Michelle Moorman in her Direct Testimony.

9 **Q. PLEASE DESCRIBE THE STRATEGIC RATIONALE FOR THIS**
10 **CONSOLIDATION.**

11 A. SMNG has struggled with lower than expected volumes and an under-utilized
12 system, essentially since the original system was built in 1995. This
13 circumstance has caused the company to underperform financially, and limited
14 the company's ability to raise capital and to maintain a modern, efficient
15 operation. MGU has a proven record of opening new service areas and
16 successfully achieving high market penetration rates. MGU also has a state-of-
17 the-art billing and customer service system, an excellent accounting system, and
18 the engineering and construction management support necessary to achieve the
19 system growth that has eluded SMNG up until the present. MGU also brings a
20 GIS mapping system, a regulatory department and a safety staff to this merger.
21 These abilities, coupled with the potential gas load from the significant number of
22 un-served homes and businesses in the SMNG territory, will allow the merged

1 company to achieve more than both companies could as stand-alone operations.
2 In addition, the increased size of the merged company will allow better financing
3 alternatives and other benefits of scale.

4 **Q. HOW DO THE JOINT APPLICANTS INTEND TO EXECUTE THE**
5 **TRANSACTION?**

6 A. MGU intends to acquire 100% of SMNG. The plan is to merge SMNG into MGU.

7 **Q. WHAT ARE THE SPECIFIC CONDITIONS OF CLOSING?**

8 A. This transaction is subject to a series of conditions, including: (i) approval by the
9 Summit Utilities, Inc. Board of Directors; (ii) approval by the General Partners of
10 SMNG; and (iii) approval by the Missouri Public Service Commission.

11 **Q. HAVE BOTH THE SUMMIT UTILITIES, INC., BOARD OF DIRECTORS AND**
12 **THE PARTNERS OF SMNG APPROVED THIS CONSOLIDATION?**

13 A. Yes, the Summit Utilities, Inc., Board of Directors and the General Partners of
14 SMNG have both approved this consolidation.

15 **Q. WHEN IS THIS TRANSACTION EXPECTED TO CLOSE?**

16 A. Both SMNG and MGU seek to close the transaction by December 31, 2011. This
17 date will allow the parties to avoid certain tax and audit costs.

18 **Q. WHAT WILL THE OWNERSHIP STRUCTURE OF MGU LOOK LIKE**
19 **FOLLOWING THE CONSOLIDATION?**

20 A. The ownership of the new merged MGU will be identical to that described above
21 for the current MGU.

22 **Q. DOES MGU HAVE EXPERIENCE IN ACQUIRING AND MERGING A NEW**
23 **DIVISION INTO THE COMPANY?**

1 A. Yes. MGU began operations by acquiring a pair of municipal gas systems in
2 northwest Missouri in 2005. These were combined into the Northern Service
3 Area of MGU, and all billing, customer service, accounting, engineering,
4 regulatory and human resources activities were taken over by MGU and its
5 parent, Summit Utilities, Inc (“Summit”). In addition, Summit and Colorado
6 Natural Gas, Inc. the regulated subsidiary operating in Colorado, recently
7 acquired Eastern Colorado Utilities, a small utility with 4000 customers also
8 operating in Colorado, and all these same functions have successfully been
9 integrated into Summit’s systems as is proposed in the SMNG merger.

10 **Q. DID THIS PREVIOUS EXPERIENCE RESULT IN POSITIVE OUTCOMES FOR**
11 **THE CUSTOMERS?**

12 A. Yes.

13 **Q. DOES MGU PLAN TO PERFORM ANY DUE DILIGENCE IN PREPARATION**
14 **FOR THIS MERGER?**

15 A. Yes. MGU will undertake Phase 1 environmental assessments of certain
16 locations on the SMNG system and will also perform due diligence in areas of
17 accounting, engineering, human resources, information technologies, and
18 customer service.

19 **Q. WHAT STEPS HAS MGU TAKEN TO ENSURE THE MERGER WILL BE**
20 **SMOOTH FROM THE CUSTOMER STANDPOINT?**

21 A. MGU has a plan in place for communicating with all the stakeholders in the
22 SMNG service area. The rates and tariff rules will not change as a result of this
23 merger

1 **Q. DOES MGU INTEND TO MAKE ANY CHANGES TO THE SMNG SYSTEMS?**

2 A. From a physical operations standpoint, MGU does not intend to make any
3 changes to the SMNG systems, except to hopefully add additional customers.

4 **Q. DOES MGU INTEND TO RETAIN ALL OF THE SMNG EMPLOYEES?**

5 A. No. Certain of the accounting, customer service and billing positions will be
6 duplicative between MGU and the current SMNG operation. The employees
7 affected will be offered a package to stay and assist in the transition, as well as
8 an additional severance package.

9 **Q. DOES MGU INTEND TO CHANGE BASE RATES OR TARIFF PROVISIONS IN**
10 **ITS NEWLY ACQUIRED SMNG DIVISION?**

11 A. MGU does not intend to change base rates, as SMNG recently completed a
12 small case rate proceeding in Case No. GR-2010-0347. SMNG's new rates went
13 into effect on February 1, 2011. Ms. Moorman will further discuss the regulatory
14 plan associated with this merger in her Direct Testimony.

15

16 **III. ECONOMIC CONDITIONS**

17 **Q. PLEASE SUMMARIZE THE FINANCIAL CONDITION OF MGU.**

18 A. The most recent SMNG audited financial statements, for the period ended
19 December 31, 2010 and MGU audited financial statements, for the period ended
20 December 31, 2010, are attached as Highly Confidential Appendices to the Joint
21 Application. MGU continues to be in excellent financial condition.

22 **Q. WHAT IS THE OVERALL VALUE OF THE MERGER?**

1 A. The overall value of the utility plant for the consolidated MGU is identified in
2 Highly Confidential Schedule TRJ-1. The numbers included in the attached
3 schedule are estimates, and MGU intends to provide actual numbers within 60
4 days of closing.

5 **Q. HOW WILL MGU ACCOUNT FOR THE MERGER?**

6 A. MGU will use FERC accounting rules and GAAP accounting rules where
7 appropriate. MGU will transfer the net assets of SMNG into the corresponding
8 FERC accounts on the books of MGU.

9 **Q. WILL THERE BE A MERGER PREMIUM ASSOCIATED WITH THIS**
10 **TRANSACTION?**

11 A. Yes. As seen in Highly Confidential Schedule TRJ-1, there is difference between
12 the total debt and equity in SMNG and the utility plant and the utility plant and
13 Construction Work In Progress (“CWIP”) total (due to construction activities
14 during the transition). In the transfer to MGU’s books, this difference will be
15 recorded in Account 1140 on the books of MGU.

16 **Q. HOW DOES MGU INTEND TO ACCOUNT FOR THE MERGER PREMIUM AND**
17 **TRANSACTION COSTS?**

18 A. The negative merger premium must be amortized over a set period of time.
19 MGU proposes to accomplish this over a 5 year period. This process will involve
20 posting an amount equal to 20% of the premium into Account 1150, until 1150
21 and 1140 offset each other. Transaction costs will be expensed as incurred.

22 **Q. DOES MGU PLAN TO SEEK RECOVERY OF ANY PORTION OF THE**
23 **MERGER PREMIUM OR TRANSACTION COSTS?**

1 A. No. The utility plant books of MGU will essentially reflect the combined totals of
2 the two current entities, plus any additions or depreciation during the transition
3 period.

4 **IV. POST-CONSOLIDATION ACCOUNTING**

5 **Q. HOW DOES MGU PROPOSE TO ACCOUNT FOR SMNG'S OPERATIONS IN**
6 **THE MGU ACCOUNTING SYSTEM AFTER THE CONSUMMATION OF THE**
7 **CONSOLIDATION?**

8 A. Separate general ledger reporting and accounting with different codes will be
9 maintained to allow the Company and the Commission to evaluate the rates
10 applicable to the current SMNG and MGU territories in a future rate case.

11 **Q, HOW WILL MGU ALLOCATE CORPORATE OVERHEAD TO SMNG?**

12 A. Corporate overhead will be allocated to the SMNG operation in the same manner
13 as such costs are currently allocated to MGU. At the conclusion of this case,
14 MGU intends to file a combined Cost Allocation Manual for the new MGU entity.

15

16 **V. MERGER SYNERGY SAVINGS**

17 **Q. DOES MGU ANTICIPATE ANY OPERATIONAL SAVINGS BY**
18 **CONSOLIDATING THE TWO COMPANIES?**

19 A. Yes. In his Direct Testimony, Mr. Dave Moody identifies synergies the
20 companies expect to see. These include synergies in field operations, corporate
21 operations, customer service, engineering, information technology, and human
22 resources. In addition to these, the companies anticipate cost savings due to the
23 recapitalization of the consolidated entity. As Ms. Moorman discusses in her

1 testimony, the Joint Applicants will file a financial filing seeking authorization to
2 recapitalize the debt and equity of the consolidated entity. This will result in
3 savings due to lower interest rates and long term debt.

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 A. Yes.