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January 21, 2000

FILED<sup>3</sup>

JAN 21 2000

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

Missouri Public  
Service Commission

**RE: Case No. EM-2000-358 – In the Matter of the Application of UtiliCorp United, Inc. for authority to acquire, indirectly, an ownership interest in Companhia Energetica De Pernambuco, an electric utility distribution business located in Brazil, and to take all other actions reasonably necessary to effectuate said transaction.**

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and fourteen (14) conformed copies of a **~~STAFF RECOMMENDATION~~ and STAFF MOTION TO LATE FILE RECOMMENDATION AND STAFF SUGGESTIONS FOR FURTHER PROCESSING UTILICORP'S APPLICATION .**

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,

Steven Dottheim  
Chief Deputy General Counsel  
(573) 751-7489  
(573) 751-9285 (Fax)

Enclosure  
cc: Counsel of Record

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

**FILED<sup>3</sup>**

JAN 21 2000

In the Matter of the Application of UtiliCorp United, )  
Inc. for authority to acquire, indirectly, an ownership )  
interest in Companhia Energetia De Pernambuco, an )  
electric utility distribution business located in Brazil, )  
and to take all other actions reasonably necessary to )  
effectuate said transaction. )

Missouri Public  
Service Commission

**Case No. EM-2000-358**

**STAFF RECOMMENDATION**

Comes now the Staff of the Missouri Public Service Commission (Staff) and submits its recommendation respecting the Application of UtiliCorp United, Inc. (UtiliCorp) for authority to acquire, indirectly, an ownership interest in Companhia Energetia De Pernambuco, an electric utility distribution business located in Brazil, and to take all other actions reasonably necessary to effectuate said transaction. The Staff recommends that the Commission approve UtiliCorp's Application subject to certain conditions, which the Staff requests be set out in any Commission Order approving UtiliCorp's Application. The Staff states as follows respecting its recommendation:

1. UtiliCorp, in its Application, identified as the applicable statute and state regulation respecting the authority that it is seeking from this Commission, Section 393.190 RSMo 1994 and 4 CSR 240-2.060(9). **Section 393.190** provides in part as follows:

1. No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease transfer mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works, or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public

utility, without having first secured from the commission an order authorizing it so to do. . . .

**2. No such corporation shall directly or indirectly acquire the stock or bonds of any other corporation incorporated for, or engaged in, the same or a similar business . . . unless . . . authorized so to do by the commission.**

**4 CSR 240-2.060** provides in part as follows:

**(9) Applications for authority to acquire the stock of a public utility shall include:**

**(C) Reasons why the proposed acquisition of the stock of the public utility is not detrimental to the public interest.**

The Staff believes that UtiliCorp has identified the applicable statute and Commission rule respecting the instant transaction.

2. As indicated in the attached Staff Recommendation of John Kiebel, approval of the UtiliCorp Application, with the conditions identified by Mr. Kiebel, would cause the transaction to be not detrimental to the public interest. The conditions identified by Mr. Kiebel are as follows:

- a. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions in any subsequent proceeding.
- b. That the Commission's order shall not be deemed to be precedent for any future financing even if the facts may be similar.
- c. That any adverse financial effects of this acquisition be borne by UtiliCorp's stockholders and not by Missouri ratepayers.
- d. That all records pertaining to these transactions be maintained at UtiliCorp's headquarters and made available to the Staff as the Staff deems necessary.
- e. That UtiliCorp be prepared to provide documentation of proper cost allocations to nonregulated entities.
- f. That UtiliCorp include any costs borne by Missouri Public Service related to these nonregulated subsidiaries in the monthly surveillance reports sent to the Staff.

3. In addition, UtiliCorp's Application as originally filed requested at page 4, paragraph 9 that the Commission certify to the federal Securities And Exchange Commission (SEC) "that it has the authority and resources to protect ratepayers subject to its jurisdiction and that it intends to exercise its authority.' See, 15 U.S.C. § 79z-5b." UtiliCorp stated that such certification by this Commission and other state public utility regulatory bodies with jurisdiction over UtiliCorp was necessary in order for UtiliCorp Canada Corp., the parent company of UtiliCorp Brazil Energy Holdings, to obtain an exemption under Section 3(b) of the Public Utility Holding Company Act of 1935. On December 20, 1999, UtiliCorp filed a Second Amended Application with the Commission, whereby it informed the Commission that it was no longer necessary for the Commission to issue a certification letter to the SEC because instead of UtiliCorp requesting that the SEC issue a new Section 3(b) exemption to UtiliCorp Canada Corp., UtiliCorp intended to utilize an existing Section 3(b) certified entity.

Wherefore the Staff hereby files the Staff Recommendation in Case No. EM-2000-358.

Respectfully submitted,

DANA K. JOYCE  
General Counsel




Steven Dottheim  
Chief Deputy General Counsel  
Missouri Bar No. 29149

Attorney for the Staff of the  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102

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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 21st day of January 2000.

  
\_\_\_\_\_

MEMORANDUM

To: Missouri Public Service Commission's Official Case File  
Case No. **EM-2000-358**, UtiliCorp United Inc.

From: John Kiebel, Financial Analysis Department (1-2664) *JK*

Subject: Staff's Recommendation Regarding the Application of UtiliCorp United Inc. for authority to acquire, indirectly, the capital stock of Companhia Energetia De Pernambuco, an electric utility located in the northeast region of Brazil.

Date: January 14, 2000

Approved by: *R. E. Schellberg* 1-14-00      *Steven Roth* 1/18/00  
Director - Utility Services Division / Date      General Counsel's Office / Date

UtiliCorp United Inc.

On December 3, 1999, UtiliCorp United Inc. (UtiliCorp, Company) filed pursuant to Section 393.190 RSMo 1994 and 4 CSR 240-2.060 (9), an application requesting authority to act through its Brazilian subsidiary, UtiliCorp Brazil Energy Holdings (UBEH), through a bid process, to acquire the capital stock of Companhia Energetia De Pernambuco (CELPE). As part of the Application, UtiliCorp has requested that the Public Service Commission (Commission) act on its application by January 21, 2000 due to the bidding timetable for this transaction.

On December 20, 1999, the Company filed an amended Application to utilize an existing 3(b) certification letter for the Securities and Exchange Commission (SEC). According to the Company, this narrows and simplifies the relief requested from the Commission.

Since 1995, the Brazilian government has taken several steps to restructure its electric power sector with the goal of increasing the role of private sector and foreign investment while introducing competition in the industry. The government enacted legislation that established a comprehensive framework for the electric sector, and amended its constitution to allow foreign ownership in electric sector concessions.

Since 1996, the Brazilian government has sold controlling interest in 16 electric distribution and three generation companies to private sector companies, including several Brazilian, European and U.S. energy concerns. These opportunities have come about due to Brazil's desire to provide liquidity to the government, improve the economy's overall efficiency, and eliminate the government's burden of investing in infrastructure associated with capital intensive industries.

CELPE is a state-owned electric utility that serves approximately 1.8 million industrial, commercial and residential customers in the northeast region of Brazil, serving approximately

29% of the Brazilian population. The ownership of CELPE is currently split among three groups. The State of Pernambuco owns 88.5% of the total stock in CELPE. Electrobas, the Brazilian government's holding company for the electric sector and the municipalities of Pernambuco, own 2.3% of the total stock. The remaining 9.2% is owned in the open market. If the transaction is approved, the acquisition of CELPE will be the third privatization of a utility in the region.

The Company, through its Brazilian subsidiary, UBEH, plans a bid to acquire all of the capital stock of CELPE. UtiliCorp's direct investment in CELPE, through UBEH, may be as much as \$425 million (U.S.) based on an exchange rate of .51 Real/\$1 U.S. as reported in the November 1, 1999 edition of The Wall Street Journal. The actual purchase price to acquire CELPE is expected to exceed this amount. However, the balance of the purchase price will be made by the investment of UtiliCorp's partner(s) in UBEH and by the issuance of non-recourse debt by CELPE. The Company's investment would represent an approximate 50% ownership interest in CELPE. The proposed ownership structure is depicted in Attachment C.

According to Standard & Poor's (S & P) Utilities Rating Service, June 1999, the Company's Commercial Paper was rated A-2, its Senior Secured Debt and Senior Unsecured Debt were both rated BBB, and its Subordinated Debt and Preference Stock were both rated BBB-. The BBB rating is the lowest rating still considered "investment grade."

Based on current and pro forma financial statements submitted with the Application, the Company's capital structure as of September 30, 1999, consisted of 51.20% long-term debt, 6.59% short-term debt, 7.95% preferred stock, and 34.26% common equity. On a pro forma basis showing the full effect of the additional \$234 million in long-term debt and the additional \$191 million in common equity, the Company's capital structure would consist of 51.54% long-term debt, 6.01% short-term debt, 7.25% preferred stock, and 35.20% common equity (see Attachment A).

The Company's proposed 55% debt/45% common stock transaction will reduce its percentage of total debt to total capital by 24 basis points, from 57.79% to 57.55%. Although this debt ratio is within acceptable range limits, the percentage of debt is more than 500 basis points higher than the mean and more than 600 basis points higher than the median for similarly rated electric utilities. As a result, the Staff does have a concern about the Company's future credit rating and its ability to attract capital.

The Staff has also reviewed other pro forma financial data submitted by the Company (see Attachment B). The pro forma pre-tax interest coverage of 2.55x approximates the midpoint of the range for similarly rated electric utilities. It is the Staff's opinion that the Company's pro forma pre-tax interest coverage ratio would remain reasonable for attracting additional capital. The pro forma funds from operations interest coverage of 3.42x is within the acceptable range, as is the pro forma funds from operations to total debt ratio of 14.82%.

S & P's January 1999 Utility Credit Report for UtiliCorp considered the Company's credit rating outlook to be "stable," but expressed concerns about its high-risk business profile. S & P stated that this conclusion "...reflects moderate utility spending needs and sound utility operations,

offset by the company's need to strengthen financial performance as it continues expanding into higher-risk, nonregulated ventures. UtiliCorp's acquisition strategy and its level of success is an important consideration and directly affects its credit quality."

The rating agency stated that the Company's "...acquisition strategy, the unpredictability of future acquisitions, and the capital requirements associated with these acquisitions impair credit quality. Furthermore, the credit profile of nonregulated operations may be weaker than the utility's core business." The rating agency also stated that "...this strategy has been slightly negative for credit quality with its high-risk business profile."

S & P had other concerns about the Company's capital structure, such as "Management's aggressive attitude regarding debt leverage and off-balance-sheet obligations shows up in the balance sheet ratios, where total debt to capital is more than 60% and is projected to remain at that level." The rating agency also stated that "...S & P believes that management's historic affinity for the use of leverage is still present and will limit credit quality in the future."

Another rating agency, Duff & Phelps Credit Rating Company (D & P), considered the Company's credit rating outlook to be "stable" in November 1999. D & P stated that "...interest coverages remain stable reflecting the Company's core domestic utility operations. Expected further slight improvement...would reflect pending utility acquisitions, its growing low business risk international portfolio, improved midstream gas market conditions, and continued growth in its profitable energy trading and marketing operations. Internal cash flow is expected to continue to be sufficient to support a moderate capital expenditure budget."

The Company's Director of Corporate Finance, who formerly was an analyst with S & P, stated that the rating agency's relationship with management is such that the Company would take whatever actions necessary to assure credit quality. According to the Director of Corporate Finance, the Company is committed to maintaining a capital structure of approximately 55% debt and 45% equity in each issuance. The Company stated that its capital structure is expected to stabilize through periodic common equity issuances used to partially refinance debt incurred with acquisitions.

These facts and expectations for the future, taken together, buffer the Staff's concerns regarding the highly leveraged capital structure that may result if the Company is successful in its endeavors. In conclusion, the Staff believes that the transactions described in UtiliCorp's Application will not be detrimental to the ratepayers of its Missouri Public Service division. The Staff recommends that the Commission approve UtiliCorp's Application, with the following conditions applicable to proposed transaction:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions in any subsequent proceeding.
2. That the Commission's order shall not be deemed to be precedent for any future financing even if the facts may be similar.



3. That any adverse financial effects of this acquisition be borne by UtiliCorp's stockholders and not by Missouri ratepayers.
4. That all records pertaining to these transactions be maintained at UtiliCorp's headquarters and made available to the Staff as the Staff deems necessary.
5. That UtiliCorp be prepared to provide documentation of proper cost allocations to non-regulated entities.
6. That UtiliCorp include any costs borne by Missouri Public Service related to these non-regulated subsidiaries in the monthly surveillance reports sent to the Staff.

Attachments:      A - Pro Forma Capital Structure as of September 30, 1999  
                         B - Selected Pro Forma Financial Ratios  
                         C - Proposed Investment Structure for CELPE

Copies:             Director - Utility Services Division  
                         Director - Utility Operations Division  
                         Director - Research and Public Affairs Division  
                         General Counsel  
                         Manager - Financial Analysis Department  
                         Manager - Accounting Department  
                         Manager - Electric Department  
                         John Empson, UtiliCorp United Inc.  
                         Paul Boudreau - Brydon, Swearingen & England P.C.  
                         Office of the Public Counsel

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

In the Matter of the Application of UtiliCorp United, )  
Inc. for authority to acquire, indirectly, an ownership )  
interest in Companhia Energetia De Pernambuco, an ) **Case No. EM-2000-358**  
electric utility distribution business located in Brazil, )  
and to take all other actions reasonably necessary to )  
effectuate said transaction. )

**STAFF MOTION TO LATE FILE RECOMMENDATION AND  
STAFF SUGGESTIONS FOR FURTHER PROCESSING UTILICORP'S APPLICATION**

Comes now the Staff of the Missouri Public Service Commission (Staff) and requests that the Missouri Public Service Commission (Commission) grant leave to Staff to late file its recommendation in this proceeding. Also, Staff has been in contact with counsel for the Applicant, UtiliCorp United, Inc. (UtiliCorp), and will offer herein suggestions reviewed by counsel for UtiliCorp respecting the further processing of UtiliCorp's Application. In support of the Staff's motion and suggestions, the Staff states as follows:

1. On December 3, 1999, UtiliCorp filed an Application for authority to acquire, indirectly, an ownership interest in Companhia Energetia De Pernambuco (CELPE), an electric utility distribution business located in Brazil, and to take all other actions reasonably necessary to effectuate said transaction. UtiliCorp requested that the Commission issue an Order approving its Application by January 21, 2000, bearing an effective date of February 1, 2000, eleven (11) days after the issuance of the Order so that UtiliCorp would be in a position to submit its bid for CELPE no later than February 15, 2000.

2. On December 17, 1999, the Commission issued an Order Directing Filing in which it directed the Staff to file its recommendation concerning the Application of UtiliCorp no later than January 14, 2000.

3. Staff's Recommendation was ready to be filed on Friday, January 14, 2000, but due to undersigned Staff counsel, the Staff Recommendation was not timely filed. Staff counsel takes full responsibility for the filing deadline not having been met and apologizes to the Commission, UtiliCorp and the Staff for the inconvenience and delay that has been caused. On Monday, January 17, 2000, the Commission's offices were closed in observance of the birthday of Martin Luther King, Jr. The Agenda Session on Tuesday, January 18, 2000 was the only Agenda Session that was scheduled for the week due to other Commission business occurring elsewhere than in Jefferson City. Rather than merely late file the Staff Recommendation, Staff counsel thought it appropriate to attempt to determine how the timing requested by UtiliCorp might best be accommodated.

4. Staff counsel has provided to counsel for UtiliCorp a copy of the Staff Recommendation for which leave to late file is being sought. Counsel for UtiliCorp has advised Staff counsel that UtiliCorp will not file a response to the Staff Recommendation and UtiliCorp is willing to submit a letter to the Commission Secretary stating such. Counsel for UtiliCorp has also informed Staff counsel that if the Commission is disposed to approve the UtiliCorp Application, an Order approving the Application on or before Thursday, January 27, 2000, bearing an effective date of February 7, 2000, eleven (11) days after the issuance of an Order on January 27, 2000, would still position UtiliCorp to submit its bid for CELPE no later than February 15, 2000. (UtiliCorp would still prefer an Order of the Commission with a minimum


ten (10) day effective date rather than an Order closer to February 1, 2000, but bearing an effective date less than ten (10) days.)

5. Counsel for UtiliCorp has reviewed the instant document and has indicated that UtiliCorp has no objection to it, and that UtiliCorp is willing to submit a letter to the Commission Secretary stating such.

Wherefore counsel for the Staff asks leave of the Commission to late file the Staff Recommendation and offers the suggestions set out above for the further processing of UtiliCorp's Application.

Respectfully submitted,

DANA K. JOYCE  
General Counsel

  
\_\_\_\_\_  
Steven Dottheim  
Chief Deputy General Counsel  
Missouri Bar No. 29149  
  
Attorney for the Staff of the  
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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 21st day of January 2000.

  
\_\_\_\_\_

Service List for  
Case No. EM-2000-358  
January 21, 2000

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