Exhibit No.: ______________

Issue(s):	Economic Public Interest Detriment
Witness/Type of Exhibit:	Busch/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	GM-2003-0238

FILED[2]

MAR 1 7 2003

Missouri Public Service Commission

REBUTTAL TESTIMONY

OF

JAMES A. BUSCH

Submitted on Behalf of the Office of the Public Counsel

SOUTHERN UNION COMPANY/MGE

Case No. GM-2003-0238

** Denotes Highly Confidential **

NP

March 17, 2003

FILED[2]

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Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the Application of Southern Union Company d/b/a Missouri Gas Energy for authority to acquire directly or indirectly, up to and including one hundred percent (100%) of the equity interests of Panhandle Eastern Pipeline Company, including its subsidiaries, and to take all other actions reasonably necessary to effectuate said transaction.	)	Case No. GM-2003-0238

AFFIDAVIT OF JAMES A. BUSCH

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Busch, of lawful age and being first duly sworn, deposes and states:

1. My name is James A. Busch. I am the Public Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 26 and Schedules JAB-1 through JAB-4.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

James A. Busch

Subscribed and sworn to me this 17th day of March 2003.

Kathleen Harrison, Notary Public

My commission expires January 31, 2006.

REBUTTAL TESTIMONY

OF

JAMES A. BUSCH

CASE NO. GM-2003-0238

SOUTHERN UNION COMPANY

d/b/a

MISSOURI GAS ENERGY

Q. Please state your name and business address.

A. My name is James A. Busch and my business address is P. O. Box 7800, Jefferson City, MO 65102.

Q. By whom are you employed and in what capacity?

A. I am a Public Utility Economist with the Missouri Office of the Public Counsel (Public Counsel).

Q. Please describe your educational and professional background.

A. In June 1993, I received a Bachelor of Science degree in Economics from Southern Illinois University at Edwardsville (SIUE), Edwardsville, Illinois. In May 1995, I received a Master of Science degree in Economics, also from SIUE. I am currently a member of the American Economic Association and Omicron Delta Epsilon, an honorary economics society. Prior to joining Public Counsel, I worked just over two years with the Missouri Public Service Commission as a Regulatory Economist in the Procurement Analysis Department and worked one year with the Missouri Department of Economic Development as a Research

Analyst. I accepted my current position with Public Counsel in September 1999. Furthermore, I am currently a member of the Adjunct Faculty of Columbia College, Jefferson City Campus, teaching both undergraduate and graduate level economics.

Q. Have you previously testified before this Commission?

A. Yes. Attached is Schedule JAB-1 which is a list of the cases in which I have filed testimony before this Commission.

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my rebuttal testimony is to address some of the economic issues of the proposed merger between Southern Union Panhandle Corp. (SUPC), a wholly-owned subsidiary of Southern Union Company (SUC) and CMS Panhandle Eastern Pipeline Company (CMS-PEPL or PEPL), a wholly-owned subsidiary of CMS Gas Transmission Company. After addressing some of the economic issues of the proposed merger, I will give my recommendation as to the appropriate course of action this Commission should take with regard to this proposed transaction. I will also propose certain conditions that the Commission should consider imposing on SUC if the Commission determines that the proposed transaction should be approved.

Q. How is your rebuttal testimony organized?

A. First, I will briefly describe the Missouri operations of SUC, PEPL, and Southern Star Central Pipeline. Second, I will discuss mergers in general. Third, I will discuss detriments that this proposed merger may have on Missouri consumers, both consumers of MGE and consumers of other Missouri LDCs. Finally, I will provide Public Counsel's recommendation regarding the proposed transaction.

Q. Briefly, what is your recommendation to the Commission regarding this proposed transaction?

A. I recommend that the Commission deny SUC's proposed purchase through SUPC of CMS Panhandle Eastern Pipeline Company due to the concerns that I will outline in my testimony, plus other concerns that will be addressed by Public Counsel witnesses Ted Robertson and Mark Burdette. However, if the Commission decides to allow the proposed transaction, I will outline certain conditions that should be imposed on SUC to help safeguard Missouri consumers from the detrimental impacts of this merger.

Q. What factors need to be considered to determine if the Commission should allow this merger?

A. There are various accounting, economic, and financial issues that need to be addressed. Public Counsel witnesses Robertson and Burdette will be addressing the accounting and financial issues, respectively. I will address certain economic issues.

I. MISSOURI OPERATIONS – SOUTHERN UNION COMPANY, PANHANDLE EASTERN PIPELINE COMPANY, AND SOUTHERN STAR CENTRAL

A. SOUTHERN UNION COMPANY

Q. Briefly describe SUC's Missouri operations.

A. SUC operates in the state of Missouri through its Missouri Gas Energy (MGE) division. MGE operates in Missouri as a Local Distribution Company (LDC) in the general areas of Kansas City, Joplin, and St. Joseph. MGE provides natural gas service to approximately 500,000 customers in its service territory, making MGE the second largest natural gas distributor in the state of Missouri. As a LDC, MGE contracts with interstate pipelines to bring natural gas from the production areas to its customers. MGE has interstate pipeline capacity on the following interstate pipelines:

TABLE 1

INTERSTATE PIPELINES
Southern Star Central – formerly Williams Gas Pipelines-Central
Panhandle Eastern
Kansas Pipeline Company
Kinder Morgan – Pony Express

(Source: MGE Reliability Report 7/1/01 – 6/30/02)

Also, MGE has storage agreements with Southern Star Central (SSC) and PEPL. Combined, MGE has over 17 BCF of storage capabilities between those two interstate pipelines with the majority of storage on SSC.

B. PANHANDLE EASTERN PIPELINE COMPANY

Q. Briefly describe PEPL's Missouri presence.

A. PEPL owns and operates an interstate pipeline that enters Missouri just south of Kansas City in the west, and exits the state south of Hannibal in the east. PEPL provides natural gas transportation and storage services to various LDCs in

Missouri, including, MGE, AmerenUE, Laclede, and Aquila. PEPL also provides transportation service to various electric utilities and other large customers throughout Missouri.

C. SOUTHERN STAR CENTRAL

Q. Briefly describe SSC's Missouri presence.

A. SSC owns and operates an interstate pipeline that enters Missouri and provides natural gas transportation mainly to the western side of the state. These areas include Kansas City, Joplin, St. Joseph, and Springfield. SSC provides natural gas transportation and storage service to most of MGE's service territory. SSC also provides natural gas transportation to Laclede Gas Company in the eastern part of Missouri. SSC also provides natural gas transportation service to various large industrial customers and electric utilities in the state of Missouri.

Q. Why is it important to discuss SSC in SUC's application for approval of this transaction?

A. As will be discussed later in my testimony, SUC has a wholly-owned subsidiary called Energy Worx that provides the managerial function of SSC.

II. ECONOMIC IMPACTS OF THE PROPOSED MERGER

A. VERTICAL MERGER VS. HORIZONTAL MERGER

Q. In economic terms, what type of transaction would the SUC – PEPL merger be characterized as?

A. In economic terms, the SUC – PEPL merger would primarily be characterized as a vertical merger. However, at certain levels, there are also some horizontal merger impacts.

Q. You have discussed vertical and horizontal mergers and the potential to lessen competition in a given market, how would this lessening of competition be detrimental to Missouri consumers?

A. This proposed transaction involves a vertical as well as a horizontal merger. Any increased vertical or horizontal market power would be detrimental to Missouri consumers. If a firm has the ability to raise prices above a competitive level, then that firm exhibits market power.

Q. Please define vertical market power.

A. As defined by the Electric Restructuring Consumer Education Message recommended by the Commission's Education Working Group in 1998, vertical market power is:

> …the ability of a firm to control an essential element in the vertical production chain and, through that control, cause competitors to be at a disadvantage through either restricted access or higher costs for the products or services required to produce and deliver the specific product.

Q. Please define horizontal market power.

A. As also defined by the Electric Restructuring Consumer Education Message, horizontal market power is:

> … when a single firm or small group of firms have the ability to affect the price of a product. In the case of a single firm, horizontal market power is present when a firm dominates a market where entry barriers protect it from competition. In the case of a small group of firms,

> horizontal market power can occur through explicit collusive behavior or through strategies that jointly maximize the self-interest of each of the firms.

Q. Please describe a vertical merger.

A. A vertical merger is simply the merger of two firms at different levels within the same supply chain. Various supply companies extract natural gas from the ground through wells in various supply areas. Interstate pipeline companies then transport the natural gas to end-users and LDCs. LDCs simply continue the transportation cycle by delivering the natural gas to its customers. End-users use the natural gas directly as either a fuel source or in their production process. Thus, a LDC merging with an interstate pipeline would be described as a vertical merger. The two firms, SUC and PEPL, are in the same direct path of getting the natural gas out of the ground and to the end-use customer. If Ford Motor Company merged with Goodyear, that would be another example of a vertical merger.

Q. What are the guidelines utilized by governmental agencies to determine the effects on the competitiveness of an industry due to a vertical merger?

A. Unlike the Horizontal Merger Guidelines approved by the Department of Justice and the Federal Trade Commission that govern horizontal mergers, there are no preset guidelines for vertical mergers. However, there are certain principal theories that the Department of Justice or Federal Trade Commission consider to determine the necessity of challenging a vertical merger. These theories are outlined in the DOJ's Non-Horizontal Merger Guidelines.

Q. Why are there no preset guidelines for vertical mergers?

A. One of the reasons for the lack of preset guidelines for vertical mergers could be the increased complexity in assessing just how much of a detrimental impact any given vertical merger could have on the public. Unlike a horizontal merger that could lessen competition by eliminating a competitor, a vertical merger does not necessarily eliminate a potential competitor from the market. Therefore, the analysis that is required to determine the public detriment of a vertical merger is not quite as simple to determine as it is when determining the impacts of a horizontal merger.

Q. Please elaborate.

A. For example, let's assume that a city has ten separately owned gas stations. Each gas station has market shares of approximately 10% of gasoline sales. This market is probably competitive, with no one firm having the ability to influence the price of gasoline. Now assume that five of the firms decided to merge. The new firm would have approximately 50% of the gasoline market in that city. This would mean that the newly formed gasoline station could be in a dominant position to control the price charged for gasoline in the city. The FTC or DOJ would then use preset horizontal merger guidelines, such as the Hirschman-Herfindahl index (HHI), to make a determination as to whether or not to challenge the merger. The HHI is a simple test where you take the summation of the market shares squared of all firms in a relevant market. If the HHI increases a certain amount between pre-merger and post-merger scenarios, the merger is challenged. If the HHI does not change sufficiently, there may be no need to challenge the proposed transaction. Vertical mergers are not as easy to categorize. A simple test such as the HHI has not been developed to apply to vertical mergers to determine whether or not the FTC or DOJ should automatically challenge or simply let stand proposed transactions. Therefore, there needs to be a case by case scrutiny of all vertical mergers to determine the ultimate effects on the consumers.

Q. You mentioned that this merger also has some horizontal merger qualities. What is a horizontal merger?

A. A horizontal merger occurs when two firms that are at the same level of the supply chain within the same industry are combined through a merger. Examples of horizontal mergers would be Coca-Cola and Pepsi or Ford Motor Company and General Motors, etc.

Q. How would the SUC – PEPL merger be viewed as a horizontal merger?

A. There are two ways that this merger can be viewed as a horizontal merger. First, there is some competition between MGE and PEPL for large industrial customers. Second, SUC, through its wholly-owned subsidiary Energy Worx, provides management control of SSC. Therefore, there is competition between PEPL and SSC on the interstate pipeline market as well.

Q. Please describe the competition between MGE and SSC.

A. One way this merger can be described as a horizontal merger is that some large customers can bypass the LDC, MGE, and receive their natural gas directly from an interstate pipeline, in this case PEPL. Therefore, the interstate pipeline and the LDC are competing to be the natural gas transportation provider to some of

MGE's large industrial type customers. Furthermore, there is also some competition between MGE and SSC for large industrial customers as well.

Q. Please describe the competition between PEPL and SSC.

A. Currently there are four interstate pipelines that provide natural gas transportation service to the western portion of Missouri. Those four interstate pipelines are SSC, PEPL, Kinder Morgan (Pony Express), and Kansas Pipeline Company. These four interstate pipelines compete in the natural gas transportation market. The proposed transaction would in effect, combine SSC and PEPL. I will go into more detail regarding the relationship between SUC, Energy Worx, and SSC later in my rebuttal testimony.

B. DETRIMENTAL IMPACT TO MISSOURI CUSTOMERS

Q. Could this proposed transaction affect Missouri customers beyond just MGE's ratepayers?

A. Yes.

Q. How could the proposed transaction between SUC and CMS-PEPL create vertical market power that could be detrimental to Missouri ratepayers?

A. One of the first issues that needs to be addressed is the issue of SUC becoming affiliated with one of the interstate pipelines that it currently utilizes to transport natural gas to its captive customers. This could be detrimental to either MGE customers or consumers of other LDCs in the state through SUC's vertical market power.

Q. Please explain how this transaction could be detrimental to MGE's ratepayers.

A. With the approval of the merger, SUC will own both the LDC and the interstate pipeline. This would then give certain economic incentives to SUC to act in a manner that would be detrimental to MGE's ratepayers.

Q. What economic incentives would SUC have that would be detrimental to MGE's ratepayers?

A. Since MGE would be affiliated with one of the interstate pipelines that it utilizes for natural gas transportation capacity, it would have the incentive and ability to pay PEPL more for natural gas transportation capacity than the price that is currently prevailing in the market. Further, to try and hide the fact that MGE would be paying above market rates for PEPL capacity from regulators, MGE would have the incentive and ability to accept higher prices from other interstate pipelines.

Q. If MGE accepted higher natural gas transportation rates from its interstate pipelines, would that cause MGE's profits to decline, holding everything else constant?

A. No. Through the Purchased Gas Adjustment/Actual Cost Adjustment (PGA/ACA) process, MGE simply passes along transportation rates to its customers on a dollar-for-dollar basis, assuming no prudence disallowance.

Q. Are the transportation rates reviewed in an ACA case?

A. Yes, transportation rates are reviewed in an ACA case. However, interstate pipeline rates are regulated by FERC. MGE may simply make the argument that it is simply passing along the interstates rates charged by the interstate pipeline company. However, there are many factors that are considered when reviewing the purchase of natural gas transportation capacity and the price that a LDC will be able to negotiate to pay an interstate pipeline for that capacity.

Q. How could PEPL start charging higher transportation rates if interstate pipeline rates are regulated by the FERC?

A. PEPL could only start charging higher natural gas transportation rates to MGE if MGE was paying discounted rates on any given transportation contract that was below the level of FERC maximum rates. Discounted rates are not regulated by the FERC.

Q. What is the difference between FERC maximum rates and discounted rates?

A. An interstate pipeline company's rates are regulated at the FERC, much like a LDC's rates are regulated by the PSC. When an interstate pipeline company applies with FERC for a rate increase, the FERC weighs all the evidence to determine the maximum rate that the interstate pipeline can charge a customer or shipper. However, due to certain market conditions such as competition with other interstate pipelines, an interstate pipeline company may offer a discounted rate to a potential shipper to keep that customer from leaving. Interstate pipelines sometimes charge a discounted rate to certain customers instead of the maximum rate allowed by FERC.

Q. Does PEPL charge its FERC authorized maximum rates to MGE?

A. **____

____

_________** In fact, in response to Staff Data Request No. 0012, concerning the due diligence SUC performed to determine if purchasing PEPL would be a good investment, it is discussed that **"____

____"**

Q. If MGE suddenly started paying higher transportation rates, would this raise a red flag during an ACA review?

A. Yes, it would raise a red flag during an ACA review.

Q. What factors are considered when determining the ultimate rate charged by interstate pipelines?

A. Factors such as, pipeline competition, number of customers, current economic conditions, and the price of natural gas are a few of the factors that need to be considered. These factors make the pricing of natural gas transportation non-transparent.

Q. How could this merger be detrimental to Missouri customers of other LDCs?

A. Such a potential detriment could occur if MGE suddenly started to increase its capacity on PEPL at the expense of other interstate pipelines. If PEPL increased capacity for MGE's use, this could cause other Missouri LDCs to lose capacity they currently have on PEPL, pay more to keep PEPL capacity or storage, pay more or receive inferior services from a different interstate pipeline to meet their obligation to serve, or pay higher prices for natural gas because other LDCs may have to acquire alternative capacity with supplies from more expensive basins. Missouri's other LDCs could be forced to pay more for existing capacity or take the chance on purchasing economically inferior capacity from alternative interstate pipelines due to SUC's ability to force PEPL to give more capacity to MGE.

Q. What other impacts could the above scenario have on Missouri citizens?

A. The above example could also affect MGE's customers negatively. If MGE started to increase its capacity on PEPL at the expense of other interstate pipelines, this could cause Missouri citizens to pay more for natural gas supplies, as well as higher transportation rates. This would occur if the supply of natural gas that MGE can purchase for shipment over PEPL is more expensive then the supply of natural gas from another interstate pipeline. This would be detrimental to MGE's customers.

Q. How much of MGE's gas transportation portfolio does PEPL currently own?

A. PEPL provides approximately **___** of MGE's transportation capacity according to Data Request (DRs) responses received by OPC from the Company.

Q. Is a **__________** presence sufficient to cause detrimental harm to MGE's customers?

A. Yes it is. Any potential increase in overall rates to customers is detrimental from the customer's perspective.

Q. Are there any other factors regarding MGE that could lead the proposed merger to have a detrimental impact on Missouri customers as a result of increased vertical market power?

A. Yes. On November 20, 2002, Energy Worx, a wholly-owned subsidiary of SUC, entered into a Management Services Agreement to manage Southern Star Central. Southern Star Central is the former Williams Pipeline Central, the interstate pipeline that provides the largest amount of interstate capacity to MGE. The agreement is attached to my testimony as Highly Confidential Schedule JAB-2.

AIG Highstar Capital, L.P., an entity similar to AIG Highstar II that is partnered with SUC in the PEPL purchase, owns Southern Star Central. The Management Agreement basically gives SUC operational control over SSC through its wholly-owned subsidiary, Energy Worx. For example, Article 1.1 of the Agreement states, **____

____

____**

The Agreement further states, **______________________________

______________________________** Therefore, if the merger between SUC and PEPL is approved, SUC will own PEPL and have operational control over SSC, giving it control of two of the four interstate pipelines serving its MGE division.

Q. What percentage of MGE's interstate pipeline capacity is provided by SSC?

A. Approximately **____** of MGE's capacity needs are served by SSC according to DR responses received by OPC from the Company.

Q. Do the same concerns you expressed for public detriment associated with MGE and PEPL's relationship exist for any potential deals between SSC and MGE?

A. Yes. SUC has the same incentive to abuse its affiliate management relationship with SSC as it has to abuse its affiliate ownership relationship with PEPL.

Q. If SUC does not own SSC, how can it possibly have an incentive to take actions itself or direct actions of SSC in a manner that could increase rates to MGE?

A. According to the Management Services Agreement between Energy Worx and Southern Star Central,

** **

Therefore, the greater SSC's earnings, the more money SUC makes. A consideration can not be any clearer than that.

Q. Are there any other potential detriments of the Energy Worx having operational control of SSC?

A. Yes. Michael Langston, the former Vice President of Gas Supply for SUC, is now working for Energy Worx. Mr. Langston, as VP of Gas Supply for SUC, was responsible for MGE's gas supply portfolio. Now, the new person in charge of MGE's gas supply function has to negotiate with the very man that created the portfolio. This puts MGE at a distinct disadvantage in trying to negotiate the best deal possible with SSC.

Q. What leverage will the new MGE employee have against Mr. Langston?

A. Very little, if any. Mr. Langston knows MGE's current situation and its needs. It will be very difficult for the new head of MGE's gas supply department to negotiate with someone who knows MGE's system as well, if not better, than he/she does.

Q. Other than those concerns, are there any other reasons the Commission needs to consider regarding SSC when trying to determine if the merger application should be approved?

A. Yes. As discussed earlier, the transaction between SUPC as a wholly-owned subsidiary of SUC and PEPL is a vertical merger. Given that SUC has control and a monetary interest in SSC, through another subsidiary, Energy Worx, then this merger becomes a horizontal merger as well. It will be equivalent in some respects to a merger between two competing interstate pipeline companies.

Q. What horizontal merger aspects should the Commission take notice of?

A. First, if the Commission agrees that SUC has some interest and control of SSC, then a merger with PEPL will give SUC some control of the majority of natural gas entering the western part of Missouri. SSC is the major interstate pipeline supplier to the Kansas City, Joplin/Springfield, and St. Joseph areas. SSC does provide some capacity to St. Louis, but a very small amount. PEPL provides natural gas interstate pipeline capacity to the Kansas City area, mid-Missouri, and the eastern part of the state. In total, SUC would control approximately 75 – 80% of interstate pipeline capacity into the western side of Missouri. Furthermore, by aligning the financial interests of PEPL and SSC, the merger would eliminate a potential competitor from the interstate pipeline transportation market in Missouri.

Q. Would SUC have horizontal market power as defined earlier in your testimony if this proposed transaction is approved?

A. Yes.

Q. What impact will the loss of a potential competitor have on Missouri consumers?

A. Generally when an industry loses competitors, customers are worse off. Less competition, especially when two large competitors become one, generally limits choices, thus giving the dominant firm the ability to raise prices. Higher prices are detrimental to consumers.

III. RECOMMENDATIONS

A. PUBLIC COUNSEL'S RECOMMENDATION

Q. Should this Commission approve the proposed merger between SUC and PEPL as structured?

A. No.

Q. Why?

A. Due to the concerns that I have discussed in my testimony, and the concerns raised by OPC witnesses Robertson and Burdette there is the potential for MGE to act in a manner that is detrimental to its consumers and other consumers in the State of Missouri.

B. PUBLIC COUNSEL'S RECOMMENDED CONDITIONS

Q. If the Commission decides to approve the proposed merger despite OPC's recommendation to the contrary, are there any conditions that Public Counsel believes the Commission should impose on SUC?

A. Yes. If the Commission decides that the merger should be approved then conditions should be imposed on SUC and its affiliates. I will discuss certain conditions in my testimony related to the concerns that I have raised. OPC witnesses Robertson and Burdette, also propose conditions that they feel are necessary if the Commission decides to approve the merger.

Q. Please list your conditions.

A. Following are conditions that should be imposed on SUC if this Commission chooses to approve the proposed transaction:

1) SUC shall agree to divest Energy Worx;

2) SUC shall be required to notify OPC, Staff, and any other proper party whenever MGE is considering the addition of new natural gas pipeline capacity or a switch in the current mix of natural gas pipeline capacity;

3) SUC shall keep and provide OPC, Staff, and any other proper party, appropriate documentation regarding inquiries made by SUC or its affiliates to various interstate pipelines. This information should be provided within seven (7) days of any negotiations with the interstate pipelines. However, in no event will the provision of this data constitute preapproval by OPC or Staff or any other proper party. This documentation shall include, but not be limited to:

a) Proposed rates, including any proposed discounts;

b) amount of interstate pipeline capacity;

c) delivery and take points;

d) any storage capabilities;

e) maximum storage quantities (MSQs), maximum daily injection quantities (MDIQs), and maximum daily withdrawal quantities (MDWQs);

f) whether the capacity is firm or interruptible, etc;

g) capacity release and off-system sales opportunities; and

h) the reason for the additional capacity or switch.

4) MGE shall create a written or electronic log that documents the date, time, seller, and terms of all offers received (where such offer includes price, delivery dates, delivery location, and delivery specifications), and indicates any proposal(s) selected by SUC or its affiliates;

5) MGE shall prepare a written analysis explaining how any winning proposal by SUPC or SSC satisfies the needs of MGE's natural gas transportation and storage portfolio when measured against other proposals;

6) MGE shall provide to OPC and Staff, and any other proper party, any and all documents filed by SUC or its affiliates that indicates SUC's or its affiliates' opposition to a rate increase filed by PEPL with the FERC; and

7) MGE shall provide OPC, Staff, and any other proper party, with any documents MGE possesses, that are not otherwise privileged or immune from discovery, discussing any potential settlement of any FERC rate case filed by PEPL, and MGE shall provide a privilege log listing any documents not provided due to privilege or are immune from discovery.

These conditions are also attached to my testimony as Schedule JAB-3.

Q. Please explain your first condition.

A. Due to the potential for harm because the transaction will increase the horizontal market power of SUC between PEPL and SSC, a precondition for approval of this transaction would be SUC's agreement to divest Energy Worx.

Q. How will divestiture of Energy Worx reduce potential harm to the ratepayers associated with the proposed SUC – PEPL deal?

A. By having SUC agree to divest Energy Worx, the potential detrimental impacts on Missouri consumers due to the combined control of PEPL and SSC by SUC will be eliminated. SUC would then have no control or profit potential from decisions made by SSC.

Q. Please describe your second proposed condition.

A. The second condition that should be imposed on SUC would be to have MGE notify OPC and Staff, and any other proper party, when MGE is considering the addition of new interstate pipeline capacity or a switch in the current mix of interstate pipeline capacity. This condition will ensure that the Staff, OPC, and any other proper party receive timely notice when MGE is considering changing its natural gas transportation portfolio. It will thus allow the parties to be cognizant of current market conditions and prepare evaluations of the change in MGE's natural gas transportation portfolio.

Q. Please describe your third condition.

A. The third condition is simply an extension of the second condition. Not only will MGE be notifying all proper parties as to potential changes in its transportation portfolio, it will be keeping and then providing all relevant factors that will go into the decision-making process of MGE in selecting new natural gas transportation. This condition is intended to help make MGE's gas supply decision-making process transparent.

Q. Please describe your fourth condition.

A. Condition four will require MGE to keep documentation of when any interstate pipeline approaches it with potential new natural gas transportation capacity, or changes to current natural gas transportation specifications. It will be necessary for regulators to be aware of the types of offers MGE may be receiving from various pipelines and how MGE is considering such offers. This condition affects both affiliated interstate pipelines and non-affiliated interstate pipelines of MGE.

Q. Please describe your fifth condition.

A. The fifth condition requires MGE to document its reasons for choosing its affiliates natural gas transportation capacity offer instead of an offer from a non-affiliate. This will help ensure that any deal between MGE and its pipeline affiliate are in the best interest of MGE's customers.

Q. Please describe condition six.

A. Condition six requires SUC and its affiliates to provide parties with documentation detailing their involvement at the FERC when its affiliated pipeline is trying to increase rates that could eventually cause Missouri consumers to pay more for natural gas service. Currently, as a representative of Missouri customers, SUC and its operating division, MGE, like all Missouri LDCs, should have an interest in fighting interstate pipeline rate increases in order to keep rates passed on to its customers as low as possible. If MGE and PEPL are affiliated, MGE and its affiliates may not have the same desire (and in fact would have the incentive not to) to fight an increase at FERC if PEPL files for a rate increase. This condition will help maintain the incentive for SUC and its operating division, MGE to oppose rate increases at the FERC on behalf of its Missouri customers.

Q. Please describe condition seven.

A. Condition seven will require SUC and its operating division, MGE to provide all documentation that it possesses concerning the settlement of the FERC rate case. This is important to (1) understand what MGE was thinking about during settlement negotiations with its affiliate and (2) to determine whether the settlement will be in the best interests of Missouri ratepayers. Further, condition seven also deals with confidential settlement information from FERC rate proceedings. The privilege log will allow the parties to see the types of documents that MGE has, but is claiming confidential treatment.

C. PUBLIC COUNSEL'S ALTERNATIVE CONDITIONS

Q. If the Commission decides not to require that SUC agree to divest Energy Worx; do you have any alternative conditions?

A. Yes, I have two alternative conditions.

Q. What is the first alternative condition?

A. The first alternative condition would be to have SUC agree to not make an equity investment in SSC. According to the Management Service Agreement dated November 20, 2002 between SSC and SUC/Energy Worx, SUC **____________

____

_______________ **

Q. Why is it important to prevent SUC from obtaining a direct ownership interest in SSC?

A. It will be harmful enough that SUC, through its subsidiary Energy Worx, has operational control of SSC and that SUC's compensation is linked to SSC's earnings. If SUC has some ownership control of SSC in addition to operational control, all of the potential detriments discussed earlier in my testimony about the SUC – PEPL merger will be there in case of a SUC – SSC merger. In fact, the detriments would be much worse because MGE has much more natural gas transportation capacity on SSC then on PEPL.

Q. If SUC tried to make an equity investment in SSC, would this Commission, as well as the FTC, have to approve the transaction?

A. Yes. However, a condition today forcing SUC to abandon any plans it may have in the future about trying to acquire SSC will save all parties and taxpayers the expense of a lengthy proceeding to determine if such transaction would be detrimental to the public.

Q. Did SUC provide the parties in this proceeding a Memorandum of Understanding (MOU) regarding the Management Services Agreement?

A. Yes. This MOU to the Management Services Agreement is attached to my testimony as Highly Confidential Schedule JAB-4.

Q. What is the purpose of the MOU?

A. Upon execution of the Purchase Stock Agreement between SUPC (a wholly-owned subsidiary of SUC) and CMS to purchase PEPL, Energy Worx and SSC agreed to the MOU. The MOU spells out seven amendments to the Management

Services Agreement. The seven amendments, among other things, specifies the information that the Chairman of Energy Worx will be privy to, and states that certain customer information is not to be shared between SSC, Energy Worx, PEPL, and the Chairman of Energy Worx.

Q. Who is the Chairman of Energy Worx?

A. The Chairman of Energy Worx is also the President and Chief Operating Officer of SUC. His name is Thomas Karam.

Q. What other members of the SUC senior executive management team are excluded from receiving information about SSC customers?

A. None according to the MOU.

Q. What penalties will be imposed on SUC if Mr. Karam is given the information he is barred from receiving through the MOU?

A. There seem to be no penalties other than a breaking of the agreement.

Q. Can Mr. Karam still impact decisions made by Energy Worx in its running of SSC without the information that he would be restricted from receiving by the MOU?

A. Yes. Since Mr. Karam would be effectively controlling two interstate pipelines, he would have the ability to have an impact on the operations of both interstate pipelines, with or without specific customer information. Mr. Karam, as President and COO of SUC, is in charge of all divisions and subsidiaries of SUC, so he would have an almost impossible time of separating the operations of the various entities. For instance, assume that as the President, Mr. Karam is the father and the divisions and subsidiaries are the sons and daughters. Further, assume some of the sons and daughters are competing against each other, but still need to report how well they did to the father. Since the ultimate goal is to increase the overall wealth of the family, the father will direct the children to do what is best for the family unit. Further, it is doubtful that if one child is telling the father his business that the father will conveniently forget that information as another child is telling him her business.

Q. What is your second alternative condition?

A. The second alternative condition would be that as long as Energy Worx is still providing services to SSC either (1) through a management agreement or (2) because SUC has made an equity investment in SSC, all above conditions for PEPL (Conditions 2 – 7) will also apply to SSC.

Q. Does this conclude your rebuttal testimony at this time?

A. Yes it does.

Cases of Filed Testimony
James A. Busch

Company	Case No.
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GO-98-484
Laclede Gas Company	GR-98-374
St. Joseph Light & Power	GR-99-246
Laclede Gas Company	GT-99-303
Laclede Gas Company	GR-99-315
Fiber Four Corporation	TA-2000-23; et al.
Missouri American Water Company	WR-2000-281/SR-2000-282
Union Electric Company d/b/a AmerenUE	GR-2000-512
St. Louis County Water	WR-2000-844
Empire District Electric Company	ER-2001-299
Missouri Gas Energy	GR-2001-292
Laclede Gas Company	GT-2001-329
Laclede Gas Company	GO-2000-394
Laclede Gas Company	GR-2001-629
UtiliCorp United, Inc	ER-2001-672
Union Electric Company d/b/a AmerenUE	EC-2002-1
Laclede Gas Company	GR-2002-356
Empire District Electric Company	ER-2002-424

Schedule JAB-2

has been deemed

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in its entirety.

CONDITIONS TO BE IMPOSED ON SUC

1) SUC shall agree to divest Energy Worx;

2) SUC shall be required to notify OPC, Staff, and any other proper party whenever MGE is considering the addition of new natural gas pipeline capacity or a switch in the current mix of natural gas pipeline capacity;

3) SUC shall keep and provide OPC, Staff, and any other proper party, appropriate documentation regarding inquiries made by SUC or its affiliates to various interstate pipelines. This information should be provided within seven (7) days of any negotiations with the interstate pipelines. However, in no event will the provision of this data constitute preapproval by OPC or Staff or any other proper party. This documentation shall include, but not be limited to:

   a) Proposed rates, including any proposed discounts;
   b) amount of interstate pipeline capacity;
   c) delivery and take points;
   d) any storage capabilities;
   e) maximum storage quantities (MSQs), maximum daily injection quantities (MDIQs), and maximum daily withdrawal quantities (MDWQs);
   f) whether the capacity is firm or interruptible, etc;
   g) capacity release and off-system sales opportunities; and
   h) the reason for the additional capacity or switch.

4) MGE shall create a written or electronic log that documents the date, time, seller, and terms of all offers received (where such offer includes price, delivery dates, delivery location, and delivery specifications), and indicates any proposal(s) selected by SUC or its affiliates;

5) MGE shall prepare a written analysis explaining how any winning proposal by SUPC or SSC satisfies the needs of MGE's natural gas transportation and storage portfolio when measured against other proposals;

6) MGE shall provide to OPC and Staff, and any other proper party, any and all documents filed by SUC or its affiliates that indicates SUC's or its affiliates' opposition to a rate increase filed by PEPL with the FERC; and

7) MGE shall provide OPC, Staff, and any other proper party, with any documents MGE possesses, that are not otherwise privileged or immune from discovery, discussing any potential settlement of any FERC rate case filed by PEPL, and MGE shall provide a privilege log listing any documents not provided due to privilege or are immune from discovery.

Schedule JAB-4

has been deemed

Highly Confidential

in its entirety.