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JUL 13 2004

Missouri Public
Service Commission

Exhibit No.:

Issue: Capital Structure

Witness: John Gillen

Type of Exhibit: Rebuttal Testimony

Sponsoring Party: Missouri Gas Energy

Case No.: GR-2004-0209

Date Filed: May 24, 2004

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

REBUTTAL TESTIMONY

OF

JOHN J. GILLEN

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

May 2004

**REBUTTAL TESTIMONY OF JOHN GILLEN
ON BEHALF OF
MISSOURI GAS ENERGY**

1 **Q: Please state your name and business address.**

2 A: My name is John J. Gillen. My business address is 10 Indian Spring Road, Media, PA.

3

4 **Q: What's your current occupation?**

5 A: I am a consultant providing advice to companies on a variety of business matters
6 including: business integration, acquisitions, internal control and compliance and
7 regulatory matters.

8

9 **Q: Briefly describe your education background and professional history .**

10 A: I graduated from Widener University with a Bachelor of Science degree in Accounting.
11 Prior to joining PricewaterhouseCoopers L.L.P, ("PwC"), I spent over three years as an
12 audit supervisor with the Federal Energy Regulatory Commission, ("FERC"). In that
13 capacity, I was in charge of field staff audits and was responsible for determining whether
14 the accounting records of electric and gas utilities, subject to FERC regulation, complied
15 with the Uniform System of Accounts. I reported directly to a Washington, D.C. Branch
16 Chief within the Office of the Chief Accountant.

17

18 **Q: Are you a member of any professional associations?**

19 A: Yes, I am a Certified Public Accountant and a member of the American Institute of
20 Certified Public Accountants and Pennsylvania Institute of Certified Public Accountants.

1
2 **Q: What were your responsibilities at PwC?**

3 A: During my career at PwC I held numerous positions and served as the audit partner on
4 many of the Firms electric and gas utility clients.
5

6 **Q: Please describe your professional history at PwC.**

7 A: I was hired by PwC, (formally Coopers and Lybrand), in 1983 as a supervisor of audit and
8 consulting services for the electric and gas industry. I was promoted to manager in 1985
9 and elected into the partnership in 1990. In 1992, I was named the Chairman of the
10 Electric and Gas Industry Practice. In 1998, post merger between Coopers and Lybrand
11 and Price Waterhouse, I was named the East Coast Leader of the Electric and Gas
12 Industry. Most recently, in 2000 the Electric and Gas industry was consolidated into the
13 Consumer and Industrial Products and Services practices, which I led for the Philadelphia
14 office until my retirement in 2003.
15

16 **Q: What were your specific duties while a partner at PwC?**

17 A: I was a partner on several of PwC's major utility clients, including Exelon Corporation,
18 Entergy Corporation, Puget Sound Energy, Madison Gas and Electric, Southern Union
19 Company ("Southern Union"), and Kansas City Power and Light Company. I was also
20 the partner on several engagements involving special audit reports on various accounting
21 and/or ratemaking issues, quarterly and annual reports to the Securities and Exchange
22 Commission ("SEC"), stock registration, debt financings and annual reports to the FERC.

1 In addition, I provided consulting services to numerous electric and gas utility companies
2 throughout the United States and have provided expert testimony before regulatory
3 agencies on a variety of matters.
4

5 **Q: Please describe any other responsibilities you had at PwC.**

6 A: In addition to my audit responsibilities I was also the PwC's representative to the
7 American Institute of Certified Public Accountants Public Utility Committee from 1994
8 to 1998 and Chairman of this committee from 1996 to 1998. I spoke before the staff of
9 the FERC, the Financial Accounting Standards Board and the SEC on financial
10 accounting and ratemaking matters. In addition, I was responsible for numerous speeches
11 before electric and gas industry associations on a variety of accounting matters.
12

13 **Q: What is the purpose of your rebuttal testimony in this case?**

14 A: The purpose of my testimony is to respond to the direct testimony of Commission Staff
15 witness David Murray. In connection with this I have prepared a capitalization statement
16 in accordance with generally accepted accounting principles for Southern Union
17 excluding Panhandle Eastern Pipe Line Company ("Panhandle Eastern"), a wholly-owned
18 subsidiary of Southern Union. I also explain the correct methodology for preparing such
19 statement.
20
21
22

1 **Q. Would you please explain how Missouri Gas Energy ("MGE") and Panhandle**
2 **Eastern fit into Southern Union's corporate structure?**

3 A. Southern Union consists of a number of "local natural gas distribution company"
4 operating divisions. These operating divisions are not "incorporated" as separate
5 subsidiary corporations, but rather, are part of Southern Union. MGE is one of these
6 operating divisions. The advantage of this operating division structure is that the
7 divisions can benefit from numerous economies of scale including debt and equity
8 financing.

9
10 **Q If this is so why does Panhandle Eastern continue to have debt in its own name?**
11

12 Southern Union is also the parent company of Panhandle Eastern. Unlike the relationship
13 with MGE and the other operating divisions, Panhandle Eastern is a wholly-owned
14 subsidiary of Southern Union, a separate corporation which issues its own debt for
15 investment in its own assets.

16
17 **Q. Given the corporate structure you describe, is it possible to prepare a statement of**
18 **capitalization for Southern Union excluding its wholly-owned subsidiary, Panhandle**
19 **Eastern?**

20 A. Certainly. Panhandle Eastern maintains separate books and records. In addition,
21 Panhandle Eastern issues its own publicly-held debt securities and, as such, is required to
22 file reports with the SEC pursuant to the Securities Exchange Act of 1934. These reports

1 clearly set forth Panhandle Eastern's capital structure.

2
3 **Q. Have you prepared any schedules which reflect the capitalization of Southern Union**
4 **excluding Panhandle Eastern?**

5 A. Yes, I have prepared two schedules. Rebuttal Schedule JJG-1 and Rebuttal Schedule JJG-
6 2 reflect the capitalization of Southern Union excluding Panhandle Eastern as of the
7 periods ended December 31, 2003, and March 31, 2004, respectively.

8
9 **Q. Did Mr. Murray attempt to determine what Southern Union's capital structure**
10 **would be if Panhandle Eastern was excluded from Southern Union's consolidated**
11 **capital structure?**

12 A. Yes. Beginning on line 18, Page 21 and ending on line 9, Page 22 of his direct testimony,
13 Mr. Murray sets forth his methodology for excluding Panhandle Eastern from Southern
14 Union.

15
16 **Q. Do you agree with Mr. Murray's approach?**

17 A. No. Mr. Murray incorrectly assumes that simply taking Southern Union's consolidated
18 capitalization as shown in its December 31, 2003, Quarterly Report on Form 10-Q and
19 subtracting Panhandle Eastern's capitalization as shown in its December 31, 2003,
20 Annual Report on Form 10-K is a proper methodology for calculating Southern Union's
21 capitalization excluding Panhandle Eastern Pipe.

1 **Q. Does Mr. Murray's methodology comply with generally accepted accounting**
2 **principles?**

3 A. No, it does not.
4

5 **Q. Please comment further on why Mr. Murray's method is incorrect.**

6 A. Mr. Murray's calculation of Southern Union's capital structure ignores the concepts of
7 Generally Accepted Accounting Principles (GAAP). In his testimony Mr. Murray is
8 removing from the Southern Union capital structure the equity of Panhandle Eastern that
9 has already been eliminated through the consolidation process.
10

11 **Q: Could you explain the accounting literature and principles that apply to Southern**
12 **Union's acquisition of Panhandle Eastern?**

13 A: The operative accounting literature that applies is Statement of Financial Accounting
14 Standards No. 141, Business Combinations, (FAS 141). Under the concepts of FAS 141
15 purchase accounting, Southern Union is required to account for the Panhandle Eastern
16 transaction as an acquisition of assets and liabilities.
17

18 **Q: Please explain the accounting required by FAS 141.**

19 A: Essentially, Southern Union is required to allocate the purchase price paid for Panhandle
20 Eastern to the assets and liabilities of Panhandle Eastern and to report those assets and
21 liabilities at their new Fair Market Value, (FMV). Once Southern Union allocates the
22 purchase price to all the assets acquired and liabilities assumed, if an amount is

1 remaining, that amount would be recorded by Southern Union as goodwill.

2
3 **Q: Was any goodwill credited as part of the Panhandle acquisition?**

4 A: No.

5
6 **Q: What happened to the historical Panhandle Eastern capital structure after the**
7 **acquisition by Southern Union?**

8 A: As I mentioned earlier in my testimony the liabilities of Panhandle Eastern, including
9 debt assumed by Southern Union in the acquisition, is recorded by Southern Union at its
10 FMV. With respect to the Panhandle Eastern equity, that is eliminated by Southern
11 Union as it is the Southern Union stand alone equity that now represents all of Southern
12 Union's shareholder value.

13
14 **Q: Does the Panhandle Eastern equity simply disappear?**

15 A. Again, following the concepts of FAS141 purchase accounting, Southern Union actually
16 acquired the assets and liabilities of Panhandle Eastern from its former owners. The
17 equity historically reported by Panhandle Eastern represented equity of those former
18 investors and was essentially returned to them from the purchase price paid them by
19 Southern Union.

1 **Q. Could you please explain Rebuttal Schedule JJG-1 and Rebuttal Schedule JJG-2 of**
2 **your testimony?**

3 **A** Yes. Rebuttal Schedule JJG-1 and Rebuttal Schedule JJG-2 reflect the Southern Union
4 and Panhandle Eastern capitalization including short-term as of December 31, 2003 and
5 March 31, 2004 respectively. These schedules report a consolidated capital structure for
6 Southern Union which is the first column titled "Total Consolidated". This would
7 represent the GAAP capital structure for Southern Union on a consolidated basis. As can
8 be seen from the column headings, the last two columns reflect the capital structure of
9 Southern Union and Panhandle Eastern on a stand alone basis prior to consolidation. The
10 column immediately to the left titled "Subtotal Consolidating" is the combination of the
11 last two columns. The amounts of \$1,547,065,540 and \$1,915,769,581 for the periods
12 December 31, 2003 and March 31, 2004, respectively, are not amounts that are reported
13 in any GAAP financial statements but simply the combined stand alone capital structures
14 of Southern Union and Panhandle Eastern.

15
16 **Q. Why is the "Subtotal Consolidating" column not a GAAP reported amount?**

17 **A.** Simply because it counts the Panhandle Eastern equity twice. Therefore, when calculating
18 the Southern Union capital structure, GAAP requires that the Panhandle Eastern equity be
19 eliminated as is done in each of these schedules under the column "Eliminations".

20

21

22

1 **Q. What did Mr. Murray do in his capital structure calculation?**

2 A. In Mr. Murray's testimony page 22 line 2 he stated "that Southern Union shows a
3 \$646,818,000 common equity balance for Panhandle". This is simply just not the case.

4
5 **Q. On a GAAP basis, what is the appropriate column from these schedules to use to**
6 **determine Southern Union's capital structure excluding Panhandle Eastern?**

7 A. The appropriate GAAP column would be the column in these schedules titled "Southern
8 Union Stand Alone".

9
10 **Q. Does this conclude your testimony?**

11 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's
Tariff Sheets Designed to Increase Rates
for Gas Service in the Company's Missouri
Service Area.

GR-2004-0209

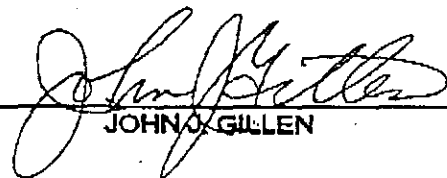
AFFIDAVIT OF JOHN J. GILLEN

STATE OF

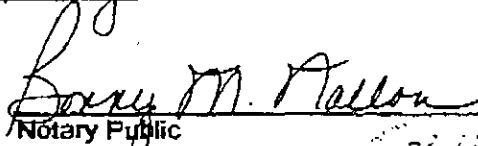
COUNTY OF

ss.

John J. Gillen, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

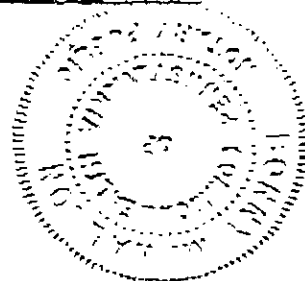

JOHN J. GILLEN

Subscribed and sworn to before me this 24th day of May 2004.


Notary Public

My Commission Expires: _____

Notarial Seal Bonny M. Nallon, Notary Public City of Wilkes-Barre, Luzerne County My Commission Expires June 1, 2006 Member, Pennsylvania Association of Notaries



Southern Union Company and Panhandle Capitalization including Short-term Debt
December 31, 2003

Schedule JJG-1

Capitalization:	Total Consolidated (A)	Reclass	Eliminations	Subtotal Consolidating	Consolidating	
					Southern Union Stand Alone	Panhandle Stand Alone (C)
Stockholders' equity						
Common stock, \$1 par value	\$ 73,181,956	\$ -	\$ -	\$ 73,181,956	\$ 73,181,956	\$ -
Preferred Stock	-	-	-	-	-	-
Premium on capital stock	903,757,804	-	(593,994,472) (B)	1,497,752,276	903,757,804	593,994,472
Retained earnings-Beg Balance	(45,024,754)	-	(4,612,118) (B)	(40,412,636)	(46,396,236)	5,983,600
Retained earnings-Current Year	30,710,860	(1,957,000) (B)	-	32,667,860	(14,172,205)	46,840,065
Unrealized holding gain/(loss) on securities	-	-	-	-	-	-
Less: Treasury Stock	(10,466,493)	-	-	(10,466,493)	(10,466,493)	-
Less: CS held in trust	(5,657,423)	-	-	(5,657,423)	(5,657,423)	-
Total common stockholders' equity	946,501,950	(1,957,000)	(598,606,590)	1,547,065,540	900,247,403	646,818,137
Preferred Stock	230,000,000	-	-	230,000,000	230,000,000	-
Long-term debt	2,004,408,263	-	-	2,004,408,263	1,008,635,467	995,772,796
Long-term debt due currently	260,729,190	-	-	260,729,190	51,058,190	209,671,000
Short-term debt - Notes payable	252,000,000	-	-	252,000,000	252,000,000	-
Total debt	2,517,137,453	-	-	2,517,137,453	1,311,693,657	1,205,443,796
Total capitalization	<u>\$ 3,693,639,403</u>	<u>\$ (1,957,000)</u>	<u>\$ (598,606,590)</u>	<u>\$ 4,294,202,993</u>	<u>\$ 2,441,941,060</u>	<u>\$ 1,852,261,933</u>

(A) Southern Union 12/31/03 Form 10-Q.

(B) Eliminate Southern Union investment in Panhandle Eastern Pipe Line

(C) Panhandle Eastern Pipe Line Form 12/31/03 Form 10-K

Southern Union Company and Panhandle Capitalization including Short-term Debt
March 31, 2004

Schedule JJG-2

	Total Consolidated (A)	Eliminations	Adjustments	Subtotal Consolidating	Consolidating	
					Southern Union Stand Alone	Panhandle Stand Alone (C)
Stockholders' equity						
Common stock, \$1 par value	\$ 73,387,820	\$ -	\$ -	\$ 73,387,820	\$ 73,387,820	\$ -
Preferred Stock	230,000,000	-	-	230,000,000	230,000,000	-
Premium on capital stock	903,971,735	(586,203,472) (B)	-	1,490,175,207	903,971,735	586,203,472
Retained earnings	54,701,988	(83,628,482) (B)	-	138,330,470	54,701,988	83,628,482
Less: Treasury stock	(10,466,493)	-	-	(10,466,493)	(10,466,493)	-
Less: CS held in trust	(5,657,423)	-	-	(5,657,423)	(5,657,423)	-
Total stockholders' equity	1,245,937,627	(669,831,954)	-	1,915,769,581	1,245,937,627	669,831,954
Long-term debt	2,188,820,231	-	-	2,188,820,231	998,547,290	1,190,272,941
Long-term debt due currently	99,501,290	-	-	99,501,290	36,058,290	63,443,000
Notes payable	75,500,000	-	-	75,500,000	75,500,000	-
Total long-term and short-term debt	2,363,821,521	-	-	2,363,821,521	1,110,105,580	1,253,715,941
Total capitalization	<u>\$ 3,609,759,148</u>	<u>\$ (669,831,954)</u>	<u>\$ -</u>	<u>\$ 4,279,591,102</u>	<u>\$ 2,356,043,207</u>	<u>\$ 1,923,547,895</u>

(A) Southern Union 3/31/04 Form 10-Q.

(B) Eliminate Southern Union investment in Panhandle Eastern Pipe Line

(C) Panhandle Eastern Pipe Line Form 3/31/04 Form 10-Q