142 FERC ¶ 61,195
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony Clark.

Missouri Interstate Gas, LLC
Missouri Gas Company, LLC
Missouri Pipeline Company, LLC

Docket No. CP06-407-007

OPINION NO. 525
ORDER ON INITIAL DECISION

(Issued March 21, 2013)

1. This proceeding is before the Commission on exceptions to the Initial Decision issued on November 28, 2011, by the Presiding Administrative Law Judge (Presiding Judge).[1] At issue is whether MoGas Pipeline LLC (MoGas) can continue to include the full purchase price of certain pipeline facilities in its rate base because that price allegedly includes an acquisition adjustment or premium, an amount above the depreciated value of the underlying assets, included on the books of a previous owner. The hearing resulted from the remand of this issue by the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) in *Missouri Public Service Commission v. FERC (Mo. PSC)*.[2]

2. In this order, the Commission affirms the Initial Decision in part and reverses the Initial Decision in part. The Commission finds that MoGas can continue to include the full purchase price of certain pipeline assets in rate base because the record demonstrates that the acquisition of these facilities at more than their net book value results in substantial benefits to ratepayers.

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[1] *Missouri Interstate Gas, LLC*, 137 FERC ¶ 63,014 (2011) (Initial Decision).

[2] 601 F.3d 581 (D.C. Cir. 2010).

I. Background

A. Procedural History of Docket No. CP06-407-000, et al.

3. In a series of orders, the Commission approved, subject to conditions, the merger of two state-regulated pipelines, Missouri Pipeline Company, LLC (MPC) and Missouri Gas Company, LLC (MGC), with one Commission-regulated interstate pipeline, Missouri Interstate Gas, LLC (Missouri Interstate).[3] In approving the merger and issuing a certificate of public convenience and necessity under section 7 of the Natural Gas Act (NGA), the Commission authorized initial rates for service on the combined facilities of the new Commission-regulated interstate pipeline, MoGas. The Commission dismissed the protest of the Missouri Public Service Commission (MoPSC) alleging that the Commission's approved rate base established for the purpose of determining MoGas's initial rates included an unlawful acquisition premium for Missouri Interstate, carried over from a prior sale of those assets, before their acquisition by Missouri Interstate.[4] The Commission declined to change its previous decision[5] granting Missouri Interstate its original NGA section 7 certificate, which permitted Missouri Interstate to include the full purchase price of its facilities in rate base. The Commission explained that it would be a more efficient use of its administrative resources to address the issue in detail in the rate proceeding MoGas would be filing within 18 months of commencing operations.[6]

4. In *Mo. PSC*, the D.C. Circuit held that the Commission erred by deferring consideration of the disputed acquisition premium to an NGA section 4 proceeding.[7] The court found that the Commission's action was inconsistent with its own precedent which establishes that such premiums are disallowed unless the Commission applies the so-called "benefits exception."[8] The court also found that the Commission's action was

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[3] *Missouri Interstate Gas, LLC*, 119 FERC ¶ 61,074 (2007), *order on reh'g*, 122 FERC ¶ 61,136 (2008), *reh'g denied*, 127 FERC ¶ 61,011 (2009).

[4] *Missouri Interstate Gas, LLC*, 122 FERC ¶ 61,136 at P 55.

[5] *Missouri Interstate Gas, LLC*, 100 FERC ¶ 61,312, at PP 24-26 (2002).

[6] *Missouri Interstate Gas, LLC*, 122 FERC ¶ 61,136 at P 53.

[7] *Mo. PSC*, 601 F.3d at 586.

[8] *Id.* at 582 (citing *RioGrande Pipeline Co. v. FERC*, 178 F.3d 533, 536-37 (D.C. Cir. 1999); *Kansas Pipeline Co.*, 81 FERC ¶ 61,005 (1997)).

inconsistent with its rejection of the acquisition premiums included in the costs associated with the facilities of the two state-regulated pipelines.[9]

5. On August 24, 2010, the Commission established settlement judge procedures to determine whether the parties could reach a settlement on the acquisition adjustment issue.[10] On September 17, 2010, settlement judge procedures were terminated.[11] On November 1, 2010, the Commission issued an order setting for hearing the remanded issue.[12] The Commission determined that resolution of the issue on remand will impact MoGas's rates for a locked-in period from June 1, 2008, the date MoGas commenced jurisdictional service, to January 1, 2010, the effective date of Settlement Rates in Docket No. RP09-791-000[13] and a decision on the merits in this case also could establish precedent in a future rate proceeding.[14]

6. The Presiding Judge conducted the evidentiary hearing in this case on August 1 and August 2, 2011. On November 28, 2011, the Presiding Judge issued the Initial Decision. On January 13, 2012, MoGas, Trial Staff, and MoPSC filed Briefs on Exceptions. On February 2, 2012, MoGas, MoPSC, and Union Electric Company doing business as Ameren Missouri (Ameren Missouri) filed Briefs Opposing Exceptions. On January 13, 2012, the Interstate Natural Gas Association of America (INGAA) filed a motion for leave to file an amicus brief and an amicus brief.

B. Pleadings Related to the Missouri Supreme Court's Ruling that MoPSC Is Not Permitted to Intervene in FERC Proceedings

7. On April 17, 2012, the Supreme Court of Missouri, on appeal in a matter initiated by MoGas, held that MoPSC has no authority to intervene in matters pending before the FERC.[15] Subsequently, on June 7, 2012, MoGas filed a motion requesting that the

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[9] *Mo. PSC* at 586-587.

[10] *Missouri Interstate Gas, LLC*, 132 FERC ¶ 61,161 (2010).

[11] *Missouri Interstate Gas, LLC*, unpublished order of the Chief Judge issued in Docket No. CP06-407-007.

[12] *Missouri Interstate Gas, LLC*, 133 FERC ¶ 61,115 (2010).

[13] *Missouri Interstate Gas, LLC*, 132 FERC ¶ 61,161 at P 6.

[14] *Missouri Interstate Gas, LLC*, 133 FERC ¶ 61,115 at P 7.

[15] *State ex rel. MoGas Pipeline LLC v. Mo. Pub Serv. Comm'n,* 366 S.W.3d 493 (Mo. Banc 2012).

Commission reverse the Initial Decision issued in this proceeding and grant MoGas judgment as a matter of law. On June 12, 2012, the State of Missouri filed a Notice of Substitution of Party of Interest (Notice of Substitution), in which it gave notice that it is substituted as the party of record in this proceeding in place of MoPSC.

C. Prior History of the MoGas Pipeline System

8. Many of the contested issues in this proceeding relate to transactions that occurred prior to the filing of MoGas's certificate application in CP06-407-000. A summary of these events follows.

9. In 1987, Amoco Pipeline Company (Amoco) sold approximately 70 miles of idle oil pipeline including 5.6 miles of pipeline connecting Missouri and Illinois under the Mississippi River, referred to as the TransMississippi Pipeline (TMP), to a wholly-owned subsidiary of Edisto Resources Corporation (Edisto) for $4,150,000.[16] Edisto formed Missouri Pipeline Company (MPC) as a wholly-owned subsidiary to own and operate the pipeline segment.

10. In 1989, MPC filed for a certificate of public convenience and necessity to operate approximately 85 miles of natural gas pipeline in Missouri and offer intrastate natural gas service.[17] Approximately 70 miles of the 85 miles of pipeline were part of the former Amoco oil pipeline system; the remaining portion of the pipeline was new construction. As proposed, the intrastate pipeline would interconnect with Panhandle Eastern Pipeline Company in Pike County, Missouri, traverse Lincoln County, Missouri, and interconnect with Laclede Gas Company in Charles County, Missouri. The certificate authorization from MoPSC was conditioned on the requirement that MPC physically sever the intrastate pipeline from the approximately 5.6 miles of the former Amoco oil pipeline that crossed underneath the Mississippi River into Illinois, referred to herein as the TMP facilities.[18] MPC's initial rates were derived based on a total rate base of $15 million.[19]

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[16] Exh. Nos. MGP-1 at 6, PSC-1 at 16, and PSC-3 at 10. The purchaser was Omega Pipeline Company which was a wholly-owned subsidiary of Vesta Natural Gas which in turn was a wholly-owned subsidiary of Edisto. Exh. No. PSC-1 at 16. The purchaser will be referred to hereafter as "Edisto."

[17] Exh. No. MGP-16.

[18] *Id.*

[19] *Id.* at 2.

11. In 1991, MoPSC authorized MPC to extend its system, and authorized a new pipeline affiliate, MGC, to construct 66 miles of new pipeline that extended southward from the terminus with MPC.[20]

12. In 1994, Edisto negotiated a sale of MPC, MGC, and the TMP facilities to UtiliCorp United Inc. (UtiliCorp).[21] The facilities were sold in two separate transactions that were dated February 14, 1994, and both deals closed simultaneously in January 1995.[22] In one agreement, called the Missouri System Agreement, Edisto sold the Missouri-regulated assets, MPC and MGC, to UtiliCorp for $55.4 million, as adjusted at closing.[23] In 1994, MoPSC approved the acquisition of MPC and MGC from Edisto by UtiliCorp but prohibited UtiliCorp from connecting MPC with the TMP facilities.[24] The second transaction, the Omega System Agreement, concerned assets not regulated by Missouri consisting of the TMP facilitates and Omega Pipeline Company (Omega Pipeline), a local distribution company servicing the U.S. Army base at Ft. Leonard Wood. UtiliCorp purchased Omega Pipeline and the TMP facilities in this transaction for approximately $22 million.[25]

13. In proceedings before the MoPSC in 2001,[26] an UtiliCorp representative stated that UtiliCorp acquired the TMP facilities from Edisto at an approximate cost of $12.6 million, including an approximate $10.6 million acquisition premium.[27] This is the alleged acquisition adjustment challenged in this proceeding.

[20] Exh. No. MGP-1 at 6.

[21] *Id.* at 7.

[22] After the sale, MPG, MGC, and the TMP facilities were owned by a subsidiary of UtiliCorp, UtiliCorp Pipeline Systems, Inc. (UtiliCorp Pipeline).

[23] Exh. Nos. MGP-1 at 7; MGP-3 at 17.

[24] Exh. No. MGP-17 at 5.

[25] Exh. Nos. MGP-1 at 7; MGP-3 at 16.

[26] These proceedings involved UtiliCorp's proposed sale of its Missouri-regulated assets to Gateway Pipeline Company (Gateway). *See infra* P 20.

[27] Exh. No. MGP-4 (data response from Denny Williams to MoPSC). Richard Kruel, former UtiliCorp Vice President and UtiliCorp Pipeline President, also testified in the MoPSC proceeding that the acquisition adjustment was attributable to the TMP. Exh. No. PSC-4.

14. UtiliCorp representatives also stated that on December 31, 1995, UtiliCorp adjusted the books of MPC and MGC to transfer and allocate this approximately $10.6 million cost related to the TMP facilities to MPC and MGC.[28] Both MPC and MGC, recorded their share of the $10.6 million cost in FERC Account 114, Gas Plant Acquisition Adjustments, in the amount of $7,019,131 and $3,608,679, respectively. MoGas asserts that the reason for the transfer may have been for MPC and MGC to amortize these costs for tax purposes because they were operating companies and the TMP was not.[29] MPC and MGC never filed a rate case under UtiliCorp's ownership.[30]

15. In 1998, UtiliCorp made other accounting entries related to the TMP facilities. MPC's 1998 Annual Report filed with the MoPSC indicates that it transferred $1,133,857 related to property located in St. Charles County, Missouri to Account No. 105, Gas Plant Held For Future Use.[31] MoGas points out that an explanatory note in the report states that these assets were "transferred from TransMississippi Pipeline in 1998." MoGas witness, Mr. Reis, testified that these amounts are related to approximately 4 miles of pipe of the TMP facilities originating where MPC was severed in West Alton, Missouri and running to the west bank of the Mississippi River in St. Charles County, Missouri.[32] Continuing Property Records maintained by UtiliCorp for MPC, MGC, and TMP, last dated August 1, 2000 also assigned a $1,133,857 cost to Account 105 on the books of MPC and assigned costs of $1,432,913.80 to TMP, totaling $2,566,770.89. MoGas claims that these entries are believed to have been related to capital costs incurred by Edisto in 1994, as a condition of the Edisto/UtiliCorp transaction, to pressure test, inspect, purge, and seal the TMP facilities in order to verify that they were capable of being converted to natural gas use.[33]

16. In 2000, UtiliCorp, the owner of all the shares of UtiliCorp Pipeline entered into negotiations with Gateway Pipeline Company (Gateway), for the sale of MPC, MGC, and the TMP facilities. A non-binding letter of intent was entered into for approximately $55 million, equal to the regulated rate base of MPC and MGC.[34] Ultimately, UtiliCorp

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[28] Exh. Nos. MGP-4; MGP-18 at 8-9.

[29] Exh. No. MGP-1 at 8.

[30] Exh. No. PSC-1 at 27.

[31] Exh. No. PSC-70 at 42.

[32] Tr. at 174.

[33] *Id.* at 173.

[34] Exh. Nos. MGP-1 at 9-10; MGP-9 at 532-533; MGP-21 at 5.

was unwilling to sell the assets at that price because they would incur a book loss on the transaction.[35] After further negotiations, the parties entered into a Stock Purchase Agreement on February 1, 2001, to sell all of the shares of UtiliCorp Pipeline to Gateway at a share price equal to the "net book value of the property, plant and equipment of the company and its subsidiaries (other than the Omega Pipeline Company) as of the Closing Date as determined in accordance with GAAP [Generally Accepted Accounting Principles] . . .."[36]

17. MoGas's President, David J. Ries, participated in the due diligence and negotiated the acquisition from UtiliCorp. Mr. Ries testified in this proceeding that prior to the consummation of the Stock Purchase Agreement, UtiliCorp reversed its December 1995 accounting entries and returned the unamortized amounts recorded in Account No. 114 on the books of MPC and MGC back to the books of its subsidiary, UtiliCorp Pipeline, the owner of the TMP facilities. UtiliCorp made this transfer at the request of Mr. Ries and this transfer was approved by UtiliCorp's corporate accounting department.[37]

18. While the transaction was a stock sale of all of UtiliCorp Pipeline's stock, the parties made an election pursuant to the Internal Revenue Code § 338(h)(10), 26 U.S.C. § 338(h)(10(2006), under which the transaction is deemed to be an asset sale. Based on December 31, 2000 valuations, the purchase price in the Stock Purchase Agreement was estimated to be $63.4 million, and allocated as follows: (i) $32.7 million was attributed to the assets of MPC; (ii) $20.4 million was attributed to the assets of MGC; and (iii) $10.3 million was attributed to "the Company" (referencing UtiliCorp Pipeline).[38] At closing, the final purchase price was $62.4 million and the amount of the sale price attributable to the Company was $10,088,925.[39]

19. Schedule 5.2 of the Stock Purchase Agreement sets out the estimated "Net Value" of the assets on the books of MPC, MGC, and the Company by subtracting the "Allocated Reserve" for each asset from its "Accumulated Costs."[40] The $10.6 million acquisition adjustment that was transferred back to the TMP facilities is included in the "Accumulated Cost" column on the books of the Company. In addition, the capital cost

[35] Exh. Nos. MGP-1 at 9.

[36] Exh. No. MGP-9 at 1 (Stock Purchase Agreement, paragraph 1.2).

[37] Exh. No. MGP-21 at 21-22; Tr. at 178.

[38] Exh. No. MGP-9 at 5-6; 269-272.

[39] Exh. No. MGP-1 at 10.

[40] Exh. No. MGP-9 at 269-272.

expenditures totaling $2,566,770.89 that MoGas claims are related to capital costs expended to pressure test, inspect, purge, and seal the TMP facilities in 1994, prior to UtiliCorp's acquisition, are included as follows: the $1,133,857 amount that that was placed in Account 105 on the books of MPC in 1998, remains on the books of MPC in the "Allocated Cost" column, and the $1,432,913.80 figure that was on the books of TMP is included on the books of the Company in the "Allocated Cost" column, in addition to the $10.6 million acquisition adjustment.

20. On April 19, 2001, Gateway, MGC, and MPC filed a joint application with the MoPSC seeking, among other things, authorization for Gateway to acquire the outstanding shares of UtiliCorp Pipeline under the Stock Purchase Agreement with UtiliCorp. By order issued on October 9, 2001, MoPSC approved Gateway's request to buy all the shares of UtiliCorp Pipeline subject to conditions.[41] The MoPSC order modified MPC's 1989 certificate condition restricting MPC from interconnecting with the TMP facilities as long as the TMP facilities were held in a company separate from MPC and MGC and gas could only flow into Missouri in order to assure continued state jurisdiction under the Hinshaw exception.[42]

21. After the Stock Purchase Agreement closed, Gateway changed the name of UtiliCorp Pipeline, to United Pipeline Systems, Inc. (United) and formed Missouri Interstate as a wholly owned subsidiary of United to own and operate the TMP facilities.

22. In 2002, Missouri Interstate filed a NGA section 7 certificate with the Commission to interconnect the TMP facilities with MPC in West Alton, Charles County, Missouri, operate the TMP facilities, and to construct and operate an approximately one-mile extension to interconnect with Mississippi River Transmission Corporation in Illinois. The Municipal Gas Commission of Missouri raised issues concerning Missouri Interstate's proposed rate base and requested that Missouri Interstate be required to demonstrate that the purchase price was the net book value of the facility when ownership was transferred from UtiliCorp to Gateway. In its order issuing the certificate, Missouri Interstate was authorized to include $10,088,925 in rate base for the TMP facilities that was represented as the depreciated net book value of the TMP facilities at the time of the sale by UtiliCorp.[43] The Commission found:

> Because the facilities will be devoted to gas utility service for the first time, we will permit Missouri Interstate to include the

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[41] Exh. No. MGP-8.

[42] *Id.* at 35-36.

[43] *Missouri Interstate Gas, LLC*, 100 FERC ¶ 61,312 at P 26.

> $10,088,000 purchase price of the existing facilities as the original cost in rate base for recourse ratemaking purposes when the assets are transferred to it.[44]

This finding was not appealed by any party to the proceeding.

23. In 2006, in the subject proceeding, the Commission approved the merger of MPC, MGC, and Missouri Interstate and authorized initial rates for service on the combined facilities of the new Commission-regulated interstate pipeline. As explained above, the Commission dismissed the protest of MoPSC alleging that MoGas's initial rates contained an unlawful acquisition premium carried over from Missouri Interstate and deferred consideration of this issue to a future rate proceeding. The Commission's decision was vacated and remanded to the Commission by the court in *Mo. PSC*. The hearing in this proceeding followed.

II. Discussion

A. Procedural Issues

1. INGAA's January 13, 2012 Motion for Leave to File an Amicus Brief and Amicus Brief

24. INGAA seeks leave to file an amicus brief on exceptions to the Initial Decision asserting that as a trade association representing the majority of United States interstate natural gas pipeline companies, it has a strong and legitimate interest apart from the outcome of this single case. INGAA states that it submits its amicus brief out of concern about the impacts of the Initial Decision on INGAA's members, on the natural gas industry, and on natural gas consumers.

25. On January 30, 2012, MoPSC filed an answer in opposition to INGAA's motion. MoPSC asserts, among other things, that INGAA has not asserted an unrepresented interest or argument that justifies granting INGAA amicus status at this late stage of the proceeding.

26. We deny INGAA's motion for leave to file an amicus brief. INGAA does not explain why it waited until after the issuance of the Initial Decision to take a position on the issues in this proceeding. Moreover, the parties' filings in this proceeding have provided a full analysis of the issues before the Commission.

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[44] *Id.*

2. Pleadings Related to the Missouri Supreme Court's Ruling that MoPSC Is Not Permitted to Intervene in FERC Proceedings

a. MoGas's Motion to Reverse Initial Decision as a Matter of Law

27. MoGas asserts that MoPSC was the only participant to present evidence in the proceeding purporting to support the allegation that MoGas's initial rates contained an improper acquisition premium. On this basis, MoGas maintains that the Commission cannot uphold the Initial Decision, because to do so it must rely on evidence submitted by MoPSC *ultra vires*.

28. MoGas states that since the Commission's rules do not address legal capacity, it is appropriate for the Commission to look to the federal rules and associated precedent for guidance. MoGas claims that under Federal Rule of Civil Procedure 17(b), lack of legal capacity under state law is a bar to suit in a federal court. Because state laws bar MoPSC from intervening at FERC and participating in FERC proceedings, MoGas claims that the Commission should find that MoPSC is barred from litigating this case and thus its evidence must be stricken or disregarded. MoGas also claims that the Commission has on occasion required entities to factually demonstrate their legal capacity under state law in order to obtain relief.[45] MoGas maintains that the Commission must do so here because any further reliance by the Commission on the testimony, exhibits, and pleadings submitted by MoPSC would confer upon MoPSC substantive legal authority that its own enabling statute denies it.

29. The State of Missouri, the Municipal Intervenors,[46] and Trial Staff filed answers in opposition to MoGas's motion. These participants argue that MoGas's assertions about *ultra vires* evidence are moot in light of the State of Missouri's Notice of Substitution. The State of Missouri also asserts that the Commission has the discretion to consider the MoPSC evidence and that it would be an abuse of discretion to grant MoGas's motion. According to the State of Missouri, the Commission has an independent obligation to ensure that MoGas's initial rates are just and reasonable. The State of Missouri claims that Missouri ratepayers would be severely prejudiced if MoGas's motion is granted.

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[45] MoGas's Motion at 9 (citing, *e.g.*, *Marsh Valley Hydro Elec. Co.*, 51 FERC ¶ 61,306, at 61,996-67 and ordering para. (B) (1990) (*Marsh Valley*) (the Commission ordered the company to provide evidence that it had legal capacity to create the company and that the company had legal capacity to construct, maintain, and operate a hydroelectric project under state law).

[46] The Municipal Intervenors consist of the Municipal Gas Commission of Missouri and the cities of St. James, St. Robert, Richland, and Waynesville, Missouri.

30. Similarly, Trial Staff argues that there is no basis for the Commission to ignore a fully developed hearing record. According to Trial Staff, granting MoGas's motion would result in a waste of resources, violate Commission policy and precedent, and frustrate a court of appeals remand order. Specifically, Trial Staff claims that MoGas has been provided notice and an opportunity to be heard in a meaningful way and nothing further is required under the Administrative Procedures Act, the NGA, or Commission precedent.

31. The Municipal Intervenors assert that MoGas's request is an impermissible collateral attack on a Commission certificate order making MoPSC a party. They also claim that the Commission must preserve the present record in order to avoid prejudice to the Municipal Intervenors who relied on MoPSC to take the lead in this remand proceeding.

Commission Determination

32. The Commission denies MoGas's motion to reverse the Initial Decision as a matter of law. The Commission has an independent obligation under section 7 of the NGA to insure that initial rates are in the public interest.[47] Moreover, the Commission has broad authority to consider relevant evidence subject to the requirement that participants be accorded due process.[48]

33. Here, MoPSC became a party by filing a timely notice of intervention and was an active participant in the hearing filing testimony and briefs. MoGas, in turn, was provided the opportunity to seek discovery, cross examine witnesses, file its own case-in-chief and rebuttal testimony, and file briefs to the Presiding Judge and the Commission. A full record has been developed consistent with the Commission's Rules of Practice and Procedure on the contested issue in this proceeding that is before the Commission on exceptions.[49] Under these circumstances, we find that MoGas has advanced no valid

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[47] *See, e.g., Missouri Pub. Service Comm. v. FERC,* 337 F.3d 1066, 1076 (D.C. Cir. 2003) ("Section 7 imposes a duty on FERC to determine for itself whether the rates it approves are in the public interest").

[48] Under the Commission's Rules of Practice and Procedure, evidence is admissible unless it is "irrelevant, immaterial, or unduly repetitious" or is not of the "kind which would affect reasonable and fairminded persons in the conduct of their daily affairs." 18 C.F.R. § 385.509(a) (2012).

[49] The Commission's ruling in *Marsh Valley* is inapposite. In *Marsh Valley,* the Commission's concern was to ensure that the company seeking a license had the legal capacity under state law to perform a jurisdictional service, namely, construct and operate a hydroelectric project. No such concern is present here.

basis for the Commission to strike or disregard MoPSC's evidence. Rather, consideration of this evidence is appropriate in order to fulfill the Commission's obligations under section 7 of the NGA to ensure that MoGas's initial rates are in the public interest.

34. For these reasons, the Commission denies MoGas's motion to reverse the Initial Decision as a matter of law. Rather, this order addresses the issue on the merits based on the record developed in this proceeding.

b. <u>The State of Missouri's Notice of Substitution of Party of Interest</u>

35. The State of Missouri asserts that the Commission should allow it to substitute as the party of record in this proceeding in the place of MoPSC pursuant to the regulations underlying Rule 214. Specifically, the State of Missouri claims that it represents the same Missouri consumers on whose behalf the MoPSC intervened initially. The State of Missouri asserts that it has a direct interest in the outcome of this proceeding and participation by the State of Missouri is in the public interest as no other participant can represent adequately the interests of Missouri ratepayers. The State of Missouri states that it agrees to adopt the record as it stands. Therefore, it asserts that no disruption of the proceeding will occur and no participant is prejudiced by this substitution because it maintains the status quo.

36. Ameren Missouri, the Municipal Intervenors, and Commission Staff filed answers in support of the substitution of the State of Missouri for MoPSC. They assert that this substitution is necessary for a fair outcome in this proceeding and will in no way prejudice the parties.

37. MoGas filed an answer requesting that the Commission reject the State of Missouri's Notice. MoGas asserts that the Notice of Substitution circumvents the Commission's regulations as well as Missouri's substantive law. MoGas complains that the Notice of Substitution does not cite any Commission regulations authorizing the substitution of a party. Rather, MoGas claims that Missouri's notice is "an attempt to file a late intervention, filed six years out-of-time."[50] MoGas claims that the State of Missouri must demonstrate good cause for its late intervention, and that the recent decision by the Missouri Supreme Court determining that MoPSC is not authorized to participate in FERC proceeding fails to meet that standard. Specifically, MoGas claims that because it sought to terminate MoPSC's involvement in 2008, Missouri should not have waited until 2012 to file its Notice of Substitution. MoGas claims that granting intervention will prejudice MoGas because if the Commission reverses the Initial Decision and finds in favor of MoGas that there was no acquisition premium, no party

[50] Answer of MoGas at 5.

other than MoPSC could seek rehearing of that order. This is, MoGas argues, because no other party submitted evidence on the issue of the presence of an acquisition adjustment. Finally, MoGas claims that, although styled as a pleading by the State of Missouri, in realty the Notice of Substitution is a filing by MoPSC under another name. In support, MoGas states that the Notice of Substitution has only two signatures, MoPSC's longstanding outside counsel and Steven Reed, MoPSC general counsel. Under these circumstances, MoGas claims that permitting Missouri's Notice of Substitution would enable MoPSC to circumvent a final order of the Missouri Supreme Court.

Commission Determination

38. The Commission accepts the State of Missouri's request to substitute as a party in the place of MoPSC in this proceeding. The Commission rules governing interventions in Rule 214 do not directly address the substitution of a party nor is there any Commission precedent directly on point. However, we find that our procedural rules are broad and give the Commission discretion to accept the State of Missouri's request to substitute as a party in this proceeding under the unique circumstances presented here.

39. Rule 214(a)(2) allows for certain entities, including State Commissions, to become a party to a proceeding upon filing a timely notice of intervention.[51] Other movants must show in sufficient detail that the movant has "an interest which may be directly affected by the outcome of the proceeding[.]"[52] These rules also set forth factors the Commission may consider in acting on a motion for late intervention.[53] In short, these rules provide

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[51] 18 C.F.R. § 385.214(a)(2) (2012).

[52] 18 C.F.R. § 385.214(b) (2012). Under Rule 214(b)(2), a motion to intervene must:

> state the movant's interest in sufficient factual detail to demonstrate that: (i) The movant has a right to participate which is expressly conferred by statute or by Commission rule, order, or other action; (ii) The movant has or represents an interest which may be directly affected by the outcome of the proceeding, including any interest as a: (A) Consumer, (B) Customer, (C) Competitor, or (D) Security holder of a party; or (iii) The movant's participation is in the public interest.

[53] The factors to be weighed are whether: (1) the movant had good cause for failing to file the motion within the time prescribed; (2) any disruption of the proceeding might result from permitting intervention; (3) the movant's interest is not adequately represented by other parties to the proceeding; and (4) any prejudice to, or additional burdens upon, the existing parties might result from permitting the intervention. 18 C.F.R. § 385.214(d) (2012).

for broad participation by interested persons in Commission proceedings and are designed to ensure an orderly administrative process as well as fairness to applicants and parties.

40. Here, MoPSC was an active party in this proceeding for approximately six years representing the interests of Missouri consumers. MoPSC protested the inclusion of the alleged acquisition adjustment in MoGas's rate base, appealed the Commission's ruling deferring consideration of this issue to a future rate proceeding to the D.C. Circuit, and was an active party in the hearing on remand, filing testimony and briefs. There is a fully developed record on the contested issue before the Commission on exceptions. The State of Missouri's Notice of Substitution would allow it to take the place of MoPSC in this proceeding to represent the interest of Missouri consumers going forward. The State of Missouri would accept the record as it stands. In these circumstances, we find that permitting the State of Missouri to substitute as a party in order to represent the interest of Missouri consumers in the final stages of this proceeding is consistent with fundamental fairness and is in the public interest.

41. The Commission rejects MoGas's claim that allowing intervention by the State of Missouri would be prejudicial to MoGas because no other party can seek rehearing of a Commission order finding that there was no acquisition adjustment. Under Rule 713, any party can seek rehearing of a final Commission decision, not only parties filing testimony on a particular issue. While acceptance of the Notice of Substitution will allow the State of Missouri, in addition to other parties, to file for rehearing and/or appeal a Commission ruling adverse to it, we find that the benefits of continued representation by Missouri consumers under the specific facts of this case outweigh any prejudice to MoGas.

42. Finally, we find that the forum for litigating MoGas's claim that the State of Missouri's Notice of Substitution would enable MoPSC to circumvent a final order of the Missouri Supreme Court is the Missouri state court system.

B. Substantive Issues

Original Cost Accounting and Application of Substantial Benefits Test

43. As explained by the Presiding Judge, the Commission's general policy is to use original cost principles in establishing the cost of service upon which a pipeline's regulated rates are based.[54] This policy limits a pipeline to including no more than the facilities' depreciated original cost (alternatively, referred to as net book value) in rate

[54] Initial Decision, 137 FERC ¶ 63,014 at PP 98-103.

base.[55] Any amount paid to acquire facilities in excess of the facilities' depreciated original cost is recorded in Account 114, Gas Plant Acquisition Adjustments, and amounts recorded in this account and related amortizations are typically excluded from rates. Thus, a pipeline that purchases facilities for a price in excess of the net book value cannot typically recover the premium in excess of net book value through jurisdictional rates. The Commission has found that absent original cost accounting, "all that pipelines would have to do to raise rates and obtain greater income would be to buy utility properties from another at a price higher than original cost and in this very simple way increase the cost of service to customers."[56]

44. The Commission makes exceptions only when a pipeline can show that its acquisition of existing facilities at more than their net book value will result in substantial benefits to ratepayers. As set out in *Longhorn Partners Pipeline*,[57] the "substantial benefits" test requires a pipeline seeking rate base treatment for an acquisition premium to meet a two-prong test. First, the pipeline must show that the facilities will be converted from one public use to a different public use or that the assets will be placed in FERC-jurisdictional service for the first time. Second, the pipeline must show clear and convincing evidence that its acquisition of the facilities will provide substantial, quantifiable benefits to ratepayers even if the full purchase price, including the portion above depreciated original cost is included in rate base.

Public Service v. Gas Utility Service

45. The Commission's regulations define original cost when applied to gas plant as "the cost of such property to the person first devoting it to *public service*."[58] Also, the Commission's regulations direct a natural gas pipeline to record gas plant acquired as an operating unit "at the cost incurred by the person who first devoted the property to *utility service*."[59] A central dispute in this proceeding relates to when a facility is first devoted to "public service" or "utility service" under the Commission's rules and regulations.

46. Trial Staff argued that the gross original cost of the TMP facilities is appropriately based on Gateway's purchase price of $10,088,925 because these facilities had not previously been devoted to natural gas service at the time they were acquired by Gateway

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[55] *See, e.g., United Gas Pipe Line Co.*, 25 FPC 26, at 64 (1961).

[56] *Arkla Energy Resources*, 61 FERC ¶ 61,004, at 61,038 (1992).

[57] 73 FERC ¶ 61,355, at 61,112 (1995) (*Longhorn*).

[58] 18 C.F.R. Part 201, Definition No. 26 (2012) (emphasis added).

[59] 18 C.F.R. Part 201, Gas Plant Instruction 2A (2012) (emphasis added).

in 2002.[60] According to Trial Staff, the original cost determination is made when the pipeline facilities are first devoted to gas utility service and the TMP facilities were first used to provide natural gas service in 2003 by Missouri Interstate. On this basis, Trial Staff claims that there is no acquisition premium on MoGas's books and no substantial benefits test analysis is required.

47. During the hearing, MoGas agreed with Trial Staff's position that the TMP facilities' original cost is determined when the facilities are first placed into jurisdictional natural gas service.[61] Alternatively, assuming that the Commission determines that the $10,088,925 purchase price of the TMP facilities included an acquisition adjustment, MoGas maintains that the record demonstrates that it meets the substantial benefits test set forth in *Longhorn*.

48. MoPSC asserted that costs of the TMP facilities were in Amoco's regulated rate base prior to 1989, and the costs of these facilities were in MPC's rate base after 1989.[62] Therefore, MoPSC maintains that the TMP facilities were previously devoted to public service and MoGas should only be permitted to include the net book value of the TMP facilities in rate base. MoPSC also disagrees with MoGas's alternative claim that it meets the substantial benefits test set forth in *Longhorn*.

Initial Decision

49. The Presiding Judge found that "public service" is a very broad concept and includes many regulated enterprises including pipelines that are used to transport oil and gas.[63] He stated that the broad meaning of "public service" and "utility service" in the Commission's Uniform System of Accounts (USofA) are well settled citing *Montana Power Company v. FERC (Montana Power)*.[64] The Presiding Judge explained that in that case, Montana Power requested that it be permitted to include the full purchase price of a transmission line that it had acquired from a railroad in rate base because it was the first electric utility to own the transmission line. The court affirmed the Commission's ruling that required Montana Power to exclude all but the depreciated original cost of the

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[60] Initial Decision, 137 FERC ¶ 63,014 at P 169 (citing Exh. No. S-1 at 17).

[61] *Id.* P 162 (citing MoGas Initial Brief at 14).

[62] MoPSC Initial Brief at 31-35.

[63] Initial Decision, 137 FERC ¶ 63,014 at P 119.

[64] 599 F.2d 295, 298 (9th Cir. 1979) (*affirming Montana Power Co*., 1976 FPC LEXIS 1151, reh'g denied, 55 FPC 2960 (1976)).

transmission line from rate base because the electric line had been previously devote to public service. Applying these principles to the facts of this proceeding, the Presiding Judge found that the TMP facilities' purchase price in the UtiliCorp/Gateway transaction does not constitute a brand-new "original cost" for the TMP facilities as a converted gas pipeline.[65] Rather, the Presiding Judge found that it was first devoted to public service when it became an oil pipeline for Amoco in the 1940s under the regulation of the Interstate Commerce Commission followed in 1977 by FERC.

50. The Presiding Judge rejected Trial Staff's and MoGas's claim that it is proper to set a new "original cost" whenever an oil pipeline is converted to gas utility service without conducting a "substantial benefits" test.[66] He found that if this was the case then none of the Commission's past cases that consistently applied the *Longhorn* Rule whenever oil pipelines were converted to gas pipelines, like *Natural Gas Pipeline Co. of America*[67] and *Cities Service Gas Company*,[68] would have made any sense. He explained that if this position was correct then in each of those cases the "new gas use" would have engendered a brand new "original cost," obviating the need to do what those cases actually did, which was to apply the "substantial benefits" analysis to the acquisition premium that had been paid for the former oil pipeline. The Presiding Judge concluded that Staff's and MoGas's approach must be rejected because it misapplies the Commission's precedents in the same way that happened initially in this docket, evoking the D.C. Circuit's consternation.[69]

51. In addition, the Presiding Judge found that Commission precedent does not support the notion, that once an original cost is established, it disappears when there is a break in the plant's public or utility service.[70] He noted that in *B-R Pipeline Company* (*B-R Pipeline*) the Commission held that "[w]here facilities are already dedicated to jurisdictional gas service, an acquiring pipeline's use of those facilities in order to continue providing jurisdictional gas service does not constitute a new public service, regardless of whether the facilities were previously underutilized or idle."[71] Therefore,

[65] Initial Decision, 137 FERC ¶ 63,014 at P 182.

[66] *Id.* P 128.

[67] 29 FERC ¶ 61,073 (1984) (*Natural*).

[68] 4 FERC ¶ 61,268, at 61,596 (1978) (*Cities Service*).

[69] Initial Decision, 137 FERC ¶ 63,014 at P 128 (citing *Mo. PSC* at 582).

[70] *Id.* PP 124-125.

[71] *Id.* P 122 (citing *B-R Pipeline*, 106 FERC ¶ 61,166, at P 17 (2004)).

he found that although the TMP facilities were idled starting in 1989 and physically remained so until 2003, its public service status did not change by reason of the interruption of use.

52. Based on these findings, the Presiding Judge concluded that in order to include the purchase price that exceeds net book value in rate base, MoGas would have to meet the substantial benefits test as articulated in *Longhorn.*

<u>Brief on Exceptions and Briefs Opposing Exceptions</u>

53. MoGas and Trial Staff assert that attributing a new "original cost" to the TMP facilities based on their conversion to an interstate natural gas pipeline is consistent with Commission precedent.[72] Trial Staff disagrees with the Presiding Judge's analysis of Commission precedent and his conclusion that "[i]n every instance, an already publicly regulated pipeline being converted to a new use was allowed to include an acquisition premium in its rates only if 'substantial benefits' were found to exist in addition to the new use.[73] For example, Trial Staff states that in *Cities Service* and *Natural,* the Commission ruled that the conversion of oil pipeline facilities for use in providing natural gas service constitutes a new public use and the original cost determination is made when the pipeline facilities are first devoted to gas utility service. While recognizing that in both of these cases the Commission noted that it would cost significantly more to construct a gas pipeline, in Trial Staff's view, these generalizations "are not the same thing as a quantification of 'benefits' after a finding that an acquisition premium exists in order to recover the acquisition premium through rates."[74]

54. MoGas asserts that the Initial Decision's starting point, that the cost to the original owner dedicating the property to any public use must remain the original cost for ratemaking purposes, is contrary to numerous cases.[75] MoGas states that in *Delhi Gas Pipeline Corporation*[76] the Commission allowed the purchase price in rate base rather than the depreciated book value of the property but made no independent benefits calculation. MoGas also claims that in many other cases the Commission found the full acquisition cost to be the original cost for rate purposes because the existing facilities

[72] MoGas Brief on Exception at 33-34; Trial Staff Brief on Exceptions at 37-43.

[73] Trial Staff Brief on Exceptions at 41 (citing Initial Decision, 137 FERC ¶ 63,014 at P 126).

[74] *Id.* at 41-42.

[75] MoGas Brief on Exceptions at 33-35.

[76] 43 FERC ¶ 61,024 (1988) (*Delhi*).

were converted to natural gas service, even if they had been in public service as an oil pipeline in the past. MoGas states that in *Questar Southern Trails Pipeline Company* (*Questar*) the Commission permitted a gas pipeline to record its full acquisition cost of a former oil pipeline facility less net salvage in Account 101, explaining "[t]he Commission permits recording the acquisition cost of a converted oil pipeline in Account 101, where the acquisition cost is included in rate base and the facilities had not been previously devoted to gas utility service."[77] MoGas also claims that in C*ities* and *Natural,* the Commission permitted the pipeline to record the full acquisition price of a former oil pipeline facility as the original cost. MoGas claims that the Initial Decision does nothing to distinguish these and other case in which the Commission allowed the full acquisition costs in rate base for facilities devoted to a new use.

55. In addition, MoGas argues that the TMP facilities lost their original public service character once Amoco ceased operating them. MoGas concludes that under these facts it is unreasonable to conclude that the TMP facilities' original cost for rate making purposes must remain Amoco's depreciated original cost.

56. MoGas also requests that the Commission affirm its 2002 finding that the TMP facilities' cost at the time of the Gateway acquisition was $10,088,925.[78] MoGas points out that that no party appealed this finding and thus it became final and no longer subject to judicial review and investors relied upon the finality of that decision when Missouri Interstate, MPC, and MGC filed to consolidate in 2008.

57. MoGas asserts that the Presiding Judge erred by relying on *Montana Power* and *B-R Pipeline* because in those cases the use of the facility did not change.[79]

58. In its Brief Opposing Exceptions, MoPSC asserts that the Commission should find that the Presiding Judge appropriately found that a new use does not automatically trigger a new original cost based on the Commission's long-standing case law.[80] MoPSC also claims that MoGas's argument that the 2002 order precludes litigation of the acquisition adjustment issue in this proceeding is without support and should be rejected.[81]

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[77] MoGas Brief on Exceptions at 33-34 (citing *Questar Southern Trails Pipeline Co.*, 89 FERC ¶ 61,050, at 61,146-47 (1999) (*Questar*)).

[78] *Id.* at 28-29 (citing *Missouri Interstate Gas, LLC*, 100 FERC ¶ 61,312 at P 26).

[79] *Id.* at 35-39.

[80] MoPSC Brief Opposing Exceptions at 22-29.

[81] *Id.* at 31-36.

Commission Determination

59. We affirm the Presiding Judge's ruling that original cost is to the person first devoting a facility to public service, not gas utility service. Because the TMP facilities were first devoted to public service as an oil pipeline by Amoco in the 1940s, its conversion to a gas pipeline alone did not entitle it to a new original cost without meeting the benefits exception test.

60. MoGas's and Trial Staff's claim that the Presiding Judge's finding is inconsistent with Commission precedent is unpersuasive. As the Presiding Judge correctly found, the cited cases do not establish a new original cost based on the purchase price of an asset solely because the facilities were converted to gas service for the first time. Rather, these cases apply the two part test set forth in *Longhorn*, including the requirement to show specific benefits to ratepayers. For example, in *Cities*, the Commission found:

> This Commission generally has a strong policy against approving the inclusion of a facility in the rate base at more than its depreciated original cost. But that policy is not inflexible. Where the transfer at a price above book value benefits consumers, it is sometimes appropriate to permit the entire purchase price to go into the rate base. Here the depreciated book value is approximately $3 million as against a purchase price of $18.5 million. But the record shows that it would cost over $40 million to construct a new gas pipeline. (footnote omitted).[82]

In a subsequent proceeding, the Commission explained its ruling in *Cities* in a parenthetical as follows: "Commission approved inclusion of full purchase price in rate base because gas consumers would be benefited by Cities Services' converting 473-mile crude oil pipeline purchased at more than net book value, rather than constructing new gas pipeline at significantly greater cost."[83]

61. A benefits calculation was performed in other cases cited by MoGas and Trial Staff. In *Natural*, the Commission found that "…though the purchase price exceeds net original cost, the replacement cost exceeds the purchase price."[84] Similarly, in *Questar*, the Commission noted that "the purchase price is substantially less than the cost to

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[82] 4 FERC at 61,596.

[83] *B-R Pipeline*, 102 FERC ¶ 61,166, at n.22 (2004).

[84] *Natural*, 29 FERC at 61,150.

construct a new line."[85] The one cited case where the Commission did not specifically discuss a benefits calculation was *Delhi*. But in that case, the Commission cited to its decisions in *Cities* and *Natural*[86] and there is no language in the order to suggest that the Commission intended to change or overturn its prior precedent on this issue. Moreover, a benefits determination was applied in subsequent cases where the Commission approved rate base treatment for a pipeline converted from oil to gas use. For example, in *Crossroads Pipeline Company*, the Commission found:

> Ordinarily, the Commission does not approve the inclusion of a facility in the rate base at more than its depreciated original cost, unless the pipeline can show that the ratepayers will realize benefits commensurate with the acquisition costs that exceed the depreciated original costs. In the instant case, we conclude that the costs associated with the acquisition of the pipeline, $16 million, along with the $6.4 million in new construction costs, will be considerably less than the costs associated with constructing a new 201-mile, 20-inch diameter pipeline. Thus, Crossroads' ratepayers will receive commensurate benefits from the acquisition of the oil pipeline. Accordingly, we will approve the inclusion of the $16 million acquisition costs in the rate base. (footnote omitted). [87]

62. We also disagree with MoGas's claim that the Presiding Judge's reliance on *Montana Power* was misplaced. In that proceeding, Montana Power, a public utility had purchased an electric transmission line from a regulated railroad. The court upheld the Commission's determination that the electric line was first devoted to public service when it was owned and operated by the regulated railroad, not when it was placed in service by the power utility. In so doing, the Commission rejected Montana Power's argument that the purchase price was the original cost because it was the first power utility to place the facilities in service. The Presiding Judge correctly relied on *Montana Power* to reject MoGas's and Trial Staff's similar argument here, that the TMP facilities were first devoted to public service when it was placed in service by the gas company.

63. We also reject MoGas's claim that the TMP facilities' idle period and interruption in use changed their public service status. MoGas's position is at odds with our

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[85] *Questar*, 89 FERC at 61,146-147.

[86] *Delhi*, 43 FERC at 61,068.

[87] 71 FERC ¶ 61,076, at 61,262-263 (1995) (*Crossroads*).

regulations that define original cost as "the cost of such property to the person first devoting it to public service." We also disagree with MoGas's assertion that the Presiding Judge's reliance on our decision in *B-R Pipeline* was misplaced. While MoGas is correct that in *B-R Pipeline* the pipeline did not propose to change the use of the gas pipeline it purchased from one utility service to another, the order's holding that the underutilization or idling of a pipeline does not end a facilities' public service status is equally applicable here.

64. Finally, we reject MoGas's request that the Commission merely affirm its 2002 finding that the TMP facilities' cost at the time of the Gateway acquisition was $10,088,925. The purpose of the hearing in this proceeding is to develop a record on the contested issue to allow the Commission to make a substantive ruling on this issue. The Commission's finding on this issue will be effective on June 1, 2008, the date MoGas commenced jurisdictional service, consistent with the requirements of section 7 of the NGA.

C. What was the Purchase Price of the TMP Facilities and Does it Include an Acquisition Adjustment?

65. In 2001, MoGas's predecessor, Gateway, purchased the TMP facilities from UtiliCorp. MoGas represents that the purchase price for the TMP facilities was $10,088,925 which the Commission permitted in Missouri Interstate's rate base for purposes of establishing initial rates. MoGas states that the $10,088,925 purchase price included $1,133,587 attributable to the original cost basis of the former oil pipeline and $8,955,068 attributable to the excess amount paid by UtiliCorp to Edisto for the non-regulated TMP facilities in the Omega System Agreement in 1995.[88]

66. On the other hand, MoPSC asserts that the purchase price of $10,088,925 in the Stock Purchase Agreement was for only 1.2 miles of the TMP.[89] MoPSC agrees that an acquisition premium was included in the 1995 transaction between UtiliCorp and Edisto but contends the premium was not paid for the TMP facilities. MoPSC puts forth several versions of the cost basis of the TMP facilities.[90]

Acquisition Adjustment in the Edisto/UtiliCorp Transaction

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[88] Exh. No. MGP-1 at 10.

[89] MoPSC Initial Brief at 53-54.

[90] *Id.* at 24-27.

67. As explained infra, Edisto negotiated a sale of MPC, MGC, and the TMP facilities to UtiliCorp in two separate transactions that were dated February 14, 1994, and closed simultaneously in January 1995. In the Missouri System Agreement, Edisto sold the Missouri-regulated assets, MPC and MGC, to UtiliCorp for $55.4 million, as adjusted at closing.[91] The second transaction, the Omega System Agreement, concerned assets not regulated by Missouri consisting of the TMP facilities and Omega Pipeline. UtiliCorp purchased Omega Pipeline and the TMP facilities in this transaction for approximately $22 million.[92] The agreement did not break out the price between the two facilities.

68. According to discovery responses between a MoPSC official and Mr. Williams, a UtiliCorp employee, that were exchanged during a MoPSC proceeding in 2001 regarding the UtiliCorp/Gateway transaction, the assets purchased under the Omega System Agreement were valued individually as follows:

> These included the Omega Pipeline (serving Fort Leonard Wood) which was acquired at an approximate cost of $8.7 million and the Trans-Mississippi Pipeline (TMP), an interstate pipeline not in operation at the time of purchase. These latter facilities were acquired at an approximate cost of $12.6 million, including an approximate $10.6 million acquisition premium.
>
> On December 31, 1995 a journal entry was made [by UtiliCorp] on the books of MPC and MGC which allocated and transferred the aforementioned acquisition premium to these two entities. It is not entirely clear why this entry was made; however, it should be noted that this adjustment was made for book and reporting purposes only. Tariffs were established without consideration being given to any acquisition premium and no subsequent changes in rates have occurred which would reflect any premium consideration.[93]

69. Paragraph 9.1 of the Omega System Agreement contained an option clause for UtiliCorp to exercise in its sole discretion. It provided that, upon notice to Edisto, UtiliCorp could exclude the TMP facilities from the assets being acquired under the Agreement and "reduce the Cash Closing Payment by $2.4 million."[94]

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[91] Exh. Nos. MGP-1 at 7; MGP-3 at 17.

[92] Exh. Nos. MGP-1 at 7; MGP-3 at 16.

[93] Exh. No. MGP-4 at 1-2.

[94] Exh. Nos. MGP-45 at 74; PSC-44.

Initial Decision

70. The Presiding Judge found that UtiliCorp paid an acquisition premium for the Omega Pipeline system.[95] He found that there is no credible record evidence to show that the acquisition adjustment was attributable to the TMP facilities. First, the Presiding Judge asserts that the statement above from Mr. Williams does not clearly relate the acquisition premium to the TMP facilities because "these latter facilities" can be read as pointing to the Omega System, the TMP facilities, or both assets together.[96] Further, the Presiding Judge finds that his statement is discredited by words appearing only two sentences later in the statement, to the effect that it is "not entirely clear" why the acquisition premium ended up on the books of MPC and MGC at all after the 1995 Edisto/UtiliCorp transaction.[97]

71. Second, the Presiding Judge found that Mr. Williams' purported explanation fails to square with the option clause in Paragraph 9.1 that valued the TMP facilities at only $2.4 million. The Initial Decision stated:

> If the Omega System Agreement's TMP option in Paragraph 9.1 valued the TMP assets at only $2.4 million, why would the same Agreement further charge UtiliCorp an additional $10.6 million as an "acquisition premium" *just* for the TMP? There is no evidence that Edisto would have forgiven UtiliCorp from paying the acquisition premium as well as reducing the total price by $2.4 million if UtiliCorp had decided to forego acquiring the TMP. Why would UtiliCorp pay Edisto a net cost of $8.2 million (*i.e.*, $10.6 million - $2.4 million = $8.2 million), essentially for *nothing*, if UtiliCorp decided not to acquire the TMP?[98]

But the Initial Decision concluded with the statement that:

> No party has pointed to any rule of law or accounting that requires a utility to allocate an acquisition adjustment in any particular way among the subsidiaries of a company whose assets are bought through a stock purchase. Thus, even though the facts demonstrate that the $10.6 million acquisition premium was not attributable to the TMP, and was in fact attributable to the unregulated Omega system rather than to the regulated

[95] Initial Decision, 137 FERC ¶ 63,014 at PP 139-144.

[96] *Id.* P 140.

[97] *Id*.

[98] *Id.* P 141.

> MPC system, there is no reason to call into question either UtiliCorp's 1995 allocation of that premium to MPC and MGC, or UtiliCorp's 2001 allocation of that premium to the TMP, other than in connection with whether the transaction was at arm's-length, as discussed later herein.[99]

Briefs on and Opposing Exceptions

72. MoGas asserts that the Initial Decision ignored substantial evidence and misinterpreted other evidence to conclude that there was an acquisition premium paid for Omega Pipeline, not the TMP facilities.[100] MoGas claims that the record contains several UtiliCorp statements, including statements procured by MoPSC, demonstrating that: (1) UtiliCorp paid an acquisition premium for the TMP Facilities when it acquired them from Edisto; (2) UtiliCorp transferred that premium amount to Account 114 on the books of MPC and MGC during its ownership to earn federal income tax depreciation; and (3) UtiliCorp transferred the dollars back to the books of the TMP facilities' holding company prior to the sale.

73. MoGas maintains that the Presiding Judge misinterpreted the response by Mr. Williams by finding that the reference to "these latter Facilities" can be read to pointing to either the Omega system, the TMP facilities, or both assets together.[101] MoGas asserts that the Presiding Judge's interpretation contravenes the data response's plain meaning and belies basic sentence construction. MoGas explains that the document assigned a specific cost, $8.7 million, to the acquisition of Omega Pipeline and in the same sentence mentioned the TMP facilities but without a dollar value mentioned. Because the next sentence states that the "latter facilities were acquired" for $12.6 million with a $10.6 million acquisition premium, MoGas submits that the statement can only be referring to the TMP facilities because the TMP is the last named of two or more mentioned or understood things.

74. Additionally, MoGas asserts that the sworn testimony of UtiliCorp Vice President Richard Kruel given before the MoPSC in 2001, which formed the basis of the D.C. Circuit's remand, contradicts the Presiding Judge's interpretation and corroborates MoGas's position. That testimony reads as follows:

> Q. Contained in these book values are there any acquisition premiums on the books of UPL or its subsidiaries related to the purchase of these assets by

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[99] *Id.* P 202.

[100] MoGas Brief on Exceptions at 49-52.

[101] *Id.* at 50-51.

UtiliCorp?

A. There is no premium on Missouri Pipeline and Missouri Gas. There is a premium on UtiliCorp bought – I'm sorry. UtiliCorp bought TransMississippi back in '95 and there was a premium in it. Those are all non-regulated pieces of pipe. [102]

Commission Determination

75. We find that the Presiding Judge's ruling that the $10.6 million acquisition premium was not associated with the TMP facilities but with Omega Pipeline is not supported by the record. First, we find that the Presiding Judge misreads the data response from Mr. Williams. In the data response, Mr. Williams describes the facilities that were acquired by UtiliCorp in the Omega Agreement and states "[t]hese included the Omega Pipeline (serving Fort Leonard Wood) which was acquired at an approximate cost of $8.7 million and the Trans-Mississippi Pipeline (TMP), an interstate pipeline not in operation at the time of purchase." In the following sentence he states "[t]hese latter facilities were acquired at an approximate cost of $12.6 million, including an approximate $10.6 million acquisition premium."[103] Since "latter" is defined as "[d]esignating the second of two persons or thing mentioned,"[104] the words "these latter facilities" clearly refer to the TMP facilities, the second of two pipelines mentioned.

76. Second, we do not agree with the Presiding Judge's finding that Mr. Williams' statement attributing the acquisition premium to the TMP facilities is discredited by his later statement regarding the subsequent transfer of the acquisition premium to MGC and MPC. The two statements involve different issues and we find there is no inconsistency between the two statements. In addition, the Presiding Judge's finding ignores the testimony of UtiliCorp Vice President Mr. Kruel that explained "UtiliCorp bought Trans-Mississippi back in '95 and there was a premium in it"[105] which corroborates Mr. Williams' position.

77. Third, we find that the Presiding Judge's determination that the option clause in paragraph 9.1 of the Stock Purchase Agreement cannot be squared with Mr. Williams' position that the purchase price of the TMP facilities includes a $10.6 million acquisition adjustment is not supported by the record. The Presiding Judge's finding is predicated on

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[102] *Id.* at 51 (citing Exh. No. PSC-4 at 2).

[103] Exh. No. MGP-4 at 1-2.

[104] *American Heritage Dictionary* at 741 (New College Edition).

[105] Exh. No. PSC-4 at 2.

the assumption that the $2.4 million figure in paragraph 9.1 represents the fair market value of the TMP facilities. However, paragraph 9.1 does not refer to fair market value or otherwise describe the meaning of the $2.4 million amount. Moreover, the Presiding Judge does not cite to any record evidence to support his interpretation of the $2.4 million amount and does not address an alternative explanation put forth by MoGas Witness Mr. Ries. Mr. Reis testified that it is far more likely that the $2.4 million discussed in paragraph 9.1 refers to the TMP facilities salvage value if the facilities were incapable of providing natural gas service.[106] Mr. Reis explained that before the Edisto/UtiliCorp transaction closed in January 1995, UtiliCorp had obtained the results of pre-closing integrity test to support a finding that the TMP facilities could be used for natural gas service. Under this interpretation, there is no apparent conflict between a purchase price for the TMP facilities that are capable of providing natural gas service that is more than the salvage value of the asset. Given the state of the record, we find that the Presiding Judge's interpretation of the option clause in such a way as to create an inconsistency between the option clause and the sworn statements of the two UtiliCorp representatives regarding the purchase price of the TMP facilities in the Omega System Agreement is not reasonable.

78. Finally, the Presiding Judge's finding that a purchaser of an asset can allocate the purchase price in any manner it chooses is not entirely correct. As explained by the Staff witness in this proceeding, if a group of assets are purchased together there are a number of reasonable ways to allocate the purchase price, including a cost per mile allocation or a fair market value approach.[107] In addition, under the USofA, an acquisition premium must be reflected on the books of the entity that holds title to the asset to which the acquisition premium relates. An acquisition premium cannot be transferred between affiliates unless the underlying asset itself is transferred. Therefore, if the Initial Decision was correct that the acquisition adjustment in the Omega System Agreement was attributable to Omega Pipeline, it would not be appropriate to allocate these dollars to the TMP facilities and there would be no need to address the substantial benefits test in this proceeding.

Purchase Price of the TMP facilities in the UtiliCorp/Gateway Transaction

79. As explained above, on February 1, 2001, UtiliCorp entered into a Stock Purchase Agreement to sell all of the shares of UtiliCorp Pipeline to Gateway at a share price equal to the "net book value of the property, plant and equipment of the Company and its Subsidiaries (other than Omega Pipeline Company) as of the Closing Date as determined

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[106] Exh. No. MGP-21 at 15-16.

[107] Exh. No. S-9 at 6.

in accordance with GAAP . . ..”[108] The Stock Purchase Agreement allocated the purchase price as follows: (i) $32.7 million was attributed to the assets of MPC; (ii) $20.4 million was attributed to the assets of MGC; and (iii) $10.3 million was attributed to “the Company” (referencing UtiliCorp Pipeline).[109] At closing, the amount of the purchase price attributable to the Company was $10,088,925.[110]

Initial Decision

80. The Presiding Judge ruled that “the $10,088,925 figure identified by all of the parties in this proceeding as the ‘purchase price for the TMP’ in the UtiliCorp/Gateway transaction was, in reality, the purchase price for *only the 1.2-mile portion of the TMP* that tunnels under the Mississippi River (give or take a few dollars).”[111] He found that the purchase price for the 4.4-mile segment of the TMP facilities is not included in this purchase price at all. The Presiding Judge’s finding is based on the fact that the $1,133,857 amount[112] that was placed in Account 105 on the books of MPC in 1998 remains on the books of MPC and the unamortized amount is included in the purchase price of MPC. The Presiding Judge also found that the $10,627,810 total of the MPC and MGC acquisition adjustments that were transferred to the TMP in the UtiliCorp/Gateway transaction was attributed in that transaction entirely to the 1.2-mile portion of the TMP facilities, not at all to the 4.4-mile portion.[113] The Presiding Judge concludes that the purchase price for the 5.6 miles of the TMP facilities in the Stock Purchase Agreement, at closing, was $11,172,979.89, with $10,088,343.71 attributable to the 1.2 mile segment, and $1,084,636.18 attributable to the 4.4 mile segment.

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[108] Exh. No. MGP-9 at 1.

[109] *Id.* at 5-6.

[110] Exh. No. MGP-1 at 10.

[111] Initial Decision, 137 FERC ¶ 63,014 at P 159.

[112] The Presiding Judge determines that this amount is associated with approximately 4.4 miles (23,338 linear feet) of the 5.6 mile TMP pipeline that is located in St. Charles County, Missouri, running east along the Mississippi River bank before turning north to cross the river into Illinois. Initial Decision, 137 FERC ¶ 63,014 at P 68.

[113] Initial Decision, 137 FERC ¶ 63,014 at P 159.

81. The following table reflects the Presiding Judge's calculations:

Item	**Accumulated Cost**	**Allocated Reserve**	**Net Book Value for Asset**
4.4-mile segment of TMP:	$1,133,857.09	($49,220.91)	$1,084,636.18
1.2-mile segment of TMP:			
-- Tangible TMP Assets:	$1,432,913.80	($69,219.09)	$1,363,694.71
-- Intangible TMP Asset:	$10,627,810.00	($1,903,161.00)	$8,724,649.00
Total for 1.2-mile segment:	$12,060,723.80	($1,972,380.09)	**$10,088,343.71**
5.6-mile total of TMP:	**$13,194,580.89**	**($2,021,601.00)**	**$11,172,979.89**

<u>Briefs on and Opposing Exceptions</u>

82. MoGas asserts that the Presiding Judge's finding that Gateway acquired the TMP facilities in two segments, a 1.2 mile segment and a 4.4 mile segment, is not supported by record evidence.[114] MoGas emphasizes that the parties to the Stock Purchase Agreement made an Internal Revenue Code section 338(h)(10) election and allocated the purchase price among the assets as set forth in the Stock Purchase Agreement's Schedule 5.2 as follows: $32.7 million allocated for MPC; $20.4 million for MGC; and the remaining $10.3 million allocated to the "Company." According to MoGas, the Company consisted of assets held directly by UtiliCorp Pipeline at the time which was not a part of MPC and MGC.

83. MoGas argues that on the contract's face the parties clearly allocated the $10.3 million to the unutilized facilities described as the TMP facilities, which were not in either MPC's or MGC's rate base. MoGas also faults the Presiding Judge for relying on Form 2s that MPC and MGC filed with the MoPSC between 1989 and 2001 to trace dollars spent on the TMP facilities, even though the Presiding Judge recognized that "this chronology . . . of accounting events" is "incomplete."[115] Additionally, MoGas asserts

[114] MoGas Brief on Exceptions at 43-49.

[115] *Id.* at 52.

that the Presiding Judge's finding also ignores the sworn testimony of the parties who negotiated the agreement, each of whom testified that "The Company" referenced all 5.6 miles of the TMP facilities.[116]

84. In its Brief Opposing Exceptions, MoPSC asserts that MoGas's argument that the Initial Decision made an arbitrary and capricious finding as to what facilities were actually transferred is incongruous given the significant ambiguity concerning the UtiliCorp sale, as well as MoGas's own assertion that the accounting records are incomplete.[117]

Commission Determination

85. We find that the record supports a finding that all 5.6 miles of the TMP facilities were held by UtiliCorp Pipeline (referenced in the agreement as the Company) at the time the Stock Purchase Agreement became effective. Thus, we find that the estimated purchase price for the TMP facilities in the Stock Purchase Agreement was $10.3 million, and the final purchase price for the TMP facilities at closing was $10,088,925.

86. The Stock Purchase Agreement states "TransMississippi Pipeline Company ('TMP') was merged with and into the Company as of June 30, 1999."[118] To the extent there is any ambiguity as to whether all 5.6 miles or some portion of the TMP was held by UtiliCorp Pipeline, the principles that negotiated the Stock Purchase Agreement both agreed that the 5.6 miles of the TMP facilities were held by UtiliCorp Pipeline and purchased for an estimated price of $10.3 million, or $10,088,925, at closing. In this proceeding, Mr. Ries testified that at the time of the transaction, the assets were MPC, MGC, and "5.6 miles of deactivated oil pipeline that went underneath the Mississippi River into Illinois."[119] Mr. Reis specifically states that "UtiliCorp had transferred TMP's assets to [UtiliCorp Pipeline's] direct ownership prior to the transaction closing,[120] and

[116] *Id.* at 44-45 (citing Exh. Nos. MGP-1 at 2, 10; PSC-4.)

[117] MoPSC Brief Opposing Exceptions at 18.

[118] Exh. No. MGP-9 at 16. A copy of the Certificate of Ownership and Merger that was filed with the State of Delaware certifying the merger of TransMississippi Pipeline Company with and into UtiliCorp Pipeline (referenced in the agreement as "the Company) effective June 30, 1999 is included as an attachment to the Stock Purchase Agreement.

[119] Exh. No. MGP-1 at 2.

[120] *Id.*

Gateway paid $10,088,925 for the TMP facilities.[121] UtiliCorp Vice President Mr. Kruel testified before the MoPSC in 2001 that the net book value of the TMP facilities "would be underneath the company, which is 10.3 million" and explained that the TMP facilities consist of six miles of pipe not currently in use.[122] In addition, the parties agreed to transfer the $10.6 million acquisition adjustment, which we find is attributable to all 5.6 miles of the TMP facilities, to the books of UtiliCorp Pipeline, further indicating that all 5.6 miles of pipeline was held by UtiliCorp Pipeline. We also note that seller's opinion of counsel letters attached to the Stock Purchase Agreement state that "[UtiliCorp Pipeline] owns a dormant interstate transmission pipeline running under the Mississippi River." [123]

87. The Presiding Judge's finding that the Company held only 1.2 miles of the TMP facilities does not address the record as a whole. Rather, it appears to be based entirely on the fact that in Schedule 5.2 of the Stock Purchase Agreement the amount of $1,133,857.09 that was allegedly attributable to the TMP facilities but transferred to the books of MPC in 1998 are still on the books of MPC, and the unamortized amount is included in the purchase price of MPC. While this fact raises an accounting issue as to whether these dollars were appropriately booked to MPC in the Stock Purchase Agreement, it does not establish that MPC owned 4.4 miles of the TMP facilities in light of the other record evidence discussed above. Moreover, it is not clear from the record whether or not these amounts are attributable to the TMP facilities. In fact, the Presiding Judge found that the $1,133,857.09 does not reflect the true value of the TMP facilities and he discredited Mr. Ries' testimony that these amounts constituted "improvements" that were made to the TMP facilities before the UtiliCorp/Gateway transaction.[124] Under these circumstances, we find that the Presiding Judge's finding that MPC held 4.4 miles of the TMP facilities is without support.[125]

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[121] *Id.* at 10.

[122] *See* MoPSC Request for Rehearing/Clarification in Docket No. CP06-407, et al., (May 21, 2007), Attachment 2 at 6 (Transcript of Proceedings, Testimony of Richard Kruel before MoPSC, Sept. 5, 2001); Exh. No. PSC-4 at 1.

[123] Exh. No. MGP-9 at 443, 445.

[124] Initial Decision, 137 FERC ¶ 63,014 at PP 147, 151.

[125] Since MoGas does not claim that the unamortized portion of the $1,133,857.09 amount was part of the purchase price for the TMP facilities, we find there is no need to address the accounting issue of whether this amount was properly booked to MPC in this proceeding.

Net Book Cost of TMP Facilities

88. There is substantial dispute among the parties regarding the net book value of the TMP facilities. Since we find that MoGas can continue to include the full purchase price of the TMP facilities in rate base because the record supports a finding that the acquisition will result in substantial benefits to ratepayers, we find there is no need to address this issue.

1. Application of the Substantial Benefits Test

89. The Presiding Judge found that the Commission makes an exception to the net book value restriction only when a pipeline can show that its acquisition of facilities at more than their net book value will result in substantial benefits to ratepayers. The Initial Decision stated that the Commission's own precedent sets forth a two-pronged, conjunctive test for the exception to apply: (i) conversion to a new use, and (ii) substantial, quantifiable benefits to ratepayers.[126] The Initial Decision stated that, according to the court in *Mo PSC* , the substantial benefits test:

> takes into account (1) whether the acquired facility is being put to a new use [citations omitted]; and (2) whether "the purchaser has demonstrated specific dollar benefits resulting directly from the sale."[citation omitted] FERC has also considered (3) whether the transaction at issue is an "arms length" sale between unaffiliated parties [citation omitted]; and (4) whether the purchase price of the asset at issue is less than the cost of constructing a comparable facility [citation omitted].[127]

90. The Presiding Judge concluded that the "substantial, quantifiable benefits" prong may be demonstrated by one or more disjunctive factors, including: (a) whether the transaction at issue is an "arm's-length" sale between unaffiliated parties; *or* (b) whether the purchase price of the acquired facility is less than the cost of constructing a comparable facility.[128]

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[126] Initial Decision, 137 FERC ¶ 63,014 at P 112 (citing *Longhorn*, 73 FERC at 61,112).

[127] *Id.* P 108 (citing *Mo PSC* at 586).

[128] *Id.* P 113.

a. The First *Longhorn* Prong: Whether MoGas Has Demonstrated That the TMP Is Being Put to a New Use

91. MoGas and Trial Staff contend that in 2001, the Commission authorized Missouri Interstate to acquire the abandoned TMP oil pipeline and to operate and place it into natural gas service for the first time.[129] According to MoGas, the TMP facilities were physically converted to natural gas service in 2003.[130]

92. MoPSC responds that although the TMP facilities were physically separated from MPC and was not in natural gas service in a physical sense, it was booked as part of MPC's rate base.[131] MoPSC considers Edisto's acquisition of the TMP facilities in 1989 to have been part of the overall purchase of the entire Amoco pipeline system, all of which was effectively converted to natural gas service in 1989.[132] In the alternative, MoPSC contends that UtiliCorp effectively converted the TMP facilities to natural gas service earlier than 2003 by having considered placing that natural gas pipeline in interstate service in 1997, even though UtiliCorp never filed a certificate application with the Commission to certificate the TMP facilities.

Initial Decision

93. Based on the record, the Presiding Judge found that MoGas had satisfied its burden of proving the first prong of the "substantial benefits tests" by showing that the TMP facilities are being put to a new use. The Presiding Judge found that it is undisputed that the Commission did not issue a section 7 certificate authorizing interstate natural gas service until September 24, 2002 and that the TMP facilities were first placed physically into natural gas service thereafter in 2003.[133] The Presiding Judge dismissed MoPSC's various arguments that the TMP facilities were either placed in natural gas service prior to 2003 or that costs attributable to the TMP facilities were included in the rates of MPC and recovered from Missouri intrastate customers.

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[129] *Id.* P 231 (citing MoGas Initial Brief at 9; Staff Initial Brief at 11-12).

[130] *Id.* (citing Exh. No. MGP-14).

[131] *Id.* P 232 (citing Exh. No. PSC-1 at 21).

[132] *Id.* (citing MoPSC Initial Brief at 40-41).

[133] *Id.* P 234.

94. But the Initial Decision concluded this discussion stating:

> At the present time, MoGas is inheriting an existing TMP gas pipeline from [Missouri Interstate], which is not in and of itself a "new use" of the pipeline. However, the use of the TMP to transport gas *out of* Missouri as well as *into* Missouri is the service of a new market, which is itself a "new use" for the pipeline under the Commission's precedents. Thus, regardless of what [Missouri Interstate] did to change the use of the TMP from oil to gas in the past, MoGas' use of the TMP to service markets outside of Missouri as well as inside Missouri since the merger took place suffices by itself to satisfy the "new use" requirement of the "substantial benefits" test. (footnote omitted).[134]

<u>Commission Determination</u>

95. No party filed exceptions to the Presiding Judge's finding that MoGas demonstrated that it met the first prong of the *Longhorn* test, the new use prong. The Commission summarily affirms the Presiding Judge's finding that the conversion of the TMP facilities from oil to gas met the new use requirement of the substantial benefits test. But we find there is no need to consider, and thus will not rule on, the Presiding Judge's alternate finding that the use of the TMP facilities to transport gas out of Missouri as well as into Missouri is itself a new use for the pipeline under the Commission's precedents.

b. <u>The Second *Longhorn* Prong: Whether MoGas has Demonstrated Specific Dollar Benefits Resulting Directly From the Purchase</u>

96. MoGas asserts that it meets the substantial benefits test because (1) the purchase price of the TMP facilities was less than the cost to construct comparable facilities; and (2) the provision of interstate service provided direct benefits including lower rates, capacity release revenues, and flexible receipt and delivery points. MoGas also claims that the transaction was an arms-length transaction.

i. <u>Whether the Purchase Price is Less than the Cost of Constructing a Comparable Facility</u>

97. MoGas contends that in 2002 the estimated cost to replace 5.6 miles of the TMP was $13,901,425.[135] By electing to purchase the TMP for $10,088,925, MoGas asserts

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[134] *Id.* P 246.

[135] *Id.* P 306 (citing Exh. No. MGP-10 at 7-8).

that it saved ratepayers an amount equivalent to a $573,751 reduction in Missouri Interstate's cost of service.[136]

98. In contrast, MoPSC argues that the construction estimate should be based on the 1.2 mile portion of the TMP that crosses the Mississippi River.[137] MoPSC contends that at the time of the UtiliCorp/Gateway transaction, only 1.2 miles of the Mississippi River Crossing remained on the books of TMP/MIG; MPC accounted for the remaining 4.4 miles.

Initial Decision

99. The Presiding Judge agreed with MoPSC that the construction estimate should be based solely on the 1.2 mile segment of the TMP that crosses under the Mississippi River (hereinafter "Mississippi River Crossing").[138] According to Schedule 5.2 of the Stock Purchase Agreement, the Presiding Judge found, the parties attributed the entire acquisition premium solely to the 1.2-mile Mississippi River Crossing and none of it was attributed to the 4.4 miles of pipeline "held for future use" on the books of MPC.

100. The Presiding Judge then made a rough allocation of MoGas's construction estimate to identify the proportional amount of costs associated with 1.2 miles of a newly-built pipeline. Specifically, he applied a ratio of 1.2 miles to the full 5.6 miles of the TMP, and derived an estimated construction cost of $2,919,299 for the 1.2 mile segment.[139] To satisfy a claim of substantial benefit under the construction comparison factor, the Presiding Judge found that MoGas must show that the cost to construct the 1.2-mile portion of the TMP is considerably more than the acquisition premium. On this basis, he found the cost to construct the 1.2-mile portion of the TMP is far less than the premium of $10,088,925, rendering the purchase as a non-beneficial transaction for the ratepayers.

101. Alternatively, the Presiding Judge concluded that even if 5.6 miles of the pipeline was the correct scope of the estimate, a variance of approximately $2.7 million between a construction cost of $13.9 million and a purchase price of approximately $11.1 million, does not support MoGas's request to include the acquisition premium in rates.[140] He

[136] *Id.* (citing Exh. No. MGP-14 at 32-33).

[137] *Id.* (citing Exh. No. MoPSC Initial Brief at 53-54).

[138] *Id.* PP 307-311.

[139] Based on the calculation that 1.2 miles is 21 percent of 5.6 miles, and $2,919,299 is 21 percent of $13,901,425.

[140] Initial Decision, 137 FERC ¶ 63,014 at P 312.

found that the facts in this proceeding are similar to those in *KN Wattenberg*,[141] where the Commission held that the cost associated with purchasing a pipeline did not provide a substantial benefit to ratepayers because the estimated construction costs for the pipeline was only 39 percent higher than the purchase price. The Presiding Judge also noted that in *KN Wattenberg* the Commission reasoned that the ratepayers may be better served to have a new pipeline than to save $860,000 to use a pipeline that was 25 years old. The Initial Decision stated:

> The TMP pipeline was built in the 1940s. Thus, in 2002 it was about 50 years old. Ignoring the deficiencies of MoGas' construction estimate (discussed later herein), the variance between the estimate and the purchase price is $2,728,445, which slashes Lovinger's estimated cost of service savings of by almost half.
>
> Further, since in 2002, [Missouri Interstate's] rates were already discounted by 50 percent, customers were neither willing nor required to pay rates consistent with the stated cost of service. Thus, Lovinger's proposed savings are irrelevant. As noted in *Crossroads*, the ratepayer's investment is justified if the construction price is exorbitant in comparison to the purchase price. Here, the comparison does not even come close to the "substantial" difference that justifies allowing the acquisition premium. (footnotes omitted).[142]

102. The Presiding Judge rejected MoPSC's contention that MoGas's construction cost estimate lacked credibility because it was not performed in 2002 and that the construction cost estimate should be based on an alternative report that was performed in 2002.[143] The Presiding Judge found that MoGas did not adequately address MoPSC's claim that the estimate of $2.4 million for standard equipment mats appeared to be unreasonably high.[144]

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[141] 85 FERC ¶ 61,204 (1998).

[142] Initial Decision, 137 FERC ¶ 63,014 at PP 312, 313.

[143] *Id.* P 317.

[144] *Id.* P 315.

Briefs on Exceptions and Briefs Opposing Exceptions

103. MoGas asserts that it meets the second prong of the *Longhorn* test because it would have cost Gateway $13,901,425 to build new pipeline facilities in 2002 that were comparable in size, scope, and location of the TMP facilities which extend from West Alton, Missouri to Wood River, Illinois.[145] MoGas claims that this amount was $3,812,500, or approximately 38 percent higher than the $10,088,925 purchase price paid to UtiliCorp that the Commission permitted in Missouri Interstate's rate base.

104. MoGas claims that MoPSC was the only party who offered any testimony addressing MoGas-Witness Skidmore's construction cost analysis and only challenged the estimate of $2.4 million for standard equipment mats as being unreasonably high. MoGas asserts that MoPSC Witness Fisher has no experience in pipeline construction and her assertions were not supported by any evidence.

105. MoGas maintains that the Presiding Judge erroneously relied upon *KN Wattenberg* to find that the approximately $4 million difference between the cost estimate and Gateway's acquisition price was not enough to be a substantial benefit. MoGas asserts that *KN Wattenberg* is inapposite. MoGas argues in that case the Commission denied the acquisition premium based on two factors, an affiliate relationship between the buyer and seller and the very limited nature of the conversion, from a wet gas to a dry gas facility. MoGas also notes the Commission explained that for 20 of the past 25 years, costs of the wet gas facilities had been recovered through interstate transportation rates. MoGas claims this case is distinguishable because the TMP facilities were an oil pipeline converted to natural gas use and no natural gas customers had ever paid for the TMP facilities' depreciation.[146]

106. Even if *KN Wattenberg* was applicable, MoGas claims that the Presiding Judge incorrectly found that $10,088,925 was paid to acquire 1.2 miles instead of 5.6 miles of the TMP facilities. MoGas also claims that the Presiding Judge was incorrect in finding that the cost of service benefit of $573,751 accrued to Missouri Interstate ratepayers, not the integrated MoGas system.[147]

107. Finally, MoGas contends that *KN Wattenberg* weighed the acquisition's estimated cost savings of $860,000 and found that they did not offset the advantages that would have been associated with constructing new facilities, such as enhanced reliability and

[145] MoGas Brief on Exceptions at 65-73.

[146] *Id.* at 72.

[147] *Id.*

lower maintenance costs. But MoGas asserts that the Presiding Judge performed no comparable analysis here. MoGas also claims that benefit cannot be measured only by dollars saved over construction, but the ability to avoid construction entirely and its attendant environmental impacts.

108. In its Brief Opposing Exceptions, MoPSC asserts that the Presiding Judge correctly concluded that the construction estimate should be based solely on the 1.2 mile segment of the TMP that crosses the Mississippi River.[148] MoPSC also maintains that the Presiding Judge's finding that paying a price of only $2.7 million less that the cost to construct a new pipeline for a fifty year old pipe may not provide a substantial benefit to customers is consistent with Commission precedent and should be affirmed.[149] MoPSC disagrees with MoGas' claim that *KN Wattenberg* is distinguishable because there was an affiliate relationship between the buyer and seller and the conversion involved was limited. According to MoPSC, these distinctions are without differences. MoPSC claims that the crux of the Commission's decision in *KN Wattenberg* was that the difference between KN Wattenberg's proposed acquisition cost and the estimated cost to construct new facilities does not approach the necessary scale of benefits realized by the ratepayers and that rationale applies to MoGas under the facts of this proceeding.

Commission Determination

109. We reverse the Presiding Judge's ruling that MoGas has not met the second prong of the *Longhorn* test. As an initial matter, we disagree with the Presiding Judge's finding that the construction cost estimate should include only the cost for the 1.2 miles of the TMP. As discussed above, the record supports a finding that the acquisition adjustment was attributable to the entire 5.6 miles of the TMP, not only to 1.2 miles of the TMP. Even if the Initial Decision was correct that the acquisition adjustment was attributable to only 1.2 miles of the TMP, which it is not, there still would be no basis for using a cost estimate for constructing only 1.2 miles of the TMP. No party disputes that MoGas's predecessor placed 5.6 miles of the TMP in service in 2003 in lieu of building comparable facilities. Therefore, it is appropriate to compare the purchase price of the acquired assets with the cost to build comparable facilities.

[148] MoPSC Brief Opposing Exceptions at 45.

[149] *Id.* at 46.

110. MoGas submitted a study that estimates that in 2002 it would cost $13,901,425 to replace 5.6 miles of the TMP.[150] Even if we exclude the entire $2.4 million cost for standard equipment mats that the Presiding Judge found was not adequately supported, the variance between the purchase price of the TMP facilities of $10,088,925 and the revised construction cost estimate ($11.5 million) is approximately $1.4 million.[151] We find this variance is sufficient to meets the benefits test under Commission precedent.

111. We disagree with the Presiding Judge's finding that in order to meet the benefits test the variance needs to be "exorbitant." In *Crossroads*, the Commission explained that the Commission does not approve the inclusion of a facility in the rate base at more than its depreciated original cost, "unless the pipeline can show that the ratepayers will realize benefits commensurate with the acquisition costs that exceed the depreciated original costs." While the Commission found that the cost associated with the acquisition of the pipeline would be considerably less than constructing comparable facilities, there is no language in the order that suggests that the variance needs to be of a particular magnitude or "exorbitant," as found by the Presiding Judge. Moreover, such a finding is at odds with the language in the order that explains that the benefits only need to be "commensurate" with the acquisition costs that exceed the depreciated original costs.

112. We also find that the Presiding Judge's finding that a variance of approximately $2.7 million is insufficient to meet the benefits test in reliance on *KN Wattenberg* is misplaced. The Commission disallowed an acquisition adjustment in *KN Wattenberg* based on factors not present here. First, the buyer and seller in *KN Wattenberg* were affiliates and the order explained "the affiliate relationship played a large part of our rationale for denying KN Wattenberg's request to acquire the wet gas facilities for any price other than the depreciated original cost."[152] Second, the Commission found that gas ratepayers had already paid for depreciation on the facility and thus "it would not be equitable to now permit KN Wattenberg to pay its affiliate a price for the wet gas

[150] We agree with the Presiding Judge's rejection of MoPSC's contention that MoGas's construction cost estimate lacked credibility because it was not performed in 2002 and that the construction cost estimate should be based on an alternative report that was performed in 2002.

[151] As explained above, the purchase price of approximately $11.1 million used by the Presiding Judge inappropriately includes amounts included in the purchase price for MPC, not TMP.

[152] *KN Wattenberg*, 85 FERC at 61,854.

facilities that is above their depreciated original cost, and then recalculate rates for services by using the above-book value paid for the facilities."[153]

113. In conversion cases involving non-affiliates, the Commission has consistently allowed the full purchase price in rate base when the record supports a finding that the purchase price is less than the cost to construct comparable facilities.[154] In *Natural,* the Commission approved rate base treatment for the full purchase price of an oil pipeline where the estimated replacement cost exceeded the purchase price by approximately $1 million.[155] Consistent with Commission precedent, we find that MoGas has demonstrated specific dollar benefits associated with the acquisition of the TMP facilities because the cost to construct comparable facilities is $1.4 million or more than the purchase price of the TMP facilities. Allowing the full purchase price of the TMP facilities in rate base in these circumstances provides specific benefits to MoGas's ratepayers because the approved recourse rates will be no higher, if not somewhat lower, than if the pipeline built new facilities.[156] This ruling also provides jurisdictional companies appropriate incentives to purchase and utilize existing facilities in lieu of constructing new facilities, thereby avoiding unnecessary construction and the attendant environmental impacts.[157]

<u>Other quantification of benefits</u>

114. MoGas also presented testimony that the TMP facilities provided specific dollar benefits after MoGas went in service, including demand charge credits to shippers, access to flexible point rights, and lower initial rates. Because we find that MoGas has demonstrated that it meets the second prong of the *Longhorn* test because the purchase price of the TMP facilities is less than the cost of constructing comparable facilities, there is no need to address these additional arguments.

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[153] *Id.*

[154] *See, e.g., Crossroads,* 71 FERC at 61,262-263; *Cities*, 4 FERC at 61,596; *Natural*, 29 FERC at 61,150.

[155] (*Natural*) 29 FERC at 61,150.

[156] The fact that Missouri Interstate's or MoGas's customers are paying discounted rates does not impact or change this analysis.

[157] There is no record support for the Presiding Judge's suggestion that MoGas's ratepayers may be better served to have a new pipeline built, in terms of reliability and lower operational costs, because the TMP facilities, in 2002, were about 50 years old.

ii. Whether the Transaction at Issue is an Arms-Length Sale Between Unaffiliated Parties

115. MoGas maintains that Gateway's purchase of the TMP facilities from UtiliCorp was an arms-length transaction because Gateway was not affiliated with either UPS or UtiliCorp.[158] In contrast, MoPSC asserts that the 2002 Gateway/UtiliCorp transaction was not at arms-length because of MoGas's ability to influence the purchase price by requesting that UtiliCorp transfer acquisition premiums from MPC and MGC to TMP immediately prior to the stock sale to Gateway.[159]

Initial Decision

116. The Presiding Judge found that there was no direct affiliation between UtiliCorp and Gateway because the seller, UtiliCorp, retained no interest in the pipeline after the sale. However, the Presiding Judge determined that the lack of direct affiliation between UtiliCorp and Gateway does not preclude the Commission from performing its regulatory duty to "carefully scrutinize the relationship of the purchaser and seller where there are reasonable grounds to believe that their economic interests overlap to the extent that the price and terms agreed to do not reflect competitive market forces."[160] In this instance, he found there is good reason to call into question the arm's-length nature of the 2001 UtiliCorp/Gateway transaction.[161] The Presiding Judge based his finding on the fact that UtiliCorp made pre-closing adjustments to its books, at Gateway's request, by shifting the acquisition premium from the books of MPC and MGC to the books of TMP.

117. The Presiding Judge disagreed with MoGas's claim that this shift was justified because the premium was attributable to the TMP all along since the 1995 Edisto/UtiliCorp deal, and was misapplied by UtiliCorp to the books of MPC and MGC. He found that the record suggests that the $10.6 million acquisition premium arose out of Edisto's 1995 sale of the unregulated Omega Pipeline system to UtiliCorp, not the TMP. He found that the only evidence on which MoGas relies, the 2001 hearsay statement by Mr. Williams, an employee of UtiliCorp, to a MoPSC official investigating the 2001

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[158] Initial Decision, 137 FERC ¶ 63,014 at P 289 (citing Exh. Nos. MGP-1 at 10, MGP-14 at 14, 20).

[159] *Id*. (citing Exh. No. PSC-1 at 66-68).

[160] Initial Decision, 137 FERC ¶ 63,014 at P 294 (citing *Midwest Gas Users Ass'n v. Northwest Central Pipeline Corp,* 44 FERC ¶ 61,200 (1988) (*Midwest Gas Users*).

[161] *Id.* PP 290-302.

Utilicorp/Gateway deal six years after the transaction, was not credible and should be given little evidentiary weight.

118. On this issue, the Initial Decision stated:

> As there is no nexus between the acquisition premium and the TMP, therefore the shifting of the premium to the TMP appears to have had no motive other than to increase the book value of the TMP beyond its true cost in order to artificially increase [Missouri Interstate's] interstate rates, and ultimately MoGas' Zone 1 rates. This shift benefited UtiliCorp by bridging the price gap, raising the price for MPC and MGC above Gateway's initial offer and reimbursing UtiliCorp's shareholders for the cost of the premium that they had borne themselves. Gateway was no worse off, either; it had an economic incentive to pay UtiliCorp the higher price for the TMP than was warranted because the transfer of the premium allowed it to be passed through to [Missouri Interstate's] interstate customers, and ultimately the Zone 1 customers of MoGas.[162]

Briefs on Exceptions and Briefs Opposing Exceptions

119. MoGas asserts that the Presiding Judge erred in ruling that UtiliCorp and MoGas's predecessor shared a common economic interest in the outcome of the negotiation that belied the arms-length nature of their transaction.[163] MoGas asserts that the Commission's general rule that presumes arms-length bargaining when negotiations occur between non-affiliated parties should apply here. In this regard, MoGas states that it is uncontested that the parties to the SPA were unaffiliated entities and the ultimate sale price was the result of a lengthy and contentious negotiation process that lasted over two years. According to MoGas, there is no evidence that Mr. Ries controlled UtiliCorp nor is their evidence of common economic interest that would have undermined the arms-length character of the their transaction.

120. MoGas disagrees with the Presiding Judge's finding that the transaction was not at arms-length based on the fact that UtiliCorp in 1995 had placed the acquisition premium paid for the TMP Facilities into a non-rate base account on the books of MPC and MGC. MoGas claims that the accounting procedure was not nefarious as the Presiding Judge

[162] *Id.* P 298.

[163] MoGas Brief on Exceptions at 74-78.

alleged but rather benign and within UtiliCorp's discretion. MoGas cites to an October 2006 email exchange between former UtiliCorp accountant, Mr. Williams, and MoPSC regulator Robert Schallenberg, explaining that UtiliCorp agreed to transfer the balances back to the TMP Facilities, "but only after internally discussing the propriety of that entry with UtiliCorp corporate accounting members and other personnel"[164] MoGas also maintains that UtiliCorp informed MoPSC that, even absent the sale to Gateway, UtiliCorp might have transferred the amounts at issue back to the TMP assets on its own. Finally, MoGas points out that MoPSC's witness testified that UtiliCorp was free to transfer assets among its affiliates.

121. MoGas also claims the Presiding Judge misapplied the ruling in *Midwest Gas* to find that UtiliCorp and MoGas's predecessor shared a common economic interest in the outcome of negotiations that belied the arms-length nature of their transaction. MoGas asserts that in that proceeding, producers were deemed affiliates of the pipeline to which they sold their gas because a limited partner in the producers' partnership was a subsidiary of the pipeline. Accordingly, MoGas maintains that the common economic interest referenced did not refer to the partners' interests towards each other but the partnerships' affiliation with the subject pipeline.

122. Trial Staff also disagrees with the Presiding Judge's finding that MoGas failed to meet its burden of demonstrating under the substantial benefits test that the acquisition premium in the UtiliCorp/Gateway sale for the TMP Facilities arose out of an arms-length transaction between non-affiliated parties.[165] Trial Staff maintains that the accounting adjustment made by UtiliCorp at the request of Gateway to transfer costs recorded on the books of MPC and MGC to TMP prior to the 2002 stock sale was an appropriate one. Trial Staff explains that UtiliCorp did not correctly account for the purchase price when it acquired the TMP facilities in 1987 and such accounting error needed to be corrected to make an appropriate determination on the net book value of MPC, MGC, and TMP under the UtiliCorp/Gateway Stock Purchase Agreement.[166]

123. In addition, Trial Staff disagrees with the Presiding Judge's conclusion that the accounting transfer benefitted both UtiliCorp and Gateway and indicates the parties have a common economic interest.[167] Specifically, Trial Staff takes issue with the Presiding Judge's finding that Gateway was no worse off from the accounting transfer because it

[164] *Id.* at 76 (citing Exh. No. MGP-18 at 8).

[165] Trial Staff Brief on Exceptions at 44-46.

[166] *Id.* at 44-45.

[167] *Id.* at 45-46.

now had an incentive to pay UtiliCorp a higher purchase price because the acquisition premium could ultimately be passed on to its interstate ratepayers. Trial Staff states that when Gateway accepted the higher purchase price after the accounting adjustment was made, Gateway accepted the risk that it may not be able to recover the higher purchase price. Therefore, Trial Staff claims, contrary to the Presiding Judge's assertion, ultimate passthrough to interstate ratepayers was not guaranteed.

124. In its brief opposing exceptions, MoPSC requests that the Commission affirm the Presiding Judge's finding that the Gateway/UtiliCorp transaction was not at arms-length.[168] According to MoPSC, MoGas was unable to rebut record evidence supporting a finding that the 2002 Gateway/UtiliCorp transaction was not at arms-length because of MoGas's ability to influence the purchase price by requesting that UtiliCorp transfer acquisition premiums from MPC and MGC to TMP.

Commission Determination

125. We reverse the Initial Decision on this issue. As the Presiding Judge acknowledged, there is no dispute that the parties to the 2002 UtiliCorp/Gateway transaction were not affiliated. Here, the Presiding Judge's finding that the parties shared a common economic interest is solely based upon his finding that the acquisition adjustment that was moved to the books of the TMP was attributable to Omega Pipeline, not to the TMP. Because he concludes that there is no nexus between the acquisition premium and the TMP, the Presiding Judge finds that the shifting of the premium "appears to have had no motive other than to increase the book value of the TMP beyond its true cost in order to artificially increase MIG's interstate rates, and ultimately MoGas' Zone 1 rates."

126. As fully explained above, the record supports a finding that the acquisition adjustment in the Edisto /UtiliCorp transaction was attributable to the TMP facilities not to Omega Pipeline. While the record shows that these dollars were placed on the books of MPC and MGC, possibly in order to take tax depreciation, Gateway requested that these dollars be transferred back to the TMP, and UtiliCorp agreed to do so after checking with its accounting department. On this basis, we find that UtiliCorp's pre-closing transfer of the acquisition adjustment from the books of MPC and MGC back to the books of the TMP was an appropriate one. Under these circumstances, the purchase price of the TMP facilities in the Stock Purchase Agreement has not been shown to be anything other than an arms-length transaction between these two non-affiliated parties.

[168] MoPSC Brief Opposing Exceptions at 43-44.

<u>The Commission orders</u>:

A. The Initial Decision is affirmed, in part, and reversed, in part, as discussed in the body of this order.

B. MoGas's motion to reverse the Initial Decision as a matter of law is denied.

C. The State of Missouri's Notice of Substitution as a party of record is accepted.

D. INGAA's motion to file an amicus brief is denied.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.