

1                   **BEFORE THE PUBLIC SERVICE COMMISSION OF WYOMING**  
2                   **DOCKET NUMBERS 30022-84-GA-06 & 30022-85-GA-06**  
3                   **PRE-FILED TESTIMONY OF BRYCE J. FREEMAN**

4  
5  
6   **Q.     PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

7  
8   A.     My name is Bryce J. Freeman. My business address is 2515 Warren Avenue, Suite 304,  
9           Cheyenne, WY, 82002. I am the Administrator of the Wyoming Office of Consumer  
10          Advocate (OCA). The OCA is an independent consumer advocacy agency that was  
11          created by an act of the legislature in the 2003 general session.

12  
13   **Q.     WHAT IS THE FUNCTION OF THE OCA?**

14  
15   A.     Pursuant to W.S. 37-2-401,

16  
17           The office of consumer advocate shall represent the interests of Wyoming citizens  
18           and all classes of utility customers in matters involving public utilities. In the  
19           exercise of its powers the office of the consumer advocate shall consider all  
20           relevant factors, including, but not limited to, the provision of safe, efficient and  
21           reliable utility services at just and reasonable prices.

22  
23  
24   **Q.     ARE THE ANALYSES AND RECOMMENDATIONS OF THE OCA, IN THIS OR**  
25           **ANY OTHER CASE BEFORE THE COMMISSION, INFLUENCED OR**  
26           **DIRECTED BY THE COMMISSION?**

27  
28   A.     No. Although the OCA is a division within the Commission according to W.S. 37-2-401,  
29           it is a separate division with no reporting or supervisory links to the Commission and the  
30           OCA has the right under W.S. 37-2-402(ii), to appeal decisions of the Commission that it  
31           does not find in the public interest. The only link between the OCA and the Public  
32           Service Commission is the source of common funding provided by the assessment on  
33           gross utility operating revenues; this assessment funds both the Commission and the

1 OCA. Additionally, as Administrator of the OCA I report directly to the Governor of  
2 Wyoming.

3  
4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**  
5 **OCCUPATIONAL EXPERIENCE.**

6  
7 A. I received a Bachelor of Science degree in business administration from the University of  
8 Wyoming in 1982. The area of concentration in my undergraduate work was statistics.  
9 After graduating from the University of Wyoming, I was employed for three years by the  
10 Laramie County Treasurer as Deputy Treasurer, and then for six years by the Wyoming  
11 Department of Revenue as a Principal Appraiser dealing primarily with utility valuation  
12 and capital cost issues. I came to the Wyoming Public Service Commission in April of  
13 1994, in the capacity of Senior Economist, serving in that position for approximately two  
14 years. In 1996 I accepted a position as Lead Rate Analyst in the rates and pricing section  
15 on the Commission Staff, and in May of 2003 I was appointed Administrator of the OCA.

16  
17 **Q. HAVE YOU TESTIFIED BEFORE THIS COMMISSION IN PREVIOUS**  
18 **PROCEEDINGS?**

19  
20 A. Yes. I have detailed the cases in which I have testified before this Commission, in  
21 Appendix A attached to my testimony.

22  
23 **Q. ON WHOSE BEHALF DO YOU APPEAR HERE TODAY?**

24  
25 A. I appear here today on behalf of the OCA. As I indicated previously, the OCA is an  
26 independent party in this proceeding, separate and apart from the Commission or its  
27 advisory staff.

28  
29 **Q. AS A MEMBER OF THE OCA, DO YOU ADVOCATE THE INTERESTS OF**  
30 **CERTAIN GROUPS OF CONSUMERS OVER OTHERS?**

31  
32 A. No. As a member of the OCA, it is my statutory obligation to advocate the best interest  
33 of all citizens in the state. Specifically, W.S. § 37-2-401 states that the OCA “shall

1 represent the interests of Wyoming citizens and all classes of utility customers in  
2 matters involving public utilities.” This public interest standard requires the OCA to  
3 represent the broadest possible utility consumer constituency, even though some of those  
4 consumers may also be represented independently as parties in this case. The OCA is  
5 responsible for balancing the positions and recommendations of the Company, and of  
6 other parties, to arrive at a set of recommendations that serve the overall long term public  
7 interest.

8  
9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

10  
11 A. The purpose of my testimony in this proceeding, which is presented in association with  
12 that of OCA witness Denise Parrish, is to present to the Commission, my review of the  
13 application of Kinder Morgan, Inc. for approval of a management led buyout (MBO) of  
14 the Company and a related application for approval of the sale of the regulated utility  
15 assets of the Company to a subsidiary of the General Electric Corporation (GE). My  
16 analysis and testimony focus on the potential financial ramifications of the proposed  
17 MBO and GE sale transaction and the risk of financial harm that could potentially impact  
18 the retail rates of the Company’s customers in Wyoming, and how the proposed  
19 stipulations address those concerns. There are, of course, other dimensions of both of  
20 these proposals that raise public interest concerns; those concerns will be addressed in the  
21 testimony of Ms. Parrish while my testimony will address the financial implications of  
22 these proposals.

23  
24 **Q. SHOULD THE COMMISSION VIEW THESE APPLICATIONS IN ISOLATION?**

25  
26 A. No. As I will discuss throughout my testimony, the increased financial risk associated  
27 with both of these transactions, and the recommendations of the OCA regarding both,  
28 overlap to a substantial degree and therefore, it is my opinion that neither application  
29 should be viewed in isolation from the other. The OCA will demonstrate through its  
30 testimony that provisions of the stipulations, which also have substantial overlap, are

1 necessary in order to ensure that the public interest is protected. My testimony in this  
2 proceeding is meant to address both applications.

3  
4 **Q. WHAT IS THE STANDARD OF REVIEW IN THIS PROCEEDING?**

5  
6 A. In both applications KM is requesting authority to transfer the regulated utility assets and  
7 certificate authority of KM to Source Gas Distribution, Inc., a wholly owned subsidiary  
8 of Source Gas, LLC. Wyoming statutes at §37-15-205(c) clearly articulate the standard  
9 of review in such a proceeding, stating in relevant part:

10  
11 Before any certificate may issue, under this section, a certified copy of its articles  
12 of incorporation or charter, if the applicant be a corporation, shall be filed in the  
13 office of the commission. The commission shall have power, after hearing  
14 involving the financial ability and good faith of the applicant and the necessity of  
15 additional service in the community, to issue said certificate, as prayed for, or to  
16 refuse to issue the same, or to issue to it for the construction of a portion only of  
17 the contemplated line, plant, or system, or of a portion only, of the contemplated  
18 line, plant, system or extension thereof, or for the partial exercise only of said  
19 right or privilege, and may attach to the exercise of the rights granted by said  
20 certificate such terms and conditions as in its judgment the public convenience  
21 and necessity may require.

22  
23 This statute, which requires that the Commission determine that the proposed transfer is  
24 consistent with the public convenience and necessity, can be distinguished from the  
25 language contained in §37-1-104(a) regarding the reorganization of a public utility and  
26 states in relevant part:

27 No reorganization of a public utility shall take place without prior approval by the  
28 public service commission. The commission shall not approve any proposed  
29 reorganization if the commission finds, after public notice and opportunity for  
30 public hearing, that the reorganization will adversely affect the utility's ability to  
31 serve the public.

32  
33 The application in Docket Number 30022-85-GA-06 additionally requests approval of a  
34 reorganization that would grant a management led buyout that would result in KM  
35 becoming a privately held company. However, because the application in this docket

1 also requests approval of the sale of utility assets and transfer of the certificate authority,  
2 the higher standard contained in §37-15-205(c) would apply.

3 **Q. WHY IS THE STANDARD OF REVIEW IMPORTANT?**

4 A. Obviously, it is much easier for the Company to satisfy the “no harm” standard set out in  
5 §37-1-104(a) than the “public interest” standard contained in §37-15-205(c). The OCA  
6 strongly believes that the “public interest” standard is the controlling standard and that  
7 KM must demonstrate not only that its ability to provide service will not be adversely  
8 impacted by either of the transactions, but that consumers will benefit as a result. The  
9 burden of this demonstration is on the Joint Applicants.

10 **Q. DO THE APPLICATIONS IN THIS PROCEEDING, AS FILED, SATISFY THE**  
11 **REVIEW STANDARD RELIED UPON BY THE OCA?**

12 A. No. In fact, without the modifications and requirements contained in the stipulations in  
13 these dockets, the applications do not satisfy even the lower “no harm” standard  
14 established in the reorganization statute as I will discuss in my testimony.

15 **Q. HOW COULD THE COMPANY’S WYOMING RETAIL UTILITY CUSTOMERS**  
16 **POTENTIALLY BE HARMED BY THE PROPOSED TRANSACTIONS?**

17 A. From a financial risk perspective, depending on the timing and ultimate resolution of  
18 these proceedings, customers will be exposed to the possibility of substantial financial  
19 harm. The MBO proposal advanced by KM, whereby it would issue approximately \$22  
20 billion dollars in additionally debt and solicit funds from private equity partners will  
21 result in an entity that is far riskier than KM is presently. Recently, KM informed the  
22 Commission that, after reviewing the credit implications of the proposed MBO  
23 transaction the credit rating agency Standard & Poors (S&P) had downgraded KM’s bond  
24 rating to “BB-” from “BBB.” This rating action alone will result in a substantial increase  
25 in the debt financing costs of KM and when coupled with the private equity financing  
26 being sought by the Company will almost certainly mean dramatically higher total capital  
27 financing costs.

1 **Q. PLEASE EXPLAIN HOW DEBT RATINGS AFFECT THE COST OF DEBT**  
2 **FINANCING.**

3 A. S&P ranks utility debt issues according to an alphabetic descending scale with “AAA”  
4 being the highest rating and “CC” being the lowest.<sup>1</sup> Credit issuers with a “AAA” rating  
5 have an “extremely strong capacity to meet its financial commitments,” according to  
6 S&P. Conversely, issuers with a “CC” rating are “highly-vulnerable to nonpayment” of  
7 their financial obligations. Prior to the announcement of the transactions that are the  
8 subject of these proceedings KM was rated “BBB,” defined by S&P as an issuer that has  
9 adequate capacity to meet its financial commitments.<sup>2</sup> Subsequent to the announcement  
10 KM was downgraded to “BB-“, defined by S&P as an issuer that faces major ongoing  
11 uncertainties and exposure to adverse business, financial, or economic conditions which  
12 could lead to the obligor’s inadequate capacity to meet its financial commitments.<sup>3</sup> S&P  
13 categorizes issuers with a credit rating of “BB or below as having significant speculative  
14 characteristics.....While such obligors will likely have some quality and protective  
15 characteristics, these may be outweighed by large uncertainties or major exposures to  
16 adverse conditions.”<sup>4</sup> Mergent (formerly Moody’s Rating Service) uses a similar rating  
17 scheme. S&P’s rating of “BB-“ would be equivalent to a rating of “Ba” on the Mergent  
18 rating scale.

19 Prospective purchasers of these obligations measure the risk associated with the relative  
20 rating of an issuer, as published by S&P and other credit rating agencies, and determine  
21 what level of return, or risk compensation is necessary for assuming incremental levels of  
22 risk that the issuer may default on its payment obligation. Logically, the higher the  
23 assumed risk of the issuer the higher the rate of return demanded by purchasers of those  
24 obligations.

25 **Q. HOW DOES THIS TRANSLATE INTO A HIGHER COST OF DEBT**  
26 **FINANCING FOR KM?**

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<sup>1</sup> S&P Long-Term Issuer Credit Ratings Definitions,  
<http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,3,0,1021558138770.html>

<sup>2</sup> Ibid

<sup>3</sup> Ibid

<sup>4</sup> Ibid

1 A. The table below shows average yields demanded by investors in the marketplace for  
 2 recent issues by bond rating. These figures were obtained from the December 2006 issue  
 3 of the Mergent Bond Record and reflect average yields for issues in November 2006  
 4 based on the Mergent rating. Although the figures in this table were taken from the  
 5 Mergent Bond Record, rating scheme is equivalent to the S&P rating scheme. For  
 6 example, an S&P rating of “AAA” is equivalent to a Mergent rating of “Aaa,” and so on.  
 7 S&P’s “BBB” rating would translate to a rating of “Baa” by Mergent. Mergent doesn’t  
 8 publish averages for bonds rated lower than “Baa.”

9 **Corporate Bond Yield Averages**

2006

Corporate

November	Average	Aaa	Aa	A	Baa
	5.78%	5.33%	5.57%	5.76%	6.20%

Utility

November	Average	Aaa	Aa	A	Baa
	5.82%		5.61%	5.80%	6.04%

10

11 As demonstrated in the table above, increasing risk corresponds to higher expected  
 12 returns on the part of investors. If KM were to issue debt today, investors would price  
 13 that debt such that the price paid would yield a return consistent with returns being  
 14 generated by other issues of similar risk in the market. If the issue was priced at a  
 15 discount to its face value in order to produce a market yield more debt would need to be  
 16 issued, on the basis of face value, than is required to raise the desired capital. For

1 instance, KM might have to issue \$120 million of face value bonds in order to raise \$100  
2 million in net proceeds from the issuance, thus raising the cost of debt financing.<sup>5</sup> This  
3 translates into higher debt financing costs than would otherwise be the case if KM had a  
4 higher debt rating. It should be noted that the above table does not indicate market yields  
5 for bond issues rated “Ba” or lower as these issues are considered to be speculative and  
6 not of investment grade quality. However, one could expect the yield on “Ba” rated  
7 bonds to be in the range of 7.5% to 8% based on recent issues of that rating.<sup>6</sup> Also of  
8 note, since the regulated retail utility operations of KM are such a small part of the  
9 Company<sup>7</sup> (approximately 5% of pretax profits) the assigned rating and corresponding  
10 market yield would align more closely with those of corporate or industrial bonds than of  
11 utility bonds.

12 **Q. HOW WILL THIS INCREASED COST OF BORROWING TRANSLATE INTO**  
13 **HIGHER COSTS AND HIGHER RATES FOR KM’S WYOMING RETAIL**  
14 **CUSTOMERS?**

15  
16 A. Based on the foregoing analysis it is clear that KM’s debt financing costs will increase as  
17 a result of the additional debt employed to affect the MBO. How those increased costs  
18 impact the Company’s retail utility ratepayers depends to a large extent on how the  
19 capital needs of the regulated distribution properties are met under continued KM  
20 ownership. If the assets and earning power of the regulated retail utility operations are  
21 properly shielded from the liabilities and obligations of the parent and its unregulated  
22 subsidiaries the cost of debt issued and collateralized by those assets would likely be less  
23 than if the parent were to issue debt based on its credit rating. On the other hand, if debt  
24 is raised for the retail utility operations backed by KM’s corporate credit rating the cost  
25 will be consistent with market debt financing issued by other “BB” rated issuers. This  
26 increased cost of debt financing, at least the portion that is attributable to the retail  
27 distribution operations would need to be recovered from ratepayers in order to maintain

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<sup>5</sup> The face value discount is dependent on the coupon rate of the bond. If the coupon rate is set lower than the expected yield of investors then the bond will sell at a discount to face value. If the coupon rate matches the expected yield then the bond will sell at face value.

<sup>6</sup> Mergent Bond Record, “U.S. Corporate Bonds (New)”, December 2006, and Wall Street Journal Online Edition, February 7, 2007, U.S. Corporate High Yield Debt (Merrill Lynch).

1 KM's ability to continue to access the capital markets, at any cost. I will discuss what  
2 the OCA considers to be appropriate measures to shield the regulated utility from adverse  
3 financial decisions of the Company in a moment.

4 **Q. HOW WILL THE EQUITY OF KM BE AFFECTED BY THE PROPOSED MBO?**

5 A. Currently, KM is a publicly traded corporation whose shares trade actively on the New  
6 York Stock Exchange. As a publicly traded company KM is subject to the full regulatory  
7 jurisdiction of federal agencies and regulatory bodies that require full and fair disclosure  
8 of the Company's financial condition and adherence to applicable financial, accounting  
9 and auditing standards. Pursuant to the transaction proposed in the MBO the Company  
10 plans to replace all of its public equity financing with a combination of new debt and  
11 private equity. Upon closing of the transaction KM will no longer be a publicly held  
12 Company and will not be subject to the laws and rules requiring financial disclosure. As  
13 a result there will no longer be financial information available publicly relative to the  
14 equity position of the Company. This will greatly reduce the transparency of KM's  
15 financial operations and render some of the information that regulators have historically  
16 relied on for ratemaking purposes inaccessible.

17 **Q. WILL THE MBO RESULT IN A HIGHER COST OF EQUITY FINANCING?**

18 A. The private equity financing for the MBO will be contributed by a consortium of private  
19 equity funds including: GS Capital Partners V Fund, L.P., American International Group,  
20 Inc., The Carlyle Group, Riverstone Holdings LLC and "roll over" equity provided by  
21 certain members of the KM's current management team. Replacing the public equity of  
22 KM with private equity will certainly vastly reduce the pool of equity available to the  
23 Company upon which it can draw to satisfy future equity funding needs. KM would not  
24 be making public stock offerings in the future. Rather, additional capital funding will be  
25 provided either from additional contributions from equity investors identified previously  
26 or from other private sources.

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<sup>7</sup> Value Line Investment Survey, Issue 3, December 15, 2006, Page 449.

1 These private equity investors generally have far different goals and expectations  
2 regarding their investments than do investors in the publicly traded shares of utility  
3 companies. Typically, the owners of common shares in utility companies make their  
4 investments for the income producing potential of the Company. These shareholders  
5 expect to hold these shares for long periods knowing that they will produce steady, albeit  
6 somewhat lower returns than those of riskier ventures.

7 Private equity investors, on the other hand, normally discount the income producing  
8 ability of a potential investment in anticipation of realizing their expected return from the  
9 growth in value of the investment. Private equity investors, such as hedge funds and  
10 equity investment partnerships that invest in high risk speculative ventures, are not, as a  
11 general rule, interested in holding these investments for long periods of time.  
12 Speculative investments often return very little income to share holders and may even  
13 suffer losses for extended periods, yet the value of the investment increases due to  
14 investors' expectations that it will eventually produce large returns. This phenomena is  
15 often observed in the technology sector of the market but is also applicable to other  
16 speculative investments. These types of investment opportunities are much riskier than  
17 investments in regulated utility assets resulting in higher expected returns.

18 Moreover, an investor who expects to earn the majority of their return from growth rather  
19 income, must liquidate the investment in order to realize the expected return.  
20 Consequently, private equity tends to move in and out of investments much more  
21 frequently than do traditional utility investors. This practice is commonly called flipping.

22 **Q. IS KM CURRENTLY REFLECTIVE OF A TYPICAL UTILITY COMPANY**  
23 **WITH REGARD TO EQUITY FINANCING?**

24 A. No. Aside from the private equity financing proposed in this proceeding, the operations  
25 of KM after the MBO will look very similar to those of the Company before the sale,  
26 which are largely not related to retail distribution service. In fact, the regulated retail  
27 utility operations of KM, as previously noted, constitute approximately only 5% of the  
28 gross pretax profits of KM. The vast majority of the operations of KM prior to the  
29 proposed MBO, are unregulated operations and include, interstate gas transportation,

1 terminal operations, merchant power generation and oil and gas exploration and  
2 production. Because of this corporate diversification into relatively riskier lines of  
3 business, the regulated retail operations, even under KM's current organizational  
4 structure, are influenced by the unregulated operations as reflected in KM's corporate  
5 credit rating before the MBO was announced. But the fact remains that the private equity  
6 investors will have substantially different return expectations than those of the previous  
7 shareholders and the Commission should take great care to ensure that the regulated  
8 utility operations, and the rates that customers pay, are not adversely impacted as a result,  
9 particularly if KM, as reorganized, is assumed to continue to own the utility assets into  
10 perpetuity.

11 **Q. IS IT POSSIBLE, IN YOUR OPINION, TO COMPLETELY QUARANTINE THE**  
12 **REGULATED UTILITY OPERATIONS FROM KM'S UNREGULATED**  
13 **BUSINESS INTERESTS ONCE THE MBO IS COMPLETED?**

14 A. No. In my opinion KM, if it continues to own the regulated utility assets, will always  
15 cast a financial shadow over the utility operations, regardless of any protections from the  
16 financial liabilities of the parent that may be required by regulators. It is possible,  
17 however, to mitigate these risks to a significant extent, but it would not be possible, in  
18 my opinion, to completely eliminate them in the minds of investors. Mitigation of these  
19 risks through the so called "ring fencing" provisions contained in the stipulation in this  
20 case would be particularly important to the regulated retail utility operations if it issues  
21 debt on its own behalf and on a stand alone basis. Requiring appropriate ring fencing  
22 protections for the utilities might enable them to issue stand alone debt at a lower cost  
23 than would be possible if the debt were issued by the parent.

24 **Q. IN ITS COMPANION PROCEEDING KM PROPOSES TO SELL THE UTILITY**  
25 **ASSETS TO AN AFFILIATE OF THE GE COMPANY AND AN INDEPENDENT**  
26 **INVESTMENT FUND. DOES THAT PROPOSAL QUELL YOUR CONCERNS**  
27 **ABOUT THE MBO FILING?**

28 A. No. The joint applicants and their representatives have, since these applications were  
29 filed with the Commission, insisted that they are stand alone applications and must be

1 treated as such. That necessarily requires the Commission to contemplate how the public  
2 interest is served if the GE transaction is ultimately not closed. Additionally, while the  
3 proposed sale of the utility assets to GE ameliorates some of the problems with the MBO  
4 transaction described earlier in my testimony, it is not without its shortcomings. I will  
5 address those issues later in my testimony, but for now it is important for the  
6 Commission to understand the importance, through a stand alone stipulation and  
7 agreement, of protecting KM's distribution utility customers from the potential financial  
8 harm to them if KM continues to own the utility business after the MBO closes.

9 **Q. HAS THE OCA ENTERED INTO AN AGREEMENT WITH KINDER MORGAN**  
10 **THAT RESOLVES THE MBO PROCEEDINGS?**

11 A. Yes.

12 **Q. HOW DOES THAT AGREEMENT ADDRESS THE CONCERNS RAISED IN**  
13 **YOUR TESTIMONY?**

14 A. Throughout its negotiations with the Company in the MBO matter, the OCA has insisted  
15 on strong commitments by KM to shield the regulated utility operations from financial  
16 liabilities and obligations of KM's unregulated business interests, which constitute the  
17 vast majority of the total enterprise. The idea is to wall off the regulated utility assets, to  
18 the greatest extent reasonably possible, so that the declining financial stability and  
19 increased risk of the enterprise impacts the regulated utility operations as little as  
20 possible. For instance, KM has committed that the regulated utility operations, which  
21 will be held in a separate subsidiary known as Source Gas Distribution (SGD) after the  
22 close of the MBO, will not assume or guarantee the financial obligations, nor pledge its  
23 assets as collateral on behalf of the parent or any unregulated subsidiary. KM has also  
24 committed that SGD will not, in the future, make investments in diversified, unregulated  
25 non-utility holdings, except as authorized by the Commission and as may currently exist.  
26 KM further commits that it will not make dividend payments to any of its parents if the  
27 payment of those dividends would cause the equity ratio of SGD to fall below 40% of  
28 total capitalization.

1 The most important provision that KM makes in the MBO agreement, from a financial  
2 risk mitigation perspective, is a commitment that SGD, in future rate proceedings during  
3 the five years following the close of the MBO, will make an affirmative showing that it is  
4 not seeking a cost of capital that is higher than it would have sought had the MBO not  
5 occurred. This paragraph in the stipulation also requires that, at a minimum, the cost of  
6 debt imputed for SGD during the five year period following the close of the MBO will be  
7 no higher than attributable to comparable companies rated “BBB+.” In the alternative,  
8 SGD may issue its own debt based on a stand alone utility credit rating to satisfy this  
9 requirement. Given the ring fencing provisions contained in the stipulation SGD should  
10 be able to independently issue debt at a lower cost than the corporation generally,  
11 although the KM shadow would still influence the rating of SGD to some extent.

12 **Q. DO THESE PROVISIONS ALLEVIATE YOUR CONCERNS WITH REGARD**  
13 **TO THE MBO PROPOSAL?**

14 A. Not entirely. In my view the MBO proposal, notwithstanding the proposed sale of SGD  
15 to GE in the companion proceeding, and in consideration of the provisions contained in  
16 the MBO agreement, still leaves Wyoming retail utility ratepayers worse off than if the  
17 MBO had not occurred. I also remind the Commission, as I indicated earlier in my  
18 testimony, that there are other equally important non-financial considerations contained  
19 in the stipulation and agreement in this docket that will be addressed in the testimony of  
20 Ms. Parrish on behalf of the OCA.

21 **Q. IN LIGHT OF THE STANDARD OF REVIEW SET OUT EARLIER IN YOUR**  
22 **TESTIMONY, WHAT IS YOUR RECOMMENDATION TO THE COMMISSION**  
23 **REGARDING APPROVAL OF THE PROPOSED MBO?**

24 A. The standard of review in this proceeding, I believe, is a public interest standard that  
25 requires the Applicants to show that the proposed reorganization of KM and subsequent  
26 sale of the utility assets is in the public interest and will benefit customers.

27 I can find no benefit that will accrue to the public interest in the MBO proposal as a stand  
28 alone proposition, and I am concerned that the application as filed, will result in utility

1 customers being exposed to the possibility of significant financial harm. The stipulation  
2 and agreement in the MBO proceeding greatly reduces this risk but I strongly recommend  
3 that the Commission not approve the MBO unless it also intends to approve the proposed  
4 sale of the utility assets to GE.

5 While the OCA has endeavored to reduce the risk associated with the MBO proposal as  
6 much as possible through the stipulation and agreement, in the event that sale proposed in  
7 the companion proceeding is either not approved, is withdrawn after the MBO is  
8 approved, or is not consummated for other reasons, it is still the second best alternative to  
9 a sale of the utility assets to GE.

10 **Q. HOW DOES THE PROPOSED SALE OF THE UTILITY ASSETS TO GE**  
11 **RELIEVE YOUR REMAINING CONCERNS REGARDING THE INCREASED**  
12 **FINANCIAL RISKS ASSOCIATED WITH THESE TRANSACTIONS?**

13 A. The application in Docket Number 30022-84-GA-06 is certainly not without its  
14 shortcomings, hence the stipulation and agreement reached in that proceeding is  
15 necessary to protect Wyoming ratepayers from any potential harm that could result from  
16 the transfer of SGD to a partnership owned by General Electric Energy Financial  
17 Services and Alinda Capital Partners who would be equal owners of SGD.

18 To this point in my testimony I have discussed the safeguards that would be necessary in  
19 the event that the utility assets of KM continue to be owned by KM after the MBO, a  
20 decidedly less desirable outcome, and urged the Commission to approve the MBO only if  
21 it also intends to approve the GE sale. Assuming that the GE sale goes forward, and I  
22 hope that it does, the proper basis of comparison for purposes of judging the public  
23 interest of the sale proceeding is not the proposed MBO. The public interest will most  
24 certainly be better served by either approving the GE sale transaction or by denying both  
25 the sale application and the MBO and allowing KM to continue to operate as a publicly  
26 traded utility company. The OCA strongly supports Commission approval of both of the  
27 agreements before it. The real question then, in view of the public interest standard that  
28 must be satisfied in this case, is whether Wyoming ratepayers will be better served under  
29 the new GE ownership or under business as usual.

1 **Q. WHAT ARE THE BENEFITS TO CUSTOMERS FROM THE PROPOSED GE**  
2 **SALE?**

3 A. The OCA has thoroughly analyzed the application in the sale proceeding for customer  
4 benefits. I have concluded that customers will not reap large benefits as a result of the  
5 sale to GE and that the sale largely is designed for the convenience of the Company and  
6 its shareholders. The proposed sale is different from merger and acquisition proceedings  
7 in which the OCA typically participates in that it is simply a transfer of the assets to a  
8 third party who will continue to operate it as a stand alone utility business. As such there  
9 are no opportunities for efficiency gains resulting in large cost reductions that can be  
10 passed on, at least in part, to retail ratepayers.

11 In fact, as proposed, the application could result in cost increases due to the fact that  
12 SGD, under GE ownership, will have to provide some services for itself that were  
13 previously provided from other parts of the corporation and shared among the various  
14 affiliate companies. The agreement in the sale proceeding contains provisions to guard  
15 against this circumstance and those provisions will be described in detail in the testimony  
16 of Ms. Denise Parrish of the OCA. Ms. Parrish' testimony will demonstrate how  
17 reasonable ring fencing provisions have been incorporated into the stipulation and  
18 agreement while at the same time preserving the opportunity achieve efficiencies through  
19 cost sharing to benefit customers, to the extent they exist.

20 There are, however, some potential benefits to customers, from a financial risk mitigation  
21 stand point, that could result from the sale of the utility assets to GE. While these  
22 benefits are not quantifiable directly in customer rates at this time, nevertheless they are  
23 benefits that for me tip the scale in favor of Commission approval of the sale.

24 **Q. PLEASE DESCRIBE THOSE POTENTIAL BENEFITS?**

25 A. As I described earlier in my testimony, continued ownership of the utility assets by KM  
26 as a privately held company, even in light of the protective measures contained in the  
27 stipulation and agreement, will cast a shadow over the utility operations that can't be  
28 completely eliminated. The opposite is true under GE ownership. The fact that GE is

1 rated "AAA" by S&P and "Aaa" by Mergent means that GE provides the highest  
2 possible degree of security to investors in the debt of GE. As discussed earlier in my  
3 testimony, the lower the risk that an issuer will default on the repayment of its obligations  
4 the lower the expected return from an investor's view point.

5 Since KM was rated as a "BBB" company prior to the announcement of the MBO and  
6 sale, it is reasonable to assume for the sake of argument that if the MBO and sale  
7 transactions were not approved, the business as usual case, the prospect of capital  
8 supplied by GE would benefit customers because it would reflect the potential of capital  
9 financing from a highly rated company at rates presumably lower than KM could  
10 achieve.

11 Further, even if SGD, as a stand alone company, were to continue to issue debt on its  
12 own behalf based solely on the credit standing of the utility assets, it would no doubt  
13 enjoy the benefit of its association with GE which would create a "halo" effect for the  
14 utility. In either case the ability of the utility to reduce the cost of its debt financing  
15 would cause the cost of utility service to decline over time producing a tangible customer  
16 benefit.

17 **Q. WOULD THE GE HALO EFFECT INFLUENCE THE COST OF EQUITY**  
18 **FINANCING FOR SGD AS WELL?**

19 A. Yes, although the influence of the GE halo on SGD's equity financing costs would be a  
20 bit more muted than on the debt since SGD will not be raising its own equity capital. In  
21 fact, the equity capital for the acquisition, and presumably any equity required in the  
22 future, will be provided equally by GE and Alinda Capital Partners. While it is not  
23 possible at this point to precisely estimate what effect the sale will have on SGD's cost of  
24 equity financing, it is possible to make some informed inferences.

25 Estimating the cost of equity for public utilities is a comparative process that begins with  
26 selecting a group comparable companies; usually utility companies that offer similar  
27 services, and for which financial information is publicly available. One common  
28 benchmark for assessing comparability is a utility's bond rating. It is also accepted

1 practice for diversified companies such as GE, to use the bond rating of the parent  
 2 company to develop the group of comparable utilities. Therefore, in estimating the cost  
 3 of capital for SGD I would begin by gathering financial data for a group of highly rated  
 4 public utilities. To give the Commission an idea of the relative magnitude of the  
 5 potential reduction in capital financing costs I have prepared the following three tables  
 6 which show, in anecdotal terms, the cost of capital financing under each of the three  
 7 ownership scenarios. The information in these tables is taken from recent work done in  
 8 other cases in which the cost of capital was at issue.

9 Table I - WACC 30022-73-GR-06

	Percent	Cost	Weighted Average Cost
Debt	56.44%	6.33%	3.57%
Preferred Stock	0%		
Equity	43.56%	11.00%	4.79%
Weighted Average Cost of Capital			8.36%

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 11 Table II - WACC KM MBO Only

	Percent	Cost	Weighted Average Cost
Debt	56.44%	7.50%	4.23%
Preferred Stock	0%		
Equity	43.56%	12.00%	5.23%

Weighted Average Cost of Capital 9.46%

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Table III - WACC GE Ownership

	Percent	Cost	Weighted Average Cost
Debt	56.44%	5.33%	3.01%
Preferred Stock	0%		
Equity	43.56%	10.00%	4.35%
Weighted Average Cost of Capital			7.36%

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Table I shows the cost of capital that was agreed to by the parties and approved by the Commission in KM’s most recent general rate case. The estimate was based on KM’s then current “BBB” credit rating for purposes of developing the group of comparable companies and results in an overall weighted average cost of capital of 8.36%. This is the business as usual case wherein neither the MBO or GE sale go forward.

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Table II shows the same information assuming that the MBO is consummated but the GE sale does not occur. This table assumes that SGD does not issue its own debt but relies on the parent to provide its capital financing needs. Table II further assumes a comparison to public utilities rated “BB” for purposes of estimating the cost of both the debt and equity components. The effect of the KM shadow on SGD clearly demonstrates a detrimental effect on the cost of KM’s capital financing which would ultimately be passed on to utility rate payers, including those in Wyoming. Although KM has committed that SGD will not advocate for a higher cost of capital than it would have if the MBO had not taken place, at least for the five years following the close of the MBO transaction, such a commitment would be unsustainable over the long run as KM would

1 ultimately need to seek recovery of the full cost of its capital financing in order to remain  
2 financially viable.

3 Table II represents the potential long run cost of capital financing for SGD if KM  
4 continues to own the utility assets and KM continues to fund the capital financing needs  
5 of the utility at the corporate level. A legitimate argument might be made that given the  
6 ring fencing provisions contained in the MBO Stipulation, the utility could issue debt on  
7 its own behalf at a lower rate than that of debt capital supplied by the parent. Because  
8 that would require speculation about the credit rating of the utility on a stand alone basis  
9 I did not attempt to make a stand alone estimation of the cost of debt financing issued by  
10 the utility. Additionally, whether or not the utility issues debt supported by its own credit  
11 rating, equity capital would still be provided by KM and its equity partners, likely at a  
12 higher long run cost than that which could be obtained in public finance markets. For  
13 these reasons, the scenario outlined in Table II represents the worst case and would be  
14 mitigated to a large degree by the provisions of the Stipulation in the MBO proceeding  
15 and by the utility issuing its own debt.

16 Table III reflects the relative cost of capital financing under GE ownership. The effects  
17 of the GE halo on the capital financing costs of SGD are as apparent in this table as the  
18 KM shadow in the previous table and suggest that capital financing costs for SGD are  
19 potentially much lower than under either KM ownership as a privately held company or  
20 the business as usual scenario.

21 Table III again assumes that the debt financing needs of the utility would be satisfied by  
22 the parent and that the parent would supply the equity needs of the utility. For the same  
23 reasons articulated for Table II above I did not attempt to estimate the effect of stand  
24 alone debt issuances on the overall cost of capital. The equity estimate given in Table III  
25 was made by analyzing the cost of equity capital for “AAA” rated utilities, again based  
26 on work done in other recent cases in which the cost of equity was at issue and not on a  
27 specific analysis for this case.

28 It should be noted that these tables are meant to be illustrative and should not be taken as  
29 an absolute indication of any position that the OCA might take in future rate making

1 proceedings on the appropriate return level for SGD. Nonetheless, these calculations  
2 should give the Commission a rough quantitative benchmark against which to compare  
3 the potential benefits and harms that could result from each of the proposals.

4 **Q. WOULD A REDUCTION IN CAPITAL FINANCING COSTS OF THIS**  
5 **MAGNITUDE BE SIGNIFICANT FOR SGD?**

6 A. Based on the rate base approved by the Commission in KM's most recent general rate  
7 case the allowed return produces revenue for return of \$7.1<sup>8</sup> million. Substituting the  
8 weighted average cost of capital from Table III produces revenue for return of \$6.3<sup>9</sup>  
9 million, a reduction in the cost of service for KM's Wyoming operations of  
10 approximately \$800,000 or a nearly 10% reduction in the total return. Again, these  
11 figures are illustrative only but they give an indication that the benefit of GE ownership,  
12 from a capital financing perspective, could be significant relative to the other two cases.

13 **Q. THE MBO STIPULATION CONTAINS A PROVISION REQUIRING KM TO**  
14 **IMPUTE A COST OF DEBT EQUAL TO OR LOWER THAN THE COST OF**  
15 **MARKET DEBT FINANCING RATED "BBB+" OR HIGHER, AND TO USE**  
16 **COMPARABLE COMPANIES RATED "BBB+" OR HIGHER FOR PURPOSES**  
17 **OF ESTIMATING THE COST OF EQUITY. WHY DOES THE GE**  
18 **STIPULATION NOT CONTAIN A SIMILAR PROVISION?**

19 A. As discussed in my testimony, the OCA is very concerned with the prospect of increased  
20 financial risk associated with the MBO transaction. To that end, several critical  
21 provisions have been included in the stipulation in the MBO proceeding to protect  
22 consumers from financial harm in the event that KM defaults on its financial obligations.  
23 KM, even before the announcement of the transactions that are the subject of this  
24 proceeding, was rated "BBB," and subsequently has been downgraded to "BB-," so  
25 imputation of a higher credit standard than that in effect either currently or prior to the  
26 announced transactions satisfied the OCA that retail ratepayers would be protected from

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<sup>8</sup> Stipulation & Agreement, Docket No. 30022-73-GR-06, Stipulation Attachment 2, Rate Base Comparison of Filed Case and Settlement

<sup>9</sup> Ibid

1 higher capital costs, at least for the five years following the close of the transaction, in the  
2 event that KM continues to own the retail utility assets.

3 Assuming that the GE sale is consummated, retail customers would be exposed to far less  
4 financial risk than if KM continues to own the retail utility assets, as I have shown earlier  
5 in my testimony. Because GE is so highly rated, there would be no additional security  
6 for retail ratepayers in including an imputation requirement in the GE stipulation and  
7 agreement. While the other ring fencing provisions of the GE stipulation provide a  
8 reasonable degree of security and protection for the retail utility operations vis-a-vis  
9 GE's other affiliates, an imputation provision would provide no such benefit to retail  
10 ratepayers and would therefore be superfluous to the agreement.

11 **Q. WHAT IS THE LIKELYHOOD THAT THE UTILITY PROPERTIES WILL**  
12 **CONTINUE TO BE OWNED BY KM IF THE GE SALE TRANSACTION DOES**  
13 **NOT CLOSE?**

14 A. KM has stated on several occasions that it intends to dispose of the utility properties.  
15 Because the regulated retail utility operations are such a small part of KM's overall  
16 operations and for practical purposes represent a different business, I have no doubt that  
17 KM would expeditiously seek a buyer for the retail utility properties if the GE sale fails  
18 to close. The question then is; can we expect an offer in the future that is equal to or  
19 better than what is on the table in these proceedings. In my opinion the potential for a  
20 better offer than the one GE has made, given its financial strength, is slim.

21 **Q. WHAT IS YOUR CONCLUSION ABOUT THE PROPOSED TRANSACTIONS**  
22 **AS THEY RELATE TO THE PUBLIC INTEREST STANDARD AT ISSUE IN**  
23 **THIS CASE?**

24 A. As I indicated earlier in my testimony, this case is not typical of the merger and  
25 acquisition proceedings that the OCA is normally involved in for a number of reasons. It  
26 is very difficult to quantify any direct consumer benefits that will result from the  
27 Commission's approval of the filed applications in these proceedings. However, based  
28 on the foregoing analysis I have concluded that, at least from a capital financing

1 perspective, there are enough potential benefits, particularly and specifically in light of  
2 the commitments made in both of the stipulations, that I recommend approval of the  
3 stipulations in both dockets. But, I want to reiterate my concern regarding the MBO  
4 proposal. The Commission should not approve the MBO proposal unless it also intends  
5 to approve the proposed sale of the retail utility properties to Source Gas and GE.

6 **Q. SHOULD THE COMMISSION BE UNCONCERNED ABOUT PROTECTING**  
7 **CUSTOMERS FROM FINANCIAL HARM IN THE GE PROCEEDING GIVEN**  
8 **GE'S FINANCIAL STRENGTH?**

9 A. Not at all, and there are conditions contained in the GE stipulation that are designed to  
10 guard against financial harm to consumers in the event that GE becomes financially  
11 distressed however remote that possibility is. In fact, many of these provisions are the  
12 same ring fencing provisions contained in the MBO stipulation such as the prohibition  
13 against SGD securing or guaranteeing the loans of affiliate companies, pledging the  
14 assets of the utility as collateral for third party loans, and making dividend payments to  
15 any parent company that would cause the equity of the utility to fall below 40%. While  
16 the possibility that GE will become financially distressed in the future is quite remote,  
17 nevertheless it is prudent to require sensible measures to protect utility ratepayers from  
18 harm no matter how unlikely.

19 There are also many other provisions of the GE sale agreement regarding such things as  
20 access to books and records, affiliate transactions and cost allocations. Those provisions  
21 and the issues associated with them will be discussed in the testimony of Ms. Denise  
22 Parrish on behalf of the OCA.

23 **Q. DOES THAT CONCLUDE YOUR TESTIMONY IN THIS PROCEEDING?**

24 A. Yes, it does.