

**ORIGINAL**

STATE OF INDIANA

**INDIANA UTILITY REGULATORY COMMISSION**

PETITION OF HEARTLAND GAS PIPELINE, LLC )  
FOR ISSUANCE OF A CERTIFICATE OF PUBLIC )  
CONVENIENCE AND NECESSITY PURSUANT TO )  
IND. CODE § 8-1-2-87.5 AND AN INDETERMINATE )  
PERMIT FOR THE CONSTRUCTION AND )  
OPERATION OF AN INTRASTATE GAS PIPELINE; )  
FOR APPROVAL OF CERTAIN STORAGE AND )  
TRANSPORTATION AGREEMENTS, AND RATES )  
AND CHARGES APPLICABLE THERETO; FOR )  
APPROVAL OF A GAS TARIFF APPLICABLE TO )  
SERVICE RENDERED BY PETITIONER; FOR )  
APPROVAL OF A SERVICE AGREEMENT FOR )  
OPERATION OF THE PIPELINE; AND FOR )  
RELATED FINANCING AUTHORITY )

CAUSE NO. 42729

PETITION OF BOARD OF DIRECTORS FOR )  
UTILITIES OF THE DEPARTMENT OF PUBLIC )  
UTILITIES OF THE CITY OF INDIANAPOLIS, AS )  
SUCCESSOR TRUSTEE OF A PUBLIC )  
CHARITABLE TRUST, d/b/a CITIZENS GAS & )  
COKE UTILITY FOR APPROVAL OF A STORAGE )  
SERVICE AGREEMENT AND GENERAL TERMS )  
AND CONDITIONS PURSUANT TO WHICH )  
CITIZENS GAS & COKE UTILITY WILL PROVIDE )  
PRIMARY AND SECONDARY STORAGE SERVICE )  
TO HEARTLAND GAS PIPELINE, LLC )

CAUSE NO. 42730

APPROVED: OCT 05 2005

**BY THE COMMISSION:**  
**David E. Ziegner, Commissioner**  
**Abby R. Gray, Administrative Law Judge**

On September 30, 2004, Heartland Gas Pipeline, LLC ("Heartland") filed its Petition in Cause No. 42729 for a certificate of public convenience and necessity and indeterminate permit for the construction and operation of a proposed natural gas pipeline, approval of certain transportation and storage agreements, approval of a Gas Tariff to be applicable to Heartland's transportation and storage services and authority to finance construction of the pipeline. On the same date, the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public chartable trust, d/b/a Citizens Gas & Coke Utility ("Citizens") filed its Petition in Cause No. 42730 for approval of an agreement and terms and conditions pursuant to which it would provide certain storage services to Heartland.

Pursuant to 170 IAC 1-1.1-12 and 19, Heartland filed on October 8, 2004, a motion to consolidate Cause Nos. 42729 and 42730, on the grounds that they involve common issues of fact and law and are sufficiently interrelated as to warrant consolidation. The motion was granted

by the Presiding Officers on the record at the Prehearing Conference held on November 3, 2004, as confirmed by the Prehearing Conference Order in this Cause.

On December 29, 2004, Heartland filed pursuant to 170 IAC 1-1.1-4 and Ind. Code § 5-14-3-4, a motion for a protective order finding that a detailed route map (Petitioner's Exhibit MWH-4), constitutes confidential, proprietary, competitively-sensitive trade secret information and an infrastructure record, the disclosure of which would have a reasonable likelihood of threatening public safety. On January 4, 2005, the Presiding Officers issued a docket entry finding that Exhibit MWH-4 should be held as confidential on a preliminary basis.

A petition to intervene in the consolidated causes was filed by an ad hoc group of industrial customers known as the Citizens Industrial Group ("CIG"). The petition to intervene was granted by docket entry on March 17, 2005.

Pursuant to the Prehearing Conference on November 3, 2004, the Prehearing Conference Order dated November 11, 2004, and notice of hearing given as provided by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public hearing was held in this Cause on April 21-22, 2005, in Room Conf. Center #32, Indiana Government Center South, Indianapolis, Indiana. At the hearing, evidence offered by Heartland, Citizens, the Office of Utility Consumer Counselor ("OUCC"), and CIG was admitted into the record.

1. **Notice and Jurisdiction.** Due legal and timely notices of the Prehearing Conference and the evidentiary hearing in this Cause were given and published as required by law. Heartland seeks authorizations necessary for it to operate as a "public utility" within the meaning of Ind. Code § 8-1-2-1(a). Citizens is a "municipally owned utility" within the meaning of Ind. Code § 8-1-2-1(h). The Commission has jurisdiction over each Petitioner and the subject matter of this consolidated proceeding.

2. **Petitioners' Characteristics.** Heartland is a limited liability company organized and existing under the laws of the State of Indiana. The membership interests in Heartland are owned equally by (a) Citizens By-Products Coal Company ("By-Products"), a wholly-owned subsidiary of Citizens and (b) ProLiance Transportation & Storage-Heartland, LLC, which is a wholly-owned subsidiary of ProLiance Transportation & Storage, LLC, which in turn is a wholly-owned subsidiary of ProLiance Energy, LLC ("ProLiance").

Citizens owns, manages, and controls plant, property, equipment, and facilities used and useful for the production, storage, transmission, distribution and furnishing of gas service to approximately 265,620 residential, commercial and industrial customers in and around Marion County, Indiana.

3. **Relief Requested.** Heartland requests a certificate of public convenience and necessity pursuant to Ind. Code § 8-1-2-87.5 and an indeterminate permit pursuant to Ind. Code § 8-1-2-1(i) allowing it to construct and operate a natural gas transmission pipeline extending from an interconnection with the interstate pipeline of Midwestern Gas Transmission Company ("MGT") in Sullivan County to Citizens' underground gas storage field near Johnstown, Indiana in Greene County ("UGS"). Heartland also requests Commission approval of the agreements and

Gas Tariff pursuant to which it will provide gas transportation and storage service, including the rates and charges and General Terms and Conditions relating thereto. Heartland seeks approval, to the extent necessary, of the Service Agreement pursuant to which Citizens will supervise the day-to-day operation of the pipeline. Finally, Heartland requests authorization to finance the pipeline, including by the issuance of bonds, notes and evidences of indebtedness payable at a period of more than twelve months.

Citizens requests Commission approval of a Storage Service Agreement and related General Terms and Conditions pursuant to which it will provide primary and secondary storage services to Heartland from UGS. Citizens also seeks authorization, to the extent necessary, to enter into and implement the terms of new and amended Appendices to the Gas Sales and Portfolio Administration Agreement between Citizens and ProLiance to reflect changes resulting from the Heartland project.

#### **4. Petitioners' Cases-In-Chief.**

(a) **Heartland's Evidence.** Petitioner's witness Mark W. Head, ProLiance's Director of Pipes and Storage, described Heartland's proposed project. He said the new pipeline will provide Heartland's customers with improved direct access to a gas supply hub near Chicago which has increased in significance in recent years due to the construction of new pipeline capacity connecting the Chicago Market Hub not only to traditional gas supply basins such as the Gulf Coast and the Mid-Continent areas, but also to Canada and increasingly the Intermountain West basin. Mr. Head explained the Heartland project was developed as a way for the Indianapolis area to derive greater benefit from this new resource at a reasonable cost. The project only requires the construction of approximately 25 miles of new pipeline by taking advantage of the fact that Citizens already owns a pipeline extending from UGS to the Indianapolis area. Also, connecting the Heartland pipeline to UGS allows Citizens to optimize the use of UGS.

Mr. Head stated that Heartland will provide firm and interruptible transportation and storage services. Heartland's initial pipeline capacity will be partially subscribed on a firm basis by ProLiance primarily for a delivered sales service on behalf of Citizens and, secondarily, to meet the requirements of ProLiance's other customers. Additional firm transportation capacity will be available for other customers. Heartland's storage capacity, obtained pursuant to its Storage Service Agreement with Citizens, will be subscribed by ProLiance, primarily for a firm delivered sales service on behalf of Citizens and, secondarily, on an interruptible and secondary basis for ProLiance's other customers.

Mr. Head said the new pipeline will allow Heartland's customers to diversify their gas supply and gas transportation options. In addition, the project will increase competition between supply basins and pipeline companies, and, therefore, will provide competitive pressure on the delivered gas prices from both the traditional Gulf Coast supply basin and the Chicago Market Hub. Finally, the project will allow the customers of Heartland to avail themselves of new storage opportunities and allow Citizens to improve the utilization of its existing UGS infrastructure.

According to Mr. Head, the capital cost of the pipeline is currently projected to be \$17.22 million. This projection was developed with the assistance of Mustang Engineering of Houston, Texas, which is providing engineering services for the proposed project. Mustang used industry-wide standard pipeline and construction practices to prepare the cost estimate.

Mr. Head testified that ProLiance will be responsible for managing the business affairs of Heartland pursuant to an Operating Agreement of the member companies (Petitioner's Exhibit MWH-7). ProLiance will be paid a fixed monthly fee to cover administrative and general overhead. ProLiance's fee is based on a cost estimate reflecting ProLiance's experience in providing similar services to the Ohio Valley Hub, LLC ("OVH"). Under the Operating Agreement, ProLiance will be reimbursed for reasonable and proper costs, expenses and expenditures paid or incurred for the services being provided.

Mr. Head identified the Service Agreement between Heartland and Citizens (Petitioner's Exhibit MWH-8) pursuant to which Citizens will supervise, direct and control the day-to-day operations of Heartland's facilities; operate, maintain and repair the facilities in compliance with applicable laws (including pipeline safety regulations); manage the rights-of-way and easements; provide the gas control function; and provide other services. As compensation, Citizens will receive a fixed monthly fee to cover administrative and general expense overheads and will be reimbursed for reasonable and proper costs, expenses and expenditures. Citizens' fee is based on Citizens' experience with operating UGS and similar pipeline facilities.

Mr. Head will be the ProLiance representative responsible for overall management of the Heartland project. He described his extensive experience in operating and managing gas transmission and distribution systems and underground storage fields, including OVH and the White River Storage Field, and while previously employed by Southern Indiana Gas and Electric Company ("SIGECO"). OVH is a ProLiance-managed, 9.2 mile long, 16-inch gas intrastate pipeline that connects a storage field of SIGECO to interstate gas pipelines owned by Texas Gas Transmission Corporation ("Texas Gas") and MGT.

Mr. Head explained that Heartland will be a so-called "Hinshaw" pipeline and, pursuant to Section 1(c) of the Natural Gas Act, will be exempt from most Federal Energy Regulatory Commission ("FERC") regulation. The Hinshaw exemption applies to pipeline companies that receive and deliver gas in the same state where the gas is consumed and are subject to regulation by a state commission. FERC's rules allow Hinshaw pipelines to obtain blanket certificates to engage in certain limited FERC jurisdictional activities that otherwise would be considered interstate transportation. Heartland intends to apply to FERC for such a blanket certificate.

Mr. Head testified that the design capacity of Heartland's pipeline will be 80,000 Dth per day on a firm basis and up to 10,000 Dth per day on an interruptible basis. Heartland and ProLiance will have two firm transportation agreements. The first agreement (Petitioner's Exhibit MWH-9) will provide firm transportation of up to 45,000 Dth per day and will be used by ProLiance to deliver gas to Citizens for Citizens' system supply. The second agreement (Petitioner's Exhibit MWH-10) will provide firm transportation of up to 25,000 Dth per day, which will be available for use by ProLiance to market gas to other customers. The remaining 10,000 Dth per day will be available to other parties wishing to transport on Heartland.

The proposed transportation rates are contained in Heartland's proposed Gas Tariff (Petitioner's Exhibit MWH-11). The maximum firm transportation reservation rate was developed from the cost of service study prepared by Heartland witness Dwight Work. The minimum transportation rate is a nominal value which will allow Heartland the flexibility, if market conditions so dictate, to provide transportation services at a discount to the maximum rate. However, a discounted rate is not available under Heartland's agreements with ProLiance. In addition, the Tariff provides for interruptible transportation services. Heartland expects that initially all of its transportation services will be pursuant to the two ProLiance contracts mentioned earlier.

Mr. Head discussed the Storage Service Agreement between Heartland and Citizens (Petitioner's Exhibit LCL-2) that will provide Heartland with primary storage service and secondary storage service. The primary storage service is a firm service with a specified Maximum Inventory Quantity, Maximum Daily Injection Quantity, and Maximum Daily Withdrawal Quantity. The obligations of Heartland under the Secondary Storage Service are "secondary" to its obligations under the primary storage service. That is, on any given day, Heartland will first meet the needs of its customer holding primary storage service before it meets the needs of customers holding secondary storage service. Similar to the primary storage service, the secondary storage service has a specified Maximum Inventory Quantity, Maximum Daily Injection Quantity, and Maximum Daily Withdrawal Quantity.

As explained by Mr. Head, Heartland will provide corresponding primary storage service to ProLiance (Petitioner's Exhibit MWH-12) with a Maximum Inventory Quantity of 4,860,000 Dth. ProLiance will use this service, in conjunction with its 45,000 Dth per day firm transportation service on Heartland, to meet its obligations to Citizens for a firm delivered service. Heartland will provide a secondary storage service to ProLiance (Petitioner's Exhibit MWH-13) with a Maximum Inventory Quantity of 2,000,000 Dth, which ProLiance can use, in conjunction with its 25,000 Dth per day firm transportation service on Heartland, to serve other customers.

As provided in Heartland's Gas Tariff, variable costs for both the primary and secondary storage service will be recovered through a commodity charge and a fuel retention factor that match those in Citizens' Storage Service Agreement with Heartland. Additionally, the secondary storage service will have a reservation rate of 15¢ per Dth per year (1.25¢ per Dth per month) that will be assessed per unit of Maximum Inventory Quantity. Because Citizens is both the ultimate recipient of the primary storage service capacity and the ultimate source of such capacity to Heartland, no separate reservation rate will be assessed for primary storage service.

The Gas Tariff (Petitioner's Exhibit MWH-11) includes the applicable rates, service request form, and transportation and storage service agreement forms. The Tariff also includes the general terms and conditions that will apply to Heartland's services.

Daniel Short, ProLiance's Vice President of Finance, testified regarding the financing of the project and the resulting capital structure and cost of capital. He said Heartland will use a combination of equity and debt capital to finance the project. Equity capital will be funded by Heartland's two owners in amounts directly proportional to their respective ownership interests, *i.e.*, 50% by ProLiance Transportation & Storage-Heartland, LLC and 50% by By-Products.

Heartland anticipates using conventional debt from a commercial bank as its source of debt capital.

Mr. Short testified that for Heartland to obtain term debt, the lender will require that a majority of the available transportation capacity be subscribed under long-term contracts providing a stable revenue stream from year to year. The lender will take into consideration other factors as well, including debt service coverage ratios. Mr. Short testified that capitalization ratios of 50% equity and 50% debt will satisfy lender expectations and produce debt service coverage ratios the lender will find reasonable. The debt also will be secured by a lien on Heartland's assets.

Mr. Short said Heartland's debt will be amortized over 15 years, a period matching the term of the supporting agreements. Debt principal payments will be made in fixed quarterly installments. The debt will mature in seven years at which time a balloon payment will be made in the remaining principal amount. During construction, the interest rate will be the London Interbank Offered Rate, plus a lender margin. Mr. Short noted that Heartland plans to fix the interest rate once capital spending is complete at the end of the construction period. He stated the applicable interest rate will depend upon market conditions, but currently the interest rate is estimated to be 4.63% during construction and 6.18% thereafter. Amortizing the underwriting fee and issuance expenses over the term of the loan results in an effective interest rate of 6.33%.

Mr. Short opined that Heartland's cost of capital, will be approximately 9.67%, as determined by Mr. Work in his cost of service study and using a cost of common equity of 13%, as recommended by Heartland witness Andrew E. Goebel, and a debt cost rate of 6.33%.

Mr. Goebel testified regarding Heartland's cost of common equity. Mr. Goebel, an independent consultant, was formerly President and Chief Operating Officer ("COO") of Vectren Corporation and its regulated subsidiaries including SIGECO. Prior to the merger that formed Vectren, he held a number of positions at SIGECO, including Controller, Treasurer, Senior Vice President, Chief Financial Officer and Chief Executive Officer. He was also the President and COO of SIGCORP, Inc., the parent company of SIGECO. Mr. Goebel has extensive experience with respect to the financial management of regulated utilities and the non-utility segments of SIGECO's and SIGCORP's businesses. He also serves on the Board of Directors of the largest bank holding company headquartered in Indiana. Mr. Goebel has been involved in the financing and refinancing of hundreds of millions of dollars of debt and equity security issuances.

In Mr. Goebel's opinion, Heartland's cost of common equity is at least 13%. He believes 13% is an appropriate rate of return on equity to use for ratemaking purposes, giving consideration to (a) the business risks associated with the project; (b) Heartland's small size; (c) the need to provide returns that encourage the building of new pipelines in Indiana; (d) the need to provide returns that encourage the development, expansion and efficient operation of Indiana-based underground gas storage; (e) the proposed capitalization of Heartland, which includes significant use of low-cost debt capital; (f) the organization of Heartland as a flow-through entity for tax purposes; and (g) the returns provided other pipeline projects by FERC.

As a start-up company in an ever changing, uncertain natural gas industry with a very significant up-front capital expenditure required to execute its business plan, Mr. Goebel's

