Exhibit No.:
Issue(s): The Transaction Public Interest Detriments
Witness: Ted Robertson
Type of Exhibit: Rebuttal
Sponsoring Party: Public Counsel
Case Number: GM-2003-0238
Date Testimony Prepared: March 17, 2003

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

SOUTHERN UNION/MGE

Case No. GM-2003-0238

** **Denotes Highly Confidential** **

NP

March 17, 2003

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 54 and Schedule TJR-1 through TJR-3.

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

Ted Robertson, C.P.A.
Public Utility Accountant III

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

Kathleen Harrison
Notary Public

My commission expires January 31, 2006.

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REBUTTAL TESTIMONY

OF

TED ROBERTSON

SOUTHERN UNION COMPANY
d/b/a
MISSOURI GAS ENERGY

CASE NO. GM-2003-0238

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 7800, Jefferson City, Missouri 65102.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri ("OPC" or "Public Counsel") as a Public Utility Accountant III.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I graduated from Southwest Missouri State University in Springfield, Missouri, with a Bachelor of Science Degree in Accounting. In November, 1988, I passed the Uniform Certified Public Accountant Examination, and obtained C. P. A. certification from the State of Missouri in 1989.

Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WHILE IN THE EMPLOY OF OPC?

A. Under the direction of the OPC Chief Public Utility Accountant, Mr. Russell W. Trippensee, I am responsible for performing audits and examinations of the books and records of public utilities operating within the State of Missouri.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION?

A. Yes, I have submitted both written and oral testimony on many occasions before the Missouri Public Service Commission ("Commission"). Please refer to Schedule No. TJR-1, attached to this Direct Testimony, for a listing of cases in which I have previously submitted testimony.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this Rebuttal Testimony is to respond to the Direct Testimonies of Southern Union Company ("Southern Union" or "SUC") witnesses, Mr. Thomas F. Karam, President and Chief Operating Officer of Southern Union Company, and Mr. David J. Kvapil, Executive Vice President and Chief Financial Officer of Southern Union Company.

STANDARD OF PUBLIC INTEREST

Q. WHAT IS THE PRINCIPAL ISSUE REGARDING THIS CASE?

A. The principal issue before the Commission is whether or not the proposed transaction ("the Transaction") cumulating in the purchase of the Panhandle Eastern Pipeline Company ("Panhandle" or "PEPLC"), by Southern Union Company, is detrimental to the public interest. If the Commission decides that the Transaction, as proposed by SUC, is detrimental to the public interest, its authorization for the Transaction should be denied.

Q. WHAT IS THE STANDARD OPC UTILIZED TO DEVELOP ITS RECOMMENDATION CONCERNING THE PROPOSED ACQUISITION?

A. OPC utilized the "not detrimental to public interest" standard when analyzing this transaction. The " not detrimental to public interest" standard was first articulated in State ex rel. City of St. Louis v. Public Service Commission, 73 S.W.2d 393, 400 (Mo. banc 1934). The Court in City of St. Louis stated:

> To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more than "not detrimental to the public."

The controlling statute is Section 393.190 RSMo. 2002.

Q. HOW DOES THE PUBLIC COUNSEL DEFINE "PUBLIC INTEREST?'

A. OPC generally views the members of the public that are to be protected as those consumers taking and receiving service from SUC and the PEPLC operations should SUC gain control of that company. Therefore, Public Counsel would define the "public interest" as referring to the level of impact or effect that the proposed transaction will have on the Missouri customers of those companies.

The fundamental concern in the regulation of public utilities is that the public being served will not be adversely impacted or harmed by those responsible for providing the monopoly services. Thus, the public interest generically addresses utilities customers because of the theory of regulation. Regulation acts as a substitute for competition in a monopoly environment; therefore, utilities are required to pass a public interest test because customer service options are limited by the fact that they generally do not have a choice in the supplier of their utility services.

Q. HAS THIS COMMISSION EVER INDICATED HOW IT VIEWS THE TERM "PUBLIC" WITH REGARD TO SECTION 393.190(2) RSMo 1994?

A. Yes, it has. In KPL/KGE, Case No. EM-91-213, this Commission identified the "Public" as Missouri ratepayers. On page 13 of its Order, the Commission stated the following:

> Based upon these findings and determinations, the Commission concludes that **Missouri ratepayers** will be shielded from any potential ill effects from the proposed merger and will suffer no detriment as a result. Therefore, the Commission concludes that, in the absence of a finding of detriment to the public interest, it may not withhold its approval of the proposed merger and will authorize KPL to acquire and merge with KGE.
>
> (Emphasis added by OPC.)

Q. IS THE COMPANY REQUIRED TO SEEK COMMISSION AUTHORIZATION OF THE PROPOSED PURCHASE?

A. Yes, it's my understanding that the Company is statutorily required to obtain the Commission's authorization before consummating the Transaction. Section 393.190 RSMo. 2002, states:

> 2. No such corporation shall directly or indirectly acquire the stock or bonds of any other corporation incorporated for, or engaged in, the same or a similar business, or proposing to operate or operating under a franchise from the same or any other municipality; neither shall any street railroad corporation acquire the stock or bonds of any electrical corporation, unless, in either case, authorized so to do by the commission. Save where stock shall be transferred or held for the purpose of collateral security, no stock corporation of any description, domestic or foreign, other than a gas corporation, electrical corporation, water corporation, sewer corporation or street railroad corporation, shall, without the consent of the commission, purchase or acquire, take or hold, more than ten percent of the total capital stock issued by any gas corporation, electrical corporation, water corporation or sewer corporation organized or existing under or by virtue of the laws of this state, except that a corporation now lawfully holding a majority of the capital stock of any gas corporation, electrical corporation, water corporation or sewer corporation may, with the consent of the commission, acquire and hold the remainder of the capital stock of

such gas corporation, electrical corporation, water corporation or sewer corporation, or any portion thereof.

Q. DOES THE PUBLIC COUNSEL OPPOSE THE TRANSACTION?

A. Yes, as currently proposed. An analysis of this transaction must consider its overall anticipated effect on ratepayers for current and potential benefits and harms. Its effect on ratepayers must include consideration of a number of factors, including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial stability of the utility. Relative to these concerns the Public Counsel believes that the Transaction is detrimental to the public interest, as currently proposed, and that it should be rejected by this Commission.

SOUTHERN UNION'S APPLICATION

Q. BRIEFLY DESCRIBE THE PROPOSED TRANSACTION.

A. On or about January 13, 2003, Southern Union Company filed an Application with the Missouri Public Service Commission for authority to acquire directly or indirectly, up to and including one hundred percent (100%) of the equity interests of Panhandle Eastern Pipeline Company, including its subsidiaries, and to take all other actions reasonably

necessary to effectuate said transaction. The Panhandle Eastern Pipeline Company is currently wholly owned by CMS Gas Transmission Company ("CMS").

In exchange for PEPLC SUC (along with two other possible investors, AIG Highstar Capital, L. P. ("AIG" or "AIG Highstar") and AIG Highstar II Funding Corporation ("AIG" or "AIG Funding") will pay CMS approximately $662 million in cash, plus or minus changes in working capital and total debt since September 30, 2002. Panhandle's estimated liabilities of approximately $1.17 billion will also be assumed by the purchaser(s). (Source: Application, page 5.) Southern Union seeks to structure the Transaction so as to enable a "like-kind" exchange for Federal income tax purposes. Thus, according to the Application, PEPLC's shares will first be transferred to a "qualified intermediary" and then from the qualified intermediary to Southern Union Panhandle Corporation ("SUPC"), a new Southern Union subsidiary created to hold the assets being purchased.

BUSINESS ENTITY DETRIMENT

Q. WHAT IS THE ISSUE?

A. This issue pertains to the accuracy of information regarding the Transaction, and the future operation of the purchased company, as described by Mr. Karam, and others, within the Company. Public Counsel believes that the Company's public statements are not congruent with the actual events that will occur to consummate the Transaction. On page 6, lines 1-6, of Mr. Karam's Direct Testimony, he states that neither AIG Highstar nor AIG Funding will

have any voting shares of SUPC, or any rights to have an observer at board meetings of SUPC. Nor will AIG Highstar or AIG Funding have any right to participate in ordinary course of management decisions regarding SUPC. However, Public Counsel finds these, and other comments, offered by Mr. Karam to be suspect.

For example, Mr. Karam, other Company personnel, and the Company's original Application, have often identified SUPC as the ultimate owner of the PEPLC operations, however, OPC has learned that SUPC will not be the ultimate owner of the PEPLC operations. Public Counsel became aware, after reading various Company provided documents (including Company's response to MPSC Staff Data Request No. 4510), that the PEPLC operations will be transferred to a "C Corporation" named Southern Union Exchange Company ("SUEC"), not SUPC. SUEC will then convert the various PEPLC "C Corporations" into Limited Liability Companies ("LLC") which through later transactions will be transferred to SUC. It is then expected that SUC will transfer its interests in those LLCs to its LLC, "Pipeline LLC." When Public Counsel inquired as to the purpose of the conversion, Company responded, "The primary purpose of the conversion is to facilitate the like-kind exchange. (Source: OPC Data Request No. 1020.)

Q. WHAT IS A LIMITED LIABILITY COMPANY?

A. A Limited Liability Company is a type of business entity commonly referred to as a "Partnership." The Partnership proposed by the Company is to be structured according to

the requirements of Title 26 United States Code - Subtitle A, Chapter 1 - Subchapter K. Company confirmed the structure in its response to OPC Data Request No. 1030:

> Yes. The legal entity will be an LLC that is treated as a partnership under Subchapter K. In general, an LLC with two or more equity owners is taxed as a partnership absent an affirmative election to be taxed as a corporation. Treas. Reg. Sec. 301.7701-3(b)(1).

Q. DOES THE GOVERNING INTERNAL REVENUE CODE ("IRC") FOR LIKE-KIND EXCHANGES REQUIRE THE CONVERSION OF "C CORPORATIONS" TO A LLC?

A. Company has stated that it does. However, my reading of the relevant sections of IRC Section 1031 did not specifically yield the necessity for such transactions to occur via an LLC.

Q. HOW IS THE TRANSACTION ACTUALLY EXPECTED TO OCCUR?

A. Public Counsel was made aware that the converted PEPLC "C Corporations" were to be transferred to an entity titled "Pipeline LLC." When OPC requested (OPC Data Request No. 1021) Company to identify and explain the creation and purpose of "Pipeline LLC", its response stated:

> 1. "Pipeline LLC" will be formed in contemplation of an equity investment by AIG Highstar. "Pipeline LLC" will be titled Southern Union Panhandle, LLC. Note that Southern Union Panhandle, LLC is currently Southern Union Panhandle Corp., a wholly owned "C Corporation" subsidiary of SUC. Prior to the drop-down of Panhandle from SUC, Southern Union Panhandle Corp. will be

converted to an LLC. In addition, the ownership of Southern Union Panhandle, LLC will be divided between two SUC entities; thus, creating a "tax" partnership. The Southern Union Panhandle, LLC partnership agreement is currently being drafted.

2. The identity of the "two SUC affiliates" have not been finalized as of this date. It is likely that SUC will own a direct membership interest in Southern Union Panhandle, LLC. The other SUC affiliate will likely be an existing 100% owned subsidiary of SUC. The purpose of using two SUC affiliates is to create a "tax" partnership in contemplation of an equity investment by AIG Highstar.

Thus, even though the Company, and Mr. Karam, have consistently stated that SUPC will own the purchased operations, that is not so. SUPC (a "C" corporation), according to the response to OPC Data Request No. 1021, and the response to MPSC Staff Data Request No. 4510, is to be converted to an LLC which in turn will be owned by two "unknown at this time" SUC affiliates.

Q. WHY IS THIS INFORMATION SIGNIFICANT?

A. The significance of this information is threefold, 1) the Company has alleged in its communications that AIG's participation in the Transaction would occur via a "preferred stock" ownership and they (AIG) would have little or no say in the management of the operations, 2) by structuring the ultimate ownership of PEPLC as an LLC, Company is creating an business entity commonly known as a "Partnership," and the terms of that Partnership have not been defined and presented for review and analysis to the reviewing parties, and 3) SUC has not yet identified the ultimate owners of PEPLC.

Q. A LLC PARTNERSHIP IS NOT THE SAME AS A "C" CORPORATION, IS THAT CORRECT?

A. Yes. A partnership is not a "C Corporation" as Company has alleged SUPC would be thus, if AIG participates in the Transaction it will not be issued "Preferred Stock." Company's public statements to this effect appear to have been only half-full since, to my knowledge, a partnership does not issue equity such as preferred stock. **Company's response to OPC Data Request No. 1033 stated that AIG has agreed to accept a preferred LLC membership interest similar to preferred stock. That is, AIG's interest in PEPLC would be a preferred LLC interest in the LLC.** If AIG does participate in the Transaction, the yet to be drafted "Partnership Agreement" will be the governing document regarding its (and the SUC entities) rights and obligations to the LLC.

Q. IS A PREFERRED LLC MEMEBERSHIP INTEREST THE SAME AS A "C" CORPORATION PREFERRED STOCK?

A. No. A "C Corporation" preferred stock is, among other things, a type of owners equity that defines ownership in the corporation, and usually it can be traded on the financial markets. A partnership equity interest is not, to my knowledge, a publicly traded financial instrument, and its rights and obligations are solely defined and governed by the Partnership Agreement.

Q. SINCE THE PARTNERSHIP AGREEMENT HAS NOT BEEN FINALIZED, DOES THAT MEAN THAT COMPANY'S PAST COMMUNICATIONS REGARDING PEPLC'S FUTURE MANAGEMENT AND OPERATIONS ARE YET TO BE DEFINED OR DECIDED?

A. Yes. The Partnership Agreement will be the governing document regarding the management, operation, and ownership rights and obligations of the LLC itself. Since this document has not been prepared or provided to the interested parties (MPSC Staff, OPC, etc.), we are unable to identify for the Commission how the LLC will actually be structured, managed and operated. Company's past comments on this issue are essentially irrelevant as long as the Partnership Agreement is not available for review. Without it, the Public Counsel, and I suspect, the other interested parties, are not able to fully analyze the Transaction.

Q. WHEN WILL THE PARTNERSHIP AGREEMENT BE FINALIZED?

A. **It has yet to be drafted.** According to the Company's response to OPC Data Request No. 1030:

> The LLC Partnership Agreement has not yet been drafted. We anticipate that the Agreement will follow a standard format and, thus, there is not an immediate need to work on a draft of this Agreement. Note that the LLC Partnership Agreement will be consistent with the terms outlined in the AIG letter dated December 20, 2002 as provided in Staff Data Request #1.

Q. DOES THE PUBLIC COUNSEL BELIEVE THERE IS AN IMMEDIATE NEED FOR THE LLC PARTNERSHIP AGREEMENT?

A. Yes. The Partnership Agreement document is the ultimate authority as to how the partnership will be managed and operated. The letter referred to in the Company's response to OPC Data Request No. 1030 is a vague formless commentary on AIG's agreement with SUC to allow it to structure the Transaction as it sees fit. It does not have the authority inherent to the LLC Partnership Agreement nor, I believe, would it be recognized as a governing document in compliance with the requirement of IRC Subchapter K. The Partnership Agreement is the ultimate authority with regard to the rights and obligations of the partnership equity owners of the LLC, and its management and operation. Without it we really know nothing of what the actual ownership interests and obligation will be or who will manage the LLC or how it will be operated. Its finalization, and review by the interested parties, is of the utmost necessity before any agreement should be reached to let this proposed transaction move forward.

Q. DOES THE PUBLIC COUNSEL ALSO BELIEVE THERE IS AN IMMEDIATE NEED TO IDENTIFY THE "TWO UNKNOWN SUC AFFILIATES" DISCUSSED IN THE COMPANY'S RESPONSE TO OPC DATA REQUEST NO. 1021?

A. Yes. Since these proposed entities are to be utilized in the resolution of the final business entity structure for the PEPLC operations, Public Counsel believes that they are an integral part of the Transaction. Therefore, all aspects of their development and operation should be made available to the interested parties for review and analysis. Absent the provision of this

information, SUC has withheld an important piece of the puzzle upon which it seeks an affirmative response from this Commission.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS SECTION OF YOUR TESTIMONY.

A. Pretty much everything the Company has alleged in its oral and written communications regarding the ultimate ownership, management and operation of PEPLC is of little relevance or consequence. Company has alleged, in a good part of its communications with the interested parties, that SUPC would be the ultimate owner of PEPLC, but that is not so. It has also claimed that if AIG participates in the Transaction it would receive preferred stock in SUPC, but that is not so either. SUPC is not going to exist. It is to be succeeded in form by an Limited Liability Company. An LLC that does not yet have a finalized, or even draft version, of its Partnership Agreement. Nor, do we know who will be the owners of the LLC. Company alleges that is has not yet made that determination either.

At a minimum, Public Counsel believes this information (i.e., Partnership Agreement and complete information regarding the affiliates that will own the LLC) must be made available for review and analysis. Absent the provision of that information, we, and the other interested parties, have no substantive knowledge of how or who will own, manage or operate PEPLC, if the Transaction is authorized. A great deal of information provided to us by the Company regarding the terms of this transaction has proven to be significantly

different that we were first led to believe. In fact, we do not even know the actual terms that will govern the finalized business entity, and in the words of Mr. Karam, when questioned by MPSC Staff employee, Ms. Morrissey, regarding the terms of an agreement Company's affiliate has with the Southern Star Central Pipeline:

Two parties can always amend the terms of an agreement.

(Source: Transcript, Informal Interview SUC, MPSC Case No. GM-2003-0238, February 5, 2003, Capital Plaza Hotel, page 155, line 4 -5.)

Public Counsel believes that the final terms associated with structure of the business entities involved have not been provided to the interested parties for review and analysis. They have not been provided because they have not been finalized thus, we can take no other position than that the Transaction is a detriment to the public interest.

ACQUISITION PREMIUM (ADJUSTMENT) DETRIMENT

Q. WHAT IS THE ISSUE?

A. In its response to OPC Data Request No. 1014, Company alleges it will incur an acquisition premium related to the Transaction:

a. As disclosed in DR 0003, the estimated acquisition premium or goodwill expected to be incurred in the transaction based on the September 30, 2002 balance sheet is approximately $127 million.

DR 0003 is a reference to MPSC Staff Data Request No. 0003. The response to that data request provides a calculation that shows the alleged historical costs of the assets acquired less liabilities assumed netted against the cash purchase price. The result is estimated goodwill (acquisition premium) of $126,669,000.

Q. PLEASE EXPLAIN WHAT IS MEANT BY THE ACCOUNTING TERM "ACQUISITION ADJUSTMENT."

A. In traditional accounting, fixed assets, such as plant, are usually recorded at "original cost". Original cost, as applied to utility plant, means the cost of property to the utility first devoting it to public service. An acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below book value. Book value relates to the value placed on utility property and recorded on the Company's financial books and records at the time the utility property is first placed in public service.

If the utility property is purchased by another utility, the purchaser must record the acquisition in the appropriate "plant and property" accounts at the selling utility's original cost; similarly, the purchaser records the seller's accumulated depreciation, amortization, and contributions in aid of construction ("CIAC") in the appropriate account(s). Any difference between the original cost and the actual price paid by a subsequent purchaser is recorded as the acquisition adjustment. An acquisition adjustment does not represent a

contribution of capital (i.e., neither cash or new investment) to the public service. It merely represents a purchase of the legal interests in the properties that were possessed by the seller.

When utility property is purchased from another utility, the buyer is allowed to capitalize only the cost of the property when it was originally dedicated to utility service. This means that the excess paid over original cost for the property cannot be recorded in the Uniform System of Accounts ("USOA") Account No. 101, Utility Plant In Service. The difference (the premium amount) is recorded in the balance sheet plant USOA Account No. 114, Utility Plant Acquisition Adjustments, and any amortization of the balance is booked to the balance sheet plant reserve USOA Account No. 115, Accumulated Provision For Amortization Of Acquisition Adjustments.

If the Commission determines that the costs should be recovered from the buyer's customers, the regulatory authority may allow an offsetting amortization (expense) entry which books the costs to the utility's income statement operating income via USOA Account No. 406, Amortization Of Utility Plant Acquisition Adjustments thus, including the premium above the line for regulatory ratemaking. If the Commission decides that ratepayers should not be held responsible for the cost, the premium is amortized (expensed) to the non-operating income USOA Account No. 425, Miscellaneous Amortization.

Simply put, an acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below book value. Book value relates to the value placed on utility property as recorded in a company's financial books and records. It consists of the property's "original cost" less depreciation, amortization, and CIAC. If the purchase price exceeds book cost, a "premium" has been paid to the seller. If the purchase price is less than book cost, a "discount" has been paid to the seller. The premium or discount is classified and booked on the purchasing company's financial records as an acquisition adjustment.

Q. WHAT IS ORIGINAL COST?

A. The term "original cost", as defined by the 1976 Uniform System of Accounts for Class A and B Gas Utilities, page 12, relates to:

> 2. Utility Plant to be Recorded at Cost.
>
> A. **All amounts included in the accounts for utility plant acquired as an operating unit or system, except as otherwise provided in the tests of the intangible plant accounts, shall be stated at the cost incurred by the person who first devoted the property to utility service.** All other utility plant shall be included in the accounts at the cost incurred by the utility. Where the term "cost" is used in the detailed plant accounts, it shall have the meaning stated in this paragraph.
>
> (Emphasis added by OPC.)

The deduction of depreciation, amortization and contributions in aid of construction from the original cost results in a net original cost recorded on the financial books and records. This principle is referred to as the "original cost first devoted to public service concept."

Q. IS THE USE OF NET ORIGINAL COST FOR VALUING RATE BASE STILL THE PREDOMINANT FORM OF REGULATION?

A. Yes. In the State of Missouri, the use of original cost less depreciation and CIAC to set rate rates is the only accepted form which has been employed by the Missouri Public Service Commission for setting gas and electric rates. I know of no other time that this Commission has deviated from the concept of using net "original cost" in setting rates.

Q. IS THE USE OF ORIGINAL COST FOR VALUING RATE BASE CONSISTENT WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES?

A. Yes, it is. The accounting profession's "cost principle" specifies that cash-equivalent cost is the most useful basis for initial accounting recognition of the elements recorded in the accounts and reported on the financial statements. It is important to note that the cost principle applies to the initial recording of transactions and events. Financial Accounting Standards Board Concepts Statement 5, paragraph 67, explains that the initial cost is commonly adjusted for depreciation, amortization or other allocations. The "accounting constant" is the starting point, which is the historical (i.e., original) cost of the property being purchased.

Q. WHAT IS THE HISTORICAL BACKGROUND FOR THE POSITION THAT ORIGINAL COST SHOULD BE THE BASIS FOR SETTING RATES?

A. Abuses occurred in the 1920's and 1930's creating the need to adopt the original cost method for setting rates. Utilities were acquiring other utility properties for amounts in excess of net book value. This valuation and transfer in excess of book value (i.e., positive acquisition premium or adjustment) created inflated rate bases which resulted in higher rates to existing customers. These customers were paying higher rates based on the exact same property that had been providing them utility service prior to the acquisition; when in fact, nothing had changed except for the valuation of the properties transferred. It was believed that it was unreasonable to charge customers higher rates for the same utility property simply because the utility providing the service was acquired by another company. Thus, the concept of using the original cost of the property when first devoted to public service came to be widely accepted. This principle has served to protect ratepayers from utilities who would buy properties at inflated prices and then seek revaluation of the properties at higher levels in order to produce greater profits. Absent this protection the potential for abuse through acquisitions and mergers is the same as it was prior to implementation of the original cost concept. The original cost of utility plant is the cost to the owner who first placed the property into public use.

Q. DOES THE PUBLIC COUNSEL OPPOSE ANY EFFORTS TO RECOVER THIS ACQUISITION PREMIUM AND THE RELATED PURCHASE TRANSACTION COSTS FROM THE COMPANY'S MISSOURI RATEPAYERS.

A. Yes. Public Counsel would oppose any recovery of the acquisition premium above the original booked cost of the assets purchased. Also, the related purchase transaction costs are incurred for the benefit of shareholder, not ratepayers, thus, we would oppose any recovery for those costs too.

Q. HAS THE COMPANY OFFERED TO FORGO RECOVERY OF THE ACQUISITION PREMIUM AND RELATED TRANSACTION COSTS?

A. Yes, in part. On page 1, Appendix 8, to the Application filed on January 13, 2003 Company states:

> B. The amount of any asserted acquisition premium (i.e., the amount of the total purchase price above net book value including transaction costs) paid by Southern Union in connection with the Transaction shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates. Southern union shall not seek either direct or indirect rate recovery or recognition of any acquisition premium, including transaction costs, through any purported acquisition saving adjustment (or similar adjustment) in any future ratemaking proceeding in Missouri. Southern union reserves the right to seek Missouri rate recovery for internal payroll costs necessary to obtain Missouri regulatory approval of the Transaction, to the extent it can be shown that the savings achieved and allocate to MGE as result of the Transaction are equal to or in excess of such costs . Other parties to any such proceeding will not be precluded from opposing rate recover of such costs, regardless of any asserted acquisition savings. In addition, Southern Union shall not seek to recover in Missouri the amount of any asserted

> acquisition premium in the Transaction as being a "stranded costs" regardless of the terms of any legislation permitting the recovery of stranded cost from Missouri ratepayers.

Q. IF THE COMPANY HAS AGREED TO FORGO RECOVERY OF THESE COSTS IN ANY FUTURE RATEMAKING PROCEEDING IN MISSOURI WHAT IS THE ISSUE?

A. The issue is two-fold, 1) the Company, as a term of the Transaction, has indicated that it will make a IRC Section 338(h)(10) election with CMS which is a tax basis valuation issue for federal income tax purposes, and 2) Company has not agreed to not seek recovery of any book basis acquisition premium and related transaction costs in the future rates the PEPLC entity will charge its customers.

Q. WHERE DOES THE COMPANY DISCUSS ITS IRC SEC. 338 ELECTION?

A. In the Stock Purchase Agreement attached to its Application to the Commission. Also, Company's response to OPC Data Request No. 1006 stated:

> Pursuant to Section 5.6(a) of the Stock Purchase Agreement, CMS and SUC have agreed to make an IRC Sec. 338(h)(10) election wherein the stock purchase will be treated as an asset purchase for federal income tax purposes.

Q. TO WHAT IS IRC SECTION 338(h)(10) A REFERENCE, AND WHAT IS ITS SIGNIFICANCE REGARDING THIS ISSUE?

A. An IRC Section 338(h)(10) election refers to Title 26 - Internal Revenue Code, Section 338.

IRC Section 338 states, in part:

> (a) General rule
>
> For purpose of this subtitle, if a purchasing corporation make an election under this section (or is treated under subsection (e) as having made such an election), then, in the case of any qualified stock purchase, the target corporation -
>
> (1) shall be treated as having sold all its assets at the close of the acquisition date at fair market value in a single transaction, and
>
> (2) shall be treated as a new corporation which purchased all of the assets referred to in paragraph (1) as of the beginning of the day after the acquisition date.
>
> (b) Basis of assets after deemed purchase
>
> (1) In general
>
> For purpose of subsection (a), the assets of the target corporation shall be treated as purchased for an amount equal to the sum of -
>
> (A) the grossed-up basis of the purchasing corporation's recently purchased stock, and
>
> (B) the basis of the purchasing corporation's nonrecently purchased stock.

Essentially, what the IRC means is that the purchase of PEPLC will be treated as an asset sale and the value of the assets to be recorded on the books of the purchaser shall equate or

"step up" to the market value of the stock purchased (the Transaction purchase price) for federal income tax purposes.

Q. HOW DOES IRC SEC. 338 IMPACT THIS TRANSACTION?

A. ** _____
_____
_____
_____**, and 2) SUC's decision to enacted an IRC Sec. 338 election may further exaggerate any difference between the actual original cost of the assets and their value as shown on the books of the purchasing entity.

Q. ** _____
_____
_____**?

A. I believe that they are. Public Counsel sent Data Request Nos. 1000 - 1005 to the Company seeking information regarding the asset values booked by CMS Holding Company subsequent to its purchase of the PEPLC properties from Duke Energy. The Company's response to Data Request No. 1001 stated, in part:

> Note that a Sec. 338(h)(10) election treats a stock purchase as an asset purchase for federal income tax purposes. The purchase price for all assets is allocated to each asset under IRC Sec. 339(b)(5) and Treas. Reg. 1.338-6.

This may result in a "step-up" and/or "step-down" for each asset depending on the facts and circumstances. In most cases, the purchase price is allocate based on a valuation study, which determines the value of each asset or class of assets.

Except for questions regarding who pays the income tax on any gain associated with the sale, and the tax treatment of the booked deferred income taxes, Company's responses to all other questions on those data requests about this matter consisted of the following:

This question was not addressed in SUC's due diligence of Panhandle.

However, contained within the Company's response to MPSC Staff Data Request No. 0012 was a document titled, ** _____

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_____ **

Of that ** _____
_____
_____ **.

Q. DID SUC HAVE ACCESS TO THIS INFORMATION?

A. SUC provided the due diligence documents to Public Counsel.

Q. IS IT THE PUBLIC COUNSEL'S BELIEVE THAT THE PANHANDLE PROPERTY, PLANT AND EQUIPMENT BEING ACQUIRED BY SUC IS RECORDED AT AN AMOUNT IN EXCESS OF ITS ACTUAL ORIGINAL BOOK COST?

A. ** ____**. However, in an effort to confirm the accuracy of the information I just discussed, Public Counsel sent to the Company the data requests I mentioned in the preceding paragraphs. The Company's responses, as I discussed, feigned a lack of knowledge.

Q. WILL THE ASSET VALUES RECORDED ON THE PIPLINE LLC BOOKS OF RECORD FOR THE PEPLC PROPERTIES LIKELY BE INFLATED BECAUSE OF SUC'S IRC SEC. 338 ELECTION?

A. I believe that that is a valid possibility. If the Pipeline LLC is allowed to increase its assets basis for the difference in the actual original booked cost of the assets and the purchase price associated with the Transaction, it is the Public Counsel's belief that the properties values will be inflated.

Q. HASN'T THE COMPANY STATED THAT IT INTENDS TO SELL SOME PEPLC OPERATIONS AND THAT THE TOTAL ACQUISITION PREMIUM WILL LIKELY FOLLOW THOSE SALES?

A. Yes. Public Counsel, in its Data Request Nos. 1014 and 1027, inquired as to the allocation of the acquisition premium among the operations to be acquired, Company's response to OPC Data Request No. 1014 stated:

> As disclosed in DR 0003, the estimated acquisition premium or goodwill expected to be incurred in the transaction based on the September 30, 2002 balance sheet is approximately $127 million. This does not consider any subsequent disposition of any properties acquired in the transaction. The specific acquisition premium amounts to allocated to the LNG Holdings and Sea Robin operations will be determined based on appraisals to be performed. If LNG Holdings were to be sold for between $500 to $550 million, most if not all of the acquisition premium, would be allocated to these assets based on the September 30, 2002 balance sheet.

Furthermore, Company's response to OPC Data Request No. 1027 stated:

> Based on financial analyst's verbal representation to Southern Union management, they believe that the LNG Holding could be sold for $500 to $550 million. If any potential sale could occur at the is price

> or if a yet to be performed appraisal would substantiate this amount, than (sic) the PEPL operations would be recorded by Southern Union at their current book carrying cost. This is due to current accounting treatment in which the majority of the goodwill on the total transaction would be allocated to LNG Holdings which would result in no financial gain if LNG was sold within one year after acquisition.
>
> Generally Accepted Accounting Principles (GAAP) require that purchases of non-regulated entities assets and liabilities be recorded at fair value. The recording of assets at fair value cannot exceed the purchase price. Since PEPL is not on FAS 71, and based on the response to item 1 above, the PEPL assets and liabilities would be recorded at their current book carrying cost if LNG were sold for approximately $550 million and the appraisal indicated a value at or above current book carrying costs.

However, the Company provides no guarantee that the appraisal will come in as expected or that a sale will occur within the one year referenced. Thus, ratepayers are still at risk regarding recovery of the acquisition premium in this transaction, and for the ** _____ _____ **.

Q. IF SUC WILL NOT AGREE AT THIS TIME TO FORGO RECOVERY, VIA BOTH RETAIL AND WHOLESALE RATES, OF ANY ACQUISITION PREMIUM, AND RELATED TRANSACTION COSTS, ASSOCIATED WITH THE TRANSACTION, WILL THAT BE A DETRIMENT TO MISSOURI RATEPAYERS?

A. Yes, it will. Although the Company has agreed to forgo retail recovery of the costs, it has not agreed to forgo wholesale cost recovery. Company's refusal to agree to a complete prohibition on recovery of the costs indicates that it is completely possible that the "step-up"

in the value of the Pipeline LLC assets basis, along with additional goodwill costs, may result in it claiming a larger rate base, and larger expenses at the wholesale level. The associated costs of that occurring would then be passed through to its retail customers in Missouri via the wholesale gas rates. This "back-door" approach to recovery of the costs would not be appropriate.

Q. WHY IS THE OPC ADDRESSING RATEMAKING MATTERS IN THIS CASE?

A. OPC believes that now is an appropriate time for the Commission to reaffirm its policy of not reflecting acquisition adjustments in rates. It is important for the Commission to understand the real risks of consummating this sale with regard to any recovery of the acquisition premium. If SUC is allowed to acquire the PEPLC properties, it should agree in advance that neither it nor PEPLC, or its successors, are going to receive recovery of the acquisition premium or the related transaction costs in regulated rates. This places the financial risk of the transaction exactly where it belongs, on the shareholders of SUC.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. The rate base of a public utility represents the reasonable value of all property which is in service and devoted to the public use. Because the actual original cost of a utility's property remains unchanged as its relates to the buying and selling its stock, the transfer of stock, the indicia of ownership in a corporate entity whose stockholders are separate and distinct from the entity itself, does not affect the value of its property in service and devoted to the public use. Thus, no recalculation of the utility's property, or rate base, for

an acquisition premium, or discount, is appropriate. The SUC proposed acquisition premium consists of nothing more than a financial transaction that values the excess purchase cost over and above the net original cost of the PEPLC properties (** _____ _____ **).

In and of itself, the acquisition premium provides no additional benefit to Missouri ratepayers; therefore, to allow the Company recovery through a rate base return or cost of service expense item unjustly penalizes consumers. Public Counsel believes that to the extent any recovery of the acquisition premium is allowed, through either retail or wholesale rates, it would increase costs to Missouri ratepayers thus, the acquisition premium is a significant detriment to the public interest. It would have a detrimental affect on the public because their service costs would then be higher than if the sale had not occurred.

DEFERRED INCOME TAXES DETRIMENT

Q. WHAT IS THE ISSUE?

A. Company response to OPC Data Request No. 1006 indicates that, per the terms agreed to in the Transaction, the deferred income taxes recorded on the books of the PEPL operation will be retained by CMS. It states:

> Panhandle's deferred income taxes will not carry over to SUC since the acquisition is treated as an asset purchase for federal income tax purposes.

Q. DID DUKE ENERGY ALSO RETAIN THE DEFERRED INCOME TAXES WHEN IT SOLD THE PROPERTIES TO CMS?

A. That is a possibility, however, I do not know that to be fact. Company's response to OPC Data Request No. 1000 states:

> If an IRC Sec. 338(h)(10) election was made in conjunction with the stock sale from Duke to CMS then, for federal income tax purposes, the sale would have been treated as an asset sale and not a stock sale. Hypothetically, upon the date of the stock sale, the sellers deferred income tax liability would have been recognized by the seller as a current income tax liability. However, the public information we reviewed does not provide this answer.

Q. WHAT ARE DEFERRED INCOME TAXES?

A. Deferred income taxes (and investment tax credits) represent money. They are in essence the result of accounting rules and procedures pertaining to the matching of income tax expense with the income that caused the income tax effect. Income tax allocation is necessary because some transactions affect the determination of income for financial accounting purposes in one period and computation of income tax payable in another period. These transactions represent either permanent or temporary tax timing differences that arise due to various tax laws. Because of these transactions income tax expense and income tax payable often are different amounts for a particular accounting period. If the

balance for these different amounts indicate money owed to the government it is a liability, and if owed to the company an asset.

Usually the net deferred income tax balance is booked as a liability on a company's balance sheet, and this amount is considered a tax-free loan to the company, from the government, for regulatory purposes. However, the monies represented by the deferred income tax liability are provided by ratepayers to a company in the form of the rates that they are charged by the company for the provision of its service and/or products. The deferred income tax liability balance is subtracted from a utility's rate base during ratemaking because the utility should not be allowed to earn a return on ratepayer supplied loans.

Q. WHY WOULD THE LOSS OF THE DEFERRED INCOME TAXES BE A DETRIMENT TO MISSOURI RATEPAYERS?

A. Because of the nature of the tax timing differences that make up the deferred income taxes. For example, one type of tax timing difference is the accelerated rates of depreciation that the Internal Revenue Code allows for investment in various types of plant. Early in the plant's life the higher rates of accelerated depreciation create, for income tax purposes, larger amounts of depreciation expense on the income statement thus, less taxable income represents lower income taxes payable. However, the book depreciation rates utilized by a company are usually lower than the accelerated depreciation rates and will create less depreciation expense on the income statement thus,

less expense equates to more taxable income and more income taxes. The regulated utility ratepayer is required to reimburse the utility a level of taxes commensurate with the income generated utilizing the usually lower book depreciation rates. The difference between tax amounts collected from the ratepayer and the amount of taxes payable to the government is recorded as a deferred income tax. The company has free use of these deferred income tax monies until such time in the future that they become taxes payable.

Later in the plant's life the situation reverses, that is, even though book depreciation rates stay the same, the accelerated depreciation expense becomes less than book depreciation expense thus, taxable income increases because most of plant's depreciation for income tax purposes occurred earlier in its life. For income tax purposes, less depreciation expense means more taxable income and more taxable income means more taxes payable. However the revenue company is collecting from the ratepayers stays the same based on book depreciation rates so the difference in what is collected from ratepayers for taxes and the income taxes now payable flows in reverse from the deferred income tax balance, and is paid as current taxes.

Because the deferred income taxes represent monies provided to the company by the ratepayers, they should remain with the plant (investments) that created them. Otherwise when the tax timing differences reverse, the ratepayers will not receive the benefit of the monies they have already provided to the CMS to pay the taxes owed at that later date. Because the Transaction, and SUC's non-recognition of the deferred income taxes

balances, and investment tax credits, on CMS's financial books, creates a situation whereby Missouri ratepayers will be forced to provide additional funds to replace the monies that they have already provided to pay the future taxes owed that are associated with the PEPLC operations, Public Counsel believes that the Transaction is a detriment to the public interest.

ENVIRONMENTAL REMEDIATION DETRIMENT

Q. WHAT IS THE ISSUE?

A. Public Counsel, based on knowledge of prior mergers, is concerned with current and potential environmental remediation efforts that may involve SUC if it is allowed to purchase PEPLC. Since these costs, along with associated regulated rate recovery of the costs, is and has been a contentious issue in the State of Missouri, Public Counsel sought from the Company information as to how Missouri ratepayers would be insulated in the event those types of costs materialized. Public Counsel sent Company OPC Data Request No. 1012 asking if an agreement exists between SUC and CMS regarding any obligation of CMS to defend and indemnify SUC, and its affiliate, against any future environmental litigation and claims related to the assets to be purchased, and if none exists, why SUC did not think it necessary to obtain and include such a safeguard in the proposed transaction's terms. Company's response to the question stated:

> The Stock Purchase Agreement was a product of negotiation.

Apparently, the Company thought such a safeguard was not necessary. Public Counsel would disagree. The absence of such indemnity subjects the ratepayers in Missouri to a level of risk that they would not experience should the Transaction not have ever occurred. This associated risk is a detriment to the public interest.

Q. DID CMS OBTAIN INDEMINFICATION FOR ENVIRONMENTAL REMEDIATION EFFORTS WHEN IT PURCHASED THE PEPLC COMPANIES FROM DUKE ENERGY?

A. ** _____
_____
_____
_____
_____
_____
_____**. Public Counsel believes that if the shareholders of the Company want to agree to shoulder that risk in its entirety, then so be it, however the regulated ratepayers of the State of Missouri should not be subjected to or responsible for such risk. This, most certainly, is a detriment to the public interest of the people of this State.

EMPLOYEE BENEFIT DETRIMENT

Q. WHAT IS THE ISSUE?

A. Under the current transaction structure, SUC will not receive any asset transfers relating to pension or other post-employment benefit plans. According to the terms of the Transaction, SUC will retain a portion of the projected benefit obligation for pensions and a portion of the accumulated other post-employment benefit obligations. CMS will retain all assets associated with these plans. Thus, SUC has agreed to adopt certain past service obligations but will retain none of the assets that back them. Subsequently, it is likely that SUC will experience higher benefit costs and funding requirements for the pension and other post-employment benefits of its PEPLC employees.

Q. WILL THE PENSION PLAN ASSETS FOR ALL THE PEPLC EMPLOYEES BE RETAINED BY CMS?

A. Yes. Regarding the retention of the assets belonging to the PEPLC employees pension plan, the Company's response to OPC Data Request No. 1015 states:

> a. All of the pension plan assets associated with Panhandle employees are being retained by CMS. We do not know the dollar amount, because CMS does not break out the Panhandle employees for this purpose in its actuarial reports.
>
> b. The new SUC subsidiary will retain no pension plan assets associated with Panhandle employees.

Q. WILL THE OTHER POST-EMPLOYMENT PLAN ASSETS FOR ALL THE PEPLC EMPLOYEES BE RETAINED BY CMS?

A. Yes. Regarding the retention of the assets belonging to the PEPLC employees other post-employment plans, the Company's response to OPC Data Request No. 1017 states:

> b. CMS is retaining all VEBA and Section 401(h) trust assets.

Q. WILL THE PENSION PLAN BENEFIT OBLIGATION FOR ALL THE PEPLC EMPLOYEES WILL BE RETAINED BY CMS?

A. SUC states that they will. Its response to OPC Data Request No. 1016 it stated:

> a. All of the pension plan obligations associated with Panhandle employees are being retained by CMS. We do not know the dollar amount, because CMS does not break out the Panhandle employees for this purpose in its actuarial reports.
>
> b. None of the pension plan obligations associated with Panhandle employees are being retained by the new SUC subsidiary.

However, its the Public Counsel's understanding that CMS intends to retain only the pension benefit obligations of PEPLC's current retirees and active employees who are eligible to retire. The pension obligations of active employees who may be "vested" but not yet eligible to retire will transfer to SUC, or be eliminated. If they were to be eliminated, that would be a great disservice to the dedicated hardworking PEPLC employees who put in

years of service with the expectation that they would receive the pension benefits once they retire.

Q. IS IT THE PUBLIC COUNSEL'S BELIEF THAT SUC WILL RETAIN A PORTION OF THE PENSION PLAN BENEFIT OBLIGATION FOR THE PEPLC EMPLOYEES IT KEEPS?

A. Yes. In its response to OPC Data Request No. 1019, SUC stated that it does not intend to sponsor a defined benefit pension plan for Panhandle thus, it will not be obligated for any PEPLC employees pension plan benefit obligation. The response stated:

> b. Pension: Southern Union will not be sponsoring a defined benefit pension plan for Panhandle, so no opening balance sheet liability will exist. ERISA/IRS mandated cash costs will be limited to a percentage of each employee's compensations, as determined by reference to a table which is entered based on the sum of the employee's age plus service as of the closing date.

Apparently, SUC, would have the Commission believe that since it will not be offering its PEPLC employees a defined benefit pension plan, no pension benefit obligation will exist. Technically, the response may be correct, however, SUC's response indicates that it does intend to provide the PEPLC employees with what is known as a "cash-type" retirement plan. SUC even admits that it will fund a cash balance based on a table reference of the sum of the employee's age plus service as of the closing date of the Transaction. Essentially, what SUC is saying is that the pension benefit obligation associated with these

b. OPEB: The opening balance sheet liability will be limited to past service accruals for employees not yet eligible to retire. It has not been quantified.

Here too the Company will incur additional costs due to the fact that CMS has retained all the assets associated with the other-employment benefit obligations for PEPLC employees not yet able to retire.

Q. WHAT IS THE SIGNIFICANCE OF SUC NOT RECEIVING THE PORTION OF THE PLANS ASSETS THAT SUPPORT THE EMPLOYEE BENEFIT OBLIGATIONS IT WILL ADOPT?

A. It's the Public Counsel's belief that a portion of the plans assets retained by CMS represent amounts for which ratepayers have already been charged for the past service obligations of PEPLC employees that SUC will retain. Because the Transaction does not provide SUC with the assets that support those benefit obligations, it is likely that ratepayers will be required to fund them again. This amounts to charging the ratepayer twice for the same cost.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. By the terms of the Transaction, SUC and CMS have negotiated that all plan assets supporting the pension and other-employment benefit plan obligations for the PEPLC employees will be retained by CMS. However, SUC has taken upon itself to assume the future payment of the benefit plan obligations for certain employees prior service with

CMS. Because it is likely that the funds related to those obligations have already been recovered from ratepayers in the rates charged by CMS, SUC risks having ratepayers charged for those same obligations again. Public Counsel believes that ratepayers should not be put at risk to fund the recovery of these expenses again thus, this issue represents a detriment to the public interest of the State of Missouri.

CLOSING PENALITIES DETRIMENT

Q. WHAT IS THE ISSUE?

A. It is likely that the Company is going to incur some monetary penalties related to the date the Transaction is expected to close, if it closes. In the Company's Application, on page 2, of the document "Motion For Expedited Treatment," it states the Transaction agreement provides monetary penalties be paid by Southern Union in the event closing is delayed beyond the end of March 2003. Should that occur, Southern Union will be obligated to pay the seller $100,000 per day in April of 2003, $200,000 per day in May 20003 and $300,000 per day thereafter. The document references the Application, Appendix 5, Section 5.20, for the exact language regarding the penalties.

Appendix 5 to the Application contains the actual Stock Purchase Agreement between CMS and SUC (and AIG). Section 5.20 of that Stock Purchase Agreement states:

> Closing Delay If the Closing has not occurred on or prior to March 31, 2003, a delay penalty (the "Delay Penalty") shall begin accruing on a daily basis on April 1, 2003 and shall continue until the earlier of the Closing Date or the termination of this Agreement in accordance with Article VII hereof, provided, as of such date, each of the conditions to Seller's obligation have been fulfilled or are reasonably capable of being fulfilled within a reasonable time. Southern Union shall pay the Delay Penalty to Seller in accordance with this Section 5.20, and the Delay Penalty shall be calculated as follows:
>
> (i) $100,000 per day in April, 2003;
>
> (ii) $200,000 per day in May 2003; and
>
> (iii) $300,000 per day on and after June 1, 2003.
>
> Southern Union shall pay the Delay Penalty on the last day of each calendar month or, with respect to such month in which the Closing occurs or in which this Agreement is terminated in accordance with its terms, on the Closing Date or the termination date, as the case may be. For the avoidance of doubt, the Delay Penalty shall be retained by Seller whether or not the Closing occurs; provided, however, 25% of the Delay Penalty shall be credited towards Buyer's payment of the Estimated Purchase Price. Any Delay Penalty payable hereunder shall be paid exclusively by Southern union and Seller shall have no claim against, and hereby releases, Highstar and Funding and their affiliates from any claim or Liability with respect to any such Delay Penalty.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT AFOREMENTIONED CLOSING PENALTIES ARE A DETRIMENT TO THE PUBLIC INTEREST?

A. Yes. It is the Public Counsel's belief that the penalties, should they occur, and should the Transaction actually close, are a detriment to the public interest. The penalty amounts were negotiated and agreed to by SUC as part of the terms of the Transaction, and as such, are and should be considered costs which either benefit or harm its shareholders. Ratepayers receive no benefit from the incurring of these costs. The costs do not support the provision or maintenance of the current level of services being provided to ratepayers nor, do they in

any way enhance the potential that the future level of services provide to ratepayers will be improved.

The penalties are what they are, and that is merely a device that encourages SUC to use all efforts to close the Transaction within the timeframe expected by the parties. In the event the Transaction does not close as expected, or does not close at all. The penalties compensate CMS, in part or total, for its efforts and/or the fact that the deal fell through. The costs are a creature of the Transaction and nothing more thus, they are a shareholder cost associated only with the Transaction.

Q. HAS SUC MADE ANY INDICATION THAT PENALTIES ARE IN FACT JUST AN ADDITION TO THE PURCHASE PRICE NECESSARY TO CONSUMATE THEIR ACQUISITION OF PEPLC?

A. Yes. Beginning on page 204, line 15, of the transcript for the informal interview held, with SUC on February 5, 2003, at the Capital Plaza Hotel, the following exchange occurred:

> MR. MICHEEL: The stock purchase agreement. And I'm focusing on Section 520, which is found at page 60 of the agreement.
>
> MR. MORGAN: The penalties?
>
> MR. MICHEEL: Yes, sir. I just want your understanding -- I mean, I'm assuming that was a negotiated part of the deal, and could you just give me some background into that --
>
> MR. KARAM: Sure.

MR. MICHEEL: -- and the particulars about that?

MR. KARAM: It was -- it was -- you're not going to like the answer, but it was great concern of the seller as to the uncertainty of the timing of Missouri approval. And there had to be incentive for us to work as closely as we can with you folks because the seller is a distressed seller and they need the money. And they don't really want the ticking fee. They want the whole, you know, 600-whatever-million dollars it is.

So we said that we had to evidence and go on the hook that we would work as expeditiously as we could, and we made representations that we were very confident that we could close this transaction by March 31st, and this was a negotiated penalty clause, if you will.

MR. MICHEEL: And you're comfortable with those penalties, then, I take it?

MR. KARAM: I would much rather not have them in there.

MR. MICHEEL: But that was something that your company --

MR. KARAM: **That was -- that was, you know, an added price that we were willing to commit to in order to acquire these assets.**

MR. MICHEEL: And my understanding of that section is that only Southern Union, not AIG Highstar Financing 2, is on the hook for those. Is that --

MR. KARAM: That's correct.

(Emphasis added by OPC.)

Q. HAS SUC OFFERED TO FORGO RECOVERY OF THESE COSTS FROM RATEPAYERS?

A. To my knowledge, the Company has made no such representation regarding these costs.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. Due to the fact that the penalties are likely to be incurred, and they represent, at least in the Company's view, a purchase price cost associated with acquiring the assets of PEPLC, and the Company has not taken any affirmative action stating their intent to forgo recovery of the costs from ratepayers, Public Counsel believes that the penalties are a detriment to the public interest of the ratepayers in the State of Missouri.

SFAS 71 DETRIMENT

Q. WHAT IS THE ISSUE?

A. Company's response to Public Counsel Data Request No. 1013 states that PEPLC discontinued its application of FAS 71, and that SUC envisioned the new company would also not follow its application. When questioned why it was discontinued, Company stated that the decision was due to its inability to meet certain requirements of Paragraph 5 of SFAS 71. Reasons given include the discounting of rates to the majority of PEPLC's, and Trunkline's customers, and the belief that they would not be allowed rate recovery of the costs for additional depreciation expense and goodwill amortization related to the acquisition of PEPLC by CMS.

Q. WHAT IS SFAS 71

A. SFAS 71 is an acronym for the Financial Accounting Standards Board Statement No. 71, *Accounting for the Effects of Certain Types of Regulation.* In general, SFAS 71 provides guidance in preparing general purpose financial statements for most public utilities. Certain other companies with regulated operations that meet specified criteria are also covered.

Q. IS SFAS 71 CONSIDERED AS A PART OF WHAT IS KNOWN AS GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP")?

A. Yes.

Q. HOW DOES THE DISCONTINUANCE OF SFAS 71 AFFECT RATEPAYERS?

A. Discontinuance of SFAS 71 will hurt ratepayers because the benefits associated with the application of the accounting standard will not be available for the setting of rates. Basically, an enterprise's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers. Those rates are often determined based on items of investment, revenues, or expenses that because of estimation, timing differences, or other factors would not be treated the same way for accounting purposes in non-regulated enterprises. As long as the regulator sets rates that are designed to recover the specific enterprise's cost of providing the regulated services and products, GAAP are met and the enterprise's outside auditors can issue an unqualified opinion on its audited public financial statements.

Q. CAN YOU GIVE AN EXAMPLE OF A SFAS 71 BENEFIT THAT WOULD BE LOST?

A. Yes. In Missouri, the Commission often utilizes an accounting process called "Accounting Authority Order ("AAO")" that allows utilities to capitalize extraordinary and unusual expenditures in their financial records for possible later recovery. One example, for those familiar with Missouri Gas Energy ("MGE"), an operating Division of SUC, is the Gas Safety Line Replacement Program. The AAO that MGE has for this investment item allows it to book certain expenses associated with the program for later recovery when new rates are determined. Absent the requirements of SFAS 71, MGE would have to write-off those expenses as incurred.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT DISCONTIUANCE OF SFAS 71 IS A DETRIMENT TO THE PUBLIC INTEREST?

A. Yes.

CONSUMER SERVICE DETRIMENT

Q. WHAT IS THE ISSUE?

A. This issue pertains to the Company's proposal to eliminate various customer performance measures and customer service operating procedures. Beginning on page 10, line 9, of Mr. Karam's Direct Testimony, he declares Company' commitment to continue the provision of certain customer performance measures and customer service operating procedures Company agreed to in Case Nos. GM-2000-43, GM-2000-500, GM-2000-

502, and GM-2000-503. Excluding the elimination of the provision relating to customer credits, Mr. Karam states that the Company is committed to these same procedures for one full calendar year beyond the conclusion of the calendar year in which the Transaction closes.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE PROPOSED ELIMINATION OF THE PREVIOUSLY AGREED TO CUSTOMER SERVICE MEASURES AND PROCEDURES WOULD BE DETRIMENTAL TO THE PUBLIC INTEREST?

A. Yes. The Company's proposal is detrimental to the public interest in two ways, 1) it eliminates the possibility of customer credits if in the future the Company fails to meet certain customer service requirements, and 2) it "deadlines" the term during which the customer service measures and procedures will be provided. Either of the two offers made by Mr. Karam, in and of themselves, would be a detriment to the public interest.

Q. PLEASE EXPLAIN WHY THE PUBLIC COUNSEL BELIEVES MR. KARAM'S OFFERS TO BE A DETRIMENT TO THE PUBLIC INTEREST.

A. Company has a history of entering various purchase/merger type transactions that have the risk of causing harm to the ratepayers of the State of Missouri. Such risks include, but are not limited to, cost allocation issues, prioritization of management efforts, and the utilization of resources that could affect the level and quality of services provided to ratepayers. In addition, in the not too distant past, Company was embroiled in a situation involving the improper billing of customers in this State. Those billing problems

necessitated a closer monitoring of its billing and billing practices. The quality of service that its ratepayers received at that time was, and still is, a factor that requires the continuation of the customer service provisions Company seeks to cease.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?

A. Public Counsel believes that the Company's commitment to continue the provision of certain customer performance measures and customer service operating procedures Company agreed to in Case Nos. GM-2000-43, GM-2000-500, GM-2000-502, and GM-2000-503 is appropriate. However, its request to cease certain provisions immediately, and to stop the rest one year after the calendar year in which the Transaction becomes final, is not appropriate. Therefore, the Public Counsel believes that this issue, were it to be approved as Company requests, presents a detriment to the public interest of the ratepayers of the State of Missouri.

MANGEMENT INCENTIVE COMPENSATION DETRIMENT

Q. ARE YOU AWARE OF CERTAIN COMPENSATION ARRANGEMENTS THAT WOULD BE DETRIMENTAL TO THE PUBLIC INTEREST IF THE COMMISSION APPROVES THIS TRANSACTION?

A. Yes. Certain compensation agreements for SUC management employees and the MGE Division management employees contain provisions whereby various management employees receive large amounts of additional compensation if SUC and the MGE

Division achieve prescribed pre-tax earnings per share goals. Because of the highly confidential nature of the compensation agreements, I have attached them to this Rebuttal Testimony as "Highly Confidential" Schedule TJR-2. TJR-2 contains only the relevant (relevant to this discussion) portions of Company's response to OPC Data Request Nos. 5001, 5002 and 5003.

Q. DO THESE INCENTIVE COMPENSATION AGREEMENTS RESULT IN CONFLICTING INCENTIVES?

A. Yes. By tying the incentive compensation of SUC management employees and MGE Divisional management employees to the earnings performance of SUC, the Transaction creates a situation whereby those employees have the incentive to charge Missouri ratepayers higher gas costs via the PEPCL operations they propose to purchase. By passing through higher gas costs to Missouri customers, the PEPCL operations would achieve more revenue, and those higher revenues will likely translate into higher per share earnings for SUC. The higher those per share earnings become, the more incentive compensation the employees will receive, if their respective defined goals are met.

Q. IS THE COMPANY AWARE THAT SUCH A CONFLICT WILL OCCUR?

A. Yes. Beginning on page 229, line 8, of the Transcript for the informal interview held, with SUC on February 5, 2003, at the Capital Plaza Hotel, the following exchange occurred:

MR. MICHEEL: Just a quick question. I know Southern Union used to give out bonuses or I guess, compensation tie to performance. Do you still do that?

MR. KARAM: Yes.

MR. MICHEEL: And I guess my question is, with respect to the MGE folks and the Panhandle folks, if you're successful in acquiring them, and the Energy Works (sic) folks, is that incentive compensation tied to overall Southern Union results or is it tied to, like in MGE's case, specific division results, in Panhandle's case specific sub results, in Energy work's case --

MR. KARAM: Historically its been a combination of those. We have not yet even addressed incentive compensation with Energy Works.

MR. MICHEEL: Because I can see an inherent conflict there, if I'm working for --

MR. KARAM: Yes.

MR. MICHEEL: - MGE, for example, and part of my compensation is tied to how ultimately the parent company does.

MR. KARAM: Right.

MR. MICHEEL: Same with all the other ones. And that was my understanding of in the past. Now, maybe your structure has changed.

MR. KARAM: **You're exactly right, and that is a something that we're aware of and we're reevaluating to make sure that we don't create even the perception of the that.**

(Emphasis added by OPC.)

Q. DOESN'T THE ACTUAL COST ADJUSTMENT ("ACA") PROCESS PREVENT THESE CONFLICTING INCENTIVES FOR MGE DIVISIONAL EMPLOYEES?

A. No. The ACA process would review MGE's actions after the SUC earnings have already been determined. Thus, a MGE divisional employee would still receive incentive compensation because that compensation is tied to earnings per share goals for a particular fiscal year. The ACA review process would not be completed during the fiscal year in which the incentive compensation would be achieved and paid.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. Because certain management employees of SUC, and the MGE Division, have agreements with SUC that provide them with large amounts of additional incentive compensation, given the achievement of Company, and/or the MGE Division, reaching a certain level of per share earnings, Public Counsel believes that the agreements provide those employees with the incentive to inappropriately manage the costs charged to Missouri customer. Thus, the Public Counsel believes that approval of the Transaction would create a situation whereby the incentive compensation agreements are a detriment to the public interest of the State of Missouri.

PUBLIC COUNSEL RECOMMENDATION

Q. WHAT IS THE PUBLIC COUNSEL'S RECOMMENDATION?

A. It is the Public Counsel's recommendation that the Commission deny the Company's request to purchase the Panhandle Eastern Pipeline Company from CMS Gas Transmission Company, as proposed. The purchase should not be approved because the Transaction

contains numerous provisions which are detrimental to the public interest. In the preceding testimony, I have identified, and briefly explained, several of the current detriments to Missouri ratepayers that will result if the Commission sanctions the proposed purchase. Those detriments include matters regarding the actual business form that the entity will take, its ownership, the owners interests and obligations, its management and operation, the recovery of any acquisition premium, the loss of the deferred income taxes, the lack of environmental remediation indemnification, the loss of the assets associated with the employee benefits obligation, the closing penalties, the discontinuance of following SFAS 71, the elimination of customer service measurements and reporting, and management incentive compensation agreements. Each of the aforementioned items is, in the Public Counsel's opinion, a detriment to the public interest, and together they provide a compelling justification for the Commission to deny authorization of the Company's Application.

CONDITIONS IF COMMISSION APPROVES APPLICATION

Q. IF THE COMMISSION DECIDES TO APPROVE SUC'S APPLICATION FOR THE PURCHASE OF PEPLC, ARE THERE ANY CONDITIONS THAT SHOULD BE ATTACHED TO THE PURCHASE BEFORE IT IS ALLOWED TO BECOME FINAL?

A. Yes. Attached to this Rebuttal Testimony, as Schedule TJR-3, is a listing of accounting/operation type conditions that the Public Counsel believes would, at a

minimum, be required in order to insulate ratepayers in the State of Missouri from possible harm, if SUC's Application is to be granted.

Q. ARE THESE CONDITONS THE ONLY CONDITIONS PUBLIC COUNSEL IS RECOMMENDING TO ENSURE THIS TRANSACTION IS NOT DETRIMENTAL TO THE PUBLIC INTEREST?

A. No. Other Public Counsel witnesses have other conditions that would need to be effectuated to ensure this transaction is not detrimental to the public interest. Those conditions are discussed in their respective Rebuttal Testimony.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

CASE PARTICIPATION
OF
TED ROBERTSON

Company Name	Case No.
Missouri Public Service Company	GR-90-198
United Telephone Company of Missouri	TR-90-273
Choctaw Telephone Company	TR-91-86
Missouri Cities Water Company	WR-91-172
United Cities Gas Company	GR-91-249
St. Louis County Water Company	WR-91-361
Missouri Cities Water Company	WR-92-207
Imperial Utility Corporation	SR-92-290
Expanded Calling Scopes	TO-92-306
United Cities Gas Company	GR-93-47
Missouri Public Service Company	GR-93-172
Southwestern Bell Telephone Company	TO-93-192
Missouri-American Water Company	WR-93-212
Southwestern Bell Telephone Company	TC-93-224
Imperial Utility Corporation	SR-94-16
St. Joseph Light & Power Company	ER-94-163
Raytown Water Company	WR-94-211
Capital City Water Company	WR-94-297
Raytown Water Company	WR-94-300
St. Louis County Water Company	WR-95-145
United Cities Gas Company	GR-95-160
Missouri-American Water Company	WR-95-205
Laclede Gas Company	GR-96-193
Imperial Utility Corporation	SC-96-427
Missouri Gas Energy	GR-96-285
Union Electric Company	EO-96-14
Union Electric Company	EM-96-149
Missouri-American Water Company	WR-97-237
St. Louis County Water Company	WR-97-382
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GR-98-374
United Water Missouri Inc.	WR-99-326
Laclede Gas Company	GR-99-315
Missouri Gas Energy	GO-99-258
Missouri-American Water Company	WM-2000-222
Atmos Energy Corporation	WM-2000-312
UtiliCorp/St. Joseph Merger	EM-2000-292
UtiliCorp/Empire Merger	EM-2000-369
Union Electric Company	GR-2000-512
St. Louis County Water Company	WR-2000-844
Missouri Gas Energy	GR-2001-292
UtiliCorp United, Inc.	ER-2001-672
Union Electric Company	EC-2002-1
Empire District Electric Company	ER-2002-424

CASE PARTICIPATION
OF
TED ROBERTSON

Company Name	Case No.
Missouri Gas Energy	GM-2003-0238

Schedule TJR-1.2

Schedule TJR-2

Has been deemed

"Highly Confidential"

in its entirety.

SCHEDULE TJR-3

CONDITIONS
TO
COMMISSION'S
APPROVAL
OF
SOUTHERN UNION COMPANY
APPLICATION

RATEPAYER INSULATION CONDITIONS:

1. Southern Union represents that it does not intend to take any action that has a material possibility of having a detrimental effect on MGE's utility customers, but agrees that, should such detrimental effects nevertheless occur, nothing in the approval or implementation of the proposed acquisition shall impair the Commission's ability to protect such customers from such detrimental effects.

2. Southern Union Panhandle Corporation ("SUPC and successor entities"), and Successor Entities or any direct or indirect subsidiary of Southern Union that acquires or owns any equity interests in Panhandle, will be owned and operated as a separate subsidiary of Southern Union.

3. Southern Union and MGE will not, directly or indirectly, allow any Panhandle debt to be recourse to them; pledge Southern Union or MGE equity as collateral or security for the debt of any Panhandle entity; give, transfer, invest, contribute or loan to any Panhandle entity, any equities or cash without Commission approval.

4. Southern Union will not transfer to SUPC and successor entities or subsidiary thereof, directly or indirectly, assets necessary and useful in providing service to MGE's Missouri customers without Commission approval.

5. Southern Union will not enter, directly or indirectly, into any "make-well" agreements, or guarantee the notes, debentures, debt obligations or other securities of any Panhandle entity without Commission approval.

6. Southern Union will not adopt, indemnify, guarantee or assume responsibility for payment of, either directly or indirectly, any of the current or future liabilities of any Panhandle entity without Commission approval.

7. Southern Union will exercise its best efforts to insulate MGE from any adverse consequences from its other operations or the activities of any of its affiliates.

8. Southern Union will ensure that the Transaction will have no adverse effect on MGE's budget and funds to meet MGE's capital needs, including but not limited to service line and main replacement programs.

ACQUISITION PREMIUM CONDITIONS:

1. The amount of any asserted acquisition premium (i.e. the amount of the total purchase price and transaction above net book value) paid by Southern Union in connection with the transaction shall be treated below the line for ratemaking purposes in Missouri and not recovered in retail distribution rates.

2. Southern Union shall not seek either direct or indirect rate recovery or recognition of any acquisition premium, including transaction costs, through any purported acquisition savings adjustment (or similar adjustment) in any future general ratemaking proceeding in Missouri.

3. Southern Union shall not seek to recover in Missouri the amount of any asserted acquisition premium in the Transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded cost from Missouri ratepayers.

RATE BASE CONDITION:

1. MGE agrees, for ten years following the closing of this Transaction, MGE agrees not to seek to recover through its PGA rate any component of SUPC and successor entities Federal Energy Regulatory Commission ("FERC") maximum tariff rate resulting from rate base deductions that have been eliminated by this Transaction; the amount of the offset for the first year shall be MGE's proportional share of the cost-of-service/revenue requirement amount related to the amount of deferred taxes and investment tax credits reflected on Panhandle's books and records as of the closing date of this Transaction (i.e., the amount that would exist on Panhandle's books and records had this transaction not occurred), which amount of deferred taxes and investment tax credits (which is the basis for the calculation of MGE's proportional share of the cost-of-service/revenue requirement) shall reduce by one-tenth on each anniversary date of the closing of this Transaction.

JOINT AND COMMON COSTS ALLOCATION CONDITIONS:

1. Total joint and common costs allocated to Missouri for purposes of setting retail distribution rates will not increase as a result of the Transaction above the latest levels proposed by MGE in Case No. GR-2001-292.

2. Southern Union agrees to make available to the Staff and the Public Counsel, at reasonable times and places, all books and records and employees and officers of Southern Union and any affiliate, division or subsidiary of Southern Union as provided under applicable law and Commission rules.

3. Southern Union agrees that, in any MGE-initiated general rate proceeding, it has the burden of proving the reasonableness of any allocated or assigned cost to MGE from any Southern Union affiliate, division or subsidiary including all corporate overhead allocations.

4. Southern Union agrees that within six (6) months of the closing of the Transaction, it shall perform, provide, and discuss with all interested parties subject to a Commission protective order a study of the impact of the acquisition and operation of SUPC and its successor entitites on Sourthern Union's structure, organization, and costs. This study will address the specific impacts of the acquisition and operation of SUPC and its successor entities on Southern Union's administrative and general (A&G) expense and cost allocation methodology.

5. Southern Union will specifically identify the process used to allocate A&G costs and expenses to its regulated, merger and acquisition, sale and non-regulated functions of its regulated divisions as well as its non-regulated subsidiaries.

6. Southern Union agrees that the types and availability of raw data necessary to perform allocations of corporate overhead costs shall be discussed at the meeting to occur within six (6) months of the close of the Transaction. The raw data to be discussed should include, but not be limited to, regulated and non-regulated information concerning customer numbers and billing information, revenue data, asset information (gross and net plant, etc.), management work time allocations, employee numbers and other payroll data, and the Missouri jurisdictional rate of return on investment ("ROR") and return on equity ("ROE"). The allocation procedures to be disclosed shall include, but need not be limited to, the use of cost allocation manuals, timesheets, time studies, and/or other means of tracking and allocating costs. The allocation procedures agreed upon should provide a means to identify and substantiate the portions of each individual corporate employee's time and associated payroll cost being allocated to Southern Union's regulated divisions.

MERGER, ACQUISITION AND SALE ACTIVITY CONDITIONS:

1. Southern Union will retain all documentation relative to the analysis of the Transaction and all merger, acquisition, and sale activity that has occurred since January 1, 2002.

2. Documentation will include a list of: (1) all Southern Union and its affiliates' personnel, consultants, legal and financial and accounting advisers; (2) the time (in hours) spent by

those individuals on related work; (3) other expenses, costs or expenditures incurred or recognized by Southern Union that are related to the Transaction, the sale of the Southern Union's Texas Division to Oneok, Inc. and the establishment of the EnergyWorx Inc. contractual relationship with Southern Star Central; (4) business entity (corporate, subsidiary and division) where the costs were booked, including account number, account description and amount; and (5) description of the nature of the work performed and costs incurred.

3. Southern Union will maintain its books and records so that all acquisition costs (including the Transaction and future Southern Union merger and acquisition transactions) are segregated and recorded separately.

4. During MGE's next general rate proceeding, Southern Union agrees to disclose to the Staff Public Counsel, and other interested parties subject to a Commission protective order Acquisition, Merger, Transition, and Transaction costs recorded in Southern Union's books and records in the appropriate test year.

5. Southern Union agrees to create and maintain records listing the names of Southern Union employees (excluding current Panhandle employees), number of hours worked, type of work performed and travel and other expenses incurred for all work related to Panhandle after the closing of the Transaction through the end of the test year, updated test year or true-up test year in MGE's next general gas rate case.

6. Southern Union will submit to the Commission's accounting department and Public Counsel verified journal entries reflecting the recording of the Transaction and all other merger, acquisition since January 1, 2002 of Southern Union's books and records within forty-five (45) days of closing.

7. Southern Union will not recommend an increase or claim Staff should make an adjustment to increase the cost of capital for MGE as a result of the Transaction.

8. Any increases in cost of capital Southern Union seeks for MGE will be supported by documented proof: (1) that the increases are a result of factors not associated with the Transaction; (2) that the increases are not a result of changes in business, market, economic or other conditions for MGE caused by the Transaction; or (3) that the increases are not a result of changes in the risk profile of MGE caused by the Transaction.

9. Southern Union will ensure that the retail distribution rates for MGE ratepayers will not increase as a result of the Transaction.

INCENTIVE COMPENSATION CONDITIONS:

1. Corporate Employees -

   Beginning with fiscal years commencing after the date of closing, and continuing for so long as MGE is an affiliate of SUPC and successor entities, for Southern Union employees, and employees of all affiliates, with direct or indirect decision-making authority over SUPC and successor entities any affiliate participating in the ownership, operation or management of a natural gas pipeline transporting natural gas to MGE, any earnings-based incentive compensation shall be calculated so that SUPC and successor entities revenues from the sale of transportation of natural gas or other services to MGE by those pipelines, are excluded from such earnings measurement.

2. MGE Employees -

   Beginning with fiscal years commencing after the date of closing, and continuing for so long as MGE is an affiliate of SUPC and successor entities, for MGE employees with direct/indirect decision-making authority over MGE's traditional gas purchasing department or who supervise any employee of MGE's gas purchasing department, any earnings-based incentive compensation shall be calculated solely on the basis of earnings measurements for the MGE operation.

ACCESS TO INFORMATION CONDITIONS:

1. Southern Union shall provide the Staff and Public Counsel with access, upon reasonable written notice during normal working hours and subject to appropriate confidentiality and discovery procedures, to all written information provided to common stock, bond, or bond rating analysts, which directly or indirectly pertains to Southern Union or any affiliate that exercises influence or control over MGE or has affiliate transactions with MGE.

2. Information includes, but is not limited to, reports provided to, and presentations made to, common stock analysts and bond rating analysts. For purposes of this condition, "written" information includes but is not limited to, any written and printed material, audio and videotapes, computer disks and electronically stored information.

3. Upon request, MGE and Southern Union agree to make available to Staff and Public Counsel, upon written notice during normal working hours and subject to appropriate confidentiality and discovery procedures, all books, records and employees of Southern Union, MGE and its affiliates as may be reasonably required to verify compliance with the CAM and the conditions set forth in this Stipulation and Agreement.

4. MGE and Southern Union shall also provide Staff and Public Counsel any other such information (including access to employees) relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over MGE.

5. MGE, each affiliate and Southern Union will maintain records supporting its affiliated transactions for at least five years.

CUSTOMER SERVICE CONDITIONS:

1. Southern Union will, through its Missouri Gas Energy ("MGE") operating division, continue uninterrupted its commitment to customer service performance measures and customer service operating procedures originally agreed to by Southern Union, through MGE, and approved by the Commission in its October 21, 1999, Order Approving Stipulation and Agreement in Case No. GM-2000-43 (and also agreed to by Southern Union and approved by the Commission in Case Nos. GM-2000-500, GM-2000-502 and GM-2000-503) for a period of three full calendar years beyond the conclusion of the calendar year in which the Transaction closes.

2. The data should continue to be presented in a monthly format and provided on a quarterly basis and may be transmitted to the Staff in an electronic format.

3. Other reporting requirements of the Commission orders in Case Nos. GM-2000-43, GM-2000-500, GM-2000-502 and GM-2000-503 are not affected by the provisions of this reporting.

4. All obligations run through to Southern Union Company.

5. Prior to the conclusion of the three-year period, Company, Staff, OPC and the other interested parties shall meet to discuss whether or not Company will continue to provide the information as require. If the parties cannot come to an agreement during this meeting, a docket will be opened so that the Commission can decide how the matter will be treated.