Exhibit No.:	
Issue(s):	Financial Public Interest Detriment
Witness:	Mark Burdette
Type of Exhibit:	Rebuttal
Sponsoring Party:	Public Counsel
Case Number:	GM-2003-0238
Date Testimony Prepared:	March 17, 2003

REBUTTAL TESTIMONY

OF

MARK BURDETTE

FILED[3]

MAR 1 7 2003

Missouri Public Service Commission

Submitted on Behalf of
the Office of the Public Counsel

SOUTHERN UNION/MGE

Case No. GM-2003-0238

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 MARK BURDETTE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Mark Burdette, of lawful age and being first duly sworn, deposes and states:

1. My name is Mark Burdette. I am a Financial Analyst 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 8.

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.

Mark Burdette
Financial Analyst

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

Kathleen Harrison
Notary Public

My commission expires January 31, 2006.

REBUTTAL TESTIMONY

OF

MARK BURDETTE

SOUTHERN UNION COMPANY

CASE NO. GM-2003-0238

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Mark Burdette, Missouri Office of the Public Counsel, P.O. Box 7800, Jefferson City, Missouri 65102-7800.

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 Financial Analyst. Also, I am an adjunct faculty member with Columbia College. I teach undergraduate Business Finance and graduate-level Managerial Finance.

A. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

Q. I earned a Bachelor of Science in Electrical Engineering from the University of Iowa in May 1988. I earned a Master's in Business Administration with double emphases in Finance and Investments from the University of Iowa Graduate School of Management in December 1994.

Q. PLEASE DESCRIBE YOUR CONTINUING EDUCATION.

A. I have attended various regulatory seminars presented by the Financial Research Institute, University of Missouri-Columbia and the National Association of State Utility Consumer

Advocates. Also, I attended The Basics of Regulation: Practical Skills for a Changing Environment presented by the Center for Public Utilities, New Mexico State University.

Q. DO YOU HAVE ANY PROFESSIONAL AFFILIATIONS?

A. Yes. I am a member of the Society of Utility and Regulatory Financial Analysts (SURFA).

Q. DO YOU HOLD ANY PROFESSIONAL DESIGNATIONS?

A. Yes. I have been awarded the professional designation Certified Rate of Return Analyst (CRRA) by the Society of Utility and Regulatory Financial Analysts. This designation is awarded based upon work experience and successful completion of a written examination.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION (MPSC OR THE COMMISSION)?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. I will comment on Southern Union Company's (Southern Union) proposed acquisition of Panhandle Eastern Pipeline Company, including its subsidiaries (Panhandle, the Panhandle Properties, Panhandle Eastern), for approximately $662 million in cash and the assumption of $1.17 billion of debt. The acquisition will be accomplished via Southern Union's new and wholly-owned subsidiary Southern Union Panhandle Corp. (SUPC), which will own the equity in the Panhandle properties.

Q. ARE THE COMPANIES IN THIS CASE INDEPENDENT AND PUBLICLY TRADED?

A. Southern Union is a publicly-traded company. It's stock trades on the New York Stock Exchange under the ticker SUG. Panhandle Eastern Pipeline Company is not publicly traded – it is owned in whole by CMS Energy Corporation. In addition, SUPC's common stock will be owned by Southern Union and will not trade on the public markets. MGE is a division of Southern Union, and as such is represented by Southern Union's common stock – MGE does not issue its own stock.

Q. WHAT CONCERNS DO YOU HAVE REGARDING SOUTHERN UNION'S PROPOSED ACQUISITION OF THE PANHANDLE PROPERTIES?

A. A primary concern is the mingling of finances and risk for Southern Union's MGE Missouri-regulated utility assets with the arguably higher-risk (and unregulated by the state of Missouri) Panhandle operations. Topics of concern include increased capital structure leverage and risk issues and the effects that increased leverage can have on the cost of equity and the company's cash flows.

Q. PLEASE COMMENT ON EACH OF THESE AREAS OF CONCERN.

A. To acquire the Panhandle properties, Southern Union Co. will assume $1.17 billion of Panhandle Eastern's debt upon closing this transaction. In addition, Southern Union states that up to $100 million of its $662 million equity investment in SUPC will come from "available resources, including short-term debt." (Kvapil-Direct, page 11, lines 2-5). Obviously, this transaction will highly pressure the debt-level of Southern Union's capital structure, increasing financial risk. And as stated my Mr. Kvapil, considering only the level of *assumed* debt does not accurately reflect the additional debt contemplated by Southern Union as a result of this transaction – part of the "equity" investment will also potentially come from debt sources.

Q. WHAT ARE THE INCREASED RISKS POTENTIALLY FACED BY MGE'S OPERATIONS STEMMING FROM THE PANHANDLE ACQUISITION?

A. Increased debt means increased financial risk. Increased financial risk will eventually lead to a higher overall cost of capital for the company. This higher overall cost of capital can result from higher debt costs and from an increased rate of return demanded by Southern

Union's common stockholders. Stockholders will demand a higher return to compensate them for the increased riskiness of the stock resulting from the increased debt load.

Increased financial risk puts pressure on both the cost of new debt as well as the cost of equity in the market. Eventually, that increased cost of capital could make it into MGE's rates, leading to a direct detriment to MGE's ratepayers based on the Panhandle acquisition.

Q. ARE MGE'S FINANCES KEPT DISCRETE AND SEPARATE FROM THE REMAINDER OF SOUTHERN UNION?

A. No. MGE is a part of the whole that is Southern Union. The finances of MGE are co-mingled with all of Southern Union's other operations. That means, for example, free cash flow generated by MGE's continuing operations are placed in Southern Union's general coffers and are available for general corporate use.

Q. HAVE THE FINANCIAL MARKETS TAKEN NOTICE OF SOUTHERN UNION'S PROPOSED ACQUISITION?

A. Yes. Standard & Poor's placed Southern Union on Credit Watch when the proposed acquisition was announced. Subsequently, S&P has lowered Southern Union's rating to BBB from BBB+. A Standard & Poor's press release dated 7 March 2003 on Southern Union's proposed acquisition states, in part:

> Standard & Poor's Rating's Services today lowered the corporate credit rating on gas utility Southern Union Co. to "BBB" from "BBB+", and removed the rating from CreditWatch where is was placed on Dec. 23, 2002, when the company announced that it would purchase CMS Panhandle Eastern Pipeline Cos.
>
> Standard & Poor's expects to see significant debt reduction over the next two years.
>
> The stable outlook for Southern Union is based on Standard & Poor's understanding that management will be taking the necessary steps to reduce debt and bring the capital structure in line with the target of 50% to 55% of debt.

> If the steps taken to reduce these targets are inadequate, the corporate credit rating will be lowered.

Obviously, Standard & Poor's is concerned about Southern Union's acquisition of additional debt and the effects on capital structure – just as the Missouri Public Service Commission should be concerned. S&P even goes so far as to threaten an additional deterioration of credit rating should Southern Union fail to reduce its level of debt.

Q. WHAT ARE THE DAY-TO-DAY CONCERNS ASSOCIATED WITH INCREASING THE LEVEL OF DEBT?

A, Simply, increased debt-load means increased cash-flow commitment to service that debt. The more cash Southern Union has to pay to creditors, the less cash available for other operations, such as additional necessary capital expenditures, paying salaries or paying common dividends. From the common stockholder's perspective, additional debt implies additional - superior - claims to assets.

A failure by Southern Union to have sufficient cash to handle MGE's day-to-day activities would be detrimental to MGE's customers, *especially* if MGE's regulated utility assets had been the primary generator of that cash. This lack-of-cash can then spiral the company deeper into trouble if it uses short-term debt to cover cash shortfalls. The situation is akin to a consumer carrying too much credit card debt – even *with* a stable cash flow, the debt service eats up the cash making it unavailable for other uses or investment. A consumer in such a cash-strapped situation faced with an unexpected bill, such as a major car repair, is then faced with taking on even more debt because she does not have the cash on hand.

Q. DOES ADDITIONAL DEBT INCREASE RISK FOR COMMON STOCKHOLDERS IN ANY OTHER WAY?

A. Yes. Increased debt not only places pressure on Southern Union's cash flow, but the increased debt means that in case of bankruptcy, there are additional claims to assets that are superior to those claims by common stockholders. Additional debt pushes common stockholders further down the food chain. This increases the risk.

Q. CAN MGE'S RATEPAYERS AND FINANCIAL POSITION BE PROTECTED FROM ANY POTENTIAL DETRIMENTS RESULTING FROM THE PANHANDLE ACQUISITION?

A. It may be possible to protect MGE ratepayers from some aspects of the Panhandle transaction via regulatory tools such as conditions placed on the approval of the transaction my the MPSC. However, no level of conditioning or shielding can completely disconnect MGE from Southern Union and other Southern Union investments, such as Panhandle.

Q. WHY IS COMPLETE PROTECTION NOT POSSIBLE?

A. Southern Union is organized as a single corporation with its major operations formed into divisions. However, an operational division is merely a fabricated entity – it is not a separate legal business entity like an actual subsidiary is. Southern Union maintains a single corporate coffer into which all revenues are placed, including MGE's.

Q. WILL SOUTHERN UNION PANHANDLE CORPORATION ALSO BE A DIVISION?

A. No. Southern Union is forming Southern Union Panhandle as a separate subsidiary. However, all of SUPC's outstanding common stock will be owned by Southern Union. Additionally, the debt of SUPC will be **nonrecourse** to Southern Union, meaning that Southern Union is not ultimately *legally* responsible for that debt if SUPC cannot make payments.

Q. DOES A SEPARATE SUBSIDIARY FORMATION FOR SUPC AND NONRECOURSE DEBT ALLEVIATE YOUR CONCERNS?

A. No. The bottom line is Southern Union will have a substantial investment and ongoing interest in SUPC and the Panhandle properties. Regardless of legal definitions and the *ability* to allow SUPC to fail (i.e. nonrecourse debt), the question is more a matter of whether Southern Union *would* allow SUPC to fail.

Q. WHAT IS YOUR OPINION ON WHETHER SOUTHERN UNION WOULD SACRIFICE ITS INVESTMENT IN SUPC IN ORDER TO PROTECT MISSOURI RATEPAYERS?

A. I find it doubtful that Southern Union would sacrifice its SUPC investment in order to protect regulated customers from any detrimental effects. Should SUPC develop financial troubles and need an equity influx from Southern Union, I believe Southern Union will make that equity investment rather than allow SUPC to fail merely to protect MGE's ratepayers.

Q. IF THE MPSC CHOOSES TO APPROVE THE PROPOSED TRANSACTION, ARE THERE CONDITIONS THAT CAN BE PLACED ON SOUTHERN UNION THAT WOULD HELP ENSURE THE PROTECTION OF MGE'S RATEPAYERS?

A. Yes. The following are examples of specific financial-related conditions that, if implemented as part of the MPSC's approval of this transaction, could provide some protection for Missouri's ratepayers. The purpose of these or similar conditions is to insulate MGE's Missouri-jurisdictional properties and ratepayers from any adverse effects of Southern Union's purchase and ownership of the Panhandle properties.

1. Southern Union Panhandle 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.

2. 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.*

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

4. 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. 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.

5. 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. Southern Union remains committed to the safety line replacement program schedules for MGE currently in effect and approved by the Commission in its Case No. GO-2002-0050.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.