

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Transfer of Assets,)	
including much of Southern Union's gas)	Case No. GO-2003-0354
supply department to EnergyWorx, a wholly)	
owned subsidiary.)	

**SOUTHERN UNION COMPANY'S RESPONSE TO
STAFF'S REPORT CONCERNING ITS INVESTIGATION OF THE SALE BY
SOUTHERN UNION COMPANY OF ITS
TEXAS DIVISION, SOUTHERN UNION GAS, TO ONEOK**

COMES NOW, Southern Union Company ("Southern Union") d/b/a Missouri Gas Energy ("MGE"), in accordance with the Missouri Public Service Commission's ("Commission") Order Establishing Procedural Schedule and Protective Order dated August 21, 2003, and submits its response to Staff's report summarizing the results of its investigation in this case (the "Report").

1. On July 8, 2003, the Commission issued an order dismissing without prejudice a Complaint filed by its staff ("Staff") against Southern Union in which it was alleged that Southern Union had transferred a portion of its "gas procurement function" in violation of Missouri law.¹ The Commission concluded that the Complaint was premature because Staff also had proposed to investigate in this case the "same transfer of the procurement function" that formed the basis of the Complaint. A copy of that order is attached hereto as Exhibit 1. Staff's Report purports to present to the Commission the results of its investigation and offers its rationale for being permitted to renew its Complaint against Southern Union. In this Response, Southern Union will demonstrate that Staff has

¹ *Staff v. Southern Union Company*, Case No. GC-2003-0348.

presented nothing to the Commission that establishes that Southern Union has violated any law, rule or order of the Commission with respect to which Staff should be authorized to file a Complaint pursuant to §386.390 RSMo 2000.

2. The enormity of what Staff is proposing alone should give the Commission good reason to deny Staff the authority to file a complaint. Apparently, Staff has concluded the sale by Southern Union to ONEOK, Inc. ("ONEOK") of its natural gas distribution company located solely in the **State of Texas** is void because Southern Union failed to file with, and obtain the approval of, the Commission under the provisions of §393.190 RSMo 2000 for permission to permit a number of employees of Southern Union Gas to either (1) transfer to an affiliate of Southern Union (i.e., EnergyWorx) or (2) to accept employment with ONEOK. On its face, this conclusion is unreasonable. The sale of Southern Union Gas was a \$420 million transaction. It involved the sale of an operation headquartered in Austin, Texas, employing approximately 740 people and serving approximately 520,000 customers in approximately 100 municipalities all in the State of Texas, including the cities of Austin, El Paso, Brownsville, Galveston and Port Arthur. The Texas operations had no physical or connection to MGE's plant or system whatsoever.

3. What are the grounds for Staff's sweeping claim? As a pretext, Staff first purports to identify approximately "\$2 million dollars of rate base assets" that were sold to ONEOK, a claim that is both inaccurate and irrelevant to the statutory language upon which Staff relies. A detailed rebuttal is contained in Southern Union's accompanying suggestions in support of its response, but the "assets" identified by Staff are no more than an allocation of overhead costs assigned to MGE's operations by Southern Union in the 2001 MGE rate case to determine cost of service. Most of the dollars in question are

attributable to Southern Union's corporate headquarters which were moved from Austin, Texas to Wilkes-Barre, Pennsylvania in 2002, well before the sale of Southern Union Gas to ONEOK on January 1, 2003. As such, there is no more than a tenuous nexus between the "assets" identified by Staff and the transaction it apparently seeks to void. The balance of this allocated overhead is simply back-office support items such as furniture or postage machines which either have been retired or replaced in the normal course of business. These were not part of MGE's works or system. Even if one were to assume that corporate overhead costs allocated for ratemaking purposes *are* part of MGE's works or system (a conclusion Southern Union strenuously disputes), such items are "conclusively presumed to have been property which is not useful or necessary in the performance of" MGE's public service obligations under applicable law "as to any purchaser of such property in good faith for value." §393.190.1 RSMo., (Emphasis added) Additionally, Staff has significantly overstated the amount of the overhead previously allocated to Missouri cost of service in 2001. Of the \$2 million of "assets" identified by Staff, only about 38% (\$718,940) of that amount was allocated as rate base to be included in Missouri cost of service as corporate overhead. This represents less than two-tenths of 1 percent of the \$420 million purchase price paid by ONEOK. By any standard one wishes to choose, this is *de minimus*; an amount not worthy of the Commission's attention. Also, for Staff to suggest that the entire transaction is void is at odds with its earlier informal representations to representatives of the company that if the amount in question was insignificant, Staff would not seek to void the sale.

4. The other stated basis for Staff's conclusion is the transfer to ONEOK, or internal reassignment of, a handful of individuals formerly employed by Southern Union

Gas in Austin, Texas. This is Staff's real grievance. Among the approximately 740 former employees of Southern Union Gas were six [6] individuals in the gas supply department, Mike Langston, Liz Smith, Verlenne Monroe, Sandy Ready, Jane Cartwright and Kelly Turner. Because these individuals had performed gas supply activities for the benefit of MGE in addition to their duties for Southern Union Gas, Staff asserts that these individuals, collectively, were a Missouri "asset" owned by Southern Union and the Commission's permission should have been obtained before allowing them to accept different job responsibilities or employment opportunities. The fallacy of this argument seems too obvious to be anything other than self-evident. Nevertheless, Southern Union feels compelled to observe that individuals employed by the company, regardless of their responsibilities or job descriptions, even as they may relate to the company's operations in Missouri, are perfectly free to seek and accept other employment within the company or with other employers for whatever reason they may choose. This is the inevitable consequence (and beauty) of a free market economy. Choosing one's own career path is a fundamental right in this country and no creative use of accounting euphemisms (such as calling groups of employees an "experienced workforce") will change the immutable fact that this is a free country. Individuals have a right to better their own situation. People are not property. Southern Union does not own its employees. Indentured servitude is expressly prohibited by the constitution of the United States². It really is remarkable that Southern Union is in the position of finding it necessary to make this point in response to allegations of the Staff.

5. The remedy apparently sought by Staff, to have the sale of Southern Union Gas to ONEOK declared void, is dramatically out of proportion to the circumstances

² U.S. Const., Amend., XIII, § 1.

alleged. Moreover, there is no practical purpose served in trying to undo the transaction. Likewise, there is no means to undo the transaction. The sale closed over a year ago and the transfer of management and operational control of Southern Union Gas to ONEOK is too far along to endeavor to roll back the clock and make things as they once were once again. Southern Union has no power to re-employ its former Southern Union Gas and to reconstitute its gas procurement group. It is just make-believe to suggest otherwise. Southern Union is not aware of any circumstance when anything even remotely similar has occurred.

6. The Report also contains astonishing gaps in proof. Many key allegations have no factual support whatsoever. A prime example is Staff's contention that the transfer of the employees handling the gas supply function in Austin, Texas, was a vital component of the sale of Southern Union Gas. Staff does not offer any factual support for this allegation. Perhaps those six employees didn't want to move from their homes Austin, Texas to Kansas City, Missouri, and leave behind familiar surroundings and a network of family and friends. Perhaps they found it convenient to accept employment with ONEOK and to not go through the daunting task of moving their family and households to a remote location. From a reading of the Report, however, it would appear that Staff is oblivious to the possibility that Mr. Langston and his staff did not wish to relocate to Missouri because the topic is not even mentioned.

7. Another example of Staff's unsubstantiated allegations is that since other Southern Union employees are now performing the gas supply function it means that MGE has not been providing adequate service in Missouri. This conclusion on the part of Staff is wholly unjustified and unsubstantiated. Staff has not met its burden of presenting the

Commission with any credible support for that allegation. There is not one scintilla of proof of any service interruptions, inadequacy of supply or delivery or any deterioration of quality of service criteria on the part of MGE as a consequence of the sale of Southern Union's Texas operations. Not even one identifiable event of alleged inadequate service by MGE is contained in the Report, a document which is the culmination of an exhaustive investigation which the Staff has conducted over a period of the last ten (10) months.

8. Finally, Staff contends at page 14 and 15 of the Report that MGE does not have a competent and trained workforce. Again, this is no more than a theory in search of some facts. The Report contains no credible basis for the Commission to conclude that MGE has been unable to provide for its gas supply requirements either through third-party contractual arrangements or that MGE has hired employees who are unqualified for their duties.

9. Staff's effort to convince the Commission to prohibit or restrict the movement of utility employees like Mike Langston to affiliated companies is nothing new. In this regard, what Staff has chosen to omit from the Report is a good more telling than the matters it has chosen to discuss. In early 2000, during the process of adopting its rules governing affiliate transactions for electric and gas utilities, the Commission expressly rejected Staff's proposal to require that utilities be compensated by their affiliates for the value of experienced employees who are transferred to an affiliate, as was the case with Mr. Langston. The Commission then stated that "employee transfers do not have to be restricted, penalized or compensated" to accomplish the legitimate regulatory objectives of preventing cost shifting or cross-subsidies. Mo. Reg. Vol. 25, No. 1, p. 61, January 3,

2000³. This was wise regulatory policy at the time it was adopted and it is no less so now. Southern Union was justified in its reliance on this express regulatory policy of the Commission. In this case, Staff has merely dusted off its discredited proposal and wrapped it in a new package by urging the Commission to require utilities to seek its prior approval of employee reassignments or transfers. This, however, is just another type of regulatory restriction and threatened penalty. It is a poorly-conceived concept that should once again be rejected by the Commission.

10. The Report seems to suggest that Southern Union may have slipped one over on the Commission and Staff by aiding and abetting its former employees in escaping their employment with the company. This is ludicrous. The ONEOK transaction was announced to the public over two months before it closed in a press release, a copy of which was provided to Staff. A copy of the press release is attached hereto and marked Exhibit 2. Southern Union made no secret of its plans to sell its operations in Texas. Staff's contention on page 4 of its Report that it "informed MGE of its concerns with the ONEOK sale . . . when [it] was reviewing" the then-pending acquisition of Panhandle Eastern Pipeline Company in Case No. GM-2003-0238 might lead the Commission to believe jurisdictional and service considerations were expressed prior to the close of the ONEOK transaction, but that is not the case at all. A copy of the data request to which Staff makes reference (No. 5024) was not issued until February 25, 2003, two months after Southern Union Gas was sold to ONEOK. This falls significantly short of a timely "heads-up" from Staff.

11. Also, a little over a month after the October 16, 2002, press release, the President and Chief Operating Officer of Southern Union, Thomas F. Karam, sent a letter

³ *Order of Rulemaking*, 4 CSR 240-40.015. Case No. GX-99-444.

to each of the five commissioners, the Commission's General Counsel and the Executive Director of Staff that, among other things, advised the Commission about the transfer of the Missouri gas supply function to MGE's offices in Kansas City, Missouri. A copy of that letter is attached as Exhibit 3. Nothing was said by Staff at that time regarding this development. The Commission has been kept fully advised at all times.

12. Staff is also attempting to shift its burden of proof in this matter to Southern Union. As the party seeking authority to file and prosecute a complaint against Southern Union, Staff would have the burden of establishing that Southern Union, by selling its gas operations in Texas, has violated a law, rule or order of the Commission because Staff would be the party asserting the affirmative of the central issues (i.e., (1) Were the former employees of Southern Union Gas assets of MGE? (2) If so, were they part of MGE's works or system and, (3) If so, were they necessary or useful in the performance of MGE's duties to the public?). See, *State ex rel. Tel-Central of Jefferson City, Inc., v. Public Service Commission*, 806 S.W.2d 432, 435 (Mo. App. 1991). Turning the law on its head, Staff contends that because Southern Union never requested Commission approval to sell its Texas operations, the law is "self-enforcing" and the transaction is void. (Report p. 2) This flawed argument is contradicted by the express language contained in §393.190.1 RSMo that "[n]othing in this subsection contained shall be construed to prevent the sale . . . by any corporation . . . of property which is not necessary or useful in the performance of its duties to the public, and any such sale of its property . . . shall be conclusively presumed to have been property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value." (emphasis added) The statute is not self-enforcing as claimed by Staff. To the contrary, the transaction is

presumptively lawful and Staff is obliged to make a credible showing that Southern Union's utility operation in **Texas** were a necessary and useful part of MGE's works or system in **Missouri** and, if so, to overcome the conclusive presumption that the **Texas** properties were not necessary and useful in the performance of MGE's duties in **Missouri**. The Report comes nowhere near making that case.

13. Procedurally, too, the Report is flawed. Staff requests the Commission to "determine that [it] has jurisdiction over the transfer." Any such finding would be inappropriate. There is no evidentiary record from which the Commission could make such a pronouncement. Moreover, the Commission has no statutory authority to make declaratory findings concerning the scope of its jurisdiction. It can only determine the scope of its authority within the context of an actual case or controversy. *State ex rel. Kansas Power and Light Company v. Public Service Commission*, 770 S.W.2d 740 (Mo. App.1989). As such, the only question presented at this time is whether Staff has presented any facts which, if true, would tend to show that Southern Union has violated any provision of law, rule or order of the Commission. For the reasons set forth above and in the accompanying memorandum of law, the answer is no.

14. Staff also requests a pre-hearing conference be convened but no provision has been made for a hearing to be held in this case and, practically speaking, this docket has served its purpose now that the Report has been submitted to the Commission and all of the events called for in the Order Establishing Procedural Schedule have come to a conclusion. This is an investigatory docket. There is nothing left to discuss or to be done but for the Commission to determine whether Staff should be authorized to expend more of the Commission's scarce resources pursuing a futile complaint against Southern Union

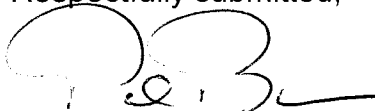
toward an impossible end with no more basis in law or fact than has been presented in the Report.

15. Submitted contemporaneously herewith is a supporting memorandum of law of Southern Union which presents the overwhelming weight of legal authority supporting each of the company's arguments. The cases briefed therein provide a compelling basis for concluding that Southern Union's conduct has been lawful in every particular and consistent with recognized principles of utility regulation. Staff unfortunately has chosen to ignore or trivialize the cases in the preparation of its Report. As a result, the Report does not provide the Commission with a fair, balanced and objective analysis of the issues.

16. Staff's tortured legal theory is not supported by law, fact or common sense. The resulting ten month investigation has uncovered no circumstances showing that the sale by Southern Union of its **Texas** operations has had any impact whatsoever on MGE's operations here in **Missouri**. It is entirely undisputed that MGE still provides natural gas service within those areas certificated to it by the Commission without impairment or interruption. MGE still owns and controls its distribution network and carries out its public service obligations. Consequently, Staff has not met its burden of presenting any credible information to the Commission which could cause it to believe that Southern Union has violated any law, rule or regulation of the Commission as a consequence of the activities alleged. To the contrary, all indications are that Southern Union conducted itself in all respects lawfully and appropriately. Staff's request for authority to file and prosecute a complaint against Southern Union under the provisions of §386.390 RSMo should be denied.

WHEREFORE, Southern Union presents its response to Staff's Report and for good cause shown requests that the Commission (1) issue an order finding that Staff has failed to present any information which would tend to show that the sale by Southern Union of its Texas operation division to ONEOK involved the sale of the whole or any part of MGE's works or system in Missouri, (2) deny with prejudice Staff's request for authority to file and prosecute a complaint against Southern Union and (3) close this case without further proceedings.

Respectfully submitted,



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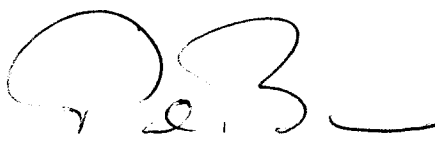
Attorneys for Southern Union Company

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was delivered by first class mail or by hand delivery, on this 23rd day of January 2004 to the following:

Ms. Lera L. Shemwell
Senior Counsel
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102-0360

Mr. John B. Coffman, Public Counsel
Office of the Public Counsel
200 Madison Street, Suite 650
P.O. Box 2230
Jefferson City, MO 65102



**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service
Commission held at its office in
Jefferson City on the 8th day of
July, 2003.

Staff of the Missouri Public Service Commission,)
)
Complainant,)
)
v.)
)
Southern Union Company,)
)
Respondent.)

Case No. GC-2003-0348

ORDER REGARDING COMPLAINT

Syllabus: Because the Commission is investigating, in another case, the same transaction complained of herein, the Commission dismisses the complaint.

On March 21, 2003, the Staff of the Commission filed a complaint against Southern Union Company, alleging that Southern Union had sold "property and assets that were located in Texas and used to serve Missouri consumers" without Commission permission.

On March 21, concurrently with the filing of this case, Staff filed a request to investigate the same transaction that it complains of here. That request has been docketed as Case Number GO-2003-0354. In that case, Staff has asked the Commission to open a case to investigate Southern Union's transfer of a portion of its gas procurement

function that served Missouri customers. This same transfer of the procurement function forms the basis of the instant complaint.

On April 22, Southern Union moved to dismiss the complaint because it failed to state a claim upon which relief can be granted. Southern Union also suggests that the matters complained of herein can be investigated in Case Number GO-2003-0354.

Staff's filing of a complaint appears to be premature. The investigation of the transaction in Case Number GO-2003-0354 may or may not reveal a violation of a statute, but it is apparent from the pleadings filed in this case that the question is an open one. Because Staff is actively investigating the same transaction in another case, the Commission will dismiss the complaint. If Staff's investigation uncovers any violation of statute, it can file a complaint concerning that violation.

IT IS THEREFORE ORDERED:

1. That the complaint filed by the Staff of the Commission on March 21, 2003, is dismissed without prejudice.
2. That this order shall become effective on July 18, 2003.
3. That this case may be closed on July 19, 2003.

BY THE COMMISSION

(S E A L)

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

Simmons, Ch., Murray, Gaw, Forbis and Clayton, CC., concur

Mills, Deputy Chief Regulatory Law Judge

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(BW)(PA-SOUTHERN-UNION)(SUG) Southern Union Company to Sell Texas Division to ONEOK

Business Editors

WILKES-BARRE, Pa.--(BUSINESS WIRE)--Oct. 16, 2002--Southern Union Company ("Southern Union" or the "Company") (NYSE:SUG) announces today that it has entered into a definitive agreement with ONEOK, Inc. ("ONEOK"), of Tulsa, Oklahoma, to sell its Southern Union Gas Company Texas division and related assets to ONEOK for approximately \$420 million in cash.

Southern Union Chairman and Chief Executive Officer George L. Lindemann stated, "This is an excellent deal for our shareholders. This transaction represents the first step in our plan to create value for our shareholders by strengthening our balance sheet and by providing sufficient liquidity to explore investments in other energy-related opportunities."

Southern Union Gas Company is Southern Union's oldest natural gas distribution operating division. Headquartered in Austin, it serves approximately 535,000 customers, including the cities of Austin, El Paso, Brownsville, Galveston and Port Arthur. Related assets being sold to ONEOK include SUPRO Energy Company, Southern Transmission Company, Mercado Gas Services, Inc., and the Company's natural gas distribution investments in Mexico. ONEOK is a diversified energy company that distributes natural gas to approximately 1.4 million customers in Kansas and Oklahoma.

The transaction, which has been approved by the boards of directors of both companies, will close as soon as possible following clearance by the Federal Trade Commission under the Hart-Scott-Rodino Act and approval by certain Texas municipalities.

J.P. Morgan Securities Inc. acted as financial advisor to Southern Union Company on this transaction. Southern Union Company is an energy distribution company serving nearly 1.5 million customers through its natural gas operating divisions in Texas, Missouri, Pennsylvania, Rhode Island, Massachusetts and Mexico. For more information, visit www.southernunionco.com.

This release and other Company reports and statements issued or made from time to time contain certain "forward-looking statements" concerning projected future financial performance, expected plans or future operations. Southern Union Company cautions that actual results and developments may differ materially from such projections or expectations.

Investors should be aware of important factors that could cause actual results to differ materially from the forward-looking projections or expectations. These factors include, but are not limited to: weather conditions in the Company's service territories; cost of gas; regulatory and court decisions; the receipt of timely and adequate rate relief; the achievement of operating efficiencies and the purchase and implementation of any new technologies for attaining such efficiencies; impact of relations with labor unions of bargaining-unit employees; the effect of any stock repurchases; and the effect of strategic initiatives (including: any recent, pending or potential acquisition or merger, recent corporate restructuring activities, any sales of non-core assets, and any related financing arrangements including refinancings and debt repurchases) on earnings and cash flow.

Exhibit 2

4/11/2003

Southern Union Company to Sell Texas Division to ONEOK

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--30--DM/ph*

CONTACT: Southern Union Company
Richard N. Marshall, 570/829-8662
www.southernunionco.com

KEYWORD: PENNSYLVANIA TEXAS
INDUSTRY KEYWORD: BANKING ENERGY OIL/GAS MARKETING AGREEMENTS
SOURCE: Southern Union Company

Thomas E. Karam
President and Chief Operating Officer

November 26, 2002

The Honorable Kelvin Simmons
Chairman, Missouri Public Service Commission
P. O. Box 360
Jefferson City, Missouri 65102

Dear Chairman Simmons:

As you may know, effective November 21, 2002, Southern Union Company's wholly-owned subsidiary, Energy Worx, Inc., entered into an agreement with AIG's Southern Star Central Corp. ("Southern Star") to manage its Central Pipeline. Southern Star acquired the Central Pipeline from the Williams Companies, Inc. on November 15, 2002. As you are aware, the Federal Energy Regulatory Commission ("FERC") has promulgated certain rules on the relationship between interstate gas pipelines and their marketing affiliates. Also, FERC is considering a rulemaking to extend these standards of conduct to other energy affiliates of interstate pipelines, including local distribution companies like our Missouri Gas Energy division ("MGE").

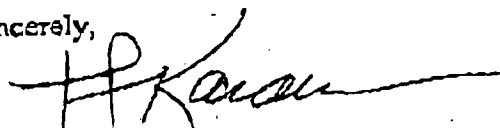
Southern Union Company intends to be proactive in complying with these standards. Accordingly, pending FERC action, and to ensure structural and operational separation, there will be no shared employees between Energy Worx, Inc. and MGE. Moreover, the employees of Energy Worx, Inc. will function entirely independently of MGE. Further, no employees of Energy Worx, Inc. will be allowed to obtain from or provide to MGE any information related to the transportation of natural gas that is not contemporaneously provided to all shippers. In this way, no confidential, non-public transportation information learned by one company will be shared with the other.

Finally, MGE will be announcing that Robert J. Hack, Vice President - Pricing and Regulatory Affairs and Assistant Secretary, will now be assuming the additional duty of responsibility for MGE's gas supply function. By placing full responsibility for MGE's gas supply with MGE officers in Kansas City, we reinforce our Company's commitment to upholding FERC standards of conduct.

The Honorable Kelvin Simmons
Chairman, Missouri Public Service Commission
November 26, 2002
Page 2

If you have any questions on these matters, please contact Dennis Morgan at (570) 820-2420 or James Moriarty at (202) 939-7919.

Sincerely,



Thomas F. Karam

TFK/bmn

cc: Commissioner Sheila Lumpe
Commissioner Connie Murray
Commissioner Steven Gaw
Commissioner Brian Forbis
Mr. Robert Quinn, Public Service Commission Executive Director
Dan Joyce, Esquire, Public Service Commission General Counsel
Douglas Micheel, Esquire, Office of the Public Counsel