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 supply department to Energy Worx, a wholly owned subsidiary.	))))	Case No. GO-2003-0354

Dissenting Opinion of Chairman Steve Gaw and Commissioner Lin Appling

We respectfully dissent from the Order Closing Case issued by the majority in this proceeding. As the following analysis demonstrates, the majority's decision merely perpetuates the uncertainty surrounding this Southern Union transaction. Furthermore, we assert that the majority did not take an opportunity to provide guidance to the Missouri utilities regarding the scope of Section 393.190.1. As such, these utilities are left, for the unforeseeable future, to question under what circumstances it should seek Commission approval for the transfer of certain utility assets. For these reasons as well as that reflected in the following analysis, we must respectfully dissent.

FACTS

In late 2002, Southern Union Company entered into an agreement to have Energy Worx, a wholly-owned Southern Union subsidiary, manage the Central Pipeline on behalf of AIG's Southern Star Central Corp. (Southern Star Agreement). As part of the transaction and largely unbeknownst to Missouri regulators, Southern Union also transferred its executive of gas procurement, Mike Langston, to Energy Worx to commence work on behalf of AIG Southern Star.[1]

Also in 2002, in a separate agreement, Southern Union announced that it had entered into an agreement to sell its entire Texas operations to ONEOK. As designed, ONEOK purchased Southern Union's operations in 100 Texas municipalities consisting of over 520,000 customers. Included in the transaction, Southern Union also transferred its remaining five gas procurement employees to ONEOK.

[1] Mr. Langston and 5 other individuals provided gas procurement services on behalf of both the Missouri and Texas operations of Southern Union.

In a letter dated November 26, 2002, Southern Union informed the Missouri Commission of the Southern Star agreement. In light of the recent FERC efforts to ensure structural and operational separation between an interstate gas pipeline and affiliated local distribution companies, Southern Union assured the Commission that employees of Energy Worx would function independently of MGE. Consistent with this pledge, MGE noted that MGE's gas supply function would now be placed within the responsibility of MGE officers in Kansas City.

Noticeably, the letter was completely silent as to the fact that the new MGE gas supply department would now be entirely staffed by new personnel and that all previous Southern Union gas procurement personnel had been transferred to either Energy Worx or ONEOK. Despite the fact that gas commodity costs represent a substantial portion of overall retail rates, MGE failed to inform the Commission or ratepayers that responsibility for this portion of its business would rest in new hands and that all former gas procurement personnel had been reassigned to other entities.

LAW

It is well recognized that a fundamental goal of regulation, in addition to rates, service, and safety, is the efficiency of management. As has been noted, "it does the buyer no good to compel the producer to accept half the former net earning if he gets in exchange a management half as efficient, for the poor management will add more to the costs of operations than the regulating commission can take away in reduced earnings."[2]

Recognizing the possibility that poor management decisions could negatively affect the operation of the utility and the cost of service to ratepayers, the General Assembly provided the Public Service Commission with oversight of several managerial decisions including decisions related to debt and equity issuances, corporate reorganizations and transfers of utility assets "necessary or useful" in providing service to the public.

Specifically, as regards the Commission oversight of corporate transfers of property, Section 393.190.1 provides that "No gas corporation. . . shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public".

Recognizing that there is no dispute that the entire gas procurement department has been transferred, the outcome of the pending MGE investigation appears to revolve around the following inquiries. First, are the personnel in the MGE gas supply department and the intellectual knowledge possessed by those personnel

[2] J.M.Clark, Social Control of Business, 2d ed. (New York: McGraw-Hill, 1939) at page 337. (emphasis added).

a part of MGE's franchise, works or system? Second, if the gas supply department is part of the MGE franchise, works or system, is the department necessary or useful in the performance of MGE's duties to the public?

ISSUES

I. The Gas Supply Personnel are part of the MGE Franchise, Works or System.

In the course of its operation of the MGE local distribution company, Southern Union has hired and trained several employees in the field of gas supply procurement. In the course of establishing customer rates, the Commission would necessarily reflect the training and payroll costs for these employees. Naturally, as the skill of the gas supply department is perfected over time, these personnel become a vital part of the franchise, works or system of the local distribution company.

Despite the critical nature of the gas procurement personnel, Southern Union has essentially treated its regulated Missouri operations as a minor league training ground by transferring these employees to the detriment of the Missouri ratepayers and without the approval of the Missouri Commission. Gas procurement employees that once provided a valuable service on behalf of the regulated local distribution company have been transferred in an effort to realize larger profits for an unregulated subsidiary. As these more experienced employees are replaced, it is naturally expected that gas procurement costs for the regulated operations will increase. Recognizing that these costs will likely be accepted by regulators and reflected in retail rates, Southern Union has effectively increased the overall profitability of the company while simultaneously increasing the costs to regulated Missouri ratepayers.

Clearly the fact that MGE found it necessary to subsequently hire new gas supply personnel provides indisputable evidence that these employees were part of the MGE "franchise, works or system." Companies routinely tout the effectiveness of their company as a product of their employees. In fact, understanding the critical nature of some of their employees, many companies take out policies to insure against the untimely death or disability of their key employees. Ultimately, the premiums associated with these employee insurance policies are presented for inclusion in retail rates.

It is a widely held concept that regulation should act as a surrogate for competition. Recognizing such a concept, it is logical to look to the competitive environment for guidance on certain issues. In the competitive environment, it is indisputable that corporate entities may view certain employees as assets of the corporation. Certainly, Microsoft views the presence and leadership of Bill Gates as a corporate asset. Similarly, it is without question that General Electric looked upon Jack Welch as an asset of the corporate entity. Undoubtedly, similar

importance would be placed on individuals that have developed skills critical to the continued performance of the company.

The fact that certain employees can constitute a part of a company's "franchise, works or system" is also found in the fact that companies routinely provide golden parachute packages to key employees to entice those employees to continue their employment at the company. As with the employee insurance policies, the costs of these retention packages are ultimately reflected in the prices charged to customers.

The importance of certain employees is not diminished in the utility environment. As competition develops in certain portions of the industry, the importance of critical employees is enhanced. It is without question that an individual and department that is responsible for the ultimate price of a firm's largest cost input would be held with similar regard. As such, it is imperative that any attempts by the regulated entity to transfer these employees be reviewed in a critical light.

The fact that the assets in question are not tangible does not negate the fact that they are critical assets of the MGE "franchise, works or system." These intangible, intellectual assets are no less important to the efficient operations of a utility as any more tangible asset.

II. The Gas Supply Personnel are Necessary or Useful in the Performance of MGE's Duties to the Public.

Recognizing that the creation and development of unregulated subsidiaries is a fairly recent development, it is not surprising to find a lack of direction in past PSC or court decisions regarding the proposed transfer of intellectual assets to an unregulated affiliate. Instead, decisions focusing on the transfer of assets under Section 393.190 have focused on the sale of tangible assets. These cases have been fairly clear-cut and have not required any definition to the statutory terms of "necessary" or "useful" as contained in Section 393.190. Nevertheless, despite the lack of guidance in opinions interpreting Section 393.190, some guidance can be found in the definition of "necessary" as used in Section 393.170 regarding the grant of certificates of public convenience and necessity.

In State ex rel. Intercon Gas Inc. v. Public Service Commission of Missouri, the Missouri Court of Appeals found that "[t]he term 'necessity' does not mean 'essential' or 'absolutely indispensable', but that an additional service would be an improvement justifying its cost."[3] Using this definition, we have proposed that the determination of whether a utility asset is "necessary" should be evaluated

[3] State ex rel. Intercon Gas Inc. v. Public Service Commission of Missouri, 848 S.W.2d (593) (Mo.App. W.D. 1993) at 597, citing Beaufort Transport Co. v. Clark, 504 S.W.2d at 219.

based upon the improvement that the asset provides to the utility's provision of service.

The case at hand would have provided this Commission an excellent opportunity to provide definitive guidance to Missouri utilities regarding their ability to transfer assets without Commission approval, on the basis that such assets are not "necessary". Specifically, adoption of the Intercon Gas test would allow a utility to sell or transfer "office equipment or other fungible assets" in the ordinary course of business, without Commission approval, on the basis that such assets do not provide an improvement to the utility's provision of service relative to the assets used to replace the sold asset. Similarly, individual gas distribution lines scheduled for retirement and replacement would not be considered necessary since they could be replaced without any perceptible diminution of service.

Unlike office equipment or other such fungible assets, the intellectual assets of a utility are unique and provide a definite improvement to the utility's provision of service. Only through the mixture of such intellectual utility assets with the rate base plant of the utility can expected utility efficiencies be realized. Given the critical nature of these intellectual assets, the Commission should be diligent in protecting the public interest by requiring that such assets not be transferred without approval.

ANCILLARY ISSUES

I. The Proposed Order Does Not Provide Certainty.

As written, the Proposed Order fails to provide certainty for Southern Union that its transfer of the gas procurement department was appropriate. Rather, the Order merely states that the Staff failed to meet its burden of proof. It does not foreclose the possibility that facts are later uncovered and another complaint filed by Staff or any other party with standing under Section 386.390. Effectively, this transaction would be forever tainted by the possibility that another complaint would be filed that provides the facts necessary for the complainant to meet its burden of proof. As such, Southern Union is left to wonder, absent a voluntary application on their part, whether it can safely proceed with this transaction. Given the punitive nature of Section 393.190 (sales are void absent Commission approval), we are left to question Southern Union's ability to proceed safely with this transaction.

Similarly, the Proposed Order does not provide Staff the guidance necessary to determine whether it should seek investigations of future transfers or the criteria under which it should present such investigations to the Commission. Instead, the Order merely suggests that, in the event that the Staff does present such a matter, it should provide a greater factual basis. Specifically in regards to the matter at hand, Staff must be left to wonder whether it should develop additional facts sufficient to satisfy the majority and then seek to file another complaint.

Finally, the Proposed Order does not provide the guidance necessary for Missouri utilities to independently determine whether it should seek Commission approval for the transfer / sale of certain utility assets. Recognizing the likelihood that additional situations will develop in which a utility attempts to transfer intellectual assets to unregulated operations, Missouri utilities are left to question whether Commission approval is needed. Unfortunately, given the majority's refusal to provide the necessary guidance, these utilities are left to continue in their uncertainty.

The test provided in this Dissent (e.g., whether the asset is "necessary" because it provides an improvement to the utility's service relative to potential replacements), would have provided the clear guidance needed by these utilities.

II. MGE's Claims that Commission Approval will Hinder Employee Freedom of Movement is Unfounded.

In its Response to Staff's Report, MGE suggests that Commission action would have hindered basic human freedoms.

> 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) or 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 States. 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.[4]

Any discussion of this topic must focus on the fact that these employees did not voluntarily leave their positions at Southern Union. Rather, Southern Union, focused solely upon corporate financial interests, informed these employees that their positions had been transferred to another entity. It was Southern Union that informed these employees that their services were no longer needed and that

[4] 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 at page 4. (emphasis in original).

their options were to move to another entity or face unemployment. It is the Southern Union decision to transfer these employees to another entity that demanded Commission review.

Commission exercise of jurisdiction under Section 393.190 does not impede an individual's right to better their situation or pursue additional employment opportunities. Nowhere does Chapter 386 or 393 provide the Commission with authority to review decisions of an individual. As such, employees of Southern Union would be free now and in the future to pursue more attractive employment opportunities.

Clearly, the indentured servitude argument is a red herring. Exercise of Commission jurisdiction would not hinder the freedom of individual employees. Rather, exercise of the Commission oversight capability would have merely ensured that utilities do not voluntarily transfer intellectual assets to the detriment of Missouri ratepayers.

III. Southern Union's Claims that the Gas Supply Department is Located in Texas is Irrelevant.

In its Response, Southern Union implies that the Commission is devoid of jurisdiction merely by way of the fact that the ONEOK agreement involved the sale of a "natural gas distribution company located solely in the State of Texas".[5] Again, this argument is baseless.

Section 386.450 clearly anticipates the situation in which a Missouri public utility may have operations in another state. As reflected in that statute, the mere fact that books, records or operations are located in another state does not preclude the Commission from exercising its full jurisdiction regarding Missouri operations.

In the case at hand, Southern Union allocated costs of its gas procurement department to both the Missouri and Texas operations. The gas procurement costs allocated to Missouri were reflected in rates, paid by customers and collected by Southern Union. As a result, the Missouri Commission clearly had regulatory oversight regarding this department. When Southern Union attempted to transfer all of the employees in the gas supply department, it invoked the jurisdiction of the Commission regardless of the fact that these employees were located in Texas.

IV. Relationship to Other Pending Cases

As noted in a previous footnote, it is an essential objective of utility ratemaking that the return "should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for

[5] *Id.* At 2 (emphasis in original).

the proper discharge of its public duties."[6] Clearly, this language imposes a duty on the Commission to analyze the decisions of a public utility's management in order to determine if they have acted in an "efficient and economical" manner. In light of this duty, the Commission has criticized MGE in the past for unsatisfactory customer service performance and penalized MGE by ordering a return on equity at the low end of the acceptable range.[7]

Interestingly, in its pending rate proceeding, MGE now requests that it be granted an additional 25 basis point on rate of return on account of management efficiency. As MGE explains in its Statement of Position in that pending proceeding, "[b]ecause the Commission has used findings of less than satisfactory management performance as justification for awarding a lower than expected compensation in the past, fairness requires that when high management efficiency is shown, higher than expected compensation should be awarded."

While it is important to note that we have not predetermined the issue of return on equity / rate of return in the pending rate proceeding, we do note that a decision to transfer an entire gas procurement department may not necessarily be reflective of an "efficient and economical" management.

CONCLUSION

It is an undeniable fact that an employee can be a corporate asset. This fact is not diminished in a regulated environment. To date, the Public Service Commission has not had the opportunity to define "necessary" as used in the context of Section 393.190.1. As such, utilities have suffered from the lack of such guidance and have been forced to make a case-by-case determination of whether to seek Commission approval for the transfer of certain assets.

This matter should have provided the opportunity for the Commission to give clear guidance to such utilities. In the Commission's deliberations, we proposed a test, based upon case law that evaluates the improvement that an asset provides to the utility's provision of service. Based upon this definition, utilities would have had the freedom to transfer fungible assets such as office supplies and non-unique inventory on the basis that these assets do not provide an improvement to the utility's provision of service. On the other hand, unique assets, such as intellectual assets and unique plant, could not have been transferred without Commission review.

As applies to the matter at hand, it is my opinion that the transfer of the Southern Union gas procurement department involved the sale of an asset that provides

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[6] State ex rel. U.S. Water / Lexington v. Missouri Public Service Commission, 795 S.W.2d 593, 597 (Mo.App.W.D. 1990).

[7] Missouri Gas Energy, 5 Mo.P.S.C. 3d 437, 468 (1997); Missouri Gas Energy, 7 Mo.P.S.C. 3d, 394, 404 (1998).

an improvement to the Southern Union provision of gas service. As such, this asset was "necessary", as used in the context of Section 393.190, and would have required Commission approval prior to transfer. The application of this test in no way disposes of the question whether such a sale should be permitted. It is conceivable that, given the opportunity to present the benefits of the transaction, the company would have been able to show that this sale was reasonable and in the public interest. Unfortunately, such a showing will not be immediately forthcoming.

Respectfully submitted,

Steve Gaw
Chairman

Lin Appling
Commissioner

Dated at Jefferson City, Missouri
on this 11th day of August, 2004