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Missouri Public Service Commission

POST OFFICE BOX 360  
JEFFERSON CITY, MISSOURI 65102  
573-751-3234  
573-751-1847 (Fax Number)  
<http://www.psc.state.mo.us>

June 15, 2000

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DALE HARDY ROBERTS  
Secretary/Chief Regulatory Law Judge

DANA K. JOYCE  
General Counsel

Mr. Dale Hardy Roberts  
Secretary/Chief Regulatory Law Judge  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102

FILED<sup>2</sup>

JUN 15 2000

Missouri Public  
Service Commission

RE: Case No. GM-2000-500

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of a **STAFF RECOMMENDATION**.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Dennis L. Frey  
Associate General Counsel  
(573) 751-8700  
(573) 751-9285 (Fax)

DLF/lb  
Enclosure  
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

FILED<sup>2</sup>

JUN 15 2000

Missouri Public  
Service Commission

In the Matter of the Application of )  
Southern Union Company for Authority to )  
Acquire the Common Stock of and to )  
Merge with Providence Energy )  
Corporation, and in Connection )  
Therewith, Certain Other Related )  
Transactions. )

Case No. GM-2000-500

STAFF RECOMMENDATION

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission") and respectfully states as follows:

1. On February 17, 2000, Southern Union Company ("Southern Union" or "Company") filed with the Commission, pursuant to Section 393.190 RSMo 1994, an Application for authority to acquire the common stock of and to merge with Providence Energy Corporation. The Application included the Company's agreement to a series of conditions to the Commission's approval of said Application.

2. On February 18, 2000, Southern Union filed a Motion for Protective Order. The Commission subsequently issued its Order Establishing Protective Order on February 23rd.

3. Also on February 23rd, in its Order Establishing Time for Filing of Recommendation, that Commission directed the Staff to file a recommendation regarding approval of the subject Application on or before June 15, 2000.

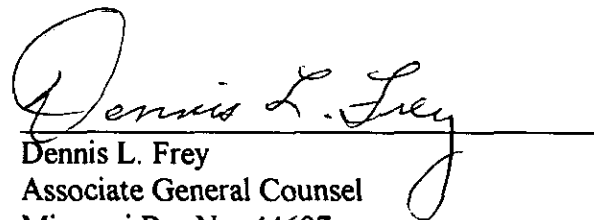
4. On May 22, 2000, following discussions with Staff, Southern Union filed an Amended Application, wherein the Company modified the language of paragraph 19 of its February 17th Application to provide more detail regarding its commitments in the area of customer service.

5. Based on its review of the subject Application, as amended, and including the aforementioned conditions, Staff is of the opinion that Southern Union's request is, pursuant to 4 CSR 240-2.060(8)(D), "not detrimental to the public interest." Therefore, in the attached Memorandum, which is labeled Appendix A, Staff recommends approval of the Company's Application, as amended, subject to those conditions.

**WHEREFORE**, the Staff respectfully requests that the Commission issue an Order granting Southern Union's request for authority to acquire the stock of and to merge with Providence Energy Corporation, subject to the conditions set forth in Staff's Memorandum attached hereto.

Respectfully submitted,

DANA K. JOYCE  
General Counsel

  
Dennis L. Frey  
Associate General Counsel  
Missouri Bar No. 44697

Attorney for the Staff of the  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102  
(573) 751-8700 (Telephone)  
(573) 751-9285 (Fax)

### **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 15th day of June 2000.

Dennis L. Frey

# MEMORANDUM

TO: Missouri Public Service Commission Official Case File  
Case No. GM-2000-500, Southern Union Company and  
Providence Energy Corporation.

FROM: Ron Bible, Financial Analysis Department *RB*  
Anne Allee, Procurement Analysis Department *ana*  
Debbie Bernsen, Management Services Department *DB*  
Janet Hoerschgen, Consumer Services Department *JH*  
Chuck Hyneman, Accounting Department *CH*

*Ronald L. Bible 6/15/00*  
Project Coordinator / Date

*Thomas R. Schuman Jr. 6/15/00*  
General Counsel's Office / Date

SUBJECT: Staffs Recommendation for approval of the Application of Southern Union  
Company and Providence Energy Corporation for authority to merge.

DATE: June 15, 2000

## Introduction

On February 17, 2000, Southern Union Company (Southern Union or Company) filed its Application with the Missouri Public Service Commission (Commission) seeking approval for Southern Union to acquire the stock of and to merge with Providence Energy Corporation (ProvEnergy). The merger agreement calls for ProvEnergy to merge into Southern Union in a transaction valued at approximately \$400 million, including assumption of debt. If approved, each ProvEnergy shareholder will receive \$42.50 in cash per share of ProvEnergy common stock. Appendix 1 of the Application is the "Agreement and Plan of Merger among Southern Union Company, GUS Acquisition Corporation and Providence Energy Corporation" dated November 15, 1999 (Merger Agreement). If this merger transaction is completed, Southern Union will serve approximately 1.5 million gas, electric, oil, and propane customers in Rhode Island, Massachusetts, Pennsylvania, Texas, Missouri, Florida, Connecticut, and Mexico.

Effective November 4, 1999, Southern Union acquired Pennsylvania Enterprises, Inc. (PEI) and its subsidiaries. This merger was approved by the Commission in Case No. GM-2000-43, in its Order Approving Stipulation and Agreement dated October 21, 1999. PEI's natural gas utility businesses are being operated as PG Energy, a division of Southern Union. Through the acquisition of PEI, Southern Union acquired and now operates a subsidiary that markets electricity and other products and services under the name PG Energy Power Plus. Other subsidiaries that Southern Union acquired in the PEI merger engage in various non-regulated activities. These activities include the construction, maintenance and rehabilitation of natural gas distribution pipelines and the sale of property for residential commercial development.

In addition to ProvEnergy, Southern Union has pending merger agreements with Fall River Gas Company (dated October 4, 1999) and Valley Resources, Inc. (dated November 30, 1999). Fall River Gas Company serves approximately 48,000 customers in southeastern Massachusetts. Valley Resources Inc. provides natural gas utility service to approximately 63,000 customers through its subsidiaries, Valley Gas Company and Bristol & Warren Gas Company, in northeastern and eastern Rhode Island.

Southern Union primarily engages in the distribution of natural gas and serves more than 1.2 million customers through its four natural gas divisions in Texas, Missouri, Pennsylvania and Florida, its propane distribution subsidiaries, and its equity ownership in a natural gas distribution company serving Piedras-Negras, Mexico. Through its subsidiaries, Southern Union also markets natural gas to end users, operates natural gas pipeline systems and is engaged in electricity generation and marketing.

Southern Union's principal line of business is the distribution of natural gas as a public utility through Southern Union Gas, Missouri Gas Energy (MGE), PG Energy and Atlantic Utilities, doing business as South Florida Natural Gas, each of which is a division of Southern Union. Southern Union Gas, headquartered in Austin, Texas, serves approximately 523,000 customers in Texas. MGE, headquartered in Kansas City, Missouri, serves approximately 487,000 customers in central and western Missouri. PG Energy, headquartered in Wilkes-Barre, Pennsylvania, serves approximately 154,000 customers in northeastern and central Pennsylvania. South Florida Natural Gas, headquartered in New Smyrna Beach, Florida, serves approximately 5,000 customers in central Florida.

ProvEnergy is a distributor and marketer of natural gas, heating oil and petroleum products, as well as a marketer of electricity and energy services. ProvEnergy serves approximately 181,000 customers in Rhode Island, Massachusetts and Connecticut. Its principal subsidiaries within its regulated operations include The Providence Gas Company (ProvGas) and North Attleboro Gas Company (collectively referred to as the "Gas Companies"). Its retail non-regulated operations include ProvEnergy Services, ProvEnergy Fuels and ProvEnergy Power.

The Gas Companies' distribution systems consist of approximately 2,400 miles of gas mains, approximately 146,000 services and approximately 173,000 active gas meters. ProvGas, Rhode Island's largest natural gas distributor, was founded in 1847 and serves approximately 168,000 customers. North Attleboro Gas Company serves approximately 4,000 customers in Massachusetts, and towns adjacent to the northeastern Rhode Island border. The total natural gas service territory of the Gas Companies encompasses 760 square miles and has a population of approximately 853,000.

According to ProvEnergy's annual report filed with the SEC, Form 10-K filed on December 22, 1999, ProvEnergy will operate as an autonomous division of Southern Union, and ProvEnergy's Chairman and Chief Executive Officer, James H. Dodge, will become a member of Southern Union's Board of Directors.

Peter H. Kelley, Southern Union's president and chief operating officer described the merger with ProvEnergy in a May 24, 1999 press release as "building greater shareholder value by expanding our geographic service territory." Describing all three of Southern Union's pending mergers, Mr. Kelley said, "these mergers strengthen Southern Union's competitive position in the attractive Northeast energy market."

Mr. Kelley elaborated on Southern Union's reasons for the three pending mergers in his direct testimony before the Massachusetts Department of Telecommunications and Energy (DTE) in the Joint Petition of North Attleboro Gas Company, Providence Energy Corporation and Southern Union Company for Approval of Merger, DTE Case No. 00-26:

Southern Union sought the three pending mergers in the New England area (ProvEnergy, Fall River Gas Company, and Valley Resources, Inc.) for strategic purposes. By expanding the geographic diversity of its operations, Southern Union will further reduce its dependence on economic and weather conditions in any single operating region. Thus, the stability of the Company's earnings and cash flow will be enhanced. Also, as a result of the merger, Southern Union will extend and enhance the scope of its operations in the northeastern United States beyond its recently completed Pennsylvania acquisition.

In entering into these mergers, Southern Union recognized that these companies and Southern Union have compatible business perspectives, providing the opportunity to effectively coordinate our operations. The assimilation of these new gas divisions into our existing structure will enable us to improve operations throughout the Company by identifying and adopting best practices from each of the operating divisions. Although the Company's primary motivation in arranging the mergers is strategic, some savings, as explained in the testimony of Ronald Endres, are likely to be realized as a result the coordination of corporate and gas distribution activities. More importantly, customer service will be enhanced over time. Through the expansion of its customer base, deployment of new technologies becomes more economical. Introducing new technologies will enhance our customer service and will improve our gas distribution operations in an unbundled, competitive marketplace. As a result, Southern Union will be well positioned to control rates and improve service for the benefit of customers.

#### **Acquisition Adjustment**

According to Southern Union's Chief Financial Officer, Mr. Ronald J. Endres, in his direct testimony in DTE Case No. 00-26, Southern Union will incur a acquisition premium of approximately \$161.3 million. This amount, plus merger transaction costs, will be recorded as an acquisition adjustment on Southern Union's balance sheet.

At September 30, 1999, Southern Union had an acquisition adjustment (principally from its acquisition of MGE in 1994) of \$133 million on its books and records. The acquisition of PEI caused Southern Union to recognize an additional \$259.5 million, for a total company acquisition adjustment balance of \$392.5 million. If the proposed acquisition of ProvEnergy is completed, Southern Union will have an acquisition adjustment balance of approximately \$554 million.

Although, as described below, Southern Union is not proposing explicit rate recovery of the ProvEnergy merger premium in Missouri, the Staff still has a concern about the rapid increase in the acquisition adjustment account on Southern Union's balance sheet. If Southern Union does not recover its acquisition adjustment (or merger premium) explicitly in rates, or indirectly through earnings above its authorized rate of return on rate base, there will be financial pressure on the Company to increase earnings through whatever means possible. The Staff addressed these concerns in the language of the Stipulation and Agreement agreed to in Southern Union's acquisition of PEI in Case No. GM-2000-43 and believes that Southern Union has adequately addressed these concerns in its Application in this case.

In paragraph 18 of the Application, Southern Union provides a list of conditions it is willing to agree to if the Commission approves this Application. These conditions are substantially the same conditions agreed to by the parties in the Stipulation and Agreement to Case No. GM-2000-43, Southern Union's Application for authority to acquire and merge with PEI.

In its review of the Application, Staff noted what it believed was language that was deficient in addressing Customer Service concerns. As a result of Staff discussions with the Company on this subject, Southern Union submitted its Amended Application on May 22, 2000. In the Amended Application, Southern Union deletes paragraph 19 of the Application and substitutes in lieu thereof the following:

19. Southern hereby ratifies and confirms its commitment to the Customer Service Performance Measures, Company Response to Customer Service Measures, Customer Complaints/Inquiries to Staff and Customer Service Operating Procedures set forth in paragraph 2(a)-(d) of the Unanimous Stipulation and Agreement filed with the Commission in Case No. GM-2000-43 and approved by the Commission in its October 21, 1999, Order Approving Stipulation and Agreement in said case, provided that, Southern Union, Staff and the Office of the Public Counsel may mutually agree to modify or eliminate any of the requirements set forth therein after a period of three years of reporting after the effective date of the order in this case.

In all other respects the Application heretofore filed on February 17, 2000, is restated, ratified and confirmed.



In addition, Southern Union has agreed, in its Application, to the following conditions:

**1. Customer Service**

In order to assist in making determinations regarding the level of service being provided to the customer, the Joint Applicants, Staff and OPC have established a series of performance measures to measure some components of customer service for Southern Union's Missouri Gas Energy customers. The measures are similar in nature to the measurements agreed to in Case No. EM-97-515, Western Resources, Inc and Kansas City Power & Light Company. This is being done to ensure that this merger will have no adverse effect on the level of customer service to post-merger MGE customers. This Agreement also contains reporting requirements to enable the Staff and OPC to monitor various other components of customer service following the closing of the merger.

Southern Union will ensure that the merger will have no adverse effect on MGE's efforts to provide high quality service to its customers. Southern Union, through its MGE operating division, agrees to the customer service performance measures as summarized below:

**a.) Customer Service Performance Measures**

- Average Abandoned Call Rate (ACR) is not to exceed 7.5% on an annual basis plus a 100 basis point variance (a maximum allowable level of 8.5%) for the calendar year beginning January 1, 2000.
- Average Speed of Answer (ASA) is not to exceed 65 seconds plus a 25 percent variance of 16 seconds annually (a maximum allowable level of 81 seconds) for the calendar year of January 1, 2000 through December 31, 2000. Thereafter, the measurement will be 65 seconds plus a 15 percent variance of 10 seconds annually (a maximum allowable level of 75 seconds).<sup>1</sup>

The base measurements of 7.5% and 65 seconds represent MGE's average actual performance during the July 1997 through June 1999 twenty-four month baseline period.

Future changes made to the annual average abandoned call rate and/or annual average speed of answer measurements established, if any, will have to be based on valid studies/analysis to determine whether such changes will result in providing efficient and economic performance.

**b.) Company Response to Customer Service Measures**

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<sup>1</sup> MGE has plans to implement an automated work order system and other automation improvements in its customer service operations during the year 2000. In recognition of this plan, an additional twenty five percent was added to the ASA measurement to allow for possible variances attributable to this implementation during the first twelve month period.

The Company shall provide the Staff and OPC quarterly reports (within 45 days of quarter-end) on the Customer Service Measures. Statistics for the measures shall be tracked and recorded monthly, reported to Staff and OPC on a calendar year quarterly basis and assessed for compliance annually. Within ninety (90) days after the end of the calendar year, the Company shall submit a draft report to the Staff and OPC which shall include actual performance measures for the year, explanation of any deviation above the measures, actions to be undertaken to eliminate the deviations above the measures and estimates of the cost of such actions. The Staff and OPC shall provide a response to the Company's draft report within thirty (30) days. The Company shall file a final report with the Commission 150 days after the end of the calendar year.

If the Customer Service Measures exceed the 24-month baseline averages for the measures identified, MGE will initiate the following responses.

- Should the actual Service Measures exceed for any calendar year, the 24-month baseline average identified, MGE shall provide the Staff and OPC a written explanation of why MGE believes these figures have increased.
- Should the actual Service Measure for any calendar year period exceed the maximum allowable levels, the Company shall also provide an estimate of the cost, if any, to improve the applicable measure to the 24-month baseline average Service Measure level. The Company shall expense or invest the appropriate amount in the next year to improve the Measure to the 24-month baseline average Service Measure level. The Company will credit to customers a like amount (annual revenue requirement) during the subsequent year for the year in which the indicator was exceeded. The credit may be booked to a deferred liability account, if the Company, Staff, and OPC agree, until a sufficient amount is accumulated to warrant a credit to customers. The credit will not be considered an Accounting Authority Order. The impact of emergencies, catastrophes, natural disasters, extreme adverse weather, extreme natural gas prices, sabotage, work stoppage or other unforeseen events beyond the Company's control shall be taken into account, in which case no credit or expenditure may be required.

c.) Customer Complaints/Inquiries to Staff

For purposes of this section, customer complaints/inquiries include contacts the Staff receives from MGE's customers, but are not necessarily the result of MGE's violation of its tariffs or Commission rules.

FISCAL YEAR	TOTAL COMPLAINTS / INQUIRIES	NO. OF CUSTOMERS (CALENDAR YR)	NO. OF CUSTOMER CONTACTS PER 1,000 CUSTOMERS
1998	1,095	480,077	2.28
1999	678	482,000	1.40

24 Month Average

1.84

Significant increases in the annual average number of complaints/inquiries of 1.84 per one thousand (1,000) customers will be explained by the Company and/or may prompt an investigation by the Staff and/or OPC. The impact of events beyond the Company's control will be taken into account in the Company's explanation and in any investigation by the Staff and/or OPC. The Staff shall provide Company and OPC quarterly reports (within 45 days of quarter-end) showing monthly information regarding the number and category of customer complaints/inquiries received by the Commission's Consumer Services Department.

d.) Customer Service Operating Procedures

The Joint Applicants agree that the present practices of MGE in the following areas will be continued, or improved upon to ensure that customers do not experience a decline in service levels.

- Company will adhere to Commission rules and MGE's approved tariffs.
- Company will, consistent with Commission rules, attempt to collect at customer premises prior to service discontinuance. If payment is not made to collector, payment can be made at the Company's available public business offices, pay stations or through auto-pay.
- Company will restore service five (5) days a week, subject to exceptions for holidays, consistent with Commission rules, and will at all times make a reasonable effort to restore service on the day requested once the reason for the discontinuance is remedied and the request for service is made. In no event shall service be restored later than the next business day following the date requested by the customer.
- Company will use bill test procedures to ensure bill accuracy.
- Company will take appropriate steps to maintain the operation of its automated meter reading system.
- Company will notify Staff and OPC of substantive changes in customer service procedures in call center operations and staffing, customer billing, meter reading, customer remittance, credit and collections, and connection and disconnection.
- Company will identify (1) personnel responsible for handling Commission complaints and ensure they have proper authority, (2) after hours contact personnel, and (3) management employee(s) accountable for ensuring MGE employees are trained in and maintain a working

knowledge of Missouri customer service rules and regulations. Company will notify Staff and OPC of any changes in these personnel within three (3) business days of the changes.

- Company will continue the following programs: "Low Income Home Energy Assistance Program" (LIHEAP) participation, the "Neighbors Helping Neighbors" Program, the "Flexible Due Date Plan", the availability of "Customer Advisors".
- Company will identify the process and level of authority for discontinuance of service to a registered customer.
- Company will provide the Staff and OPC quarterly reports (within 45 days of quarter-end) containing customer service organization charts, customer service staffing, number of estimated bills (including consecutive estimates), list of customer pay station locations, and actual Missouri jurisdictional bad debt write-off by customer class, including the dollar amount written off, number of accounts written off and revenue by customer class.

The customer service measures are subject to renegotiations by the parties in the event of natural gas restructuring.

## 2. **Merger Premium**

The amount of any asserted merger premium (i.e., the amount of the total purchase price above net book value, including transaction costs), paid by Southern Union for ProvEnergy or incurred as a result of the acquisition 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 the merger premium, including transaction costs, through any purported merger savings adjustment (or similar adjustment) in any future ratemaking proceeding in Missouri.

Southern Union reserves the right to seek Missouri rate recovery of internal payroll costs necessary to obtain Missouri regulatory approval of this transaction, to the extent that it can be shown that merger savings achieved and allocated to MGE as a result of this transaction are equal to or in excess of such costs. Other parties to this proceeding reserve the right to oppose rate recovery of such costs, regardless of any asserted merger savings.

In addition, Southern Union shall not seek to recover in Missouri the amount of any asserted merger premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from Missouri ratepayers.

## 3. **MGE's Construction Budget**

Southern Union agrees that the proposed acquisition will have no effect on its budget to complete MGE's service line and main replacement program and will continue to comply with the replacement schedules approved by the Commission in Case No. GO-99-302, and Case No. GO-91-277.

4. **Joint and Common Costs Allocated to MGE**

Total joint and common costs allocated to Missouri will not increase as a result of the proposed transaction. Southern Union agrees to make available to the Staff and the Office of the Public Counsel (OPC), 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. Southern Union agrees that, in any MGE-initiated rate proceeding, it has the burden of proving the reasonableness of any allocated or assigned cost to Missouri Gas Energy from any Southern Union affiliate, division or subsidiary, including all corporate overhead allocations.

5. **State Jurisdictional Issues**

- a.) Southern Union will retain all documentation relative to the analysis of the ProvEnergy acquisition. This documentation will include a list of: a) all Southern Union personnel, consultants, legal, financial and accounting advisors involved in the acquisition; b) the time (in hours) spent by those individuals on work related to the proposed acquisition; c) other expenses, costs or expenditures incurred or recognized by Southern Union that are related to the proposed acquisition; d) business entity (corporate, subsidiary, division) where the costs were booked, including account number, account description and amount; e) description of the nature of the costs incurred.
- b.) Southern Union will maintain its books and records so that all acquisition and merger costs (including this transaction and future Southern Union merger and acquisition transactions) are segregated and recorded separately.
- c.) During MGE's next general rate proceeding, Southern Union agrees to work with the Staff and OPC to identify all acquisition-related costs recorded in Southern Union's book and records in the appropriate test year. This condition does not restrict Southern Union's right to seek rate recovery of merger and acquisition costs related to future transactions.
- d.) Southern Union agrees to create and maintain records listing the names of Southern Union employees (excluding current ProvEnergy employees), number of hours worked, type of work performed and travel and other expenses incurred for all work related to ProvEnergy 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 rate case.
- e.) Southern Union will submit to the Commission's accounting department and OPC verified journal entries reflecting the recording of the proposed acquisition in Southern Union's books and records within forty-five (45) days of closing.

6. **Financial Issues**

Southern Union will not seek an increase in Cost of Capital for MGE as a result of this transaction. Any increases in the Cost of Capital Southern Union seeks for MGE will be supported by documented proof: that the increases are a result of factors not associated with this transaction; that the increases are not a result of changes in business, market, economic, or other conditions for MGE caused by this transaction; or that the increases are not a result of changes in the risk profile of MGE caused by this transaction. Southern Union will ensure that the rates for MGE ratepayers will not increase as a result of this transaction.

7. **ACA Issues**

Southern Union agrees that any Stipulation and Agreement to which Southern Union is a signatory, with regard to any MGE Actual Cost Adjustment case approved by the Commission which occurs prior to the merger closing of Southern Union and ProvEnergy, will be adhered to by Southern Union Company.

8. **Allocations Agreements**

Southern Union agrees that within six (6) months of the close of the merger, it shall meet with the Staff and OPC to discuss the impact of the ProvEnergy acquisition on the Company's structure and organization, including Southern Union's progress toward incorporating ProvEnergy's operations into its Administrative and General ("A&G") expense allocation methodology. In its A&G expense allocation methodology, the Company should specifically identify how its total company corporate overheads are to be allocated between the Company's regulated and non-regulated functions of its regulated divisions, as well as its non-regulated subsidiaries. The Company agrees that the types and the 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 acquisition. This 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 discussed may include, but need not be limited to the use of cost allocation manuals, time sheets, 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 costs to be allocated to Southern Union's regulated divisions.

**Recommendation**

Staff finds that Southern Union's request, including the above-noted terms and conditions, is not detrimental to the public interest. Therefore, Staff recommends that Southern Union's Application, as amended, be approved, subject to said terms and conditions.

**Service List for  
Case No. GM-2000-500  
June 15, 20000**

**Office of the Public Counsel  
P.O. Box 7800  
Jefferson City, MO 65102**

**Paul A. Boudreau/James C. Swearengen  
Brydon, Swearengen & England P.C.  
P.O. Box 456  
Jefferson City, MO 65102-0456**