STAFF'S INVESTIGATION INTO SOUTHERN UNION'S CORPORATE REORGANIZATION AND THE SALE, TRANSFER OR DISPOSAL OF ITS ENTIRE GAS SUPPLY DEPARTMENT TO ONEOK AND ENERGY WORX

I. INTRODUCTION

Section §393.190 requires that a Missouri utility seek the authorization of the Missouri Public Service Commission before it sells or transfers any part of its franchise, system or works. Was Southern Union Company (SU or Company) required to seek Commission authorization prior to selling rate base property and transferring its assembled experienced and trained gas supply workforce? Yes. Missouri courts have interpreted this Section to mean that a utility may not sell or transfer assets that are necessary and useful in the provision of service without obtaining Commission authorization. SU sold and transferred assets. Whether the transfer involved assets that were useful and necessary in the provision of service is a matter for the Commission, as the finder of fact, to decide. The question before the Commission now is whether SU violated Missouri law by ignoring its statutory obligation to seek Commission authorization.

Staff's investigation of the transfer or sale or other disposal of property and other assets, however, has led Staff to conclude that the transfer of assets, as implemented, required Commission authorization, and absent that authorization, that SU violated Missouri law. Staff's investigation revealed facts establishing that Southern Union, as part of the sale of its Texas operations, sold or transferred parts of its franchise, works and system, assets and property, and that SU should have come to the Commission for a determination as to whether the assets were useful and necessary in its provision of service to its Missouri captive customers, and whether the transaction was detrimental to the public interest.

The Public Service Commission was established to protect captive customers from overreaching by monopoly utilities, and the Public Utility Law should be liberally interpreted with an eye to protecting the public interest. With a publicly held utility, a natural conflict may arise between making a profit for shareholders and serving the needs of captive utility customers. This case raises important policy questions about the jurisdiction of the Commission to protect captive customers from actions by a utility that moves to benefit shareholders, while ignoring its customers. Section 393.190 is an example of legislation requiring Commission oversight so that utilities may sell or transfer parts of its system or works that are useful in the provision of service. The statute requires a utility company to seek Commission authorization so that it cannot sell rate base property or transfer other assets useful to ratepayers in order to benefit shareholders. In its investigation Staff has been able to determine that in this transaction SU sold rate base property and transferred an assembled workforce that was performing functions necessary and useful to the provision of service in Missouri . SU had the incentive to package the sale to ONEOK for its shareholders benefit by achieving the maximum profit on this transaction. Missouri statutes require that the Commission review this type of transaction to ensure that SU does not pursue its incentive to maximize profit to the detriment of its Missouri ratepayers. The ONEOK sale is precisely the type of situation that requires the Commission to exercise its regulatory authority to determine whether the sale should be approved.

Thus, SU violated Section 393.190 because it sold rate base property and transferred its experienced gas supply workforce in a sale to ONEOK and ignored the requirement of the Missouri statute that requires it to seek Commission authorization before selling any part of its franchise, system, or works necessary and useful in the performance of its duties to the public.

Legal analysis below will show that Missouri courts have interpreted Section 393.190 to mean that a Missouri utility may not sell assets without Commission authorization to do so. State ex rel Martigney Creek Sewer Co. v. Public Serv. Comm'n.,537 S.W.2d 388, 399 (Mo. 1976)(in referring to §393.190 the court notes that no sale of "assets" had taken place); State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz, 596 S.W.2d 466, 468 (Mo.App. 1980).

When Missouri courts have construed Missouri statutes, it is that construction that directs this Commission, not decisions of other courts. As a result of its investigation, Staff has been able to determine that SU did in fact sell Missouri rate base property in the sale to ONEOK, without seeking Commission authorization to do so, in contravention of Section 393.190. SU sold $2,000,000 of items that had been included in rate base in its last rate case. All property included in rate base is by definition necessary and useful in the performance of duties to the customer. Additionally SU, transferred its entire gas supply workforce as part of (or in connection with Energy Worx) the sale. That transfer was a critical component of the sale.

The Commission should have been given the opportunity to decide whether the assets included in the sale transaction (including utility plant, equipment and trained assembled workforce) was part of MGE's system, works or franchise, and whether these assets were transferred or sold were useful and necessary to the provision of service. Even though the only issue is whether SU was required by statute to come before this Commission for authorization before transferring or selling assets, in its investigation, Staff determined that the transaction did, in fact, constitute a detriment to the public interest in the form that SU closed the transaction.

II. HISTORY

SU provides regulated natural gas utility service in Missouri through its Missouri Gas Energy (MGE) division. The Commission opened this case on a motion by Staff to investigate issues concerning Southern Union's corporate reorganization that resulted when Southern Union sold its Texas-based operations to ONEOK, transferring the whole of its gas supply operations, including other property and its assembled workforce, to ONEOK with the exception of the Vice President of Gas Supply, Mr. Michael Langston, who was transferred to Energy Worx. The sale/transfer included property that was in rate base and assets used to serve Missouri customers. The sale and transfer resulted in the requirement for MGE to develop its own gas supply department from scratch.

In this report to the Commission, Staff reports on its investigation into the sale/transfer to ONEOK of one of the critical components of MGE's operations. Staff examined this transaction in light of the Commission's statutory authority to generally supervise all natural gas companies to assure that the consumers receive safe and reliable service, and in light of the statutory prohibition against the sale or transfer of the franchise, works, or system used to serve captive customers without Commission authorization. Section 393.190 RSMo.[1]

Staff initially informed MGE of its concerns with the ONEOK sale, and with the transfer of assets, when Staff was reviewing the proposed Panhandle Eastern Pipeline acquisition. MGE replied to Staff Data Request No. 5024 that the ONEOK transaction did not involve a sale of the system, works, or franchise necessary and useful in the provision of service to Missouri

[1] All statutory references are to the Revised Statutes of Missouri (2000) unless otherwise noted.

customers. Staff maintains that it is for the Commission and not MGE to determine whether what was being sold or transferred was useful and necessary in the provision of service.

There are several transactions that are relevant to the scope of this investigation. These transactions are Southern Union's acquisition of Panhandle, SU's sale of its Texas business to ONEOK, the settlement of SU's litigation against ONEOK related to Southern Union's effort to acquire Southwest Gas Company, and Southern Union efforts to acquire Williams' Central Pipeline. The relevant chronology has been attached to this report.

III. THE FACTS

MGE is a division of Southern Union Company, a publicly held utility company regulated by the Commission. SU, operating as MGE, is a public utility as defined by § 386.020, and is subject to the jurisdiction of the Commission, pursuant to § 386.250. Further, SU is a gas corporation, as defined by §386.020 (18), that exists to provide natural gas service to consumers in Missouri under the fictitious name "Missouri Gas Energy" (MGE).

In addition to its Missouri operations, prior to the sale to ONEOK, SU provided natural gas service to specific areas in Texas under the fictitious name "Southern Union Gas," (SUG) also a division of SU corporate entity. The SUG division provided the gas supply function for both Missouri and Texas operations including MGE and its Missouri consumers. In particular, SUG provided critical gas-supply functions including: purchasing natural gas, contract management and billing support. In performing these functions, SUG used assets that were included in MGE's Missouri jurisdictional rate base and that were required to provide safe and reliable service to Missouri consumers. MGE's natural gas distribution business is totally

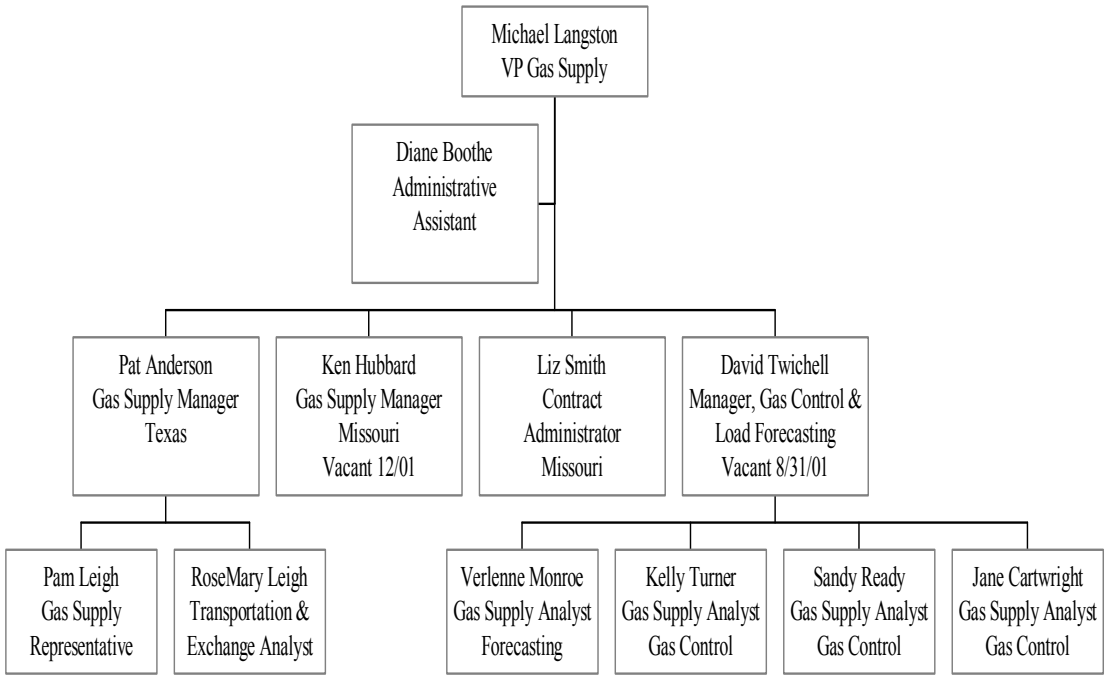
dependant on its ability to deliver natural gas to consumers through arrangements (gas supply, transportation and storage contracts) with suppliers and interstate pipelines to deliver natural gas to its city gates, the point at which the interstate pipeline delivers gas to the local distribution company. The gas purchases for MGE and its captive customers were made by SU's gas supply department, which was disbanded upon the sale of SUG.

When SU sold its Texas SUG division to ONEOK, two things happened. First, ONEOK acquired a Texas local distribution company that consisted of pipelines in several regions, and as part of the transaction, ONEOK also acquired SUG's entire assembled gas procurement workforce, except Mr. Michael Langston, that was experienced in procuring gas for the MGE system that supplies Missouri consumers. To state it another way, in the sale to ONEOK, in addition to the sale of physical assets used to provide services to MGE, SU also transferred, as part of the sale, an in-place, trained and knowledgeable assembled workforce with critical expertise and all the institutional knowledge of MGE's gas purchasing practices, except for the employee that was transferred to a non-regulated affiliate.

As a result of the sale, MGE had to completely build a gas purchasing department which it needs to supply gas to its customers. The action necessary to assemble a gas purchasing function for MGE was not the result of a corporate decision that MGE's gas supply activities could be improved by immediately replacing all of its trained personnel. This is evidenced by the fact that SU had to contract with ONEOK to support MGE's gas supply activities until it could replace the assets conveyed to ONEOK through the sale. The evidence demonstrates that, in making this sale, which included, among other things, a Texas LDC and SU's entire gas purchasing department, SU sacrificed the interests of its Missouri customers in order to profit

from the sale of a portion of its business to ONEOK. ONEOK needed this trained workforce because it performed the gas supply activities for the property that it was purchasing as well as for MGE's Missouri customers. SU decided to allow its trained workforce to transfer to ONEOK to maximize the value that SU would receive from ONEOK from the sale. SU should have obtained the authorization of this Commission prior to the sale or transfer, and absent Commission authorization to do so, the sale or transfer is void by operation of law under Missouri statutes. Section 393.190.

Texas/Missouri Gas Supply Department @ 12/12/02



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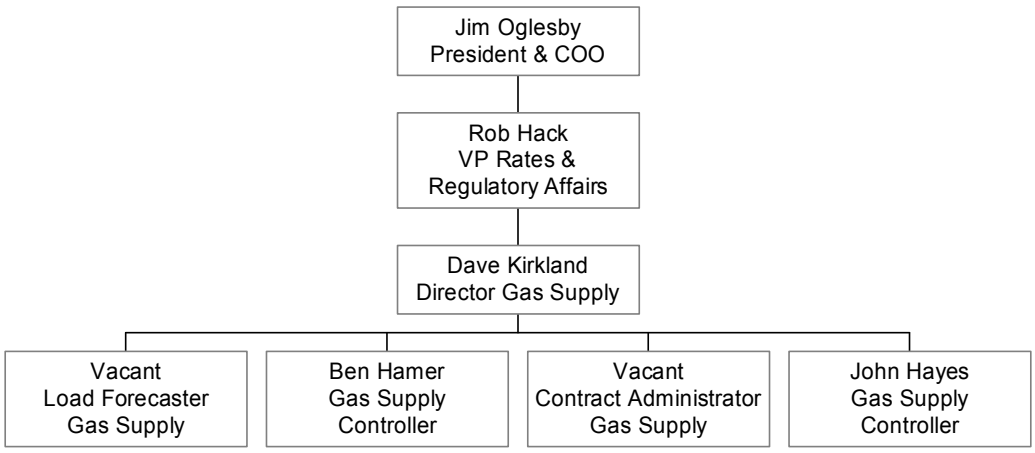

V. DISCUSSION

1. SU transferred part of its system, works or franchise in the sale of the Texas business to ONEOK.

SU began gas sale and distribution operations in Missouri in 1994. At that time SU was already performing gas sale and distribution business in Texas. Southern Union combined its Texas and Missouri operations in such a manner so that the operations in one state support the operations in both states. This combination was designed to eliminate duplicate functions being provided in both states. The result was that neither state operation was totally independent of the operation in the other state. Corporate, gas supply, and other functions for both Missouri and Texas operations were located in Texas.

The rates Southern Union charged its Missouri consumers contained significant costs from Southern Union's operations in Texas. Southern Union has allocated a significant portion (approximately 30% to 40%) of its corporate overhead costs to Missouri Gas Energy. Some of the corporate overhead departments Southern Union allocated to MGE were Chairman and CEO, President, Treasury, Engineering, Accounting and Finance, Human Resources, Legal,

Information Technology, Investor Relations and Gas Supply.

For Southern Union's fiscal year ended June 30, 2000, the test year used for corporate allocations in MGE's latest rate case, MGE sought recovery from its Missouri ratepayers of $9.7 million in corporate allocated expenses (Schedule H-8, Missouri Gas Energy, Twelve Months Ended June 30, 2000, Joint and Common Costs, Case No. GR-2001-292).

In addition to expenses such as labor and other personnel-related costs, Southern Union charged MGE for the use of the property, plant and equipment (building, computers, furniture) used by personnel in Southern Union's corporate overhead departments in Austin Texas to provide service to MGE. In Case No. GR-2001-292, SU sought recovery of depreciation expense and a financial return on $7,246,595 of net corporate allocated plant in service by including these assets in MGE's rate base (Schedule C, Missouri Gas Energy, Twelve Months Ended June 30, 2000, Plant in Service, Case No. GR-2001-292) In response to Staff Data Request No. 29 (Attachment A) Southern Union identified approximately $2 million dollars of assets which were allocated to MGE in MGE's last rate case and included as a part of the sale of Southern Union Gas to ONEOK.

2. What the Legislature meant when it used the terms franchise, works or system.

The Commission is granted specific authority over the transfer, sale or disposal of utility assets in §393.190.1, which provides in pertinent part:

> 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, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person, or public utility, without having first secured from the commission an order authorizing it

so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void. (emphasis added).

Missouri courts have interpreted §393.190 to mean that a utility may not transfer assets without Commission authorization. "Before a utility can sell assets that are necessary or useful in the performance of its duties to the public it must obtain approval of the Commission. § 393.190 RSMo. (1969). *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo.App. 1980). SU argues that the facts of *Fee Fee Trunk Sewer* differ from the facts of this case; however, SU cannot avoid the fact that the court was construing the clear language of §393.190 and intent of the legislature in enacting this section. SU did transfer or otherwise dispose of assets in this sale. The purchase agreement for the SU transaction defines assets to mean: **"HC

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Whether these assets were useful or necessary to the provision of service is a matter for Commission decision and because SU failed to apply to the Commission, the Commission was deprived of the opportunity to decide. In its failure to make application SU violated the statute.

In this case, it would benefit SU if the Commission were to read the term franchise very narrowly to mean a franchise granted by a municipality. The context, however, does not permit such a reading nor does application of the oft-stated principle that a remedial statute, such as the PSC Law, is to be read broadly to effectuate its purposes. Since the Public Utility law is remedial, it is to be broadly construed for the benefit of the customer with little protection of the company. **"**(T)he Public Service Commission Law of our own state has been uniformly held and

recognized by this court to be a remedial statute, which is bottomed on, and is referable to, the police power of the state, and under well-settled legal principles, as well as by reason of the precise language of the Public Service Commission Act itself, is to be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities. *State ex rel. Laundry, Inc. v. Public Service Comm'n*, 34 S.W.2d 37, 42-3(2, 3) (Mo.1931). In its broadest aspects, the general purpose of such regulatory legislation is to substitute regulated monopoly for destructive competition. But the dominant thought and purpose of the policy is the protection of the public, while the protection given the utility is merely incidental. *De Paul Hospital School of Nursing, Inc. v. Southwestern Bell Tel. Co*., 539 S.W.2d 542, 548 (Mo.App. 1976).

Despite the fact that Missouri courts have construed this section of the statute ("franchise, works, or system") to mean utility assets, Southern Union claims that the term "works" as used in Section 393.190.1 RSMo (2000) may be limited to the term "gas plant" in Section 386.020(19) RSMo 2000 as including:

> All real estate, fixtures and personal property owned, operated, controlled or used or to be used for or in connection with or to facilitate the manufacture, distribution or sale of furnishing of gas, natural or manufactured, for light, heat and power.

This definition is certainly broad enough to encompass what SU sold or transferred to ONEOK, requiring SU to come before the Commission to request authorization to make the sale or transfer.

3. Is an assembled workforce a utility asset and thus part of MGE's franchise, works or system?

Again, Missouri courts have construed this specific statute to mean that a utility may not

sell assets that are useful and necessary to the provision of service without Commission authorization.

Section 386.756.2 makes it clear that the *Legislature* considers a utility's employees to be utility assets:

> 386.756.2. No affiliate or utility contractor may use any vehicles, service tools, instruments, **employees, or any other utility assets**, the cost of which are recoverable in the regulated rates for utility service, to engage in HVAC services unless the utility is compensated for the use of such assets at cost to the utility. [emphasis supplied].

No one claims that SU "owns" individual employees. However, every employer controls its workforce, from scheduling the times that individual employees will work, specifying what work is to be done and the manner in which it is to be done, and when it is to be done. SU transferred its entire assembled gas supply workforce related to the gas supply function as a result of the sale or at the approximate time of the sale. This workforce had value to a third party buyer (e.g. ONEOK) as well as to Southern Union's Missouri consumers. The Missouri statutes require Commission approval to ensure that a company does not compromise its obligation to provide safe and adequate service in exchange for higher profits from the sale of its operations to third parties.

Specifically, §393.190 was written to assure that the needs of customers are taken into account and that obligations of the utility to its captive ratepayers are considered before a utility sells property or assets that are useful and necessary to the provision of service to consumers. Under this principle, this transfer required Commission authorization. Besides the legal

requirements noted above, and the list of real property that was sold to ONEOK, the basis of this assertion is that a well-trained and highly competent in-place assembled workforce represents an asset, which is useful and necessary in the performance of functions required to provide utility service. After the sale and transfer of assets to ONEOK, the assembled, trained workforce that for years had made purchasing and operating decisions for MGE had to be completely replaced. This experienced gas supply department had provided all natural gas procurement services to both Southern Union's Texas and Missouri jurisdictions. This in-place, trained workforce, which managed $300,000,000 in Missouri gas supply costs annually, was an essential part of MGE's gas supply system operations because of this particular staff's direct knowledge of key information related to the negotiation and implementation of gas supply and transportation agreements relevant to MGE's service area, and the operational details and performance of the MGE delivery system and historical knowledge of the pipelines serving the Kansas City area. SU transferred its entire assembled gas supply workforce related to the gas supply function as a result of the sale or at the approximate time of the sale. Key highly-trained, and experienced employees that are acquired by one company from another in a business transaction are also classified as "intangible" assets. Assembled workforce refers to an intangible asset which is meant to represent the cost savings realized by the purchaser of an existing business in which the employees will continue to work despite the change of ownership. Because the purchaser will not have to spend time, effort and money to go out on the open market and find, hire and then train new employees, an assembled workforce has value. MGE's system and works requires an assembled trained workforce to fulfill its statutory obligation to provide safe and reliable service. SU acknowledged, by execution of a transition services agreement that it could not operate

effectively without access to these employees and their skills.

SU cannot sell or distribute gas without a competent and trained workforce. A competent and trained workforce is as essential to Southern Union's system, works or franchise in Missouri as any section of pipe or metering device. Southern Union's employees collectively, are necessary and useful in the provision of service to its Missouri customers. The quality of its gas purchasing department was promoted as an integral part of the quality of service SU could provide to Missouri customers when SU applied to purchase MGE. In September of 1993, Southern Union Company Senior Vice President – Mergers and Acquisitions, Eugene N. Dubay, filed Direct Testimony explaining why he believed the transaction was not detrimental to the public interest. In part, he indicated that Southern Union was "fully qualified" to own and operate the transferred assets. He went on to state the following:

> Q. Please explain the Company's gas procurement expertise.
>
> A. In the past, many local distribution companies (LDCs) relied on interstate pipelines to perform all aspects of the acquisition function. In many instances, only one pipeline historically serviced particular geographic areas. In the post-Order 636 environment, these LDCs have learned that they must acquire gas procurement capabilities.
> By contrast, Southern Union began directly acquiring its supplies in the mid-1980s when interstate pipelines systems opened their systems for transportation service. By the late 1980s to early 1990s, the Company was substantially converted to transportation service in the interstate and intrastate areas. To accomplish this conversion, the company established the organization, personnel, and equipment necessary to dispatch and monitor gas volumes on a daily and even hourly basis to ensure reliable service to customers. The Company's personnel have negotiated favorable pricing arrangements with a number of different gas supplies to the benefit of our customers. In the intrastate area, for example, the Company has brought more than $ 2 million in gas costs savings to its 12,000 customer South Texas Service Area system since acquiring it in 1991.
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> Our customers have also benefited through the Company's participation in pipeline regulatory proceedings. . .

As a result of these and other representations, on December 29, 1993, the Commission issued its Report and Order authorizing Southern Union to purchase and acquire assets from Western Resources, Inc. It that Order, the Commission stated, *"In approving this agreement, the Commission relies on the testimony of SU and the expertise of both the Staff and OPC in regard to the capabilities of SU to provide safe and adequate service over a period of years without detriment to the ratepayers or the general public."* (Emphasis added).

Thus, the workforce was an integral part of the sale of SU's Texas operations to ONEOK. ONEOK benefited from this transfer because it did not have to incur what MGE's ratepayers have already paid in salaries. and other employee-related costs. MGE consumers need and are entitled to the benefits of a highly trained, assembled workforce but were deprived of these benefits when SU transferred this entire workforce as a condition of the sale to ONEOK and creation of Energy Worx. Now all of this wealth of knowledge and experience has been lost to Missouri consumers because of the sale to ONEOK. MGE's operations are burdened with the additional training costs for new employees as well as the consequences of these employees learning their new jobs. It is clear that the sale resulted in a significant loss to MGE customers that was to the detriment of the public interest.

In conclusion, in completing this transaction, MGE transferred its assembled workforce and sold rate base property, both of which were useful and necessary in the provision of service to its captive Missouri customers.

4. The terms "useful" and "necessary."

Under Missouri law, SU has sold, assigned or transferred assets or works or parts of its system. The statute requires Commission authorization for the sale or transfer or other disposal

of part of a utility's system or works or franchise or assets that are necessary and useful in the provision of service. §393.190. That the assets that MGE transferred or sold were useful and necessary to the performance of its duties to the public must be assumed until MGE proves otherwise to the Commission since the property was in rate base. MGE, notably, has never asserted in a rate case that rate base items are not necessary and useful in the provision of service to its customers

The question of whether something is necessary and useful is resolved by observing whether MGE could perform its duties to the public without the particular assets. Without a gas purchasing department MGE would be unable to perform its duties to the public. The department, therefore, was reasonably necessary for a public use. *River's Bend Red-E-Mix, Inc. v. Parade Park Homes, Inc*., 919 S.W.2d 1, 3-4(Mo.App. 1996).

MGE's need for the transferred items is further supported by the fact that the business operations sold were not completely separate from SU's other operations. To state it another way, the business operations that were sold were not a separate affiliate or entity, but instead, were an integrated part of the company as a whole. SU sold, or otherwise transferred to ONEOK, operations that included the gas procurement and supply functions that supported more than the Texas distribution operations. These operations also provided gas supply purchasing, scheduling and delivery of natural gas to Missouri customers.

Disclaimers to the contrary may be refuted by one simple uncontested fact. SU had to contract with ONEOK to continue to provide services SU was no longer able to provide after the sale. ONEOK had to, at least, provide essential services for months until MGE could rebuild its gas procurement department.

If MGE did not rely upon the operating division in Texas for any part of the system needed for the performance of its duties to the public in Missouri, then SU would not need to contract with ONEOK for the services listed in the Transition Service Agreement attached to Staff's complaint.

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In addition as a result of the sale of assets to ONEOK, SU required ONEOK to provide

"General Accounting and Financial Reporting Services" for six months. This service is the provision of assistance for all external regulatory and financial reporting requirements and provision of bank reconciliation services. This service includes training of SU employees for bank reconciliation services.

A copy of the entire Transition Service Agreement as provided by the Company in response to Data Request Number 5011 is attached as (proprietary) Attachment).* Additionally the entire Purchase Agreement is attached as proprietary attachment ( ). As the Commission can see from the Purchase Agreement, the gas supply department with its assembled workforce is a vital component of the sale.

5.. This transaction was more than a simple management decision.

The Commission has a statutory mandate to generally supervise utility companies to protect the public interest, §393.140, but not to interfere with the day-to-day management of a company. The idea that the Commission, in its regulation of utility companies, may not interfere with the management of a company is long established. "The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incidental to ownership. It is obvious that [the commission] has no authority to take over the general management of any utility." *State ex rel. Public Service Com'n v. Bonacker*, 906 S.W.2d 896, 900 (Mo.App. S.D. 1995). A much earlier case delineated the type of activities that the court considers to be purely management decisions. The courts have explained that while the Commission may not dictate the manner in which a utility company manages its business, there are decisions where the Legislature has required Commission authorization

before a utility may act. Specifically in *Kansas City* Transit the court said: "We agree with the statement in *State ex rel. City of St. Joseph v. Public Service Commission*, 30 S.W.2d 8, 14, that '[I]t must be kept in mind that the commission's authority to regulate does not include the right to dictate the manner in which the company shall conduct its business.' Transit asserts that the order complained of was doing just that. We do not agree. The order does not relate to action by Transit in determining whether to pay a regular dividend out of earnings, or some other purely management prerogative . . . . Rather, it involves a change in capital structure of the company, just as much as where there is a merger or reorganization or the issuance of additional stock or bonds. These are areas in which the Legislature has required Commission approval." *State ex rel. Kansas City Transit, Inc. v. Public Service Comm'n*, 406 S.W.2d 5, 11 (Mo. 1966).

SU would portray this transaction as just something in the ordinary course of business. That this is a complete mischaracterization is evidenced by the fact that SU sold an entire division to ONEOK, and SU transferred virtually all of its gas supply resources to ONEOK as an integral part of that sale, such that SU had to have support service from ONEOK for six months and that MGE even lost control of its gas supply records for several months.

In this case, the question is not whether SU may transfer a single employee. Rather, the question is whether, in selling rate base property and transferring its entire gas procurement operations including an assembled workforce, SU has violated a Missouri statute resulting in the transaction being void by operation of law. Additionally, this transaction was not a day-to-day management decision that had anything to do with providing service to MGE customers but instead was a decision made so that the corporation and its shareholders could benefit. The asset transfer was not a decision that SU management would have made independent of a sale of

portions of its business to ONEOK. The asset transfer was necessitated by the fact that SU sold a portion of its operations to a buyer that wanted to continue to operate that business segment as an ongoing business activity. The assets sold to ONEOK were essential for ONEOK to receive the value it sought from the sale or an on-going business operation. SU received value from ONEOK commensurate with the on-going business entity that SU conveyed to ONEOK. The sale depended on the transfer of the entire assembled experienced gas procurement workforce during the middle of the winter heating season. The decision was not made as part of the efficient management of the corporation, but, instead, was made to reap benefits – profits - for the company and its shareholders with no concern for its Missouri customers.

6. The transaction was detrimental to the public interest.

Staff's investigation has determined that the transaction was detrimental to the public interest, to the interests of MGE's captive Missouri customers, in numerous ways. The gas procurement function is founded upon experience in negotiating reliable gas supply, storage, and transportation agreements at a reasonable cost. The reorganization of the gas supply function, was, in the main, necessitated by the sale of assets to ONEOK. MGE had to reorganize and completely rebuild its entire gas supply function because it was sold to ONEOK. The sale to ONEOK was disruptive to the experienced gas supply workforce. MGE's customers funded the training and development of these employees for nearly 10 years. Most of the traditional gas supply employee base went to ONEOK because of the sale. The value of this workforce was diverted to Southern Union shareholders through the receipt of the ONEOK proceeds while MGE's customers were saddled with the consequences of the loss of these valuable employees. This made an already difficult situation worse.

Additionally, a detriment resulted from the transfer of the leadership of MGE's gas purchasing function from an individual with many years of experience in actual gas procurement, Mr. Michael Langston, to an individual who had little or no experience in the gas procurement, who was in charge of this essential function, in addition to his other duties. A further detriment occurred because MGE had to spend the time, effort and money to go out on the open market to find, hire and then train new gas supply employees a result of the ONEOK sale.

Additionally, no cost-benefit analysis was undertaken to evaluate the appropriateness of this reorganization. Only short-term gas supply related services were acquired from ONEOK for transition purposes. Pursuant to exhibit 6.6 of the Stock Purchase and Sales Agreement with ONEOK, the scope and description of these services was very limited. Moreover, MGE's gas supply information was, during the winter heating season, in the possession of a Kansas gas company that has little or no relationship with Missouri or MGE's natural gas consumers except perhaps as a competing buyer of gas supply, transportation, and storage services serving the Kansas and Missouri area. Gas supply arrangements as well as strategies and plans are routinely designated as Highly Confidential on the basis of protecting trade secrets or limiting access to competitive information. The information provided to Staff does not indicate any restriction on ONEOK's use of this information to MGE's customers' disadvantage.

Information related to the MGE's gas supply function was under ONEOK's control by virtue of the interim access to MGE gas supply documents and access to the institutional experience and knowledge of longtime SU gas supply employees. The Transition Agreement between SU and ONEOK, provided in response to Staff Data Request Numbers 5011 and 5024 from Case No. GM-2003-0238, details the length of time that former employees of Southern

Union would be made available to assist in the transition of the gas supply department from Southern Union Gas to Missouri Gas Energy. This will effectively sever MGE's access to this institutional knowledge.

In the response to Staff Data Request Number 5017, the Company represented that "MGE will be receiving, prior to February 28, 2003, all current and historical files (data and paper) from the former Southern Union Gas supply department pertaining to MGE's gas supply and interstate transportation." In addition to this response indicating that critical information was unavailable to MGE during the winter heating season, a February 14, 2003 e-mail to the Staff illustrates that information critical to evaluation of MGE's purchasing and supply activities was not immediately available either to the Staff or to MGE's newly assembled gas supply department:

> "Regarding the latest round of staff data requests in GR-2001-382 received on Feb. 4, Mike Langston reports that much of the historical information requested from him is in storage which is managed by ONEOK. He has been out of town on his new job and will have to get with them to see about retrieval of that information. He is unsure whether it can be produced in the next ten days, so in an abundance of caution, we are providing this notice. As always, he will attempt to obtain the information as quickly as he can. At this time, under the circumstances, he can't give an accurate prediction of when the information can be obtained." (emphasis added)

Not only was all of the information related to gas supply jeopardized, the safety and adequacy of the service provided by MGE's system to supply natural gas to its captive customers

was jeopardized when the gas supply functions provided to MGE by Southern Union were transferred, resulting in the necessity for ONEOK to provide interim services and for MGE to assemble a new workforce to perform these functions. The new workforce lacked the training and experience as well as the knowledge of MGE's contracts, supply needs, and the performance of its system, to effectively and efficiently acquire and deliver gas to MGE's customers. When the Commission considers that MGE acquires approximately $300,000,000 of gas each year for its customers, it becomes apparent that day to day decisions can impact gas costs by millions of dollars, costs that are passed through to customers through the PGA. In addition, the gas supply function assesses reliability issues, and impacts the adequacy of service on a short and long term basis. Strategic and tactical decisions require years of specifically applicable experience in the area of gas procurement negotiation and planning. MGE access to this critical infrastructure was severed with Southern Union's decision to proceed with the ONEOK sale.

MGE customers were deprived of the experience and training of the workforce that supplied natural gas to their homes and businesses, and for which they had paid salaries and training and other benefits for years. For example, at page 3 of its *Response of Southern Union Company in Opposition to Staff's Motion to Open a Case to Investigate Southern Union's Transfer of its Gas Supply Department to a Wholly Owned Subsidiary*, filed on April 22, 2003 in case no. XXXXX, Southern Union states that the reason for the creation of a stand-alone gas supply department at MGE's offices in Kansas City is the sale of Southern Union's Texas Division. Appendix 1 to this Motion is a November 26, 2002 letter to then Commission Chairman, Kelvin Simmons, from Southern Union's President and Chief Operating Officer, Thomas F. Karam. In that letter, Mr. Karam states that Mr. Robert J. Hack, MGE's Vice

President - Pricing and Regulatory Affairs will be assuming the additional duty of responsibility for MGE's gas supply function. While Mr. Hack has considerable experience in regulatory affairs, his experience in gas purchasing is limited, especially when compared to the workforce he was replacing. SU needed to complete this transaction quickly to fund its interstate pipeline acquisitions and did what was necessary to make it happen. Part of what it did was to deny the fact that the transaction required this Commission's approval prior to making the sale or transfer. Assets related to the Missouri operations were sold or disposed of in the ONEOK sale. This statement is true even if one holds the view that a trained workforce is not an asset to an organization. The fact that Southern Union had to put its regulatory attorney in charge of its gas supply, because they had no one with any greater experience in gas purchasing, speaks volumes regarding the extent to which Southern Union will risk its Missouri gas operations in exchange for funds to support its acquisition strategies. The sale and transfer of the entire gas supply operation by Southern Union -- which then required rebuilding, from scratch, essentially on a moment's notice, MGE's gas purchasing and supply department during a Midwest heating season -- was detrimental to the public interest.

Additionally, this transfer has every likelihood of increasing gas supply costs and, thus, has an adverse impact on the rates and charges to MGE customers for natural gas. The reorganization of the gas supply group is likely to produce increased gas supply and transportation costs for MGE's customers.

The gas procurement and supply function controls and administers expenditures that exceed $300,000,000 for Missouri on an annual basis**.** Strategic and tactical decisions require years of specifically applicable experience in the area of gas procurement negotiation and

planning. This critical infrastructure and institutional knowledge was dismantled with Southern Union's decision to proceed with the ONEOK sale. The Commission was denied the opportunity to review the nature of the transaction and its impact on Missouri consumers through Southern Union's failure to request Commission authorization.

V. Commission authority over SU and its transaction.

The Commission's authority to regulate the sale, transfer, or disposition of a utility's system or assets is broad. SU operating as MGE is a public utility as defined by § 386.020 and is subject to the jurisdiction of the Commission, pursuant to § 386.250.

The sale transfer or other disposal of any part of SU/MGE's franchise, works, or system necessary or useful in the performance of its duties to the public must be authorized by an order of the Commission. § 393.190.1 RSMo; *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo.App. 1980). As a regulated gas utility serving captive Missouri customers, SU is required under statute to seek and receive Commission approval before it can sell or transfer or otherwise dispose of assets that are used to perform its duties to the public including such essential functions such as gas supply. Specifically §§ 393.190 and 393.250 require SU to obtain authorization from the Commission prior to selling or transferring assets providing service to Missouri consumers or reorganizing its operations.

The Commission's jurisdiction over SU's sale or transfer of assets to a separate corporation (i.e. ONEOK), is found in several sections of the Commission's enabling statute. First, §386.250(1) provides that the Commission has general supervision of public utilities, like MGE, operating in this state:

> The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:
> To the manufacture, sale or distribution of gas, natural and artificial, and

> electricity for light, heat and power, within the state, and to persons or corporations owning, leasing, operating or controlling the same; and to gas and electric plants, and to persons or corporations owning, leasing, operating or controlling the same . . . . (emphasis supplied)

This extensive grant of general authority to regulate gas corporations is broad enough to encompass both SU and its operating division, MGE. Additionally, the Commission is granted specific authority over gas corporations in §393.190.1, which provides in pertinent part:

> 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, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person, or public utility, without having first secured from the commission an order authorizing it so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void. (emphasis added).

Supplying gas, including all of the functions necessary to both purchase and transport natural gas for space heating, is the essence of SU/MGE's regulated service to its customers. A completely separate company, ONEOK, was enlisted to take the responsibility to provide essential elements of this function because MGE was unable to perform these critical functions itself. The personnel, and property, that once performed or were used to perform these functions for MGE now belong to ONEOK. MGE depended upon ONEOK until such time as MGE rebuilt this function from the ground up and regains the ability to perform these functions independently from ONEOK.

Moreover, Section 393.130.1 requires MGE to maintain instrumentalities and facilities sufficient to provide safe and adequate service. Specifically this section reads:

> Every gas corporation, every electrical corporation, every water corporation, and every sewer corporation shall furnish and provide such service

> instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable.

§ 393.130 RSMo (2000)

While the facts underlying the case are different, the Court in *Ozark Electric*, in addressing what constituted adequate facilities under this section of the statute, stated that the ability of a utility to insure a reliable source of energy, and its experience in supplying energy was a consideration in determining what constituted adequate facilities. *State ex rel. Ozark Elec. Co-op. v. Public Service Com'n.,* 527 S.W.2d 390, 394 (Mo.App. 1975)(the relative experience of competing suppliers of electric energy regarding the type of facilities to implement the service to be afforded certainly bears a direct relationship to the criterion of 'adequate' facilities.) In this case, MGE was forced to rely on ONEOK to provide gas supply services to MGE customers during the 2002-2003 winter heating season and when compared with SU's abilities to provide such reliable service, did not meet the criterion of "adequate facilities" under Missouri law. The fact that MGE had to rebuild its entire gas supply purchasing department from the ground up in the middle of the winter heating season is evidence of its disregard for the statutory requirement that it "shall furnish and provide such service instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable." § 393.130.1 RSMo (2000).

An additional source of Commission authority over this transaction is §393.250, that provides: "[r]eorganizations of gas corporations, electrical corporations, water corporations and sewer corporations shall be subject to the supervision and control of the commission, and no such reorganization shall be had without the authorization of the commission."

This extensive grant of general authority to regulate gas corporations is broad enough to encompass both SU and its operating division, MGE.

Since this entire in-place experienced and knowledgeable workforce was transferred to another company as part of a sale (or transfer to Energy Worx) of its Texas system and works, SU required authorization from this Commission prior to completing this transaction. The detriment that MGE customers have and will suffer is exactly the type of detriment that the Legislature intended to be considered by this Commission pursuant to §393.190. While §393.190.1 does not set forth a standard or test for the Commission's approval of the transfer, the Missouri Supreme Court in *State ex rel. City of St. Louis v. Public Service Comm'n*, 73 S.W.2d 393, 395 (1934), recognized that the standard for the PSC's approval was whether the merger "would be detrimental to the public." In this case, the Court held that "[t]o prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions." The Court went on to explain, however, that it is not the Commission's "province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment." The standard of "not detrimental to the public interest" adopted by the Court in *City of St. Louis* balances the rights of a utility to sell any or a part of its business against the right of the public served by the utility not to be harmed by such a transfer.

VI. CONCLUSION

The ONEOK sale required Commission approval. This transaction involved a sale of a major part of SU's business including and the sale or transfer of assets useful or necessary to the provision of service to Missouri ratepayers and this is a transaction that the Legislature has

determined required Commission authorization. As noted above, MGE acquires, transports, and delivers natural gas to its captive customers. It is a privately owned monopoly whose property has been dedicated to the public use. As such it enjoys numerous benefits, including limited or no competition. With the benefits of being a regulated monopoly come duties and responsibilities. The legislature has stated that if a utility transfers or sells part of its works system or that is necessary and useful in the performance of its duties to the public it must obtain Commission permission to do so.

It is undisputed that assets assigned to Missouri operations were sold or disposed of as a result of this sale. In addition, MGE lost its trained and experienced assembled workforce that provided its gas supply function. The Company does not agree that these employees constituted an asset to its business. The Staff disagrees, believing that the assembled workforce was an important asset. While this issue is certainly not the sole basis for Staff's position that Southern Union needed Commission approval of its ONEOK sale, this issue demonstrates the significant detriment to Missouri consumers from the sale.