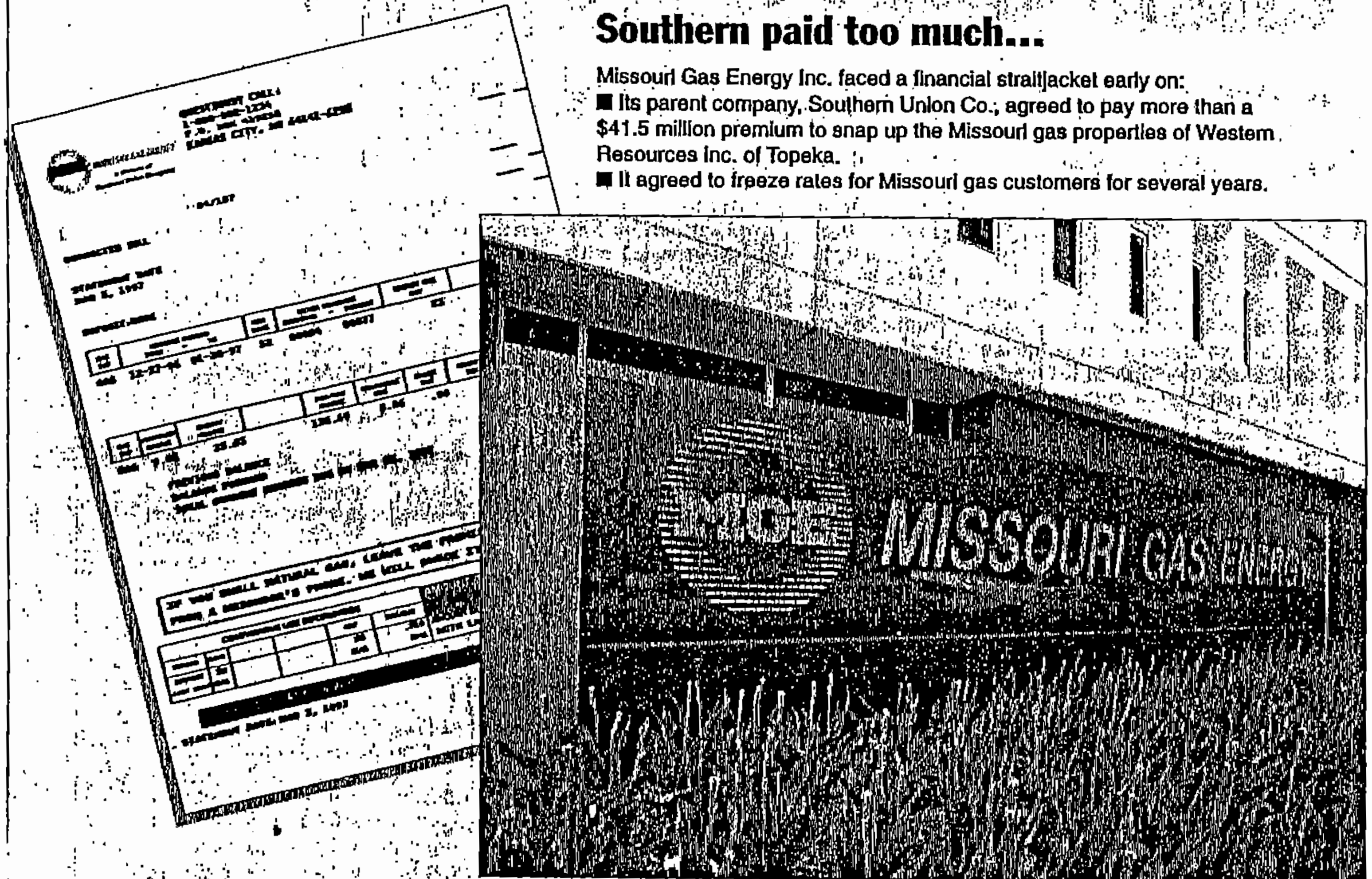
# MGE suffers from need to scrimp

## Debt load brings deep cuts; ability to serve public in question

### Southern paid too much...

Missouri Gas Energy Inc. faced a financial straitjacket early on:

- Its parent company, Southern Union Co., agreed to pay more than a $41.5 million premium to snap up the Missouri gas properties of Western Resources Inc. of Topeka.
- It agreed to freeze rates for Missouri gas customers for several years.




KEVIN ANDERSON/The Star

Company officials say they are aware of the problems at Missouri Gas Energy.

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# System still safe, even critics say, but some practices raise worries

By STEVE EVERLY KC Star
and MARTIN ROSENBERG
Staff Writers p. 1 5/9/97

Missouri Gas Energy executives were tense as they looked at budget numbers two summers ago in a Texas corporate suite. The message from their Southern Union Co. superiors was unmistakable: agree to steep budget cuts.

But the cuts risked slashing into muscle rather than fat, some of them feared. Two of the half dozen Missouri Gas executives gave their approval, but the rest refused.

"We're all gone," warned Gene Dubay, Missouri Gas chief operating officer, as he and the others who dissented left the meeting.

Dubay's comments were prophetic.

Dubay, in an emotional meeting three months later, told his staff he was being forced out. By early 1996, the three other executives who wouldn't submit also were gone.

Missouri Gas is finishing a winter in which it faced thousands of customer complaints about billing errors and high prices. The utility blames many of the grievances on volatile wholesale gas prices.

But interviews in recent weeks with two dozen current and former Missouri Gas employees, officials at other utilities and state regulators suggest a larger problem.

Southern Union, based in Austin, Texas, is saddled with debt and has relentlessly

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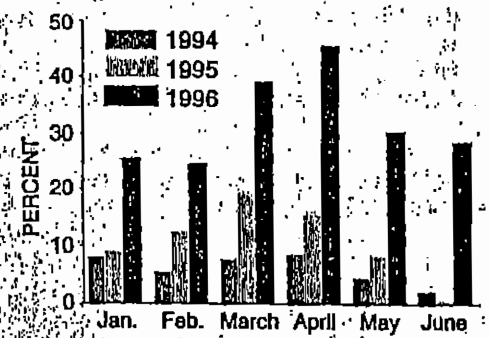
## ... and service suffered

Before long, cost-cutting reduced service levels: Calls to the company were increasingly going unanswered as a result of surging calling volumes and busy lines.

### Percentage of abandoned calls




Source: Missouri Public Service Commission

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cut expenses to a point that it's had to scramble to perform even basic tasks such as reading meters and calculating bills.

While most critics of the company say that safety has not been compromised, they contend that cost-cutting remains the company's chief priority.

Southern Union concedes that it cut back further in some areas than it should have. In response to recent billing problems, it's enlarging its customer service staff.

"We've got this problem in our sights and we'll fix it," said Peter H. Kelley, Southern Union president.

But Southern Union denies it has set out to strip Missouri Gas because of financial pressures.

"That statement is completely and utterly false," Kelley said. "We realize that we cut back greater than we should have."

## Rough beginning

Natural gas is the latest of a variety of business pursuits by Southern Chairman George L. Lindemann, who amassed a fortune in cosmetics, contact lenses, cable television and cellular telephones. A 1993 article in *Forbes* magazine estimated Lindemann's worth at $600 million.

But Lindemann, who could not be reached for comment, faced a major challenge in turning around the fortunes of Missouri Gas.

Southern Union bought Missouri Gas from Western Resources for roughly $41.5 million above its book value. Kelley said his company drove a hard bargain and bought Missouri Gas at a good price. Missouri Gas serves 475,000 customers.

But the acquisition burdened Southern Union with too much debt, contends Missouri Public Counsel Martha Hogerty, who represents the state's consumers in regulatory matters. The utility's debt after the deal represented 72 percent of its capital, which was in excess of other utilities, she said.

Southern Union, which was barred from seeking immediate rate increases, did, in fact, move rapidly to cut internal costs after buying Missouri Gas in early 1994. Several company trucks, compressors and other equipment from Joplin were auctioned off.

Southern also closed Missouri Gas' last Kansas City office where customers could pay bills and ask questions in person. And it tried to alter an existing program in which customers take their monthly gas payments to grocery stores or other retailers. The retailers are paid a handling fee. Southern wanted to eliminate the fee but eventually backed off.

Many of these cuts were overdue and necessary to prepare the utility for deregulation, the new owners said. But just months after the purchase, state regulators were seeing a growing number of complaints against Missouri Gas.

Part of the problem was staffing. Missouri Gas' customer service ranks decreased 32 percent from 164 in 1994 to 111 in 1996, according to an August report by the Missouri Public Service Commission

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sion.

"The deal with Southern Union is that it wants to cut expenses no matter what," said John Fernald, former director of rates and regulation for Missouri Gas Energy. He was one of the executives who didn't approve the budget cuts; he was fired in October 1995.

Fernald said training sessions for customer service workers often were haphazard, and that trainers often argued among themselves about the material, such as the rules for disconnecting gas service during cold weather.

Fernald also said there were recurring problems with the billing system. Computers were supposed to select unusually high bills to be double-checked, but the function wasn't working.

"I was always told, 'Yeah, yeah, we'll get to it,' but it never was," said Fernald, who now owns a utility consulting company. He added: "I'm putting my career at risk, but I'm talking because I think it's important."

The problem worsened last year. In the first half of 1996, Missouri Gas customers encountered jammed lines, and 24 percent to almost 46 percent of those calls had to be abandoned, according to the Missouri Public Service Commission.

Janet Hoerschgen, Public Service Commission staff member, summarized the staff's growing concerns in 1996 about Southern Union's commitment to adequate service and meeting regulatory obligations by referring to the company's annual report.

"To make certain that no one underestimates the degree of emphasis," she wrote, "management describes Southern Union as 'a sales and marketing company that just happens to be in the utility business.'"

Southern Union recently hired more meter readers and opened a branch office as part of the effort to improve customer service.

## Pressure to cut

But the company had looked for other cuts beyond those related to serving customers.

At one point, Southern Union pushed Missouri Gas to delay the utility's gas-line replacement program, a safety measure mandated by the state that Southern had promised to continue.

The program began in the late 1980s. Several deaths caused by leaking natural gas lines pushed Missouri regulators to require that all pipes susceptible to corrosion — and leaks — be replaced.

Southern Union promised to continue the program. But just months after the purchase, it began to pressure Missouri Gas executives to extend it over more years, Fernald said.

Southern Union discovered that some small Missouri utilities had received delays in replacing pipes and it wanted a delay for Missouri Gas.

Fernald said Missouri Gas executives resisted the effort. The smaller utilities won delays because only one or two gas lines were involved, while Missouri Gas faced a massive line replacement program. They forwarded the request to the company attorney in Jefferson City. It never reached the state's regulators.

Southern Union eventually dropped its request and told the utility to destroy documents that mentioned the proposed delay,

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Fernald said. (Fernald said he doesn't know if the documents were destroyed.)

Darrek Porter, a spokesman for Missouri Gas Energy, said the company did consider a plan to fine-tune the replacement program and perhaps lengthen some portions while shortening others. Nothing would have harmed safety even if it had been adopted, which it wasn't, he said.

He said no one at Missouri Gas or Southern Union recalls an order to destroy documents. In addition, the documents weren't destroyed and they remain in company files.

"We have nothing to hide here," he said.

Porter would not produce the documents for *The Kansas City Star* because they never were made available to the Missouri Public Service Commission.

"That wouldn't be good form," he said.

## Budget cuts OK'd

By June 1995, when Southern Union summoned the Missouri Gas executives to discuss the capital budget, Kelley reminded them they were over budget for the year and more reductions had to be made.

One source of the tension, Fernald said, was failure to get the pipe replacement program extended.

By the end of the first day of the budget meeting, those involved agreed to cut the budget by $10 million to $37 million. Among the cuts was the reduction of fees paid to some contractors who laid gas lines. Missouri gas officials sought to level what it paid contractors across all of its regions. Some contractors, then, are getting less pay for the same amount of work.

The next morning, the meeting turned tougher. The figure "$34.6 million" had been written on a flip chart — a figure the four Missouri Gas executives refused to approve in part because they didn't know where the extra cuts would be made, Fernald said.

Southern Union and current Missouri Gas executives point out that such budget negotiations are common in business.

Since the pivotal meeting, other cost-cutting has occurred.

Jerry Riley, a retired Missouri Gas inspector in Joplin, was bothered last summer when he learned Missouri Gas no longer would install seals in lines that were turned off to homes and businesses. The change required less labor.

The gas lines have "stops" that shut off the gas when turned by utility employees. But the stops don't always completely seal the lines; small amounts of gas can leak through, Riley said.

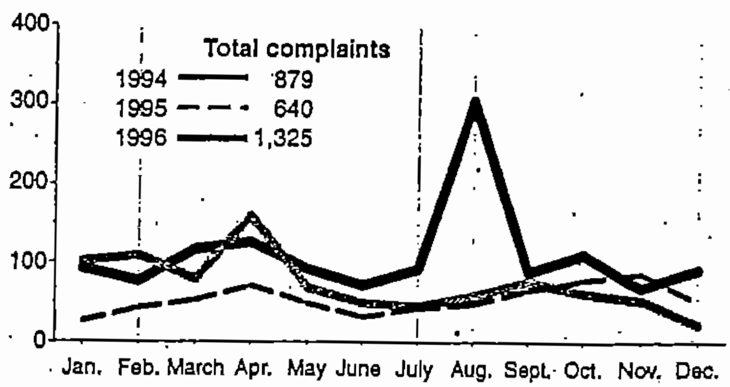
The seals aren't required by state law, but Missouri Gas Energy's previous owners, including Western Resources, considered them an important safety precaution, Riley said.

Missouri Gas executives say they still seal lines to old meters. New meters have stops that are tight enough when shut off, so seals aren't needed, they say. Riley disagrees. New or old, all such lines should be sealed, he said.

Riley and two current Missouri Gas employees knowledgeable about pipe installation also question a company decision to stop using a rubber seal in a pipe replacement procedure. (The em-

## Number of complaints

And while complaints about MGE to state regulators dipped in 1995, they grew at a fast clip, particularly after the fall of 1995.




Source: Missouri Public Service Commission

The Star

ployees asked not to be identified because they believed their jobs would be at risk.)

As gas service lines to homes and businesses are replaced with plastic tubing, the plastic line is threaded through the existing metal line.

That leaves a gap between the plastic and metal pipes. If there's a leak in the gas main under the street, gas could enter the gap and make its way to the home or business.

Western Resources, when it owned the utility, placed a rubber, tubelike "shrink" or seal at the end of the metal pipe so that gas couldn't get in. Western still uses the seals when installing lines for its KPL and KGE customers.

Missouri Gas is phasing out the rubber shrink and using tape to seal the gap. A Missouri regulator said he was told the rubber shrink, which isn't required by state law, was being phased out because of expense. The rubber shrink costs $5.33; the tape costs just a few cents.

Missouri Gas, Southern Union, state regulators and most critics of the companies say they don't think anything has been done to harm safety. Southern Union executives point to statistics that show that leaks in the Missouri Gas system have declined nearly 50 percent since 1993.

Even Fernald, the former Missouri Gas executive, said that while cost cutting has affected customer service, the system so far is safe.

## Not bailing out

Southern Union says it plans to hold on to its Missouri properties and will make any necessary improvements. Twenty-five more customer service staff members are undergoing training. The company vows to avoid past problems by next winter.

Two-thirds of Southern Union's utility-related capital expenditures are in Missouri, even though Missouri represents roughly half of the company's customer base, he said.

"There should be no doubt in the community mind that safety is pretty important to us," Kelley said.

Kelley said top officials at Southern Union know that the industry is consolidating, and executives with marketing savvy will be the big winners as the industry is deregulated.

Southern Union would like to expand its customer base within about seven years to about 2 million people from almost 500,000, Kelley said.

But the company will have to win back the confidence of critics in territories it already serves.

Karl Zobrist, chairman of the Missouri Public Service Commission, is eager to see improvements.

"I'm trying to fix the problem, not fix the blame," he said.