



The Commonwealth of Massachusetts
DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY

May 28, 2004

D.T.E. 04-36

Petition of Southern Union Company for approval and authorization to enter into a long-term \$400 million revolving credit agreement providing borrowing capacity up to \$230 million beyond the Company's recently authorized long-term debt issuance and issue up to \$130 million in common stock for the purpose of refinancing outstanding debt and improving the debt-to-equity capital ratio pursuant to G.L. c. 164, § 14.

APPEARANCE:

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265 Franklin Street
Boston, Massachusetts 02110
FOR: SOUTHERN UNION COMPANY
Petitioner

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I. INTRODUCTION

On March 16, 2004, Southern Union Company ("Southern Union" or "Company") filed a petition with the Department of Telecommunications and Energy ("Department") pursuant to G.L. c. 164, § 14, for approval and authorization to (1) enter into a long-term \$400 million revolving credit agreement, and (2) issue up to \$130 million in common stock. There were no intervening parties. The Department docketed the filing as D.T.E. 04-36.

Pursuant to notice duly issued, the Department conducted public and evidentiary hearings at the Department's offices on April 26, 2004. In support of its petition, the Company offered the testimony of Richard N. Marshall, Vice President and Treasurer of Southern Union. The evidentiary record consists of 31 exhibits and two record requests. The Company submitted post-hearing comments on May 5, 2004.

II. DESCRIPTION OF THE COMPANY'S PROPOSAL

A. Long-Term Debt

Southern Union seeks approval to enter into a long-term debt obligation of approximately \$230 million in addition to the Company's recently authorized debt issuance of \$400 million (Exh. SU-1, at 2). See Southern Union Company, D.T.E. 03-64 (2003). Of the \$400 million authorized, the Company issued \$230 million in preferred securities in October 2003 (Exh. SU-1, at 3). Rather than issue the remaining authorization of \$170 million in the form of senior notes or preferred securities, the Company proposes to enter into a three- to five-year revolving credit agreement that would provide up to \$400 million of borrowing capacity (id.).

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The Company's proposed three- to five-year credit facility will replace two existing facilities, consisting of a \$150 million revolving credit facility that matured on April 1, 2004, and a \$225 million credit facility that expires on May 29, 2004 (SU-1, at 4). As of March 1, 2004, a balance of \$175 million was outstanding on these two facilities (*id.*). The Company anticipates that the interest rate for the new facility will be based on the prime rate and the London Interbank Offering Rate ("LIBOR") (*id.* at 5). The prime rate will be applicable to overnight borrowings (*id.*). LIBOR-based borrowings will be available for 30-, 60-, 90-, and 180-day periods, with the interest charged to the Company calculated at a credit spread over the LIBOR rate based on the Company's senior secured long-term debt ratings by Standard & Poor's ("S&P") and Moody's Investor Service ("Moody's") (Exhs. SU-1, at 5; SU-DTE-1-2). The Company's senior secured long-term debt was rated BBB by S&P and Baa3 by Moody's at the time of filing (Exh. SU-1, at 5). Based on the Company's current credit ratings and anticipated credit spread of 0.75 percent, Southern Union estimates that interest rates would range between 1.85 percent and 7.0 percent over the term of the revolving credit agreement (Exh. SU-DTE-1-2).

B. Stock Issuance

Southern Union seeks approval and authorization to issue shares of common stock with an aggregate value of up to \$130 million for the purpose of repaying long-term debt (Exh. SU-1, at 3). The Company is proposing the sale of approximately 6.5 million shares of common stock with an anticipated market value of \$20 per share, with an aggregate value of \$130 million (Exhs. SU-1, at 12; SU-DTE 1-13(b); Tr. at 12).

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The Company states that the proceeds from the stock issuance will be used to repay long-term debt in order to maintain and enhance the Company's financial position (Exh. SU-1, at 7). According to the Company, the issuance will improve the Company's debt-to-equity ratio, improve overall borrowing liquidity that, in turn, should ensure that the Company is able to maintain its investment grade rating (Exh. SU-1, at 3; Company Brief at 7). The Company states that the recapitalization from debt to equity is consistent with Southern Union's utility-service obligations (Exh. SU-1, at 7; Company Brief at 10).

III. STANDARD OF REVIEW

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness¹ by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.² Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose

¹ Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

² The net plant test is derived from G.L. c. 164, § 16.

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having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946) ("Lowell Gas"). In cases where no issue has been raised about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to a determination of reasonableness of the Company's proposed use of the proceeds of a stock issuance. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 841, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the

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appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

IV. CAPITAL STRUCTURE OF THE COMPANY

As of December 31, 2003, Southern Union's utility plant (including \$119,132,000 in construction work in progress ("CWIP")) was \$3,882,168,000 (Exh. SU-DTE 1-13(a)). After removing \$698,858,000 in accumulated depreciation and amortization, the Company reported a net utility plant of \$3,183,310,000 (id.). In addition, Southern Union had \$230,854,000 of gas inventories (id.). Thus, as of December 31, 2003, the Company had a net utility plant and gas inventory balance of \$3,414,164,000 (id.). As of December 31, 2003, the Company reported a total capitalization of \$3,441,639,000, consisting of (1) \$2,140,137,000 in long-term debt, (2) \$230,000,000 in preferred securities, (3) \$125,000,000 in mandatory convertible securities, and (4) \$946,502,000 in common equity, which included a retained earnings balance of \$47,567,000 (id.; Tr. at 14-15).

Southern Union proposed a number of adjustments to these capitalization and net utility plant balances (Exhs. SU-1, at 9-11; Exh. SU-DTE 1-13(a)). First, the Company excluded \$14,535,000 (\$16,909,000 in plant, less accumulated depreciation of \$2,374,000) plus material and supply inventories of \$8,173,000 from net plant in service to remove plant associated with unregulated operations and other non-plant related assets (Exhs. SU-DTE 1-13(a); SU-DTE-1-11). The Company then eliminated an additional \$119,132,000 in CWIP from its property, plant and equipment accounts (Exhs. SU-DTE 1-13(a)). As a result of these adjustments, the Company's property, plant and equipment, amounted to \$3,272,324,000 (id.).

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In recognition of the above plant adjustments, the Company made corresponding adjustments to its capitalization. First, the Company reduced its total capitalization by \$14,535,000, based on a pro rata reduction to long-term debt, preferred securities, and premiums on common stock related to the removal of unregulated operations (Exh. SU-DTE 1-13(a)).³ Second, the Company similarly excluded \$642,921,000 associated with acquisition premiums, representing the excess of the purchase price over book value of several natural gas utilities acquired in recent years (*id.*).⁴ Third, the Company excluded from capitalization retained earnings of \$47,567,000 (*id.*). As a result of these adjustments, the Company's total capitalization amounted to \$2,736,616,000 (*id.*).

V. ANALYSIS AND FINDINGS

A. "Reasonably Necessary" Standard

1. Long-Term Debt

Southern Union proposes to enter into a \$400 million three- to five-year credit facility for the purpose of financing ongoing utility operations (Exhs. SU-1, at 3). The Department has found previously that issuing debt for the purposes of reducing short-term debt and refinancing long-term debt is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Blackstone Gas Company, D.T.E. 03-65, at 4 (2003); Western Massachusetts Electric Company, D.T.E. 02-49, at 10 (2003); New England Power Company, D.P.U. 95-101, at 11 (1995). Moreover, the revolving credit agreement will allow Southern Union to fund general

³ The Company's unregulated operations have been supported over the years through a combination of debt and equity (Exh. SU-1, at 12).

⁴ The Company stated that it has financed its acquisitions over the years through a combination of debt and equity and cannot directly attribute the acquired facilities to specific capital sources (Exh. SU-1, at 11).

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working capital requirements, which is also a legitimate utility purpose. Berkshire Gas Company, D.T.E. 03-89, at 19 (2003); Cambridge Electric Light Company, D.P.U. 96-91, at 7 (1996); Eastern Edison Company, D.P.U. 93-24, at 8, 12 (1993). Accordingly, the Department finds that the \$400 million three- to five-year credit facility is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14.

The Company's petition relies on the issuance of \$170 million in unused borrowing capacity associated with the \$400 million securities issuance approved in Southern Union Company, D.T.E. 03-64 (2003). Authorizations from previous financings remain valid for purpose of later Section 16 reviews. Southern Union Company, D.T.E. 02-27, at 13 (2002). To allow the Company maximum flexibility to enter into the \$400 million revolving credit facility, the Department approves the Company's request to apply the \$170 million in unused authorization from D.T.E. 03-64 to the \$400 million three- to five-year revolving credit facility sought in this proceeding.

2. Stock Issuance

Southern Union states that the objective of its proposed issuance is to improve the Company's debt-to-equity ratio (Exh. SU-1, at 3). Through the issuance of additional equity, the Company intends to repay long-term debt, improve the overall borrowing liquidity, and maintain its investment grade for financing purposes (*id.*).

The Department has found previously that issuing stock for the purposes of acquiring and maintaining equity is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Bay State Gas Company, D.P.U. 93-14, at 14 (1993); Colonial Gas Company, D.P.U. 90-50,

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at 6 (1990). Redeeming existing securities and funding utility operations is also a customary purpose of stock issuances. Berkshire Gas Company, D.T.E. 96-64, at 8-9 (1996); Berkshire Gas Company, D.T.E. 94-14, at 4, 9 (1994). In a previous proceeding, the Department directed the Company to improve its high debt to capitalization ratio. Southern Union Company, D.T.E. 03-3, at 16 (2003). Since that time, the Company has continued its efforts to achieve a more traditional utility capitalization ratio through repaying long-term debt and issuing additional equity (Exh. SU-1, at 7). The proposed issuance will reduce the ratio of long-term debt to total capitalization (including short-term debt) from 61.33 percent to 57.81 percent (Exh. SU-DTE-1-10). Accordingly, the Department finds that the proposed issuance of not more than \$130 million in stock for the purpose of repayment of long-term debt is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14, and therefore meets the first prong of the Department's two-prong standard.

B. Net Plant Test

With regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization, thereby supporting the additional amount of financing, pursuant to G.L. c. 164, § 16. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). The purpose of the net plant test is both to protect ratepayers from excessive rates associated with overcapitalization and to assure the creditors of a utility that the company has sufficient tangible assets to cover its liabilities. Boston Gas Company, D.T.E. 03-40, at 321 (2003); Colonial Gas Company, D.P.U. 1247-A at 7 (1982); Report of the Department of Public Utilities Relative to the Capitalization of Gas and Electric

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Companies, Senate Document No 315, at 8-15 (January 1922). Under the net plant test, a company must present evidence showing that its net utility plant (utility plant less accumulated depreciation) is equal to or greater than its total capitalization (the sum of debt, preferred stock and common stock outstanding). Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Southern Union has proposed a number of adjustments to its capital structure.

First, the Company has proposed to exclude CWIP from its plant investment balance and to exclude retained earnings from its capitalization (Exh. SU-DTE 1-13(a)). The Department has determined previously that CWIP should be excluded from a company's plant accounts for purposes of the net plant test calculation. Boston Edison Company, D.T.E. 03-129, at 16 (2004); Southern Union Company, D.T.E. 01-52, at 9; Colonial Gas Company, D.P.U. 84-96, at 5. CWIP is excluded because the term "fair structural value of the plant", as used in G.L. c. 164, § 16, includes only plant that is used and useful in providing utility service to ratepayers. Southern Union Company, D.T.E. 03-64, at 9 (2003); Colonial Gas Company, D.P.U. 84-96, at 5. In regard to retained earnings, the Department has determined previously that a company must demonstrate that its net utility plant (utility plant less accumulated depreciation) is equal to or in excess of its total capitalization. Berkshire Gas Company, D.T.E. 03-89, at 15-16 (2004); Colonial Gas Company, D.P.U. 84-96, at 5. Past orders of the Department have defined, or implicitly applied, a standard for total capitalization in treating of the net plant test. Id. The Department's definition of total capitalization is the sum of debt, preferred stock, and common stock outstanding.⁵ Colonial Gas Company, D.P.U. 84-96, at 5. On the principle of construction that to express all items that are included

⁵ For purposes of the net plant test, the premium on common stock is treated as common stock. Berkshire Gas Company, D.T.E. 03-89, at 23 (2004).

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within a term is implicitly to exclude other, unexpressed items, see Boston Edison Company, D.P.U. 87-214, at 8 (1988), the Company has correctly interpreted the Department's net plant test as precluding crediting retained earnings to satisfy the net plant test. Accordingly, the Department finds that Southern Union's adjustments to exclude CWIP and retained earnings are appropriate.

Southern Union has proposed excluding unregulated property, plant and equipment in service and the capital used to finance those assets from the net plant calculation (Exh. SU-DTE 1-13(a)). The costs associated with unregulated operations, including those associated with capital costs, should not be borne by ratepayers. NYNEX Price Cap, D.P.U. 94-50, at 440 (1995); Colonial Gas Company, D.P.U. 84-94, at 51 (1984). Therefore, the Department finds that the Company has appropriately excluded its investments and capital associated with unregulated operations. Southern Union Company, D.T.E. 01-52, at 9-10 (2001); Southern Union Company, D.T.E. 01-32, at 10-11 (2001). See also NYNEX Price Cap, D.P.U. 94-50, at 440; Colonial Gas Company, D.P.U. 84-94, at 51 (1984).

Similarly, the Company's proposed adjustment for acquisition premiums is appropriate, given that an acquisition premium, or goodwill, is intangible and, as such, should be excluded as a component in a utility's plant for purposes of G.L. c. 164, § 16. Southern Union Company, D.T.E. 02-27, at 12; Southern Union Company, D.T.E. 01-32, at 11 (2001); New England Power Company, D.T.E. 00-53, at 8-9 (2000). Accordingly, the Department finds that the Company appropriately excluded acquisition premiums from its capital structure.

The record demonstrates that the approval of a \$400 million credit facility for the purpose of financing ongoing utility operations, as well as the issuance and distribution of up

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to \$130 million in common stock, will not exceed the Company's net utility plant following the securities issuance. After these adjustments, the Company's adjusted utility plant amounts to \$3,272,324,000, which is \$535,708,000 more than its adjusted capitalization of \$2,736,616,000 (Exh. SU-DTE 1-13(a)). Accordingly, the Department finds Southern Union's request for a \$400 million revolving credit facility and issuance of \$130 million in common stock meets the net plant test as provided in G. L. c. 164, § 16.

Issues concerning the prudence of the proposed financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its customers. The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs, including interest expense, associated with the proposed financing.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department:

VOTES: That entering into the long-term \$400 million credit facility is reasonably necessary for a legitimate purpose in meeting the Company's service obligations, pursuant to G.L. c. 164, § 14; and further

VOTES: That entering into the long-term \$400 million credit facility is in accordance with G.L. c. 164, § 16, in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company will exceed its outstanding stock and long-term debt; and further

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VOTES: That issuing up to \$130 million in common stock is reasonably necessary for a legitimate purpose in meeting the Company's service obligations, pursuant to G.L. c. 164, § 14; and further

VOTES: That issuing up to \$130 million in common stock is in accordance with G.L. c. 164, § 16, in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company will exceed its outstanding stock and long-term debt; and it is

ORDERED: That the Department approves and authorizes the Company to enter into the long-term revolving credit agreement described herein; and it is

FURTHER ORDERED: That the Department approves and authorizes the issuance and sale by Southern Union Company, in conformity with all the provisions of law relating thereto, of common stock with an aggregate value of up to \$130 million; and it is

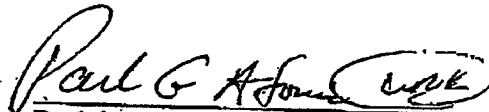
FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of State of the Commonwealth; and it is


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FURTHER ORDERED: That Southern Union Company comply with all other directives contained in this Order.

By Order of the Department


Paul G. Afonso, Chairman

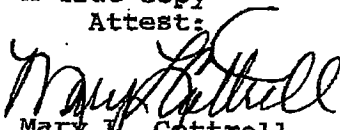

James Connelly, Commissioner


W. Robert Keating, Commissioner


Eugene J. Sullivan, Jr. Commissioner


Deirdre K. Manning, Commissioner

A true copy
Attest:


Mary J. Cottrell
Secretary

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Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).