

Southern Union Company

**504 Lavaca Street, Eighth Floor
Austin, Texas 78701**

October 3, 2000

Dear Stockholder:

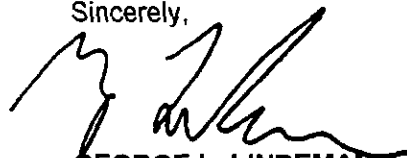
You are cordially invited to attend the Annual Meeting of Stockholders of Southern Union Company (the "Company") to be held at 2:00 p. m. (Central Standard Time) on Tuesday, November 14, 2000 in the eighth floor atrium of the Company's offices at Lavaca Plaza, 504 Lavaca Street, Austin, Texas. A notice of the meeting, a proxy and a proxy statement containing information about the matters to be acted upon are enclosed.

In addition to the specific matters to be acted upon, there will be a report on the progress of the Company and an opportunity for questions of general interest to the stockholders.

Whether or not you plan to attend the meeting on November 14, 2000 please mark, sign and date the enclosed proxy and return it in the envelope provided (which requires no postage if mailed in the United States) so that your shares will be represented. Your prompt cooperation will be appreciated.

On behalf of the Board of Directors,

Sincerely,



GEORGE L. LINDEMANN
*Chairman of the Board and
Chief Executive Officer*

TABLE OF CONTENTS

Notice of Annual Meeting of Stockholders	i
Defined Terms	ii
Questions and Answers	1
Proposals to be Voted Upon	3
Board of Directors	4
Board Size and Composition	4
Board Committees and Meetings	5
Board Compensation	6
Directors' Deferred Compensation Plan	6
Board of Directors' Report on Executive Compensation	7
Executive Officers and Compensation	8
Executive Officers Who Are Not Directors	8
Executive Compensation	9
Summary Compensation Table	9
Option Grants in 2000	10
Options Exercised in 2000 and 2000 Year-End Values	11
Retirement Benefits	11
Employment Contracts, Termination of Employment and Change-in Control Arrangements	12
Compensation Committee Interlocks and Insider Participation	13
Section 16(a) Beneficial Ownership Reporting Compliance	13
Security Ownership	15
Common Stock Performance Graph	17
Certain Relationships	18
Independent Auditors	18
The Company's 2000 Annual Report	19

Southern Union Company

504 Lavaca Street, Eighth Floor
Austin, Texas 78701

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS To Be Held November 14, 2000

To the Holders of Common Stock of
SOUTHERN UNION COMPANY:

The 2000 Annual Meeting of Stockholders of Southern Union Company, a Delaware corporation, will be held in the eighth floor atrium of the Company's offices at Lavaca Plaza, 504 Lavaca Street, Austin, Texas on Tuesday, November 14, 2000 at 2:00 p. m. (Central Standard Time) to consider and take action upon the following:

- (i) the election of four persons to serve as the Class I directors until the 2003 Annual Meeting of Stockholders or until their successors are duly elected and qualified;

Your Board of Directors recommends a vote "FOR" these nominees. The Board of Directors is not aware of any other business to come before the Annual Meeting.

Stockholders of record of the Company's Common Stock at the close of business on October 2, 2000 will be entitled to vote at the Annual Meeting or any adjournment or postponement thereof. A complete list of stockholders of record entitled to vote at the Annual Meeting will be maintained in the Company's corporate offices at 504 Lavaca Street, Eighth Floor, Austin, Texas 78701, for ten days prior to the Annual Meeting.

Whether or not you plan to attend the Annual Meeting in person, please mark, execute, date and return the enclosed proxy in the envelope provided (which requires no postage if mailed within the United States). Should you attend the Annual Meeting in person you may, if you wish, withdraw your proxy and vote your shares in person.

By Order of the Board of Directors,


DENNIS K. MORGAN
Secretary

Austin, Texas
October 3, 2000

DEFINED TERMS

"1982 Plan" means Southern Union's 1982 Stock Option Plan.

"1992 Plan" means Southern Union's 1992 Long Term Stock Incentive Plan.

"401(k) Plan" means Southern Union's Savings Plan.

"Board" or **"Board of Directors"** means Southern Union's Board of Directors.

"Common Stock" means Southern Union's Common Stock.

"Company" or **"Southern Union"** or **"we"** means Southern Union Company.

"Directors' Plan" means Southern Union's Directors' Deferred Compensation Plan.

"Pennsylvania Incentive Plan" means the Pennsylvania Division Stock Incentive Plan, which was assumed by Southern Union upon the November 4, 1999 acquisition of Pennsylvania Enterprises, Inc.

"Pennsylvania Option Plan" means the Pennsylvania Division 1992 Stock Option Plan which was assumed by Southern Union upon the November 4, 1999 acquisition of Pennsylvania Enterprises, Inc.

"Plan Committee" means the 1992 Long-Term Stock Incentive Plan Committee of the Board of Directors of the Company, which administers the 1992 Plan, the 1982 Plan, the Pennsylvania Incentive Plan and the Pennsylvania Option Plan.

"Stock Plan" means Southern Union's Executive Deferred Stock Plan in which the participant has deferred receipt of the stock from their options exercise which is held in the Trust under the Stock Plan.

"Supplemental Plan" means Southern Union's Supplemental Deferred Compensation Plan.

Southern Union Company

504 Lavaca Street, Eighth Floor
Austin, Texas 78701

PROXY STATEMENT

The accompanying proxy, to be mailed to stockholders together with the Notice of Annual Meeting and this Proxy Statement on or about October 6, 2000, is solicited by Southern Union Company in connection with the Annual Meeting of Stockholders to be held on November 14, 2000.

QUESTIONS AND ANSWERS

Q: What am I voting on?

A: Election of four directors (John E. Brennan, Frank W. Denius, Roger J. Pearson and Ronald W. Simms). (See page 3 for more details.)

Q: Who is entitled to vote?

A: Stockholders as of the close of business on the Record Date, October 2, 2000, are entitled to vote at the Annual Meeting. Each share of Common Stock is entitled to one vote. With respect to the election of directors, stockholders have cumulative voting rights, which entitle each stockholder to that number of votes which equals the number of shares he or she holds multiplied by the number of directors to be elected at the Annual Meeting; which is four. The Bylaws of the Company require that a stockholder who intends to exercise cumulative voting rights at the Annual Meeting must give written notice to the Secretary of the Company no later than ten (10) days after notice of the Annual Meeting was first sent to stockholders.

Q: How do I vote?

A: Sign and date each Proxy Card you receive and return it in the prepaid envelope. If you do not mark any selections, your Proxy Card will be voted in favor of the four nominees. You have the right to revoke your proxy at any time before the Annual Meeting by (1) notifying Southern Union's Corporate Secretary, (2) attending the Annual Meeting and voting in person or (3) returning a later-dated proxy. If you return your signed Proxy Card, but do not indicate your voting preferences, the proxy will be voted on your behalf **FOR** the four nominees.

The Board of Directors is not aware of any matter other than the election described above to be presented for action at the Annual Meeting. If a proposal other than the election described in the Notice is properly presented at the Annual Meeting, your signed proxy card gives authority to George L. Lindemann and Peter H. Kelley to vote on such matters. They intend to vote in accordance with their best judgment.

Proxies should **NOT** be sent by stockholders of record to the Company but to Fleet Bank, N. A., c/o EquiServe, L.P., the Company's Registrar and Transfer Agent, at 150 Royall Street, Canton, Massachusetts 02021. Beneficial holders should return their proxies in accordance with instructions they receive from their broker, bank or other custodian, nominee, fiduciary or agent.

Q: Is my vote confidential?

A: Yes. Proxy cards, ballots and voting tabulations that identify individual stockholders are confidential. Only the inspectors of election and certain employees associated with processing proxy cards and counting the vote have access to your card. Additionally, all comments directed to management (whether written on the Proxy Card or elsewhere) will remain confidential, unless you ask that your name be disclosed.

Q: Who will count the vote?

A: Representatives of the Company and its legal counsel, Fleischman and Walsh, L.L.P., will tabulate the votes and act as inspectors of election.

Q: What does it mean if I get more than one proxy card?

A: It is an indication that your shares are registered differently and are in more than one account, including your accounts in Southern Union's Direct Stock Purchase Plan, the executive compensation plans, employee benefit plans and shares credited to your Savings Plan account held in custody by the trustee, Wilmington Trust. Sign and return all proxy cards to ensure that all your shares are voted.

Q: What constitutes a quorum?

A: As of the Record Date, 50,895,272 shares of the Company's Common Stock were issued and outstanding. A majority of the outstanding shares, present or represented by proxy, constitutes a quorum for the transaction of adopting proposals at the Annual Meeting. If you submit a properly executed proxy card, then you will be considered part of the quorum. If you are present or represented by a proxy at the Annual Meeting and you abstain, your abstention will have the same effect as a vote **AGAINST** the proposal to elect the four directors. Broker non-votes will be counted as part of the quorum but will not be part of the voting power present.

Q: Who can attend the Annual Meeting?

A: All stockholders as of the Record Date can attend.

Q: When are the 2001 stockholder proposals due?

A: In order to be considered for inclusion in next year's proxy statement, stockholder proposals must be submitted in writing by June 30, 2001, to Dennis K. Morgan, Corporate Secretary, Southern Union Company, 504 Lavaca Street, Eighth Floor, Austin, Texas 78701.

Q: How does a stockholder nominate someone to be considered for election as a director of Southern Union?

A: Any stockholder may recommend any person as a nominee for director of Southern Union by writing to the Company's Secretary at least 45 days before an annual meeting (which was September 30, 2000 for this year's Annual Meeting) or no later than ten (10) days after the date of the notice of a special meeting. The notice must include certain information about the nominating stockholder and the nominee(s). Certain persons are disqualified by the Bylaws from serving as directors. A copy of the relevant Bylaws provisions may be obtained from the Company's Secretary. As of the date of this Proxy Statement, no stockholder has nominated any person to serve as a director of the Company.

Q: Who pays for this proxy solicitation?

A: Southern Union will reimburse brokerage houses and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy and solicitation material to the owners of Common Stock.

PROPOSALS TO BE VOTED UPON

1. Election of Directors

Nominees for election this year are John E. Brennan, Frank W. Denius, Roger J. Pearson and Ronald W. Simms. Each has consented to serve a three-year term. (See page 4 for more information.)

Directors are elected by a plurality of the votes of shares present in person or represented by proxy and entitled to vote in the election. Your Board recommends a vote **FOR** election of these four directors.

If any director declines or becomes unable to serve as a director for any reason, votes will be cast instead for a substitute nominee designated by the Board of Directors. If no substitute is designated, votes will be cast according to the judgment of George L. Lindemann and Peter H. Kelley. If cumulative voting is in effect by a stockholder, unless authority is withheld, George L. Lindemann and Peter H. Kelley will allocate the votes represented by such proxy in the manner they deem proper in their best judgment.

BOARD OF DIRECTORS

Board Size and Composition

The Board of Directors of the Company is comprised of thirteen directors and is divided into three classes, each of which serves a staggered three-year term. The terms of the Class I directors expire at the Annual Meeting. The Class II directors will serve until the 2001 Annual Meeting of Stockholders and the Class III directors will serve until the 2002 Annual Meeting of Stockholders. This year's Nominees, John E. Brennan, Frank W. Denius, Roger J. Pearson and Ronald W. Simms, are the Class I directors standing for election for a three-year term of office expiring at the 2003 Annual Meeting of Stockholders or when their successors are duly elected and qualified.

The following pages contain information concerning the Nominees and the directors whose terms of office will continue after the meeting.

NOMINEES

Class I - Term expires in 2000

John E. Brennan has been Vice Chairman of the Board and Assistant Secretary of Southern Union since February 1990. Mr. Brennan has also been engaged in private investments since May 1992. Prior to May 1992, Mr. Brennan had been President and Chief Operating Officer of Metro Mobile CTS, Inc. ("Metro Mobile"). Director since February 1990. Age: 54.

Frank W. Denius has been Chairman Emeritus of Southern Union since February 1990. Since February 1990, Mr. Denius has been engaged primarily in the private practice of law in Austin, Texas. Prior to 1990, Mr. Denius had been Chairman of the Board and President of the Company. Director since 1976. Age: 75.

Roger J. Pearson has been an attorney in private practice in Stamford, Connecticut for more than the past five years. He has been of counsel to the firm of Neville, Shaver, Hubbard & McLean since 1991. Mr. Pearson has been a Director of the Company since January 1992. Mr. Pearson is also a director of Workflow Management, Inc. Age: 54.

Ronald W. Simms has been Chief Executive Officer of Petroleum Services Company, Inc. since 1980. He has also been Chairman of the Board of Directors and Chief Executive Officer of Mountain Productions, Inc. since 1994. Mr. Simms was Chairman of the Board of Directors of Pennsylvania Enterprises, Inc. and, upon its merger with Southern Union in November 1999, became a Director of the Company. Age: 60.

THE BOARD RECOMMENDS A VOTE FOR ALL NOMINEES TO SERVE AS CLASS I DIRECTORS.

DIRECTORS CONTINUING IN OFFICE

Class II - Term expires in 2001

James H. Dodge has been President and Chief Executive Officer of the Company's New England operations (the New England operations consist of the Company's recent acquisitions of Providence Energy Corporation, Valley Resources, Inc. and Fall River Gas Company), and a Director since September 2000. Previously, he had been President and Chief Executive Officer of Providence Energy Corporation since August 1990. Mr. Dodge is also a director of Capital Properties, Inc. Age: 60.

Aaron I. Fleischman has been Senior Partner of Fleischman and Walsh, L.L.P., a Washington, D.C. law firm specializing in regulatory, corporate-securities, litigation and legislative matters for telecommunications, regulated utilities and transportation companies, since 1976. Director since February 1990. Mr. Fleischman is also a director of Citizens Communications Company. Age: 61.

Kurt A. Gitter, M.D. has been an ophthalmic surgeon in private practice in New Orleans, Louisiana, since 1969. He has also been a Clinical Professor of Ophthalmology at Louisiana State University since 1978 and an assistant professor of ophthalmology at Tulane University since 1969. Director since June 1995. Age: 63.

Adam M. Lindemann has been the managing member of Lindemann Capital Advisors, L.L.C. since November, 1996, which manages investments for various private investment funds including Lindemann Capital Partners, L.P. Previously, he had been a personal investor manager for Third Point Partners since August 1996. From 1994 until August 1996, he was a securities analyst for Oppenheimer & Company. Adam M. Lindemann is the son of George L. Lindemann, Chairman of the Board and Chief Executive Officer of Southern Union. Director since February 1990. Age: 39.

George Rountree, III has been an attorney in private practice in Wilmington, North Carolina where he has been a senior partner in the firm of Rountree & Seagle since its formation in 1977. Director since February 1990. Age: 67.

Class III - Term expires in 2002

George L. Lindemann has been Chairman of the Board, Chief Executive Officer and a Director of Southern Union since February 1990. He has been Chairman of the Executive Committee of the Board of Directors since March 1990. He was Chairman of the Board and Chief Executive Officer of Metro Mobile from its formation in 1983 through April 1992. He has been President and a director of Cellular Dynamics, Inc., the managing general partner of Activated Communications Limited Partnership, a private investment business, since May 1982. Mr. Lindemann is also a director of Del Laboratories, Inc., YouthStream Media Networks, Inc. and Total Research Corporation. Age: 64.

Peter H. Kelley has been President, Chief Operating Officer and a Director of Southern Union since February 1990, Chief Executive Officer of Southern Union Gas Company ("Southern Union Gas"), a division of the Company, since June 1998, and Chief Executive Officer of Missouri Gas Energy ("MGE"), a division of the Company, since December 1993. From February 1990 to June 1998 Mr. Kelley was also President and Chief Operating Officer of Southern Union Gas and from December 1993 to September 1995, was also President of MGE. Prior to joining the Company, he had been an officer of Metro Mobile since 1986. Age: 53.

Thomas F. Karam has been Executive Vice President of Corporate Development of the Company, President and Chief Executive Officer of PG Energy, a division of the Company, and a Director since November 1999. Previously, he had been President and Chief Executive Officer of Pennsylvania Enterprises, Inc., and from September 1995 to August 1996, he was Executive Vice President of Pennsylvania Enterprises, Inc. From July 1989 to September 1995, Mr. Karam was Vice President, Investment Banking, Legg Mason Wood Walker. Age: 41.

Dan K. Wassong has been the President, Chief Executive Officer and a director of Del Laboratories, Inc., a manufacturer of cosmetics, toiletries and pharmaceuticals, for more than the past five years. Director since February 1990. Mr. Wassong is also a director of Moore Medical Corporation. Age: 70.

Board Committees and Meetings

The Board of Directors has an Executive Committee, composed of Messrs. George Lindemann (Chairman), Brennan and Kelley. The Executive Committee held four meetings and acted by unanimous written consent on thirty-one occasions during fiscal year 2000. During the intervals between meetings of the Board of Directors, this committee has the authority to, and may exercise all of the powers of, the Board of Directors in the management of the business, property and affairs of the Company in all matters that are not required by statute or by the Company's Restated Certificate of Incorporation or Bylaws to be acted upon by the Board. This committee must exercise such authority in such manner as it deems to be in the best interests of the Company and consistent with any specific directions of the Board.

The Board of Directors has an Audit Committee, currently composed of Messrs. Denius (Chairman), Gitter and Simms. The Audit Committee met six times during fiscal year 2000. This committee has the duties of recommending to the Board the appointment of independent auditors, reviewing their charges for services, reviewing the scope and results of the audits performed, reviewing the adequacy and operation of the Company's internal audit function, and performing such other duties or functions with respect to the Company's accounting, financial and operating controls as deemed appropriate by it or the Board.

The Board of Directors has a Long-Term Stock Incentive Plan Committee which may consist of no fewer than two directors. The Plan Committee is currently composed of Messrs. Rountree (Chairman) and Pearson who have the

authority to make all decisions regarding: (i) the granting of awards under the Company's stock-based employee benefit plans; (ii) eligibility of employees to receive awards under the stock-based employee benefit plans; and (iii) interpretation of the stock-based employee benefit plans. To serve on the Plan Committee a director may not receive any awards under the stock-based employee benefit plans during the prior year, cannot currently be eligible to receive any awards under the stock-based employee benefit plans and must be an "outside" non-employee director. The Plan Committee met one time and acted by unanimous written consent on five occasions during fiscal year 2000.

The Board has a Human Resources Committee currently composed of Messrs. Pearson (Chairman) and Gitter. The Human Resources Committee was formed in 1998 and met five times during the fiscal year 2000. This Committee has the authority to investigate any allegations of harassment or discrimination against any senior executive officers of the Company. This Committee also reviews, on a quarterly basis, all outstanding claims of discrimination which result in an administrative claim or litigation.

The Board of Directors held two meetings and acted by unanimous written consent on thirteen occasions during fiscal year 2000. All directors attended at least 75% of the total number of meetings of the Board and committees, collectively, on which they served that were held in fiscal year 2000 while they were directors and a member of any such committee.

Board Compensation

Compensation for each director is \$20,000 per year, payable in quarterly installments, except for: Mr. George Lindemann (who is compensated as the Chief Executive Officer of the Company); Mr. Brennan (who receives \$175,011 per year as Vice Chairman of the Board of the Company and a member of the Executive Committee); Mr. Kelley (who is compensated as an executive officer and employee of the Company and its divisions and subsidiaries); Mr. Karam (who is compensated as Executive Vice President of Corporate Development of the Company and President and Chief Executive Officer of PG Energy); Mr. Dodge (who is compensated as President and Chief Executive Officer of the Company's New England operations); and the chairman and the other members of the Audit Committee of the Board, who receive \$30,000 and \$25,000 per year, respectively. Members of the Board of Directors also are reimbursed for travel expenses incurred in connection with Company business, including attendance at meetings of the Board and its committees.

Directors' Deferred Compensation Plan

The Board of Directors has a Directors' Deferred Compensation Plan which is designed to attract and retain well-qualified individuals to serve as outside directors and to enhance the identity of their interests and the interests of stockholders. Participation in the Directors' Plan is optional.

Under the Directors' Plan, each director who is not also an employee of the Company may choose to defer all or any percentage of his or her director's fees and invest such deferred amount in Common Stock. The Directors' Plan requires the Company to make a matching contribution of 100% of the first 10% of the participant's total directors' fees, to the extent deferred.

A participating director is 100% vested with respect to the amount of director's fees that he or she elects to defer and any related income, gains and losses. The Company's matching contributions do not vest until the participating director either has completed five (5) years of service as a director or dies while serving as a director. Deferred amounts may not be withdrawn by a participant until (i) thirty (30) days after such time as the director either retires or ceases to be a director of the Company; or (ii) with the permission of the Board, in the event of severe financial hardship.

The Board may terminate, suspend or amend the Directors' Plan under certain circumstances, but the Board has no discretion regarding its administration.

BOARD OF DIRECTORS' REPORT ON EXECUTIVE COMPENSATION

The Board of Directors closely aligns the total compensation of the executive officers with the profitability of the Company. Merit increases to the base salaries for the officer group have been adjusted in the last few years to reflect industry standards. The 1992 Plan and Stock Plan was introduced in order to focus the attention of management on the long-term improvement of stockholder value.

The Company's 2000 short-term incentive plan was aligned with each officer's and manager's compensation to directly reflect the desired short-term customer service, safety, reliability and profitability goals of the Company applicable to such officer or manager. By balancing the use of short- and long-term incentive and adequate base salary, the Board believes it has been and will continue to be able to recruit the talent needed to manage the Company, retain the talents of current management and align the successes of the Company and management.

The factors and criteria utilized by the Board include the assessment of comparable information from similarly-sized operations. It is the philosophy of the Board to set the base salaries and incentives of executive officers at an amount comparable to a financial peer group of other similarly-sized companies. This peer group includes neighboring and other similarly-sized natural gas distribution companies and other companies which share operating and financial characteristics with the Company. The Board believes the performance on which executive officer compensation is based should be assessed both on an annual basis and also over a longer period of time to ensure that executive officers work to support both the Company's current objectives as well as its strategic objectives.

The Board regularly reviews the Chief Operating Officer's recommended base salary merit increases, cash incentive plan and stock option plan awards for the Company's other executive officers. Base salary merit increase and cash incentive award recommendations, if any, are primarily based on corporate operating and financial performance, as well as on executive officers' individual performance, for the prior fiscal year. Merit increases are also based on a review of peer group base salaries and executive officers' individual contributions to the Company's strategic objectives. Stock option recommendations, if any, are primarily based on executive officers' individual performance during the prior fiscal year, but also relate to performance judgments as to the past contributions of the individual executive officers and judgments as to their individual contributions to the Company's strategic objectives. The Board then determines compensation for such executive officers, in light of (a) the Company's actual performance as compared to its corporate financial goals for the prior fiscal year, (b) individual executive officers' actual performance as compared to their individual goals supporting the Company's financial and operating objectives, (c) the Company's executive officer compensation levels relative to its peer group and (d) periodic reports from independent compensation consultants regarding the compensation competitiveness of the Company. The Board also reviews the above types of compensation for the Chief Executive Officer with the assistance of the Company's human resources staff and recommends adjustments as deemed appropriate based on the above compensation review criteria and its expectation as to his future contributions in leading the Company.

Neither the Chairman of the Board and Chief Executive Officer, the Vice Chairman, the President and Chief Operating Officer nor the Executive Vice President of Corporate Development were included in the Short-Term Incentive Plan for 2000, but are eligible for discretionary bonuses based on performance as determined by the Board. The Executive Vice President and Chief Financial Officer and the President - Southern Union Gas had the ability to obtain short-term incentive awards for 2000. See "Executive Officers and Compensation -- Executive Compensation."

The 1992 Long-Term Stock Incentive Plan Committee considers all aspects of compensation provided to the executive officers prior to determining appropriate awards to be given under the stock-based employee benefit plans to each executive.

In 1993, the Board established the Supplemental Plan. The Supplemental Plan is designed to encourage greater ownership of Company shares by executive employees by enhancing the Company's matching contribution, and to provide employee benefits similar to the benefits such employee would have received under the 401(k) Plan if not for the existence of certain limitations that are set forth in the Internal Revenue Code of 1986, as amended (the "Code"), relating to "highly compensated employees" as defined in the Code. Under the Supplemental Plan, an eligible employee may defer up to 100% of his or her annual compensation (salary and bonus) through payroll deductions (the "Employee Contributions"). In addition, the Supplemental Plan requires the Company to make a 100% matching contribution on Employee Contributions up to a maximum of 10% of the participant's annual

compensation. The first 8% of the Employee Contributions, together with the Company's matching contributions, are invested by the Supplemental Plan's trustee in shares of Common Stock.

The Company also provides retirement benefits through various defined benefit and defined contribution plans. See "Executive Officers and Compensation -- Retirement Benefits."

The Board believes that it has concentrated, and intends to continue to concentrate, the bulk of Mr. Lindemann's compensation as the Chairman of the Board and Chief Executive Officer on long-term incentives such as stock option grants which are directly attributable to increasing stockholder value.

By: The Board of Directors.

George L. Lindemann
Frank W. Denius
Aaron I. Fleischman
Adam M. Lindemann
George Rountree, III
Thomas F. Karam
James H. Dodge

John E. Brennan
Peter H. Kelley
Roger J. Pearson
Kurt A. Gitter, M.D.
Dan K. Wassong
Ronald W. Simms

EXECUTIVE OFFICERS AND COMPENSATION

Executive Officers Who are not Directors

Executive Officers of the Company are elected by the Board to serve at the pleasure of the Board or until their successors are elected and qualified. Generally, officers are reelected annually by the Board. The following Executive Officers of the Company are not directors.

Steven W. Cattron has been President of MGE since June 1998. Prior to joining the Company, Mr. Cattron was employed with Kansas City Power and Light Company since 1982 where most recently he was Vice President - Marketing and Sales. Age: 44.

Ronald J. Endres has been Executive Vice President since June 1996 and Chief Financial Officer since October 1989. He was a Senior Vice President from April 1987 until June 1996. Previously, Mr. Endres had held other financial and operating positions with the Company since June 1969. Age: 56.

David J. Kvapil has been Senior Vice President and Corporate Controller since January 1998. He was Vice President - Controller from July 1993 to December 1997, and Controller from August 1992 to July 1993. Age: 45.

Dennis K. Morgan has been Senior Vice President - Legal and Secretary since January 1998. He was Vice President - Legal and Secretary from April 1991 to December 1997. Previously, Mr. Morgan had held various legal positions with the Company or a subsidiary of the Company since June 1981. Age: 52.

David W. Stevens has been President of Southern Union Gas since June 1998. Previously, Mr. Stevens held other financial and operating positions with Southern Union Gas since 1993, most recently Senior Vice President of Sales and Operations from July 1996 to June 1998. Prior to that, Mr. Stevens had held various operational positions with subsidiaries of the Company since 1984. Age: 41.

Executive Compensation

The following table sets forth the remuneration paid by the Company and its subsidiaries (i) to the Chairman of the Board and Chief Executive Officer and (ii) to each of the four most highly compensated key executive officers at June 30, 2000 of the Company (this group is referred to as the "Named Executive Officers"):

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation			Securities Underlying Options/SARs(2)	All Other Compensation (3)
		Salary	Bonus	Other Annual Compensation(1)		
George L. Lindemann Chairman of the Board and Chief Executive Officer	2000	\$263,772	\$ —	\$ 74,904 (4)	210,000	\$ 46,530
	1999	245,971	—	41,543 (4)	—	45,190
	1998	227,861	—	45,930 (4)	173,645	24,248
Peter H. Kelley President and Chief Operating Officer	2000	578,456	141,363	678,852 (5)(6)(7)	210,000	126,515
	1999	506,599	87,700	533,562 (5)(6)	—	123,365
	1998	468,296	105,679	342,467 (5)(6)	173,644	65,610
Ronald J. Endres Executive Vice President and Chief Financial Officer	2000	344,610	93,750	110,616 (7)	84,000	70,571
	1999	297,891	35,615	613,223 (5)	—	72,664
	1998	274,745	85,848	464,515 (5)	86,822	40,824
Thomas F. Karam(8) Executive Vice President of Corporate Development	2000	291,346	1,031,618 (9)	—	63,001	21,250
	1999	—	—	—	—	—
	1998	—	—	—	—	—
David W. Stevens President - Southern Union Gas	2000	218,325	85,775	3,038 (7)	44,100	56,209
	1999	198,823	62,904	—	—	54,989
	1998	185,558	91,251	—	34,730	32,643

- (1) Does not include the value of perquisites and other personal benefits because the aggregate amount of such items, if any, does not exceed the lesser of \$50,000 or 10 percent of the total amount of annual salary and bonus for any named executive officer.
- (2) No Stock Appreciation Rights were granted in 2000, 1999 and 1998. Additionally, no restricted stock awards or long-term incentive plan payouts were made in 2000, 1999 and 1998.
- (3) Company matching provided through the 401(k) Plan and the Supplemental Plan. See "— Retirement Benefits."
- (4) Represents perquisites and other personal benefits received from the Company, consisting primarily of the use of the Company aircraft.
- (5) Indicates the difference between the price paid by the individual for common stock of the Company purchased from the Company upon the exercise of non-qualified (but not incentive) stock options and the fair market value of such common stock. See "— Options Exercised in 2000 and 2000 Year-End Values."
- (6) Also includes forgiveness of interest by the Company. See "Certain Relationships."
- (7) Includes payment of Medicare tax for the named executive officer of \$205,630, \$110,616 and \$3,038 for Messrs. Kelley, Endres and Stevens, respectively, due to changes in the Non-Qualified retirement income plan. See "— Retirement Benefits."
- (8) Elected Executive Vice President of Corporate Development in November 1999. See "Certain Relationships."
- (9) Amount is a result of acquisition of Pennsylvania Enterprises, Inc. on November 4, 1999 and related employment agreement. See "Certain Relationships."

Option Grants in 2000

The following table provides information regarding the award of stock options to the Named Executive Officers during fiscal 2000.

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(1)	
	Number of Securities Underlying Options Granted(2)	% of Total Options Granted to Employees In Fiscal Year	Exercise or Base Price Per Share(3)	Expiration Date	5%	10%
George L. Lindemann	200,900	19.82%	\$ 17.23	12/9/2009	\$2,177,201	\$ 5,517,455
	9,100(4)	0.90%	18.96	12/9/2004	47,657	105,309
Peter H. Kelley	199,416	19.68%	17.23	12/9/2009	2,161,119	5,476,699
	10,584	1.04%	17.23	12/9/2009	114,701	290,676
Ronald J. Endres	69,342(5)	6.84%	17.23	12/9/2009	751,476	1,904,387
	14,658(6)	1.45%	17.23	12/9/2009	158,852	402,563
Thomas F. Karam	33,989	3.35%	17.23	12/9/2009	368,347	933,463
	29,012	2.86%	17.23	12/9/2009	314,410	796,777
David W. Stevens	34,377(7)	3.39%	17.23	12/9/2009	372,552	944,119
	9,723(8)	0.96%	17.23	12/9/2009	105,370	267,029

- (1) The dollar amounts under these columns are the result of calculations for the period from the date of grant to the expiration of the option at the 5% and 10% annual appreciation rates set by the Securities and Exchange Commission and, therefore, are not intended to forecast possible future appreciation, if any, in the price of the Common Stock. No gain to the optionee is possible without an increase in price of the Common Stock. In order to realize the potential values set forth in the 5% and 10% columns of this table for options with a ten-year term, the per share price of the Company's Common Stock would be \$28.07 and \$44.70, respectively, or 63% and 159%, respectively, above the exercise or base price.
- (2) Options vest at a rate of 20% per annum commencing on the first anniversary of the date of grant, unless noted otherwise. All options are non-qualified except for the 9,100, 10,584, 14,658, 29,012 and 9,723 options of Messrs. Lindemann, Kelley, Endres, Karam and Stevens, respectively, which are qualified.
- (3) All options were granted at 100% of the fair market value on the date of grant, except for Mr. Lindemann's 9,100 qualified options which were granted at 110% of the fair market value on the date of grant.
- (4) Options vest over four years commencing on the first anniversary of the date of grant at 2,212 options in year one, 3,205 options per year for year two and three and 478 options in year four.
- (5) Options vest over five years commencing on the first anniversary of the date of grant at 14,538 options in year one, 13,503 options per year for year two and three, 16,800 options in year four and 10,998 options in year five.
- (6) Options vest over five years commencing on the first anniversary of the date of grant at 2,262 options in year one, 3,297 options per year for year two and three and 5,802 options in year five.
- (7) Options vest over five years commencing on the first anniversary of the date of grant at 7,162 options in year one, 7,302 options in year two, 8,075 options in year three, 8,820 options in year four and 3,018 options in year five.
- (8) Options vest over five years commencing on the first anniversary of the date of grant at 1,658 options in year one, 1,518 options in year two, 745 options in year three and 5,802 options in year five.

Options Exercised in 2000 and 2000 Year-End Values

The following table provides information regarding the exercise of stock options, incentive and non-qualified, by each of the Named Executive Officers and the value of unexercised "in-the-money" options as of June 30, 2000.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year End(1)		Value of Unexercised In-the-Money Options at Fiscal Year End(2)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
George L. Lindemann	*	*	538,102	394,233	\$ 4,243,217	\$ 352,707
Peter H. Kelley	103,100	\$ 1,424,660	309,912	440,903	1,682,905	752,428
Ronald J. Endres	4,935	75,008	253,526	179,632	2,069,248	194,600
Thomas F. Karam	*	*	474,784	63,001	1,983,746	-
David W. Stevens	1,732	28,292	56,515	73,219	370,654	30,457

* No options were exercised during the year ended June 30, 1999 by the Named Executive Officer

- (1) The securities underlying unexercised options have been adjusted to reflect each of the 5% stock dividends distributed on June 30, 2000, August 6, 1999, December 9, 1998, December 10, 1997, December 10, 1996, November 27, 1995 and June 30, 1994, and the 50% stock dividend distributed on July 13, 1998, the 33 1/3% stock dividend distributed on March 11, 1996 and the 50% stock dividend distributed on March 9, 1994.
- (2) Based on a closing price on June 30, 2000 of \$15.8125 per share as reported by the New York Stock Exchange.

Retirement Benefits

The Company sponsors three "Qualified" retirement income plans (Plan A, Plan B and the Employees' Retirement Plan of Southern Union Company Pennsylvania Division) and one "Non-Qualified" retirement income plan. With respect to the Qualified Plans, Employees' Retirement Plan of Southern Union Company Pennsylvania Division covers all employees of PG Energy, Plan B covers all employees of Missouri Gas Energy and Plan A covers all employees other than employees of PG Energy, Missouri Gas Energy, Lavaca Realty Company, Atlantic Utilities, Atlantic Gas Corporation, Mercado Gas Services, Inc., SUPRO Energy Company, Energy WorX, Inc. and ConTigo, Inc. All officers listed in the Summary Compensation Table, except Mr. Karam, are presently covered by Plan A. Mr. Karam is covered by the Employees' Retirement Plan of Southern Union Company Pennsylvania Division.

Plan A, the Non-Qualified Plan and the portion of Plan B covering Non-Union employees were converted effective December 31, 1998 from traditional defined benefit plans with benefits based on years of service and final average compensation to cash balance defined benefit plans in which an account is maintained for each employee. The initial value of the account was determined as the actuarial present value (as defined in the Plans) of the benefit accrued at transition (December 31, 1998) under the pre-existing traditional defined benefit plan. The initial credit for Messrs. Kelley and Endres under the Non-Qualified Plan was adjusted by dividing the present value described above by a factor of 0.60 to reflect the effects of taxes at an assumed 40% marginal rate. Future contribution credits to the accounts are based on a percentage of future compensation, which varies by individual as shown in the table below. Compensation in Plan A, Plan B and the Employees' Retirement Plan of Southern Union Company Pennsylvania Division is limited to \$170,000 in 2000. Interest credits to the accounts are based on 30-year Treasury bond yields except for the Non-Qualified Plan accounts for Mr. Kelley and Mr. Endres, for whom interest credits are based on twice the 30-year Treasury bond yields. Normal Retirement Age under each of the plans is defined as age 65.

The Employees' Retirement Plan of Southern Union Company Pennsylvania Division provides benefits equal to 1.1% of final 5-year average compensation plus 0.5% of that portion of final average compensation which exceeds the Base Amount, with the sum multiplied by years of credited service, up to a maximum of 30 years. The Base Amount is the lesser of: (a) the average Social Security non-Medicare maximum taxable wage base over the preceding 35 years or (b) the 1997 Base Amount increased annually by 1% more than the annual CPI change.

Benefits under Plan A may be paid in a single lump sum payment or as a monthly pension payable for life, with a 10-year certain period. The single lump sum payment is the account balance at the time of distribution. The monthly pension is the sum of the benefit accrued as of December 31, 1998 under the pre-existing plan plus an amount actuarially equivalent to the value of post-1998 contribution credits (and interest credits thereon).

The data for each of the Named Executive Officers is shown in the table below, assuming 5% growth in annual compensation, 6% future Treasury bond yields under the cash balance plans, actuarial conversions at normal retirement age based on a 6% interest rate, a 3% rate of growth in the \$170,000 compensation limit under the Qualified Plans and a 4% annual increase in the Base Amount under the Employees' Retirement Plan of Southern Union Company Pennsylvania Division.

<u>Name</u>	<u>Plan A Contribution Credit Rate</u>	<u>Estimated Annual Benefits at Normal Retirement Age from Qualified Plan</u>
George L. Lindemann	1.5%	\$ 19,113
Peter H. Kelley	—	18,235
Ronald J. Endres	3.5%	52,934
David W. Stevens	—	27,485
Thomas Karam	—	103,476

Benefits under the Non-Qualified plan are paid in five annual installments which deplete the account balance. All officers listed in the Summary Compensation Table, except Mr. Lindemann and Mr. Karam, are covered by the Non-Qualified Plan. The average annual benefit payable in five annual installments at normal retirement age from the Non-Qualified plan for Messrs. Kelley, Endres and Stevens is \$7,724,282, \$2,944,742 and \$667,702, respectively. The average annual benefit payable in five annual installments assuming immediate termination from the Non-Qualified plan for Messrs. Kelley, Endres and Stevens is \$2,065,430, \$1,114,153 and \$41,756, respectively.

Employment Contracts, Termination of Employment and Change-In-Control Arrangements

All executive officers of the Company, unless noted, serve at the discretion of the Board. Generally, the executive officers are appointed to their position by the Board annually.

The Company has an agreement with Mr. Kelley that upon certain occurrences, the outstanding balance on his promissory note due to the company will be canceled and deemed paid in full. These occurrences include, among other items, termination of employment other than for cause, diminution in base salary or a change-in-control of the Company. See "Certain Relationships."

As of June 30, 2000, the Company had an employment agreement in effect with Mr. Karam which provides that during the term of the agreement, his base salary will not be reduced and he will remain eligible for participation in the Company's executive compensation and benefit programs. Additionally, the agreement provides for an annual bonus of \$600,000 to be paid on July 1st of each year. The agreement runs until June 30, 2010 and provides that if, in the sole discretion of the President of Southern Union, certain mutually agreed financial performance goals are achieved, the agreement will be automatically renewed for twelve months.

The agreement provides that Mr. Karam may terminate the agreement at any time by delivering written notice of termination to the Board at least 30 calendar days prior to the effective date of such termination, in which case he will be entitled to payment of his base salary through the effective date of termination, plus all other benefits to which he has a vested right at that time. Additionally, the agreement provides that he may terminate the agreement for "good reason," which is defined in the agreement, in general, as any substantial change in the nature of his employment by the Company without his express written consent; the requirement that he be based at a location at least 50 miles further than from his current residence; any reduction in his base salary; any material reduction in his level of participation in any compensation, benefit or retirement plans; and any failure by the Company to obtain a satisfactory agreement from any successor to assume the terms of the agreement. In the event of termination for good reason, absent a Change in Control, Mr. Karam will be entitled to receive, in a lump sum payment, an amount equal to one times his annual base salary and the unpaid annual bonus payments.

The agreement provides that if within two years following the effective date of a Change in Control Mr. Karam is terminated, he is entitled to certain severance benefits. Mr. Karam's agreement provides that, in the event of termination of his employment in connection with a Change in Control, he is entitled to a lump sum payment consisting of the following components: (i) an amount equal to three times the base salary in effect; (ii) an amount equal to three times his target bonus potential established for the fiscal year in which the effective date of termination occurs; (iii) an amount equal to his unpaid annual bonus payments (iv) an amount equal to his unpaid base salary and accrued vacation pay through the effective date of termination; and (v) an amount equal to a pro rata share of his targeted

bonus payment, established for the plan year in which termination occurs. Additionally, Mr. Karam is entitled to a continuation of life and medical benefits for a period of three full years after the effective date of termination.

The employment agreement with Mr. Karam provides that the continuation of medical, dental and life insurance shall be discontinued prior to the end of the applicable periods in the event he has available substantially similar benefits from a subsequent employer. Additionally, the agreement provides for excise tax equalization payments.

Effective September 28, 2000, the Company entered into an employment agreement with Mr. Dodge which provides that during the term of the agreement, his base salary will not be reduced and he will remain eligible for participation in the Company's executive compensation and benefit programs. Additionally, the agreement provides for a \$2,000,000 bonus (the "special bonus") with \$1,000,000 payable upon the effective date of the Company's acquisition of Providence Energy Corporation and \$500,000 on both the first and second anniversary of such acquisition. The agreement runs until Mr. Dodge attains age sixty-two at which time the remaining term shall be three years.

The agreement provides that Mr. Dodge may terminate the agreement at any time by delivering written notice of termination to the Board at least 30 calendar days prior to the effective date of such termination, in which case he will be entitled to payment of his base salary through the effective date of termination, plus all other benefits to which he has a vested right at that time. Additionally, the agreement provides that he may terminate the agreement for "good reason," which is defined in the agreement, in general, as any substantial change in the nature of his employment by the Company without his express written consent; the requirement that he be based at a location at least 50 miles further than from his current residence; any reduction in his base salary; any material reduction in his level of participation in any compensation, benefit or retirement plans; any failure by the Company to obtain a satisfactory agreement from any successor to assume the terms of the agreement; prior to the time that Mr. Dodge has attained age sixty-two; and the failure of Mr. Dodge not being elected as a member of the Board.

Mr. Dodge's agreement provides that, in the event of termination of his employment in connection with a Change in Control or good reason, he is entitled to a lump sum payment consisting of the following components: (i) an amount equal to three times the base salary in effect; (ii) an amount equal to three times his target bonus potential established for the fiscal year in which the effective date of termination occurs; (iii) an amount equal to his unpaid special bonus; (iv) an amount equal to his unpaid base salary and accrued vacation pay through the effective date of termination; and (v) an amount equal to a pro rata share of his targeted bonus payment, established for the plan year in which termination occurs. Additionally, Mr. Dodge is entitled to a continuation of welfare benefits for the later of three full years after the effective date of termination or until age sixty-five.

The employment agreement with Mr. Dodge provides outplacement assistance up to fifteen percent of his base salary in effect upon termination for a period of three years following such termination. Additionally, the agreement provides for excise tax equalization payments.

Compensation Committee Interlocks and Insider Participation

The Board does not have a separate compensation committee. Except with respect to the 1992 Plan, which is administered by the Board's Plan Committee, all decisions regarding management compensation are made by the full Board. Chairman Lindemann and Directors Brennan, Kelley and Karam, each of whom is also an executive officer of the Company, participated in deliberations of the Board of Directors concerning compensation for members of management but did not participate in Board votes as to compensation for themselves. See "Certain Relationships."

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") requires the Company's directors and certain officers, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission and the New York Stock Exchange. These officers, directors and greater than ten-percent stockholders are required by Securities and Exchange Commission regulations to furnish the Company with copies of all Section 16(a) forms they file.

Except as set forth below, based solely on review of the copies of the forms furnished to the Company, or written representations that no Forms 5 were required, during fiscal year 2000, all Securities and Exchange Commission filings of the Company's officers, directors and greater than ten-percent stockholders complied with all applicable Section 16(a) filing requirements. Messrs. Denius, Gitter and Kelley inadvertently failed to file on a timely basis reports required by Section 16(a) of the Exchange Act. Mr. Denius inadvertently failed to report on a timely basis two transactions that occurred on June 30, 2000. Such transactions were reported on his 2000 Form 5. Dr. Gitter inadvertently failed to report on a timely basis one transaction that occurred on January 25, 2000. Such transaction was reported on his April 2000 Form 4. Mr. Kelley inadvertently failed to report on a timely basis two transactions, one that occurred on April 20, 2000, and one that occurred on March 1, 1997. Such transactions were reported on his amended June 2000 Form 4.

SECURITY OWNERSHIP

The following table sets forth the number of all shares of the Company's common stock beneficially owned by each director, by each Named Executive Officer, by each person known by the Company to beneficially own 5% or more of the Company's outstanding common stock, and by all directors and executive officers as a group on September 30, 2000, unless otherwise indicated in the footnotes. Each of the following persons and members of the group had sole voting and investment power with respect to the shares shown unless otherwise indicated in the footnotes. Number of shares held excludes options to acquire shares of common stock that are not exercisable within sixty days of October 2, 2000.

<u>Name of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>		<u>Percent of Class</u>
	<u>Number of Shares</u>	<u>Beneficially Owned(1)</u>	
George L. Lindemann	5,348,477	(2)(3)	10.66%
Adam M. Lindemann	2,893,738	(3)(4)	5.84%
George Lindemann, Jr. 4500 Biscayne Boulevard Miami, Florida 33137	2,897,599	(3)(5)	5.84%
Sloan N. Lindemann 550 Park Avenue New York, New York 10021	2,896,544	(3)	5.84%
John E. Brennan	704,016	(6)	1.41%
Frank W. Denius	78,761	(7)	*
James H. Dodge	--		*
Aaron I. Fleischman	564,646	(8)	1.14%
Kurt A. Gitter, M.D	194,629	(9)	*
Thomas F. Karam	663,211	(10)	1.32%
Peter H. Kelley	572,585	(11)	1.15%
Roger J. Pearson	51,527	(12)	*
George Rountree, III	63,846	(13)	*
Ronald W. Simms	630,736	(14)	1.27%
Dan K. Wassong	59,814	(15)	*
Ronald J. Endres	390,381	(16)	*
David W. Stevens	91,231	(17)	*
Bass Reporting Persons 201 Main Street Fort Worth, Texas 76102	3,145,661	(18)	6.34%
Baron Capital Group 767 Fifth Avenue, 49th Floor New York, New York 10153	5,773,537	(19)	11.64%
All directors and executive officers as a group (18 persons)	13,069,845	(20)	26.36%

* Less than one percent.

- (1) Includes options to acquire shares of Southern Union common stock that are exercisable presently or within 60 days of October 2, 2000. All shares owned by each director or Named Executive Officer in the 401(k) Plan, Directors Plan, Supplemental Plan, the Southern Union Pennsylvania Division Employees' Savings Plan and the Southern Union Company Direct Stock Purchase Plan is as of June 30, 2000.
- (2) Includes: 2,180,560 shares owned by SUG 1 L.P. in which Mr. Lindemann is the sole general partner; 2,578,242 shares owned by SUG 2 L.P. in which Mr. Lindemann's wife, Dr. F.B. Lindemann, is the sole general partner; 15,290 vested shares held through the Southern Union Supplemental Plan for Mr. Lindemann; 9,481 vested shares held by the 401(k) Plan for Mr. Lindemann; and 564,904 shares of Southern Union common stock Mr. Lindemann is entitled to purchase upon the exercise of stock options exercisable pursuant to the 1992 Plan.
- (3) This information regarding direct share ownership by Mr. and Dr. Lindemann and their three children (Adam M., George, Jr., and Sloan N.) (together, the "Lindemann Family") generally was obtained from and is reported herein in reliance upon a Schedule 13D (as amended through August 15, 2000) as adjusted for any stock dividends and splits since the date of such report filed by

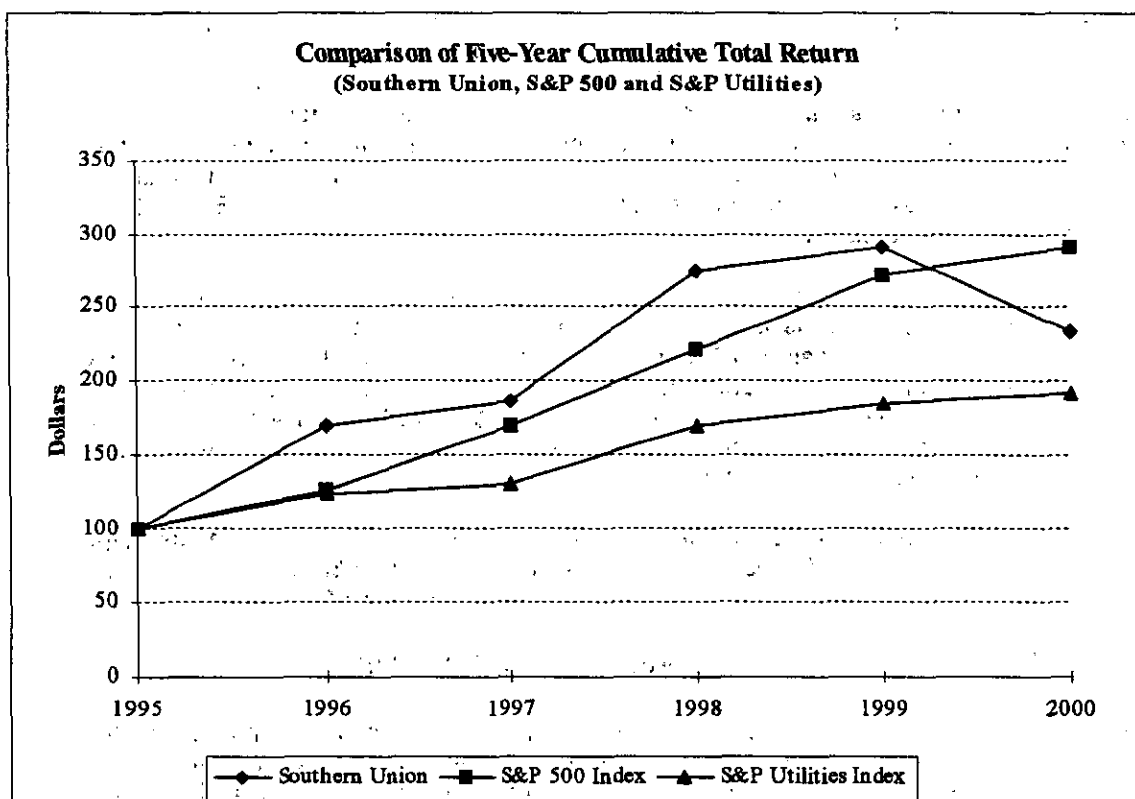
George L. Lindemann, Adam M. Lindemann, Sloan N. Lindemann, SUG 1 L.P., SUG 2 L.P., and SUG 3 L.P. In addition, information regarding share ownership by George L. Lindemann (including shares beneficially owned by his wife, Dr. F. B. Lindemann) and Adam M. Lindemann reflects information derived from their respective reports on Form 4 and Form 5 under the Exchange Act filed to date. Each member of the Lindemann Family disclaims beneficial ownership of any shares owned by any other member of the Lindemann Family. Accordingly, with respect to each member of the Lindemann Family, the above table reflects only individual share ownership except that the shares beneficially held by Dr. F. B. Lindemann are reflected as owned by George L. Lindemann, as explained in Note (2):

- (4) Includes 4,749 vested shares pursuant to the Directors' Plan.
- (5) These shares are owned by SUG 3 L.P. in which George Lindemann Jr. is the sole general partner.
- (6) Of these shares, 5,481 vested shares are held by the 401(k) Plan; 6,801 vested shares are held through the Supplemental Plan; 4,993 shares are owned by his wife; 211,806 are held in two separate trusts for the benefit of members of his family; 56,010 are held in an irrevocable trust under the Stock Plan; and 258,228 represent shares that Mr. Brennan is entitled to purchase upon the exercise of stock options exercisable pursuant to the 1992 Plan.
- (7) Includes: 955 shares owned by his wife; 49,017 shares that The Effie and Wofford Cain Foundation (the "Foundation"), in which Mr. Denius is a director, owns; and 8,641 vested shares pursuant to the Directors' Plan. Mr. Denius disclaims beneficial ownership of those shares held by the Foundation since he does not have a pecuniary interest in or control of the Foundation's assets.
- (8) Includes: 105,531 shares that Fleischman and Walsh, L.L.P., in which Mr. Fleischman is Senior Partner, is entitled to purchase upon exercise of a Warrant exercisable presently or within 60 days of October 2, 2000; 14,081 vested shares pursuant to the Directors' Plan; 112,215 shares owned by the Fleischman and Walsh 401(k) Profit Sharing Plan for which Mr. Fleischman is a trustee and a beneficiary; and 22,204 shares owned by the Aaron I. Fleischman Foundation for which Mr. Fleischman is the sole trustee. Mr. Fleischman disclaims beneficial ownership of those shares held by the Fleischman and Walsh 401(k) Profit Sharing Plan, to the extent that he does not have a pecuniary interest, and those shares held by the Aaron I. Fleischman Foundation.
- (9) Includes 7,829 vested shares pursuant to the Directors' Plan and 1,000 shares owned by Dr. Gitter's daughter.
- (10) Includes: 89,983 shares held by various entities through which Mr. Karam has voting power; 21,703 shares held in the name of Lakeside Drive Association, in which Mr. Karam's wife has an interest; 3,768 vested shares held by the Southern Union Pennsylvania Division Employees' Savings Plan for Mr. Karam; 2,463 vested shares held through the Supplemental Plan; and 474,784 shares of Southern Union common stock. Mr. Karam is entitled to purchase upon the exercise of stock options exercisable pursuant to the Pennsylvania Option Plan.
- (11) Includes 324,499 shares that Mr. Kelley is entitled to purchase upon the exercise of stock options exercisable pursuant to the 1992 Plan. Such number also includes: 35,306 shares held in the Stock Plan; 20,420 vested shares held by the 401(k) Plan; 4,440 shares owned by his wife; 4,186 shares held through the Southern Union Company Direct Stock Purchase Plan; and 40,011 vested shares held through the Supplemental Plan.
- (12) Includes 3,080 shares held by Mr. Pearson as Custodian (pursuant to the Uniform Gifts to Minors Act) for his children; and 5,341 vested shares pursuant to the Directors' Plan.
- (13) Includes 1,444 shares owned by his wife and 16,376 vested shares allocated to Mr. Rountree pursuant to the Directors' Plan. Also includes 3,150 shares owned by the Rountree & Seagle Profit Sharing Plan & Trust for which Mr. Rountree is a co-trustee and co-administrator. Mr. Rountree disclaims beneficial ownership of shares held by such plan to the extent that he has no pecuniary interest.
- (14) Includes: 149,364 shares owned by Mr. Simms's wife; 178,796 shares for which Mr. Simms has voting power; and 59,348 shares of Southern Union common stock. Mr. Simms is entitled to purchase upon the exercise of stock options exercisable pursuant to the Pennsylvania Incentive Plan.
- (15) Includes 6,705 vested shares pursuant to the Directors' Plan.
- (16) Includes 262,028 shares Mr. Endres is entitled to purchase upon the exercise of stock options exercisable pursuant to the 1992 Plan. Such number also includes: 12,736 vested shares held through the 401(k) Plan; 24,243 vested shares held through the Supplemental Plan; and 315 shares owned by Mr. Endres' children.
- (17) Includes 59,234 shares that Mr. Stevens is entitled to purchase upon the exercise of stock options exercisable pursuant to the 1992 Plan. Such number also includes: 12,676 vested shares held by the 401(k) Plan; 1,825 vested shares held through the Southern Union Company Direct Stock Purchase Plan and 14,743 vested shares held through the Supplemental Plan.
- (18) The information set forth in the table above with respect to the Bass Reporting Persons (as defined below) and the information in this note were obtained from and are reported herein in reliance upon a Schedule 13G filed by: Sid R. Bass Management Trust, 820 Management Trust, Bass Enterprises Production Company, the Bass Foundation, and the Lee and Ramona Bass Foundation (collectively, the "Bass Reporting Persons"), on November 3, 1999 (as adjusted for any stock dividends since the date of such report). Because of their relationships with certain of these persons, Sid R. Bass, Perry M. Bass and Lee M. Bass may be considered controlling persons with respect to certain of the Bass Reporting Persons, all as described in said Schedule 13G.
- (19) This information regarding share ownership by Baron Capital Group ("BCG") was obtained from and is reported herein in reliance upon a Schedule 13G, as amended through June 29, 2000 (the "Baron Filing"), filed by BCG, BAMCO ("BAMCO"), Baron Capital Management, ("BCM"), Baron Asset Fund ("BAF") and Ronald Baron (collectively, the "Baron Filing Group"). Pursuant to the Baron Filing, the members of the Baron Filing Group own beneficially and have shared power to vote or direct the vote of and to dispose or direct the disposition of the following number of shares of Southern Union common stock: BCG—5,773,537 shares; BAMCO—4,282,250 shares; BCM—1,491,287 shares; BAF—2,870,000 shares; and Mr. Baron—5,773,537 shares. The members of the Baron Filing Group disclaim beneficial ownership in each other's shares.
- (20) Excludes options granted pursuant to the 1992 Plan to acquire shares of Southern Union common stock that are not presently exercisable or do not become exercisable within 60 days of October 2, 2000. Includes vested shares held through certain Southern Union benefit and deferred savings plans for which certain executive officers and directors may be deemed beneficial owners, but excludes shares which have not vested under the terms of such plans. Also, includes 606,005 shares held by a "Rabbi Trust" known

as the Trust for Miscellaneous Southern Union Company Deferred Compensation Arrangements ("Rabbi Trust"). The shares are held as a part of Southern Union's efforts to provide funding for a portion of the future liability under the Southern Union Supplemental Executive Retirement Plan ("SERP"). Any assets held for the benefit of the SERP are held in the Rabbi Trust. Southern Union management directly or indirectly controls the investment of any assets, and the voting of any securities, held for the SERP.

COMMON STOCK PERFORMANCE GRAPH

The following performance graph compares the performance of the Company's common stock to the Standard & Poor's 500 Stock Index ("S&P 500 Index") and the Standard & Poor's Utilities 40 Index ("S&P Utilities Index"). The comparison assumes \$100 was invested on June 30, 1995 in the Company's Common Stock, the S&P 500 Index and in the S&P Utilities Index. Each case assumes reinvestment of dividends.



CERTAIN RELATIONSHIPS

In April 1992 Southern Union advanced \$375,980 to Peter H. Kelley, President, Chief Operating Officer and a Director of Southern Union, to enable him to repay certain funds borrowed by him from his previous employer in connection with his departure from his previous employer and relocation to become an executive officer of the Company. In May 1995 the note was restructured calling for 359 monthly payments of approximately \$1,909 and a balloon payment of \$147,746. The restructuring is evidenced by a renewal promissory note, bearing an annual percentage interest rate equal to 7.4%. During the fiscal year ended June 30, 2000, \$13,366 in interest was forgiven by the Company. See "Executive Compensation." The outstanding balance at June 30, 2000 was \$221,550.

In December 1999, the Company advanced \$4,000,000 and entered into a note agreement with Thomas F. Karam, Executive Vice President of Corporate Development and a Director of Southern Union. The note calls for nine annual payments of \$569,510 commencing on December 20, 2000 and the outstanding principal balance and any accrued but unpaid interest due and payable on December 20, 2009. The note bears interest at 7% and is collateralized by the outstanding stock options of Mr. Karam. The outstanding balance at June 30, 2000 was \$4,000,000.

In January 2000, the Company advanced \$308,000 and entered into a note agreement with Dennis K. Morgan, Senior Vice President -- Legal and Secretary of Southern Union. The note calls for monthly payments of \$1,500 commencing on February 15, 2000 and the outstanding principal balance and any accrued but unpaid interest due and payable on January 27, 2010. The note bears interest at five basis points plus the Eurodollar Rate and is uncollateralized. The outstanding balance at June 30, 2000 was \$308,609.

On October 4, 1993, Southern Union's Board of Directors approved and ratified payments by the Company to Activated Communications, Inc. or its successor ("Activated") for access to and use by the Company of Activated's office space in New York City. Chairman George L. Lindemann and Vice Chairman John E. Brennan control and operate, and Director Adam M. Lindemann has a beneficial interest in, Activated; none of these three Directors participated in such Board action. Payments to Activated were \$255,000 in the fiscal year ended June 30, 2000 and \$251,000 in each of the fiscal years ended June 30, 1999 and 1998, based on the Board's approved formula for sharing of Activated's actual lease expenses.

Director Fleischman is Senior Partner of Fleischman and Walsh, L.L.P., which provides legal services to the Company and certain of its subsidiaries. For the fiscal year ended June 30, 2000, the total amount paid by the Company to Fleischman and Walsh, L.L.P. for legal services was \$2,574,000.

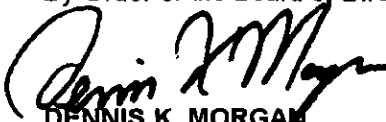
INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP has served as the Certified Public Accountants of the Company for the fiscal year ended June 30, 2000. Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting, and to be given an opportunity to make a statement if they desire to do so, and to be available to respond to appropriate questions. The Audit Committee of the Board of Directors of the Company presently expects to recommend to the Board, and the Board is expected to approve, the selection of PricewaterhouseCoopers LLP to serve as the Company's Certified Public Accountants for the fiscal year ending June 30, 2001.

THE COMPANY'S 2000 ANNUAL REPORT

The Company's Annual Report to Stockholders and Annual Report on Form 10-K for the fiscal year ended June 30, 2000, as filed with the Securities and Exchange Commission are available without charge to stockholders upon writing to the Secretary of the Company. Neither such Annual Report to Stockholders nor the Annual Report on Form 10-K for the fiscal year ended June 30, 2000 is to be treated as part of the proxy solicitation materials or as having been incorporated herein by reference.

By Order of the Board of Directors,



DENNIS K. MORGAN
Secretary

Austin, Texas
October 3, 2000

THE UNIVERSITY OF CHICAGO

DEPARTMENT OF THE HISTORY OF ARTS
AND ARCHITECTURE

THE UNIVERSITY OF CHICAGO
DEPARTMENT OF THE HISTORY OF ARTS
AND ARCHITECTURE

1980

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-K/A
Amendment No. 1

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended June 30, 2000

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File No. 1-6407

SOUTHERN UNION COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

75-0571592

(I.R.S. Employer
Identification No.)

504 Lavaca Street, Eighth Floor
Austin, Texas

(Address of principal executive offices)

78701

(Zip Code)

Registrant's telephone number, including area code: **(512) 477-5852**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, par value \$1 per share

Name of each exchange on which registered
New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

The aggregate market value of the voting stock held by non-affiliates of the registrant on September 15, 2000, was \$673,574,656. The number of shares of the registrant's Common Stock outstanding on September 15, 2000 was 49,589,799.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Annual Report to Stockholders for the year ended June 30, 2000, are incorporated by reference in Parts II and IV.

Portions of the registrant's proxy statement for its annual meeting of stockholders to be held on November 14, 2000, are incorporated by reference into Part III.

1. The first part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations

$$\begin{aligned} & \Delta u = f(x, y, z, u, v, w) \\ & \Delta v = g(x, y, z, u, v, w) \\ & \Delta w = h(x, y, z, u, v, w) \end{aligned}$$

in the domain G of the space E_3 under the boundary conditions

$$u = \varphi(x, y, z), \quad v = \psi(x, y, z), \quad w = \chi(x, y, z)$$

on the surface S .

It is shown that if the functions f, g, h and φ, ψ, χ satisfy certain conditions, then the system of equations has a unique solution.

2. In the second part of the paper the problem of the existence of a solution of the system of equations

$$\begin{aligned} & \Delta u = f(x, y, z, u, v, w) \\ & \Delta v = g(x, y, z, u, v, w) \\ & \Delta w = h(x, y, z, u, v, w) \end{aligned}$$

in the domain G of the space E_3 under the boundary conditions

$$u = \varphi(x, y, z), \quad v = \psi(x, y, z), \quad w = \chi(x, y, z)$$

on the surface S is considered.

It is shown that if the functions f, g, h and φ, ψ, χ satisfy certain conditions, then the system of equations has a unique solution.

3. In the third part of the paper the problem of the existence of a solution of the system of equations

$$\begin{aligned} & \Delta u = f(x, y, z, u, v, w) \\ & \Delta v = g(x, y, z, u, v, w) \\ & \Delta w = h(x, y, z, u, v, w) \end{aligned}$$

in the domain G of the space E_3 under the boundary conditions

$$u = \varphi(x, y, z), \quad v = \psi(x, y, z), \quad w = \chi(x, y, z)$$

on the surface S is considered.

PART I

ITEM 1. *Business.*

Introduction

Southern Union Company (*Southern Union* and together with its subsidiaries, the *Company*) was incorporated under the laws of the State of Delaware in 1932. Southern Union is one of the top ten natural gas utilities in the United States, as measured by number of customers. The Company's principal line of business is the distribution of natural gas as a public utility through its operating divisions principally in Texas, Missouri, Florida, Pennsylvania since November 1999, and Rhode Island and Massachusetts effective with three acquisitions completed in September 2000 (see *Acquisitions Subsequent to Year-End*).

Southern Union Gas, headquartered in Austin, Texas, serves approximately 523,000 customers in Texas (including Austin, Brownsville, El Paso, Galveston, Harlingen, McAllen and Port Arthur). Missouri Gas Energy, headquartered in Kansas City, Missouri, serves approximately 491,000 customers in central and western Missouri (including Kansas City, St. Joseph, Joplin and Monett). PG Energy, headquartered in Wilkes-Barre, Pennsylvania, serves approximately 154,000 customers in northeastern and central Pennsylvania (including Wilkes-Barre, Scranton and Williamsport). SFNG, headquartered in New Smyrna Beach, Florida, serves approximately 5,000 customers in central Florida (including New Smyrna Beach, Edgewater and areas of Volusia County, Florida.) With the acquisition of Providence Energy Corporation, Valley Resources, Inc. and Fall River Gas Company in September 2000 (collectively hereafter referred to as the *New England Division*), the Company now serves approximately 286,000 customers in Rhode Island and Massachusetts (including Providence, Newport and Cumberland, Rhode Island and Fall River, North Attleboro and Somerset, Massachusetts.) This diverse geographic area of the Company's natural gas distribution systems should reduce the overall sensitivity of Southern Union's operations to weather risk and local economic conditions.

Pennsylvania Enterprises, Inc. Acquisition

On November 4, 1999, the Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the *Pennsylvania Operations*) for approximately 16.7 million pre-stock dividend shares of Southern Union common stock and approximately \$36 million in cash plus the assumption of approximately \$115 million in long-term debt. The acquisition was accounted for using the purchase method. The income from the acquired Pennsylvania Operations is consolidated with the Company beginning on November 4, 1999. Thus, the results of operations for the year ended June 30, 2000 are not comparable to prior periods. PG Energy, the regulated gas utility within the Pennsylvania Operations, is a division of the Company serving approximately 154,000 customers in northeastern and central Pennsylvania. Other subsidiaries of the Company acquired in the acquisition of the Pennsylvania Operations include PG Energy Services Inc., (Energy Services), PEI Power Corporation (PEI Power), and Theta Land Corporation. Theta Land Corporation, which was engaged in the sale of property for residential and commercial development, was sold for \$12.1 million in January 2000. Through Energy Services, the Company markets a diversified range of energy-related products and services under the name PG Energy PowerPlus, principally in northeastern and central Pennsylvania. Through PEI Power, an exempt wholesale generator (within the meaning of the Public Utility Holding Company Act of 1935), the Company generates and sells electricity in Pennsylvania and surrounding states. Also included in the acquisition of the Pennsylvania Operations was Keystone Pipeline Services, Inc. (*Keystone*, a wholly-owned subsidiary of Energy Services). Keystone is engaged primarily in the construction, maintenance and rehabilitation of natural gas distribution pipelines. Concurrent with the acquisition, the Company decided to dispose of Keystone and the propane operations of Energy Services; these operations are not material to the Company.

Acquisitions Subsequent to Year-End

On September 20, 2000, Southern Union completed the acquisition of Valley Resources, Inc. (Valley Resources) for approximately \$125 million in cash plus the assumption of \$30 million in long-term debt. Valley Resources is engaged in natural gas distribution operating as Valley Gas Company and Bristol and Warren Gas Company which are now included as part of the New England Division of Southern Union. The non-utility subsidiaries of Valley

Resources are now subsidiaries of Southern Union. Valley Resources, which is headquartered in Cumberland, Rhode Island, provides natural gas utility service to more than 64,000 customers within a 92 square mile area in the northeastern portion of Rhode Island that has a population of approximately 250,000 and an approximately 15 square mile area in the eastern portion of Rhode Island that has a population of approximately 35,000. The non-utility subsidiaries rent and sell appliances, offer a service contract program, sell liquid propane in Rhode Island and nearby Massachusetts, and distribute as a wholesaler franchised lines to plumbing and heating contractors. Included in the acquisition was Valley Resources' 90% interest in Alternate Energy Corporation, which sells, installs and designs natural gas conversion systems and facilities, is an authorized representative of the ONSI Corporation fuel cell, holds patents for a natural gas/diesel co-firing system and for a device to control the flow of fuel on dual-fuel equipment.

On September 28, 2000, Southern Union completed the acquisition of Providence Energy Corporation (ProvEnergy) for approximately \$270 million in cash plus the assumption of \$90 million in long-term debt. The ProvEnergy natural gas distribution operations are Providence Gas and North Attleboro Gas. Providence Gas serves approximately 168,000 natural gas customers in Providence and Newport, Rhode Island, and 23 other cities and towns in Rhode Island and Massachusetts. North Attleboro Gas serves approximately 6,000 customers in North Attleboro and Plainville, Massachusetts, towns adjacent to the northeastern Rhode Island border. The ProvEnergy utility service territories encompass approximately 760 square miles with a population of approximately 850,000. These operations are also now included as part of the New England Division of the Company. Subsidiaries of the Company acquired in the ProvEnergy merger are ProvEnergy Oil Enterprises, Inc., Providence Energy Services, Inc., and ProvEnergy Power Company, LLC. ProvEnergy Oil Enterprises, Inc. operates a fuel oil distribution business through its subsidiary, ProvEnergy Fuels, Inc. (ProvEnergy Fuels). ProvEnergy Fuels serves over 14,000 residential and commercial customers in Rhode Island and Massachusetts. Providence Energy Services, Inc., whose operations are planned to be sold, markets natural gas and energy services throughout New England. ProvEnergy Power Company owns 50% of Capital Center Energy Company, LLC, a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power.

Also on September 28, 2000, Southern Union completed the acquisition of Fall River Gas Company (Fall River Gas) for approximately 1.5 million shares of Southern Union common stock and approximately \$27 million in cash plus assumption of \$20 million in long-term debt. Also now included as a part of the New England Division of the Company, Fall River Gas serves approximately 48,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in southeastern Massachusetts. Fall River Gas' non-regulated subsidiary, Fall River Gas Appliance Company, Inc., is now a subsidiary of Southern Union. Headquartered in Fall River, Massachusetts, Fall River Gas Appliance Company, Inc., rents water heaters and conversion burners (primarily for residential use) in Fall River Gas' service area.

The aforementioned acquisitions subsequent to year-end will be accounted for under the purchase method.

Company Operations

The Company's principal line of business is the distribution of natural gas through its Southern Union Gas, Missouri Gas Energy, PG Energy, and SFNG divisions, and, effective with the September 2000 acquisitions, its New England Division. (See *Acquisitions Subsequent to Year-End*). The Company's gas utility operations are generally seasonal in nature, with a significant percentage of its annual revenues and earnings occurring in the traditional winter heating season. As such, the Company is a sales and market-driven energy company whose management is committed to achieving profitable growth of its utility businesses in an increasingly competitive business environment and partnering with companies which complement Southern Union's existing customer service and core utility business. Management's strategies for achieving these objectives principally consist of: (i) promoting new sales opportunities and markets for natural gas; (ii) enhancing financial and operating performance; (iii) expanding the Company through development of existing utility businesses and selective acquisition of new utility businesses; and (iv) selective investments in complementary businesses. Management develops and continually evaluates these strategies and their implementation by applying their experience and expertise in analyzing the energy industry, technological advances, market opportunities and general business trends. Each of these strategies, as implemented throughout the Company's existing businesses, reflects the Company's commitment to its core natural gas utility business.

The Company may consider, when appropriate and if financially practicable to pursue, the acquisition of other utility distribution or transmission businesses. The nature and location of any such properties, the structure of any such acquisitions, and the method of financing any such expansion or growth will be determined by management and the

Southern Union Board of Directors. See *Management's Discussion and Analysis of Results of Operations and Financial Condition (MD&A)* -- *Cautionary Statement Regarding Forward-Looking Information*.

Subsidiaries of Southern Union have been established to support and expand natural gas sales and other energy sales and to capitalize on the Company's energy expertise. These subsidiaries market natural gas and electricity to end-users, operate natural gas pipeline systems, generate electricity, distribute propane and sell commercial gas air conditioning and other gas-fired engine-driven applications. The Company distributes propane to 7,500, 2,000 and 1,000 customers in Texas, Pennsylvania and Florida, respectively. With the subsequent acquisition of the companies in New England, the Company will now also serve 14,000 and 3,700 fuel oil and propane customers, respectively, in Rhode Island and Massachusetts. Additionally, certain subsidiaries own or hold interests in real estate and other assets, which are primarily used in the Company's utility business. Central to all of the Company's present businesses and strategies is the sale and transportation of natural gas.

Southern Union Energy International, Inc. (SUEI) and Southern Union International Investments, Inc. (Investments), both wholly-owned subsidiaries of Southern Union, participate in energy-related projects internationally. Energia Estrella del Sur, S. A. de C. V. (Estrella), a wholly-owned Mexican subsidiary of SUEI and Investments, seeks to participate in energy-related projects in Mexico. Estrella has a 43% equity ownership in a natural gas distribution company, along with other related operations, which currently serves 22,000 customers in Piedras Negras, Mexico, across the border from Southern Union Gas' Eagle Pass, Texas service area.

Mercado Gas Services, Inc. (Mercado), a wholly-owned subsidiary of Southern Union, markets natural gas to commercial and industrial customers. Mercado's sales and purchasing activities are made through short-term and long-term contracts. These contracts and business activities are not subject to direct rate regulation.

Southern Transmission Company (STC), a wholly-owned subsidiary of Southern Union, owns and operates 165.3 miles of intrastate pipeline that serves commercial, industrial and utility customers in central, south and coastal Texas.

Norteño Pipeline Company (Norteño), a wholly-owned subsidiary of Southern Union, owns and operates interstate pipelines that serve the gas distribution properties of Southern Union Gas and the Public Service Company of New Mexico. Norteño also transports gas through its interstate network to the country of Mexico for Pemex Gas y Petroquímica Básica (PEMEX).

SUPro Energy Company (SUPro), a wholly-owned subsidiary of Southern Union, provides propane gas services to customers located principally in Austin, El Paso and Alpine, Texas as well as Las Cruces, New Mexico and surrounding communities.

Atlantic Gas Corporation, a wholly-owned subsidiary of Southern Union, provides propane gas services to 1,000 customers located in and around the communities of New Symma Beach, Lauderdale and Dunnellon, Florida. Atlantic Gas Corporation sold 1,193,000 and 1,348,000 gallons of propane for the year ended June 30, 2000 and 1999, respectively.

PG Energy Services Inc. (Energy Services), a wholly-owned subsidiary of Southern Union, markets a broad array of energy and energy-related products and services under the name PG Energy PowerPlus. Presently, PG Energy PowerPlus offers the sale of natural gas and electricity to 17,000 residential, commercial and industrial users primarily in central and northeastern Pennsylvania; and the inspection, maintenance and servicing of residential and small commercial gas-fired equipment.

PEI Power Corporation (Power Corp.), a wholly-owned subsidiary of Southern Union, an exempt wholesale generator (within the meaning of the Public Utility Holding Company Act of 1935), generates and sells electricity provided by a cogeneration facility it acquired in November 1997. This 25-megawatt facility, located in Archbald, Pennsylvania, is fueled by a combination of natural gas and methane recovered from a nearby landfill.

Southern Union Total Energy Systems, Inc., a wholly-owned subsidiary of Southern Union, markets and sells gas-fired engine-driven applications and related services to the industrial and commercial marketplace.

See *Acquisitions Subsequent to Year-End* for a description of other subsidiaries subsequently acquired in the acquisitions of ProvEnergy, Valley Resources and Fall River Gas.

The Company also holds investments in commercially developed real estate in Austin, El Paso, Harlingen and Kansas City through Southern Union's wholly-owned subsidiary, Lavaca Realty Company (Lavaca Realty). Additionally, through the acquisition of the Pennsylvania Operations, the Company has investments in several tracts of land, certain of which is being prepared for development, situated in northeastern Pennsylvania, primarily Lackawanna County. Depending upon market conditions the Company may sell certain of these investments from time to time.

Southern Union's strategy for long-term growth includes acquiring the right assets that will position the Company favorably in an evolving competitive marketplace. The Pennsylvania Operations acquisition, which closed in November 1999, provides Southern Union with a strong presence in the attractive northeastern market. In addition, the acquisitions of Fall River Gas, ProvEnergy and Valley Resources completed subsequent to year-end have further expanded Southern Union's territory into New England. These four acquisitions also provide geographic and weather diversity to the Company's service areas. Within the past several years, the Company's growth strategy also has resulted in Southern Union expanding its gas service into Mexico in a service area adjacent to Southern Union Gas, and Florida. Going forward, Southern Union may consider other acquisitions which will financially enhance growth and take advantage of future market opportunities.

The information about the Company in the remainder of *Item 1 -- Business* does not include information related to Fall River Gas, ProvEnergy or Valley Resources, the companies acquired subsequent to year-end. (See *Acquisitions Subsequent to Year-End*.)

Company Investments

Southern Union's culture promotes independent thinking and encourages innovation. Southern Union is involved in several strategic projects.

Over the past several years, the Company acquired an equity interest in Capstone Turbine Corporation (Capstone). This company has developed a microturbine fueled by natural gas or propane that produces electricity and creates less pollution than conventional systems. The refrigerator-sized microturbine unit can efficiently provide nearly 30 kilowatts of electricity to a small business. Additionally, this technology is highly reliable and requires low maintenance. The Company's cost basis in Capstone is \$10,625,000. In late June 2000, Capstone completed its initial public offering (IPO). As of June 30, 2000 and August 31, 2000, the value of the Company's investment in Capstone was \$187,817,000 and \$384,753,000, respectively, based on the closing prices for Capstone shares on those days.

Southern Union also holds a \$2,586,000 equity interest in PointServe, Inc. (PointServe) a business-to-business online scheduling solution for Internet portals seeking to enrich the consumer value of their site, and service industries seeking to harness the power of the Internet. Patent-pending, online scheduling technology should enable service providers to spend less and earn more by creating accountability of marketing dollars, increasing operational efficiencies, and increasing customer satisfaction and loyalty. PointServe technology is intended to allow consumers to "wait less and do more" by making it easier to find, select and schedule a service provider.

Southern Union has a \$3,000,000 equity interest in Servana.com, Inc. (Servana). Based in Austin, Texas Servana partners with utility companies to deliver comprehensive e-commerce solutions to the customer's home. The company is positioning itself to become the dominant utility-based home-service portal, leveraging the utility's brand identity and prominence in local markets. For example, a new resident who moves to Austin, Texas and needs to establish gas service will be able to access Southern Union's website, schedule service through PointServe, and register for a variety of other services (i.e., electric, pest control, lawn service, etc.).

As of June 30, 2000, Southern Union had a \$2,000,000 equity interest in Advent Networks, Inc. (Advent), headquartered in Austin, Texas. Southern Union intends to make an additional investment of up to approximately \$2,500,000 in Advent this Fall. Advent is developing a next generation UltraBand™ platform, which is expected to deliver digital broadband services 50 times faster than digital subscriber lines (DSL) or cable modems, and 1,000 times faster than dial-up modems, over the "last mile". UltraBand™ should provide cable network overbuilders a

competitive advantage with its capability to deliver content at a quality and speed that cannot be provided over cable modem. Beta testing of UltraBand™ is expected in Spring 2001 in Missouri Gas Energy's Kansas City service area.

Competition

Natural gas distribution has been evolving from a highly regulated environment to one where competition and customer choice is being promoted. The restructuring of natural gas distribution began in the 1990's when the Federal Energy Regulatory Commission (FERC) required interstate pipeline companies to separate, or unbundle, the merchant function of selling natural gas from the transportation and storage services they provide and offer those services to end users on the same terms as local distribution companies. As a result, certain large volume customers, primarily industrial and significant commercial customers, have had opportunities to access alternative natural gas supplies and, in some instances, delivery service from other pipeline systems. The Company has offered transportation arrangements to customers who secure their own gas supplies. These transportation arrangements, coupled with the efforts of Southern Union's unregulated marketing subsidiaries, enable the Company to provide competitively priced gas service to these large volume customers. In addition, the Company has successfully used flexible rate provisions, when needed, to retain customers who may have access to alternative energy sources.

As energy providers, Southern Union Gas, Missouri Gas Energy, PG Energy and SFNG have historically competed with alternative energy sources, particularly electricity and also propane, coal, natural gas liquids and other refined products available in the Company's service areas. At present rates, the cost of electricity to residential and commercial customers in the Company's service areas generally is higher than the effective cost of natural gas service. There can be no assurance, however, that future fluctuations in gas and electric costs will not reduce the cost advantage of natural gas service. The cost of expansion for peak load requirements of electricity in some of Southern Union Gas' and Missouri Gas Energy's service areas has historically provided opportunities to allow energy switching to natural gas pursuant to integrated resource planning techniques. Electric competition has responded by offering equipment rebates and incentive rates.

Competition between the use of fuel oils, natural gas and propane, particularly by industrial, electric generation and agricultural customers, has also increased due to the volatility of natural gas prices and increased marketing efforts from various energy companies. In order to be more competitive with certain alternate fuels in Pennsylvania, PG Energy offers an Alternate Fuel Rate for eligible customers. This rate applies to large commercial and industrial accounts that have the capability of using fuel oils or propane as alternate sources of energy. Whenever the cost of such alternate fuel drops below the cost of natural gas at PG Energy's normal tariff rates, PG Energy is permitted by the Pennsylvania Public Utility Commission (PPUC) to lower its price to these customers so that PG Energy can remain competitive with the alternate fuel. However, in no instance may PG Energy sell gas under this special arrangement for less than its average commodity cost of gas purchased during the month. While competition between such fuels is generally more in Pennsylvania than the Company's other service areas, this competition affects the nationwide market for natural gas. Additionally, the general economic conditions in the Company's service areas continue to affect certain customers and market areas, thus impacting the results of the Company's operations.

The Company's gas distribution divisions are not currently in significant direct competition with any other distributors of natural gas to residential and small commercial customers within their service areas, other than in Pennsylvania. In 1999, the Commonwealth of Pennsylvania enacted the Natural Gas Choice and Competition Act, which extended the ability to choose suppliers to small commercial and residential customers as well. In accordance with the provisions of the legislation, PG Energy submitted a restructuring plan to the PPUC on August 2, 1999. This plan describes the terms and conditions, including the tariffs, by which PG Energy proposed to offer unbundled transportation service and the rules alternate natural gas suppliers must follow to operate on PG Energy's distribution system. Following extensive review and negotiations by PG Energy and various interested stakeholders, including representatives of the PPUC, a Settlement Agreement was reached in November 1999. PG Energy filed revised tariffs in accordance with the Settlement Agreement on February 1, 2000 for PPUC review and approval. Based upon the legislation, the Settlement Agreement and the tariffs as filed, PG Energy does not believe any significant amount of transition costs will be incurred and that any transition costs that are incurred will generally be recoverable through rates or other customer charges.

Following PPUC review, PG Energy filed final tariffs, with modifications, on April 28, 2000. Effective April 29, 2000, all of PG Energy's customers have the ability to select an alternate supplier of natural gas, which PG Energy will continue to deliver through its distribution system. Customers can also choose to remain with PG Energy as their

supplier under regulated natural gas rates. In either case, PG Energy serves as the supplier of last resort. To date, few small commercial and residential customers have switched due to the lack of supplier offers that provide any savings over PG Energy's current regulated gas rates. The natural gas industry is currently experiencing higher than normal wholesale prices for natural gas, which is preventing suppliers from offering competitive rates. However, the number of supplier offers and the occurrence of customers switching suppliers may likely increase as the wholesale market moderates over time and PG Energy's regulated rates are adjusted to reflect the market.

Gas Supply

The historically low cost of natural gas service is dependent upon the Company's ability to contract for natural gas using favorable mixes of long-term and short-term supply arrangements and favorable transportation contracts. The Company has been directly acquiring its gas supplies since the mid-1980s when interstate pipeline systems opened their systems for transportation service. The Company has the organization, personnel and equipment necessary to dispatch and monitor gas volumes on a daily, hourly and even a real-time basis to ensure reliable service to customers.

The FERC required the "unbundling" of services offered by interstate pipeline companies beginning in 1992. As a result, gas purchasing and transportation decisions and associated risks have been shifted from the pipeline companies to the gas distributors. The increased demands on distributors to effectively manage their gas supply in an environment of volatile gas prices provides an advantage to distribution companies such as Southern Union who have demonstrated a history of contracting favorable and efficient gas supply arrangements in an open market system.

The majority of Southern Union Gas' 2000 gas requirements for utility operations were delivered under short- and long-term transportation contracts through five major pipeline companies. The majority of Missouri Gas Energy's 2000 gas requirements were delivered under short- and long-term transportation contracts through four major pipeline companies. The majority of PG Energy's 2000 gas requirements were delivered under short- and long-term transportation contracts through four major pipeline companies. The majority of SFNG's 2000 gas requirements were delivered under a management supply contract through one major pipeline company. These contracts have various expiration dates ranging from calendar year 2000 through 2018. Southern Union Gas also purchases significant volumes of gas under long- and short-term arrangements with suppliers. The amounts of such short-term purchases are contingent upon price. Southern Union Gas, Missouri Gas Energy and SFNG all have firm supply commitments for all areas that are supplied with gas purchased under short-term arrangements. Missouri Gas Energy also holds contract rights to over 16 Bcf of storage capacity and PG Energy holds contract rights to over 11 Bcf of storage capacity to assist in meeting peak demands.

Due to the operation of purchase gas adjustment (PGA) clauses, gas purchase costs generally do not directly affect earnings of our regulated utility operations. However, the Company's unregulated gas marketing operations are subject to price risk related to fixed-price sales commitments that are not matched with corresponding fixed price purchase agreements. At June 30, 2000, the Company had fixed-price sales commitments with various customers that provide for the delivery of approximately 1,922,201 Dekatherms of natural gas through April 2001 at an average sales price per Dekatherm of \$3.00. The Company has exposure to the changes in gas prices related to fluctuating commodity prices, which can impact the Company's financial position or results of operations, either favorably or unfavorably. The Company's open positions are actively managed, and the impact of changing prices on the Company's financial position at a point in time is not necessarily indicative of the impact of price movements throughout the year.

Gas sales and/or transportation contracts with interruption provisions, whereby large volume users purchase gas with the understanding that they may be forced to shut down or switch to alternate sources of energy at times when the gas is needed for higher priority customers, have been utilized for load management by Southern Union and the gas industry as a whole. In addition, during times of special supply problems, curtailments of deliveries to customers with firm contracts may be made in accordance with guidelines established by appropriate federal and state regulatory agencies. There have been no supply-related curtailments of deliveries to Southern Union Gas, Missouri Gas Energy, PG Energy or SFNG utility sales customers during the last ten years except for one instance relating to PG Energy in January 1997.

The Company is committed under various agreements to purchase certain quantities of gas in the future. At June 30, 2000, the Company has purchase commitments for certain quantities of gas at variable, market-based prices that have an annual value of \$113,666,000. The Company's purchase commitments may extend over a period of several years depending upon when the required quantity is purchased. The Company has purchase gas tariffs in effect for all its utility service areas that provide for recovery of its purchase gas costs under defined methodologies.

In August 1997, the Missouri Public Service Commission (MPSC) issued an order authorizing Missouri Gas Energy to begin making semi-annual PGAs in November and April, instead of more frequent adjustments as previously made. Additionally, the order authorized Missouri Gas Energy to establish an Experimental Price Stabilization Fund for purposes of procuring natural gas financial instruments to hedge a minimal portion of its gas purchase costs for the winter heating season. The cost of purchasing these financial instruments and any gains derived from such activities are passed on to the Missouri customers through the PGA. Accordingly, there is no earnings impact as a result of the use of these financial instruments. These procedures help stabilize the monthly heating bills for Missouri customers. The Company believes it bears minimal risk under the authorized transactions.

The MPSC approved a three year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers shared in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas was acquired above benchmark levels, both the Company and customers shared in such costs. For the years ended June 30, 1999 and 1998, the incentive plan achieved a reduction of overall gas costs of \$6,900,000 and \$9,200,000, respectively, resulting in savings to Missouri customers of \$4,000,000 and \$5,100,000, respectively. The Company recorded revenues of \$2,900,000 and \$4,100,000 in 1999 and 1998, respectively, under this plan. Missouri Gas Energy received authorization from the MPSC for a new gas supply incentive plan that became effective August 31, 2000. Earnings under the plan are primarily dependent on market prices for natural gas declining to certain preauthorized levels which are now below current market prices. There is no assurance that the Company will have an opportunity to generate earnings under this aspect of the plan during fiscal 2001.

Utility Regulation and Rates

The Company's rates and operations are subject to regulation by local, state and federal authorities. In Texas, municipalities have primary jurisdiction over natural gas rates within their respective incorporated areas. Rates in adjacent environs and appellate matters are the responsibility of the Railroad Commission of Texas (RRC). In Missouri, natural gas rates are established by the MPSC on a system-wide basis. In Pennsylvania, natural gas rates for PG Energy are approved by the PPUC on a system-wide basis. In Florida, natural gas rates are established by the Florida Public Service Commission on a system-wide basis. The FERC has jurisdiction over rates, facilities and services of Norteño and Power Corp., and the RRC has jurisdiction over STC.

The Company holds non-exclusive franchises with varying expiration dates in all incorporated communities where it is necessary to carry on its business as it is now being conducted. Kansas City, Missouri; El Paso, Texas; Austin, Texas; Port Arthur, Texas; and St. Joseph, Missouri are the five largest cities in which the Company's utility customers are located. The franchises in the following cities expire as follows: El Paso, Texas in 2030; Austin, Texas in 2006; Port Arthur, Texas in 2013; and Kansas City, Missouri in 2010. The Company fully expects these franchises to be renewed upon their expiration. The franchise in St. Joseph, Missouri is perpetual.

Gas service rates are established by regulatory authorities to permit utilities the opportunity to recover operating, administrative and financing costs, and the opportunity to earn a reasonable return on equity. Gas costs are billed to customers through PGA clauses which permit the Company to adjust its sales price as the cost of purchased gas changes. This is important because the cost of natural gas accounts for a significant portion of the Company's total expenses. The appropriate regulatory authority must receive notice of such adjustments prior to billing implementation.

Other than in Pennsylvania, the Company supports any service rate changes to its regulators using a historic test year of operating results adjusted to normal conditions and for any known and measurable revenue or expense changes. Because the regulatory process has certain inherent time delays, rate orders may not reflect the operating costs at the time new rates are put into effect. In Pennsylvania, a future test year is utilized for ratemaking purposes, therefore, there is no delay and rate orders more closely reflect the operating costs at the time new rates are put into effect.

The monthly customer bill contains a fixed service charge, a usage charge for service to deliver gas, and a charge for the amount of natural gas used. While the monthly fixed charge provides an even revenue stream, the usage charge increases the Company's annual revenue and earnings in the traditional heating load months when usage of natural gas increases. In recent years, the majority of the Company's rate increases in Texas have resulted in increased monthly fixed charges which help stabilize earnings. Weather normalization clauses, in place in the City of Austin, El Paso environs, Galveston, Port Arthur and two other service areas in Texas, also help stabilize earnings.

On April 3, 2000, PG Energy filed an application with the PPUC seeking an increase in its base rates designed to produce \$17,900,000 in additional annual revenues, to be effective June 2, 2000. On May 11, 2000, the PPUC suspended this rate increase request for seven months, until January 2, 2001, in order to investigate the reasonableness of the proposed rates. On August 30, 2000, PG Energy and the principal parties to the base rate proceeding informed the Administrative Law Judge (ALJ) assigned to the proceeding that a complete settlement of the proceeding had been reached. The proposed settlement is designed to produce \$10,800,000 of additional annual revenue. The parties are currently in the process of finalizing a Settlement Agreement and Joint Petition for Settlement of Rate Investigation (the *Settlement Petition*) which will be filed with the ALJ upon its completion. The Settlement Petition will request PPUC approval for the rate increase to become effective on January 1, 2001. It is not presently possible to determine what action either the ALJ or the PPUC will ultimately take with respect to this rate increase request or the Settlement Petition.

On October 18, 1999, Southern Union Gas filed a \$1,696,000 rate increase request for the El Paso service area with the City of El Paso. In February 2000, the City of El Paso approved a \$650,000 revenue increase, and an improved rate design that collects a greater portion of the Company's revenue stream from the monthly customer charge. Additionally, the City of El Paso approved a new 30-year franchise for Southern Union Gas.

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a \$13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of \$2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. On June 15, 2000, the MPSC ruled that it would not rehear or reconsider its decision on one issue valued at \$1,500,000. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional \$700,000 of base revenues increasing the \$13,300,000 initially authorized in its August 21, 1998 order to \$14,000,000. The MPSC is expected to rule on this rehearing in October 2000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

On April 13, 1998, Southern Union Gas filed a \$2,228,000 request for a rate increase from the city of El Paso, a request the city subsequently denied. On April 21, 1998, the city council of El Paso voted to reduce the Company's rates by \$1,570,000 annually and to order a one-time cost of gas refund of \$475,000. On May 21, 1998, Southern Union Gas filed with the RRC an appeal of the city of El Paso's actions to reduce the Company's rates and require a one-time cost of gas refund. On December 21, 1998, the RRC issued its order implementing an \$884,000 one-time cost of gas refund and a \$99,000 base rate reduction. The cost of gas refund was completed in February 1999.

On January 22, 1997, Missouri Gas Energy was notified by the MPSC of its decision to grant an \$8,847,000 annual increase to revenue effective on February 1, 1997. Pursuant to a 1989 MPSC order, Missouri Gas Energy is engaged in a major gas safety program in its service area (Missouri Safety Program). In connection with this program, the MPSC issued an accounting authority order (AAO) in Case No. GO-92-234 in 1994 which authorized Missouri Gas Energy to defer depreciation expenses, property taxes and carrying costs at a rate of 10.54% on the costs incurred in the Missouri Safety Program. This AAO was consistent with those which were issued by the MPSC from 1990 to 1993 to Missouri Gas Energy's prior owner. The MPSC rate order of January 22, 1997, however, retroactively reduced the carrying cost rate applied by the Company on the expenditures incurred on the Missouri Safety Program since early 1994 to an Allowance for Funds Used During Construction (AFUDC) rate of approximately 6%. The Company filed an appeal of that portion of the rate order in the Missouri State Court of Appeals, Western District. On August 18, 1998, the Missouri State Court of Appeals denied the Company's appeal resulting in a one-time non-cash write-off of \$5,942,000 of previously recorded deferred costs which was recorded as of June 30, 1998. The Company believes that the inconsistent treatment by the MPSC in subsequently changing to the AFUDC rate from

the previously ordered 10.54% rate constitutes retroactive ratemaking. Unfortunately, the decision by the Missouri State Court of Appeals failed to address certain specific language within the 1994 AAO that the Company believed prevented the MPSC from retroactively changing the carrying cost rate. Southern Union requested transfer to the Missouri Supreme Court, but was denied that request.

The approval of the January 31, 1994 acquisition of the Missouri properties by the MPSC was subject to the terms of a stipulation and settlement agreement, which, among other things, requires Missouri Gas Energy to reduce rate base by \$30,000,000 (amortized over a ten-year period on a straight-line basis) to compensate rate payers for rate base reductions that were eliminated as a result of the acquisition.

During the three-year period ended June 30, 2000, the Company did not file for any other rate increases in any of its major service areas, although several annual cost of service adjustments were filed.

In addition to the regulation of its utility and pipeline businesses, the Company is affected by numerous other regulatory controls, including, among others, pipeline safety requirements of the United States Department of Transportation, safety regulations under the Occupational Safety and Health Act, and various state and federal environmental statutes and regulations. The Company believes that its operations are in compliance with applicable safety and environmental statutes and regulations.

Environmental

The Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in its former service territories, principally in Arizona and New Mexico, and present service territories in Texas, Missouri and its newly acquired service territories in Pennsylvania. While the Company's evaluation of these Texas, Missouri, Arizona, New Mexico and Pennsylvania MGP sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. See *MD&A -- Cautionary Statement Regarding Forward-Looking Information and Commitments and Contingencies* in the Notes to the Consolidated Financial Statements.

Investments in Real Estate

Lavaca Realty owns a commercially developed tract of land in the central business district of Austin, Texas, containing a combined 11-story office building, parking garage and drive-through bank (Lavaca Plaza). Approximately 52% of the office space at Lavaca Plaza is used in the Company's business while the remainder is leased to non-affiliated entities. Lavaca Realty also owns a two-story office building in El Paso, Texas as well as a one-story office building in Harlingen, Texas. Other significant real estate investments held at June 30, 2000 include 39,341 square feet of undeveloped land in McAllen, Texas and 25,000 square feet of improved property in Kansas City, Missouri, of which 40% is occupied by Missouri Gas Energy and the remainder by a non-affiliated entity. Additionally, through the acquisition of the Pennsylvania Operations, the Company owns several tracts of land, certain of which is being prepared for development, situated in northeastern Pennsylvania, primarily Lackawanna County. Depending upon market conditions the Company may sell certain of these investments from time to time.

Employees

As of July 31, 2000, the Company had 2,296 employees, of whom 1,757 are paid on an hourly basis and 539 are paid on a salary basis. Of the 1,757 hourly paid employees, 44% are represented by unions. Of those employees represented by unions, 68% are employed by Missouri Gas Energy, 29% are employed by PG Energy and 3% by Southern Union Gas. During fiscal 2000, the Company agreed to a one-year contract and a three-year contract with bargaining units representing Pennsylvania employees, which were effective on April 1, 2000 and August 1, 2000, respectively. In December 1998, the Company agreed to five-year contracts with each bargaining-unit representing Missouri employees, which were effective in May 1999.

From time to time the Company may be subject to labor disputes; however, such disputes have not previously disrupted its business. The Company believes that its relations with its employees are good.

Statistics of Principal Utility and Related Operations

The following table shows certain operating statistics of the Company's gas distribution divisions with operations in Texas, Missouri and Pennsylvania, which the Company owned during part or all of the year ended June 30, 2000:

	Year Ended June 30,		
	2000	1999	1998
Southern Union Gas:			
Average number of gas sales customers served:			
Residential	483,220	473,563	465,844
Commercial	31,860	30,847	29,828
Industrial and irrigation	253	258	252
Public authorities and other	2,862	2,849	2,755
Total average customers served	<u>518,195</u>	<u>507,517</u>	<u>498,679</u>
Gas sales in millions of cubic feet (MMcf):			
Residential	19,524	19,553	23,217
Commercial	8,677	8,539	9,425
Industrial and irrigation	969	1,082	1,208
Public authorities and other	2,377	2,266	2,752
Gas sales billed	31,547	31,440	36,602
Net change in unbilled gas sales	137	175	(82)
Total gas sales	<u>31,684</u>	<u>31,615</u>	<u>36,520</u>
Weather:			
Degree days (a)	1,516	1,576	2,118
Percent of 30-year measure (b)	71%	74%	99%
Gas transported in MMcf	17,472	16,668	16,535
Missouri Gas Energy:			
Average number of gas sales customers served:			
Residential	424,771	418,266	413,703
Commercial	58,323	57,247	57,693
Industrial	309	313	312
Total average customers served	<u>483,403</u>	<u>475,826</u>	<u>471,708</u>
Gas sales in MMcf:			
Residential	34,999	36,578	41,104
Commercial	15,640	16,842	18,705
Industrial	412	375	400
Gas sales billed	51,051	53,795	60,209
Net change in unbilled gas sales	37	204	35
Total gas sales	<u>51,088</u>	<u>53,999</u>	<u>60,244</u>
Weather:			
Degree days (a)	4,176	4,438	4,723
Percent of 30-year measure (b)	80%	85%	90%
Gas transported in MMcf	31,644	31,774	30,165

(a) "Degree days" are a measure of the coldness of the weather experienced. A degree day is equivalent to each degree that the daily mean temperature for a day falls below 65 degrees Fahrenheit.

(b) Information with respect to weather conditions is provided by the National Oceanic and Atmospheric Administration. Percentages of 30-year measure are computed based on the weighted average volumes of gas sales billed.

**Eight Months
Ended June 30,
2000(a)**

PG Energy:

Average number of gas sales customers served:

Residential	140,019
Commercial	13,872
Industrial	209
Public Authorities and Other	314
Total average customers served	<u>154,414</u>

Gas sales in MMcf:

Residential	14,830
Commercial	4,969
Industrial	215
Public Authorities and Other	213
Gas sales billed	20,227
Net change in unbilled gas sales	(314)
Total gas sales	<u>19,913</u>

Weather:

Degree days (b)	5,287
Percent of 30-year measure (c)	92%

Gas transported in MMcf	19,403
-------------------------------	--------

(a) PG Energy was acquired on November 4, 1999. See *Pennsylvania Enterprises, Inc. Acquisition*.

(b) "Degree days" are a measure of the coldness of the weather experienced. A degree day is equivalent to each degree that the daily mean temperature for a day falls below 65 degrees Fahrenheit.

(c) Information with respect to weather conditions is provided by the National Oceanic and Atmospheric Administration. Percentages of 30-year measure are computed based on the weighted average volumes of gas sales billed.

Customers. The following table shows the number of customers served by the Company, through its divisions, subsidiaries and affiliates, as of the end of its last three fiscal years.

	<u>Gas Utility Customers as of June 30,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
Southern Union Gas:			
Austin and other central and south Texas communities	183,872	175,596	173,228
El Paso and other west Texas communities	187,189	182,516	178,812
Galveston and Port Arthur	50,237	50,543	50,673
Panhandle and north Texas communities	24,584	24,728	24,900
Rio Grande Valley communities and Eagle Pass	75,608	75,983	76,840
	<u>521,490</u>	<u>509,366</u>	<u>504,453</u>
Missouri Gas Energy:			
Kansas City, Missouri Metropolitan Area	379,804	354,189	348,543
St. Joseph, Joplin, Monett and others	104,432	122,883	121,766
	<u>484,236</u>	<u>477,072</u>	<u>470,309</u>
PG Energy	154,399	--	--
Other (a)	<u>25,971</u>	<u>24,947</u>	<u>20,874</u>
Total	<u>1,186,096</u>	<u>1,011,385</u>	<u>995,636</u>

(a) Includes Mercado, South Florida Natural Gas, Atlantic Gas Corporation, SUPro Energy Services, PG Energy Services, Inc. and 43% (the Company's equity ownership) of the customers of a natural gas distribution company serving Piedras Negras, Mexico, in each case for the year-end in which the Company had such operations or investments.

ITEM 2. *Properties.*

See Item 1, *Business*, for information concerning the general location and characteristics of the important physical properties and assets of the Company:

Southern Union Gas has 9,651 miles of mains, 4,428 miles of service lines and 164 miles of transmission lines. STC and Norteño have 171 miles and 7 miles, respectively, of transmission lines. Missouri Gas Energy has 7,709 miles of mains, 5,004 miles of service lines and 47 miles of transmission lines. PG Energy has 2,449 miles of mains, 1,452 miles of service lines and 9 miles of transmission lines. SFNG has 140 miles of mains and 85 miles of service lines. The Company considers its systems to be in good condition and well-maintained, and it has continuing replacement programs based on historical performance and system surveillance.

Power Corp. owns a 25-megawatt cogeneration facility located in Lackawanna County, Pennsylvania which burns methane and natural gas. Power Corp. also owns a methane recovery facility at a nearby landfill which supplies methane gas burned at its cogeneration facility.

The information above does not include Fall River Gas, ProvEnergy or Valley Resources, the companies acquired subsequent to year-end. (See Item 1 *Business -- Acquisitions Subsequent to Year-End*.)

ITEM 3. *Legal Proceedings.*

See *Commitments and Contingencies* in the Notes to Consolidated Financial Statements for a discussion of the Company's legal proceedings. See MD&A -- *Cautionary Statement Regarding Forward-Looking Information*.

ITEM 4. *Submission of Matters to a Vote of Security Holders.*

There were no matters submitted to a vote of security holders of Southern Union during the quarter ended June 30, 2000.

PART II

ITEM 5. *Market for the Registrant's Common Stock and Related Stockholder Matters.*

Market Information

Southern Union's common stock is traded on the New York Stock Exchange under the symbol "SUG". The high and low sales prices (adjusted for any stock dividends and stock splits) for shares of Southern Union common stock since July 1, 1998 are set forth below:

	\$/Share	
	High	Low
July 1 to September 15, 2000	\$ 20.75	\$ 16.00
(Quarter Ended)		
June 30, 2000	17.27	14.41
March 31, 2000	18.16	12.63
December 31, 1999	20.00	16.61
September 30, 1999	20.66	17.14
(Quarter Ended)		
June 30, 1999	20.75	16.78
March 31, 1999	22.11	15.77
December 31, 1998	22.22	16.80
September 30, 1998	19.33	13.50

Holders

As of August 31, 2000, there were 7,888 holders of record of Southern Union's common stock. This number does not include persons whose shares are held of record by a bank, brokerage house or clearing agency, but does include any such bank, brokerage house or clearing agency that is a holder of record.

There were 49,589,799 shares of Southern Union's common stock outstanding on August 31 2000 of which 33,547,896 shares were held by non-affiliates (i.e., not beneficially held by directors, executive officers, their immediate family members, or holders of 10% or more of shares outstanding).

Dividends

Provisions in certain of Southern Union's long-term debt and its bank credit facilities limit the payment of cash or asset dividends on capital stock. Under the most restrictive provisions in effect, Southern Union may not declare or pay any cash or asset dividends on its common stock or acquire or retire any of Southern Union's common stock, unless no event of default exists and the Company meets certain financial ratio requirements, which presently are met.

Southern Union has a policy of reinvesting its earnings in its businesses, rather than paying cash dividends. Since 1994, Southern Union has distributed an annual stock dividend of 5%. There have been no cash dividends on its common stock during this period. On June 30, 2000, August 6, 1999, December 9, 1998 and December 10, 1997, the Company distributed its annual 5% common stock dividend to stockholders of record on June 19, 2000, July 23, 1999, November 23, 1998 and November 21, 1997, respectively. A portion of each of the 5% stock dividends distributed on June 30, 2000, August 6, 1999 and December 9, 1998 was characterized as a distribution of capital due to the level of the Company's retained earnings available for distribution as of the declaration date. On July 13, 1998, Southern Union effected a 3-for-2 stock split by distributing a 50% stock dividend to holders of record on June 30, 1998. The Massachusetts Department of Telecommunications and Energy order approving the Company's acquisitions of Fall River Gas and ProvEnergy's North Attleboro Gas requires that Southern Union cease distributing stock dividends because of a Massachusetts law prohibition. Rhode Island law may also restrict Southern Union's

ability to distribute stock dividends, or at least require prior regulatory approval. Southern Union intends to seek relief from or authority under Massachusetts and Rhode Island law, including, if appropriate, legislative action, in order to continue distributing its annual stock dividend. Although it hopes to resolve these issues successfully prior to next summer, there can be no assurance that Southern Union will be able to distribute any stock dividends in the future including its next anticipated annual 5% stock dividend in summer 2001.

ITEM 6. Selected Financial Data.

	As of and for the Year Ended June 30,				
	2000(a) (Restated)	1999(b)	1998(b)	1997	1996
(dollars in thousands, except per share amounts)					
Total operating revenues	\$ 831,704	\$ 605,231	\$ 669,304	\$ 717,031	\$ 620,391
Earnings from continuing operations (c)	9,845	10,445	12,229	19,032	20,839
Earnings per common and common share equivalents (d)	.22	.31	.37	.59	.65
Total assets	2,021,460	1,087,348	1,047,764	990,403	964,460
Common stockholders' equity	734,647	301,058	296,834	267,462	245,915
Short-term debt and capital lease obligation	2,193	2,066	1,777	687	615
Long-term debt and capital lease obligation, excluding current portion	733,774	390,931	406,407	386,157	385,394
Company-obligated mandatorily redeemable preferred securities of subsidiary trust	100,000	100,000	100,000	100,000	100,000
Average customers served	1,132,699	998,476	979,186	955,838	952,934

- (a) The Pennsylvania Operations were acquired on November 4, 1999 and were accounted for as a purchase. The Pennsylvania Operations' assets were included in the Company's consolidated balance sheet at June 30, 2000 and its results of operations have been included in the Company's consolidated results of operations since November 4, 1999. For these reasons, the consolidated results of operations of the Company for the periods subsequent to the acquisition are not comparable to the same periods in prior years.
- (b) On December 31, 1997, Southern Union acquired Atlantic for 755,650 pre-split and pre-stock dividend shares of common stock valued at \$18,041,000 and cash of \$4,436,000.
- (c) In March 2001, the Company discovered unauthorized financial derivative energy trading activity by a non-regulated, wholly-owned subsidiary. All such transactions were subsequently closed in April 2001, resulting in a cumulative cash expense of \$191,000, net of tax. As of June 30, 2000 the related contracts were marked to market resulting in non-cash losses of \$1,207,000, net of tax. As a result, the Company has restated fiscal year 2000 financial information. See Item 7 - Management's Discussion and Analysis of Results of Operations and Financial Condition. As of June 30, 1998, Missouri Gas Energy wrote off \$8,163,000 pre-tax in previously recorded regulatory assets as a result of announced rate orders and court rulings.
- (d) Earnings per share for all periods presented were computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year adjusted for (i) the 5% stock dividends distributed on June 30, 2000, August 6, 1999, December 9, 1998, December 10, 1997 and December 10, 1996, and (ii) the 50% stock dividend distributed on July 13, 1998, and the 33 1/3% stock dividend distributed on March 11, 1996.

ITEM 7. Management's Discussion and Analysis of Results of Operations and Financial Condition.

Overview. Southern Union Company's core business is the distribution of natural gas as a public utility through: Southern Union Gas; Missouri Gas Energy; Atlantic Utilities, doing business as South Florida Natural Gas (SFNG); PG Energy, acquired on November 4, 1999; and, effective with the acquisitions subsequent to year-end of Providence Energy Corporation, Valley Resources, Inc. and Fall River Gas Company, its New England Division. Southern Union Gas serves 523,000 customers in Texas (including Austin, Brownsville, El Paso, Galveston, Harlingen, McAllen and Port Arthur). Missouri Gas Energy serves 491,000 customers in central and western Missouri (including Kansas City, St. Joseph, Joplin and Monett). PG Energy serves 154,000 customers in northeastern and central Pennsylvania (including Wilkes-Barre, Scranton and Williamsport). SFNG serves 5,000 customers in portions of central Florida (including New Smyrna Beach, Edgewater and areas of Volusia County, Florida). The New England Division serves approximately 286,000 customers in Rhode Island and Massachusetts (including Providence, Newport and Cumberland, Rhode Island, and Fall River, North Attleboro and Somerset, Massachusetts).

On November 4, 1999, the Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the *Pennsylvania Operations*) for approximately 16.7 million pre-stock dividend shares of Southern Union common stock and approximately \$36 million in cash plus the assumption of approximately \$115 million in long-term debt. The acquisition was accounted for using the purchase method. Pennsylvania Operations' natural gas utility businesses are being operated as the PG Energy division of the Company. Through the acquisition of the Pennsylvania Operations, the Company acquired and now operates a subsidiary that markets a diversified range of energy-related products and services under the name of PG Energy PowerPlus, principally in northeastern and central Pennsylvania. Other subsidiaries that the Company acquired in the Pennsylvania Operations engage in non-regulated activities. The income from the acquired Pennsylvania Operations is consolidated with the Company beginning on November 4, 1999. Thus, the results of operations for the year ended June 30, 2000 are not comparable to prior periods.

See *Other Matters -- Acquisitions Subsequent to Year-End* for a discussion of acquisitions completed after June 30, 2000.

Results of Operations

Net Earnings Southern Union Company's 2000 (fiscal year ended June 30) net earnings were \$9,845,000 (\$.22 per common share, diluted for outstanding options and warrants -- hereafter referred to as *per share*), compared with \$10,445,000 (\$.31 per share) in 1999. The acquisition of the Pennsylvania Operations, net of interest expense on \$300,000,000 of 8.25% Senior Notes issued on November 3, 1999, contributed \$4,266,000 in net earnings. Throughout fiscal year 2000, the Company continued to experience extremely warm winter weather in all of its service territories. In addition, the Company expended costs associated with unsuccessful acquisition activities and related litigation. Also, during fiscal year 2000, the Company incurred non-cash losses of \$1,207,000, net of tax from unauthorized financial derivative energy trading activity. This was partially offset by an increase in the average number of customers served. Though weather in the Southern Union Gas service territories during 2000 was 4% warmer than 1999, gas sales volumes in the corresponding period remained constant due to an increase of 11,000 average number of customers served. In the Missouri service territories weather was 6% warmer during 2000 than 1999 and gas sales volumes in the corresponding period decreased 5%. An increase of 8,000 average number of customers served in Missouri partially offset the decrease in gas sales volumes in 2000. During fiscal years 2000 and 1999, the Company incurred pre-tax costs of \$10,363,000 and \$3,839,000, respectively, related to an unsuccessful acquisition effort and related litigation, impacting per share earnings by \$.13 and \$.07, respectively. Average common and common share equivalents outstanding increased 33% in 2000 due to the issuance of 16,713,735 pre-stock dividend shares of the Company's common stock on November 4, 1999 in connection with the acquisition of the Pennsylvania Operations. The Company earned 1.9% on average common equity in 2000.

The Company's 1999 net earnings were \$10,445,000 (\$.31 per share), compared with \$12,229,000 (\$.37 per share) in 1998. The decrease was primarily due to the extremely warm winter of 1998/1999, which was experienced in all of the Company's service territories. Weather in the Southern Union Gas service territories during 1999 was 25% warmer than 1998 while gas sales volumes in the corresponding period decreased 13%. Weather in the Missouri service territories during 1999 was 6% warmer than 1998 while gas sales volumes in the corresponding period decreased 10%. A \$13,300,000 annual rate increase to be earned volumetrically was granted by the Missouri Public Service Commission (MPSC) to Missouri Gas Energy effective as of September 2, 1998. As a result of the volumetric nature of revenues and unusual warm weather, 1999 net earnings were only marginally impacted by the

rate increase. The decrease in net earnings for 1999 is also attributed to \$3,839,000 of pre-tax costs associated with various acquisition efforts, impacting per share earnings by \$.07. Average common and common share equivalents outstanding increased 3.2% in 1999 due to the issuance of 755,650 pre-split and pre-stock dividend shares of the Company's common stock on December 31, 1997 in connection with the acquisition of Atlantic Utilities Corporation and Subsidiaries (Atlantic). The Company earned 3.5% and 4.3% on average common equity in 1999 and 1998, respectively.

Operating Revenues Operating revenues in 2000 increased \$226,473,000, or 37%, to \$831,704,000, while gas purchase and other energy costs increased \$155,397,000, or 45%, to \$497,698,000.

The increase in both operating revenues and gas purchase and other energy costs was primarily due to a 14% increase in gas sales volumes from 105,156 MMcf in 1999 to 119,778 MMcf in 2000 and by a 14% increase in the average cost of gas from \$3.23 per Mcf in 1999 to \$3.67 per Mcf in 2000. The acquisition of PG Energy contributed 19,913 MMcf of the increase while the remaining operations of the Company resulted in a gas sales volume decrease of 5,291 MMcf. The increase in the average cost of gas is due to increases in average spot market gas prices throughout the Company's distribution system as a result of seasonal impacts on demands for natural gas as well as the current competitive pricing occurring within the entire energy industry. Additionally impacting operating revenues in 2000 was a \$2,862,000 increase in gross receipt taxes primarily due to the acquisition of the Pennsylvania Operations. Gross receipt taxes are levied on sales revenues billed to the customers and remitted to the various taxing authorities. Operating revenues in 2000 compared with 1999 were also impacted by a \$2,900,000 decrease in revenues under a gas supply incentive plan approved by the MPSC in July, 1996. Under the plan, Southern Union and its Missouri customers shared in certain savings below benchmark levels of gas costs incurred as a result of the Company's gas procurement activities. Operating revenues were marginally impacted by the \$13,300,000 annual increase to revenues granted to Missouri Gas Energy, effective as of September 2, 1998, as this rate increase is primarily earned volumetrically and therefore was impacted by the warmer than normal weather in both 2000 and 1999.

Gas purchase costs generally do not directly affect earnings since these costs are passed on to customers pursuant to purchase gas adjustment (PGA) clauses. Accordingly, while changes in the cost of gas may cause the Company's operating revenues to fluctuate, net operating margin is generally not affected by increases or decreases in the cost of gas. Increases in gas purchase costs indirectly affect earnings as the customer's bill increases, usually resulting in increased bad debt and collection costs being recorded by the Company.

Gas transportation volumes in 2000 increased 21,323 MMcf to 77,015 MMcf at an average transportation rate per Mcf of \$.43 compared with \$.36 in 1999. PG Energy contributed 19,403 MMcf of the increase in 2000. Transportation volumes at Missouri Gas Energy in 2000 were relatively flat and increased from 23,918 MMcf to 25,969 MMcf in 2000 for Southern Union Gas and the Company's pipeline subsidiaries. This increase was primarily due to a 15% increase, or 990 MMcf, in the amount of volumes transported into Mexico by Norteño Pipeline Company (Norteño), a subsidiary of the Company.

Operating revenues in 1999 compared with 1998 decreased \$64,073,000, or 10%, to \$605,231,000, while gas purchase and other energy costs decreased \$63,279,000, or 16%, to \$342,301,000.

Operating revenues and gas purchase and other energy costs in 1999 were affected by both a reduction in gas sales volumes and decreases in the cost of gas. Gas sales volumes decreased 9% in 1999 to 105,156 MMcf due to the significantly warmer winter weather in the Missouri and Texas service territories. Gas sales volumes were also impacted by a reduction in average usage per customer throughout the Company's service territories as a result of more energy efficient housing and appliances. The average cost of gas decreased \$.26 to \$3.23 per Mcf in 1999 due to decreases in average spot market gas prices. The average spot market price of natural gas decreased 16% to \$1.88 per MMBtu in 1999. Additionally impacting operating revenues in 1999 was a \$2,852,000 decrease in gross receipt taxes due to the mild weather in 1999. Operating revenues in 1999 compared with 1998 were also impacted by a \$1,200,000 decrease in revenues under the previously discussed gas supply incentive plan. Operating revenues were favorably impacted by the \$13,300,000 annual increase to revenues granted to Missouri Gas Energy, effective as of September 2, 1998. However, as previously stated, the impact from this rate increase was marginal as it is earned volumetrically.

Gas transportation volumes in 1999 decreased 3,461 MMcf to 55,692 MMcf at an average transportation rate per Mcf of \$.36 compared with \$.33 in 1998. Transportation volumes increased from 30,165 MMcf to 31,774 MMcf in

1999 for Missouri Gas Energy and decreased from 28,988 MMcf to 23,918 MMcf in 1999 for Southern Union Gas and the Company's pipeline subsidiaries. This decrease was mainly caused by a 45% decrease, or 5,190 MMcf, in the amount of volumes transported into Mexico by Norteño.

In 2000, 1999 and 1998, the gas distribution operations in Texas contributed 25%, 29% and 32%, respectively, of the Company's consolidated operating revenues. In 2000, 1999 and 1998, the gas distribution operations in Missouri contributed 44%, 61% and 59%, respectively, of the Company's consolidated operating revenues. In 2000 the gas distribution operations in Pennsylvania contributed 17% of the Company's consolidated operating revenues. Four suppliers provided 55%, 50% and 45% of gas purchases in 2000, 1999 and 1998, respectively.

Net Operating Margin Net operating margin in 2000 (operating revenues less gas purchase and other energy costs and revenue-related taxes) increased by \$68,214,000, compared with an increase of \$2,058,000, in 1999. Operating margins and earnings are primarily dependent upon gas sales volumes, gas service rates, and in 2000, the timing of the acquisition of the Pennsylvania Operations. The level of gas sales volumes is sensitive to the variability of the weather. If normal weather had been present throughout the Company's service territories in 2000, 1999 and 1998, net operating margin would have increased by approximately \$21,214,000, \$20,334,000 and \$8,443,000, respectively. Texas and Missouri accounted for 32% and 42%, respectively, of the Company's net operating margin in 2000 and 40% and 55%, respectively, in 1999. Pennsylvania accounted for 23% of the Company's net operating margin in 2000.

Weather Weather in the Missouri Gas Energy service territories in 2000 was 80% of a 30-year measure, 6% warmer than in 1999. Weather in the Southern Union Gas service territories in 2000 was 71% of a 30-year measure, 4% warmer than in 1999. Weather in the PG Energy service territories was 92% of a 30-year measure for the eight months ended June 30, 2000. Weather in Missouri in 1999 was 85% of a 30-year measure, 6% warmer than in 1998, while weather in Texas in 1999 was 74% of a 30-year measure, 25% warmer than in 1998.

Customers The average number of customers served in 2000, 1999 and 1998 was 1,132,699, 998,476 and 979,186, respectively. These customer totals exclude Southern Union's 43% equity ownership in a natural gas distribution company in Piedras Negras, Mexico which currently serves 22,000 customers. Southern Union Gas served 518,195 customers in Texas during 2000. Missouri Gas Energy served 483,403 customers in central and western Missouri and PG Energy served 154,414 customers in northeastern and central Pennsylvania during the eight months ended June 30, 2000. SFNG and Atlantic Gas Corporation, a propane subsidiary of the Company, served 4,303 and 1,036 customers, respectively, during 2000. SUPro Energy Company (SUPro), a subsidiary of the Company, served 9,274 propane customers while PG Energy Services Inc. (Energy Services), a subsidiary of the Company, served 19,971 electric, propane and natural gas customers during the eight months ended June 30, 2000.

Operating Expenses Operating, maintenance and general expenses in 2000 increased \$26,894,000, or 25%, to \$136,587,000. An increase of \$23,804,000 was the result of the acquisition of the Pennsylvania Operations. Increased expenses associated with increased bad debt expense and inventory write-downs for SUPro, as well as increases in Company employee benefit costs also contributed to the increase in 2000.

Depreciation and amortization expense in 2000 increased \$13,285,000 to \$55,140,000. The increase was primarily due to the acquisition of the Pennsylvania Operations and normal growth in plant. Taxes other than on income and revenues, principally consisting of property, payroll and state franchise taxes increased \$2,768,000 to \$17,269,000 in 2000. The increase was also primarily the result of the acquisition of the Pennsylvania Operations.

Operating, maintenance and general expenses in 1999 increased \$2,166,000, or 2%, to \$109,693,000. The increase is a result of increased expenses associated with various claims and litigation and increases in employee benefit costs.

Depreciation and amortization expense in 1999 increased \$3,416,000 to \$41,855,000 as a result of including certain costs into rate base that were previously deferred as provided in the Missouri Gas Energy revenue increase effective as of September 2, 1998 and normal growth in plant. Taxes other than on income and revenues, principally consisting of property, payroll and state franchise taxes increased \$296,000 to \$14,501,000 in 1999. The increase was primarily due to increases in property taxes resulting from the inclusion of certain plant assets pursuant to the Missouri Gas Energy Safety Program that were previously deferred prior to the September 2, 1998 revenue increase in Missouri.

Employees The Company employed 2,285, 1,554, and 1,594 individuals as of June 30, 2000, 1999, and 1998, respectively. After gas purchases and taxes, employee costs and related benefits are the Company's most significant expense. Such expense includes salaries, payroll and related taxes and employee benefits such as health, savings, retirement and educational assistance. During fiscal 2000, the Company agreed to a one-year contract and a three-year contract with two bargaining units representing Pennsylvania employees, which were effective on April 1, 2000 and August 1, 2000, respectively. In December 1998, the Company agreed to five-year contracts with each of the bargaining units representing Missouri employees, which were effective in May 1999.

Interest Expense and Dividends on Preferred Securities Total interest expense in 2000 increased by \$15,493,000, or 43%, to \$51,492,000. Interest expense on long-term debt and capital leases increased by \$17,736,000 in 2000 primarily due to the issuance of \$300,000,000 of 8.25% Senior Notes on November 3, 1999, (8.25% Senior Notes) which was used to extinguish \$136,000,000 of existing debt of the Pennsylvania Operations at the time of the merger, and the assumption of \$45,000,000 of Pennsylvania Operations' debt by the Company.

Interest expense on short-term debt in 2000 decreased \$284,000 to \$1,266,000 primarily due to the decrease in the average short-term debt outstanding by \$6,472,000 to \$21,002,000. The average rate of interest on short-term debt increased from 5.6% in 1999 to 6% in 2000.

Total interest expense in 1999 increased by \$1,115,000, or 3%, to \$35,999,000. Interest expense on long-term debt and capital leases increased by \$752,000 in 1999 primarily due to an increase of \$14,984,000 in the average capital lease obligation outstanding associated with the installation of an Automated Meter Reading (AMR) system at Missouri Gas Energy. The installation of the AMR system was completed during the first quarter of fiscal year 1999.

Interest expense on short-term debt in 1999 decreased \$849,000 to \$1,550,000 due to the average short-term debt outstanding during 1999 decreasing \$11,631,000 to \$27,474,000. The average rate of interest on short-term debt also decreased from 6.1% in 1998 to 5.6% in 1999. Interest expense incurred on PGA liabilities increased \$850,000 during 1999 due to lower than anticipated gas supply costs.

Write-Off of Regulatory Assets During 1998, the Company was impacted by pre-tax non-cash write-offs totaling \$8,163,000 of previously recorded regulatory assets. Pursuant to a 1989 MPSC order, Missouri Gas Energy is engaged in a major gas safety program. In connection with this program, the MPSC issued an accounting authority order in 1994 which authorized Missouri Gas Energy to defer carrying costs at a rate of 10.54%. The MPSC rate order of January 22, 1997, however, retroactively reduced the 10.54% carrying cost rate used since early 1994 to an Allowance for Funds Used During Construction (AFUDC) rate of approximately 6%. The Company filed an appeal of this portion of the rate order in the Missouri State Court of Appeals, Western District, and on August 18, 1998 was notified that the appeal was denied. This resulted in a one-time non-cash write-off of \$5,942,000 by the Company of previously deferred costs in its fiscal year ended June 30, 1998. See *Commitments and Contingencies* in the Notes to Consolidated Financial Statements.

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a \$13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs associated with the rate filing, requiring a non-cash write-off of \$2,221,000. Though the Company has requested a rehearing on significant portions of these disallowances, the Company recorded this charge to earnings in its fiscal year ended June 30, 1998.

Trading Losses In March 2001, the Company discovered unauthorized financial derivative energy trading activity by a non-regulated, wholly-owned subsidiary. During March 2001 and April 2001, all unauthorized trading activity was closed resulting in a cumulative cash expense of \$191,000, net of tax. However, due to certain accounting rules, such trading contracts must be recorded at fair value as of each balance sheet date with gains and losses included in earnings. As a result, a restatement of financial information for the fiscal year ended June 30, 2000 and the two subsequent quarters was required. This restatement resulted in non-cash losses of \$1,207,000, net of tax, for the fiscal year ended June 30, 2000; \$1,726,000, net of tax, for the three-month period ended September 30, 2000; and \$3,158,000, net of tax, for the three-month period ended December 31, 2000.

The Audit Committee of the Board of Directors promptly initiated an investigation through the Company's Legal Department with the assistance of outside counsel and independent accountants of the financial derivative trading

activities. The Company believes that the investigation has identified all unauthorized trading transactions by the subsidiary. Certain personnel changes have occurred at the subsidiary. Outside counsel and independent accountants have been engaged to review the relevant policies and procedures for possible enhancements.

Other Income (Expense), Net Other expense, net, in 2000 was \$9,708,000, compared to \$1,814,000 in 1999. Other expense in 2000 included \$10,363,000 of costs associated with unsuccessful acquisition efforts and related litigation and \$2,236,000 of non-cash trading losses, previously discussed. This was partially offset by net rental income of Lavaca Realty Company (Lavaca Realty) of \$1,757,000.

Other expense in 1999 included \$3,839,000 of costs associated with various acquisition efforts and a net expense of \$619,000 related to the amortization and current deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program. This was partially offset by net rental income of Lavaca Realty of \$1,448,000 and equity earnings of \$609,000 from Southern Union's 43% equity ownership of a natural gas distribution company in Piedras Negras, Mexico.

Other income in 1998 included \$1,671,000 in deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program; realized gains on the sale of investment securities of \$1,088,000; and net rental income of Lavaca Realty of \$1,119,000. This was partially offset by \$885,000 of costs associated with various acquisition efforts.

Federal and State Income Taxes Federal and state income tax expense in 2000, 1999, and 1998 was \$9,589,000, \$7,109,000 and \$7,984,000, respectively. The Company's consolidated federal and state effective income tax rate was 49%, 40% and 39% in 2000, 1999 and 1998, respectively. The increase in the effective federal and state income tax rate is a result of non-tax deductible amortization of additional purchase cost.

Liquidity and Capital Resources

Operating Activities The seasonal nature of Southern Union's business results in a high level of cash flow needs to finance gas purchases and other energy costs, outstanding customer accounts receivable and certain tax payments. To provide these funds, as well as funds for its continuing construction and maintenance programs, the Company has historically used its credit facilities along with internally-generated funds. Because of available short-term credit and the ability to obtain various market financing, management believes it has adequate financial flexibility to meet its cash needs.

The Company has increased the scale of its operations and the size of its customer base by pursuing and consummating business combination transactions. On November 4, 1999, the Company acquired the Pennsylvania Operations and, subsequent to year-end, the Company acquired Valley Resources, Inc. (Valley Resources), Fall River Gas Company (Fall River Gas) and Providence Energy Corporation (ProvEnergy). See *Other Matters -- Acquisitions Subsequent to Year-End*. Acquisitions require substantial financial expenditures which may need to be financed through cash flow from operations or future debt and equity offerings. The availability and terms of any such financing sources will depend upon various factors and conditions such as the Company's combined cash flow and earnings; the Company's resulting capital structure, and conditions in financial markets at the time of such offerings. Acquisitions and financings also affect the Company's combined results due to factors such as the Company's ability to realize any anticipated benefits from the acquisitions, successful integration of new and different operations and businesses, and effects of different regional economic and weather conditions. Future acquisitions or merger-related refinancing may involve the issuance of shares of the Company's common stock, which could have a dilutive effect on the then-current stockholders of the Company. See *Other Matters -- Cautionary Statement Regarding Forward-Looking Information*.

Cash flow from operating activities in 2000 decreased by \$6,331,000 to \$70,522,000, and increased by \$8,596,000 to \$76,853,000 in 1999. Operating activities were impacted by the timing of acquisitions, the non-cash write-off of previously recorded regulatory assets in 1998 discussed above, the timing of natural gas stored in inventory at Missouri Gas Energy and PG Energy and general changes in other operating accounts.

At June 30, 2000, 1999 and 1998, the Company's primary source of liquidity included borrowings available under the Company's credit facilities. A balance of nil and \$21,000,000 was outstanding under the credit facilities at

June 30, 2000 and 1999, respectively. In May 2000, the Company amended and restated these credit facilities. As of August 31, 2000 there was a balance of \$26,320,000 outstanding under these credit facilities.

Investing Activities Cash flow used in investing activities in 2000 increased by \$73,314,000 to \$154,523,000, and increased by \$15,575,000 to \$81,209,000 in 1999. Investing activity cash flow was primarily affected by additions to property, plant and equipment, acquisition and sales of operations and sales and purchases of investment securities.

During 2000, 1999 and 1998, the Company expended \$100,446,000, \$73,147,000 and \$77,018,000, respectively, for capital expenditures excluding acquisitions. These expenditures primarily related to distribution system replacement and expansion. Included in these capital expenditures were \$14,286,000, \$17,951,000 and \$21,125,000 for the Missouri Gas Energy Safety Program in 2000, 1999 and 1998, respectively. Cash flow from operations has historically been utilized to finance capital expenditures and is expected to be the primary source for future capital expenditures.

On November 4, 1999, Southern Union acquired the Pennsylvania Operations for 16,713,735 pre-stock dividend shares of common stock and \$36,152,000 in cash. On the date of acquisition, Pennsylvania Operations had \$576,000 in cash and cash equivalents. In January 2000, a former subsidiary of the Pennsylvania Operations was sold for \$12,150,000. No gain or loss was recognized on this transaction. On December 31, 1997, Southern Union acquired Atlantic for 755,650 pre-split and pre-stock dividend shares of common stock and \$4,436,000 of cash. On the date of acquisition, Atlantic had \$11,683,000 of cash and cash equivalents.

During 2000, the Company purchased investment securities of \$21,001,000. In late June 2000, Capstone Turbine Corporation (Capstone) completed its initial public offering (IPO). As of June 30, 2000 and August 31, 2000, the value of the Company's investment in Capstone was \$187,817,000 and \$384,753,000, respectively. The Company has classified this investment as current, as it plans to monetize its investment as soon as practicable following the completion of the applicable lock-up periods to which it was subject in connection with the IPO and use the proceeds to reduce outstanding debt. During 1999, the Company purchased investment securities of \$7,000,000. During 1998, the Company purchased investment securities of \$5,000,000 and had proceeds from the sale of investment securities of \$6,531,000.

The Company completed the installation of an AMR system at Missouri Gas Energy during the first quarter of fiscal year 1999. The installation of the AMR system involved an investment of approximately \$30,000,000 which is accounted for as a capital lease obligation. As of June 30, 2000, the capital lease obligation outstanding was \$25,104,000.

Financing Activities Cash flow from financing activities was \$111,830,000 in 2000. Cash flow from financing activities was \$4,356,000 in 1999, while a cash flow used in financing activities was \$2,623,000 in 1998. Financing activity cash flow changes were primarily due to acquisition financing, repayment of debt, net activity under the revolving credit facilities, purchase of treasury stock and changes in cash overdrafts. As a result of these financing transactions, the Company's total debt to total capital ratio at June 30, 2000 was 46.8%, compared with 49.0% and 50.6% at June 30, 1999 and 1998, respectively. The Company's effective debt cost rate under the current debt structure is 8.03% (which includes interest and the amortization of debt issuance costs and redemption premiums on refinanced debt).

In connection with the acquisition of the Pennsylvania Operations, the Company issued \$300,000,000 of 8.25% Senior Notes due 2029 which were used to: (i) fund the cash portion of the consideration to be paid to the Pennsylvania Operations shareholders; (ii) refinance and repay certain debt of Pennsylvania Operations, and (iii) repay outstanding borrowings under the Company's various credit facilities. These senior notes are senior unsecured obligations and will rank equally in right of payment with each other and with the Company's other unsecured and unsubordinated obligations, including the 7.60% Senior Notes due 2024. In connection with the acquisition of the Pennsylvania Operations, the Company assumed \$30,000,000 of 8.375% Series First Mortgage Bonds due in December 2002 and \$15,000,000 of 9.34% Series First Mortgage Bonds due in 2019.

On August 28, 2000 the Company entered into a short-term bank note (the *Term Note*) to fund (i) the cash portion of the consideration to be paid to the Fall River Gas' stockholders, (ii) the all cash consideration to be paid to the ProvEnergy and Valley Resources stockholders, and (iii) all related acquisition costs and refinancing of debt done

in connection with these mergers. In September 2000, draws totaling \$480,000,000 were made under this Term Note. Remaining commitments under the Term Note are \$95,000,000 as of September 28, 2000 to cover any trailing costs. The Term Note expires August 21, 2001 but may be extended at the Company's option through August 26, 2002 for a 12.5 basis point fee. The interest rate on borrowings under the Term Note is a floating rate based on LIBOR or prime interest rates. See *Quantitative and Qualitative Disclosures About Market Risk*. In connection with the acquisitions subsequent to year-end, the Company will assume all these companies' long-term debt outstanding except for approximately \$20,000,000 outstanding of Valley Resources' 8% First Mortgage Bonds.

In fiscal year 2001, the Company may choose or need to refinance some portion or all of the short-term bank note. Sources of future or alternative financing that the Company may consider include commercial and investment banks, institutional lenders, institutional investors and public securities markets. The availability and terms of any such financing sources will depend upon various factors and conditions such as the Company's combined cash flow and earnings, the Company's resulting capital structure, and conditions in financial markets at the time of such offerings. Acquisitions and financings will also affect the Company's combined results due to factors such as the Company's ability to realize any anticipated benefits from the mergers and any other acquisitions, successful integration of new and different operations and businesses, and effects of different regional economic and weather conditions. See *Other Matters -- Cautionary Statement Regarding Forward-Looking Information*.

Southern Union Financing I, a consolidated wholly-owned subsidiary of Southern Union, issued \$100,000,000 of Preferred Securities in May 1995. The issuance of the Preferred Securities was part of a \$300,000,000 shelf registration filed with the Securities and Exchange Commission on March 29, 1995. Southern Union may sell a combination of preferred securities of financing trusts and senior and subordinated debt securities of Southern Union of up to \$196,907,200 (the remaining shelf) from time to time, at prices determined at the time of any offering.

In June 1999, the Company repurchased \$20,000,000 of Senior Notes. Depending upon market conditions and available cash balances, the Company may repurchase additional debt securities in the future. See *Preferred Securities of Subsidiary Trust and Debt and Capital Lease* in the Notes to the Consolidated Financial Statements.

On May 31, 2000, the Company restated and amended its short-term and long-term credit facilities (together referred to as *Revolving Credit Facilities*). The Company has available \$90,000,000 under the short-term facility, which expires May 30, 2001, and \$135,000,000 under the long-term facility, which expires on May 31, 2003. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Revolving Credit Facility is subject to a commitment fee based on the rating of the Senior Notes. As of June 30, 2000, the commitment fee was an annualized 0.14%.

The Company had standby letters of credit outstanding of \$6,199,000 at June 30, 2000 and \$1,622,000 at June 30, 1999, which guarantee payment of various insurance premiums and state taxes.

Quantitative and Qualitative Disclosures About Market Risk

The Company has long-term debt, Preferred Securities and Revolving Credit Facilities, which subject the Company to the risk of loss associated with movements in market interest rates.

At June 30, 2000, the Company had issued fixed-rate long-term debt, capital lease and Preferred Securities aggregating \$835,967,000 in principal amount and having a fair value of \$800,934,000. These instruments are fixed-rate and, therefore, do not expose the Company to the risk of earnings loss due to changes in market interest rates. However, the fair value of these instruments would increase by approximately \$42,660,000 if interest and dividend rates were to decline by 10% from their levels at June 30, 2000. In general, such an increase in fair value would impact earnings and cash flows only if the Company were to reacquire all or a portion of these instruments in the open market prior to their maturity.

The Company presently has no balance outstanding under its Revolving Credit Facilities. The floating-rate obligations under the Revolving Credit Facilities expose the Company to the risk of increased interest expense in the event of increases in short-term interest rates. In connection with the acquisitions subsequent to year-end, the Company entered into the Term Note, as discussed above. At September 28, 2000, the Term Note has a balance outstanding of approximately \$480,000,000. The floating rate obligations under the Term Note expose the Company to risk of

increased interest expense in the event of increases in short-term interest rates. If the floating rates were to increase by 10% from September 28, 2000 levels, the Company's consolidated interest expense would increase by a total of approximately \$300,000 each month in which such increase continued.

The risk of an economic loss is mitigated at this time as a result of the Company's regulated status. Any unrealized gains or losses are accounted for in accordance with the Financial Accounting Standards Board *Accounting for the Effects of Certain Types of Regulation* as a regulatory asset/liability because the Company believes that its future contributions which are currently recovered through the rate-making process will be adjusted for these gains and losses.

The change in exposure to loss in earnings and cash flow related to interest rate risk from June 30, 1999 to June 30, 2000 is not material to the Company.

See *Preferred Securities of Subsidiary Trust and Debt and Capital Lease* in the Notes to the Consolidated Financial Statements.

The Company owns approximately 4.2 million shares of Capstone common stock. This investment is classified as "available for sale" under the Financial Accounting Standards Board *Accounting for Certain Investments in Debt and Equity Securities*. Unrealized gains and losses resulting from changes in the market value of Capstone are recorded in Other Comprehensive Income. The Capstone investment exposes the Company to losses in the fair value of Capstone common stock. A 10% decline in the market value per share of Capstone common stock from the June 30, 2000 levels would result in an \$18,800,000 loss in value to the Company.

Due to the operation of purchase gas adjustment clauses, gas purchase costs generally do not directly affect earnings of our regulated utility operations. However, the Company's unregulated gas marketing operations are subject to price risk related to fixed-price sales commitments that are not matched with corresponding fixed-price purchase agreements. At June 30, 2000, the Company had fixed-price sales commitments with various customers that provide for the delivery of approximately 1,922,201 Dekatherms of natural gas through April 2001 at an average sales price per Dekatherm of \$3.00. The Company has exposure to the changes in gas prices related to fluctuating commodity prices, which can impact the Company's financial position or results of operations, either favorably or unfavorably. The Company's open positions are actively managed, and the impact of changing prices on the Company's financial position at a point in time is not necessarily indicative of the impact of price movements throughout the year.

As a result of the unauthorized financial derivative energy trading activity, an open contract of a non-regulated, wholly-owned subsidiary was present at June 30, 2000 for 10,000 MMBtu's of natural gas per day for the contract period of January 2001 to December 2001 at a fixed price of \$2.72 per MMBtu. During the contract period, such subsidiary would receive funds if the respective monthly price of natural gas falls below \$2.72 and will be required to pay for any amount over \$2.72 per MMBtu. The Company has exposure to the changes in gas prices related to fluctuating commodity prices, which can impact the Company's financial position or results of operations, either favorably or unfavorably. A 10% increase in natural gas commodity prices from June 30, 2000 levels would result in a \$1,300,000 loss to the Company.

In connection with the acquisition of the Pennsylvania Operations, the Company assumed a guaranty with a bank whereby the Company unconditionally guaranteed payment of financing obtained for the development of PEI Power Park. In March 1999, the Borough of Archbald, the County of Lackawanna, and the Valley View School District (together the *Taxing Authorities*) approved a Tax Incremental Financing Plan (TIF Plan) for the development of PEI Power Park. The TIF Plan requires that: (i) the Redevelopment Authority of Lackawanna County raise \$10,600,000 of funds to be used for infrastructure improvements of the PEI Power Park; (ii) the Taxing Authorities create a tax increment district and use the incremental tax revenues generated from new development to service the \$10,600,000 debt; and (iii) PEI Power Corporation, a subsidiary of the Company, guarantee the debt service payments. In May 1999, the Redevelopment Authority of Lackawanna County borrowed \$10,600,000 from a bank under a promissory note (TIF Debt). The TIF Debt has a 12-year term, with a 7.75% annual interest rate, and requires semi-annual principal and interest payments of approximately \$725,000 (interest only for the first year). As of June 30, 2000, incremental tax revenues cover approximately 17% of the annual debt service. The balance outstanding on the TIF Debt was \$9,805,000 as of June 30, 2000.

Other Matters

Acquisitions Subsequent to Year-End On September 20, 2000, Southern Union completed the acquisition of Valley Resources for approximately \$125 million in cash plus the assumption of \$30 million in long-term debt. Valley Resources is engaged in natural gas distribution operating as Valley Gas Company and Bristol and Warren Gas Company which are now included as part of the New England Division of Southern Union. The non-utility subsidiaries of Valley Resources are now subsidiaries of Southern Union. Valley Resources, which is headquartered in Cumberland, Rhode Island, provides natural gas utility service to more than 64,000 customers within a 92 square mile area in the northeastern portion of Rhode Island that has a population of approximately 250,000 and an approximately 15 square mile area in the eastern portion of Rhode Island that has a population of approximately 35,000. The non-utility subsidiaries rent and sell appliances, offer a service contract program, sell liquid propane in Rhode Island and nearby Massachusetts, and distribute as a wholesaler franchised lines to plumbing and heating contractors. Included in the acquisition was Valley Resources' 90% interest in Alternate Energy Corporation, which sells, installs and designs natural gas conversion systems and facilities, is an authorized representative of the ONSI Corporation fuel cell, holds patents for a natural gas/diesel co-firing system and for a device to control the flow of fuel on dual-fuel equipment.

On September 28, 2000, Southern Union completed the acquisition of ProvEnergy for approximately \$270 million in cash plus the assumption of \$90 million in long-term debt. The ProvEnergy natural gas distribution operations are Providence Gas and North Attleboro Gas. Providence Gas serves approximately 168,000 natural gas customers in Providence and Newport, Rhode Island, and 23 other cities and towns in Rhode Island and Massachusetts. North Attleboro Gas serves approximately 6,000 customers in North Attleboro and Plainville, Massachusetts, towns adjacent to the northeastern Rhode Island border. The ProvEnergy utility service territories encompass approximately 760 square miles with a population of approximately 850,000. These operations are also now included as part of the New England Division of the Company. Subsidiaries of the Company acquired in the ProvEnergy merger are ProvEnergy Oil Enterprises, Inc., Providence Energy Services, Inc., and ProvEnergy Power Company, LLC. ProvEnergy Oil Enterprises, Inc. operates a fuel oil distribution business through its subsidiary, ProvEnergy Fuels, Inc. (ProvEnergy Fuels). ProvEnergy Fuels serves over 14,000 residential and commercial customers in Rhode Island and Massachusetts. Providence Energy Services, Inc., whose operations are planned to be sold, markets natural gas and energy services throughout New England. ProvEnergy Power Company owns 50% of Capital Center Energy Company, LLC, a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power.

Also on September 28, 2000, Southern Union completed the acquisition of Fall River Gas for approximately 1.5 million shares of Southern Union common stock and approximately \$27 million in cash plus assumption of \$20 million in long-term debt. Also now included as a part of the New England Division of the Company, Fall River Gas serves approximately 48,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in southeastern Massachusetts. Fall River Gas' non-regulated subsidiary, Fall River Gas Appliance Company, Inc., is now a subsidiary of Southern Union. Headquartered in Fall River, Massachusetts, Fall River Gas Appliance Company, Inc. rents water heaters and conversion burners (primarily for residential use) in Fall River Gas' service area.

The aforementioned acquisitions subsequent to year-end will be accounted for under the purchase method.

Foreign Operations On July 23, 1997, Energía Estrella del Sur, S. A. de C. V., a wholly-owned subsidiary of Southern Union International, Inc. and Southern Union International Investments, Inc., both subsidiaries of the Company, acquired an equity ownership in a natural gas distribution company and other operations which currently serves 22,000 customers in Piedras Negras, Mexico, which is across the border from the Company's Eagle Pass, Texas service area. Southern Union currently has a 43% equity ownership in this company. Financial results of foreign operations did not have a significant impact on the Company's financial results during 2000, 1999 and 1998.

Stock Splits and Dividends On June 30, 2000, August 6, 1999 and December 9, 1998, Southern Union distributed a 5% common stock dividend to stockholders of record on June 19, 2000, July 23, 1999 and November 23, 1998. A portion of each of these 5% stock dividends was characterized as a distribution of capital due to the level of the Company's retained earnings available for distribution as of the declaration date. Additionally, Southern Union distributed an annual 5% common stock dividend on December 10, 1997. On July 13, 1998, a three-for-two stock split was distributed in the form of a 50% stock dividend. Unless otherwise stated, all per share data included herein

and in the accompanying Consolidated Financial Statements and Notes thereto have been restated to give effect to the stock split and stock dividends.

Contingencies The Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in its former service territories, principally in Arizona and New Mexico, and present service territories in Texas, Missouri and its newly acquired service territories in Pennsylvania. While the Company's evaluation of these Texas, Missouri, Arizona, New Mexico and Pennsylvania MGP sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. Certain MGP sites located within the Company's service territories are currently the subjects of governmental actions.

On February 1, 1999, Southern Union submitted a proposal to the Board of Directors of Southwest Gas Corporation (Southwest) to acquire all of Southwest's outstanding common stock for \$32.00 per share. Southwest then had a pending merger agreement with ONEOK, Inc. (ONEOK) at \$28.50 per share. On February 22, 1999, Southern Union and Southwest both publicly announced Southern Union's proposal, after the Southwest Board of Directors determined that Southern Union's proposal was a Superior Proposal (as defined in the Southwest merger agreement with ONEOK). At that time Southern Union entered into a Confidentiality and Standstill Agreement with Southwest at Southwest's insistence. (This agreement expired on its own terms in August 2000.) On April 25, 1999, Southwest's Board of Directors rejected Southern Union's \$32.00 per share offer and accepted an amended offer of \$30.00 per share from ONEOK. On April 27, 1999, Southern Union increased its offer to \$33.50 per share and agreed to pay interest which, together with dividends, would provide Southwest shareholders with a 6% annual rate of return on its \$33.50 offer, commencing February 15, 2000; until closing. According to public statements by Southwest, Southern Union's revised proposal was also rejected by Southwest's Board of Directors. On January 21, 2000, ONEOK terminated its agreement to merge with Southwest.

There are several lawsuits pending that relate to activities surrounding Southern Union's efforts to acquire Southwest. In addition, there is before the U. S. Court of Appeals for the Tenth Circuit, an appeal by Southern Union of a preliminary injunction entered by the U. S. District Court for the Northern District of Oklahoma. Southern Union intends to pursue vigorously its claims against Southwest, ONEOK, and certain individual defendants, and defend itself vigorously against the claims by Southwest and ONEOK. See *Commitments and Contingencies* in the Notes to Consolidated Financial Statements for a discussion of these lawsuits.

In August 1998, a jury in Edinburg, Texas concluded deliberations on the City of Edinburg's franchise fee lawsuit against PG&E Gas Transmission, Texas Corporation (formerly Valero Energy Corporation (Valero)) and a number of its subsidiaries, as well as former Valero subsidiary Rio Grande Valley Gas Company (RGV) and RGV's successor company, Southern Union Company. The case, based upon events that occurred between 1985-1987, centers on specific contractual language in the 1985 franchise agreement between RGV and the City of Edinburg. Southern Union purchased RGV from Valero in October 1993. The jury awarded the plaintiff damages, against all defendants under several largely overlapping but mutually exclusive claims, totaling approximately \$13,000,000. The trial judge subsequently reduced the award to approximately \$700,000 against Southern Union and \$7,800,000 against Valero and Southern Union together. The Company is pursuing reversal on appeal. The Company believes it will ultimately prevail, and that the outcome of this matter will not have a material adverse impact on the Company's results of operations, financial position or cash flows. Furthermore, the Company has not determined what impact, if any, this jury decision may have on other city franchises in Texas.

Southern Union and its subsidiaries are parties to other legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject, and not to be material to the Company's overall business or financial condition, results of operations or cash flows.

See *Commitments and Contingencies* in the Notes to Consolidated Financial Statements.

Inflation The Company believes that inflation has caused and will continue to cause increases in certain operating expenses and has required and will continue to require assets to be replaced at higher costs. The Company continually reviews the adequacy of its gas service rates in relation to the increasing cost of providing service and the inherent regulatory lag in adjusting those rates.

Regulatory The majority of the Company's business activities are subject to various regulatory authorities. The Company's financial condition and results of operations have been and will continue to be dependent upon the receipt of adequate and timely adjustments in rates. Gas service rates, which consist of a monthly fixed charge and a gas usage charge, are established by regulatory authorities and are intended to permit utilities the opportunity to recover operating, administrative and financing costs and to have the opportunity to earn a reasonable return on equity. The monthly fixed charge provides a base revenue stream while the usage charge increases the Company's revenues and earnings in colder weather when natural gas usage increases.

On April 3, 2000, PG Energy filed an application with the Pennsylvania Public Utility Commission (PPUC) seeking an increase in its base rates designed to produce \$17,900,000 in additional annual revenues, to be effective June 2, 2000. On May 11, 2000, the PPUC suspended this rate increase request for seven months, until January 2, 2001, in order to investigate the reasonableness of the proposed rates. On August 30, 2000, PG Energy and the principal parties to the base rate proceeding informed the Administrative Law Judge (ALJ) assigned to the proceeding that a complete settlement of the proceeding had been reached. The proposed settlement is designed to produce \$10,800,000 of additional annual revenue. The parties are currently in the process of finalizing a Settlement Agreement and Joint Petition for Settlement of Rate Investigation (the *Settlement Petition*) which will be filed with the ALJ upon its completion. The Settlement Petition will request PPUC approval for the rate increase to become effective on January 1, 2001. It is not presently possible to determine what action either the ALJ or the PPUC will ultimately take with respect to this rate increase request or the Settlement Petition.

On October 18, 1999, Southern Union Gas filed a \$1,696,000 rate increase request for the El Paso service area with the City of El Paso. In February 2000, the City of El Paso approved a \$650,000 revenue increase, and an improved rate design that collects a greater portion of the Company's revenue stream from the monthly customer charge. Additionally, the City of El Paso approved a new 30-year franchise for Southern Union Gas.

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a \$13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of \$2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. On June 15, 2000, the MPSC ruled that it would not rehear or reconsider its decision on one issue valued at \$1,500,000. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional \$700,000 of base revenues increasing the \$13,300,000 initially authorized in its August 21, 1998 order to \$14,000,000. The MPSC is expected to rule on this rehearing in October 2000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

On April 13, 1998, Southern Union Gas filed a \$2,228,000 request for a rate increase from the city of El Paso, a request the city subsequently denied. On April 21, 1998, the city council of El Paso voted to reduce the Company's rates by \$1,570,000 annually and to order a one-time cost of gas refund of \$475,000. On May 21, 1998, Southern Union Gas filed with the RRC an appeal of the city of El Paso's actions to reduce the Company's rates and require a one-time cost of gas refund. On December 21, 1998, the RRC issued its order implementing an \$884,000 one-time cost of gas refund and a \$99,000 base rate reduction. The cost of gas refund was completed in February 1999.

Pursuant to a 1989 MPSC order, Missouri Gas Energy is engaged in a major gas safety program in its service territories. This program includes replacement of company- and customer-owned gas service and yard lines, the movement and resetting of meters, the replacement of cast iron mains and the replacement and cathodic protection of bare steel mains. In recognition of the significant capital expenditures associated with this safety program, the MPSC permits the deferral, and subsequent recovery through rates, of depreciation expense, property taxes and associated carrying costs. The continuation of the Missouri Gas Energy Safety Program will result in significant levels of future capital expenditures. The Company estimates incurring capital expenditures of \$15,631,000 in fiscal 2001 related to this program which are expected to be financed through cash flow from operations. See *Utility Regulation and Rates and Commitments and Contingencies* in the Notes to Consolidated Financial Statements.

In August 1997, the MPSC issued an order authorizing Missouri Gas Energy to begin making semi-annual purchase gas adjustments (PGA) in November and April, instead of more frequent adjustments as previously made.

Additionally, the order authorized Missouri Gas Energy to establish an Experimental Price Stabilization Fund for purposes of procuring natural gas financial instruments to hedge a minimal portion of its gas purchase costs for the winter heating season. The cost of purchasing these financial instruments and any gains derived from such activities are passed on to the Missouri customers through the PGA. Accordingly, there is no earnings impact as a result of the use of these financial instruments. These procedures help stabilize the monthly heating bills for Missouri customers. The Company believes it bears minimal risk under the authorized transactions.

The MPSC approved a three year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers shared in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas was acquired above benchmark levels, both the Company and customers shared in such costs. For the years ended June 30, 1999 and 1998, the incentive plan achieved a reduction of overall gas costs of \$6,900,000 and \$9,200,000, respectively, resulting in savings to Missouri customers of \$4,000,000 and \$5,100,000, respectively. The Company recorded revenues of \$2,900,000 and \$4,100,000 in 1999 and 1998, respectively, under this plan. Missouri Gas Energy received authorization from the MPSC for a new gas supply incentive plan that became effective August 31, 2000. Earnings under the plan are primarily dependent on market prices for natural gas declining to certain preauthorized levels which are now below current market prices. There is no assurance that the Company will have an opportunity to generate earnings under this aspect of the plan during fiscal 2001.

The Company is continuing to pursue certain changes to rates and rate structures that are intended to reduce the sensitivity of earnings to weather including weather normalization clauses and higher monthly fixed service charges. Southern Union Gas has weather normalization clauses in the City of Austin, El Paso environs, Port Arthur, Galveston and in two other service areas in Texas. These clauses allow for the adjustments that help stabilize customers' monthly bills and the Company's earnings from the varying effects of weather.

Year 2000 The Company did not experience any significant malfunctions or errors in its operating or business systems when the date changed from 1999 to 2000. Based on operations since January 1, 2000, the Company does not expect any significant impact to its ongoing business as a result of the Year 2000 problem. The Year 2000 problem is the inability of computer application software programs to distinguish between the year 1900 and 2000 due to a commonly-used programming convention. Unless such programs were modified or replaced prior to 2000, calculations and interpretations based on date-based arithmetic or logical operations performed by such programs may have been incorrect.

It is possible that the full impact of the date change has not been fully recognized. The Company believes that any such problems are not likely. In addition, the Company could still be negatively affected if its customers or suppliers are adversely affected by the Year 2000 or similar issues. The Company currently is not aware of any significant Year 2000 or similar problems that have arisen for its customers and suppliers.

The Company incurred costs of approximately \$2,922,000 to complete this project. The Company also expects to spend approximately \$1,500,000 in equipment leasing expenses that will be incurred over the life of the equipment that were incurred in order to be Year 2000 compliant.

Accounting Pronouncements In June 1998, the Financial Accounting Standards Board (FASB) issued *Accounting for Derivative Instruments and Hedging Activities*. The Statement, as amended, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000; the Company as required will adopt the Statement on July 1, 2000. The Statement requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. During the Company's implementation procedures, the Company identified a fair value hedge, cash flow hedges and gas purchase contracts that are considered derivatives under the Statement. Based on the Company's risk exposure, the Company does not anticipate a material effect on its financial position, results of operations or cash flows resulting from counterparty non-performance.

The Company entered into an interest rate swap to reduce exposure to changes in fair value of fixed interest payments related to a lease commitment. For fair-value hedge transactions in which the Company is hedging changes in an asset's, liability's or firm commitment's fair value, changes in the fair value of the derivative instrument

will generally be offset in the income statement by changes in the hedged item's fair value. The Company estimates that the transition adjustment related to the fair value hedge will be immaterial to the financial statements.

The Company is party to two interest rate swaps designed to hedge exposure to variability in cash flows from interest rate changes on variable rate debt. For cash flow hedges related to a variable-rate asset, liability or a forecasted transaction, changes in the fair value attributed to the effective portion of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings. The Company estimates that it will record a net-of-tax cumulative-effect-type adjustment of \$960,000 gain in accumulated other comprehensive income to recognize at fair value all derivative instruments that will be designated as cash flow hedging instruments.

The Company's assessment also identified two gas purchase contracts at its recently acquired PG Energy Division that have been determined to be derivatives that do not qualify for hedge accounting treatment under the Statement. The Company estimates that it will record a net-of-tax cumulative effect-type adjustment of \$700,000 gain in earnings to recognize the fair value of the derivative instruments that do not qualify for hedge accounting treatment under the Statement. These derivatives will be reflected at quoted or estimated market value with resulting gains and losses included in operating income in the Consolidated Statement of Income.

Energy trading contracts entered into for speculative purposes are recorded at fair value as of each balance sheet date with gains and losses included in earnings.

In December 1999, the Securities Exchange Commission staff issued a Staff Accounting Bulletin, *Revenue Recognition*, which provides guidance on the recognition and disclosure of revenues. Implementation of this Staff Accounting Bulletin is required by the fourth quarter of 2001 and will have no effect on the Company's Consolidated Financial Statements.

See the Notes to Consolidated Financial Statements for other accounting pronouncements followed by the Company.

Cautionary Statement Regarding Forward-Looking Information This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Annual Report on Form 10-K/A contain forward-looking statements that are based on current expectations, estimates and projections about the industry in which the Company operates, management's beliefs and assumptions made by management. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are outside the Company's control. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to put undue reliance on such forward-looking statements. Stockholders may review the Company's reports filed in the future with the Securities and Exchange Commission for more current descriptions of developments that could cause actual results to differ materially from such forward-looking statements.

Factors that could cause or contribute to actual results differing materially from such forward-looking statements include the following: cost of commodity prices; gas sales volumes; weather conditions in the Company's service territories; the achievement of operating efficiencies and the purchases and implementation of new technologies for attaining such efficiencies; impact of relations with labor unions of bargaining-unit employees; the receipt of timely and adequate rate relief; the outcome of pending and future litigation; governmental regulations and proceedings affecting or involving the Company; unanticipated environmental liabilities; changes in business strategy; the risk that the businesses acquired and any other businesses or investments that Southern Union has acquired or may acquire may not be successfully integrated with the businesses of Southern Union; and the nature and impact of any extraordinary transactions such as any acquisition or divestiture of a business unit or any assets. These are representative of the factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions, and general economic conditions, including interest rate fluctuations, federal, state and local laws and regulations affecting the retail gas industry or the energy industry generally, and other factors.

ITEM 8. *Financial Statements and Supplementary Data.*

The information required here is included in the report as set forth in the *Index to Consolidated Financial Statements* on page F-1.

ITEM 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.*

None.

PART III

ITEM 10. *Directors and Executive Officers of Registrant.*

There is incorporated in this Item 10 by reference the information in the Company's definitive proxy statement for the 2000 Annual Meeting of Stockholders under the captions *Board of Directors -- Board Size and Composition* and *Executive Officers and Compensation -- Executive Officers Who Are Not Directors*.

ITEM 11. *Executive Compensation.*

There is incorporated in this Item 11 by reference the information in the Company's definitive proxy statement for the 2000 Annual Meeting of Stockholders under the captions *Executive Officers and Compensation -- Executive Compensation* and *Certain Relationships*.

ITEM 12. *Security Ownership of Certain Beneficial Owners and Management.*

There is incorporated in this Item 12 by reference the information in the Company's definitive proxy statement for the 2000 Annual Meeting of Stockholders under the caption *Security Ownership*.

ITEM 13. *Certain Relationships and Related Transactions.*

There is incorporated in this Item 13 by reference the information in the Company's definitive proxy statement for the 2000 Annual Meeting of Stockholders under the caption *Certain Relationships*.

PART IV

ITEM 14. *Exhibits, Financial Statement Schedules and Reports on Form 8-K.*

(a)(1) and (2) **Financial Statements and Financial Statement Schedules.** See *Index to Consolidated Financial Statements* set forth on page F-1.

(a)(3) **Exhibits.**

Exhibit No.

Description

- 2(a) Agreement of Merger between Southern Union Company and Fall River Gas Company dated as of October 4, 1999. (Filed as Exhibit 2 to Southern Union's Current Report on Form 8-K filed on October 4, 1999 and incorporated herein by reference.)
- 2(b) Agreement and Plan of Merger among Southern Union Company, GUS Acquisition Corporation and Providence Energy Corporation dated November 15, 1999. (Filed as Exhibit 2 to Southern Union's Current report on Form 8-K filed on November 19, 1999 and incorporated herein by reference.)

Exhibit No.**Description**

- 2(c) Agreement and Plan of Merger among Southern Union Company, SUG Acquisition Corporation and Valley Resources, Inc. dated November 30, 1999. (Filed as Exhibit 2 to Southern Union's Current Report on Form 8-K filed on December 6, 1999 and incorporated herein by reference.)
- 2(d) Agreement of Merger between Southern Union Company and Pennsylvania Enterprises, Inc. dated as of June 7, 1999. (Filed as Exhibit 2 to Southern Union's Current Report on Form 8-K filed on June 15, 1999 and incorporated herein by reference.)
- 3(a) Restated Certificate of Incorporation of Southern Union Company. (Filed as Exhibit 3(a) to Southern Union's Transition Report on Form 10-K for the year ended June 30, 1994 and incorporated herein by reference.)
- 3(b) Amendment to Restated Certificate of Incorporation of Southern Union Company which was filed with the Secretary of State of Delaware and became effective on October 26, 1999. (Filed as Exhibit 3(a) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 and incorporated herein by reference.)
- 3(c) Southern Union Company Bylaws, as amended. (Filed as Exhibit 3(a) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 and incorporated herein by reference.)
- 4(a) Specimen Common Stock Certificate. (Filed as Exhibit 4(a) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1989 and incorporated herein by reference.)
- 4(b) Indenture between Chase Manhattan Bank, N.A., as trustee, and Southern Union Company dated January 31, 1994. (Filed as Exhibit 4.1 to Southern Union's Current Report on Form 8-K dated February 15, 1994 and incorporated herein by reference.)
- 4(c) Officers' Certificate dated January 31, 1994 setting forth the terms of the 7.60% Senior Debt Securities due 2024. (Filed as Exhibit 4.2 to Southern Union's Current Report on Form 8-K dated February 15, 1994 and incorporated herein by reference.)
- 4(d) Officer's Certificate of Southern Union Company dated November 3, 1999 with respect to 8.25% Senior Notes due 2029. (Filed as Exhibit 99.1 to Southern Union's Current Report on Form 8-K filed on November 19, 1999 and incorporated herein by reference.)
- 4(e) Certificate of Trust of Southern Union Financing I. (Filed as Exhibit 4-A to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(f) Certificate of Trust of Southern Union Financing II. (Filed as Exhibit 4-B to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(g) Certificate of Trust of Southern Union Financing III. (Filed as Exhibit 4-C to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(h) Form of Amended and Restated Declaration of Trust of Southern Union Financing I. (Filed as Exhibit 4-D to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(i) Form of Subordinated Debt Securities Indenture among Southern Union Company and The Chase Manhattan Bank, N.A., as Trustee. (Filed as Exhibit 4-G to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)

Exhibit No.**Description**

- 4(j) Form of Supplemental Indenture to Subordinated Debt Securities Indenture with respect to the Subordinated Debt Securities issued in connection with the Southern Union Financing I Preferred Securities. (Filed as Exhibit 4-H to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(k) Form of Southern Union Financing I Preferred Security (included in 4(g) above.) (Filed as Exhibit 4-I to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(l) Form of Subordinated Debt Security (included in 4(i) above.) (Filed as Exhibit 4-J to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(m) Form of Guarantee with respect to Southern Union Financing I Preferred Securities. (Filed as Exhibit 4-K to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
- 4(n) First Mortgage Bonds Debenture of Mortgage and Deed of Trust dated as of March 15, 1946 by Southern Union Company (as successor to PG Energy, Inc. formerly, Pennsylvania Gas and Water Company, and originally, Scranton-Spring Brook Water Service Company to Guaranty Trust Company of New York. (Filed as Exhibit 4.1 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(o) Twenty-Third Supplemental Indenture dated as of August 15, 1989 (Supplemental to Indenture dated as of March 15, 1946) between Southern Union Company and Morgan Guaranty Trust Company of New York (formerly Guaranty Trust Company of New York). (Filed as Exhibit 4.2 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(p) Twenty-Sixth Supplemental Indenture dated as of December 1, 1992 (Supplemental to Indenture dated as of March 15, 1946) between Southern Union Company and Morgan Guaranty Trust Company of New York. (Filed as Exhibit 4.3 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(q) Thirtieth Supplemental Indenture dated as of December 1, 1995 (Supplemental to Indenture dated as of March 15, 1946) between Southern Union Company and First Trust of New York, National Association (as successor trustee to Morgan Guaranty Trust Company of New York). (Filed as Exhibit 4.4 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(r) Thirty-First Supplemental Indenture dated as of November 4, 1999 (Supplemental to Indenture dated as of March 15, 1946) between Southern Union Company and U. S. Bank Trust, National Association (formerly, First Trust of New York, National Association). (Filed as Exhibit 4.5 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(s) Pennsylvania Gas and Water Company Bond Purchase Agreement dated September 1, 1989. (Filed as Exhibit 4.6 to Southern Union's Current Report on Form 8-K filed on December 30, 1999 and incorporated herein by reference.)
- 4(t) Southern Union is a party to other debt instruments, none of which authorizes the issuance of debt securities in an amount which exceeds 10% of the total assets of Southern Union. Southern Union hereby agrees to furnish a copy of any of these instruments to the Commission upon request.
- 10(a) Amended and Restated Revolving Credit Agreement (Long-Term Credit Facility) between Southern Union Company and the Banks named therein dated May 31, 2000.

<u>Exhibit No.</u>	<u>Description</u>
10(b)	Amended and Restated Revolving Credit Agreement (Short-Term Credit Facility) between Southern Union Company and the Banks named therein dated May 31, 2000.
10(c)	Term Loan Credit Agreement between Southern Union Company and the Banks named therein dated August 28, 2000.
10(d)	Southern Union Company 1982 Incentive Stock Option Plan and form of related Stock Option Agreement. (Filed as Exhibits 4.1 and 4.2 to Form S-8, File No. 2-79612 and incorporated herein by reference.)(*)
10(e)	Form of Indemnification Agreement between Southern Union Company and each of the Directors of Southern Union Company. (Filed as Exhibit 10(i) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1986 and incorporated herein by reference.)
10(f)	Southern Union Company 1992 Long-Term Stock Incentive Plan, As Amended. (Filed as Exhibit 10(l) to Southern Union's Annual Report on Form 10-K for the year ended June 30, 1998 and incorporated herein by reference.)(*)
10(g)	Southern Union Company Director's Deferred Compensation Plan. (Filed as Exhibit 10(g) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1993 and incorporated herein by reference.)(*)
10(h)	Southern Union Company Amended Supplemental Deferred Compensation Plan with Amendments. (Filed as Exhibit 4 to Southern Union's Form S-8 filed March 27, 1999 and incorporated herein by reference.)(*)
10(i)	Form of warrant granted to Fleischman and Walsh L.L.P. (Filed as Exhibit 10(j) to Southern Union's Transition Report on Form 10-K for the year ended June 30, 1994 and incorporated herein by reference.)
10(j)	Renewal Promissory Note Agreement between Peter H. Kelley and Southern Union Company dated May 31, 1995. (Filed as Exhibit 10(i) to Southern Union's Annual Report on Form 10-K for the year ended June 30, 1995 and incorporated herein by reference.)
10(k)	Employment agreement between Thomas F. Karam and Southern Union Company dated December 28, 1999. (Filed as Exhibit 10(a) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 and incorporated herein by reference.)
10(l)	Secured Promissory Note and Security Agreements between Thomas F. Karam and Southern Union Company dated December 20, 1999. (Filed as Exhibit 10(b) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 and incorporated herein by reference.)
10(m)	Southern Union Company Pennsylvania Division Stock Incentive Plan. (Filed as Exhibit 4 to Form S-8, SEC File No. 333-36146, filed on May 3, 2000 and incorporated herein by reference.)*
10(n)	Southern Union Company Pennsylvania Division 1992 Stock Option Plan. (Filed as Exhibit 4 to Form S-8, SEC File No. 333-36150, filed on May 3, 2000 and incorporated herein by reference.)*
13	Portions of Company's Annual Report to Stockholders.
21	Subsidiaries of the Company.

* Indicates Management Compensation Plan.

<u>Exhibit No.</u>	<u>Description</u>
--------------------	--------------------

23	Consent of Independent Accountants.
----	-------------------------------------

24	Power of Attorney.
----	--------------------

27	Financial Data Schedule.
----	--------------------------

(b) **Reports on Form 8-K.** Southern Union's Current Report on Form 8-K dated June 5, 2000 providing certain historical financial statements and related notes thereto of Valley Resources, Inc. and Providence Energy Corporation.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Southern Union has duly caused this report to be signed by the undersigned, thereunto duly authorized, on April 25, 2001.

SOUTHERN UNION COMPANY

By RONALD J. ENDRES

Ronald J. Endres

Executive Vice President and Chief Financial Officer

By DAVID J. KVAPIL

David J. Kvapil

Senior Vice President and Corporate Controller
(Principal Accounting Officer)

SOUTHERN UNION COMPANY AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Financial Statements	
Consolidated statement of operations -- years ended June 30, 2000, 1999 and 1998	F-2
Consolidated balance sheet -- June 30, 2000 and 1999	F-3 to F-4
Consolidated statement of cash flows -- years ended June 30, 2000, 1999 and 1998	F-5
Consolidated statement of common stockholders' equity -- years ended June 30, 2000, 1999 and 1998	F-6
Notes to consolidated financial statements	F-7 to F-28
Report of independent accountants	F-29

All schedules are omitted as the required information is not applicable or the information is presented in the consolidated financial statements or related notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended June 30,		
	2000	1999	1998
	(Restated)		
	(thousands of dollars, except shares and per share amounts)		
Operating revenues	\$ 831,704	\$ 605,231	\$ 669,304
Cost of gas and other energy	497,698	342,301	405,580
Operating margin	334,006	262,930	263,724
Revenue related taxes	(34,896)	(32,034)	(34,886)
Net operating margin	299,110	230,896	228,838
Operating expenses:			
Operating, maintenance and general	136,587	109,693	107,527
Depreciation and amortization	55,140	41,855	38,439
Taxes, other than on income and revenues	17,269	14,501	14,205
Total operating expenses	208,996	166,049	160,171
Net operating revenues	90,114	64,847	68,667
Other income (expenses):			
Interest	(51,492)	(35,999)	(34,884)
Dividends on preferred securities of subsidiary trust	(9,480)	(9,480)	(9,480)
Write-off of regulatory assets	--	--	(8,163)
Other, net	(9,708)	(1,814)	4,073
Total other expenses, net	(70,680)	(47,293)	(48,454)
Earnings before income taxes	19,434	17,554	20,213
Federal and state income taxes	9,589	7,109	7,984
Net earnings available for common stock	\$ 9,845	\$ 10,445	\$ 12,229
Net earnings per share:			
Basic	\$.23	\$.32	\$.38
Diluted	\$.22	\$.31	\$.37
Weighted average shares outstanding:			
Basic	43,427,728	32,437,242	31,925,072
Diluted	45,400,778	34,216,984	33,169,295

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

ASSETS

	June 30,	
	2000	1999
	(Restated)	
	(thousands of dollars)	
Property, plant and equipment:		
Plant in service	\$ 1,580,077	\$1,106,905
Construction work in progress	<u>30,192</u>	<u>13,271</u>
	1,610,269	1,120,176
Less accumulated depreciation and amortization	<u>(509,947)</u>	<u>(376,212)</u>
	1,100,322	743,964
Additional purchase cost assigned to utility plant, net of accumulated amortization of \$39,551,000 and \$31,115,000, respectively	<u>386,839</u>	<u>134,296</u>
Net property, plant and equipment	1,487,161	878,260
Current assets:		
Cash and cash equivalents	27,829	--
Accounts receivable, billed and unbilled, net	74,959	50,693
Inventories, principally at average cost	60,259	29,373
Investment securities	187,817	--
Prepayments and other	<u>877</u>	<u>4,692</u>
Total current assets	351,741	84,758
Deferred charges	145,006	96,635
Investment securities	10,489	12,000
Real estate	9,461	9,420
Other	17,602	6,275
Total assets	<u>\$ 2,021,460</u>	<u>\$1,087,348</u>

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET (Continued)

STOCKHOLDERS' EQUITY AND LIABILITIES

	June 30,	
	2000	1999
	(Restated)	
	(thousands of dollars)	
Common stockholders' equity:		
Common stock, \$1 par value; authorized 200,000,000 shares; issued 50,521,004 shares at June 30, 2000	\$ 50,521	\$ 31,240
Premium on capital stock	599,835	276,610
Less treasury stock: 1,010,077 and 51,625 shares at cost at June 30, 2000 and 1999, respectively	(15,554)	(794)
Less common stock held in Trust: 964,577 and 281,939, respectively, shares	(15,330)	(5,562)
Accumulated other comprehensive income	115,175	(436)
Retained earnings	--	--
	<u>734,647</u>	<u>301,058</u>
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated notes of Southern Union	100,000	100,000
Long-term debt and capital lease obligation	<u>733,774</u>	<u>390,931</u>
Total capitalization	1,568,421	791,989
Current liabilities:		
Long-term debt and capital lease obligation due within one year	2,193	2,066
Notes payable	3	21,003
Accounts payable	77,488	37,834
Federal, state and local taxes	7,359	13,300
Accrued interest	15,922	12,176
Customer deposits	17,255	17,682
Deferred gas purchases	11,708	22,955
Other	<u>30,778</u>	<u>16,612</u>
Total current liabilities	162,706	143,628
Deferred credits and other	106,823	81,493
Accumulated deferred income taxes	183,510	70,238
Commitments and contingencies	--	--
	<u>---</u>	<u>---</u>
Total stockholders' equity and liabilities	<u>\$2,021,460</u>	<u>\$1,087,348</u>

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended June 30,		
	2000	1999	1998
	(Restated)		
	(thousands of dollars)		
Cash flows from operating activities:			
Net earnings	\$ 9,845	\$ 10,445	\$ 12,229
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	55,140	41,855	38,439
Deferred income taxes	435	7,867	6,363
Provision for bad debts	4,998	3,279	5,461
Write-off of regulatory assets	—	—	8,163
Financial derivative trading losses	2,236	—	—
Deferred interest expense	(312)	619	(1,671)
Gain on sale of investment securities	—	—	(1,088)
Other	1,708	1,004	1,447
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable, billed and unbilled	(3,830)	(212)	132
Accounts payable	22,602	5,228	(7,066)
Taxes and other liabilities	(5,636)	(1,240)	146
Customer deposits	(3,407)	(4)	201
Deferred gas purchases	(15,114)	10,698	8,693
Inventories	91	(3,213)	(4,361)
Other	1,766	527	1,169
Net cash flows from operating activities	<u>70,522</u>	<u>76,853</u>	<u>68,257</u>
Cash flows from (used in) investing activities:			
Additions to property, plant and equipment	(100,446)	(73,147)	(77,018)
Acquisition of operations, net of cash received	(38,366)	—	6,502
Purchase of investment securities	(21,001)	(7,000)	(5,000)
Increase in customer advances	1,350	2,139	3,562
Decrease in deferred charges and credits	(3,657)	(4,086)	(1,786)
Proceeds from sale of investment securities	—	—	6,531
Proceeds from sale of subsidiary	12,150	—	—
Other	(4,553)	885	1,575
Net cash flows used in investing activities	<u>(154,523)</u>	<u>(81,209)</u>	<u>(65,634)</u>
Cash flows from (used in) financing activities:			
Issuance of long-term debt	300,000	—	—
Issuance cost of debt	(7,292)	—	—
Premium on early extinguishment of debt	(719)	—	—
Purchase of treasury stock	(14,425)	—	—
Repayment of debt and capital lease obligation	(138,791)	(20,837)	(1,309)
Net borrowings (payments) under revolving credit facilities	(21,000)	19,403	—
Increase (decrease) in cash overdrafts	(6,655)	6,033	(945)
Other	712	(243)	(369)
Net cash flows from (used in) financing activities	<u>111,830</u>	<u>4,356</u>	<u>(2,623)</u>
Increase in cash and cash equivalents	27,829	—	—
Cash and cash equivalents at beginning of year	—	—	—
Cash and cash equivalents at end of year	<u>\$ 27,829</u>	<u>\$ —</u>	<u>\$ —</u>

Cash paid for interest, net of amounts capitalized, in 2000, 1999 and 1998 was \$57,735,000, \$45,039,000 and \$33,997,000, respectively. Cash paid for income taxes in 2000, 1999 and 1998 was \$4,311,000, \$1,194,000 and \$4,511,000, respectively.

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock, \$1 Par Value	Premium on Capital Stock	Treasury Stock, at Cost	Common Stock Held in Trust	Accumulated Other Comprehen- sive Income	Retained Earnings	Total
	(thousands of dollars)						
Balance July 1, 1997	\$ 17,171	\$ 225,252	\$ (794)	\$ —	\$ 664	\$ 25,169	\$ 267,462
Comprehensive income:							
Net earnings	—	—	—	—	—	12,229	12,229
Reclassification adjustment for gains included in net income	—	—	—	—	(664)	—	(664)
Comprehensive income	—	—	—	—	—	—	11,565
5% stock dividend	856	19,802	—	—	—	(20,658)	—
Three-for-two stock split	9,400	(9,400)	—	—	—	(2)	(2)
Issuance of stock for acquisition	756	17,285	—	—	—	—	18,041
Exercise of stock options	69	(301)	—	—	—	—	(232)
Balance June 30, 1998	28,252	252,638	(794)	—	—	16,738	296,834
Comprehensive income:							
Net earnings	—	—	—	—	—	10,445	10,445
Minimum pension liability adjustment, net of tax	—	—	—	—	(436)	—	(436)
Comprehensive income	—	—	—	—	—	—	10,009
Common stock held in trust	—	—	—	(5,562)	—	—	(5,562)
5% stock dividend — declared November 11, 1998	1,411	7,483	—	—	—	(8,898)	(4)
5% stock dividend — declared July 13, 1999	1,485	16,797	—	—	—	(18,285)	(3)
Exercise of stock options	92	(308)	—	—	—	—	(216)
Balance June 30, 1999	31,240	276,610	(794)	(5,562)	(436)	—	301,058
Comprehensive income:							
Net earnings (restated)	—	—	—	—	—	9,845	9,845
Unrealized gain in investment securities, net of tax	—	—	—	—	115,175	—	115,175
Minimum pension liability adjustment, net of tax	—	—	—	—	436	—	436
Comprehensive income	—	—	—	—	—	—	125,456
Common stock held in trust	—	—	—	(10,037)	—	—	(10,037)
5% stock dividend (restated)	2,359	7,452	—	—	—	(9,845)	(34)
Purchase of treasury stock	—	—	(14,425)	—	—	—	(14,425)
Issuance of stock for acquisition	16,714	315,235	—	—	—	—	331,949
Exercise of stock options	208	538	(335)	269	—	—	680
Balance June 30, 2000 (restated)	\$ 50,521	\$ 599,835	\$ (15,554)	\$ (15,330)	\$ 115,175	\$ —	\$ 734,647

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

I Summary of Significant Accounting Policies

Operations Southern Union Company (*Southern Union* and, together with its wholly-owned subsidiaries, the *Company*), is a public utility primarily engaged in the distribution and sale of natural gas to residential, commercial and industrial customers located (during the periods reflected) primarily in Texas, Missouri and Pennsylvania. See *Acquisitions -- Acquisitions Subsequent to Year-End*. Subsidiaries of Southern Union also market natural gas to end-users, distribute propane, operate natural gas pipeline systems and sell commercial gas air conditioning and other gas-fired engine-driven applications. The Company has also entered the electric generation and marketing business through the recent acquisition of Pennsylvania Enterprises, Inc. (hereafter referred to as the *Pennsylvania Operations*). Certain subsidiaries own or hold interests in real estate and other assets, which are primarily used in the Company's utility business. Substantial operations of the Company are subject to regulation. Accounting policies conform to the Financial Accounting Standards Board (FASB) standard, *Accounting for the Effects of Certain Types of Regulation* in the case of regulated operations.

Principles of Consolidation The consolidated financial statements include the accounts of Southern Union and its wholly-owned subsidiaries. Investments in which the Company has significant influence over the operations of the investee and the Company owns a 20% to 50% interest are accounted for using the equity method. All significant intercompany accounts and transactions are eliminated in consolidation. All dollar amounts in the tables herein, except per share amounts, are stated in thousands unless otherwise indicated.

Gas Utility Revenues and Gas Purchase Costs Gas utility customers are billed on a monthly-cycle basis. The related cost of gas and revenue taxes are matched with cycle-billed revenues through utilization of purchased gas adjustment provisions in tariffs approved by the regulatory agencies having jurisdiction. Revenues from gas delivered but not yet billed are accrued, along with the related gas purchase costs and revenue-related taxes. The distribution and sale of natural gas in Texas, Missouri and Pennsylvania contributed in excess of 85% of the Company's total revenue, net earnings and identifiable assets in 2000, 1999 and 1998. Four suppliers provided 55%, 50% and 45% of the Company's gas purchases in 2000, 1999 and 1998, respectively.

Earnings Per Share The Company's earnings per share presentation conforms to the FASB standard, *Earnings per Share*. All share and per share data have been restated for all stock dividends and stock splits unless otherwise noted.

Accumulated Other Comprehensive Income In 1999, the Company adopted *Reporting Comprehensive Income*, an FASB standard which established rules for the reporting of comprehensive income and its components. The main components of comprehensive income that relate to the Company are net earnings, unrealized holding gains on investments and additional minimum pension liability adjustments, all of which are presented in the consolidated statement of stockholders' equity. Prior to adoption, the unrealized holding gains were presented as part of stockholders' equity and the pension liability adjustments were presented in the consolidated balance sheet.

Unrealized holding gains on investment securities were \$115,175,000, nil and nil in 2000, 1999 and 1998, respectively. The reclassification adjustment for gains included in net income, net of tax, for reporting other comprehensive income was nil, nil and \$664,000 in 2000, 1999 and 1998, respectively. The unrealized holding gains on investment securities and the reclassification adjustment for gains are combined and reflected on the consolidated statement of stockholders' equity.

Credit Risk Concentrations of credit risk in trade receivables are limited due to the large customer base with relatively small individual account balances. In addition, Company policy requires a deposit from certain customers. The Company has recorded an allowance for doubtful accounts totaling \$7,503,000, \$6,588,000, \$8,267,000 and \$10,765,000 at June 30, 2000, 1999, 1998 and 1997, respectively. The allowance for doubtful accounts is increased for estimated uncollectible accounts and reduced for the write-off of trade receivables.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Value of Financial Instruments The carrying amounts reported in the balance sheet for cash and cash equivalents, accounts receivable, accounts payable and notes payable approximate their fair value. The fair value of the Company's preferred securities of subsidiary trust and long-term debt is estimated using current market quotes and other estimation techniques.

Inventories Inventories consist of natural gas in underground storage and materials and supplies. Natural gas in underground storage of \$51,869,420 and \$23,680,000 at June 30, 2000 and 1999, respectively, consists of 15,226,000 and 10,429,000 British thermal units, respectively.

Segment Reporting The FASB standard, *Disclosures about Segments of an Enterprise and Related Information*, requires disclosure of segment data based on how management makes decisions about allocating resources to segments and measuring performance. The Company is principally engaged in the gas distribution industry in the United States and has no other reportable industry segments.

New Pronouncements In June 1998, the FASB issued *Accounting for Derivative Instruments and Hedging Activities*. The Statement, as amended, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000; the Company as required will adopt the Statement on July 1, 2000. The Statement requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. During the Company's implementation procedures, the Company identified a fair value hedge, cash flow hedges and gas purchase contracts that are considered derivatives under the Statement. Based on the Company's risk exposure, the Company does not anticipate a material effect on its financial position, results of operations or cash flows resulting from counterparty non-performance.

The Company entered into an interest rate swap to reduce exposure to changes in fair value of fixed interest payments related to a lease commitment. For fair-value hedge transactions in which the Company is hedging changes in an asset's, liability's or firm commitment's fair value, changes in the fair value of the derivative instrument will generally be offset in the income statement by changes in the hedged item's fair value. The Company estimates that the transition adjustment related to the fair value hedge will be immaterial to the financial statements.

The Company is party to two interest rate swaps designed to hedge exposure to variability in cash flows from interest rate changes on variable rate debt. For cash flow hedges related to a variable-rate asset, liability or a forecasted transaction, changes in the fair value attributed to the effective portion of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings. The Company estimates that it will record a net-of-tax cumulative-effect-type adjustment of \$960,000 gain in accumulated other comprehensive income to recognize at fair value all derivative instruments that will be designated as cash flow hedging instruments.

The Company's assessment also identified two gas purchase contracts at its recently acquired PG Energy Division that have been determined to be derivatives that do not qualify for hedge accounting treatment under the Statement. The Company estimates that it will record a net-of-tax cumulative effect-type adjustment of \$700,000 gain in earnings to recognize the fair value of the derivative instruments that do not qualify for hedge accounting treatment under the Statement. These derivatives will be reflected at quoted or estimated market value with resulting gains and losses included in operating income in the Consolidated Statement of Income.

Energy trading contracts entered into for speculative purposes are recorded at fair value as of each balance sheet date with gains and losses included in earnings.

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 1999, the Securities Exchange Commission staff issued a Staff Accounting Bulletin, *Revenue Recognition*, which provides guidance on the recognition and disclosure of revenues. Implementation of this Staff Accounting Bulletin is required by the fourth quarter of 2001 and will have no effect on the Company's Consolidated Financial Statements.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

II Restatement

In March 2001, the Company discovered unauthorized financial derivative energy trading activity by a non-regulated, wholly-owned subsidiary. During March 2001 and April 2001, all unauthorized trading activity was closed resulting in a cumulative cash expense of \$191,000, net of tax. However, due to certain accounting rules, such trading contracts must be recorded at fair value as of each balance sheet date with gains and losses included in earnings. As a result, a restatement of financial information for the fiscal year ended June 30, 2000 and the two subsequent quarters was required. This restatement resulted in non-cash losses of \$1,207,000, net of tax, (\$.02 per diluted share) for the fiscal year ended June 30, 2000. Additionally, a portion of the 5% common stock dividend which was previously reported in 2000 as a reduction of retained earnings has been reclassified to premium on capital stock.

III Acquisitions

Pennsylvania Enterprises, Inc.

On November 4, 1999, the Company acquired the Pennsylvania Operations in a transaction valued at approximately \$500 million, including assumption of long-term debt of approximately \$115 million. The Company issued approximately 16.7 million pre-stock dividend shares of common stock and paid approximately \$36 million in cash to complete the transaction. The Pennsylvania Operations are headquartered in Wilkes-Barre, Pennsylvania with natural gas distribution being its primary business. The principal operating division of the Pennsylvania Operations is the PG Energy division of the Company which serves more than 154,000 gas customers in northeastern and central Pennsylvania. Subsidiaries of the Company included in the Pennsylvania Operations include PG Energy Services Inc., (Energy Services), Keystone Pipeline Services, Inc. (*Keystone*, a wholly-owned subsidiary of PG Energy Services Inc.), PEI Power Corporation, and Theta Land Corporation. Through Energy Services the Company markets a diversified range of energy-related products and services under the name of PG Energy PowerPlus and supplies propane under the name of PG Energy Propane. Keystone provides pipeline and fiber optic cable construction, installation, maintenance, and rehabilitation services. PEI Power Corporation operates a cogeneration plant that generates steam and electricity for resale. Theta Land Corporation, which provided land management and development services for more than 44,000 acres of land, was sold for \$12,150,000 in January, 2000. No gain or loss was recognized on this transaction. Upon acquiring the Pennsylvania Operations, the Company made the strategic decision to sell Keystone and the propane operations of Energy Services; these operations are not material to the Company. The Company has not yet sold these operations and there can be no assurance that a sale on terms satisfactory to the Company will be completed.

The Company funded the cash portion of the acquisition of the Pennsylvania Operations and related refinancings with the sale of \$300,000,000 of 8.25% Senior Notes due 2029 completed on November 3, 1999 (8.25% Senior Notes). See *Debt and Capital Lease*. The assets of the Pennsylvania Operations are included in the consolidated balance sheet of the Company at June 30, 2000 and the results of operations from the Pennsylvania Operations has been included in the statement of consolidated operations since November 4, 1999. The acquisition was accounted for using the purchase method. The additional purchase cost assigned to utility plant of approximately \$261,000,000

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

reflects the excess of the purchase price over the historical book carrying value of the utility plant. Amortization of the additional purchase cost assigned to utility plant is provided on a straight-line basis over forty years.

Prior to the consummation of the acquisition, the Company purchased 358,500 shares of Pennsylvania Enterprises, Inc. stock for \$11,887,000 during both the first and second quarters of the Company's fiscal year 2000. As all necessary approvals for the merger had not been obtained, these purchases were treated as investment securities.

Pro Forma Financial Information

The following unaudited pro forma financial information for the year ended June 30, 2000 and 1999 is presented as though the following events had occurred at the beginning of the earliest period presented: (i) the acquisition of Pennsylvania Enterprises, Inc.; (ii) the sale of the 8.25% Senior Notes; and (iii) the refinancing of certain short-term and long-term debt at the time of acquisition. The pro forma financial information is not necessarily indicative of the results which would have actually been obtained had the acquisition of Pennsylvania Enterprises, Inc., the sale of senior notes or the refinancings been completed as of the assumed date for the periods presented or which may be obtained in the future.

	Year Ended June 30,	
	2000 (Restated)	1999
Operating revenues	\$ 880,190	\$ 838,836
Income before extraordinary item	2,079	5,782
Net earnings available for common stock	2,079	5,782
Net earnings per common stock:		
Basic05	.12
Diluted05	.11

Other Acquisitions

Effective December 31, 1997, the Company acquired Atlantic Utilities Corporation and Subsidiaries (Atlantic) for 755,650 pre-split and pre-stock dividend shares of common stock valued at \$18,041,000 and \$4,436,000 of cash. Atlantic is operated as South Florida Natural Gas, a natural gas division of Southern Union, and Atlantic Gas Corporation, a propane subsidiary of the Company. Atlantic currently serves 6,000 customers in central Florida. The assets of Atlantic were included in the Company's consolidated balance sheet at January 1, 1998 and its results of operations have been included in the Company's statements of consolidated operations and cash flows since January 1, 1998. On the date of acquisition, Atlantic had \$11,683,000 of cash and cash equivalents. The acquisition was accounted for using the purchase method. The additional purchase cost assigned to utility plant of \$10,000,000 reflects the excess of the purchase price over the historical book carrying value of the net assets acquired. The additional purchase cost is amortized on a straight-line basis over forty years.

On July 23, 1997 two subsidiaries of Southern Union acquired an equity ownership in a natural gas distribution company and other related operations currently serving 22,000 customers in Piedras Negras, Mexico (Mexico Operations) for \$2,700,000. Southern Union currently has a 43% equity ownership in this company. This system is across the U. S. - Mexico border from the Company's Eagle Pass, Texas service area.

Acquisitions Subsequent to Year-End

On September 20, 2000, Southern Union completed the acquisition of Valley Resources, Inc. (Valley Resources) for approximately \$125 million in cash plus the assumption of \$30 million in long-term debt. As a result of the Valley Resources merger, Valley Resources' two utility subsidiaries are now one division of Southern Union operating as Valley Gas Company and Bristol and Warren Gas Company, and Valley Resources' two non-utility subsidiaries are

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

now subsidiaries of Southern Union. Valley Resources, which is headquartered in Cumberland, Rhode Island, provides natural gas utility service to more than 64,000 customers. Valley Resources' utility service area covers a 92 square mile area in the northeastern portion of Rhode Island that has a population of approximately 250,000 and approximately 15 square miles in the eastern portion of Rhode Island that has a population of approximately 35,000. Valley Resources' non-utility subsidiaries rent and sell appliances, offer a service contract program, sell liquid propane in Rhode Island and nearby Massachusetts, and distribute as a wholesaler franchised lines to plumbing and heating contractors. Included in the acquisition was Valley Resources' 90% interest in Alternate Energy Corporation, which sells, installs and designs natural gas conversion systems and facilities, is an authorized representative of the ONSI Corporation fuel cell, holds patents for a natural gas/diesel co-firing system and for a device to control the flow of fuel on dual-fuel equipment.

On September 28, 2000, Southern Union completed the acquisition of Providence Energy Corporation (ProvEnergy) for approximately \$270 million in cash plus the assumption of \$90 million in long-term debt. The ProvEnergy natural gas distribution operations are Providence Gas and North Attleboro Gas. Providence Gas serves approximately 168,000 natural gas customers in Providence and Newport, Rhode Island, and 23 other cities and towns in Rhode Island and Massachusetts. North Attleboro Gas serves approximately 6,000 customers in North Attleboro and Plainville, Massachusetts, towns adjacent to the northeastern Rhode Island border. The ProvEnergy utility service territories encompass approximately 760 square miles with a population of approximately 850,000. Subsidiaries of the Company included in the ProvEnergy merger are ProvEnergy Oil Enterprises, Inc., Providence Energy Services, Inc., and ProvEnergy Power Company, LLC. ProvEnergy Oil Enterprises, Inc. operates a fuel oil distribution business through its subsidiary, ProvEnergy Fuels, Inc. (ProvEnergy Fuels). ProvEnergy Fuels serves over 14,000 residential and commercial customers in Rhode Island and Massachusetts. Providence Energy Services, Inc., whose operations may be sold or disbanded, markets natural gas and energy services in New England. ProvEnergy Power Company owns 50% of Capital Center Energy Company, LLC., a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power.

On September 28, 2000, Southern Union completed the acquisition of Fall River Gas Company (Fall River Gas) for approximately 1.5 million shares of Southern Union common stock and approximately \$27 million in cash plus assumption of \$20 million in long-term debt. As a result of the merger, Fall River Gas is now a division of Southern Union and Fall River Gas' non-regulated subsidiary, Fall River Gas Appliance Company, Inc., is now a subsidiary of Southern Union. Headquartered in Fall River, Massachusetts, Fall River Gas serves approximately 48,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in southeastern Massachusetts. Fall River Gas Appliance Company, Inc., rents water heaters and conversion burners (primarily for residential use) in Fall River Gas' service area.

The aforementioned acquisitions subsequent to year-end shall be accounted for under the purchase method.

IV Write-Off of Regulatory Assets

During 1998, the Company was impacted by pre-tax non-cash write-offs totaling \$8,163,000 of previously recorded regulatory assets. Pursuant to a 1989 Missouri Public Service Commission (MPSC) order, Missouri Gas Energy, a division of the Company, is engaged in a major gas safety program. In connection with this program, the MPSC issued an accounting authority order in 1994 which authorized Missouri Gas Energy to defer carrying costs at a rate of 10.54%. The MPSC rate order of January 22, 1997, however, retroactively reduced the 10.54% carrying cost rate used since early 1994 to an Allowance for Funds Used During Construction (AFUDC) rate of approximately 6%. The Company filed an appeal of this portion of the rate order in the Missouri State Court of Appeals, Western District, and on August 18, 1998 was notified that the appeal was denied. This resulted in a one-time non-cash write-off of \$5,942,000 by the Company of previously deferred costs in its fiscal year ended June 30, 1998. See *Commitments and Contingencies*.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a rate increase which, among other things, disallowed certain previously recorded deferred costs associated with the rate filing, requiring an additional pre-tax non-cash write-off of \$2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. See *Utility Regulation and Rates*.

V Other Income (Expense), Net

Other expense of \$9,708,000 in 2000 included \$10,363,000 of costs associated with unsuccessful acquisition efforts and related litigation and \$2,236,000 of pre-tax non-cash financial derivative energy trading losses. This was partially offset by net rental income of Lavaca Realty Company (Lavaca Realty) of \$1,757,000.

Other expense of \$1,814,000 in 1999 included: \$3,839,000 of costs associated with various acquisition efforts and a net expense of \$619,000 related to the amortization and current deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program. This was partially offset by net rental income of Lavaca Realty of \$1,448,000 and equity earnings of \$609,000 from Southern Union's 43% equity ownership of its Mexico Operations.

Other income of \$4,073,000 in 1998 included: \$1,671,000 related to the deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program; realized gains on the sale of investment securities of \$1,088,000; and net rental income of Lavaca Realty of \$1,119,000. This was partially offset by \$885,000 of costs associated with various acquisition efforts.

VI Cash Flow Information

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Short-term investments are highly liquid investments with maturities of more than three months when purchased, and are carried at cost, which approximates market. The Company places its temporary cash investments with a high credit quality financial institution which, in turn, invests the temporary funds in a variety of high-quality short-term financial securities.

Under the Company's cash management system, checks issued but not presented to banks frequently result in overdraft balances for accounting purposes and are classified in accounts payable in the consolidated balance sheet.

VII Earnings Per Share

During the three-year period ended June 30, 2000, no adjustments were required in net earnings available for common stock for the earnings per share calculations. Average shares outstanding for basic earnings per share were 43,427,728, 32,437,242 and 31,925,072 for the years ended June 30, 2000, 1999 and 1998, respectively. Diluted earnings per share includes average shares outstanding as well as common stock equivalents from stock options and warrants. Common stock equivalents were 1,973,050, 1,779,742 and 1,244,223 for the years ended June 30, 2000, 1999 and 1998, respectively.

VIII Property, Plant and Equipment

Plant Plant in service and construction work in progress are stated at original cost net of contributions in aid of construction. The cost of additions includes an allowance for funds used during construction and applicable overhead charges. Gain or loss is recognized upon the disposition of significant utility properties and other property constituting operating units. Gain or loss from minor dispositions of property is charged to accumulated depreciation and amortization. The Company capitalizes the cost of significant internally-developed computer software systems and amortizes the cost over the expected useful life. See *Debt and Capital Lease*.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	June 30,	
	2000	1999
Distribution plant	\$ 1,479,426	\$1,033,281
General plant	138,206	109,178
Other	19,735	16,648
Total plant	1,637,367	1,159,107
Less contributions in aid of construction	(57,290)	(52,202)
Plant in service	1,580,077	1,106,905
Construction work in progress	30,192	13,271
	1,610,269	1,120,176
Less accumulated depreciation and amortization	(509,947)	(376,212)
	1,100,322	743,964
Additional purchase cost assigned to utility plant, net	386,839	134,296
Net property, plant and equipment	<u>\$ 1,487,161</u>	<u>\$ 878,260</u>

Acquisitions of rate-regulated entities are recorded at the historical book carrying value of utility plant. On November 4, 1999, Pennsylvania Operations was acquired in which historical utility plant and equipment had a cost and accumulated depreciation and amortization of \$408,304,000 and \$103,275,000, respectively. On December 31, 1997, Atlantic was acquired in which historical utility plant and equipment had a cost and accumulated depreciation and amortization of \$5,253,000 and \$2,540,000, respectively.

Additional purchase cost assigned to utility plant is the excess of the purchase price over the book carrying value of the net assets acquired. In general, the Company has not been allowed recovery of additional purchase cost assigned to utility plant in rates. Periodically, the Company evaluates the carrying value of its additional purchase cost assigned to utility plant, long-lived assets, capital leases and other identifiable intangibles by comparing the anticipated future operating income from the businesses giving rise to the respective asset with the original cost or unamortized balance. No impairment was indicated or expected at June 30, 2000.

Depreciation and Amortization Depreciation of utility plant is provided at an average straight-line rate of approximately 3% per annum of the cost of such depreciable properties less applicable salvage. Franchises are amortized over their respective lives. Depreciation and amortization of other property is provided at straight-line rates estimated to recover the costs of the properties, after allowance for salvage, over their respective lives. Internally-developed computer software system costs are amortized over various regulatory-approved periods. Amortization of additional purchase cost assigned to utility plant is provided on a straight-line basis over forty years unless the Company's regulators have provided for the recovery of the additional purchase cost in rates, in which case the Company's policy is to utilize the amortization period which follows the rate recovery period.

Depreciation of property, plant and equipment in 2000, 1999 and 1998 was \$46,757,000, \$37,771,000 and \$34,477,000, respectively.

IX Investment Securities

At June 30, 2000, the Company held securities of Capstone Turbine Corporation (Capstone). In late June 2000, Capstone completed its initial public offering (IPO). This investment is classified as "available for sale" under the Financial Accounting Standards Board Standard *Accounting for Certain Investments in Debt and Equity Securities*; accordingly, these securities are stated at fair value, with unrealized gains and losses recorded in a separate component of common stockholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when incurred. As of June 30, 2000, the Company's investment in Capstone had a fair value of \$187,817,000 and the unrealized gains, net of tax, related to this investment were \$115,175,000 at such date. The Company has classified

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

this investment as current, as it plans to monetize its investment as soon as practicable following the completion of the applicable lock-up periods to which it was subject in connection with the IPO and use the proceeds to reduce outstanding debt.

At June 30, 2000 and 1999, all other securities owned by the Company are accounted for under the cost method. The Company's other investments in securities consist of preferred stock in non-public companies whose value is not readily determinable. Realized gains and losses on sales of these investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when incurred, and dividends are recognized as income when received.

X Stockholders' Equity

Stock Splits and Dividends On June 30, 2000, August 6, 1999, December 9, 1998 and December 10, 1997 Southern Union distributed its annual 5% common stock dividend to stockholders of record on June 19, 2000, July 23, 1999, November 23, 1998 and November 21, 1997, respectively. A portion of the 5% stock dividend distributed on June 30, 2000, August 6, 1999 and December 9, 1998 was characterized as a distribution of capital due to the level of the Company's retained earnings available for distribution as of the declaration date. On July 13, 1998, Southern Union distributed a three-for-two stock split in the form of a 50% stock dividend to stockholders of record on June 30, 1998. Unless otherwise stated, all per share and share data included herein have been restated to give effect to the dividends and split.

Common Stock The Company maintains its 1992 Long-Term Stock Incentive Plan (1992 Plan) under which options to purchase 6,986,010 shares were provided to be granted to officers and key employees at prices not less than the fair market value on the date of grant. The 1992 Plan allows for the granting of stock appreciation rights, dividend equivalents, performance shares and restricted stock. The Company also had an incentive stock option plan (1982 Plan) which provided for the granting of 787,500 options, until December 31, 1991. Upon exercise of an option granted under the 1982 Plan, the Company may elect, instead of issuing shares, to make a cash payment equal to the difference at the date of exercise between the option price and the market price of the shares as to which such option is being exercised. Options granted under both the 1992 Plan and the 1982 Plan are exercisable for periods of ten years from the date of grant or such lesser period as may be designated for particular options, and become exercisable after a specified period of time from the date of grant in cumulative annual installments. Options typically vest 20% per year for five years but may be a lesser or greater period as designated for particular options.

In connection with the acquisition of the Pennsylvania Operations, the Company adopted the Pennsylvania Division 1992 Stock Option Plan (Pennsylvania Option Plan) and the Pennsylvania Division Stock Incentive Plan (Pennsylvania Incentive Plan). Under the terms of the Pennsylvania Option Plan, a total of 378,002 shares were provided to be granted to eligible employees. Stock options awarded under the Pennsylvania Option Plan may be either Incentive Stock Options or Nonqualified Stock Options. Upon acquisition, individuals not electing a cash payment equal to the difference at the date of acquisition between the option price and the market price of the shares as to which such option related, were converted to Southern Union options using a conversion rate that maintained the same aggregate value and the aggregate spread of the pre-acquisition options. No additional options will be granted under the Pennsylvania Option Plan. Under the terms of the Pennsylvania Incentive Plan, a total of 181,514 shares were provided to be granted to eligible employees, officers and directors. Awards under the Pennsylvania Incentive Plan may take the form of stock options, restricted stock, and other awards where the value of the award is based upon the performance of the Company's stock. Upon acquisition, individuals not electing a cash payment equal to the difference at the date of acquisition between the option price and the market price of the shares as to which such option related, were converted to Southern Union options using a conversion rate that maintained the same aggregate value and the aggregate spread of the pre-acquisition options. During 2000, 12,600 options were granted to a Director of the Company at an exercise price of \$17.23. These options granted vest 20% per year for five years. No additional options will be granted under the Pennsylvania Incentive Plan.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company accounts for its incentive plans under the Accounting Principles Board opinion, *Accounting for Stock Issued to Employees* and related authoritative interpretations. The Company recorded no compensation expense for 2000, 1999 and 1998. During 1997, the Company adopted the FASB standard, *Accounting for Stock-Based Compensation*, for footnote disclosure purposes only. Had compensation cost for these incentive plans been determined consistent with this standard, the Company's net income and diluted earnings per share would have been \$8,179,000 and \$.18, respectively, in 2000, \$9,429,000 and \$.28, respectively, in 1999, and \$11,141,000 and \$.34, respectively, in 1998. Because this standard has not been applied to options granted prior to July 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in 2000 and 1998, respectively: dividend yield of nil for both years; volatility of 27.5% and 19.5%; risk-free interest rate of 6% and 5.5%; and expected life outstanding of 5.5 to 7.2 years for both years. No options were granted during 1999.

	1992 Plan		1982 Plan	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding July 1, 1997	2,040,966	\$ 7.83	476,679	\$ 2.93
Granted	780,951	16.12	--	--
Exercised	(89,230)	4.26	(93,724)	2.93
Canceled	(22,713)	11.99	--	--
Outstanding June 30, 1998	2,709,914	10.30	382,955	2.93
Exercised	(113,176)	6.10	(43,789)	2.94
Canceled	(44,531)	14.22	--	--
Outstanding June 30, 1999	2,552,267	10.42	339,166	2.93
Granted	1,026,695	17.25	--	--
Exercised	(117,637)	6.91	(216,381)	2.95
Canceled	(17,018)	15.63	--	--
Outstanding June 30, 2000	<u>3,444,307</u>	12.55	<u>122,785</u>	2.90

The following table summarizes information about stock options outstanding under the 1992 Plan at June 30, 2000:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$ 0.00 - \$ 5.00	344,761	2.3 years	\$ 3.67	344,761	\$ 3.67
5.01 - 10.00	862,122	4.3 years	7.50	719,558	7.34
10.01 - 15.00	475,084	6.8 years	12.47	288,549	12.44
15.01 - 20.00	<u>1,762,340</u>	8.8 years	16.78	<u>293,755</u>	16.13
	<u>3,444,307</u>			<u>1,646,623</u>	

The shares exercisable under the 1992 Plan and the corresponding weighted average exercise price at June 30, 2000, 1999 and 1998 were 1,646,623 and \$9.03; 1,426,417 and \$7.89; and 1,084,224 and \$6.26, respectively. The shares exercisable under the 1982 Plan and the corresponding weighted average exercise price at June 30, 2000, 1999 and 1998 were 122,785 and \$2.90; 339,167 and \$2.93; and 382,958 and \$2.93, respectively. The shares exercisable under the Pennsylvania Option Plan and the corresponding weighted average exercise price at June 30, 2000 were 378,002 and \$11.09. The shares exercisable under the Pennsylvania Incentive Plan and the corresponding weighted average exercise price at June 30, 2000 were 168,913 and \$12.69. The weighted average

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

remaining contractual life of options outstanding under the 1982 Plan at June 30, 2000 was 0.4 years. The weighted average remaining contractual life of options outstanding under the Pennsylvania Option Plan and the Pennsylvania Incentive Plan at June 30, 2000 were 6 and 7.9 years, respectively. There were 3,074,674 shares available for future option grants under the 1992 Plan at June 30, 2000. No shares were available for future option grants under the 1982 Plan at June 30, 2000.

On February 10, 1994, Southern Union granted a warrant which expires on February 10, 2004, to purchase up to 105,531 shares of Common Stock at an exercise price of \$6.58 to the Company's outside legal counsel.

Retained Earnings Under the most restrictive provisions in effect, as a result of the sale of Senior Notes, Southern Union will not declare or pay any cash or asset dividends on common stock (other than dividends and distributions payable solely in shares of its common stock or in rights to acquire its common stock) or acquire or retire any shares of Southern Union's common stock, unless no event of default exists and the Company meets certain financial ratio requirements. In addition, Southern Union's charter relating to the issuance of preferred stock limits the payment of cash or asset dividends on capital stock.

XI Preferred Securities of Subsidiary Trust

On May 17, 1995, Southern Union Financing I (Subsidiary Trust), a consolidated wholly-owned subsidiary of Southern Union, issued \$100,000,000 of 9.48% Trust Originated Preferred Securities (Preferred Securities). In connection with the Subsidiary Trust's issuance of the Preferred Securities and the related purchase by Southern Union of all of the Subsidiary Trust's common securities (Common Securities), Southern Union issued to the Subsidiary Trust \$103,092,800 principal amount of its 9.48% Subordinated Deferrable Interest Notes, due 2025 (Subordinated Notes). The sole assets of the Subsidiary Trust are the Subordinated Notes. The interest and other payment dates on the Subordinated Notes correspond to the distribution and other payment dates on the Preferred Securities and the Common Securities. Under certain circumstances, the Subordinated Notes may be distributed to holders of the Preferred Securities and holders of the Common Securities in liquidation of the Subsidiary Trust. The Subordinated Notes were redeemable at the option of the Company on or after May 17, 2000, at a redemption price of \$25 per Subordinated Note plus accrued and unpaid interest. The Preferred Securities and the Common Securities will be redeemed on a pro rata basis to the same extent as the Subordinated Notes are repaid, at \$25 per Preferred Security and Common Security plus accumulated and unpaid distributions. Southern Union's obligations under the Subordinated Notes and related agreements, taken together, constitute a full and unconditional guarantee by Southern Union of payments due on the Preferred Securities. As of June 30, 2000, the quoted market price per Preferred Security was \$24.31. As of June 30, 2000 and 1999, 4,000,000 shares of Preferred Securities were outstanding.

XII Debt and Capital Lease

	June 30,	
	2000	1999
7.60% Senior Notes due 2024	\$ 364,515	\$ 364,515
8.25% Senior Notes due 2029	300,000	--
8.375% First Mortgage Bonds, due 2002	30,000	--
9.34% First Mortgage Bonds, due 2019	15,000	--
Capital lease and other	26,452	28,482
Total debt and capital lease	735,967	392,997
Less current portion	2,193	2,066
Total long-term debt and capital lease	<u>\$ 733,774</u>	<u>\$ 390,931</u>

The maturities of long-term debt and capital lease payments for each of the next five years ending June 30 are: 2001 -- \$2,193,000; 2002 -- \$2,330,000; 2003 -- \$42,660,000; 2004 -- \$8,871,000; 2005 -- \$216,000 and thereafter -- \$679,697,000.

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Senior Notes On November 3, 1999, the Company completed the sale of \$300,000,000 of 8.25% Senior Notes (8.25% Notes) due 2029. The net proceeds from the sale of these 8.25% Notes were used to: (i) fund the acquisition of Pennsylvania Enterprises, Inc.; (ii) repay approximately \$109,900,000 of borrowings under the revolving credit facility, and (iii) repay approximately \$136,000,000 of long- and short-term debt assumed in the acquisition. On January 31, 1994, Southern Union also completed the sale of the 7.60% Senior Debt Securities (7.60% Notes). During 1999, \$20,000,000 of 7.60% Notes were repurchased at \$941 per \$1,000 note resulting in a net pre-tax gain of \$425,000, net of related debt expense. Debt issuance costs and premiums on the early extinguishment of debt are accounted for in accordance with that required by its various regulatory bodies having jurisdiction over the Company's operations. The Company recognizes gains or losses on the early extinguishment of debt to the extent it is provided for by its regulatory authorities and in some cases such gains or losses are deferred and amortized over the term of the new or replacement debt issues.

The 8.25% Notes and the 7.60% Notes traded at \$983 and \$918 (per \$1,000 note), respectively on June 30, 2000, as quoted by a major brokerage firm. The carrying amount of long-term debt at June 30, 2000 and 1999 was \$735,967,000 and \$392,997,000, respectively. The fair value of long-term debt at June 30, 2000 and 1999 was \$700,934,000 and \$369,759,000, respectively.

First Mortgage Bonds In connection with the acquisition of the Pennsylvania Operations, the Company assumed \$30,000,000 of 8.375% Series First Mortgage Bonds due in December 2002 and \$15,000,000 of 9.34% Series First Mortgage Bonds due in 2019.

Capital Lease The Company completed the installation of an Automated Meter Reading (AMR) system at Missouri Gas Energy during the first quarter of fiscal year 1999. The installation of the AMR system involved an investment of approximately \$30,000,000 which is accounted for as a capital lease obligation. As of June 30, 2000, the capital lease obligation outstanding was \$25,104,000 with a fixed rate of 5.79%. This system has significantly improved meter reading accuracy and timeliness and provided electronic accessibility to meters in residential customers' basements, thereby assisting in the reduction of the number of estimated bills. Depreciation on the AMR system is provided at an average straight-line rate of approximately 5% per annum of the cost of such property.

Credit Facilities On May 31, 2000, the Company restated and amended its short-term and long-term credit facilities (together referred to as "Revolving Credit Facilities"). The Company has available \$90,000,000 under the short-term facility, which expires May 30, 2001, and \$135,000,000 under the long-term facility, which expires on May 31, 2003. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Revolving Credit Facilities are subject to a commitment fee based on the rating of the Senior Notes. As of June 30, 2000, the commitment fee was an annualized 0.14% on the unused balance. The interest rate on borrowings on the Revolving Credit Facilities is calculated based on a formula using the LIBOR or prime interest rates. The average interest rate under the facilities was 6.0% for the year ended June 30, 2000 and 5.6% for the year ended June 30, 1999. A nil and \$21,000,000 balance was outstanding under the facilities at June 30, 2000 and 1999, respectively. A balance of \$26,320,000 was outstanding under the facilities at August 31, 2000.

On August 28, 2000 the Company entered into a short-term bank note (the *Term Note*) to fund (i) the cash portion of the consideration to be paid to the Fall River Gas' stockholders; (ii) the all cash consideration to be paid to the ProvEnergy and Valley Resources stockholders, and (iii) all related acquisition costs and refinancing of debt done in connection with these mergers. In September 2000, draws totaling \$480,000,000 were made under this Term Note. Remaining commitments under the Term Note are \$95,000,000 as of September 28, 2000 to cover any trailing costs. The Term Note expires August 27, 2001 but may be extended at the Company's option through August 26, 2002 for a 12.5 basis point fee. The interest rate on borrowings under the Term Note is a floating rate based on LIBOR or prime interest rates.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

XIII Employee Benefits

Pension and Other Post-retirement Benefits The Company adopted in 1999, *Employers Disclosures About Pensions and Other Post-Retirement Benefits*, a FASB standard which changed the Company's reporting requirements for its pension and post-retirement benefit plans.

The Company maintains three trustee non-contributory defined benefit retirement plans (Plans) which cover substantially all employees. The Company funds the Plans' cost in accordance with federal regulations, not to exceed the amounts deductible for income tax purposes. The Plans' assets are invested in cash, government securities, corporate bonds and stock, and various funds. The Company also has a supplemental non-contributory retirement plan for certain executive employees and other post-retirement benefit plans for its employees. Post-retirement medical and other benefit liabilities are accrued on an actuarial basis during the years an employee provides services. The following table represents a reconciliation of the plans at June 30, 2000 and 1999.

	<u>2000</u>	<u>1999</u>
Change in Benefit Obligation		
Benefit obligation at beginning of year	\$ 204,461	\$ 188,038
Acquisition	54,261	--
Service cost	2,251	3,364
Interest cost	16,265	13,829
Benefits paid	(17,798)	(13,563)
Actuarial (gain) loss	(20,452)	7,968
Plan amendments	8,115	7,027
Curtailment	--	(2,202)
Benefit obligation at end of year	<u>\$ 247,103</u>	<u>\$ 204,461</u>
Change in Plan Assets		
Fair value of plan assets at beginning of year	\$ 162,621	\$ 166,353
Acquisition	50,657	--
Return on plan assets	21,499	3,420
Employer contributions	7,445	6,411
Benefits paid	(17,798)	(13,563)
Fair value of plan assets at end of year	<u>\$ 224,424</u>	<u>\$ 162,621</u>
Funded Status		
Funded status at end of year	\$ (22,679)	\$ (41,839)
Unrecognized transition obligation	2,637	2,764
Unrecognized net actuarial gain	(31,417)	(7,404)
Unrecognized prior service cost	17,080	9,913
Accrued benefit cost	<u>\$ (34,379)</u>	<u>\$ (36,566)</u>
Amounts Recognized in the Consolidated Balance Sheet		
Prepaid benefit cost	\$ 11,738	\$ 4,880
Accrued benefit liability	(62,498)	(52,618)
Intangible asset	16,381	10,501
Accumulated other comprehensive income	--	671
Net amount recognized	<u>\$ (34,379)</u>	<u>\$ (36,566)</u>

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets as of June 30, 2000 were \$19,492,000; \$19,492,000; and

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

nil, respectively, and for those same plans were \$58,985,000; \$58,985,000; and \$42,181,000, respectively as of June 30, 1999.

The accumulated post-retirement benefit obligation and fair value of plan assets for post-retirement benefit plans with accumulated post-retirement benefit obligations in excess of fair value of plan assets as of June 30, 2000 were \$45,920,000 and \$7,859,000 respectively, and for those same plans were \$38,035,000 and \$3,878,000, respectively as of June 30, 1999.

The weighted-average assumptions used for the year ended June 30, 2000, 1999 and 1998 were:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Discount rate			
Beginning of year	7.00%	7.00%	7.75%
End of year	8.00%	7.00%	7.00%
Expected return on assets - tax exempt accounts	8.00%	8.00%	8.00%
Expected return on assets - taxable accounts	5.25%	5.25%	8.00%
Rate of compensation increase (average)	5.62%	5.62%	5.62%
Health care cost trend rate	9.00%	7.25%	7.50%

Net periodic benefit cost for the year ended June 30, 2000, 1999 and 1998 includes the following components:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Service cost	\$ 2,251	\$ 3,364	\$ 3,302
Interest cost	16,265	13,829	13,658
Expected return on plan assets	(14,554)	(13,006)	(11,737)
Amortization of transition amount	127	127	127
Amortization of prior service cost	948	438	340
Recognized actuarial gain	(2,704)	(3,319)	(4,828)
Curtailment	--	131	--
Net periodic pension cost	<u>\$ 2,333</u>	<u>\$ 1,564</u>	<u>\$ 862</u>

The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 9.00% during 2000. This rate was assumed to decrease gradually each year to a rate of 6.0% for 2003 and remain at that level thereafter. For Pennsylvania's participants in the HMO plan who have reached age 65, the assumed health care cost trend rate used was 30.0% and it was assumed to decrease gradually to 6.0% by 2006. (The health care cost trend rate of 30.0% is due to increases in HMO premium rates experienced in 2000.)

Amortization of unrecognized actuarial gains and losses for Missouri Gas Energy plans were determined using a rolling five year average gain or loss position with a five year amortization period pursuant to a stipulation agreement with the MPSC.

Effect of health care trend rate changes on health care plans:

	<u>One Percentage Point Increase in Health Care Trend Rate</u>	<u>One Percentage Point Decrease in Health Care Trend Rate</u>
Effect on total service and interest cost components	\$ 40,000	\$ (36,000)
Effect on post-retirement benefit obligation	599,000	(561,000)

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's three qualified defined benefit retirement Plans cover (i) those Company employees who are not employed by Missouri Gas Energy or the Pennsylvania Operations; (ii) those employees who are employed by Missouri Gas Energy; and (iii) those employees who are employed by the Pennsylvania Operations. On December 31, 1998, the Plans covering (i) and (ii) above, exclusive of Missouri Gas Energy's union employees, were converted from the traditional defined benefit Plans with benefits based on years of service and final average compensation to cash balance defined benefit plans in which an account is maintained for each employee. The initial value of the account was determined as the actuarial present value (as defined in the Plans) of the benefit accrued at transition (December 31, 1998) under the pre-existing traditional defined benefit plan. Future contribution credits to the accounts are based on a percentage of future compensation, which varies by individual. Interest credits to the accounts are based on 30-year Treasury bond yields.

Defined Contribution Plan The Company provides a Savings Plan available to all employees. Since January 1, 1997, the Company had contributed \$.50 of Company stock for each \$1.00 contributed by a non-Missouri Gas Energy participant up to 5% of the employee's salary. Additionally, the Company contributes \$.75 of Company stock for each \$1.00 contributed by a non-Missouri Gas Energy participant from 6% to 10% of the employee's salary. Effective July 1, 1998, Company contributions for Missouri Gas Energy non-union employees were revised to coincide with that of non-Missouri Gas Energy participants as described above. For Missouri Gas Energy union employees, the Company contributes \$.50 of Company stock for each \$1.00 contributed by such a participant up to 7% of the employee's salary. In Pennsylvania, the Company contributes 40% of the first 4% of the participant's compensation paid into the Savings Plan for all participants, other than those employed by Keystone. The matching contribution for Keystone participants is equal to 50% of the first 4% of the participant's compensation paid into the Savings Plan. Company contributions are 100% vested after five years of continuous service. Company contributions to the plan during 2000, 1999 and 1998, were \$2,034,000, \$1,717,000 and \$1,656,000, respectively.

Effective January 1, 1999 the Company amended its defined contribution plan to provide contributions for certain employees who were employed as of December 31, 1998. These contributions were designed to replace certain benefits previously provided under defined benefit plans. Employer contributions to these separate accounts, referred to as Retirement Power Accounts, within the defined contribution plan were determined based on the employee's age plus years of service plus accumulated sick leave as of December 31, 1998. The contribution amounts are determined as a percentage of compensation and range from 3.5% to 8.5%. Company contributions to Retirement Power Accounts during 2000 and 1999 were \$2,281,000 and \$1,118,000, respectively.

Post-employment Benefits Certain post-employment benefits such as disability and health care continuation coverage provided to former or inactive employees after employment but before retirement, are accrued if attributable to an employees' previously rendered service. The Company has recorded a regulatory asset to the extent it intends to file rate applications to include such costs in rates and such recovery is probable. As of both June 30, 2000 and 1999, the Company has recorded a regulatory asset and a related liability of \$1,343,000.

Common Stock Held in Trust From time to time, the Company purchases outstanding shares of common stock of Southern Union to fund certain Company employee stock-based compensation plans. At June 30, 2000 and 1999, 942,395 and 281,939 shares, respectively, of common stock were held by various rabbi trusts for certain of the Company's benefit plans. During 2000 certain employees deferred receipt of Company shares for stock options exercised. At June 30, 2000, 22,182 shares were held in a rabbi trust for these employees.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

XIV Taxes on Income

	Year Ended June 30,		
	2000 (Restated)	1999	1998
Current:			
Federal	\$ 6,640	\$ (516)	\$ 1,381
State	345	(242)	240
	<u>6,985</u>	<u>(758)</u>	<u>1,621</u>
Deferred:			
Federal	1,857	7,024	5,984
State	747	843	379
	<u>2,604</u>	<u>7,867</u>	<u>6,363</u>
Total provision	<u>\$ 9,589</u>	<u>\$ 7,109</u>	<u>\$ 7,984</u>

Deferred credits and other liabilities also include \$524,000 and \$560,000 of unamortized deferred investment tax credit as of June 30, 2000 and 1999, respectively.

Deferred income taxes result from temporary differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities.

	June 30,	
	2000 (Restated)	1999
Deferred tax assets:		
Estimated alternative minimum tax credit	\$ 21,389	\$ 9,557
Insurance accruals	1,100	2,297
Bad debt reserves	1,135	2,715
Post-retirement benefits	1,888	1,466
Minimum pension liability	--	234
Other	11,118	3,020
Total deferred tax assets	<u>36,630</u>	<u>19,289</u>
Deferred tax liabilities:		
Property, plant and equipment	(123,907)	(74,909)
Unamortized debt expense	(4,732)	(5,049)
Deferred state and local taxes	(12,289)	(3,950)
Regulatory liability	(8,769)	--
Unrealized holding gain on securities	(62,017)	--
Other	(7,336)	(2,781)
Total deferred tax liabilities	<u>(219,050)</u>	<u>(86,689)</u>
Net deferred tax liability	<u>(182,420)</u>	<u>(67,400)</u>
Less current tax assets	1,090	2,838
Accumulated deferred income taxes	<u>\$ (183,510)</u>	<u>\$ (70,238)</u>

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company accounts for income taxes utilizing the liability method which bases the amounts of current and future tax assets and liabilities on events recognized in the financial statements and on income tax laws and rates existing at the time the temporary differences are expected to reverse.

	Year Ended June 30,		
	2000 (Restated)	1999	1998
Computed statutory tax expense at 35%	\$ 6,802	\$ 6,144	\$ 7,075
Changes in taxes resulting from:			
State income taxes, net of federal income tax benefit	710	348	402
Amortization of acquisition adjustment	2,311	830	723
Other	(234)	(213)	(216)
Actual tax expense	<u>\$ 9,589</u>	<u>\$ 7,109</u>	<u>\$ 7,984</u>

XV Utility Regulation and Rates

On April 3, 2000, PG Energy filed an application with the PPUC seeking an increase in its base rates designed to produce \$17,900,000 in additional annual revenues, to be effective June 2, 2000. On May 11, 2000, the PPUC suspended this rate increase request for seven months, until January 2, 2001, in order to investigate the reasonableness of the proposed rates. On August 30, 2000, PG Energy and the principal parties to the base rate proceeding informed the Administrative Law Judge (ALJ) assigned to the proceeding that a complete settlement of the proceeding had been reached. The proposed settlement is designed to produce \$10,800,000 of additional annual revenue. The parties are currently in the process of finalizing a Settlement Agreement and Joint Petition for Settlement of Rate Investigation (the *Settlement Petition*) which will be filed with the ALJ upon its completion. The Settlement Petition will request PPUC approval for the rate increase to become effective on January 1, 2001. It is not presently possible to determine what action either the ALJ or the PPUC will ultimately take with respect to this rate increase request or the Settlement Petition.

On October 18, 1999, Southern Union Gas filed a \$1,696,000 rate increase request for the El Paso service area with the City of El Paso. In February 2000, the City of El Paso approved a \$650,000 revenue increase, and an improved rate design that collects a greater portion of the Company's revenue stream from the monthly customer charge. Additionally, the City of El Paso approved a new 30-year franchise for Southern Union Gas.

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a \$13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of \$2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. On June 15, 2000, the MPSC ruled that it would not rehear or reconsider its decision on one issue valued at \$1,500,000. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional \$700,000 of base revenues increasing the \$13,300,000 initially authorized in its August 21, 1998 order to \$14,000,000. The MPSC is expected to rule on this rehearing in October 2000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

On April 13, 1998, Southern Union Gas filed a \$2,228,000 request for a rate increase from the city of El Paso, a request the city subsequently denied. On April 21, 1998, the city council of El Paso voted to reduce the Company's rates by \$1,570,000 annually and to order a one-time cost of gas refund of \$475,000. On May 21, 1998, Southern Union Gas filed with the Railroad Commission of Texas (RRC) an appeal of the city of El Paso's actions to reduce the Company's rates and require a one-time cost of gas refund. On December 21, 1998, the RRC issued its order

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

implementing an \$884,000 one-time cost of gas refund and a \$99,000 base rate reduction. The cost of gas refund was completed in February 1999.

On January 22, 1997, Missouri Gas Energy was notified by the MPSC of its decision to grant an \$8,847,000 annual increase to revenue effective on February 1, 1997. See *Commitments and Contingencies*.

The MPSC approved a three-year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers shared in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas was acquired above benchmark levels, both the Company and customers shared in such costs. For the years ended June 30, 1999 and 1998, the incentive plan achieved a reduction of overall gas costs of \$6,900,000 and \$9,200,000, respectively, resulting in savings to Missouri customers of \$4,000,000 and \$5,100,000, respectively. The Company recorded revenues of \$2,900,000 and \$4,100,000 in 1999 and 1998, respectively, under this plan. Missouri Gas Energy received authorization from the MPSC for a new gas supply incentive plan that became effective August 31, 2000. Earnings under the plan are primarily dependent on market prices for natural gas declining to certain preauthorized levels which are now below current market prices. There is no assurance that the Company will have an opportunity to generate earnings under this aspect of the plan during fiscal 2001.

Under the order of the Federal Energy Regulatory Commission, a major supplier of gas to Missouri Gas Energy is allowed recovery of certain previously unrecovered deferred gas costs with a remaining balance of nil and \$669,000 at June 30, 2000 and 1999, respectively. Missouri Gas Energy is allowed to recover these costs from its Missouri customers through a purchase gas adjustment mechanism which is filed with and approved by the MPSC. The receivable and liability associated with these costs have been recorded as a deferred charge and a deferred credit, respectively, on the consolidated balance sheet as of June 30, 2000 and 1999.

As a result of the January 31, 1994 acquisition of Missouri Gas Energy, the MPSC required Missouri Gas Energy to reduce rate base by \$30,000,000 to compensate Missouri rate payers for rate base reductions that were eliminated as a result of the acquisition. This is being amortized over a ten-year period on a straight-line basis since the date of acquisition.

XVI Leases

The Company leases certain facilities, equipment and office space under cancelable and noncancelable operating leases. The minimum annual rentals under operating leases for the next five years ending June 30 are as follows: 2001 -- \$7,513,000; 2002 -- \$6,322,000; 2003 -- \$16,905,000; 2004 -- \$3,999,000; 2005 -- \$4,052,000 and thereafter \$10,862,000. Rental expense was \$10,384,000, \$7,732,000 and \$6,054,000 for the years ended June 30, 2000, 1999 and 1998, respectively.

XVII Commitments and Contingencies

Environmental The Company is subject to federal, state and local laws and regulations relating to the protection of the environment. These evolving laws and regulations may require expenditures over a long period of time to control environmental impacts. The Company has established procedures for the on-going evaluation of its operations to identify potential environmental exposures and assure compliance with regulatory policies and procedures.

The Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in its former service territories, principally in Arizona and New Mexico, and present service territories in Texas, Missouri and its newly acquired service territories in Pennsylvania. At the present time, the Company is aware of certain MGP sites in these areas and is investigating those and certain other locations. While the Company's evaluation of these Texas, Missouri, Arizona, New Mexico and Pennsylvania MGP sites is in

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. Certain MGP sites located within the Company's service territories are currently the subject of governmental actions. These sites are as follows:

Kansas City, Missouri MGP Sites In a letter dated May 10, 1999, the Missouri Department of Natural Resources (MDNR) sent notice of a planned Site Inspection/Removal Site Evaluation of the Kansas City Coal Gas Former Manufactured Gas Plant site. This site (comprised of two adjacent MGP operations previously owned by two separate companies and hereafter referred to as Station A and Station B) is located at East 1st Street and Campbell in Kansas City, Missouri and is owned by Missouri Gas Energy. A 1988 investigation of the site performed by an Environmental Protection Agency (EPA) contractor determined that further remedial assessment was not required under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended by the SUPERFUND Amendments and Reauthorization Act of 1986. The MDNR has stated that the reassessment of the Kansas City Coal Gas site is part of a statewide effort to identify, evaluate, and prioritize the potential hazards posed by all of Missouri's MGP sites. During July 1999, the Company sent applications to MDNR submitting the two sites to the agency's Voluntary Cleanup Program. The sites were accepted into the VCP on August 2, 1999 and MDNR subsequently approved the Company's proposed workplans for the environmental assessment of the sites. The final environment reports were sent to the state on March 6, 2000. In a letter dated June 21, 2000, MDNR responded to the Station A environmental report submitted by the Company. In that letter, MDNR stated that soil remediation will be necessary at the site (Station A) but that further exploration and delineation of site contamination should be performed before remedial methods can be determined. MDNR has requested that the Company submit a work plan for further investigation of the site. MDNR has not responded to the Station B environmental report submitted by the Company.

Independence, Missouri MGP Site The Company received a letter dated December 16, 1999 from MDNR notifying the Company of a Pre-CERCLIS Site Screening investigation of a former manufactured gas plant located at Pacific Avenue & South River Boulevard in Independence, Missouri. The Company contacted the MDNR to inform the state that, as this property is not owned by the Company, it cannot grant access to the property for MDNR's investigation. MDNR proceeded to investigate the site in cooperation with the site's current owner. In a letter dated May 17, 2000, MDNR reported that the site is not recommended for CERCLIS (Comprehensive Environmental Response, Compensation and Liability Information System) entry and no further CERCLA action is recommended. However, due to the presence of characteristic waste, the site is eligible for the state's Registry of Confirmed Abandoned or Uncontrollable Hazardous Waste Disposal Sites in Missouri.

To the extent that potential costs associated with former manufactured gas plants are quantified, the Company expects to provide any appropriate accruals and seek recovery for such remediation costs through all appropriate means, including insurance and regulatory relief. In addition, at the time of the closing of the acquisition of the Company's Missouri service territories, the Company entered into an Environmental Liability Agreement that provides that Western Resources retains financial responsibility for certain liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy.

Although significant charges to earnings could be required prior to rate recovery, management does not believe that environmental expenditures for MGP sites will have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company follows the provisions of an American Institute of Certified Public Accountants Statement of Position, *Environmental Remediation Liabilities*, for recognition, measurement, display and disclosure of environmental remediation liabilities.

Regulatory On August 18, 1998, the Missouri State Court of Appeals, Western District, denied the Company's appeal of the February 1, 1997 rate order which retroactively reduced the carrying cost rate applied by the Company on expenditures incurred on the Missouri Gas Energy Safety Program. The Company believes that the inconsistent

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

treatment by the MPSC in subsequently changing to the Allowance for Funds Used During Construction rate of approximately 6% from the previously ordered rate of 10.54% constitutes retroactive ratemaking. Unfortunately, the decision by the Missouri State Court of Appeals failed to address certain specific language within a 1994 MPSC accounting authority order that the Company believed prevented the MPSC from retroactively changing the carrying cost rate. Southern Union sought a transfer of the case to the Missouri Supreme Court which was denied on November 24, 1998.

The continuation of the Missouri Safety Program will result in significant levels of future capital expenditures. The Company estimates incurring capital expenditures of \$15,631,000 in fiscal 2001 related to this program.

In August 1998, a jury in Edinburg, Texas concluded deliberations on the City of Edinburg's franchise fee lawsuit against PG&E Gas Transmission, Texas Corporation (formerly Valero Energy Corporation (Valero)) and a number of its subsidiaries, as well as former Valero subsidiary Rio Grande Valley Gas Company (RGV) and RGV's successor company, Southern Union Company. The case, based upon events that occurred between 1985-1987, centers on specific contractual language in the 1985 franchise agreement between RGV and the City of Edinburg. Southern Union purchased RGV from Valero in October 1993. The jury awarded the plaintiff damages, against all defendants under several largely overlapping but mutually exclusive claims, totaling approximately \$13,000,000. The trial judge subsequently reduced the award to approximately \$700,000 against Southern Union and \$7,800,000 against Valero and Southern Union together. The Company is pursuing reversal on appeal. The Company believes it will ultimately prevail, and that the outcome of this matter will not have a material adverse impact on the Company's results of operations, financial position or cash flows. Furthermore, the Company has not determined what impact, if any, this jury decision may have on other city franchises in Texas.

Southwest Gas Litigation On February 1, 1999, Southern Union submitted a proposal to the Board of Directors of Southwest Gas Corporation (Southwest) to acquire all of Southwest's outstanding common stock for \$32.00 per share. Southwest then had a pending merger agreement with ONEOK, Inc. (ONEOK) at \$28.50 per share. On February 22, 1999, Southern Union and Southwest both publicly announced Southern Union's proposal, after the Southwest Board of Directors determined that Southern Union's proposal was a Superior Proposal (as defined in the Southwest merger agreement with ONEOK). At that time Southern Union entered into a Confidentiality and Standstill Agreement with Southwest at Southwest's insistence. On April 25, 1999, Southwest's Board of Directors rejected Southern Union's \$32.00 per share offer and accepted an amended offer of \$30.00 per share from ONEOK. On April 27, 1999, Southern Union increased its offer to \$33.50 per share and agreed to pay interest which, together with dividends, would provide Southwest shareholders with a 6% annual rate of return on its \$33.50 offer, commencing February 15, 2000, until closing. Southern Union's revised proposal was rejected by Southwest's Board of Directors. On January 21, 2000, ONEOK announced that it was withdrawing from the Southwest merger agreement.

There are several lawsuits pending that relate to activities surrounding Southern Union's efforts to acquire Southwest. In addition, there is before the U.S. Court of Appeals for the Tenth Circuit, an appeal by Southern Union of a preliminary injunction entered by the U.S. District Court for the Northern District of Oklahoma. Southern Union intends to vigorously pursue its claims against Southwest, ONEOK, and certain individual defendants, and vigorously defend itself against the claims by Southwest and ONEOK.

California Action -- Arthur Klein, et al. v. Southwest Gas Corporation, et al., Southern Union Company, Intervenor, Case No. 726615 (Superior Court of California, County of San Diego) On September 24, 1999, the court dismissed Southern Union's claims against Southwest Gas without prejudice, allowing Southern Union to subsequently refile the claims as of September 24, 1999 if related federal court litigation does not resolve the claims.

Nevada Action -- Southwest Gas Corporation v. Southern Union Company; Case No. CV-S-99-0530-JBR (U.S.D.C., District of Nevada) (transferred to the District of Arizona to Case No. CIV-00-452-PHX-RGS) On April 20, 1999, Southwest filed an action against Southern Union in the United States District Court for the District of Nevada. The complaint alleged breach of the Confidentiality and Standstill Agreement between Southern Union

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

and Southwest, misappropriation of original trade secrets in violation of California statutes, intentional interference with the ONEOK merger agreement, intentional interference with prospective advantage, breach of a common-law duty of good faith and fair dealing, and unfair business practices in violation of California statutes. On May 6, 1999, Southwest filed an amended complaint that added a claim for breach of the Securities Exchange Act of 1934 to the claims in the original complaint. Southwest seeks declaratory and injunctive relief together with money damages "in excess of \$75,000.00." Southern Union has answered the complaint, denying liability under all counts. Southern Union has filed a counterclaim alleging breach of contract, breach of duty of good faith and fair dealing, mistake of fact and fraudulent inducement with respect to the Confidentiality and Standstill Agreement. The counterclaim seeks partial rescission of the Confidentiality and Standstill Agreement and/or declaratory relief. On March 8, 2000, the Nevada Court transferred this case to the District of Arizona where it has been lodged before Judge Roger G. Strand as Case No. CIV-00-452-PHX-RGS.

Oklahoma Action -- ONEOK, Inc. v. Southern Union Company; Case No. 99-CV-0345H(M) (U.S.D.C., Northern District of Oklahoma) On May 5, 1999, ONEOK filed an action against Southern Union in the United States District Court for the Northern District of Oklahoma, asserting third-party beneficiary status under the Confidentiality and Standstill Agreement between Southern Union and Southwest, and alleging a claim for breach of that Agreement as well as a claim for intentional interference with the ONEOK-Southwest merger agreement. That same day, ONEOK moved for a temporary restraining order against Southern Union to bar Southern Union from making any attempt to solicit proxies from or influence the shareholders of Southwest with respect to Southern Union's offer to purchase Southwest, from taking any actions in the regulatory proceedings that concern the proposed merger of ONEOK and Southwest, from taking any actions in the *Klein v. Southwest Gas Corp.* case and from taking any actions to seek to control or influence the shareholders, management, directors or policies of Southwest, either alone or in concert with others. The court entered a preliminary injunction on May 17, 1999. Southern Union has answered the Complaint, denying liability under all counts. Southern Union has asserted a counterclaim seeking declaratory judgment on enforceability of the Confidentiality and Standstill Agreement and a declaration that Southern Union has not breached the Confidentiality and Standstill Agreement. On September 12, 2000, the court entered an order transferring this case from the Northern District of Oklahoma to the District of Arizona.

Appeal of Oklahoma Action -- ONEOK, Inc. v. Southern Union Company; Case No. 99-5103 (Tenth Circuit Court of Appeals) On May 17, 1999 Southern Union noticed its appeal of the Oklahoma District Court's preliminary injunction in the United States District Court of Appeals for the Tenth Circuit. On March 22, 2000, the appellate court returned this matter to the district court for consideration of whether the facts underlying ONEOK's original request for a preliminary injunction have so materially changed that the need for injunctive relief originally granted no longer exists.

Arizona Action -- Southern Union Company v. Southwest Gas Corporation; Case No. CIV-99-1294-PHX-ROS (U.S.D.C., District of Arizona) On July 19, 1999, Southern Union filed an action in the United States Court for the District of Arizona (which was subsequently amended on October 11, 1999 and July 26, 2000). The current defendants are Southwest, ONEOK, Michael O. Maffie (Southwest's President), Thomas Y. Hartley (Southwest's Chairman), Eugene N. Dubay (President of Kansas Gas Service, a division of ONEOK), James M. Irvin (an Arizona Corporation Commissioner), Jack D. Rose (former Executive Director of the Arizona Corporation Commission), John A. Gaberino (ONEOK's General Counsel) and Mark D. Dioguardi (ONEOK's outside counsel). The suit alleges racketeering under federal and state law, fraud in the inducement, breach of contract, Securities Exchange Act violations, breach of the covenant of good faith and fair dealing, rescission, intentional interference with business relationship, tortious interference with contractual relations and civil conspiracy. Southern Union seeks damages of \$750 million on each of the two racketeering counts, to be trebled; \$750 million on six other counts; punitive damages on four counts; and rescission of its Standstill Agreement with Southwest.

Southwest Action in Arizona -- Southwest Gas Corporation v. ONEOK, Inc. and Southern Union Company; Case No. CIV-00-119-PHX-ERC (U.S.D.C., District of Arizona) On January 21, 2000, ONEOK announced its withdrawal from the Southwest merger and filed a declaratory judgment action against Southwest. On January 24,

SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2000, Southwest Gas filed an action in Arizona naming ONEOK and Southern Union as defendants. The Complaint asserts claims against Southern Union for breach of contract, breach of the implied covenant of good faith and fair dealing, interference with contract, intentional interference with prospective economic advantage, misappropriation of trade secrets and declaratory relief. Southwest seeks damages against Southern Union in excess of \$75,000 as well as exemplary damages. Southern Union has answered the Complaint, denying liability under all counts.

The Company believes that the results of the above-noted Southwest litigation will not have a materially adverse effect on the Company's financial condition, results of operations and cash flows.

Other Southern Union and its subsidiaries are parties to other legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject, and not to be material to the Company's overall business or financial condition, results of operations or cash flows.

Commitments The Company is committed under various agreements to purchase certain quantities of gas in the future. At June 30, 2000, the Company has purchase commitments for certain quantities of gas at variable, market-based prices that have an annual value of \$113,666,000. The Company's purchase commitments may extend over a period of several years depending upon when the required quantity is purchased. The Company has purchase gas tariffs in effect for all its utility service areas that provide for recovery of its purchase gas costs under defined methodologies.

Due to the operation of purchase gas adjustment clauses, gas purchase costs generally do not directly affect earnings of our regulated utility operations. However, the Company's unregulated gas marketing operations are subject to price risk related to fixed-price sales commitments that are not matched with corresponding fixed-price purchase agreements. At June 30, 2000, the Company had fixed-price sales commitments with various customers that provide for the delivery of approximately 1,922,201 Dekatherms of natural gas through April 2001 at an average sales price per Dekatherm of \$3.00. The Company has exposure to the changes in gas prices related to fluctuating commodity prices, which can impact the Company's financial position or results of operations, either favorably or unfavorably. The Company's open positions are actively managed, and the impact of changing prices on the Company's financial position at a point in time is not necessarily indicative of the impact of price movements throughout the year.

As a result of the unauthorized financial derivative energy trading activity, an open contract of a non-regulated, wholly-owned subsidiary was present at June 30, 2000 for 10,000 MMBtu's of natural gas per day for the contract period of January 2001 to December 2001 at a fixed price of \$2.72 per MMBtu. The Company had exposure to the changes in gas prices related to fluctuating commodity prices, which can impact the Company's financial position or results of operations, either favorably or unfavorably.

In connection with the acquisition of the Pennsylvania Operations, the Company assumed a guaranty with a bank whereby the Company unconditionally guaranteed payment of financing obtained for the development of PEI Power Park. In March 1999, the Borough of Archbald, the County of Lackawanna, and the Valley View School District (together the *Taxing Authorities*) approved a Tax Incremental Financing Plan (TIF Plan) for the development of PEI Power Park. The TIF Plan requires that: (i) the Redevelopment Authority of Lackawanna County raise \$10,600,000 of funds to be used for infrastructure improvements of the PEI Power Park; (ii) the Taxing Authorities create a tax increment district and use the incremental tax revenues generated from new development to service the \$10,600,000 debt; and (iii) PEI Power Corporation, a subsidiary of the Company, guarantee the debt service payments. In May 1999, the Redevelopment Authority of Lackawanna County borrowed \$10,600,000 from a bank under a promissory note (TIF Debt). The TIF Debt has a 12-year term, with a 7.75% annual interest rate, and requires semi-annual principal and interest payments of approximately \$725,000 (interest only for the first year). As of June 30, 2000, incremental tax revenues cover approximately 17% of the annual debt service. The balance outstanding on the TIF Debt was \$9,805,000 as of June 30, 2000.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During fiscal 2000, the Company agreed to a one-year contract and a three-year contract with each bargaining unit representing Pennsylvania employees, which were effective on April 1, 2000 and August 1, 2000, respectively. In December 1998, the Company agreed to five-year contracts with each bargaining-unit representing Missouri employees, which were effective in May 1999. Of the Company's employees represented by unions, 95% are employed by Missouri Gas Energy.

The Company had standby letters of credit outstanding of \$6,199,000 and \$1,622,000 at June 30, 2000 and 1999, respectively, which guarantee payment of various insurance premiums and state taxes.

XVIII Quarterly Operations (Unaudited)

Year Ended June 30, 2000	Quarter Ended				Total(1)
	September 30	December 31	March 31	June 30(1)	(Restated)
Total operating revenues	\$ 84,786	\$ 239,595	\$ 344,789	\$ 162,534	\$ 831,704
Operating margin	45,509	94,483	126,997	67,017	334,006
Net operating revenues	1,807	30,897	52,902	4,508	90,114
Net earnings (loss) available for common stock	(6,100)	7,132	19,516	(10,703)	9,845
Earnings (loss) per share -- diluted ⁽²⁾	(.19)	.16	.38	(.22)	.22

Year Ended June 30, 1999	Quarter Ended				Total
	September 30	December 31	March 31	June 30	
Total operating revenues	\$ 77,455	\$ 174,224	\$ 251,863	\$ 101,689	\$ 605,231
Operating margin	42,781	70,286	98,106	51,757	262,930
Net operating revenues (loss)	(627)	19,986	40,647	4,841	64,847
Net earnings (loss) available for common stock	(7,048)	5,374	17,624	(5,505)	10,445
Earnings (loss) per share -- diluted ⁽²⁾	(.22)	.16	.51	(.17)	.31

(1) See Note II -- Restatement.

(2) The sum of earnings per share by quarter may not equal the net earnings per common and common share equivalents for the year due to variations in the weighted average common and common share equivalents outstanding used in computing such amounts.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of
Southern Union Company:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, cash flows and stockholders' equity after the restatement described in Note II, present fairly, in all material respects, the financial position of Southern Union Company and its subsidiaries at June 30, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Austin, Texas
August 23, 2000, except for
Notes III, XII and XV, as to which
the date is September 28, 2000
and Note II, as to which the
date is April 9, 2001

CONSENT OF INDEPENDENT ACCOUNTANTS

Exhibit 23

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (File Nos. 33-58297, 333-02965 and 333-10585) and Form S-8 (File Nos. 2-79612, 33-37261, 33-69596, 33-69598, 33-61558, 33-79443, 333-08994, 333-42635, 333-89971, 333-90347, 333-36146, 333-36150 and 333-46382) of Southern Union Company and Subsidiaries of our report dated August 23, 2000, except for Notes III, XII and XV as to which the date is September 28, 2000 and Note II, as to which the date is April 9, 2001, relating to the consolidated financial statements, which appears in the Annual Report to Stockholders, which is incorporated in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP

Austin, Texas
April 25, 2001

[This Page Intentionally Left Blank]