STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DIVISION OF PUBLIC UTILITIES AND CARRIERS
100 ORANGE STREET
PROVIDENCE, RHODE ISLAND 02903

IN RE: Petition of Valley Gas Company, Bristol and Warren Gas Company and Southern Union Company for Approval of Mergers	:	Docket No. D-00-02
IN RE: Petition of Providence Energy Corporation, Providence Gas Company and Southern Union Company for Approval of Mergers	:	Docket No. D-00-03

REPORT AND ORDER

1. INTRODUCTION

On January 27, 2000, the Valley Gas Company ("Valley") the Bristol and Warren Gas Company ("Bristol") and the Southern Union Company ("Southern Union") (collectively the "Valley/Southern Union Companies" or "Petitioners" or "Companies"), filed a petition with the Rhode Island Division of Public Utilities and Carriers ("Division") seeking an approval of merger. The petition included a proposed *Agreement and Plan of Merger* ("*Merger Agreement*"). The petition was filed pursuant to the requirements of Rhode Island General Laws, Sections 39-3-24, 39-3-25 and 39-3-26. The Division docketed the Valley/Southern Union Companies petition and designated the case D-00-02.

Also on January 27, 2000, the Providence Energy Corporation ("ProvEnergy") and Southern Union filed a notification with the Division detailing an *Agreement and Plan of Merger* ("*Merger Agreement*") that ProvEnergy and Southern Union had previously executed on November 15,

1999. The notification stated that ProvEnergy had merged with and into Southern Union.

Upon receipt of the January 27, 2000 ProvEnergy and Southern Union notification of merger, the Division contacted ProvEnergy to notify ProvEnergy that the Division would be exercising jurisdiction over the merger through authority conferred under Sections 39-3-24 and 39-3-25, supra; and also under the broad regulatory powers of the Division as conferred under Rhode Island General Laws, Sections 39-1-1, 39-1-15, 39-1-38, 39-3-28, 39-3-30, 39-4-3 and 39-4-13. The Division indicated that the invocation of jurisdiction was necessitated by virtue of ProvEnergy's ownership of the Providence Gas Company ("ProvGas"), a natural gas distribution company operating in Rhode Island under the regulatory oversight of the Division.

Neither ProvEnergy nor Southern Union objected to the Division's invocation of jurisdiction and authority over the merger. ProvEnergy and Southern Union accepted the Division's interest in the merger's concomitant impact on ProvGas and ProvGas' Rhode Island ratepayers. Accordingly, the Division transformed the ProvEnergy, ProvGas and Southern Union (collectively the "ProvGas/Southern Union Companies" or "Petitioners" or "Companies") notification into a formal petition for approval of merger and designated the docketed case D-00-03.

Following the docketing of the two merger petitions, the Division received motions to intervene by the Energy Council of Rhode Island ("TEC-RI") and the

Department of Attorney General ("Attorney General"), each seeking to intervene in both merger dockets.[1]

The Division subsequently scheduled and conducted a consolidated prehearing conference on March 23, 2000. The dockets were consolidated in view of Southern Union's involvement in both mergers and for reasons of administrative economy. A procedural and hearing schedule was established at the March 23 prehearing conference. The petitioners also stated that they had no objections to the interventions requested by TEC-RI and the Attorney General.[2] The Division's Advocacy Section ("Advocacy Section"), an indispensable party, also entered an appearance in each docket.

2. SUMMARY OF MERGER PETITIONS

A. Valley Gas/Southern Union Companies' Merger Petition

The Valley Gas/Southern Union Companies' merger petition recites the following relevant information and claims:

- Valley and Bristol are both public utilities in the State of Rhode Island, and Southern Union is a public utility corporation organized under the laws of the State of Delaware. Valley and Bristol are wholly-owned subsidiaries of Valley Resources, a Rhode Island corporation, and serve approximately 64,000 customers.

[1] TEC-RI's motions were filed on February 28, 2000. The Attorney General's motions were filed on March 2, 2000.
[2] The petitioners did not object to the intervention motions and consequently all were granted perfunctorily pursuant to Rule 17(e) of the Division's Rules of Practice and Procedure.

- Southern Union is an international energy distribution company based in Austin, Texas with approximately $1.8 billion in assets as of December 31, 1999. After consummating this and other previously-announced mergers, Southern Union will operate as a utility in Rhode Island, Massachusetts, Pennsylvania, Texas, Missouri and Florida, serving more than 1.6 million customers.
- If the merger is approved, Southern Union will operate as a public utility in the State of Rhode Island with Valley and Bristol constituting the "Valley Division" of the "New England Business Unit" of Southern Union. Southern Union, to the extent that it operates as a public utility in the State of Rhode Island, will be subject to regulation under Title 39 of the General Laws.
- The *Merger Agreement* provides initially for the merger of Valley Resources into SUG Acquisition Corporation, a wholly-owned subsidiary of Southern Union. Upon consummation of this merger, SUG Acquisition Corporation's corporate existence will cease and Valley Resources will be a wholly-owned subsidiary of Southern Union. Immediately after this merger is completed, Valley and Bristol, wholly-owned subsidiaries of Valley Resources, each will be merged into Valley Resources. Immediately following these subsidiary mergers, Valley Resources will merge into Southern Union. Valley Resources' utility operations will then become the Valley Division of the New England Business Unit of Southern Union, and Valley

Resources' non-utility subsidiaries will become subsidiaries of Southern Union. The mergers will become effective following the approval of the *Merger Agreement* by the stockholders of Valley Resources and the satisfaction or waiver of all other conditions to the mergers, including the requisite regulatory approvals. As a result of the initial merger of Valley Resources into SUG Acquisition Corporation, each share of Valley Resources' common stock will be converted into the right to receive $25.00 in cash.

- Valley and Bristol are currently seeking legislative amendments to conform their respective charters to the provisions of Rhode Island General Laws, Section 39-3-26 which was amended at the last session of the General Assembly – to allow their respective mergers.
- The mergers are designed to be transparent to Valley's and Bristol's customers. There will be no base rate increase sought as a result of the mergers. Southern Union will continue to provide service to Valley's and Bristol's customers.
- The current directors of Valley Resources, Valley and Bristol will resign. The officers of Valley and Bristol will continue as officers of the Valley Division until such time as the surviving corporation determines otherwise.
- Southern Union will not seek recovery of merger-related costs, including the acquisition premium, in Valley's or Bristol's base rates. However, Southern Union will request that in future ratemaking

proceedings consideration be given to alternative performance-based approaches to recognize and encourage operational improvements, whether or not merger related.

- The petition states that the mergers "will have specific benefits" for Valley's and Bristol's customers. The anticipated benefits include the following:

  - The customers of Valley and Bristol will become customers of a financially larger company.
  - Gas cost fluctuations will be mitigated as a result of the greater purchasing power of the surviving corporation and a greater opportunity to enter into more beneficial long-term gas supply contracts.
  - The surviving corporation will have an enhanced ability to raise capital at reasonable rates for investment in the gas distribution system and customer service. This will result in improved opportunities to introduce new technologies.
  - There will be a further unbundling of rates to allow customers a broader range of choice of gas suppliers.
  - There will be savings of administrative costs (e.g. elimination of directors' fees and other costs associated with Valley Resources as a publicly traded company).

- As a result of the mergers there will be no layoffs in Valley's or Bristol's work forces. Southern Union will honor Valley's and Bristol's

union contracts, and there will be no change in employee benefit programs for at least two years.

- All other existing contracts will be honored after the mergers.
- The officers and employees of Valley and Bristol will continue their commitment to community service with non-profit agencies. (Valley Exh. 1).

B. ProvGas/Southern Union Companies' Merger Petition

The ProvGas/Southern Union Companies' merger petition (notification) recites the following relevant information and claims:

- Founded in 1929, Southern Union is a natural gas local distribution company, incorporated under the laws of the State of Delaware, with a principal place of business in Austin, Texas. Southern Union serves approximately 1.2 million distribution customers through four operating divisions located in Texas, Missouri, Florida and Pennsylvania.
- ProvEnergy is a holding company established and incorporated under the laws of the State of Rhode Island in 1981, with a principal place of business in Providence, Rhode Island. ProvEnergy owns two regulated natural gas distribution companies, The Providence Gas Company ("ProvGas") and North Attleboro Gas Company ("North Attleboro"). ProvEnergy's unregulated business enterprises consist primarily of Providence Energy Services, Inc., a retail marketer of natural gas, oil and electricity, and ProvEnergy Fuels, Inc. a retail

fuel-oil distributor. ProvGas was organized in 1847 as a Rhode Island corporation and currently serves approximately 170,000 customers in Providence, Newport and 23 other cities and towns in Rhode Island. North Attleboro was organized in 1930 as a Massachusetts corporation and currently serves approximately 3800 customers in North Attleboro and Plainville, Massachusetts.

- ProvEnergy concluded that significant benefits could result from a business combination with a larger organization having access to greater resources, and therefore, that such a combination would be in the best interest of ProvEnergy's customers, employees and shareholders. ProvEnergy chose Southern Union as a merger partner based on the assessment that Southern Union was in the best position to offer the highest value for shareholders while meeting those principal objectives.
- The ProvGas/Southern Union Companies maintain that the merger will provide opportunities to improve service quality and to create the potential for gas-cost reductions as a result of the coordination of gas resources. Because ProvEnergy will serve as the headquarters for Southern Union's New England operations, ProvGas states that it will continue to serve its customers with the same skilled and dedicated employees who know and understand local needs.
- As a result of the merger, ProvGas will become an operating division of Southern Union. The *Merger Agreement* sets forth the sequence of

events that will result in the merger of ProvEnergy and Southern Union, which includes the following steps:

(1) *Southern Union and ProvEnergy will obtain all necessary approvals of the mergers from their respective shareholders;*
(2) *Southern Union will create GUS Acquisition Corporation ("NewCo") as a Rhode Island corporation and wholly owned subsidiary of Southern Union for the purpose of effecting the merger with ProvEnergy and its wholly owned subsidiaries;*
(3) *NewCo will be merged with and into ProvEnergy in accordance with the laws of the State of Rhode Island. ProvEnergy will be the surviving corporation in the merger and will continue its existence under the laws of the State of Rhode Island;*
(4) *Immediately following the merger of NewCo with and into ProvEnergy, North Attleboro will merge with and into ProvEnergy, in accordance with the general business laws of Massachusetts and Rhode Island, with ProvEnergy being the surviving corporation;*
(5) *Immediately following the merger of North Attleboro with and into ProvEnergy, ProvGas will merge with and into ProvEnergy, in accordance with the general business laws of Rhode Island, with ProvEnergy being the surviving corporation;*
(6) *Immediately following the merger of ProvGas with and into ProvEnergy, ProvEnergy will merge with and into Southern Union in accordance with the general business laws of Rhode Island and Delaware, with Southern Union being the surviving corporation;*
(7) *At the effective time of the merger between ProvEnergy and Southern Union, each share of the approximately 6.1 million issued and outstanding shares of ProvEnergy common stock, will be automatically converted into the right to receive $42.50 in cash;*
(8) *Upon the completion of the conversion of ProvEnergy common stock into cash, as described above, ProvEnergy will become a division of Southern Union. (ProvGas Exh.1).*

- As a result of the mergers with Southern Union, ProvEnergy, ProvGas, North Attleboro Gas, Valley Gas and the Fall River Gas Company

("Fall River Gas") will become operating divisions of Southern Union.[3] Each company, however, will continue to do business under the name currently used. These operating divisions will be organized by Southern Union into its "New England Business Unit," which will be anchored by ProvEnergy.

- Although organized as separate operating divisions within the New England Business Unit, the new divisions will not function wholly as stand-alone entities. The Petitioners represent that certain corporate and administrative functions such as treasury, financial reporting, and investor relations, will be more economical if performed on a consolidated basis, and therefore, will be performed by Southern Union for all of its operating divisions. In addition, gas distribution activities will be managed on a coordinated basis, which the Petitioners claim will increase overall system reliability and lower overall gas costs.
- The Petitioners state that the overall impact of the merger on customers will largely be in the nature of customer-service enhancements that will result from technology upgrades, increased distribution system reliability and similar benefits that will flow over time from participation in a larger organization. The Petitioners claim that the merger with Southern Union is likely to produce some cost

[3] In addition to its proposed mergers with ProvEnergy, Valley and Bristol, Southern Union is contemporously seeking a merger with the Fall River Gas Company, in Massachusetts.

savings over the long term by virtue of the ability to coordinate and consolidate certain corporate and gas-distribution activities of the New England Business Unit.

- The Petitioners claim that the merger of Southern Union and ProvEnergy will have no immediate impact on base rates. The base rates charged to ProvGas customers are the product of *Energize RI,* a three-year Price Stabilization Plan Settlement approved by the Rhode Island Public Utilities Commission ("Commission") in August 1997, which is set to expire on September 30, 2000. The Petitioners state that any base-rate change necessitated by the expiration of *Energize RI,* will be unrelated to the merger.
- The Petitioners state that some cost savings will result from the merger over time as a result of the consolidation of certain administration activities. The Petitioners state that these cost savings will actually help to offset rate increases that may otherwise be required in the absence of the merger.
- The Petitioners note, however, that these savings are not of the same magnitude as the costs that will be incurred by Southern Union to accomplish the merger. The petition identifies the following three costs to be borne by Southern Union:

> *(1) transaction costs relating to fees, appraisals and outside service such as accounting, legal, investment banking, actuarial, environmental, and engineering consultants; (2) integration costs to effect the consolidation of the operations of the*

> *merging companies, such as the cost of upgrading computer systems and restructuring business functions to attain net cost savings; and (3) the acquisition premium.*

- The Petitioners state that Southern Union is not seeking recovery of the acquisition premium or other merger-related costs based on achieved synergies. Rather, Southern Union proposes that consideration be given to alternative ratemaking models that recognize and encourage operational improvements, whether or not merger-related. Southern Union encourages the Division to continue initiatives to move away from the traditional cost-of-service, rate-of-return model for establishing utility rates and instead to rely on alternative approaches involving performance-based ratemaking ("PBR") concepts. Southern Union believes that PBR and earnings-sharing models can provide a workable framework within which ProvGas can be given sufficient incentives to increase operating efficiencies, while improving customer service and system integrity with a corresponding opportunity for increased earnings to shareholders.
- The Petitioners state that operating these systems as a single, integrated system will create the ability to adjust gas deliveries and gas flows between the affiliated distribution systems, thereby improving the delivery capabilities of the overall system. In addition, the coordination of the gas-supply portfolios of the combined

operations will enable Southern Union to utilize peak-shaving facilities and peaking-supply contracts more efficiently. The merger is also expected to create economies of scale in relation to gas-purchasing and outsourcing opportunities that may result in cost savings over the long term.

- The Petitioners state that the proposed merger will not adversely affect the quality of service experienced by ProvGas customers and is likely to result in improved service quality because of the resources that will be available from the larger organization.

3. HEARINGS AND APPEARANCES

In response to the petition filings, the Division conducted duly noticed consolidated public hearings on May 31, and June 1, 2000. The hearings were held at the Division's hearing room, located at 100 Orange Street in Providence. The following counsel entered appearances:

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For Valley, Bristol and Southern Union:	Deming E. Sherman, Esq.
For the Advocacy Section:	Elizabeth Kelleher, Esq. Special Assistant Attorney General
For the Attorney General:	Paul J. Roberti, Esq. Assistant Attorney General
For TEC-RI:	Andrew J. Newman, Esq.

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For ProvEnergy, ProvGas and Southern Union:	Robert J. Keegan, Esq.

For the Advocacy Section	Elizabeth Kelleher, Esq.
For the Attorney General:	Paul J. Roberti, Esq. Assistant Attorney General
For TEC-RI:	Andrew J. Newman, Esq.

4. PETITIONERS' DIRECT CASES

A. Valley Gas/Southern Union Companies' Direct Case

The Valley Gas/Southern Union Companies proffered four witnesses in support of their merger petition. The witnesses were identified as: Mr. Alfred P. Degen, Chairman, President and CEO of Valley and Bristol, and Chairman, President and CEO of Valley Resources, Inc. ("Valley Resources"), the parent of Valley and Bristol; Mr. Peter H. Kelley, President and Chief Operating Officer of Southern Union; Mr. Ronald J. Endres, Executive Vice President and Chief Financial Officer of Southern Union; and Mr. Orlando M. Magnani, a principal in the consulting firm of Navigant Consulting, Inc., 200 Wheeler Road, Suite 400, Burlington, MA 01803.

Mr. Alfred Degen's testimony echoed many of the merger details contained in the petition. Mr. Degen also sponsored a copy of the *Merger Agreement* being proposed by the Companies. (Valley Exh. 3).

Mr. Degen related that Valley Resources decided to enter into the *Merger Agreement* with Southern Union because its directors and officers believe that the proposed mergers are in the best interests of both the stockholders of Valley Resources and the customers of Valley and Bristol. He testified that the stockholders of Valley Resources will receive fair value for their shares, and, over time, as part of a larger company, Valley's and Bristol's customers will

receive a number of benefits. Mr. Degen thereupon reiterated the benefits outlined in the petition. In sum, he related that the surviving company would be a financially larger company, with greater purchasing power and with an enhanced ability to raise capital (Id., p. 6).

Mr. Degen also emphasized that there will be no base rate increases sought as a result of the mergers. He further related that Valley's and Bristol's customers will notice no changes in the day-to-day operations of the Companies.(Id., p. 5).

In closing, Mr. Degen assured the Division that the "public interest will be served by the proposed mergers and the quality of service rendered by Valley and Bristol to their customers will be enhanced." (Id. p. 7).

Mr. Peter Kelley offered testimony relative to Southern Union's organizational structure, and its business approach and strategic direction. He also discussed the reasons for the merger with Valley Resources, and why he believes the merger will be beneficial to Valley's and Bristol's customers.

Mr. Kelley offered the following description of Southern Union and its organization structure:

> *... the Company's primary business is the sale and distribution of natural gas. Southern Union now serves approximately 1.2 million gas distribution customers through four operating divisions. Our Texas division, Southern Union Gas Company, serves approximately 523,000 customers in various Texas towns and cities in west Texas (including El Paso and Monahans), the Gulf Coast (including Galveston and Port Arthur), the Rio Grande Valley (including McAllen and Brownsville), south Central Texas (including Austin and Lockhart), and north Texas (including Mineral Wells and Weatherford). Our Missouri division, Missouri Gas Energy, serves approximately 487,000 customers in western Missouri,*

> *including the cities of Kansas City, St. Joseph, Monett, and Joplin. Southern Union acquired its Missouri properties in early 1994. Our Florida division, South Florida Natural Gas, serves approximately 5,000 customers in the vicinity of New Smyrna Beach and Lauderhill and was acquired in January 1998. Our newest division, PG Energy, was acquired by Southern Union in November 1999 and serves about 154,000 gas distribution customers in central and northeastern Pennsylvania, including the cities of Scranton, Wilkes-Barre and Williamsport.*
>
> *In addition to its natural gas distribution divisions, Southern Union has several energy-related, non-utility subsidiaries. These subsidiaries are involved in natural gas marketing, electric power marketing, intrastate pipeline transportation service, propane sales and distribution, and international (Mexico) activities (Valley Exh. 4, pp. 2-3).*

Mr. Kelley testified that Southern Union's business approach emphasizes efficient operations, high quality customer service, sales activities that focus on improved utilization of Southern Union's distribution systems, and growth through cost-effective system expansions and strategic acquisitions. He related that Southern Union believes that this approach will make it "a highly successful participant in the increasingly competitive energy marketplace" (Id., p. 4). Mr. Kelley added that Southern Union expects that highly reliable, low cost gas distribution service will lead to growth in customers and throughput, thereby creating value for both customers and shareholders. (Id.).

Mr. Kelley stated that a number of factors make Southern Union's business approach successful. He identified the factors as safety and reliability, low cost gas procurement, highly motivated employees, deployment of new technologies, and economic development.

Mr. Kelley related that providing safe and reliable service is a prerequisite to successful participation in an increasingly competitive marketplace. He related that price is secondary if the service is not safe and dependable. He further related that recent developments in the area of performance-based regulation typically recognize the importance of maintaining service quality and reliability.

Mr. Kelley observed that after safety and reliability, the customer's primary concern is the amount he or she pays for gas service. He related that although low cost distribution service benefits the customer, the cost of gas portion of a customer's bill often can represent more than half of the total bill for a sales customer. Accordingly, the witness stated, Southern Union works diligently to secure additional supply sources in order to place competitive pressures on incumbent suppliers in its service areas. As an example, Mr. Kelley stated that after acquiring its Missouri properties, the Company successfully negotiated with a major pipeline to expand service to the Kansas City area. He stated that the Company also actively participates in proceedings before the Federal Energy Regulatory Commission. Mr. Kelley also noted that Southern Union has participated in various El Paso Natural Gas Company rate proceedings to help keep customer bills in Southern Union's El Paso Service Area among the lowest in the nation. Mr. Kelley noted that in the Northeast, the natural gas industry competes with fuel oil and other heating energy sources for the "privilege of serving customers." He concluded, therefore, that it is imperative that Southern Union maintain the lowest costs possible in order to maintain and grow our customer base in this region. He stated that Southern Union

would apply its resources and expertise to meet Valley's and Bristol's customer demands for reasonably priced, reliable service (Id., p. 6).

Mr. Kelley next testified that for its business objectives to be achieved, employees must have a clear understanding of the Company's overall business strategy and must be able to make effective, timely decisions in today's fast paced business environment. He described Southern Union's employees as knowledgeable, highly motivated individuals who are provided with the tools to achieve Southern Union's objectives. He explained that Southern Union has a "flat" organizational structure. He related that employees at all levels have significant decision making responsibility and authority and are committed to Southern Union's business strategy and objectives. Mr. Kelley testified that through cross-training opportunities and active team participation, Southern Union's employees have proven to be the Company's most valuable resource (Id., pp. 6-7).

Mr. Kelley testified that Southern Union has determined that cost-effective deployment of technology initiatives is the key to the attainment of improved operating efficiencies and/or enhanced customer service, both of which he asserted are critical to successful participation in today's energy marketplace.

As an example, he cited Southern Union's installation of automated meter reading systems throughout its Missouri properties. Mr. Kelley related that this new technology allowed Southern Union to achieve its objective of enhancing customer service by ensuring timely and accurate billing.

Mr. Kelley testified that Southern Union believes that when a local economy prospers, both businesses and residents benefit. It is for this reason, the witness stated, that Southern Union works "to keep its rates and gas costs as low as possible." Mr. Kelley contended that this is how Southern Union contributes to the economic development of the local economy (Id., p. 8).

Mr. Kelley next discussed the reasons why Southern Union is seeking three mergers in the New England area. He related that by merging with Valley, ProvEnergy and the Fall River Gas, Southern Union would be expanding its geographic diversity. He explained that this diversity would reduce Southern Union's dependence on economic and weather conditions in any single-operating region. He testified that Southern Union will benefit because "the stability of the Company's earnings and cash flow will be enhanced" (Id., p. 9).

Mr. Kelley also explained that these three New England companies were chosen because their business perspectives are compatible with Southern Union's business perspectives. He related that the compatibility provides "the opportunity to effectively coordinate our operations" (Id.).

Mr. Kelley additionally opined that Valley's and Bristol's customers will experience enhanced customer service over time. He reasoned that due to the expansion of its customer base, Southern Union believes that the deployment of new technologies will become more economical. He related that introducing new technologies will enhance Southern Union's customer service and will improve the Company's gas distribution operations in an unbundled, competitive marketplace. Mr. Kelley concluded that, as a result, Southern

Union will be well positioned to control rates and improve service for the benefit of customers (Id., p. 9).

Mr. Kelley added that Valley's and Bristol's (and ProvGas') customers would also benefit by being customers of a financially larger company. He stated that the improved access to capital markets and greater flexibility in financing alternatives should bring benefits to Valley and Bristol and their customers (Id., p.10).

Mr. Ronald Endres was proffered by the Valley/Southern Union Companies for the purpose of describing the terms of the *Merger Agreement* between Southern Union and Valley Resources; and the other corporate commitments that Southern Union has made in connection with the merger. Mr. Endres also discussed why Southern Union believes the price paid for Valley Resources is fair and reasonable. Mr. Endres additionally reviewed the specific costs and benefits associated with achieving the merger and why Southern Union believes the merger is consistent with the public interest. His testimony concluded with a description of the various state regulatory approvals required for completion of the merger (Valley Exh. 6).

Mr. Endres testified that under the terms of the *Merger Agreement,* Valley Resources would merge into Southern Union in a transaction valued at approximately $160 million, including Southern Union's assumption of Valley Resources' debt. He related that for each outstanding share of Valley Resources common stock, Valley Resources shareholders would receive $25.00 in cash (Id., p. 2).

In addition to the financial terms of the agreement, Mr. Endres testified that Southern Union has made several significant commitments related to employees. He testified that Southern Union has agreed to maintain employee benefits that are no less favorable in the aggregate than the current benefits for a 24-month period subsequent to closing of the merger. He further testified that Southern Union has agreed to provide retiree medical plan coverage substantially comparable to the current coverage for a five-year period. Mr. Endres related that Southern Union has agreed to recognize the tenure of the employees under all benefit plans and to assume all of the collective bargaining agreements. The witness stated that with regard to management, the merger agreement identifies current Valley Resources officers, who will become officers of Southern Union's Valley division of its New England Business Unit, which will be composed of the pending transactions with Valley Resources, ProvEnergy, and Fall River Gas. (Id., pp. 2-3).

Mr. Endres further testified that although not required by the *Merger Agreement,* Southern Union has committed that there would be no layoffs as a result of the merger. He related that Southern Union would rely on its local management for decisions relating to Valley's and Bristol's gas distribution operations and will require local management, in carrying out those responsibilities, to be responsive to Rhode Island regulators. He also stated that the Company would continue the level of investment in Valley's and Bristol's distribution systems necessary to maintain safe and reliable service to all customers. Mr. Endres assured the Division that Southern Union and

Valley Resources intend to work cooperatively with Rhode Island regulators to ensure that all regulatory requirements are satisfied (Id., pp. 3-4).

Mr. Endres testified that Southern Union has determined that the purchase price of Valley Resources is fair and reasonable based on a comparison of certain measures of value for recent, comparable mergers. Mr. Endres explained that the following three measures of value for recent mergers were considered: (1) price-to-earnings multiples, (2) price-to-book value multiples, and (3) total price paid (including assumption of debt) per customer. Mr. Endres thereupon offered an exhibit that provided details on twelve other mergers, to show that buyers have paid multiples of between 19.6 and 39.2 of earnings, with an average of 28.9.[4] He related that the corresponding measure for the Valley Resources acquisition in 24.0, which is below 75 percent of the listed transactions. With regard to price-to-book value multiples, Mr. Endres stated that the instant merger with Valley Resources entails a multiple of 3.3, which is slightly above the high end of the listed transactions (Id., p. 4).

Mr. Endres testified that the last measure of utility transaction value is the price paid per customer. He explained that the use of this measure is predicated on the belief that access to customers is a major driver of the future value of a utility. Mr. Endres related that research shows a fairly broad range for this measure, with an average of approximately $3,100 per customer. He testified that Southern Union's merger with Valley Resources reflects a price

[4] Mr. Endres' exhibit includes details on twelve comparable merger transactions (See Exhibit RJE-1, attached to Valley Exh. 6).

per customer of $2,480, which is lower than 80 percent of the listed transactions (Id., p. 5).

Mr. Endres concluded that based on these comparisons, Southern Union determined that the price offered for Valley Resources is entirely consistent with recent market valuations for gas distribution properties and is fair and reasonable (Id.).

Mr. Endres next discussed the anticipated benefits of the merger. He related that the merger would enhance gas supply reliability, particularly with respect to the operation of local peak shaving facilities. He opined that over time, economies would also be realized through dispatching on a combined system and in purchasing supplies to satisfy the larger portfolio of the combined companies (Id. p. 5).

Mr. Endres predicted further savings associated with the elimination of certain "public company" functions, which will be performed by Southern Union on a consolidated basis after the merger, as well as savings in industry association dues and credit line commitment fees (Id., p. 6). He opined that other savings may occur over time as a result of realization of economies of scale in purchasing materials and supplies, centralized employee benefits administration, consolidation of information technology systems, adoption of the best practices of operating properties throughout the combined companies, and regional coordination of the New England operations. He related that these other types of savings can only be reasonably identified, quantified, and realized subsequent to the consummation of the merger after experience with

joint operations is achieved and a thorough assessment of human and non-human resource capabilities has occurred (Id.).

Regarding the types of savings to be realized from the elimination of duplicative "public company" functions, Mr. Endres related that Southern Union and Valley Resources incur annual expenses associated with their respective boards of directors, annual shareholder meetings, preparation and processing of required public filings, stock exchange listings, and stock transfer agents. He explained that these functions would no longer be separately performed by Valley Resources. He added that dividend processing and disbursement expenses would also be eliminated for Valley Resources. Mr. Endres did note, however, that although Valley Resources will no longer incur these "public company" expenses, Valley Resources will be allocated a share of Southern Union's expenses associated with these functions. Mr. Endres also noted that Valley Resources will save expenses through single memberships in the American Gas Association and the New England Gas Association and through lower credit line commitment fees. In total, Mr. Endres calculated the estimated annual net savings to be $264,644 for Valley Resources from these sources (Id., p.7).[5]

Mr. Endres next discussed merger-related costs, including the acquisition premium being paid by Southern Union. Mr. Endres defined an acquisition premium as the :

[5] See Exhibit RJE-3, attached to Valley Exh. 6.

> *... amount paid for a utility in excess of the historical book value of the seller's recorded net assets (Id., p. 7).*

Mr. Endres related that this concept and the requirement that utilities separately recognize premiums in their accounting records, is unique to regulated utilities and has existed for a number of years. He explained that by accounting for acquisition premiums independently of the related net assets, the acquisition premium could be separately analyzed by regulatory authorities.

Regarding the acquisition premium in the instant *Merger Agreement*, Mr. Endres offered the following calculation:

> *... the merger agreement requires the payment of $25.00 in cash per share of Valley [Resources] common stock, or $124,625,000, assuming 4,985,000 outstanding shares. The recorded historical book value of Valley's net assets at May 31, 1999 was $37,467,000, resulting in an acquisition premium of approximately $87,158,000. The precise amount of the acquisition premium may differ at closing depending on a number of factors, including the results of operations of Valley prior to closing (Id., p. 8).*

In addition to the acquisition premium, Mr. Endres testified that other costs are required to accomplish the *Merger Agreement*. He explained that these expenditures can generally be separated into transaction costs and integration costs. He related that transaction costs encompass the direct, non-recurring costs to consummate an acquisition and includes items such as fees paid to outside consultants for accounting, legal, investment banking, actuarial, environmental, engineering and other services, appraisals, and other direct

costs to complete the acquisition. He quantified the additional transaction costs related to Valley Resources at $5,000,000 (Id., p. 8). Mr. Endres explained that integration costs are incurred to effect the consolidation of the operations of the merging companies and could include items such as the costs of upgrading computer systems and costs of restructuring certain business functions. He testified that integration costs would become quantifiable as integration efforts develop (Id.).

Mr. Endres testified that Southern Union is not seeking recovery for any of the transaction, acquisition or integration costs it will incur through the mergers. He related that to pursue such recovery would invariably lead to extensive analyses and protracted debates about whether specific savings would offset merger-related costs. Mr. Endres testified that as an alternative Southern Union will be endorsing initiatives to move away from the traditional cost-of-service, rate-of-return model for establishing utility rates and instead to rely on alternative approaches involving PBR concepts. He stated that Southern Union believes that PBR and earnings-sharing models can provide a workable framework within which Valley Resources can be given sufficient incentives to increase operating efficiencies, while maintaining quality customer service and system integrity with a corresponding opportunity for increased earnings to shareholders. He called this type of plan a "win-win" for customers and shareholders (Id., p. 9).

Accordingly, Mr. Endres declared that Southern Union:

> *... will request that it be afforded the opportunity to develop, for filing in a future proceeding, a proposal to*

> *establish an alternative performance-based approach to setting rates for Valley, which would tie its performance, under an approved set of criteria, to its earnings. In making such a proposal in the future, Southern Union would ask that Rhode Island regulators consider performance-based approaches to strengthen incentives for continued operational improvements following the merger. In the event that this alternative approach is not acceptable, Southern Union would request that merger-related costs be recognized in future ratemaking proceedings to the extent that savings are demonstrated to have resulted from the merger. In the interim, Southern Union proposes no change to the base rates for Valley (Id., p. 10).*

Mr. Endres also hoped that future ratemaking proceedings would take into account Southern Union's efforts to provide "efficient high quality service and to arrange low cost, reliable gas supplies" (Id.).

Mr. Endres next discussed the factors on which he based his conclusion that the instant merger is in the public interest. He identified six factors, namely: (1) impact on rates, (2) financial integrity of the post-merger entity, (3) effect on service quality, (4) effect on competition, (5) social costs, and (6) economic development (Id., p. 11).

Mr. Endres opined that the merger would not have an adverse effect on rates because Southern Union plans to continue with Valley's current base rates after the merger.

Mr. Endres also contended that Valley's financial integrity would be improved as a result of the merger. Mr. Endres related that the size and diversity of Southern Union's operations will provide Valley and Bristol with greater financial stability, improved access to capital markets and enhanced

financing flexibility. He opined that over time, this should result in lower overall financing costs on more favorable terms and conditions.

As for the merger's effect on service quality, Mr. Endres echoed Mr. Kelly's comments. He emphasized that high quality customer service is essential in today's energy marketplace. He opined that the merger would result in improved service quality because of the resources that will be available from the larger organization (Id., p. 12).

Regarding competition, Mr. Endres pointed out that Southern Union does not have any operations in the New England area. He concluded, therefore, that the acquisition would not eliminate or have any adverse impact on existing competition (Id., p. 13).

Mr. Endres also claimed that there would not be any societal costs resulting from the merger. He offered the following basis for this conclusion:

> *Societal costs typically result when a merger causes involuntary employee reductions that are accomplished without programs, such as outplacement programs and retraining support, to provide assistance to displaced employees. Southern Union did not enter the merger with the intent of achieving cost savings through employee layoffs. The Company has stated that there will be no layoffs caused by the merger. Future developments in the business, including customer demands and new technologies, will drive staffing, both types and levels. At the same time, Valley employees will have improved career opportunities as a result of being a part of a larger, growing organization. Further, as explained in the testimony of Peter Kelley, local management will be responsible for Valley's operations, including staffing. Thus, there will be no adverse effect on Valley's workforce as a result of the merger (Id., p. 14).*

Mr. Endres also maintained that the merger would have a positive impact on economic development in Valley's and Bristol's service territories. Mr. Endres relied on Southern Union's commitment to high quality customer service and the lowest possible rates as the bases for this prediction (Id., pp.14-15).

Predicated on the foregoing factors, Mr. Endres asserted that the proposed merger is "consistent with the public interest" (Id. p.15).

Mr. Orlando Magnani was offered by the Valley/Southern Union Companies to describe the gas supply benefits to Valley and Bristol resulting from the merger of Fall River Gas, ProvEnergy and Valley Resources with Southern Union.

Mr. Magnani testified that Valley and Bristol customers will receive two types of benefits, specifically, increased reliability and gas cost savings. He opined that reliability would increase as a result of the ability to plan, contract and dispatch on an integrated basis. He opined that gas cost savings will occur as a result of more efficient utilization of upstream pipeline resources; more efficient utilization of peakshaving facilities and contracts; and economies of scale and enhanced market knowledge in purchasing gas supply (Valley Exh. 5, p. 3).

Mr. Magnani supported his conclusion with an overview of Valley's and Bristol's existing gas supply and transmission portfolio. Mr. Magnani testified that Valley and Bristol currently receive pipeline deliveries from Tennessee Gas Pipeline ("Tennessee") and Algonquin Gas Transmission ("Algonquin") and peaking supplies from Distrigas, Duke Energy and Pawtucket Power. He

related that Distrigas can be received in the form of liquid deliveries by truck or vapor through Tennessee. Mr. Magnani testified that the contract to provide liquid terminates on October 31, 2002 while the contract to provide a combination of liquid and vapor expires on October 31, 2005. He stated that the Duke Energy supply was delivered by Tennessee but terminated on March 31, 2000. He further stated that the Pawtucket Power supply is delivered by Tennessee under a long-term contract that expires on October 31, 2010. Mr. Magnani concluded that Valley's and Bristol's portfolio is heavily weighted to supplies from Tennessee and their ability to receive gas from Algonquin is limited (Id., p. 4).

Mr. Magnani testified that the merger with Southern Union would improve supply reliability because Southern Union's supply sources will further diversify the portfolio available to the Northeast. He also opined that improved communications will allow the combined companies to better plan for routine projects and to react more quickly if a problem occurs (Id.).

Mr. Magnani also explained that dispatching on a combined system basis is more efficient than dispatching on a stand-alone basis. He noted that if one company has more capacity to receive gas from a less expensive source than it can use, that gas could be moved to one of the other companies by displacement (Id. pp. 5-6). He also explained that additional savings may result from the aggregation of deliveries across more delivery points. Mr. Magnani related that aggregating deliveries will reduce the likelihood and magnitude of daily imbalances on a given pipeline system (Id., p. 6).

Mr. Magnani further testified that the integration of the portfolios would allow the Companies to reduce purchases of LNG or other high cost supplemental fuels. He noted that Valley and Bristol both currently need to purchase LNG (Id., pp. 6-7).

Mr. Magnani also testified that integration would further allow more effective utilization of combined vapor/liquid contracts. He suggested that pipeline and storage surplus of one company could be used to displace the need of another company to take LNG as vapor during the winter season. He testified that this will allow more of the winter LNG supplies to be taken as liquid. Mr. Magnani stated that this will permit the companies to extract more of the higher form value of liquid LNG as well as reduce their overall takes of LNG (Id., p. 7).

Mr. Magnani explained that integration would also facilitate the Companies' ability to provide backup services for each other's peak shaving facilities. He related that this is true because there would be more peakshaving capacity available to offset the loss of a single source and because the communication between the Companies would significantly reduce the time required to implement backup services compared to a non-integrated system (Id.).

Mr. Magnani additionally noted that Valley and Bristol would benefit from having access to the backup capabilities of ProvEnergy's Providence LNG facility. He related that, when required, ProvEnergy could vaporize additional LNG into its system and redirect a corresponding amount of its Tennessee gas to Valley and Bristol. He explained that there would be no incremental

transportation charges for this service because the cost of delivering gas to Valley and Bristol is the same as delivering gas to Providence. He noted that gas could also be exchanged directly between Valley, Bristol and ProvEnergy through an existing interconnect (Id., p. 8).

Mr. Magnani next testified that the mergers should provide economies of scale with respect to the purchases of gas required for the Companies' combined New England market requirements. He identified two factors from which savings could result:

> *First, the New England companies and the Southern Union companies are connected to pipelines that are owned by the same parent companies but operate in different parts of the United States. The companies also buy gas from the same national suppliers. This provides for greater operational flexibility and the opportunity for more efficient dispatch of available supply contracts.*
>
> *Second, the availability of greater market knowledge than would be available to the individual companies provides an opportunity to lower daily gas costs. Stand-alone companies do not share market knowledge. The combined companies will share their knowledge and will realize economies associated with making larger purchases on a more informed basis (Id., p. 9).*

In closing, Mr. Magnani related that there are a number of synergies that can be identified from the proposed mergers. He concluded that these various synergies will bring about significant reductions in gas cost in the future.

B. ProvGas/Southern Union Companies' Direct Case

The ProvGas/Southern Union Companies proffered three witnesses in support of their merger petition. The witnesses were identified as: Mr. James

DeMetro, Executive Vice President of ProvEnergy and ProvGas; Mr. Peter H. Kelley, President and Chief Operating Officer of Southern Union; and Mr. Ronald J. Endres, Executive Vice President and Chief Financial Officer of Southern Union.

Mr. James DeMetro's testimony included a brief description of ProvEnergy and its affiliate, ProvGas. Mr. DeMetro also discussed the reasons for the merger and why he believes ProvGas' customers will benefit (ProvGas, Exh. 5).

Mr. DeMetro's description of ProvEnergy and ProvGas essentially paralleled the description provided in the petition. Mr. DeMetro's testimony did indicate that ProvGas' service territory is comprised of 730 square miles (Id., p. 2).

Mr. DeMetro testified that over the past several years, ProvEnergy's Board of Directors (the "Board") and the management of ProvEnergy have closely followed industry-restructuring developments. He related that deregulation of the gas industry, which first started at the national level with the unbundling of interstate natural gas pipeline services, has continued at the state level with unbundling initiatives being promoted by both LDCs and regulators. Mr. DeMetro testified that with this restructuring of the utility industry, the attractiveness of LDCs has grown significantly. According to the witness, convergence in the energy industry has made local utilities an extremely valuable part of any retail energy company's portfolio. He explained that traditional regional gas and electric utilities are repositioning themselves

as national and even international retailers of distributed power and energy services. At the same time, he related, restructuring initiatives are requiring companies to make significant investments in technology, which Mr. DeMetro contends has motivated companies to reach across industry lines and geographic borders in an effort to grow their customer base and to capture additional economies of scale. Mr. DeMetro testified that New England LDCs have been targeted for acquisition for a number of additional reasons, including the area's relatively low saturation of natural gas, the introduction of new gas transmission lines into the region, and the large number of small LDCs in the region (Id., pp. 2-3).

Mr. DeMetro testified that the Board has concluded that three primary factors are driving gas industry mergers. He identified the underlying factors as:

> *... (1) the need to create economies of scale and/or scope in order to maintain competitiveness; (2) the recognition that technology investments are key to achieving efficiency gains, but require a larger capital base; and (3) that convergence in the energy industry was causing a high value to be placed on local utilities by larger, more diverse energy companies looking to become major players in the utility industry (Id., p. 3).*

Mr. DeMetro related that after considering these factors, the Board concluded that significant benefits could result from a business combination with a larger organization. Mr. DeMetro related that the Board also believes

that such a combination would be in the best overall interest of ProvEnergy's customers, shareholders and employees (Id., p. 4).

Mr. DeMetro testified that upon reaching this conclusion ProvEnergy sought a larger financial partner with resources to support continued growth as a broad based energy supplier throughout New England with a shared commitment to serve customers safely and reliably (Id.). Mr. DeMetro related that ProvEnergy has found this partner in Southern Union. Mr. DeMetro stated that ProvEnergy believes that Southern Union is in the:

> *... best position to offer the highest value for our shareholders while providing benefits for customers and enhanced opportunities for employees (Id., p. 5).*

Mr. DeMetro testified that ProvEnergy expects the following benefits will result from the merger:

> *First and foremost, the merger will enable us to deliver benefits to the customers of ProvGas that would likely not be realized without the merger. The merger will provide ProvEnergy with access to resources that will enable us to be more competitive and to continue to honor our commitments to our customers, the communities we serve and our employees. This merger offers the potential for increased efficiency and improved customer service for customers of ProvGas. In addition, Southern Union has agreed to operate ProvEnergy as the headquarters for its New England operations, which will enable us to continue serving our market with the same skilled and dedicated people who know and understand local needs. Moreover, ProvEnergy believes that a larger, more diversified company will benefit ProvGas employees over the long term by providing them with greater opportunities and a more dynamic working environment. ProvEnergy's shareholders will also benefit from*

the merger because they will receive a fair value for their stock in an all-cash transaction (Id., p. 5).

Mr. DeMetro next discussed the anticipated benefits for ProvGas' customers. He explained that the impact of the merger on customers will largely be in the nature of customer-service enhancements resulting from technology upgrades, increased distribution system reliability and similar benefits that would flow over time from participation in a larger organization. He added that even though undertaken for strategic purposes, he believes the merger with Southern Union is likely to produce some cost savings by virtue of the ability to coordinate and consolidate certain corporate functions as well as the opportunity to integrate the operations of Southern Union's other Northeast companies over the long term (Id., p. 6).

Mr. DeMetro also stated that ProvGas' customers will experience some benefits relating to the gas supply function. One benefit was described as a increase in overall system reliability, resulting from the ability to plan, contract and dispatch gas supply resources on an integrated basis (Id.). A second benefit was described as gas cost savings resulting from more efficient utilization of peakshaving facilities and peaking supply contracts, as well as the attainment of larger economies of scale and enhanced market knowledge in purchasing gas supply (Id.).

Mr. DeMetro explained that coordinating the gas supply resources of ProvGas, Fall River Gas and Valley Resources will improve supply reliability because the integrated system will have access to a more diverse set of resources than would be available on an individual basis. He related that this

is particularly important with respect to peaking resources. Mr. DeMetro explained that if operational or supply difficulties occur on one company's system, supplies accessible to one of the other companies can be diverted to meet that need. Mr. DeMetro related that the same is true for dispatching gas supply resources. He related that dispatching on a combined system basis is more efficient than dispatching on an individual system basis, because gas supplies can be moved across the system using displacement, and therefore, all companies have the ability to take advantage of lower-cost supplies that may be available today to only one of the companies. He opined that seasonal resources can be managed more efficiently in the same way (Id., p. 7).

Mr. DeMetro added that the most significant potential for achieving gas-cost savings will occur in relation to peaking supplies. As an example, he related that ProvGas currently is evaluating alternatives for obtaining a new peaking supply. He stated that by coordinating its peak-shaving needs and resources with those of Fall River Gas and Valley, ProvGas' need for this new resource may be reduced or eliminated. He concluded that this would provide substantial value to customers (Id.).

Mr. DeMetro also testified that he expects gas supply-related savings when each company's assets are planned, managed and dispatched in an integrated manner. Additionally, he expects that the combined companies will share their market knowledge, which he believes should create the opportunity to lower daily gas costs where, on a stand-alone basis, such market information would not normally be shared (Id., p. 8).

Also regarding the issue of benefits to ProvGas' ratepayers, Mr. DeMetro maintained that the merger "will have no immediate impact on the base rates charged to ProvGas customers" (Id.). He related that although ProvGas may need to seek a base-rate increase after the expiration of its *Energize RI* rate plan, he emphasized that such an increase would not be related to the merger with Southern Union (Id., pp. 8-9).

As in the Valley/Southern Union Companies' direct case, Southern Union's President and Chief Operating Officer, Mr. Peter Kelley; and its Executive Vice President and Chief Financial Officer, Mr. Ronald Endres, also testified in support of the ProvGas/Southern Union Companies' merger petition.

The testimony proffered by Messrs. Kelley and Endres in the ProvGas/Southern Union Companies' case was substantially similar to the testimony proffered in the Valley/Southern Union Companies' merger case.

Mr. Kelley again described the organizational structure of Southern Union. He also reiterated the Company's business approach and strategic direction.

Mr. Kelley similarly discussed the reasons why safety, reliability, low cost gas procurement, motivated employees, new technology deployment and economic development are important to Southern Union (ProvGas Exh. 3, pp. 3-8).

Mr. Kelley's description of why Southern Union agreed to the merger with ProvEnergy directly paralleled the description in the Valley/Southern Union

Companies merger case. In short, Southern Union is endeavoring to expand the geographic diversity of its operations in order to reduce its independence on economic and weather conditions in an single operating region (Id., pp. 8-9).

As in the Valley/Southern Union Companies' case, Mr. Endres described the principal terms of the *Merger Agreement*. In the ProvGas/Southern Union Companies *Merger Agreement*, each share of the approximately 6.1 million shares of ProvEnergy common stock will be converted into the right to receive $42.50 in cash (ProvGas Exh. 4, pp. 2-3). All other terms are substantially similar to the Valley/Southern Union Companies' *Merger Agreement* (Id., pp. 3-4).

Mr. Endres again analyzed the merger based on a comparison of certain measures of value for recent comparable transactions. As in the Valley/Southern Union Companies case, Mr. Endres considered three measures of value: (1) price-to-earnings multiples, (2) price-to-book value multiples, and (3) total price paid (including assumption of debt) per customer (Id., pp. 4-5).

Mr. Endres sponsored an exhibit[6] reflecting that buyers have paid multiples of between 19.6 and 39.2 of earnings, with an average of 28.9 (Id., p. 5). He related that the corresponding measure for the ProvEnergy acquisition is 21.1, which he noted is lower than all but one of the other listed transactions. Mr. Endres observed that the price-to-book value multiples for the ProvEnergy acquisition is 2.6, which he noted is somewhat below the

[6] See Exhibit RJE-2, attached to ProvGas Exh. 4.

average of the other listed transactions (Id.). As for the price paid per customer measure, Mr. Endres related that Southern Union's merger with ProvEnergy reflects a price per customer of $2,131. He contrasted this price to the average price of $3,100 per customer among the other listed transactions (Id.).

Based on these comparisons, Mr. Endres testified that Southern Union has concluded that the price offered for ProvEnergy is consistent with recent market valuations for gas distribution companies and is fair and reasonable (Id.).

Mr. Endres next discussed the reasons why the Division should find the merger to be consistent with the public interest. This testimony too, directly paralleled the testimony presented in the Valley/Southern Union Companies merger case. Generally, the reasons included: the elimination of duplicative 'public company' functions, no acquisition premium or other merger-related costs, enhanced service quality, no adverse effect on competition, no resulting societal costs, and a positive impact on economic development (Id., pp. 11-15).

5. DIRECT CASES OF THE ADVOCACY SECTION AND ATTORNEY GENERAL

A. Valley/Southern Union Companies' Merger Case

The Advocacy Section and the Attorney General jointly presented one witness in the Valley/Southern Union Companies' merger case. The witness was identified as Mr. Bruce R. Oliver, the President of Revilo Hill Associates, Inc., 7103 Laketree Drive, Fairfax Station, Virginia. Revilo Hill Associates, Inc. was described as a consulting firm, specializing in economics and utility planning matters. Mr. Oliver was qualified as an expert witness in these areas.

Mr. Oliver prefaced his testimony with an observation that the several benefits identified by the Valley/Southern Union Companies' witnesses, which said witnesses claim will accrue to ratepayers as a result of the proposed merger, are either unquaified or speculative (Advocacy/A.G. Exh. 1, p. 6). Moreover, he stated, the limited portion of such benefits that have been quantified is small relative to the Companies' $5 million of estimated transaction costs and the more than $87 million of acquisition premium to be paid by Southern Union for Valley and Bristol (Id.).

Mr. Oliver also rejected the Companies' claim that no base rate increase will be sought as a result of the mergers. Mr. Oliver contended that Southern Union's representation that there will be no change in base rates for Valley or Bristol as a result of the mergers "is only an interim commitment" (Id., p. 7). He pointed out that Mr. Endres testified that Southern Union may seek recognition of merger-related costs in future ratemaking proceedings if Southern Union's request for an alternative performance-based approach to setting rates is not accepted (Id.).

Based upon his review and analysis of the Valley/Southern Union Companies' petition and supporting testimony, exhibits and workpapers[7], Mr. Oliver recommended that the Division adopt the following thirteen findings and conclusions:

> 1. *As provided under Section 39-3-25 of the Rhode Island General Laws, the Companies must demonstrate: (a) that the proposed mergers will not diminish facilities for*

[7]

furnishing service to the public, and (b) that the terms of the mergers are consistent with the public interest.

2. *Any assessment of the merits of the proposed mergers must consider whether the ability to provide safe and adequate service at the lowest reasonable cost will be jeopardized. In this context, the Division's determinations in this proceeding should address: (a) the degree to which the mergers can be expected to impact ratepayer costs, (b) the effects of the mergers on the reliability and safety of the services provided, (c) the impact of the mergers on competition, and (d) the potential influences of the mergers on regulatory control and oversight of the utility operations.*

3. *The mergers' economic impact on ratepayers is a key determinant of whether the mergers are consistent with the public interest. Thus, as a general matter, the Division's approval of the mergers should be contingent upon demonstration of reliable ratepayer benefits that cannot be diminished by the Companies' future actions or future regulatory determinations.*

4. *The record in this proceeding indicates that substantial uncertainties exist regarding the merger's impact on service reliability and customer rates. Therefore, any approval of the mergers by the Division should require specific rate and service commitments from the Companies. Moreover, any approval of the merger should be structured in a manner that does not in any way impede the ability of the RIPUC to ensure that prospective regulated earning will be premised on the Companies' future performance concerning service and rates.*

5. *Representations that the proposed merger transactions will yield no net harm should not be viewed as sufficient basis for concluding that the mergers are consistent with the public*

interest. The Division should require that the mergers clearly produce net benefits for stakeholders other than Valley and Bristol shareholders, particularly for ratepayers. Valley and Bristol shareholders should not be the only stakeholders who stand to benefit from the mergers. Speculative assessments of future ratepayer benefits should not be held sufficient to justify a finding that the merger is consistent with the public interest.

6. *The Companies have not attempted to quantify substantial elements of the merger-related cost savings that they anticipate. Without more specific identification and quantification of such cost savings, segregation of merger-related and non-merger-related cost savings becomes extremely difficult, and ratepayers may be denied the benefit of cost reductions that could have, and perhaps would have, been achieved in the absence of the proposed mergers.*

7. *The Companies make numerous references to opportunities for savings resulting from consolidation of activities among the utilities that would comprise SU's New England Division. However, the Companies have not provided a timetable or plan to bring about either the rate consolidation or consolidation of operations for those companies. In the context of this proceeding, a key element of the public interest for the State of Rhode Island is the potential for consolidation of Valley and ProvGas operations and tariffs.*

8. *The proposed mergers will give rise to approximately $87 million of acquisition premium costs, an estimated $5.0 million of transaction costs, and an as yet unquantified amount of integration costs. The rate treatment of these costs and their ultimate impact on Valley ratepayers, however, cannot be determined due to a contingency that SU has imposed based on future action by the RIPUC. If SU cannot remove that contingency*

(i.e., the possibility that base rates will go up as a result of the merger), then the Division should defer any approval of the mergers in this proceeding until the Companies gain RIPUC approval of a post-merger rate plan. Any Division order approving the merger should make it explicitly clear that the Division is not approving or endorsing the concept of the inclusion of an acquisition premium or other merger-related costs in base rates.

9. *The merger proposals in this proceeding represent just one of several recent efforts by SU to acquire gas distribution utility operations. Over the past several years, SU also has acquired gas distribution utility operations in Missouri, Florida and Pennsylvania. It is also in the process of acquiring Fall River Gas Company in Massachusetts and Providence Gas Company in Rhode Island. However, Southern Union's post-merger operations in Missouri have produced some significant customer service and billing problems. Nothing in the merger proposals in this proceeding provide substantial assurance that similar post-merger customer service problems will be avoided if the Division approves the Companies' Petition.*

10. *To provide assurance to Valley customers that similar post-merger customer service problems will not arise, the Division should require the Companies to commit to a comprehensive service measurement and monitoring program. Standards should be developed prior to approval of the merger, as well as a structure that compensates ratepayers if historic levels of service quality are not maintained. Given Southern Union's experience in Missouri, it may be appropriate to utilize some or all of the service standards that have been developed and implemented in that jurisdiction.*

11. *With Southern Union's diverse operations, the cost allocation procedures that SU will use to determine the allocation of corporate overheads*

and other commonly incurred costs to Valley are critical for public interest in Rhode Island. At this point, however, the procedures that SU will use to make such allocations, as well as the accounting treatment for costs and benefits resulting from additional Southern Union acquisitions, have yet to be established. Missouri has already taken a fairly aggressive position on these matters, and Rhode Island should require protections for its ratepayers that are at least comparable to those required of SU in Missouri.

12. Additionally, the Companies should be required to commit to maintaining a major presence in Rhode Island so that management and operations remain responsive to the needs of both customers and the broader public interest in Rhode Island. The Companies should also commit to specified actions and procedures to ensure continuation of necessary regulatory oversight and avoid any unwarranted impairment of the Commission's authority. Similarly, Valley customers need greater assurance that the Companies' commitments to capital projects, low income programs, and service enhancements will be continued over time, not just for a brief transitional period.

13. The public interest of Rhode Island also suggests that the Division should act in this proceeding to ensure that rate of return determinations in future Valley proceedings before the RIPUC limit the percentage of common equity which is recognized for rate setting purposes. Without such assurance of limits on the percentage of common equity, the Division may not be able to confidently conclude that rate impacts resulting from the mergers are consistent with the public interest. Thus, when calculating Valley's weighted cost of capital in future rate proceedings, any unamortized acquisition premium should be deducted from the common equity measurement in order to properly match the Companies' capitalization with its actual

> *utility assets. Or alternatively, the cost of capital should be developed based on a proxy group of comparable local gas distribution companies (Id., pp. 9-15).*

Mr. Oliver next discussed issues which he believed to be relevant to the Division's assessment of the merits of the proposed mergers. He contended that the most critical issues are those associated with the impacts of the mergers on:

> *(1) changes in the levels of rates charged to customers,*
> *(2) maintenance of at least historic levels of service quality, and*
> *(3) merger effects on regulatory oversight and control (Id., p.18).*

Mr. Oliver also stated that the Division must consider the meaning of the phrase "consistent with the public interest," as contained in Section 39-3-25, of the Rhode Island General Laws.

Concerning this latter issue, Mr. Oliver related that the Valley/Southern Union Companies have indicated that they consider the phrase to mean that '*in Rhode Island, a merger is consistent with the public interest when there is no net harm resulting from the transaction*' (Id., p.19)[8] Mr. Oliver took exception to this 'no harm' standard espoused by the Companies. Instead, he opined that any approval of the Companies' petition in this proceeding should be premised on the same criteria that the Division applied in the "Narragansett, Blackstone Valley, and Newport merger proceeding, which is '*the best interest of*

[8] Reciting language from Companies' response to discovery request AG 1-9 in Docket No. D-00-3.

ratepayers' (Id., pp.19-20).[9] He further opined that it would be difficult to conceive a situation in which the assignment of 100 percent of merger-related benefits to the Companies would constitute the "best interest of ratepayers" (Id., p. 20). Accordingly, Mr. Oliver related that the central issue then becomes "what is the appropriate balance between ratepayer and shareholder interests" (Id.).

Mr. Oliver also emphasized that in this proceeding the Division's appropriate focus should be on the merger's long-term impact on rates. He noted that Southern Union has estimated that the mergers would give rise to an acquisition premium of $87 million and estimated transaction costs of $5 million. Mr. Oliver related that if these costs were to be amortized over 40 years the annual cost would be $2.3 million. He, therefore, concluded that what the Companies might represent relative to rate impact for an interim period is not dispositive. Mr. Oliver stated that a $2.3 million annual increase in Valley's non-gas costs of service would represent roughly an 8% increase in the Company's base rate revenues (Id., p. 24).

Mr. Oliver testified that the rate implications of the acquisition premium and other merger-related costs could potentially become an issue in future rate proceedings in the event that the Commission refuses to adopt the performance

[9] Mr. Oliver's reference to the "Narragansett, Blackstone Valley and Newport merger," relates to a similar merger proceeding conducted before the Division in Docket D-99-12 (See Order No. 16186, issued on February 25, 2000); and a concomitant rate proceeding before the Public Utilities Commission in Docket No. 2930.

based rates being suggested by Southern Union (Id., pp.24-25). For this reason, Mr. Oliver recommended that the Division consider the potential customer impacts of such merger cost recovery in the context of this proceeding (Id. p. 24).

Mr. Oliver also recommended that two other rate-related issues be considered in this proceeding. First, he contended that it is important that any unamortized acquisition premiums for any Southern Union mergers not be considered in developing measures of capital structure or costs of capital for Valley. He concluded, therefore, that in future rate proceedings the fair rate of return that underlies Valley's rates should be based on the capitalization and cost rates of the Valley operation. He related that to the degree these measures are not representative, then the rate of return should be established using data for comparable local gas distribution companies (Id., p. 27).

Secondly, Mr. Oliver testified that the Division should require that the Companies commit to a timetable and plan for the consolidation of Valley and ProvGas. Mr. Oliver presumed that a large portion of any merger-related savings will stem from such a consolidation, and therefore, he concluded, its nature and timing will have a direct bearing on public interest considerations. He further recommended that the Companies be required to disclose their principles of consolidation with respect to unifying the tariff structures of Valley and ProvGas and provide an explanation of how consolidation costs and benefits are to be allocated between the two utilities (Id., pp. 27-28).

Mr. Oliver also spent some time discussing why he finds the merger-related benefits enumerated by the Valley/Southern Union Companies to be small, unquantified and/or speculative. Mr. Oliver testified that the only benefits that the Companies have quantified to date are those associated with the elimination of duplicative public company functions. Relying on a Southern Union exhibit, Mr. Oliver related that the merger-related benefits are expected to produce annual savings of $264,655 or less than 0.5% of Valley's annual utility revenues. Mr. Oliver observed that these benefits would have little, if any, perceptible impact on customers' bills. He added that any claims of net benefits that have not been quantified must be considered at best, speculative in nature, and therefore, unreliable and not sufficient support for a determination that the proposed mergers are consistent with the public interest (Id., p. 29).

Mr. Oliver also offered explanations for why he concludes that the merger may not mitigate gas cost fluctuations, reduce gas procurement costs, promote further rate unbundling, improve reliability, or improve service for Valley and Bristol ratepayers, as suggested by the Valley/Southern Union Companies' witnesses. In short, Mr. Oliver maintained that the record lacks sufficient evidence to support these predictions (Id., pp. 30-34).

In his closing comments, Mr. Oliver emphasized the importance of the Division's ability to maintain regulatory authority and oversight over a post-merger public utility. He related that cost allocations become a primary

concern after a merger with a "foreign" company. He also voiced concern regarding the priority that will be given by the foreign corporate parent for the local utility's capital expenditures and service commitments (Id., pp. 35-38).

B. ProvGas/Southern Union Companies' Merger Case

The Advocacy Section and Attorney General jointly presented one witness in the ProvGas/Southern Union Companies's merger case. The witness was identified as Mr. Richard W. LeLash, 18 Seventy Acre Road, Redding, Connecticut. Mr. LeLash described himself as an independent financial and regulatory consultant. Mr. LeLash was qualified as an expert witness in public utility financial and regulatory matters.

Mr. LeLash testified that based on his review and analysis of the ProvGas/Southern Union Companies merger petition and supporting testimony and exhibits, he has reached several findings and conclusions. He presented the following summary:

> 1. *In evaluating proposed mergers, regulatory agencies consider whether or not the utilities' ability to provide safe and adequate service at the lowest reasonable cost will be jeopardized. Their analyses typically address: the degree that ratepayer costs are reduced; the effects on service reliability and safety; the impact on competition; and the potential for reduced regulatory control and oversight of the utility operations.*
>
> 2. *Under Section 39-3-25 of the Rhode Island General Laws, any proposed utility merger should demonstrate that the facilities for furnishing service to the public will not be diminished, and that purchase, sale, or lease terms are consistent with the public interest.*

3. *Given the lack of specificity in the Companies' filing concerning merger related issues, substantial uncertainties exist regarding the merger's impact on service reliability and customer rates. Therefore, any approval of the mergers by the Division should require specific rate and service commitments by the Companies, and the approval should be structured in such a way that prospective regulated earnings will be based on the Companies' future performance concerning service and rates.*

4. *The Companies have stated that the proposed mergers will be in the public interest if there is not net harm resulting from the transactions. However, the Division should require that there be some net benefit to ratepayers in order to approve the mergers. Given the level of risk which will be assumed by ratepayers concerning rates and service quality, it is only reasonable that they should have some share of any merger related savings. In the end analysis, the shareholders of Providence Energy should not be the only stakeholders who stand to benefit from the mergers.*

5. *In their Petition, the Companies claim that the proposed mergers will bring about 'customer service enhancements' and are 'likely to produce some cost savings over the long term.' However, in support of the mergers, the Companies have not claimed, let alone quantified, cost savings which will be associated with the envisioned combination of companies. Accordingly, the merger approval process must address and circumscribe the mergers' impact on service, regulatory control, and consumer rates.*

6. *Under any reasonable interpretation of the public interest within the context of utility regulation, a proposed merger's economic impact on ratepayers is considered to be a major determinant of whether or not the merger is consistent with the public interest. As a general matter, it is desirable that any proposed merger brings about long-term ratepayer benefit.*

7. *The proposed mergers will give rise to a $161.3 million acquisition premium and an unquantified amount of transaction and integration costs. At this time the Companies are not seeking recovery of the premium or other merger-related costs. However, in the future, they plan to request a performance based regulatory (PBR) framework so that ProvGas can have performance incentives. If such a PBR is not approved, Southern Union will 'request that merger-related costs be recognized in future ratemaking proceedings to the extent that savings are demonstrated to have resulted from the merger.'*

8. *In addition to not specifying what type of PBR mechanism would be acceptable to the Companies or attempting to quantify possible merger related savings, the Companies have not provided a timetable or a plan to bring about the consolidation of the Valley and ProvGas operations and tariffs. Absent such information, it is impossible to assess the post-merger impact of the envisioned consolidation. Under the assumption that prospective ratepayer benefits will be related to such a consolidation, it is reasonable to require that the Companies provide a timetable and general plan for operational consolidation. Even with an acceptable consolidation plan, the Division should still require service standards and oversight procedures. There is a real risk that, in restructuring labor intensive functions, necessary staffing may be reduced below acceptable levels. In effect, service should not become a trade-off for cost reductions.*

9. *In its Missouri operations, Southern Union has experienced problems with customer service, and it has been required to institute various programs and service measures to address the problem areas. During 1994, in its first year of ownership of the Missouri operation, Southern Union had 1.1 million customer inquiries and complaints from its 470,000 Missouri customers. As a result of service problems, the Missouri PSC initiated an*

investigation of Southern Union's billing and customer service practices. In its resulting report, filed on April 28, 1995, the Commission's Management Service Department ("MSD") staff made 37 recommendations for service improvements. Subsequently, between November 1996 and February 1997, over 100,000 Missouri customers experienced billing errors.

10. *In order to ensure that similar problems do not arise for ProvGas after the merger, the Companies should commit to a comprehensive service measurement and monitoring program. Mutually agreeable standards should be developed with some form of incentive and/or penalty structure to avoid service related issues concerning customers and system reliability. Given Southern Union's experience in Missouri, it may be appropriate to utilize some or all of the service standards which have already been developed and implemented in that jurisdiction.*

11. *Concerning the issue of regulatory control, there are several merger related issues which need to be addressed. With Southern Union's diverse operating structure, there must be specification of cost allocation procedures for Valley and ProvGas as well as for the regulated and unregulated entities of Southern Union. Procedures for cost allocation associated with the consolidation of Rhode Island operations as well as the accounting treatment for additional Southern Union acquisitions should be codified by the Companies as a condition of the merger. Also, the Division should ensure that in any future proceedings where ProvGas' rate of return is at issue, there should be a limit on the percentage of common equity which is recognized for rate setting purposes. When calculating ProvGas' weighted cost of capital, any unamortized acquisition premium should be deducted from the common equity measurement in order to properly match the capitalization with the actual utility assets. In the alternative, the cost of capital should be developed based on a proxy group of comparable local gas distribution companies.*

> *12. Finally, the Companies should commit to specified actions and procedures to ensure continuation of necessary regulatory oversight and avoid any unwarranted impairment of the Commission's authority. Similarly, the Companies should be required to commit to maintaining a major presence in Rhode Island so that management and operations remain responsive to the needs of both customers and the broader public interest. Rhode Island customers also need to obtain an assurance that ProvGas will continue its commitments to capital projects, low income programs, service enhancements, and its on-going competitive initiatives (Advocacy/AG Exh. 1).*

Mr. LeLash next discussed the standards that he believed should apply to the Division's approval of a utility merger in Rhode Island. He asserted that the applicable standard should ensure that the proposed merger will maintain or improve reliability and customer service. Mr. LeLash also opined that a merger is not in the public interest if it will have the effect of increasing rates. Moreover, he testified that there is "ample precedent that ratepayers should be provided quantifiable benefits in order to warrant approval of a merger" (Id., p. 16).

Mr. LeLash explained that without tangible commitments from Southern Union, the proposed mergers are problematical because the Companies have not provided specifics as to how ratepayers may be affected (Id., p. 21). He emphasized that there is uncertainty concerning the ultimate rate treatment for the acquisition premium and related transition and integration costs. He related that he was troubled because the Companies have not quantified potential cost savings or provided any timetable or plan for the consolidation of the Valley and ProvGas operations (Id.).

Mr. LeLash thereupon offered recommendations relative to the requisite commitments that the Division should require of Southern Union in the areas of rates, service, and regulatory control. Beginning with rates, Mr. LeLash contended that while Southern Union indicates that it will not seek the recovery of merger costs through rates, it has implicitly based this statement on an expectation of a PBR framework in a future rate proceeding.

For this reason, Mr. Lelash recommended that the Division require the Companies to affirm their initial public statements that the Companies "have no intention of seeking to recover any of the premium paid for ProvEnergy by the ratepayers."[10] He added that the Division should likewise specify that ratepayers should be entitled to a share of any demonstrated merger savings (Id., p. 24). Mr. LeLash asserted that Southern Union should not be permitted to retain 100 percent of such merger savings based on any claim involving the amortization of the acquisition premium (Id.).

Of additional concern regarding rates, Mr. LeLash maintained that it is also important that any unamortized acquisition premiums for any Southern Union mergers not be considered in developing measures of capital structure or costs of capital for ProvGas. He further recommended that the Division require that the Companies commit to a timetable and plan for the consolidation of Valley and ProvGas. Mr. LeLash recognized that a large portion of any merger related savings will result from such a consolidation (Id., pp. 26-27).

[10] Southern Union response to Discovery Request AG 1-32.

On the issue of service, Mr. Lelash related that to the degree that Southern Union seeks to achieve merger related savings, there is a risk that labor extensive functions might be reduced with some degradation in the level of service (Id., p. 27). As an example, Mr. LeLash testified that such service degradation occurred in Missouri after Southern Union took control of Missouri Gas Energy Company ("MGE") (Id., p. 28).

Mr. LeLash related that after Southern Union and MGE merged in 1994, MGE received 1.1 million customer inquiries and complaints from its 470,000 Missouri customers on matters to do with billings and customer service. He explained that in response to the complaints, the Missouri Public Service Commission ("MPSC") opened an investigation and discovered that MGE had mis-billed over 100,000 residential customers and more than 10,000 general service customers. Mr. LeLash related that the MPSC investigation resulted in 37 audit recommendations (Id., pp. 28-29). To avoid this result in the instant merger, Mr. LeLash recommended that Southern Union be required to define appropriate service measures and performance benchmarks which will be achieved on a prospective basis (Id., p. 29).

Mr. LeLash next addressed the importance of addressing the matter of regulatory authority and oversight as part of the merger issue. Based on the type of issues that arose in Missouri and based on broader regulatory concerns, Mr. LeLash contended that Southern Union should be directed to provide the Division with a 'most favored nation' commitment. In short, Mr. LeLash related that the commitment should include specification that ProvGas

and its ratepayers will not be adversely affected by any other Southern Union acquisitions and that any allocation of joint and common costs will be subject to Commission review and approval before such costs can be recovered in Rhode Island rates. He added that there also should be commitments that ProvGas' capital programs and expenditures as well as its customer assistance programs will not be curtailed or diminished without specific Commission authorization. Similarly, he related, the Commission should have full access to information concerning all of Southern Union's operations for matters related to the setting of rates and oversight of ProvGas' regulated operations (Id., pp. 32-33).

Lastly, Mr. LeLash recommended that the Division require Southern Union to make a concrete commitment to ensure that operations and management functions continue to be controlled from a Rhode Island based headquarters. Mr. LeLash asserted that it is very beneficial that ProvGas maintain a local presence so that customers and regulators have direct access to decision-makers (Id., pp. 33-34).

6. SETTLEMENT AGREEMENT

At the outset of the May 31, 2000 hearing, the parties collectively moved for a one day continuation of the proceedings in the consolidated dockets for the purpose of completing and submitting a settlement agreement. The parties indicated that they were attempting to reach a comprehensive settlement agreement that could result in a dispositive resolution to the parties'

differences in the instant dockets. The Division verbally granted the motion on May 31, 2000.

During a subsequent hearing on June 1, 2000, the parties represented that a comprehensive settlement agreement had been achieved. The parties proffered a joint exhibit as evidence of the agreement. The exhibit, entitled "Settlement Agreement" was proffered as a consolidated settlement agreement by all parties and in both dockets. The "Settlement Agreement" is attached to this Report and Order, and incorporated by reference.[11]

As a consequence of this Settlement Agreement reached between the parties, the hearing held on June 1, 2000 resulted in a nonadversarial proceeding during which the parties' witnesses discussed the principal elements of the agreement and/or answered questions posed by the hearing officer. At the conclusion of the hearing, all parties urged adoption and approval of the Settlement Agreement.[12]

7. DIVISION FINDINGS

The regulatory review necessitated by the petitions in issue is based on statutory provisions contained in Rhode Island General Laws, Sections 39-3-24 and 39-3-25. Section 39-3-24 provides that with the consent and approval of the Division, but not otherwise:

> *Any public utility may merge with any other public utility ... provided that the merger ... shall be authorized by a vote of at*

[11] The Settlement Agreement was entered on the record as "Consolidated Joint Exhibit 1".
[12] Due to the settlement reached in the Valley/Southern Union Companies' case, rebuttal testimony which had been previously filed by Valley and Bristol on May 30, 2000 was marked for identification purposes only (See Valley Exhibits 7 and 8).

> *least two-thirds (2/3) in interest of its stockholders at a meeting duly called for the purpose.*[13]

Section 39-3-25 provides, in pertinent part, that:

> *If, after the hearing … the Division is satisfied that the prayer of the petition should be granted, that the facilities for furnishing service to the public will not thereby be diminished, and that the purchase [and] sale … and the terms thereof are consistent with the public interest, it shall make such order … as it may deem proper and the circumstances may require.*

Predicated on these relevant provisions, the Division considered the instant petitions, primarily in the context of their potential for adversely affecting existing service quality, and generally whether the mergers are consistent with the public interest. Toward this end, the Division spent considerable time examining the record evidence for confirmation that ratepayers will not be harmed by the proposed mergers. The Division also looked for substantiation that ratepayers would actually benefit from the mergers, a claim universally asserted by all Petitioners.

The Petitioners have consistently maintained that the costs associated with the mergers would not be borne by ratepayers. However, this commitment appeared to be intertwined with a condition subsequent that the Commission ultimately adopt a performance-based ratemaking methodology for Southern Union in future rate proceedings. This ambiguity in the Petitioners' promise to not pass the costs of the mergers onto ratepayers was clearly an issue of concern for the Division.

[13] R.I.G.L. § 39-3-24(3).

The Division was similarly concerned about the merger-related cost savings espoused by the Petitioners, in view of the lack of supporting evidence quantifying such projected savings. The merger petitions further neglected to provide any plans for either the rate consolidation or consolidation of operations for the merging companies.

The Division also took great interest in the billing and customer service problems that resulted in the State of Missouri after Southern Union merged with a local distribution company in that state. The Petitioners' cases did little to allay concerns of a similar potential debacle in Rhode Island.

Additionally, issues regarding future cost allocations relative to Southern Union's aggregated (multi-state) overhead costs, Southern Union's commitment to capital projects in the State, and the direction that post-merger regulatory oversight would take were all concerns of the Division.

The record reflects that all of the aforementioned concerns were shared by the Advocacy Section and Attorney General. The testimony proffered by Messrs. Oliver and LeLash included detailed discussions regarding these very issues along with several warnings and recommendations for the Division to consider.

The record reflects that the direct cases filed by the Advocacy Section and the Attorney General sparked ensuing settlement discussions between the parties. These settlement discussions have been productive, as evidenced by the jointly filed Settlement Agreement before the Division.

The Division has thoroughly examined the record in this case, and finds that the stipulation proffered by the parties represents a fair and reasonable resolution to the issues previously in dispute. The Division also finds that the stipulated agreement satisfies the Division's initial concerns over the future rate implications associated with the mergers' costs, especially the acquisition premium and "golden parachute" related costs.

Regarding the issue of "public interest", the Division recognizes that:

> *In litigation involving the administration of regulatory statutes designed to promote the public interests ... interests of private litigants must give way to the realization of public purposes"*[14]

In the instant merger cases the Division finds that the Settlement Agreement reached between the parties is consistent with the public interest. Indeed, the efforts being made to consolidate the rates and operations of the merging companies should, if properly monitored by the Division, result in a net benefit to the ratepayers. Consequently, the Division shall adopt the "Settlement Agreement" in its entirety, and approve its terms as a dispositive conclusion to this consolidated merger proceeding.

The approval granted herein must, however, be conditioned on the stockholder approvals mandated under Section 39-3-24(3), supra. Specifically, Rhode Island law requires that two-thirds of each utility's stockholders authorize the merger at a special meeting. This law, therefore, would require Southern Union's, ProvEnergy's (ProvGas) and Valley Resources' (Valley's and

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[14] New England Tel & Tel Co. v. PUC 376 A.2d 1036 (1977) quoting from Virginia Petroleum Jobbers Ass'n v. Federal Power Commission, 259 F.2d at 925.

Bristol's) stockholders to each approve their respective mergers by at least a two-thirds majority vote. The Division's approval of the mergers must be conditioned on these requisite stockholder approvals.

Accordingly, it is

(16338) ORDERED:

1. That the January 27, 2000 petition filing by the Valley Gas Company, the Bristol and Warren Gas Company and the Southern Union Company, seeking Division approval of a proposed merger agreement between the Petitioners, as modified by the Settlement Agreement reached and filed during the instant proceeding, is hereby approved.
2. That the January 27, 2000 notification/petition filing by the Providence Energy Corporation and Southern Union, seeking Division approval and ratification of a merger agreement previously executed between the two companies on November 15, 1999, as modified by the Settlement Agreement reached and filed during the instant proceeding, is hereby approved.
3. That the Division hereby adopts and approves the parties' "Settlement Agreement," attached herewith, in toto. The attached Settlement Agreement is incorporated by reference.
4. That the approvals granted herein are conditioned upon the stockholder approvals mandated under Rhode Island General Laws, Section 39-3-24(3). The instant approvals shall be effective upon the submission of

evidence by the Petitioners that the stockholder approvals discussed herein have been satisfied. In the absence of such evidence of stockholder approvals, this report and order shall become null and void.

5. The Petitioners shall have 90 days from the issue date of this Report and Order to effectuate the necessary stockholder approvals, unless extended by order of the Division.

Dated and Effective at Providence, Rhode Island on July 24, 2000.

Division of Public Utilities and Carriers

_____
John Spirito, Jr., Esq.
Hearing Officer

_____
Thomas F. Ahern
Administrator

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DIVISION OF PUBLIC UTILITIES AND CARRIERS

In Re: Petition of Valley Gas Company Bristol and Warren Gas Company, and Southern Union Company	Docket No. D-00-2
In Re: Petition of Providence Energy Corporation, Providence Gas Company, and Southern Union Company	Docket No. D-00-3

SETTLEMENT AGREEMENT

Providence Energy Corporation ("ProvEnergy"), The Providence Gas Company ("ProvGas"), Valley Gas Company ("Valley Gas"), Bristol and Warren Gas Company ("Bristol and Warren"), Southern Union Company ("Southern Union") (collectively, the "Companies"), the Advocacy Section of the Division of Public Utilities and Carriers (the "Advocacy Section"), Sheldon Whitehouse, Attorney General (the "Attorney General") and The Energy Council of Rhode Island ("TEC-RI") (together with the Companies, the "Settling Parties") have reached agreement on all issues arising in Docket Nos. D-00-2 and D-00-3, as set forth herein, relating to the merger of ProvEnergy and ProvGas with and into Southern Union and the merger of Valley Gas and Bristol and Warren with and into Southern Union, and hereby jointly request approval by the Division of Public Utilities and Carriers (the "Division") of this Settlement Agreement

(the "Agreement"). The Agreement provides that the mergers of ProvEnergy, ProvGas and Southern Union and Valley Gas, Bristol and Warren and Southern Union are consistent with the public interest subject to the conditions set forth herein relating to: (1) the impact on rates charged to gas customers in Rhode Island; (2) post-merger service quality; and (3) post-merger regulatory oversight and control.

I. PREAMBLE

A. Introduction

On November 15, 1999, ProvEnergy and Southern Union entered into an Agreement and Plan of Merger providing for the merger of ProvEnergy, and its principal operating subsidiary, ProvGas, with and into Southern Union. As a result of the merger, ProvGas will become a division of Southern Union, which, as the surviving corporation, will operate as a public utility in Rhode Island as defined in R.I. Gen. Laws § 39-1-2.

On November 30, 1999, Valley Resources, Inc. ("Valley Resources"), the parent corporation of Valley Gas and Bristol and Warren, and Southern Union entered into an Agreement and Plan of Merger providing for the merger of Valley Resources, Valley Gas and Bristol and Warren, with and into Southern Union. As a result of the merger, Valley Gas and Bristol and Warren will become a division of Southern Union, which, as the surviving corporation, will operate as a public utility in Rhode Island as defined in R.I. Gen. Laws § 39-1-2.

This Agreement is the result of the Settling Parties' efforts to resolve issues relating to the mergers and is intended to ensure that Rhode Island gas customers experience a net benefit as a result of the mergers in relation to their rates for gas service. The Settling Parties' further intend that Rhode Island gas customers experience no diminishment in the quality of service that they receive or the level of oversight and control by Rhode Island regulatory authorities as a result of these mergers.

B. Procedural History

On January 27, 2000, ProvEnergy, ProvGas and Southern Union provided the Division with information regarding the structure and impacts of the merger transaction. Included in the filing were the statements of Peter H. Kelley, President and Chief Operating Officer of Southern Union; Ronald J. Endres, Executive Vice President and Chief Financial Officer of Southern Union; and James DeMetro, Executive Vice President of ProvEnergy.

On January 27, 2000, Valley Gas, Bristol and Warren and Southern Union filed with the Division a petition for approval of the proposed merger with Southern Union. Included in the filing was the testimony of Peter H. Kelley, President and Chief Operating Officer of Southern Union; Ronald J. Endres, Executive Vice President and Chief Financial Officer of Southern Union; Alfred P. Degen, Chairman, President and Chief Executive Officer of Valley Gas and Bristol and Warren; and Orlando M. Magnani, Principal, Navigant Consulting, Inc.

On March 23, 2000, the Division conducted a pre-hearing conference in Docket Nos. D-00-2 and D-00-3, in order to establish a procedural schedule for the Division's

review of the filings. At that time, the Division granted the motion of TEC-RI to intervene in both proceedings. Pursuant to the procedural schedule, testimony of Richard W. LeLash was filed on behalf of the Advocacy Section of the Division and the Attorney General's office on May 3, 2000 in Docket No. D-00-3, and the testimony of Bruce R. Oliver was filed on May 4, 2000 in Docket No. D-00-2, also on behalf of the Advocacy Section and the Attorney General's office. Subsequent to the filing of this testimony, the Settling Parties commenced discussions on the proposed mergers.

C. Parties' Statement

This Agreement is based on discovery and negotiations among the Settling Parties and resolves all outstanding issues in Docket Nos. D-00-2 and D-00-3. The Settling Parties agree that the provisions of the Agreement, and the terms and conditions reflected therein, will ensure that the mergers are, as a whole, consistent with the public interest and will provide direct benefits to customers. Accordingly, the Settling Parties jointly request the Division's approval of the Agreement.

II. TERMS OF SETTLEMENT

A. Impact on Rates

1. Acquisition Premium

The Settling Parties agree that the Companies will not seek direct or indirect recovery of any acquisition premium in rates either through an

amortization or rate base adjustment in the future rate cases of ProvGas, Valley Gas and Bristol and Warren, or their successors or assigns.

2. No Cost Recovery of "Golden Parachutes"

The Companies agree that they shall not recover any costs from customers associated with so-called "golden parachute" or merger-related bonus payments to any of the parent company officers that are triggered as a result of the mergers. Nor shall the Company include in rates the costs of any "golden parachute" or merger-related bonus payments for such parent company officers arising from other future mergers.

3. Plan and Timetable for Consolidation

In recognition of the fact that the Companies have not compiled or submitted detailed information on the consolidation of operations and resulting cost savings as of the date of this Agreement, the Settling Parties agree that the Companies will develop and serve on all Settling Parties a plan pertaining to the consolidation of the operations and tariffs of ProvGas, Valley Gas and Bristol and Warren (the "Plan"), no later than September 1, 2001. The Plan will evaluate consolidating various operational and support activities of the Companies including, but not limited to, those relating to: (a) information systems, such as customer call-center activities, customer billing functions and financial management and accounting systems; (b) gas supply; (c) employee benefits administration; and (d) rate tariffs. The Plan will include estimated savings that are projected to result from such consolidation and a timeline for

implementing such changes, as well as estimates of the present value of such savings.

No later than July 1, 2001, the Companies shall provide an outline of the Plan to the Settling Parties and provide the Settling Parties with the opportunity to propose additions or modifications to the Companies for consideration in the final Plan. The Settling Parties shall indicate their desire to discuss such proposed additions or modifications with the Companies no later than August 15, 2001. No Settling Party shall waive the right to accept, oppose or take any other position with regard to the final Plan as a result of being provided with the opportunity to "preview" the Plan and to provide input to the Companies.

Any base-rate case filing by the Companies made subsequent to the production of this Plan, and any rate filing made pursuant to Section II.A.4 of this Agreement, will incorporate the provisions of the Plan. The results of any such consolidation are presumed to produce net savings. The Plan will evaluate "One State, One Rate" with the goal of moving toward such a rate design.

4. Treatment of Merger-Related Savings

The Settling Parties agree that merger-related savings pertaining to consolidation and coordination among the merging companies will be shared between the customers of ProvGas, Valley Gas and Bristol and Warren, or their successors or assigns, and Southern Union shareholders. The Settling Parties further agree that reasonable merger related transaction and integration costs

(excluding any acquisition premium or "golden parachute" and merger-related bonus payments as described in Sections II.A.1 and II.A.2) would be recovered only from demonstrated merger-related savings and the resulting net benefit will be shared by customers and shareholders.[15] The distribution of savings between customers and shareholders will be subject to determination by the Rhode Island Public Utilities Commission (the "Commission") in a subsequent proceeding. This sharing determination will also consider the regulatory treatment of post-merger extraordinary gains and losses on current or past utility assets of ProvGas, Valley Gas and Bristol and Warren and their impact on overall sharing mechanisms. To this end, no later than December 1, 2001, the Companies will file with the Commission a rate plan (the "Rate Plan") as well as the detailed consolidation plan developed pursuant to Section II.A.3 of this Agreement. The Rate Plan will be accompanied by supporting documentation as required by Commission rules. The Rate Plan will include a merger-related savings sharing mechanism and will be subject to review by all Settling Parties and the approval of the Commission. Accordingly, Valley Gas and Bristol and Warren agree not to file any base-rate increase proposals with the Commission prior to the filing of the Rate Plan. In addition, the Settling Parties reserve all rights to accept, oppose or take any other position with regard to any base-rate increase or Gas Cost Charge filing proposed by ProvGas prior to the submission of the Rate Plan.

[15] Following the merger closing, the Companies will provide the Settling Parties with the journal entries made to account for any "golden parachute" and merger-related bonus payments as defined in Section II.A. 2 of this Agreement.

5. Future Performance-Based Ratemaking Proposal

The Companies have a right to propose a performance-based ratemaking plan ("PBR Plan") in the future that would allow ProvGas, Valley Gas and Bristol and Warren customers to share in benefits resulting from operational improvements, whether merger-related or non-merger-related, on an ongoing basis. Such a PBR Plan would be structured to ensure service quality is maintained and would be subject to review and approval by the Commission. None of the Settling Parties waive any rights with regard to such PBR plan, if and/or when proposed, including opposition to PBR as proposed by the Companies.

B. Post-Merger Service Quality

1. Establishment of Post-Merger Service Quality Measurement Program

The Settling Parties agree that the quality of service experienced by customers must not be diminished as a result of the mergers. The Settling Parties further agree that service-quality measures will be implemented after the mergers as part of a comprehensive service-quality measurement and monitoring program.

The Settling Parties agree to undertake a collaborative process to accomplish the following objectives: (1) to establish appropriate service measures and enforcement mechanisms; (2) to establish an initial measurement period for each measure for the purpose of setting performance benchmarks; and (3) to determine a schedule for reporting such data to the

Settling Parties. The Settling Parties will conclude the collaborative process within the 90-day period and a proposal will be submitted to the Division within ninety (90) days of the date of a Division order accepting this agreement. If the Settling Parties reach agreement on such service-quality measures and enforcement mechanisms, the Settling Parties will jointly submit a proposal to the Division for an order of approval. If unresolved by the collaborative process, the Companies will make a proposal to the Division, which may be accepted or opposed by the Settling Parties, and will be subject to determination by order of the Division following a litigated process. In establishing this approval process, the Settling Parties hereby agree that the Division has jurisdiction to review and approve such service measures and enforcement mechanisms. Appeal from a Division order establishing service measures and enforcement mechanisms will be made in accordance with the Administrative Procedures Act R.I.G.L. § 42-35-1 *et seq.* Appeal of any subsequent Division order assessing enforcement mechanisms will also be made in accordance with the Administrative Procedures Act R.I.G.L. § 42-35-1 *et seq.*

Within 30 days of the date of a Division order approving the service-quality measures and enforcement mechanisms (proposed jointly by the Settling Parties or as the result of a litigated process involving the Companies' proposal), the Companies will commence a service-quality measurement period using the approved measures. Within 30 days of the close of this measurement period, the Companies will propose a service-quality measurement and

monitoring program that includes performance benchmarks for each measure based on the data gathered over the measurement period or such other benchmarks as the Division may determine, as well as a schedule for periodic reporting of the data compiled for the purposes of monitoring post-merger service quality. The Settling Parties reserve the right to challenge or propose any alternative benchmarks in a litigated proceeding.

2. Interim Reporting Requirements

Within 30 days of the date of an order by the Division approving this agreement, ProvGas, Valley Gas and Bristol and Warren will provide the Settling Parties with 12 months of historical data reflecting the statistics that are currently compiled by each company. Thereafter, for the period prior to the proposal of the service-quality measurement and monitoring program as provided above, ProvGas, Valley Gas and Bristol and Warren will provide the Settling Parties with quarterly reports on the currently available service-quality statistics.

C. Regulatory Oversight and Control

1. Joint and Common Cost Allocation

The Settling Parties agree that a portion of Southern Union's joint and common costs may be allocated to ProvGas, Valley Gas and Bristol and Warren, or their successors or assigns, and may be requested for recovery in the cost of service in future base-rate proceedings. The Settling Parties agree that, in any base-rate proceeding initiated by the Companies, the Companies will have the burden of proving the reasonableness of any allocated or assigned

cost to ProvGas, Valley Gas and Bristol and Warren from any Southern Union affiliate, division or subsidiary, including all corporate cost allocations. The Settling Parties further agree that the Commission has the authority to assess the reasonableness of such costs and the allocation thereof as part of its determination of the revenue requirement in that proceeding.

2. Access to Books and Records

The Settling Parties agree that Southern Union will make available to the Commission and the Division, and their designated representatives, at reasonable times and places, pursuant to Commission rules, all books and records and employees and officers of Southern Union and any affiliate, division or subsidiary of Southern Union to provide access to information pertaining to Southern Union's operations as they relate to matters relevant to setting rates and providing oversight over the regulated operations of ProvGas, Valley Gas and/or Bristol and Warren.

3. Cost of Capital

The Settling Parties agree that it is the intent of this Settlement that acquisition premiums and ownership by a parent company not distort future cost of capital determinations for either ProvGas, Valley Gas and/or Bristol and Warren, or their successor or assigns. Therefore, prospectively, the Companies will propose the following alternatives for establishing an appropriate capital structure and associated capital cost rates for use in establishing rates for gas distribution service:

- Southern Union's actual, consolidated capital structure, its embedded debt and preferred equity cost rates, and a reasonable cost of common equity consistent with this capital structure and financial market and economic conditions at that time; and

- A capital structure that reflects the capital structure for a comparable group of local gas distribution companies similar in risk to ProvGas, Valley and/or Bristol and Warren or their successors or assigns, on a stand alone basis, along with cost rates for sources of capital that are consistent with this capital structure and financial market and economic conditions at that time.

In addition, the Companies may propose other appropriate capital structures and associated capital cost rates. The Commission, in determining prospective costs of capital, will retain the right to use one of the alternatives proposed by the Companies, an alternative proposed by any Settling Party, or some other alternative which the Commission determines to be most reflective of the capitalization and cost of capital components for a typical, stand alone, gas distribution utility.

4. Rhode Island Presence and Operations

The Settling Parties agree that a strong local presence is required in order to ensure responsiveness to customers and to regulators overseeing the regulated gas operations in Rhode Island and that, to ensure this responsiveness, operations will continue to be managed from Rhode Island-based corporate headquarters. The Companies agree to the level of distribution-system investment necessary to maintain safe and reliable service to the customers of ProvGas, Valley Gas and Bristol and Warren, or their successors or assigns. The Companies further agree to maintain charitable contributions consistent with commitments set forth in the merger agreements.

5. Merger Approval

The Settling Parties agree that, pursuant to the Division's approval of the mergers and consistent with the provisions of R.I. Gen. Laws § 39-3-24, Southern Union may exercise and enjoy all of the rights, powers, easements, privileges, and franchises following the merger theretofore exercised and enjoyed by ProvGas, Valley Gas and Bristol and Warren with respect to the property, assets, plant and business merged with Southern Union. Southern Union acknowledges that it is assuming the franchise and service requirements and responsibilities required of ProvGas, Valley Gas and Bristol and Warren.

6. Expansion of Eligibility for Transportation Services

The Settling Parties agree that, as part of the consolidation plan (set forth in Section II.A.3) and the Rate Plan (set forth in Section II.A.4) Valley Gas and Bristol and Warren will make a proposal to the Division to expand commercial and industrial customer eligibility for transportation services to be roughly comparable to that presently offered by ProvGas.

7. Failure to Comply with Agreement

If any Settling Party believes that the Companies have failed to comply with any material provision of this Agreement that Settling Party may apply to the Commission for a finding that the Companies have so failed to comply and the Commission may assess appropriate penalties.

III. EFFECT OF SETTLEMENT AGREEMENT

This Agreement is the result of a negotiated settlement among the Settling Parties. The discussions that have produced this Agreement have been conducted with the understanding that all offers of settlement and discussions

relating hereto are and shall be privileged, shall be without prejudice to the position of any party or participant presenting such offer or participating in any such discussion, and are not to be used in any manner in connection with these or other proceedings involving any one or more of the parties to this Agreement or otherwise. The consent by a party to the terms of this Agreement shall not be construed as an agreement as to any matter of fact or law for any other purpose. In the event the Division (i) rejects this Agreement, (ii) fails to accept this Agreement as filed, or (iii) accepts this Agreement subject to conditions unacceptable to any party hereto, then this Agreement shall be deemed withdrawn and shall be null and void in all respects.

IN WITNESS WHEREOF, the Settling Parties hereto attest that this Agreement is reasonable and have caused this document to be executed by their respective representatives, each being fully authorized to do so. Dated this 31st day of May, 2000.

Respectfully submitted,

In Re: Petition of Valley Gas Company)
Bristol and Warren Gas Company,) Docket No. D-00-2
and Southern Union Company)

ADVOCACY SECTION OF THE DIVISION OF PUBLIC UTILITIES AND CARRIERS
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_____
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BRISTOL AND WARREN GAS COMPANY
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In Re: Petition of Providence Energy Corporation, Providence Gas Company, and Southern Union Company	)))	Docket No. D-00-3

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